Broking Breakfast: Regulatory Update

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Today’s speakers

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Agenda

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01 Welcome

02 **Wind-down planning**
Paul Goldwin

03 **Update on Part IV applications for UK branches/CASS 5 permissions**
Paul Goldwin

04 **Consumer Duty**
Richard Willshire

05 **M&A Update**
John Needham

06 **Q&A**

Wind-down planning

Paul Goldwin

Wind-down planning/Liquidity resources – good and bad practices

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Background

- **FCA 2021/22 Business Plan** – 'Financial Resilience and Resolution' – overarching priority across all sectors
- **Financial Resilience surveys** have continued – will embed in RMAR – 'Baseline Financial Resilience Regulatory Return'
- **FCA concerned** – still firms with weak financial resilience – current and looming macro-economic headwinds do not help
- **Regulator expects** firms to have sufficient capital and liquidity
- **FCA expects** firms to tell them if they haven't – and to put in place plans to shut down their businesses in an orderly manner
- **FCA expects** firms to have **well thought-out wind-down plans in place –** to demonstrate how they will exit market without causing undue harm to customers and markets

Wind-down planning (continued)

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FCA guidance

- FCA published its **Wind-Down Planning Guidance (WDPG**) in June 2020 – refreshed August 2021 amid COVID-19 concerns
- FCA reminds firms of need to comply with **TC 2.4** throughout period of activity and wind-down – ensuring firms have ‘adequate financial and non-financial resources’
- FCA reminds firms of obligations under **Principle 4** (PRIN 2.1) – need to maintain ‘adequate resources throughout’

Wind-down planning (continued)

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Wind-down plans

- Applies to **all regulated firms** – not just those in financial distress
- **No set template or pro forma** – tailored to firm's own circumstances
- Objective to **reduce risk of harm** on consumers/markets when firms wind-down their business
- Will generally consist of following components:
  - Evaluation of scenarios leading to wind-down – trigger event
  - Plan put in place to steer firm in an orderly manner
  - Assessment of financial/non-financial resources required
  - Process for identifying and mitigating material risks/obstacles to orderly wind-down

Wind-down planning (continued)

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- **In practice** will include:
  - **Financial projections/modelling** with detailed assumptions - identifying the TC2.4 buffer required to wind-down
  - **Detailed practical narrative plan** – setting out how orderly wind-down will be achieved
- Needs buy-in of governing body (not just Finance department)
- Firm’s Part IV permission not cancelled by FCA – until satisfied that orderly wind-down has been completed

FCA Thematic Review – TR 22/1 – Observations - Wind-down planning

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FCA Thematic High Level Review

- Firms' WDPs at early stage of maturity with substantial gaps
- Significant work to be done to meet minimum FCA standards
- Key weaknesses centre on three main areas – liquidity, intra-group dependencies and identification of 'trigger' event

Liquidity

- Firms need to demonstrate TC 2.4 compliance during WDP to avoid falling into a disorderly wind-down
- Firms good at monitoring capital needs – not liquidity needs
- Firms need to demonstrate calculation of TC 2.4 cash buffer – and how funds are 'ring-fenced' in case of need in wind-down
- Firms need to better demonstrate how they will fund cash-flow timing mismatches in WDP
- Firms need better handle of calculation of 'net cash impact' of wind-down – ensuring cash positive throughout
- Need healthy cash balance at start of WDP – avoid entering WDP in financial distress

FCA Thematic Review (continued)

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Intra-group dependencies

- FCA permits WDP on ‘group basis’ – as long as each regulated entity covered and ‘entity view’ available
- FCA found weakness in firms’ assessment and mapping of inter-connectivity in groups and impact of wind-down
- FCA found issues around:
  - **Financial inter-connectedness** (where parent/group support in place)
  - **Operational inter-connectedness** (where sharing of group resources)
  - **Contingent financial support** (where companies may be subject to cross guarantees etc)
- FCA found insufficient documentation and mapping of:
  - Clear **governance structures** in place – showing interaction between boards to understand how WDP decisions made
  - **Operational plans** and impact assessment – setting out which entities were being wound down and how

FCA Thematic Review (continued)

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Wind-down triggers

- FCA noticed a failure to identify and act on a well thought out wind-down trigger – a credible initiation point for the WDP
- FCA of view that there needs to be a **range of appropriate triggers** – linked to firms' risk register – as failure to considering options can lead to delayed decision making when firm already in distress – maximising the chance of poor wind-down outcomes

FCA Multi-Firm Review – September 2022

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FCA multi-firm survey

- FCA published a more detailed assessment of their GI brokers multi-firm review of WDPs in September 2022
- FCA sampled 10 GI brokers (London market/Commercial GI brokers) – will continue engaging with GI market until 2025 on WDP. Ensure your WDPs are up to date – you may be picked in the next round!
- FCA assessed the credibility and operability of firms' modelling of minimum liquidity required to achieve orderly wind-down
- **FCA found**:
  - Most firms sampled had WDP arrangements – many not updated for some time
  - Some examples of good practice – but most showed room for improvement
  - FCA encourages firms to compare own WDP arrangements with FCA findings to ensure standards are improved where necessary

FCA Multi-Firm Review – September 2022 (continued)

Examples of good practice

- Clear identification and regular reviews and mapping of risks inherent in their business plans (using risk register)
- Strong consideration of harms that could raise from these risks – steps needed to mitigate them
- Detailed and well thought out capital and liquidity projections and accompanying narrative plans – assisting operable and credible planning
- Stress testing embedded in risk management framework – providing a broader and better view of the likelihood of risks crystallising
- Regular reviews of WDPs and modelling of minimum liquidity required to ensure orderly wind-down

FCA Multi-Firm Review – September 2022 (continued)

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Examples of poor practice

- Weakness in embedding firm's risk management framework in process
- Lack of risk metrics and monitoring – unable to determine if firm operating within its risk appetite and tolerance levels
- Poor forward looking MI – hindering firms ability to make sound decisions
- Inadequate quantification of risk probability or potential impact
- Limited granularity in firm's capital/cashflow monitoring due to lack of detail and superficial analysis
- Absence of, or poorly documented, narrative wind-down plans

Wind-down planning

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In conclusion

- FCA will continue to assess firms' financial resilience against their minimum standards
- Firms must be financially resilient, have strong arrangements to protect clients and be able to recover quickly from disruptions
- If unable to – firms must shut down in an orderly manner without causing undue harm – **the WDP is critical to this**
- FCA now aware that this is an **area of weakness and concern for them** – and will continue to engage with the market
- Ensure you are prepared !

Update on Part IV applications for UK branches/CASS 5 permissions

Paul Goldwin

Part IV applications for UK branches/CASS permissions

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Background

- Brexit planning – UK authorised firms set up EU intermediaries then created UK branch (back branching)
- UK branches of EU intermediaries – operated under TPR (Temporary Permissions Regime) initially
- UK branches awarded ‘landing slots’ by FCA and invited to apply for Part IV permissions to become fully authorised
- Deadline for application for full authorisation (UK branches and others) is 31 December 2022
- In anticipation of full authorisation, UK branches set up identical systems to UK authorised firms, including client money systems – for example: CMCs, NST bank accounts were opened (not without great difficulty), client money auditors appointed etc
- General expectation at the time was that UK branches would fall under jurisdiction of FCA for client money purposes (CASS 5)

Part IV applications for UK branches/CASS permissions (continued)

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Part IV application process

- Expectation of FCA approval was justified – Part IV application requires a tick box to notify whether client money permissions required or not
- Those firms ticking the box – required to submit auditor certification of adequacy of systems and controls for purposes of holding client money
- Early 2022 – **FCA shock** – ' FCA policy decision that UK branches of EU firms should not hold or control client money – therefore FCA **not giving UK branches 'client money permissions**'
- UK branch to obtain client money permissions from relevant Home State Regulator (easier said than done)
- FCA wants to ensure that client money rules for UK EU branches consistent with jurisdiction applied in case of insolvency of EU intermediary
- FCA would not have jurisdiction of EU intermediary if insolvent – therefore could not protect client monies

Part IV applications for UK branches/CASS permissions (continued)

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What's happening in practice?

- Many UK branches now not ticking client permissions box on Part IV applications or informing FCA that client permissions no longer required (to avoid having to submit a new application)
- EU firms seeking client money permissions from EU regulators – informing FCA that they have done so – enabling Part IV applications to be cleared and granted. PKF have seen consent given from Italian and Dutch regulators
- Some EU firms have been unsuccessful in getting client money permissions – with their applications 'open' with FCA and they continue in TPR:
  - Greece – particularly unhelpful – they don't recognise client money concept
  - Other jurisdictions – delaying consent as do not understand concept (trying to work it out)
- Obvious that client money in EU not regulated as robustly as in the UK

Part IV applications for UK branches/CASS permissions (continued)

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What can be done?

- No clarity at present for those UK branches – 'stuck in process' – client money issues/other issues
- Cannot remain in TPR indefinitely – perhaps some clarity next year from FCA post 31/12/22 deadline?
- Where EU regulator does not recognise client money – insurance funds held by UK branch would need to be handled under a Risk Transfer arrangement
- Consider withdrawing application (if not in TPR) – make EU branch an AR of UK FCA registered entity – still possible, although FCA may take dim view (particularly if problems with original application)
- Watch this space!

Consumer Duty

Richard Willshire

Summary – How did we get here?

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Summary – How did we get here?

Misleading information, format or presentation

Products fail to deliver benefits reasonably expected by consumers

Practices that cause consumer harm

Fair Value

Poor support for consumers

What's different in the Consumer Duty?

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Consumer Principle

- Firms must act to deliver good outcomes for retail consumers

Cross-cutting rules

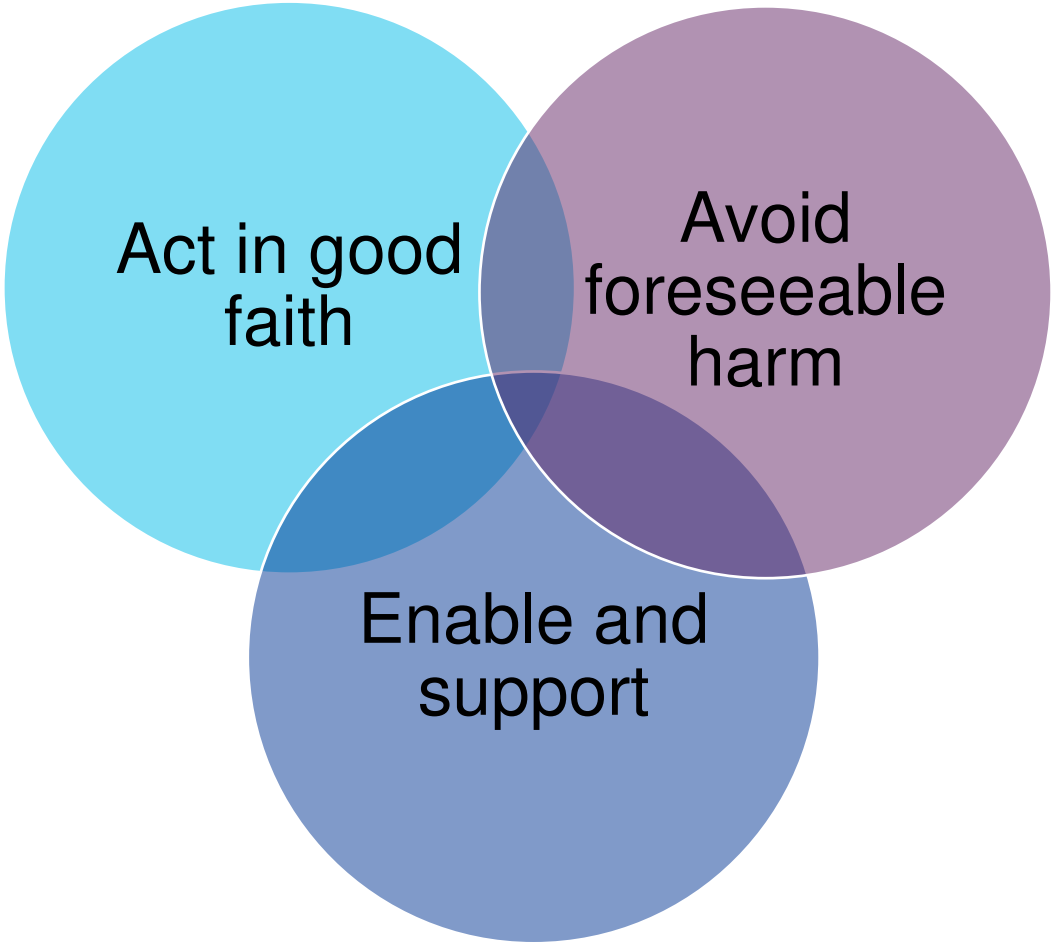
- Act in good faith towards retail customers
- Avoid foreseeable harm to retail customers
- Enable and support retail customers to pursue their financial objectives

Four Outcomes

- Products and services
- Price and Value
- Consumer understanding
- Consumer support

What’s different in the Consumer Duty?

Cross-cutting rules



What's different in the Consumer Duty?

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Products and services

Embed robust consideration of a products target market's needs, characteristics and objectives in order to deliver good outcomes.

Price and value

The FCA does not set detailed requirements for the fair value assessment. Instead, it proposes to set out the factors firms must consider, as a minimum, to assess value.

1 2
3 4

Consumer understanding

Firms need to put themselves in their customers' shoes

Consumer support

Consumer support is "*designed and delivered to an appropriate standard such that consumers do not meet unreasonable barriers when they want to pursue their financial objectives*". As part of those "*unreasonable barriers*" the FCA include unreasonable additional costs.

Implementation and impact

October 2022	31st July 2023	31st July 2024
• By the end of **October 2022,** firms' boards should have agreed implementation plans and established processes to maintain oversight of their delivery.	• Manufacturers share key information with distributor three-months ahead of the implementation deadline • Firms need to apply the Duty to new and existing products and services that are open to sale (or renewal) from **31 July 2023**.	• Firms are given until **31 July 2024** to apply the Duty to products and services held in these books

Early engagement by the FCA?

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Supervisory Approach

- The FCA have been clear that they are taking a more proactive approach to supervision.
- Before the implementation date, the FCA will monitor firms’ readiness and the production of plans to initiate and maintain momentum through the key dates.
- Between the initial implementation date and the completion of work around existing products (April 2023) – the FCA have suggest a period of more pro-active engagement with firms to understand and measure progress.

Approach to assurance

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1 Products and services

Product governance processes

Data collection, collation and analysis

Distribution chain engagement and oversight

2 Price and value

Review and monitoring regime

Value measures – consideration, identification and capture

How this is embedded in firms actions and decision making.

3 Consumer understanding

Analysis of consumer information and communications

How firms equip their retail consumers with information to make informed decisions

Consideration across the lifecycle of products and services.

4 Consumer support

Assessment of consumer processes throughout the lifecycle of products / distribution / communication channels

Cancellations and complaints handling and journey analysis and enhancement.

Assessing consumer base for vulnerable characteristics and alignment of services to meet their needs

M&A Update

John Needham

Market observations

Market observations

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General trends

- Last 12 months has seen new territory in terms of deal pricing – influencing pricing decisions lower down chain
- Has had an impact on all deal sizes
- Lack of larger targets means some turning attention to smaller deals
- Size and definition of “platform” business has changed
- MBO and start-up activity
- Minority interest and non PE deals e.g. HNW / family office
- Still PE wanting into the market – driving “platform pricing”
- Bank lending seems to have disappeared as a way of doing and MBO – cant compete with other debt

Market observations

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- A few deals fall over – possibly weaker businesses / management coming to the market and giving it a try. Usually a regulatory issue rather than financial. Usually non advised.
- Still amazing that there are reasonable sized businesses coming onto the market that never heard of
- Seemingly endless supply of brokers out there as price is bringing firms onto the market
- Firms moving away from core business to increase volume of deals e.g. different types of businesses and geographies
- Market pricing preventing succession unless planned a long time ago or PE backed
- Competition across advisors also contributing to pricing
- Bandwidth of professional services providers is being tested e.g. don’t panic!

Market observations

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Smaller acquisitions

- Hub and Spoke model facilitating smaller deals
- Pricing multiple might be say 50% of ultimate exit multiple
- In house diligence where possible
- Integration focussed
- Means less time on each acquisition
- Deal costs still high relative to size
- Can deliver value if get it right but accepted there may be some fallout
- Management stretch underestimated

Observations from deals / diligence

Observations from deals /diligence

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General trends

- Client money
  - Clean audit opinions
  - Expected issue from most acquirers (up to a point)
  - If severe will stop deal until resolved
  - FCA attitude consistent

- VAT
  - Reverse charge
  - Group recharges

- Income recognition
  - Everyone loves cash….

- Data and proof of revenue

- Lifestyle expenses

- Consumer duty issues and pricing practices really hurting a few deals

Observations from deals /diligence

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Deal features

- Shape of deals not changing
- More cheeky / generous in terms of normalisation adjustments (linked to multiple)
  - Run rate allowances
  - Synergies sharing
- Acturis still desirable in non London market deals. No equivalent in MGA or London market deals.
- Sellers still under prepared and under resourced to complete the transactions – in some cases we have been asked by acquirers to provide sell side support even when a CF advisor (non specialist) has been in place.

Outlook

Outlook

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- Continued trend towards smaller deals with market adapting to take these businesses on
- Debt leverage multiples coming down due to higher servicing costs impacting those reliant on debt
- Listed business with less debt will be in a relatively strong position
- Sellers wise to PE model and is a concern but money talks
- Continued wave of start-ups with 5 year lifecycle i.e. specifically built with a view to selling
- New operating models e.g. micro branches / WFH
- Have we seen the peak?

Question and answer

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Any questions?

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