

# Broking Breakfast: Financial and Operational Resilience – FCA concerns and how to address them

11 June 2024

PKF

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# Agenda



**01** Introduction  
Paul Goldwin

**02** Operational resilience  
Jessica Wills

**03** Financial resilience  
Paul Goldwin



**04** Legacy balances and  
credit write backs  
Tim Goodger

**05** Closing and Q&A  
Paul Goldwin

## Today's speakers





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June 2024

# Operational resilience

Jessica Wills  
PKF Littlejohn

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**Introduction and background**

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**FCA Business Plan 2024/25**

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**Operational resilience recap – timeline**

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**Operational resilience recap – key components**

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**FCA insights and observations – May 2024 (1-7)**

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# FCA Business Plan 2024/25

## ■ FCA Business Plan 2024/25

- Minimising the impact of operational disruptions on consumers and the market remains a key commitment for the FCA
- High, growing and evolving threats and risks
- Proposed FCA activity for 2024/25
  - Continue to deal with firms that cannot meet operational resilience standards. From 31 March 2025, all relevant firms (for insurance intermediaries this is enhanced scope SM&CR firms) will need to maintain their important business services without intolerable harm to consumers and markets
  - Publish consultation paper clarifying expectations for reporting operational incidents to the FCA
  - Progress the recent consultation proposing new rules to address systemic risks from critical third parties (CTPs)

*Operational disruptions can prevent consumers accessing essential financial services, disrupt markets and threaten confidence in the sector.*

*Firms still face a high, and growing, level of cyber threats and operational resilience risks, against a complex geopolitical backdrop.*

*We are also seeing increasing levels of systemic risk build up in the system due to reliance on critical third parties.*

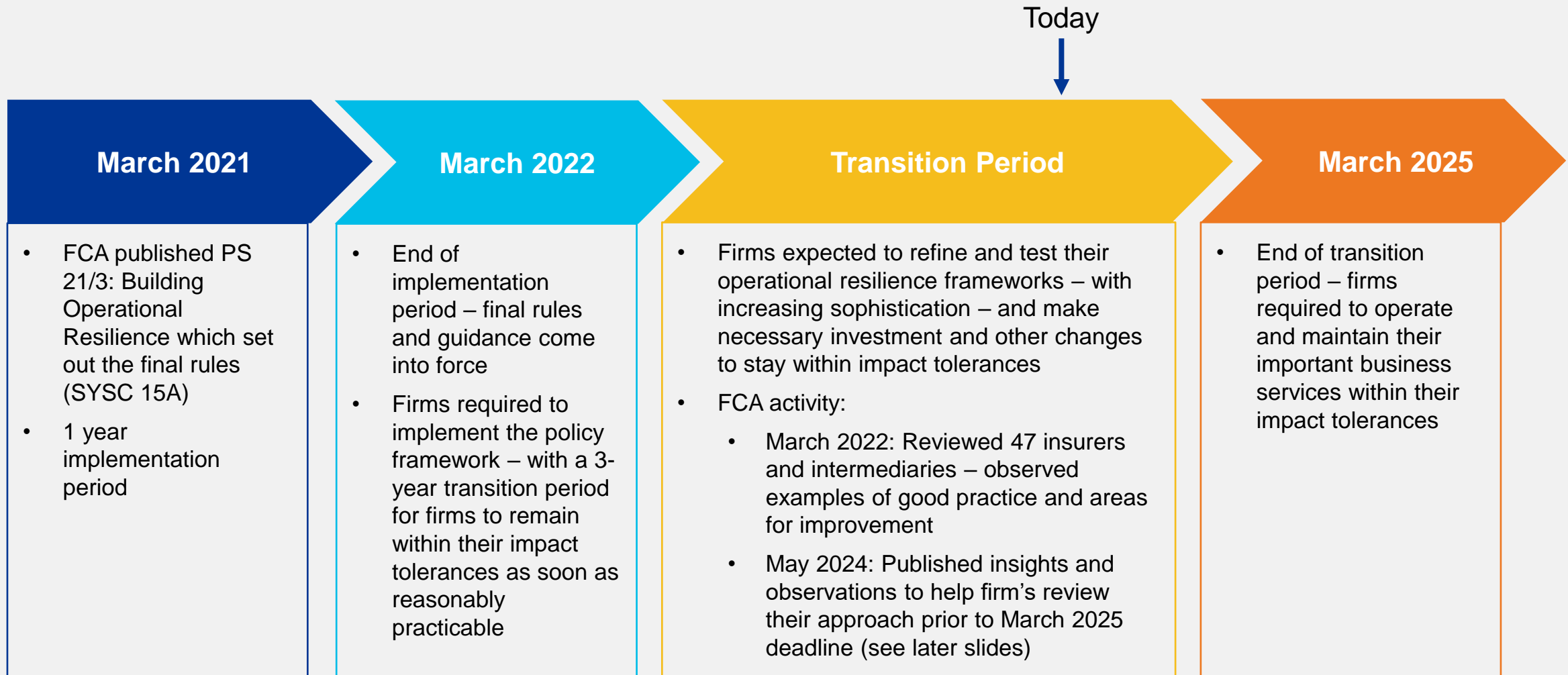
*FCA Business Plan 2024/25*

- **Overall, FCA commitment to operational resilience continues and the end of the transition period is drawing near – are you ready?**

# Operational resilience recap



## Operational resilience recap – timeline



## Operational resilience recap – key components

### Identify important business services (IBS)

- Could cause intolerable harm to clients or risk to market if disrupted
- Need to identify specific services and the users of the services
- Various factors to help identify
- Keep under regular review (at least annually)

### Set impact tolerances

- Thresholds for maximum tolerable disruption
- Measured by length of time / duration and other metrics
- Keep under regular review (at least annually)

### Identify and document (map) people, processes, tech, facilities and information to deliver each IBS

- Allows firm to identify dependencies and vulnerabilities
- Expected to develop / evolve over time
- Consider relationships third parties
- Keep under regular review (at least annually)

### Scenario testing

- Gives assurance that firms can remain within impact tolerances for each IBS
- Use a range of severe but plausible scenarios
- Some examples given
- Plan of regular testing – keep up to date

### Conduct lessons learned exercise

- Conduct and document lessons learned after scenario testing and in the event of disruption
- Act on lessons learned and be able to demonstrate this!

### Develop communications plan

- Internal and external communications (including FCA)
- Takes account of circumstances, needs and vulnerabilities of clients and other stakeholders

### Self-assessment

- Must document assessment of compliance with the various requirements
- Review and approval by board
- Retain for 6 years and provide to FCA on request

# FCA insights and observations – May 2024

## ▀ FCA insights and observations – May 2024 (1)

### FCA insights and observations

### Questions for firms to consider

#### Important business services (IBS)

- Variability in firms appropriately identifying their IBS
- Need to consider all factors when identifying IBS – SYSC 15A.2.4 lists 13 different factors to be considered as a minimum
- Rationale and justification for IBS should be documented in firm's self-assessment

- Have there been any changes to your business model or the services you provide and have these been considered from an operational resilience perspective?
- Have there been any changes impacting the minimum factors that would influence your identification of an IBS?
- Is your consideration of and conclusion on each of the minimum factors clearly documented?
- Does your self-assessment document provide sufficient information about the IBS you have selected / not selected and reasons thereof?

## ▀ FCA insights and observations – May 2024 (2)

### FCA insights and observations

### Questions for firms to consider

#### Impact tolerances

- Wide range of impact tolerances identified by firms with limited rationale – this should be documented in firm's self-assessment
  - Many firms setting time-bound tolerances – firms should consider other measures to complement this
  - Impact tolerances differ from recovery time objectives (RTOs) which is the maximum time to recover the service – to avoid intolerable harm, processing will need to take place once the recovery of service is complete
- How well have you explained and justified the impact tolerances you have established? Does the Board have a clear understanding of what has been set and why?
  - Other than time-bound tolerances, what additional metrics have you considered / established e.g. numbers / types of customers or transactions affected?
  - Have you considered the interaction between impact tolerances and RTOs? RTOs will typically need to be set well within impact tolerances to ensure you can remain within tolerance



## ▀ FCA insights and observations – May 2024 (3)

### FCA insights and observations

### Questions for firms to consider

#### Mapping and third parties

- Mapping expected to have matured over time
  - Where third parties support or deliver your IBS and fail to remain within impact tolerance, this remains the responsibility of the firm
  - Relationships with third parties should be actively managed
  - Detailed mapping should help firms to identify vulnerabilities
- Have there been any changes to people, processes, technology, facilities and information that need to be reflected in your mapping?
  - Have all relevant third parties been captured in your mapping?
  - Where relying on third parties for provision of an IBS, how well do you understand their people, processes, technology, facilities and information?
  - Have you established appropriate governance and controls around critical third party relationships to manage these on an ongoing basis?
  - Have you revisited your mapping to see if any new dependencies or vulnerabilities have emerged?

## ▀ FCA insights and observations – May 2024 (4)

### FCA insights and observations

### Questions for firms to consider

#### Scenario testing

- Firms should consider the 5 minimum scenarios in SYSC 15A.5.6
  - Testing expected to have matured over time and developed in sophistication – including increasing the severity of disruption to fully understand the effectiveness of response / recovery plans and the severity at which no longer able to remain within impact tolerance
  - Firms should mature the format and type of testing – evolve from judgement, desk-based scenario tests to a wider range of tests e.g. penetration tests, disaster recovery / failover tests, simulations, lessons learned from real scenarios
  - Testing should include third parties
  - Perform horizon scanning to develop understanding of new and emerging risks – will inform testing
- Has the testing performed to date considered the minimum scenarios?
  - Have you completed the testing plan that you originally established and has this evolved and matured over time, including testing against greater levels of severity?
  - Have you performed different types of tests including live simulations etc?
  - To what extent has your testing involved third parties?

## ▀ FCA insights and observations – May 2024 (5)

### FCA insights and observations

### Questions for firms to consider

#### Vulnerabilities and remediation

- Vulnerabilities identified in early part of transition period should have been remediated (or significantly progressed) and retested to verify vulnerability has been resolved
- Remediation plans should be approved, fully funded and governed
- As mapping and scenario testing matures, vulnerabilities should be regularly reviewed with any additional / new vulnerabilities being remediated
- Have you addressed any vulnerabilities identified from the testing performed to date?
- Have you re-tested these vulnerabilities and used different scenarios or severities to really prove that the vulnerability has been remediated?
- Are there any remaining vulnerabilities and do you have an approved and fully funded remediation plan in place? What is the governance around this to ensure completion prior to March 2025?

## ▀ FCA insights and observations – May 2024 (5)

### FCA insights and observations

### Questions for firms to consider

#### Response and recovery plans

- Response plans important as can “buy time” for recovery plans to complete and may help to avoid breaching impact tolerance
- Limited testing of response plans
- Do you have response plans setting out your initial response to an operational incident?
- Does your response plan consider management actions / decision-making and the communications that will need to occur?
- Have you tested your response plan?

## ▀ FCA insights and observations – May 2024 (6)

### FCA insights and observations

### Questions for firms to consider

#### Governance and self-assessment

- Self-assessment needs to include minimum requirements in SYSC 15A.6.1 and detail the firm's journey to becoming operationally resilient
  - Expected to mature and develop over time
  - From a governance perspective, must provide sufficient information and justifications on the determinations, decisions and plans to ensure continued resilience – to allow governing body members to understand the firm's position and roadmap to resilience
  - Should highlight any concerns and document the remediation work needed
- Is your self-assessment up-to-date and does it contain the minimum requirements?
  - Does the self-assessment reflect the journey e.g. from March 2021 to date and the actions the firm has taken to improve its operational resilience?
  - Is the self-assessment clear and does it provide sufficient information to inform your Board?
  - Has your self-assessment been subject to any assurance e.g. from internal audit or external parties?
  - Does your self-assessment provide a realistic view of any remaining vulnerabilities and the actions you need to take?



## ▀ FCA insights and observations – May 2024 (7)

### FCA insights and observations

### Questions for firms to consider

#### Embedding operational resilience

- Requirement to be operationally resilient is not a “one and done activity” or seen as a tick-box regulatory compliance – should be a way of working that is embedded into overall firm culture
  - Should be embedded into firms’ overall ERM frameworks including change management and strategic planning
  - As part of BAU, should be reviewing IBS, impact tolerances and mapping regularly (at least annually or if there is a material change to firm’s business or market) – as well as regular testing
- Is consideration of operational resilience sufficiently prominent e.g. within Board and management discussions and decision-making? Is it front of mind?
  - How have operational resilience risks been incorporated into your ERM framework, risk registers etc?
  - Is operational resilience given sufficient consideration within strategic planning and change activities?
  - Have you implemented a regular cycle of reviewing and testing your operational resilience?

# Considerations for 'core' firms

## ■ Considerations for ‘core’ firms

- Although not a regulatory requirement, ‘core’ firms should be considering operational risks and threats and their potential impact on strategy, operations and reputation
- Some of the larger / Top 50 insurance intermediary groups consist of a collection of ‘core’ firms – share common people, processes, systems etc so subject to same dependencies / vulnerabilities
- ‘Core’ firms conducting acquisition / integration activity may reach thresholds for becoming ‘enhanced’ firm – will need to implement the FCA’s requirements immediately – won’t have benefit of implementation / transition period
- If haven’t already, start to implement the core components of the FCA’s operational resilience framework



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# Financial resilience

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**Introduction and background**

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**FCA monitoring and reporting**

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**FIN 073 - Baseline Financial Resilience Report**

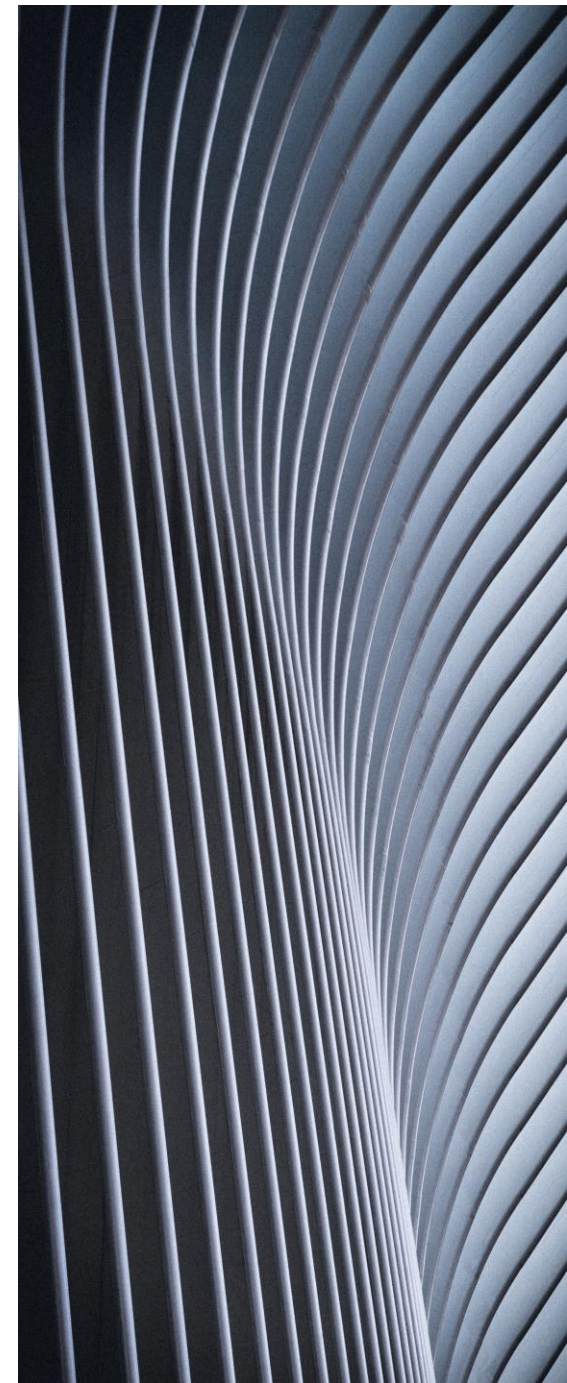
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**Financial Resilience Survey**

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**Indicators of weak financial resilience**

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# Introduction and background

## Introduction and background

**‘Financial resilience - ability of an entity to withstand events that affect capital structure, liquidity, revenue and assets - a measure of the robustness of an entity’s financial plan to shocks’**

- Financial resilience as a regulatory topic is not new - Principles for Businesses and Threshold Conditions have been around since 2001
- Principle 4 - duty for firms to ‘maintain adequate financial resources’
- Threshold Condition (TC 2.4) - requires firms to maintain adequate ‘financial and non-financial resources’ to meet current/expected obligations from regulated activity (forward-looking)
- FCA Prudential Sourcebook - Insurance Intermediaries (MIPRU Rules) - minimum financial resource requirements for capital resources (historic data)

# FCA monitoring and reporting

## ▀ FCA monitoring and reporting

- Financial resilience grew in prominence during COVID - FCA recognised that weak financial resilience following 'COVID shock' could lead to business failure and expected firms to fail

June 2020

FCA started monitoring financial resilience data - COVID 19 surveys (then re-named 'financial resilience' surveys) - an exercise repeated many times

During 2020

FCA updated and published its 'wind-down planning' guidance - ensuring that firms that do fail do so in a manner without causing 'undue harm' to its clients, counterparts or market at large

2021/22

FCA Business Plan - 'Financial Resilience and Resolution' - overarching priority, continued as high-focus priority through to 2023/24 Business Plan

October 2022

FCA Consultation Paper CP22/9 - proposing to replace financial resilience surveys with more formalised reporting through regulatory returns

Policy Statement  
PS23/3

FIN 073 Baseline Financial Resilience Report - with effect from January 2024

# FIN 073 - Baseline Financial Resilience Report



## ■ FIN 073 - Baseline Financial Resilience Report

- FCA formalised financial resilience data reporting in a standard format to assist it in assessing financial resilience - identifying 'weak financial resilience'
- Applies to 'solo-regulated' firms and covers insurance intermediaries, full permission consumer credit firms and certain firms registered under the Payment Services Regulations
- Reporting embedded via RegData - firms will receive automated reminders
- Quarterly reporting - to be reported within 20 business days of relevant accounting reference date

## ■ FIN 073 - Baseline Financial Resilience Report

- Simplistic reporting to demonstrate financial resilience covering:
  - Total liquid assets under firm's control/unrestricted access (including 'available committed facilities')
  - Average monthly cash needs arising from fixed costs (which cannot be avoided) - being next three months 'average' monthly requirement
  - Net profit/(loss) of last quarter (3-month figures only - not cumulative)
  - Revenue for year to date - cumulative (and need not be audited)
  - Net asset/(liability) at end of last financial quarter

# Financial Resilience Survey

## Financial Resilience Survey

### Is there weak financial resilience in insurance intermediary sector?

- FCA issued their final 'Financial Resilience Survey' in October 2023 prior to transition to FIN 073
- Over 14,000 businesses involved, including 2,933 insurance intermediaries (Lloyd's and London Market, personal and commercial lines and aggregators)

**17.29%**

Insurance brokers/  
intermediaries  
unprofitable

Of the rest,

**£22,637**

average three-  
month net profit

Average revenue  
in last financial  
year

**£585,420**

**£178,719**

average liquidity  
resources at end of  
September 2023

Average broker expected  
cash inflows of

**£132,088**

versus cash needs of

**£98,000**

**13.4%** of

brokers were  
pessimistic about  
the future

**20.97%** of

brokers had received  
Government support

## Financial Resilience Survey



- FCA remain concerned that there are still many brokers with 'weak financial resilience' who will fail
- FIN 073 designed to provide 'early warning system' of weak resilience, enabling prompt regulatory intervention

# Indicators of weak financial resilience

## ■ Indicators of weak financial resilience

### What constitutes 'weak financial resilience'?

- Significant reliance on Government backed loan schemes/other Government assistance
- Liquidity constraints - low/no headroom against facility limits/need to periodically change funding requirements to meet ongoing needs
- Reliance on non-commercial/sub-prime debt facilities
- Reliance on inter-group funding
- Subordinated loans by owner/directors
- Track record of low profits/losses



## ▀ Indicators of weak financial resilience

### What constitutes 'weak financial resilience'?

- Recognition of deferred tax assets
- Lack of inadequate TC2.4 'buffer' to meet wind-down costs
- Poor systems/controls around client money protection or insurer funds
- Requirement or resolve to carry out 'credit write backs' to prop up their balance sheets



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# Legacy balances and credit write backs

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## Introduction/ overview of issues

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### Intermediary's obligations:

- CASS 5
- Common law
- Trusts

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## Policies and process

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## Conclusion and takeaways

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# The regulator's perspective

## ■ The regulator's perspective

- FSA's 2008 Articulation on Credit Write backs
- Draft CASS 5A proposed in CP 12/20
- CP 23/12 entitled *“Awakening Dormant Assets: Navigating the Expansion of the UK's Dormant Assets Scheme”*.
- Regulatory issues
  - Threshold Condition 4
  - Poor system and controls
  - Support profitability (or solvency)

# CWB and misconceptions

## ▀ CWB and misconceptions

- Lack of definition
- Does not solve all ills nor release a broker from its duties
- Does not safeguard against a claim
- Can be the result of a process appropriate to the business to
  - identify extraneous items
  - identify funded items and net accounting
  - identify anomalous ledger entries



# Intermediary's regulatory obligations

## Intermediary's regulatory obligations

### CASS 5

CASS 5.1.2

Monies in the pool are reconciled and identifiable

CASS 5.1.5R

Money is not client money when:

(1) It becomes properly due and payable to the firm:

(a) For its own account; or

(b) In its capacity as agent of an insurance undertaking

CASS 5.5.80 R

When money ceases to be client money

CASS 5.4.1G and 5.4.4 R

Systems and controls

# Intermediary's duties

# ▀ Intermediary's duties

## As agent

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- A fiduciary duty
- Retain documents
- Not to make a secret profit
- An on-going duty to account (client money)
- Collect reasonably promptly and pay over premium to re/insurers

Actionable by the principal against the broker.

# ▀ Intermediary's duties

## As Trustee

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- Knowledge and control of trust affairs and property
- Act with fidelity and prudence
- Impartiality and payment
- Retain information and keep accounts

## Fiduciary relationship

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- Custodian and steward of funds
- Act in good faith and in the principal's interests

## Contractual duties

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- TOBA or otherwise

# Policy and process

## ▀ Policy and process



### Policy

- Addressing unreconciled and/or legacy balances
- Take account of the broker' duties
- Process for investigation of rightful beneficial owners/ and recipients
- Suitable controls according with obligations
- Consider different approaches for different books of business
- Purpose and effect of a policy
- Reconciled balances ought not be part of a CWB



## ▀ Policy and process



### Implementing policy

- Approval of policy
- Reporting lines
- Board's knowledge of and decision to make a CWB

## Policy and process

### Process

- Are the funds in the right pot?
  - NST v statutory trust v IBA (debtor / creditor) v insurer trust account
- What did the relevant counterparty agree?
- Use right people with the necessary skills to conduct a review
- Desired outcomes
  - accurate data and information
  - repatriate funds to the relevant counterparties
  - considered decisions regarding any orphan balances
- Costs

## Policy and process

### Common issues

- Funding - voluntary and involuntary
- Insolvency, dissolution and strike off
- De Minimis
- Legacy computer systems/programs
- Retention of Documents and Records
- Limitation periods
- Costs

# Takeaways

## Takeaways



CWB is not just an accounting entry

No review/investigation = criticism & potential breach of trust

Policy or strategy in the context of obligations and duties

Proper investigation and a suitably documented process

## ▀ Question and answer



# Any questions?

Notes



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