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Ten Key Trends to Watch in the UK's Regulatory Outlook for 2022

The UK's financial services sector is braced for a year of change as we embark on 2022. New regulatory requirements will come into force this year, and further developments are expected from the Financial Conduct Authority (FCA) in the coming months.

In a recent webinar, four experts from fscom highlighted the main trends and developments firms should prepare for in the coming year and beyond. They are:

- Jamie Cooke, Managing Director of fscom and Head of Investments.
- Alison Donnelly, Director and Head of Payments.
- Phil Creed, Director and Head of Financial Crime.
- Nick Gumbley, Associate Director and Head of Cyber Security.

They brought their knowledge and experience from across the financial services sector to highlight the implications of upcoming regulations and supervisory priorities for payment and e money institutions, cyber security, financial crime and investments.

The general trend across all sectors is clear: the Financial Conduct Authority (FCA) has signalled that they will be more interventionist in 2022 in order to protect consumers and market confidence. The impact being that financial institutions need to ensure they can demonstrate compliance with the applicable regulations, and this report offers guidance on where they should focus their efforts.

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1. Consumer duty is at the top of the FCA's agenda

The FCA has become frustrated in recent years that firms don't get things right for the consumers in the first place, so rules and guidance that introduces a consumer duty on companies are being formalised. The new Consumer Duty rules are likely to be rolled out in July 2022, with implementation expected by 30 April 2023. Essentially, they place requirements on firms to ensure they deliver good consumer outcomes. It is likely to impact all firms with retail clients and will also apply to unregulated but ancillary services, such as the provision of unregulated FX alongside a payment service.

Further obligations to protect vulnerable customers came in at the end of 2021 with new guidance from the FCA. Firms must ensure they have assessed the entire customer journey and identified possibilities for engaging with vulnerable customers. They should then have the right system in place to treat them with sensitivity, making reasonable accommodation to them to ensure they are not disadvantaged. Once you have a framework, you can develop policies and procedures and share information with management.

Read more about safeguarding here.

2. Firms must demonstrate financial resilience and plan for failure

A key regulatory requirement related to consumer duty is that firms should have a plan in place for if they fail. This has become more relevant due to the significant rise in cost of living and the impact of the pandemic. The FCA want to see that firms have sufficient capital, liquidity and resources to be able to fail in an orderly manner.

The Investment Firms Prudential Regime (IFPR) came into force on 1 January this year with this aim in mind. It applies to regulated investment firms and is designed to have a more accurate assessment of capital, including an enhanced adequacy assessment, which should mitigate the risk of failure due to macro-economic events. We expect to see more targeted FCA interventions against firms whose financial resilience appears to be weak in 2022.

The need for companies to have wind-down plans in place were introduced in July 2020 and formalised in late 2021. Firms must show a proper plan to the FCA which contains sufficient information about thresholds, financial forecasts and stress testing.

3. The deadline to demonstrate operational resilience planning is approaching

The FCA's business plan also specifies operational resilience of financial services firms as a priority for the year ahead. PS21/3 requires firms to demonstrate that they are taking steps towards operational resilience by 31 March 2022. Firms need to have identified the key operational processes that could have a material impact on business continuity. Moreover, by March 2025, firms must have fully mapped and tested their important business services to ensure they operate consistently within their impact tolerances.

The need for operational resilience looms large in the priorities and concerns of financial services companies, too. At our webinar, we asked participants to identify their main area for improvement in 2022. A clear majority of 62% picked operational resilience.

This task need not be overwhelming for firms, however. Our best advice is to build on the knowledge, experience and work already completed across your business – a lot of components of operational resilience exist in functions across the company, and the pandemic proved a test of Business Continuity Planning in particular. Bringing in stakeholders and subject matter experts in each function will help you to build on and reflect current business practices in support of operational resilience.

Read more about operational resilience best practices in our blog.

4. Heightened scrutiny on the Payment and E-Money sector

For those in the Payment and E-Money sector that are operating as if still in infancy there's a warning that the FCA is not prepared to tolerate this any longer. While there may not be any plans for thematic reviews specifically for the sector, the uptick in the level of scrutiny applied to the sector will continue in 2022, at both the gateway for applicants and for the established institutions. The FCA is also being more targeted in its approach, gleaning information from surveys and market intelligence to identify which institutions to scrutinise. Payment and e-money institutions should also consider the possibility that the FCA's Senior Managers and Certification Regime could be applied to them – if not this year, then soon.

Applicants and firms' best defence is to implement – and be ready to demonstrate to the FCA – systems and controls to protect customers through:

- A detailed and bespoke safeguarding policy with accompanying procedures.
- A vulnerable customer framework and accompanying procedures including for handling complaints.
- A wind-down plan that is reviewed at least annually.
- Ensuring that directors and senior managers have adequate skills and experience for the role they hold, as well as being fit and proper persons.

5. Fraud scandals will lead to renewed focus on financial crime compliance

Fraud is high up in the news agenda, and as a result it's front of mind for politicians and the regulatory authorities. In the last year, the national papers in the UK have extensively covered the scale of fraudulent activity within the government's Bounceback Loan scheme. This will only heighten the FCA's scrutiny of fraud taking place within financial institutions and their clients and third parties. Financial services firms should expect more regular and more rigorous checks that they have appropriate controls in place around fraud, AML and wider financial crime.

More broadly, the FCA has been more forthright in tackling financial crime over the last two years. A number of Section 166 notices under the Financial Services and Markets Act have been implemented when a firm's activities caused them concern or required further investigation. Cryptocurrency firms have faced especial scrutiny and several firms have had to rewrite compliance programmes to ensure they are fit for purpose for the size of the business.

Our main advice for financial crime professionals is to carry out a business-wide risk assessment. We still see varying levels of qualities in these documents, yet it is the cornerstone from which everything else in your anti-financial crime regime can be built out.

6. Rising risk of cyber attacks requires careful information management

The rate of cyber attacks has rocketed since the pandemic forced more interactions online, and bad actors' methods have acquired greater sophistication. The UK regulators expect companies to protect sensitive information that they hold about their customers and employees; financial statements; five-year plans and more.

Cyber security will also be increasingly recognised as a core component of operational resilience. Likewise, the security of the supply chain and outsourcing will be a focus of the regulators, as well as ensuring information shared with these third parties is appropriately secured. The Information Commissioner's Office expects firms to meet strict requirements around the General Data Protection Regulation.

Firms are advised to follow a three-stage process to meet regulatory expectations and manage the risk of a damaging cyber attack:

Stage 1: Understand what personal data you hold, how you collect it, how it is transmitted internally and to third parties, and how it is destroyed when it is no longer required.

Stage 2: Assess the effectiveness of your information security controls against a baseline to highlight where controls need to be implemented and improved. This assessment should cover your third parties and assess the security of your supply chain.

Stage 3: Carry out remediation by designing a programme that improves your controls, laying out milestones to report back to senior stakeholders and the board. You should continue to perform audits and reviews every year.

Read more about cyber security here.

7. Normalisation of the FCA's approach to cryptocurrency firms

We envisage this year being a significant period of change for cryptocurrency firms on the regulatory side. Around 30 firms have now been authorised by the FCA. These tend to be smaller household names rather than the big players, which reflects the FCA's worry that large firms buying and selling large volumes of cryptoassets could pose risks to consumer protection.

Cryptocurrency is being pulled by the FCA into more familiar territory, with growing moves to control what such firms can and cannot do in the UK. Crypto firms recently have received stricter enforcement actions from the Advertising Standards Authority, and the FCA will take over this role in 2022. They will expect that firms are clearer when communicating to customers who may not understand how these investments work. We should expect to see cryptocurrency treated more and more like an investment product similar to the crypto asset approach.

Crypto firms are going through a period of remediation. The FCA has been directing them towards compliance with the EU's Fifth Anti-Money Laundering Directive, and many firms have brought in experienced and high-quality compliance professionals to devise and execute an appropriate AML framework. Cryptocurrency firms tend to perform Customer Due Diligence in AML effectively, but struggled in other areas like periodic review, event-driven review and Suspicious Activity Reports (SARs). We can expect firms' anti-financial crime frameworks to get iteratively better and the industry is moving in the right direction – but high trading volumes ensure that risks remain.

8. Greater regulatory divergence between the UK and EU is anticipated

We are into the second year post-Brexit and whilst the immediate focus of on shoring EU regulation into the UK has been completed there has been no significant equivalence decisions.

Conversely, we are starting to see the UK start to consider how they can take advantage of the regulatory independence that Brexit has created. We anticipate more divergence in regulations between the UK and the EU this year and are already starting to see this in practice. Towards the end of February, the newly appointed "Brexit opportunities minister" was urging to rewrite Solvency II rules which are legacy EU rules relating to the insurance industry in order to get a competitive advantage over the EU. We have also seen similar divergence from the EU around adoption of Basel III measures.

We also anticipate a more assertive approach from the FCA regarding their Temporary Permissions Regime for EEA-based firms seeking authorisation in the UK. Four firms were recently refused, and despite long backlogs in the application process, the FCA said in January that it expected firms going through the process to:

- Be ready to meet their deadline for a landing slot.
- Provide information in a suitable timeframe.
- Show that they want to be authorised.

If they don't demonstrate all three, they will be refused. UK and EEA firms must not make the mistake of assuming that the process to become authorised in the other jurisdiction will be automatic.

9. The BNPL sector will take its first steps on the march towards regulation

The Buy Now, Pay Later (BNPL) sector is growing rapidly but is so far unregulated in the UK because of an exemption under the Financial Services and Markets Act for firms providing short-term interest-free credit.

Yet change is coming. A consultation closed in January 2022 which explored two ways to supervise and regulate these firms:

1. BNPL and short-term interest-free credit activity would only be regulated when a third-party lender is involved, not when the relationship is directly between the merchant and the consumer.

2. Regulation would apply when there is a pre-existing relationship between the lender and the consumer.

Whichever way the regulator goes, it seems regulation is inevitable because of the risk to the consumer from a default on a BNPL commitment. Credit checks are likely to be implemented for those applying to use BNPL, and those consumers will be reminded that they are taking out credit so their credit rating could be adversely affected.

10. Diversity, inclusion and ESG are moving from good practice towards a regulatory expectation

The FCA is putting greater emphasis on diversity and inclusion, believing that firms with an inclusive culture are better run because staff feel able to raise concerns and challenge decisions. Firms should expect the regulator to issue surveys to capture information on their diversity and inclusion, which could inform future policy decisions.

The FCA is also working towards the government's target for carbon net zero by 2050 and monitoring how financial services companies are impacting the environment – as all arms of government are after the commitments made at COP26 late last year. Many firms are required to make disclosures on climate and sustainability. There will be an outsized impact on the asset management and investment sector, as climate-related disclosed required by listed companies are being standardised and investor stewardship is influencing sustainability strategies.

Diversity, inclusion and sustainability will only become more salient in the coming year so companies should consider getting on the front foot by reviewing their record on – and commitment to – these important issues.

In a nutshell: fscom experts' top advice for regulatory compliance in 2022

This report has covered a wide range of regulations and trends across the sector, and companies can be excused for feeling overwhelmed by their compliance to-do list. So, we asked our webinar speakers for their one key piece of advice:

" Update your enterprise risk assessment with particular focus on conduct and culture" – **Jamie Cooke.**

" Assess how your business impacts and protects vulnerable customers" – **Alison Donnelly.**

" Forward plan your resource requirements and prepare before it becomes a problem – nothing screams to a regulator more than backlogs" – **Phil Creed.**

" Understand and document how your data is shared with third parties and how they meet your security requirements" – **Nick Gumbley.**

For advice on any of the topics covered in this report, contact fscom for a free consultation

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If you would like to find out more about any of the regulatory matters in this report, contact the relevant expert today.

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