FINANCIAL CONDUCT AUTHORITY

12 Endeavour Square
London
E20 1JN

Tel: +44 (0)20 7066 1000
Fax: +44 (0)20 7066 1099
www.fca.org.uk

Harriett Baldwin MP
Chair
Treasury Select Committee
House of Commons
SW1A 0AA

24 January 2024

Our ref: 230108A

Dear Harriett,

Re: Follow-up questions to the 12 December 2023 evidence session on the work of the Financial Conduct Authority

Thank you for your letter dated 8 January. I have addressed the Committee's questions below.

Asset management

1. *Will the forbearance the FCA has given on the cost disclosures of investment companies lead to changes on what is provided through the EMT [European Mifid Template] data feed? [Q672]*

The EMT is an industry initiative that allows manufacturers to share key product information with distributors.

Currently, packaged retail and insurance-based investment product (PRIIP) manufacturers submit a single ongoing charges figure, calculated in accordance with the PRIIPs methodology. The Government has committed to repealing the PRIIPs legislation and intends to repeal the relevant MiFID provisions at the same time. Pending this, our forbearance statement sought to facilitate amendments to be made to the EMT to reflect the additional costs displayed in the key information document (KID) required under PRIIPs, specifically to allow manufacturers to provide a breakdown of the ongoing charges figure. We are working with industry on how to operationalise this.

2. *Should cost disclosure by investment companies be more akin to the disclosure by other types of listed firms? [Q673]*

Following the UK's exit from the EU, we have been working on fundamental and structural reforms to disclosures, which enable us to tailor rules to the UK market and bring benefits for retail investors and firms. We recognise the importance of UK investment companies and their longstanding history in the UK market.

As I explained at the evidence session, investment companies are often marketed as retail savings products either for one-off or regular investments to retail investors and therefore are different to other types of listed firms. While our starting position is that investment trusts should still be required to disclose clear and transparent costs, allowing a retail investor to understand their investment, we recognise that the existing PRIIPs requirements do not accurately reflect the unique characteristics of investment companies. We have had good engagement with industry, and via our statutory panels, to develop and inform our proposals for reform. We will

consult on these in the first half of 2024. Central to our approach will be outcomes focused disclosure that enables a retail investor to make informed decisions.

Insurance

3. *To what extent does the FCA consider the outcomes of Flood Re, include take up of insurance in flood prone areas? [Q702]*

As a reinsurer, Flood Re allows for better pooling of flood risk. Insurers set the terms & conditions they ask consumers to agree and the premiums they pay. While Flood Re is authorised by the FCA and PRA, our conduct rules do not apply directly to it because its 'customers' are not consumers, but insurers. These insurers are however subject to our conduct rules and the Consumer Duty, including the fair value requirement for firms to understand customer outcomes and the value of their products.

Flood Re's 2023 annual report sets out that 99% of households in properties at high risk of flooding could find quotes from 15 or more insurers.[1] The availability of flood insurance in flood-prone areas has also been the subject of extensive and ongoing research by the Department of the Environment, Food and Rural Affairs (DEFRA); they sponsored an independent review following the November 2019 flooding in Doncaster and a 2022 review of affordability and availability of flood insurance in 2022.[2] [3] This report detailed findings about the take-up of flood insurance, with little variation between those at-risk and those with flood control measures in place (83% and 84% respectively for owner occupiers). Given this level of coverage we do not currently think that there is a need to undertake further work as the scheme appears to support an effective market. We understand that DEFRA plans to repeat this earlier study.[4]

4. *Flood Re will run into 2039. What will happen after that point? What were the recommendations made to Treasury on how the scheme may be taken forward? [Q702]*

Flood Re is a joint initiative between the Government and the insurance industry, who between them will be responsible for successor arrangements after 2039. When that happens, it is necessary that a market is in existence that is based both on risk-reflective pricing of household insurance and is affordable and available for households at risk of flooding. Flood Re's Transition Plan sets out a strategic plan to manage its exit from the market.

5. *To what extent is the FCA aware of concerns around insurance pricing on renewal, and whether current rules around the prices offered by firms at that point are appropriate* and fair? [Q702]

We are aware of the growing concern about the cost of renewing insurance, particularly for homes and cars, and we are monitoring the situation closely. Coming after a period where these products have been loss-making or marginally profitable for many insurers, increases were expected, but we recognise they are particularly difficult for consumers experiencing cost-of-living pressures.

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[1] Flood Re Annual Report and Financial Statements: https://www.floodre.co.uk/wp-content/uploads/Flood-Re-Annual-Report-2023.pdf
[2] Independent Review of Flood Insurance in Doncaster, led by Amanda Blanc, April 2020: https://assets.publishing.service.gov.uk/media/5fa28b70e90e0704157fb18a/review-flood-insurance-doncaster.pdf
[3] https://randd.defra.gov.uk/ProjectDetails?ProjectId=20448
[4] Flood Re and household flood insurance, July 2023: https://researchbriefings.files.parliament.uk/documents/CBP-8751/CBP-8751.pdf

For motor insurance, we have continually analysed data sources across the market. On average, consumers have seen their annual premiums increase by 21% since June 2022,[5] though we have observed some much higher rises than this and predictions show further increases in the year ahead.[6] There are a range of factors contributing to increased premiums including the cost of car repairs, paint, labour and spare parts having risen considerably alongside a highly fluctuating cost of energy.

In addition, the market price of used cars has increased. These factors have led to a significant increase in the value of claims pay-outs year-on-year, which has impacted premium levels. Claims costs for insurers have risen 16% between Q2 2019 and Q2 2023 (£2.2bn to £2.5bn). We see similar issues for home insurance, with the cost of materials and labour increasing.

As the regulator, we do not control or set prices, but bearing in mind our objective to ensure markets work well and in the interests of consumers, we are acutely aware of the impact of higher premiums and will continue to monitor the data closely, particularly with a lens of ensuring consumers receive fair value. We observe that both the home and motor insurance markets are highly competitive, and firms are incentivised to offer lower prices to attract customers. We also introduced new rules in 2021 to tackle loyalty penalties and ensure prices for home insurance customers are fair and appropriate. These:

- require firms to ensure their products and pricing models provide fair value. This means there must be a reasonable relationship between the price and the benefits provided, including the underlying cost of meeting claims, and
- prevent firms from charging a customer more than they would if they were a new customer.

Our reforms have made the insurance market fairer, as loyal customers can no longer be penalised for staying with their provider. When we consulted on changes, we were clear that some unsustainably low-priced deals would no longer be offered. Premiums for some customers have therefore increased. However, the analysis we conducted when implementing the rules indicated there would be a substantial net benefit to customers overall. Nevertheless, we always encourage customers to shop around to find the best deal.

We plan to carry out a full evaluation of the impact of our pricing rules this year. As part of this evaluation, we will assess the current state of the market, the underlying profitability of insurers, and look at concerns about some insurance add-ons and additional costs, such as those incurred by using premium finance (a product about which we have been raising concerns with the industry since 2022).

Securitisation

6. *Are the changes you have proposed to the securitisation rules in CP23/17 sufficient to allow the UK to materially expand its securitisation market?*

The Securitisation Regulation (2019) consolidated various regulations, with the aim of reviving high-quality securitisation markets and avoiding the mistakes that led to the global financial crisis of 2007/8.

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[5] ABI motor premium tracker: https://www.insuranceage.co.uk/insight/7953988/abi-calls-for-ipt-cut-as-motor-insurance-prices-hit-record-high

[6] https://www.ey.com/en_uk/news/2023/06/ey-uk-motor-insurance-results-analysis

HM Treasury conducted a review of the Securitisation Regulation (SR) in 2021, with an overarching aim to support and develop securitisation markets in the UK.[7] It concluded that the UK SR remained important to the functioning of securitisation markets in the UK and identified specific areas where policy changes could be considered.[8] Whilst supportive of the regulation, we, HM Treasury, and the PRA are in the process of making amendments in order to provide greater clarity, improve the proportionality of the requirements, and remove unnecessary barriers to the issuance of – and investment in – securitisations. We published a first consultation in August 2023,[9] and a second one is currently scheduled for Q4 2024 or Q1 2025.

Our first consultation focused on the transfer of the firm-facing provisions from the UK SR into our Handbook. We also took the opportunity to propose some policy changes, including a more proportionate approach to due diligence which could enable UK investors to invest in a wider range of securitisations and proposed changes to the risk retention requirements for non-performing exposures, making it easier to securitise them. Early industry engagement on the proposals has been positive.

In our second consultation we plan to propose further changes, leveraging the agility gained through the transfer of firm-facing requirements into FCA and PRA rules. Amongst other potential proposals, our focus will be to review the disclosure requirements, addressing one of the issues raised in the 2021 review as a potential barrier to securitisation growth. Any changes would consider if the current disclosure framework is appropriate and will seek to improve the proportionality of the requirements, whilst maintaining appropriate investor protections.

The focus of our consultations are proposals to amend and reform the UK SR to underpin growth in the market where it is within the FCA's power to do so. Other factors, for example prudential treatment relating to securitisation (on which the PRA have published a discussion paper) and macro-economic conditions will also affect market activity.[10]

7. *Will your proposed changes to the securitisation rules allow UK companies to access lower borrowing costs via their lenders being able to fund their loans more cheaply?*

We are seeking to make the UK securitisation market work better and a market that operates efficiently can lead to greater liquidity and potentially reduces the costs of issuing securitisations, whilst increasing the number of financial institutions able to access securitisation as a funding tool.

However, the costs lenders incur and the borrowing rates they offer to UK companies would be impacted significantly by macro-economic conditions and other factors, beyond this regulation.

Office for Professional Body Anti-Money Laundering Supervision (OPBAS) Reform

8. *In their annual report, OPBAS have noted that the anti-money laundering supervision bodies have increased the number of fines issued since 2018, while membership suspensions and cancellations have remained mostly stable. In their 2019 report OPBAS found that 92% of accountancy bodies were hesitant to take robust action for fear of*

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[7] For further detail, see paragraph 1.19 of the June 2021 Call for Evidence on the Securitisation Regulation: https://assets.publishing.service.gov.uk/media/60e7fda6e90e0764d36143cf/Securitisation_Regulation_Call_for_Evidence_June_2021.pdf

[8] https://assets.publishing.service.gov.uk/media/61b370f38fa8f503816404eb/Securitisation_Regulation_Review.pdf

[9] CP23/17: Rules relating to Securitisation: https://www.fca.org.uk/publications/consultation-papers/cp23-17-rules-relating-securitisation

[10] DP3/23: Securitisation: capital requirements: https://www.bankofengland.co.uk/prudential-regulation/publication/2023/october/securitisation-capital-requirements

losing members. Given the lack of significant change in suspensions and cancellations, do you have concerns about the enforcement activities of accountancy bodies?

The OPBAS report of March 2019 was based on its initial year of activity. OPBAS has driven improvements in the following four years. In its most recent report from April 2023,[11] OPBAS identified a statistically significant relative increase in formal enforcement action by Professional Body Supervisors (PBSs) through fines for anti-money laundering (AML) breaches, but much less so in membership cancellations and suspensions.[12] OPBAS has been consistent in the view (for example as set out in OPBAS' response to the Solicitors Regulation Authority's November 2021 consultation on financial penalties) that PBSs across both the legal and accountancy sectors still need to improve the overall effectiveness of enforcement frameworks. [13]

In 2023 we set out that we will increasingly focus on enforcement and more formal supervisory powers if necessary. For example, OPBAS has used its powers to issue specific supervisory directions to two separate PBSs within 2023. OPBAS has also clarified and strengthened its expectations of the PBS through its revised sourcebook published in January 2023, including the requirement for appropriate division between the advocacy and regulatory functions at PBSs.[14]

While OPBAS's first and second progress reports show that OPBAS was quick to drive up compliance by PBSs with their supervisory obligations, [15] [16] measurable changes to their effectiveness take more time and effort to achieve. In the absence of evidence of consistent effectiveness across all PBSs, there is rightly a challenge on the impact of the current framework. This makes the case for further supervisory system reform.

9. *The Institute of Chartered Accounts of England and Wales, responding to the Treasury's consultation on reform plans, argued that removing OPBAS in favour of a consolidated supervisor or an independent body would be a waste of "significant investment". Do you agree?*

The National Crime Agency estimates that the scale of money laundering impacting the UK is more than £100 billion each year.[17] PBSs between them supervise around 42,000 entities within scope of the Money Laundering Regulations 2017,[18] each of which has an important role to play in building UK resilience to money laundering and reducing this figure. Under OPBAS supervision, the PBSs have invested in their AML supervisory frameworks and capabilities over the last five years, although this needs to be an ongoing process. We do not consider such investment would

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[11] Anti-Money Laundering Supervision by the Legal and Accountancy Professional Body Supervisors: Progress and themes from our 2022/23 supervisory work: https://www.fca.org.uk/publication/opbas/opbas-report-progress-themes-supervisory-work-2022-23.pdf

[12] HMT AML annual return (December 2022): https://assets.publishing.service.gov.uk/media/63a03ecfd3bf7f37598eda96/Supervision_report_final_draft_-_signed.pdf_h

[13] OPBAS letter to the Solicitors Regulation Authority, 4 March 2022: https://www.fca.org.uk/publication/opbas/response-sra-consultation.pdf

[14] FG23/1: OPBAS Sourcebook update: https://www.fca.org.uk/publications/finalised-guidance/fg23-1-opbas-sourcebook-update

[15] Anti-Money Laundering Supervision by the Legal and Accountancy Professional Body Supervisors: Progress and themes from the 2018 OPBAS anti-money laundering supervisory assessments: https://edit.fca.org.uk/publication/opbas/themes-2018-opbas-anti-money-laundering-supervisory-assessments.pdf,

[16] Anti-Money Laundering Supervision by the Legal and Accountancy Professional Body Supervisors: Progress and themes from 2019: https://edit.fca.org.uk/publication/opbas/supervisory-report-progress-themes-2019.pdf

[17] National Crime Agency, National Strategic Assessment of Serious and Organised Crime (2021): https://www.nationalcrimeagency.gov.uk/who-we-are/publications/533-national-strategic-assessment-of-serious-and-organised-crime-2021/file

[18] HM Treasury report, Anti-money laundering and the countering the financing of terrorism: Supervision Report 2020-22 (December 2022): https://assets.publishing.service.gov.uk/media/63a03ecfd3bf7f37598eda96/Supervision_report_final_draft_-_signed.pdf

be lost if the UK moves to a more effective model of supervision. The resources spent on identifying sectoral risks and strengthening firms and PBS members to date will support whichever supervisory option is chosen.

10. *One of the options proposed by the Treasury would see you cease to be an anti-money laundering supervisor. What are the risks, in your view, from that decision?*

Option 4, a single AML/combating terrorist financing (CTF) supervisor (SAS), could achieve the government's objectives for reform. However, we consider that the additional cost and risk of splitting the supervisory oversight of the UK financial services sector and casinos would be disproportionately disruptive when compared to option 3: a single professional services supervisor (SPSS).

Option 4 would require not only transfer of FCA AML expertise to the SAS; coordination between the SAS and FCA (and PRA as needed) would also be essential for effective oversight of financial services firms. This model would create friction in the wider economic system given the difficulties for existing supervisors to fully divest themselves of AML oversight and would likely present operational difficulties for regulated firms - who would have to engage with up to 3 different supervisory bodies (PRA, FCA and a new AML SAS).

For example, the FCA has a conduct role, and reducing the risk of financial crime is embedded in the FCA's integrity objective. Currently the FCA uses a systemic, 'whole-firm' framework of regulation to apply to financial services, which it would likely seek to retain if it were to cease being the sector's AML supervisor given the imperative to maintain UK financial stability, market integrity and consumer protection. The FCA is one of the most prolific enforcers globally of the AML regime with 27 regulatory/civil financial penalties issued against firms for inadequate AML systems and controls.

While other supervisors also have the objective of preventing economic crime, the FCA's holistic approach differs from the oversight remit of PBSs, given the much broader role and responsibilities of the FCA with regard to the financial sector. Particularly in the accounting sector, PBSs' role can also involve conflicting functions as both representative and regulatory bodies for their sectors. And, given some firms can choose which PBS supervises them, there is an arbitrage risk which is not present in the regulation of financial services.

11. *Of the four options for the reform of OPBAS proposed by the Treasury in its consultation, does the FCA have a preferred outcome?*

All four options have pros and cons, but we consider that option 3, a single professional services supervisor (SPSS), is the option most likely to improve the effectiveness of supervision and coordination across the whole AML/CTF) ecosystem in a proportionate way.

Option 1 (OPBAS+) proposes extending OPBAS's powers. But even with a significantly enhanced OPBAS, this option would not reduce the complexity of the AML/CTF supervisory regime nor address the drawbacks to which that complexity gives rise to, particularly of gathering and sharing information and intelligence between a large number of supervisors, law enforcement and other stakeholders. Wide variations between PBSs (regarding the resourcing, systems and approaches used, and the numbers of firms under supervision) place limits on what is proportionate to require by way of consistency.

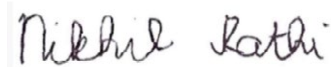
Option 1 also fails to address the inherent conflict between many PBSs' advocacy and supervisory functions, which OPBAS has found can contribute to a less robust approach to supervision.[19] Option 2 (PBS consolidation), has the potential to improve consistency, but does not fully resolve the inherent conflict risk. And, to the extent that OPBAS does not view any of the current regulatory PBSs as being fully effective, either option risks embedding under-performance.

By contrast, option 3 (the SPSS model) would reduce AML supervisory complexity, cutting the number of AML/CTF supervisors and addressing the sectors which were considered weakest when the UK was last assessed by the international standard setting body, the Financial Action Task Force (FATF). It would address the inherent risk of conflict of interest between many PBSs' regulatory and representative functions.

It could also improve consistency, holding sectors more fully to account and generating a model better able to understand and address cross-sectoral risks. This could include looking at high risk areas such as trust or company service providers (TCSPs) or conveyancing, which cut across legal, accountancy and (for conveyancing) real estate sectors, which are currently overseen by multiple supervisors. As a supervisor on the same statutory footing as the FCA, HMRC and the Gambling Commission, it would simplify intelligence and information sharing between supervisors and other agencies, including law enforcement. A model which separates financial and non-financial sectors is also consistent with the direction of travel at FATF.

I hope this addresses your follow-up and additional questions, and I look forward to our next evidence session on the work of the Financial Conduct Authority later this year.

Yours sincerely,



Nikhil Rathi
Chief Executive

[19] Anti-Money Laundering Supervision by the Legal and Accountancy Professional Body Supervisors: Progress and themes from our 2020/21 supervisory work: https://www.fca.org.uk/publication/opbas/supervisory-assessments-progress-themes-2020-21.pdf