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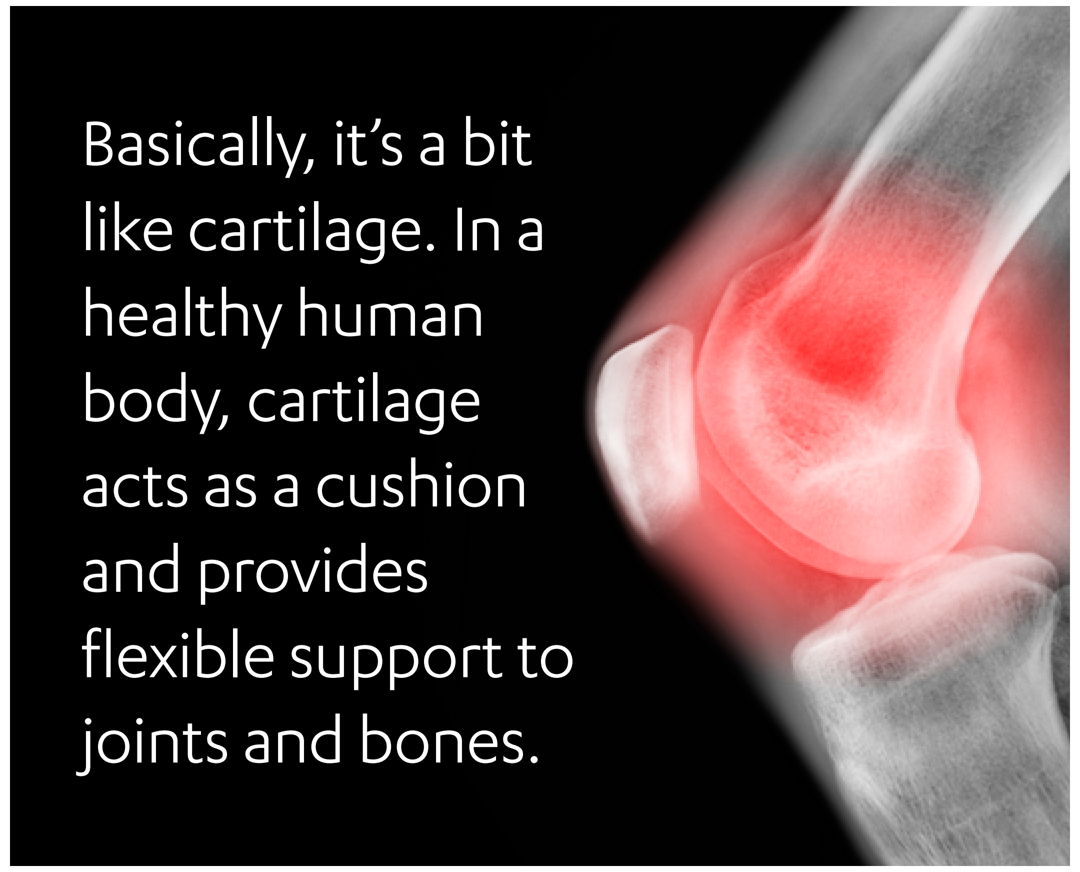
Operational resilience - preparations for 31 March 2022

The deadline of 31 March 2022 is approaching when new rules on operational resilience come into force.

Financial resilience and business continuity has dominated the boardrooms of many financial services organisations over the last decade. As this sector seeks to embrace digital transformation (accelerated by COVID-19 and with a heavy reliance on technology, cloud solutions and outsourced IT services), attention has shifted to operational resilience.

What is operational resilience? Think of it as cartilage

In their 2018 discussion paper, the Bank of England (BoE), the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) define operational resilience as the ability *"to prevent, respond to, recover and learn from operational disruptions"*. Clear as mud, right?



Operational resilience works in the same way and essentially gives structure and processes to a business, enabling it to absorb shocks resulting from volatility and disruptions (whether arising from external or internal events or circumstances). These may include economic shocks, cyber-attacks, or technological failures. Operational resilience seeks to ensure that organisations are prepared, enabling them to adapt and react quickly to either prevent incidents from occurring or at the very least to minimise impact and disruption.

Operational resilience in the limelight: why does it matter?

The financial services sector is core to modern day society not only in a domestic context, but also globally. In an increasingly connected world, the rise in cyber-attacks, (unplanned) system outages, greater reliance on digital services and the increasing complexity of systems and their interactions and interfaces means that the shift in focus by regulators isn't surprising.

COVID-19 has been an example of why robust business continuity and operational resilience is necessary, as much of the world moved to home working overnight. It has also resulted in the rapid adoption of technology to enable and sustain new ways and locations of working. With these changes come solutions and innovations but also challenges, such as potentially increasing security, data and resiliency risks.

In respect of cloud-based services, the rapid adoption of these by firms (including in response to the pandemic) carries its own unique risks, as an overreliance on a select few providers can exacerbate the scale of any disruption when issues do inevitably occur; as evidenced by Amazon Web Services' most recent high-profile outage in December 2021, which affected everything from delivery operations to mobile banking apps.

It is a matter of record that these 'concentration risks' are very much of concern to UK regulators.

The BoE and the PRA, and the FCA all launched consultations in 2019. In light of the pandemic and the conclusions drawn following responses (that disruptions and the unavailability of important business services have the potential to cause wide-reaching harm to consumers and market integrity), the BOE, PRA and FCA have developed in partnership a set of rules aimed at increasing the overall operational resilience of UK businesses.

Who do these new rules apply to?

The rules apply to the usual subjects (eg banks, investment firms, building societies and insurers), but interestingly, also impact the relatively new kids on the block - payment and electronic money organisations.

Certain rules will become effective from 31 March 2022, so let's remind ourselves what is expected.

What is the expectation?

The expectation is that impacted organisations can provide an audit trail demonstrating that they have:

- Identified their important busines services. These are services, which could, if disrupted, likely cause intolerable harm to their customers/the financial markets within which they operate.
- Set impact tolerances to effectively measure/gauge the extent to which said services are able to withstand certain levels of disruption.
- Mapped the resources necessary to deliver the important business services and tested their ability to remain within any tolerance levels set against a range of adverse scenarios.
- Developed their internal and external communications strategies.
- Prepared a self-assessment document showing how they will meet their operational resilience requirements.

What's next?

It's important to remember that this is just the first step in building an 'operational resilience framework'. In-scope firms are encouraged to ensure that sufficient mapping and testing activities have been undertaken to ensure that firms remain in their impact tolerances in respect of each impacted business service as soon as possible but no later than 31 March 2025.

It is crucial therefore, that firms stay ahead of the curve and are proactive in aligning their business functions with these incoming regulations. Certainly for most, growing that cartilage has and will continue to take some considerable time and effort going forward!

Ready, set, GO! The FCA starts to warm up in the world of Buy Now Pay Later

The HM Treasury consultation into the regulation of Buy Now Pay Later (BNPL) products closed on 6 January 2022. While we wait for HM Treasury to publish its response, the Financial Conduct Authority (FCA) hasn't been resting on its laurels. In fact, the FCA has been working away in the background and has secured changes to potentially unfair and unclear contract terms in certain BNPL agreements.

The FCA, concerned with the potential risk of harm to consumers because of the way terms were drafted in certain BNPL agreements, has chosen to take action prior to any legislative or regulatory change being made to the sector. On 14 February 2022, the FCA announced that it was able to obtain contract term changes from Klarna, ClearPay, OpenPay and LayBuy. Even though these agreements are not regulated, the FCA used the Consumer Rights Act 2015 to undertake an assessment as to whether or not the contract terms were fair and transparent.

Sheldon Mills, Executive Director of Consumers and Competition at the FCA, said:

'Buy-Now Pay-Later has grown exponentially. We do not yet have powers to regulate these firms, but we do have powers to review the terms and conditions of consumer contracts for fairness, and have acted proactively to ensure that the BNPL industry adopts high standards in their terms and conditions.

'The four BNPL firms we have worked with have all voluntarily agreed to change their approach. We welcome this and hope that the rest of the industry will now follow.'

What's next?

This work means that these firms are changing terms, for example, dealing with cancellations and continuous payment authorities to ensure they are fairer and easier to understand. In particular, as a result of making changes to terms involving late payment fees, Clearpay, Laybuy and Openpay have agreed to voluntarily refund customers who have been charged late payment fees in certain instances.

It also demonstrates quite clearly that the FCA has the BNPL sector firmly set in its sights and it is not waiting for HM Treasury nor legislative change to start effecting change. The FCA is keen address any potential risk of consumer harm from the BNPL industry and this is only just the first move in a year where we can anticipate key regulatory change in the sector.

Things are going to get interesting, watch this space!

"Are you guys into crypto?" Curbing the crypto ad boom (but please don't blow up your Lambo!)

In recent years, crypto has grown in popularity, but with around 2.3 million people in the UK thought to own a cryptoasset and research suggesting that many don't fully understand what they are buying (perhaps not a surprise for those who have discussed the topic at the pub), the FCA looks to step in by tightening up the rules on advertising.

In today's digital world advertising is everywhere. You can barely go 5 seconds without the tidal wave of ads hitting you. Indeed, to anyone browsing social media or riding the tube in recent times (or even watching the Super Bowl), the surge in ads for cryptoassets and exchanges has been obvious. Referenced as the 'technology of the future' and the ultimate way to 'get rich quick' you've probably seen countless adverts, memes, articles and podcasts about them on at least a daily basis.

Quick recap: what are cryptoassets and cryptocurrencies?

In very simple terms when we talk about cryptoassets or exchanges, we are talking about cryptocurrency that is held as an investment (and typically expecting their value to rise) or sold on an exchange.

Cryptocurrencies are a form of digital or virtual currency – so you won't stumble across a physical bitcoin, dogecoin, catcoin and insert 'whatever name' coin that someone's dropped in the street (unfortunately). Crypto currencies are also issued differently to physical money in that instead of being produced by a central bank, it is created or circulated through a technical process involving decentralised networks and blockchain technology meaning that it can be spent or received by anyone, anytime and anywhere in the world without the involvement of a bank or government etc.

What is the problem with advertising crypto?

Well for starters – it's got someone blowing up their Lamborghini Huracan (and we don't mean the toy version!) in protest of the crypto 'get rich quick' culture.

Parking that for a second (no pun intended), part of the issue is that crypto is pretty risky business as result of its volatility – the majority aren't 'controlled investments' or regulated in the same way other investments are. Yet, a report published by the Financial Conduct Authority (FCA) in October 2021 found that 58% of new investors in crypto had been inspired by social media. Now don't get me wrong, I'll have a quick scroll through my 'Insta feed' but it's not the first place I would think to look for advice on making a financial investment – let alone high risk investments. Therein lies the problem: high risk investments being advertised to the masses without adequate information to understand the risks of the investment.

While the Advertising Standards Agency announced investigations into various media due to concerns that ads: trivialised cryptocurrency investments, take advantage of people's inexperience with cryptoassets, and create a sense of urgency to invest, it has also caught the attention of the Treasury and the FCA. Between 20 July 2020 and 26 October 2020 the Treasury ran a consultation on Cryptoasset Promotions. The Treasury sought to understand how best to control these activities without stifling innovation.

Consultation response

On 18 January 2022, the Treasury published its Consultation Response on Cryptoasset Promotions, proposing that 'qualifying cryptoassets' be considered as controlled investments and thus, within the FCA's remit and within the scope of the financial promotions regime. This would mean that only authorised firms will be able to advertise such cryptoassets. While the definition of 'qualifying cryptoassets' is yet to be confirmed, the current proposed definition identifies the following defining characteristics: (i) transferable; (ii) fungible; (iii) not e-money; and (iv) not a government backed currency. Interestingly, as currently proposed, this would see NFTs (non-fungible tokens) fall outside the scope of the definition.

Before these proposals can be put into effect, legislation will be required to amend the Financial Promotion Order regime and the complementary FCA rules.

What's next?

Whilst the timetable for any legislation is unclear, it is likely that these changes will be aligned with the broader changes to the Financial Promotions Order regime proposed by the FCA, having recently launched a consultation. The FCA has proposed to extend its financial promotion rules to include 'qualifying cryptoassets' which could lead to: (i) banning the use of inducements to invest (eg refer a friend or new joiner bonuses); (ii) clearer risk warnings for consumers (eg pop-up windows or cooling off periods for first time investors); (iii) clarification on self-categorisation to aid consumers in better defining their status as 'sophisticated' or 'high-net worth' and what that actually means; and (iv) an appropriateness test in respect of all direct offer financial promotions. The consultation runs until 23 March 2022, with the hope to publish the final rules in summer 2022.

Access to cash update: a look at the direction of travel

With a landmark initiative by the major retail banks set to play a pivotal role in ensuring continued access to cash, we take a look at some of the recent and not so recent developments in respect of access to cash.

Quick recap – what is access to cash?

In a little over a decade, cash use has dropped from accounting for 56% of all UK payment transactions to as little as 17% of all payment transactions in the UK. The methods of payment are now many and accessible at the tap of a card or smartphone, with many opting for these methods instead of cash. If the declining trend in cash use continues as is predicted (no doubt accelerated by COVID-19 – enter stage left), cash may account for as little as one in every ten payment transactions in the UK.

Given the decline in cash use and resulting decline in the availability of core cash services there is increasing concern that certain parts of society will be "left behind" in an increasingly digital society. So what has been and is being done about it?

How did we get here?

The Access to Cash Review

The Access to Cash Review was commissioned in 2018 as a response to the rapid decline in cash use and growing concerns about those "left behind".

The independent Access to Cash Review published its final report in March 2019 and stated that: "Sleepwalking into a cashless society will leave millions behind. Action is needed now" and called for further legislative action to be taken.

Specific Direction 8

In 2018, Specific Direction 8 (which has now been revoked by Specific Direction 12), came into effect. Under Specific Direction 8, the Payment Systems Regulator required LINK (the operator of the LINK Scheme, the payment system for most ATMs in the UK) to fully develop its policies and processes to ensure that LINK does all it can to fulfil its public commitment to maintain the broad geographical spread of free-to-use ATMs in the UK.

Community Access to Cash Pilots

A pilot initiative was established in 2020 (led by the chair of the Access to Cash Review and supported by major retail banks, consumer groups and the like) to test various solutions aimed at preserving cash across various locations in the UK including banking hubs, counter services, automated deposit taking machines and cash back services. Initially set to run until October 2021, the pilot was extended until at least 2023 in respect of two banking hubs on the basis of their popularity locally.

Cashback without purchase

As result of industry lobbying, in 2021 legislative change was achieved to facilitate the roll out of 'cashback without purchase' at retailer tills. This is considered to be an important additional tool to provide easily accessible cash services, including in locations where an ATM isn't feasible.

The Access to Cash Consultation

On 1 July 2021 the Treasury launched a consultation on access to cash. The consultation set out proposals for further legislation and sought views on: establishing geographic requirements for the provision of cash withdrawal and deposit facilities, the designation of firms for meeting these requirements, and establishing further regulatory oversight of cash service provision. The evidence gathered from the consultation, which closed in September 2020, continues to be assessed and we await publication of the findings.

The Access to Cash Action Group

The Access to Cash Action Group (ACAG), was established in 2021 with the aim of finding ways to ensure that access to cash issues in the United Kingdom can be, and are, resolved for the benefit of consumers absent legislation. It comprises senior members of a number of banks and building societies, together with UK Finance, Age UK, Toynbee Hall, the Federation of Small Business, the Post Office and LINK Scheme Ltd.

ACAG have made the following commitments:

- ensuring that cash will be available for those who need it, particularly small businesses, the elderly and vulnerable, when they need it
- supporting the Community Access to Cash Pilots
- working together to consider possible models for future access to cash which addresses changing access requirements and meets the needs of customers and communities
- protecting current critical cash infrastructure until a viable alternative to cash is available
- establishing and maintaining a framework to enable early identification of potential cash 'cold spots'

December 2021 saw proactive action from ACAG, taking steps to ensure access to cash is preserved, with major UK retail banks agreeing to share services to secure fair access to cash in the UK. It is stated as being the beginning of a long-term commitment to ensuring this is achieved.

As part of this LINK was appointed as 'Co-ordinating Body' and will be responsible for assessing, by applying 'criteria' provided by relevant stakeholders, whether there is adequate access to cash in communities and/or geographical areas across the United Kingdom, following the closure of bank branches. LINK will also be responsible for determining which measures (if any) may be required to be implemented in order to address any access to cash needs identified as part of its assessment. This has received a positive response from regulators including the FCA and PSR who have issued statements welcoming the proactive action of the ACAG group.

What's next?

Although the outcome of the Access to Cash Consultation remains to be published, there appears to be firm commitment from the industry, the FCA, the PSR, the Bank of England and the Treasury, to protect access to cash – as well as proactive industry action. Furthermore, the general consensus seems to be that legislation is on the horizon.

Latest developments

Financial Promotions/Advertising

- On 8 February 2022, the FCA ordered UK fintech company, Freetrade to remove all paid for social media influencer posts concerned it could lure young people into making risky investments.
- On 22 March, the Advertising Standards Agency (ASA) issued an Enforcement Notice to over 50 companies which advertise cryptocurrencies, instructing them to review their ads and to ensure they understand and are complying with advertising rules.

Payment Systems Regulation

- The Payment Systems Regulator published a policy statement on 10 February 2022 on the roll out of Phase 2 of Confirmation of Payee.
- The Payment Systems Regulator consults on remedies relating to its card-acquiring services market review. The consultation closes on 6 April 2022.
- The Payment Systems Regulator has issued the new Specific Direction 12 to replace Specific Direction 8. The new Specific Direction 12 is designed to support LINK in meeting its commitment to maintain a broad geographic spread of free to use ATMs and meets users' needs.

Credit Regulation

- On 23 March 2022, Brian Corr, Interim Director of Retail Lending at the FCA, delivered a speech at the Credit Summit 2022. In his speech he highlighted the priorities for credit regulations such as, the implementation of the new Consumer Duty which will play a big part in helping to deliver the right outcomes for consumers who make use of credit products and that the regulator will also be looking at how to help people with limited borrowing options whilst maintaining protection from unaffordable lending.

Buy Now Pay Later

- On 3 March 2022, Barclays published its research into unregulated Buy Now Pay Later (BNPL) products. The study (conducted among 2,000 BNPL users) showed that 68% of 18-24 year olds users of unregulated BNPL products have racked up debts across multiple providers. This has left 66% of parents concerned about their adult children using BNPL.

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