



The Recovery, Resolution and Resilience Team
Prudential Regulation Authority
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AFM Response to PRA Discussion Paper 3/22; FCA Discussion Paper 22/3, Operational Resilience

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:
 - Comment on the proposals, and their consequences for members of AFM and their customers.

About AFM and its members

2. The Association of Financial Mutuals (AFM) represents insurance and healthcare providers that are owned by their customers, or which are established to serve a defined community (on a not-for-profit basis). Between them, mutual insurers manage the savings, pensions, protection and healthcare needs of over 32 million people in the UK and Ireland, collect annual premium income of over £22 billion, and employ nearly 30,000 staff¹.
3. The nature of their ownership and the consequently lower prices, higher returns or better service that typically results, make mutuals accessible and attractive to consumers, and have been recognised by Parliament as worthy of continued support and promotion. In particular, FCA and PRA are required to analyse whether new rules impose any significantly different consequences for mutual businesses² and to take account of corporate diversity³.

¹ ICMIF and AFM, 2022: <https://www.icmif.org/uk-market-insights-uk-2022/>

² Financial Services Act 2012, section 138 K: <http://www.legislation.gov.uk/ukpga/2012/21/section/24/enacted>

³ <http://www.legislation.gov.uk/ukpga/2016/14/section/20/enacted>

AFM comments on the proposals

4. We welcome the Discussion Paper and the opportunity to comment. As AFM members are 'firms' as defined in the paper, they do not deliver 'FMI'⁴ services, and do not provide the form of critical third-party services highlighted in the paper, such as cloud service provision or ICT services. However, as small businesses, they are very reliant on a wide range of third parties, both in delivering services but also in ensuring they are operationally effective and resilient. Indeed, where the EY research referenced in the Paper indicates 49% of insurers plan 'to move most of their business to the cloud in the next few years'⁵, indications from AFM members suggest this is an underestimate, and that the pandemic accelerated many firms' ambitions.
5. The regulators are correct to identify that whilst third-party service providers offer a range of benefits to firms and their customers, there are also various risks which could potentially outweigh those benefits, if the service provider failed or the service was delivered unsatisfactorily. In our sector we have seen some instances of IT firms' failures and many more cases of IT contracts failing to deliver the expected outcomes. It is not the regulators job to shield firms from poor decision-making, but where cloud service providers (for example) sell products into the financial services market, whether from within the UK or elsewhere, there should be some form of regulation and standard setting, as proposed by the Treasury Select Committee, particularly where a failure would leave consumers unable to access their money, or otherwise more vulnerable. Mitigating that risk for consumers of financial services is a role both for regulators and regulated firms, and the argument that service providers also support non-regulated businesses is not relevant to the need for standards in financial services.
6. We agree therefore on the need for the regulators to strengthen the current framework. However, we also consider this should be delivered proportionately, and with minimal duplication of firms' own standards: otherwise, the costs of a new framework will be passed onto firms, and in turn consumers would suffer higher costs and/ or a reduction in services. We would also stress the vital importance of regulators in different sectors agreeing wherever possible on common standards.

⁴ Regulatory shorthand for financial market infrastructure firms, such as clearing houses, investment exchanges and specified service providers. We note that the Discussion Paper makes extensive use of non-mainstream terminology, and this regrettably has the risk of blurring the messages and obscuring the relevance to mainstream providers. For simplicity in our response we will refer purely to 'firms'.

⁵ https://www.ey.com/en_uk/financial-services-emeia/how-insurers-can-transform-by-adopting-public-cloud

7. We consider there is a potential role for the regulators in publishing transparently the data it collects from self-attestations and reliance testing, to enable firms to verify that minimum standards have been achieved, and as part of firms' own evidence gathering.
8. With regard to the content of such standards, we agree that the list set out in paragraph 5.3, and which is derived from CPMI-IOSCO principles, appears valid. Where those principles are set in relation to FMIs though, they may need some adaption to ensure they provide a similar set of expectations for firms that manage the interests of retail consumers. The minimum standards in Table C provide an effective framework, and are broadly compatible with the standards expected of regulated firms.
9. We are less convinced that in the short-term a rating system is appropriate or desirable, as it may confuse messages provided to consumers. Transparency around how standards are delivered, and public reports on critical incidents will inform partners and reduce risk to consumers. We also wonder whether regulators should undertake some form of financial assessment of critical third parties, to ensure they have appropriate capital reserves and contingency plans, to draw on in the event of a major incident, and the appropriate governance standards and management expertise to manage in differing business conditions. This appears to have been a failure of Ofgem, in seeking to embrace new technology providers, only to find many had shortcomings. Financial regulators run the same risk by a headlong rush to encourage fintech providers, and the standards proposed in the Discussion Paper should help address some of those risks.
10. We would welcome the opportunity to discuss further the issues raised by our response.

Yours sincerely,



Martin Shaw
Chief Executive
Association of Financial Mutuals