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[16 February 2021]

Dear Independent Non-Executive Directors

Virtual Meetings with the PRA's Senior Advisors

On behalf of the PRA Senior Advisors, we would like to thank you for participating in our pilot programme of virtual meetings between the PRA's Senior Advisors and independent Non-Executive Directors (iNEDs) from around 40 PRA-regulated banks and insurers (firms) which took place in October and November of last year. The objective of these meetings was to provide an informal opportunity to discuss issues and risks that were on board agendas.

As requested, we have shared within this letter some of the themes which emerged from our discussions. We have spent some time synthesising the outputs of our discussions, and ensured that none of the content could be attributed to any particular firm(s). We hope you will find the content useful. We are also planning to publish this letter on the PRA website to ensure the messages are available to all PRA-regulated firms.

The coronavirus outbreak was as expected a dominant theme in our discussions. A number of iNEDs noted that the uncertain macroeconomic environment had heightened pre-existing risks in the near term, and with the longer term implications still very uncertain, planning for the future has been made much more difficult.

Below we have set out a summary of the key themes that were raised by iNEDs which covered a number of areas:

1. The effect of the economic downturn on business models

iNEDs felt that the economic consequences of the outbreak would place further pressure on firms' profitability, and mentioned several other potential impacts on their firms, which included:

- (i) an acceleration in spending on digital technologies;
- (ii) pressure on some firms to identify more cost-cutting opportunities;
- (iii) firms were conscious that the impact of the outbreak on asset quality would damage balance sheets for some years to come;



- (iv) some consolidation in both the banking and insurance sectors is expected as a result of the market dynamics;
- (v) the ongoing low interest rate scenario is a significant factor in retail banks' search for other revenue streams as net interest margins continue to be squeezed;
- (vi) the well-capitalised investment banks that had invested heavily in electronic trading would continue to dominate the sector;
- (vii) insurers were hopeful that Solvency II changes in a 'post-Brexit' world may help address capital constraints for some insurers; and
- (viii) general Insurers were thoughtful about the consequences on the sector of the Business Interruption court case¹ and the Financial Conduct Authority's general insurance pricing review (please note, the business interruption court case was undecided at the time of these discussions).

2. Operational resilience in light of the new working environment

iNEDs were very positive on how their firms, and in general the industry, had adapted to remote working during the outbreak but recognised that:

- (i) their operational resilience was under increased pressure and scrutiny as a result;
- (ii) the controls environment was challenging with 'insider', and other risks heightened and effective second and third line oversight more difficult; and
- (iii) the risks associated with implementing larger scale IT programmes would be amplified while the staffing effects of the outbreak persist, and while staff are executing while operating from home.

3. Governance and people challenges

The iNEDs indicated that Chairs and boards had adapted well to the virtual environment, more specifically we heard the following:

- (i) some iNEDs, especially of international firms, reporting increased efficiencies; but many yearned for more contact with senior management outside formal meetings;
- (ii) senior level recruitment has continued despite the challenges of remote working; and
- (iii) concerns of remote working carrying on for much longer, notably:
 - (a) the challenges of building/maintaining a desired culture with a disparate workforce;

¹ Available at: <https://www.fca.org.uk/news/press-releases/supreme-court-judgment-business-interruption-insurance-test-case>.



- (b) the need to refine the operational practices of the risk function and internal audit in a virtual operating model;
- (c) reduced opportunities for creativity; and
- (d) concern for the mental health of staff, especially those with less than ideal home working environments.

4. Climate related financial risk

iNEDs were supportive of the PRA's active supervisory approach to this global risk:

- (i) some iNEDs acknowledged that their firms' climate risk work had been de-prioritised during the outbreak, however it was widely recognised as a key priority;
- (ii) investing in 'green' assets will be key to firm strategies, but several iNEDs flagged that managing the effects of the transition to a low carbon environment would be extremely challenging;

5. Feedback on the regulatory landscape

The key elements of the feedback from iNEDs were as follows:

- (i) the PRA's communications and response to the coronavirus outbreak has been well received;
- (ii) supervisors and senior staff at the PRA have been accessible to firms during the outbreak, but there is a general concern at the rate of staff turnover in supervision teams; and
- (iii) some iNEDs flagged the need to ensure regulators co-operate as effectively as possible in the critical post-coronavirus period;

6. Other Issues

Several iNEDs reflected on some of the wider consequences of the outbreak for their business strategies:

- (i) the level of government borrowing would mean hard fiscal choices being made in terms of taxation policy and/or spending cuts;
- (ii) there was likely to be a growing cadre of vulnerable customers facing hardship through unemployment and/or business failures;
- (iii) younger customers will likely find it even more difficult to step on to the housing ladder and/or contribute to a pension;



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- (iv) pension incomes of post baby-boomers would be squeezed further;
- (v) some insurers were concerned with the reputational consequences of the well-publicised debate on the validity of policy claims;
- (vi) new recruits will have had their education disrupted by the outbreak, and may require additional support and training in their early career years;

Brexit was mentioned in most of the discussions, although iNEDs felt that their firms and the sector generally were well prepared for the UK's departure from the EU (please note this discussion took place before the end of the transition period).

Conclusion

From our discussions it is clear coronavirus and its aftermath will continue to create uncertainty in the banking and insurance sectors. Our conversations provided an invaluable insight to the issues at the top of iNEDs' minds. Thank you for giving us the opportunity to explore these issues with you.

We hope that you will share this summary with your board colleagues and that it will be helpful to inform them of the current and horizon risk issues shared by industry peers.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'N. Dexter', written over a horizontal line.

Nick Dexter
Senior Advisor
Prudential Regulation Authority

A handwritten signature in black ink, appearing to read 'M. D'Souza', written over a horizontal line.

Michael D'Souza
Senior Advisor
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