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B9: Skilled Persons (S166 review) – practical tips

Karen Bloomfield, Trevor Jones

KPMG LLP

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Agenda

- The Regulators' toolkit
- Update on S166 activity
- How does the S166 process work?
- Agreeing the scope
- Fieldwork
- Reporting and Closure

The Regulators' toolkit

The Regulators' information and investigation toolbox

S165 – Power to require information

The Regulator may require an Authorised Person to provide information or specific documentation within a reasonable timeframe

S166 – Skilled Person's report

The Regulator may require an Authorised Person to provide it with a report on any matter about which the Regulator has required or could require the provision of information or production of documents under section 165. The Skilled Person must be nominated or approved by the Regulator and must appear to the Authority to have the skills necessary to make a report on the matter concerned. The Regulator may also appoint the Skilled Person itself.

S166a – Skilled Person's collection and update of information

If the Regulator considers that an authorised person has contravened a requirement in rules to collect, and keep up to date, information, it may either require the authorised person to appoint a skilled person to collect or update the information, or itself appoint a skilled person to do so.

S167 – Investigation

If it believes it has good reason, the Regulator may appoint one or more competent persons to conduct an investigation on its behalf into an Authorised Person or its Appointed Representative:

- (a) the nature, conduct or state of the business
- (b) a particular aspect of that business; or
- (c) the ownership or control of the Authorised Person.



Features of the s166 review



What it is

- Supervisory tool – allows the Regulator to gain clarity on a particular matter
- Invoked if the Regulator is unclear/has concerns
- Could be invoked following a supervisory visit (ARROW/FSF), a particular event (e.g. “rogue” trader incident), or a thematic review
- Often covers systems and controls over a particular part of the business



What it is not

- Automatically a Bad Thing
- Automatically a matter for Enforcement
- An audit

Scope of the s166 review – different types of review



“Review and recommend”

- No assurance opinion
- Based on Skilled Person’s assessment
- Often includes recommendations where Skilled Person identifies weaknesses
- Examples of scope areas:
 - Quality of sales/ advice
 - Governance
 - Quality of Compliance function



Assurance based

- Defined opinion
- Based on testing assertions made by management
- Work carried out in accordance with formal assurance framework
- Examples of scope areas:
 - Regulatory returns eg liquidity
 - Compliance with CASS rules



Agreed upon procedures

- No assessment of the subject matter
- No assurance conclusion
- Regulator assesses results and draws its own conclusions
- Examples of scope areas:
 - Reperformance of key calculations
 - Vouching valuation inputs to broker quotes

Financial Services Act 2012 – changes to the regime

Use of s166

- Both PRA and FCA have said that they will continue to use the s166 review as a supervisory tool...
 - ...but not anticipating a massive increase in volumes
- Both have cited "proportionate use" as a key objective

Direct appointment

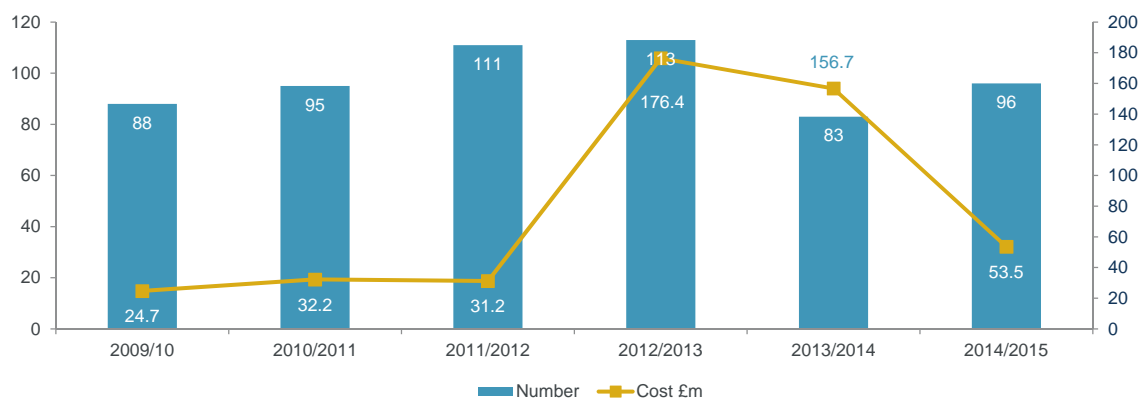
- Regulators now empowered to appoint the Skilled Person directly
- Expected to be rare:
 - the Regulator has a concern that the firm is not able to manage the appointment/review
 - there is a particular urgency to getting the work done
 - the Regulator has other reasons to keep close control over the review
- Framework Agreement between FCA and Skilled Person Firms for direct appointment
- European Procurement Directive implications
- Regulator pays the Skilled Person and recharges the firm

S166 Panel

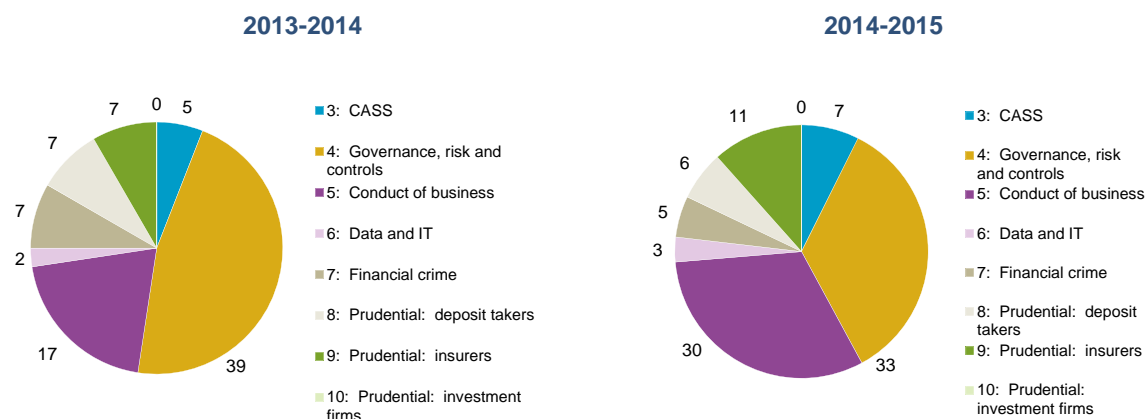
- Skilled Person Firm Panel set up for each Lot (category) of work
- Where firms continue to appoint the Skilled Person, they are expected to use firms from the Panel for that Lot...
 - ...But may propose alternatives to be approved by the Regulator
- **Individual Skilled Persons must be approved by the Regulator for each appointment**

Update on s166 activity

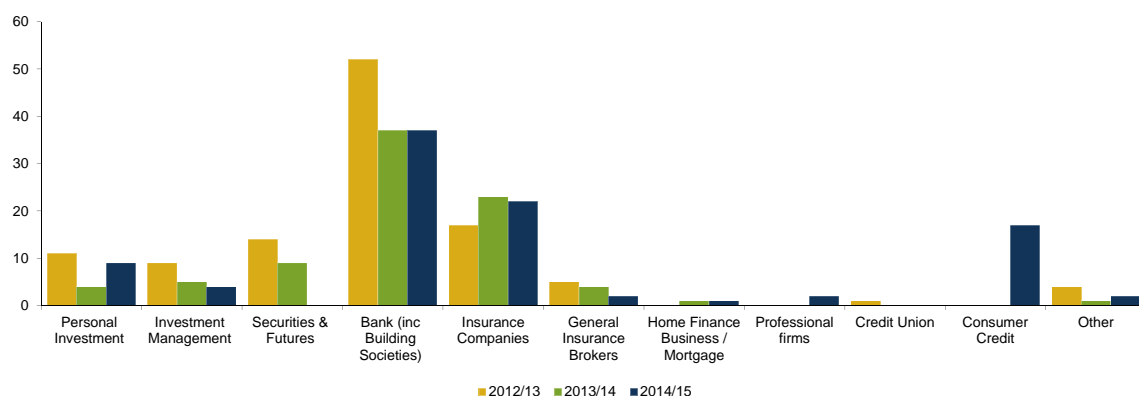
S166 reviews – number and cost



2014/2015 – s166 reviews commissioned



Reviews commissioned by type of firm



FCA and PRA insights on s166 reviews

FCA

- More focus on use of judgement and being forward looking
- More focus on the business model and the firm's culture
- Less focus on controls per se, and more on front line business processes and their impact on customers – "How firms run themselves"
- Plan to use increasingly to provide validation that firms have undertaken something they said they would do

PRA

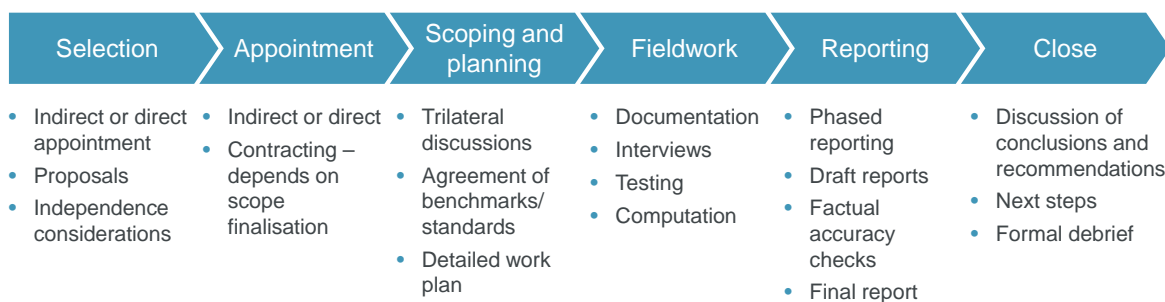
- Stressed that this is NOT primarily an Enforcement tool
- Will use it for situations where tight timeframes or lack of resource constrain them
- Anticipate growing use of direct appointment route, particularly where speed is essential or public interest case

Supervisors' view – both regulators

- All parties to be clear on objectives of review and requirements of the draft and final scope
 - Good communication is key and includes:
 - Initial trilateral meeting
 - Progress updates to the regulator during the course of the review
 - Meet deadlines, but if cannot be met, signal in advance
 - Communication of initial findings and ultimate conclusions
-

**How does the
s166 process
work?**

S166 process



Selecting a Skilled Person

Indirect appointment

- Firm must make its selection
- Normally required to select three Skilled Person Firms, indicating which is its preferred choice
- Skilled Person Firms must be taken from the Panel firms for the relevant Lot(s)
- Regulator confirms its approval of relevant Skilled Person Firm and Individual Skilled Person

Direct appointment

- The regulator runs a tender process, inviting Skilled Person Firms in the relevant Lot(s)
- Assessment of SPFs' proposals, based on technical content and commercials (usually 70:30 or 80:20 weighting)
- Shortlist of firms make presentations to FCA/PRA
- Awarded to Skilled Person Firm who scores highest after presentations
- Communicated to firm that is the subject of the review

Skilled Person independence

- Essential the skilled person and their team (and firm) are independent
 - Declare all conflicts – real or otherwise
 - It is the regulator's view of independence that matters (but getting it wrong can create the wrong impression)
 - Monitor independence throughout the work and brief if issues arise
 - If in doubt tell them!
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Formal appointment

Indirect appointment

- Must be approved by the FCA/PRA
- Contracts can then be finalised

Direct appointment

- Confirmed by the FCA/PRA
 - Call-off contract under Framework Agreement between FCA and Skilled Person Firm
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Agreeing the scope

Agreeing the scope – the Requirement Notice

- Proposals usually based on a draft Requirement Notice
 - Regulators' expectation is that the Skilled Person will look to discuss the scope in detail and it may change before finalisation
 - Key questions on the scope:
 - Reasonable assurance opinion required?
 - If not, what conclusions/opinions are required?
 - Recommendations for improvement?
 - Action plans?
 - Scope of business operations to be covered?
 - Normally discussed in trilateral meeting
-

Agreeing the scope – setting the standards/ benchmarks

- How will the Skilled Person assess the firm's arrangements/systems/controls/ transactions in order to reach a conclusion?
 - What benchmarks/standards will be applied?
 - Rules and/or guidance in the FCA Handbook/PRA Rulebook
 - Industry standards or guidance
 - Industry practice
 - The Skilled Person's knowledge and experience
 - Important to discuss and agree with the Regulator before work starts
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Agreeing how issues will be categorised

- What is the Regulator looking for?
 - Customer outcomes – fair or unfair – or unclear
 - Rule breaches
 - Overall assessment of adequacy and effectiveness
- Findings/issues need to be categorised/prioritised
- Agree up-front how these will be assessed

Example:

Fundamental: systemic weakness that has led to, or is likely to lead to, unfair customer outcomes

Significant: non-systemic weakness that may lead to unfair outcomes

Other: minor one-off errors or "house-keeping" in nature or good practice

Fieldwork

Preparation – data and documentation

- Documentation requests
 - Try to pre-empt what the Skilled Person will require
 - Put it all in one place (data room – whether hard or soft copy)
 - Keep a detailed log of what is provided and when
 - Ensure that relevant staff know what documents have been provided... and what they contain
 - Keep a log of questions posed by the Skilled Person and the responses given
 - General presumption is that if it is not documented, it does not exist (unless it can be tested in practice)
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Preparation – getting your people aligned

- The Skilled Person should have access to anyone they consider necessary to carry out their agreed scope of work
 - Looking for consistency of message and corroboration of facts
 - Preparation of individuals is **essential**
 - Storyboarding
 - Practice runs of interviews
 - Individual coaching
 - Encourage people to be open and honest...
 - ...but not to stray outside their own sphere of responsibility or expertise
 - Top tips: don't leave your briefing notes on the printer for your Skilled Person to find...
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Initial meetings with the Skilled Person

- Trilateral with FCA/PRA and Skilled Person to discuss and agree final scope
 - Storyboarding
 - Teach in
 - Listen to what the Skilled Person is asking / saying
 - Introduce relevant staff
 - Agree protocols – Q&A logs / points of contact / data rooms / turnaround times / catch ups
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Q&A logs

- Can be onerous but vitally important
 - Ensure that detail is captured in both question and the answer
 - Cross check to documents
 - Make sure stay current
 - Ensure clear ownership of dealing with questions
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Interviews

- May be many interviews:
 - senior management
 - key operations/business people
 - front office/back office
 - risk/control functions
 - Agree who the interviewees will be as early as possible
 - Ensure plenty of preparation (some firms may engage another advisor to assist, eg hold practice interviews)
 - Common practice is to have one other person in the room as observer (eg from Compliance)
 - Interview notes – should be written up and circulated within specified time
 - Signed off as agreed by interviewee
 - Additional information – note it as such
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Regular updates

- Progress updates on a regular basis with the regulator
 - Seeking initial views... but beware forming initial conclusions that cannot be changed in light of later work
 - Typically monthly updates – but could be weekly or even daily depending on timelines
 - Commonly done on a trilateral basis, but could be bilateral
 - NB: normal expectation is that Skilled Person can relay messages/outcomes from bilateral meetings back to the firm...unless instructed otherwise by the regulator
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Validating understanding

- Applies on both sides
 - Its important to give the skilled person the time to make sure they do understand
 - Be firm but polite if the understanding is wrong
 - Cross check to how the investigation is progressing
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Reporting and Closure

Structure of report

- Requirement Notice will specify report contents
 - Executive Summary: the Regulator will expect to see some conclusions
 - Scope sections: detail of what was covered and the findings
 - Factual section
 - Documentation
 - Interviews
 - Testing of processes/controls/transactions
 - Re-performance of calculations
 - Comment section
 - The Skilled Person's views on whether what they found is adequate or needs improvement
 - Detail of any issues and recommendations
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Presentation of issues and conclusions/opinions

- Its important that all parties are comfortable with how issues are reported and how opinions are given
 - Take your time to rehearse how you deal with points that you do not agree with
 - Allow for the fact that some of these will be subjective and others' views may be valid even if you don't agree with them!
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Confirming factual accuracy

- Skilled Person will base the facts on documentation reviewed and interviews
 - Should be no surprises in the facts stated, however...
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Releasing simultaneous drafts

- PRA / FCA requirement
 - Doesn't allow the firm to influence the way things are being drafted
 - Should not be any surprises if investigation is run well with clear assessment criteria and regular updates
 - Don't nitpick on the drafting – the skilled person will be less than impressed and unsympathetic if you're difficult on silly stuff
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Post-report meetings

- Trilateral meeting to discuss report and key findings
 - Possible bilateral debrief between Regulator and the Skilled Person
 - Agreement of next steps
 - Production of action plans
 - Further reports on actions
 - Phase 2 review
 - Formal closure
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Our top tips

Preparation for a s166

- Anticipate the Skilled Person's requests for:
 - Documentation
 - Interviews
- Preparation for interviews:
 - Consistent messaging
 - Not straying outside field of responsibility
 - Balance between guarded and open
- Advise the business on regulatory expectations



Receiving notice of a s166 review



Do

- Engage fully with the Skilled Person
- Be open and honest with the Skilled Person and with the Regulator
- Discuss and, if necessary, challenge on the scope
- Prepare as much as possible – documentation, interviews
- Get known issues onto the table early
- Expect that the Regulator and the Skilled Person may hold bilateral discussions



Don't

- Panic! It does not necessarily mean Enforcement action...
- Try to hide any known issues or weaknesses

Questions

Comments

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