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Internal Audit Support

Investment & Wealth Management

October 2024

Welcome to your October update

BDO's Investment and Wealth Management update summarises the key regulatory developments and emerging business risks relevant for all designated investment firms and wealth managers.

Our FS Advisory Services team are working with more than 60 investment and wealth management firms, including platform providers and administrators, as internal auditors and advisors, giving us a broad perspective on the issues facing the sector.

We have aggregated insights from our in-house research, client base, the Regulators and professional bodies, including the Chartered Institute of Internal Auditors (CIIA), to support your audit plans and activities.

We hope this pack provides value to you and your colleagues; please do share with us any feedback you may have for our future editions.

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Internal Audit-led penetration testing

The objective of a penetration test is to check how strong an organisation's security measures are by simulating the actions of a threat actor. The importance of penetration testing has become even more topical recently due to evolving regulatory requirements.

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In the UK, the Financial Conduct Authority ("FCA") and the Prudential Regulation Authority ("PRA") have introduced stricter guidelines on operational resilience and cyber security. The FCA's operational resilience framework mandates that financial services organisations identify critical business services and test their ability to withstand severe disruptions, including cyber-attacks. Additionally, the EU's Digital Operational Resilience Act ("DORA"), expected to take effect soon, will require financial institutions to regularly conduct thorough testing of their cybersecurity defences, including penetration testing, to meet compliance standards.

Traditionally, penetration tests have been managed by IT or Information Security teams however, a penetration test can also be seen as a valuable tool to provide third line assurance. Conducting a penetration test will allow an internal audit function to attempt to achieve some of the same objectives as a threat actor, thereby providing real insights as to how well the cyber security posture of the organisation is working. In essence, it can answer the fundamental question 'are we protected?' which is of key concern to senior stakeholders.

What are the benefits of Internal Audit conducting penetration testing?

Penetration testing within internal audit offers numerous advantages. Internal audit's independent role ensures that cyber security assessments remain objective, free from the potential biases that may arise when IT departments assess their own systems. By evaluating vulnerabilities in broader context of business risks and reputational impacts, internal audit offers a more strategic view of cybersecurity.

This comprehensive approach helps financial institutions not only detect technical vulnerabilities, but also understand their potential impact to the wider business. Internal Audit's experience in reporting to senior stakeholders means that internal audit is well-positioned to explain cyber security issues and risks in a way that aids evaluation of risk exposure, informs decision-making, and helps ensure that resources are effectively prioritised to address the most critical vulnerabilities.

From an efficiency perspective it can also be argued that a penetration test offers a broader deeper dive into cyber controls than a conventional audit, whilst absorbing fewer resources.

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Internal Audit-led penetration testing

Key challenges

Despite these benefits, there are challenges when incorporating penetration testing into internal audit testing. One significant issue is the skills gap. Internal auditors may lack the technical expertise required to conduct penetration testing, necessitating investment in training or hiring specialists. This imposes resource constraints, especially for smaller organisations with limited budgets.

It may also be difficult to attach an assurance rating to a penetration test using conventional methodologies and internal audit functions may need to take a step back in order to incorporate results of penetration tests into overall assurance statements.

What should Internal Audit teams think about?

With the incoming updated CIIA Code of Practice and the increasing focus on technology and technology-led audits into the overall Internal Audit Strategy, penetration tests present an excellent opportunity for an internal audit function to demonstrate a move towards more detailed and comprehensive testing. Auditing cyber controls against good practice frameworks will continue to have its place, however, integrating penetration testing into internal audit offers financial services firms a more impartial, comprehensive, and business-aligned approach to understanding and managing cybersecurity risks. Whilst this shift introduces the aforementioned challenges, the benefits derived can make it a valuable strategy for expanding assurance across the whole three line of defence model, providing insights to first line, risk functions and internal audit alike..

If you have any queries regarding the role of Internal Audit in conducting penetration tests, or would like to discuss BDO’s experience in supporting IA teams on this topic, please contact:
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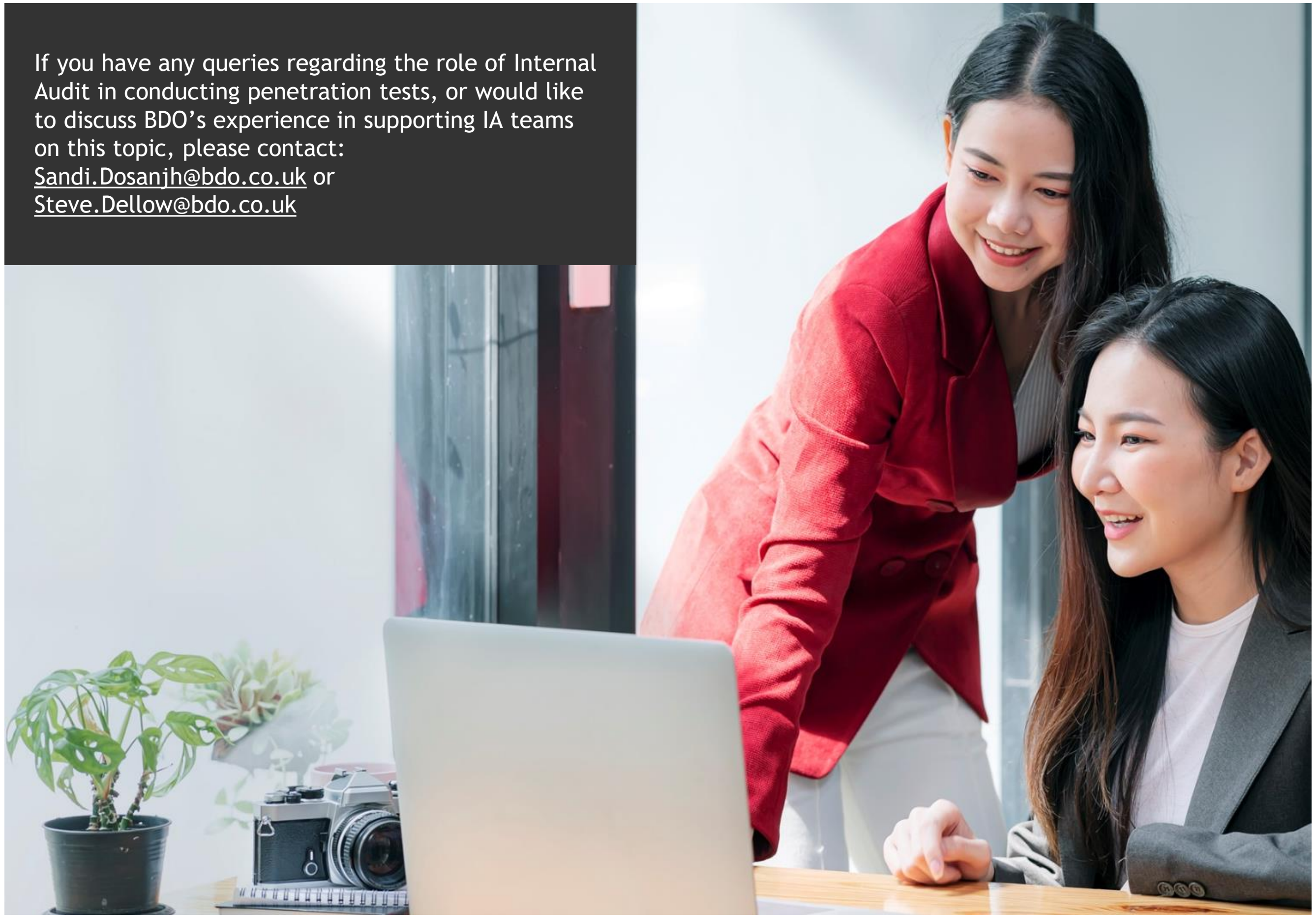

02

FCA portfolio letter

FCA portfolio letter

On 7th October, FCA released its most recent portfolio letter for the private wealth sector. Some of the areas of focus are no surprise, however there is specific mention of the current trend in market consolidation. The letter is straight forward and clear. The FCA is assessing this market carefully and will intervene where it needs to.

Click here to visit the FCA website and read the portfolio letter: FCA's expectations for financial advisers and investment intermediaries

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The top risks are no surprise, but the tone is clear and direct.
We are at a moment of societal shift. The FCA figures show over twenty-two million employees are in a workplace pension and by 2050, 25% of the UK population will be over 65. From a government perspective, the onus on managing a sustainable level of retirement income, is now for individuals and not the state to manage. An increasingly aging population with responsibility for managing their finances, to enable sustainable retirement is a complex challenge and there is a clear need for an advice sector that serves these clients with the highest quality advice to support this. This is a pervasive theme in the Portfolio Letter.

Income in retirement
The FCA's thematic review of retirement income advice TR24/1: Retirement income advice thematic review (fca.org.uk)) called out a number of areas for improvement: sustainable income strategies supported by robust cash flow modelling; improved methods to assess risk appetite; better ongoing services to ensure the income strategy remains sustainable; and a strong control framework to ensure standards are met. The FCA also published a retirement income advice assessment tool for firms to use under licence.
https://www.fca.org.uk/firms/retirement-income-advice-

Just to note, the FCA call out this tool as valuable for PII firms insuring liabilities of financial advisers and investment intermediaries.

The FCA plan to revisit this topic with further assessment work and a report in Q1 2025. That timetable indicates the work may already be underway. Compliance and Internal Audit functions should consider this for a full review.

Ongoing service
The FCA note 90% of clients are placed into ongoing service contracts (OGS) and importantly, that the revenue stream from OGS has shifted from 60% in 2016 to 80% in 2023. The FCA is continuing its focus to ensure these services deliver fair value, are flexible to the clients' circumstances, are delivered, and can be cancelled. These areas have been a challenge for many firms and a key action will be for firms to review their offering and the controls around effective delivery.

Market consolidation and acquisitions
There is a high volume of consolidation activity in this market with older advisers who are looking to retire and sell their books and investors who see the future growth in this sector, plus the ongoing income streams, leads to significant investment opportunities. It is a perfect storm of willing buyers and willing sellers. However, the FCA letter provides a note of caution. Consolidation needs to put clients and their best interests firmly into the acquisition equation. Investor influence may risk deals which make unsustainable demands for growth and profit. Buying client books without thorough due diligence could lead to a risk of unexpected liabilities, mismatched clients to firms' target markets or those which expand faster than the infrastructure of the acquirer can support.

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FCA portfolio letter

The focus for Boards and the second line should be to ask difficult questions about such acquisitions:

- Is the firm ready and able to take on more advisers?
- Is the target client book a good match?
- What are the client's best interests and how are they served?
- What are the terms of the deal? Will those terms deliver increased pressures that put client best interests at risk?
- Is there sufficient robust analysis and evidence upon which to make a decision?

The FCA has made it clear it will intervene where it sees an issue and it is likely all change in control applications in this sector will receive greater scrutiny. The message on reserving capital to pay redress liabilities underlines this as does its ongoing focus on holding senior individuals to account where it can.

What should Internal Audit teams think about?

The FCA's thematic review of retirement income advice highlights the need for sustainable income strategies, robust cash flow modelling, and improved methods to assess risk appetite. Internal audit should evaluate whether these areas are adequately addressed within their firms, ensuring that ongoing services are flexible, deliver fair value, and can be cancelled if necessary. This includes whether their firms have assessed the effectiveness of their control frameworks to maintain high standards and where applicable to use of the FCA's retirement income advice assessment tool to support these evaluations.

Additionally, internal audit should scrutinise how their firms have conducted market consolidation activities, particularly the acquisition of client books and the controls in place to ensure that thorough due diligence is conducted, focusing on whether the firm is ready to take on more advisers, if the target client book aligns with the firm's market, and how client interests are served.

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03

Appointed Representatives

Appointed Representatives

What actions should Risk and Compliance Directors be taking to assess effective oversight of Appointed Representatives?

The Financial Conduct Authority ("FCA") recently published its views on effective oversight of Appointed Representatives (ARs) and Introducer Appointed Representatives (IARs). In this article we discuss the FCA's recent publication with our insights from our Risk and Compliance Directors.

> "Principal firms must oversee their appointed representatives (ARs) effectively and are responsible for making sure their ARs comply with our rules in relation to their activities as ARs." Principal firms embedding the new rules for effective appointed representative oversight: Good practice and areas for improvement | FCA

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What is the issue?
Put simply, the FCA publication concludes some effort has been made to embed requirements, but there is more to do. The FCA is holding Principals to account. Whilst ARs and IARs bring significant benefits to a business, they also pose significant risks which require mitigation and monitoring. Looked at in this way, the FCAs requirements in PS 22/11 are the basics. A culture of risk assessment and risk management should deliver a more controlled way of de-risking the benefits ARs and IARs can bring.

A recap on the background
The Appointed Representative regime has been a longstanding feature of UK financial services legislation – as far back as the original Financial Services Act 1986 for investment business. It was extended to a broader range of financial activities in the Financial Services and Markets Act 2000, including an important change allowing ARs to conduct a regulated activity independent of the principals' activities. This change in legislation has enabled some 40,000 individuals and businesses to operate in the Financial Sector without direct authorisation, which is almost equal to the number of current directly authorised firms. The requirements in PS22/11 set about clarifying expectations of principals and improving data available to the FCA to monitor risks.

A few clear themes arise from the FCA's recent review:

- Inadequate risk assessment and understanding of the AR business, both financial sector and other business, at onboarding and on an ongoing basis.
- A tick box approach to onboarding and oversight both failing to adequately cover the requirements of SUP 12.6 (Continuing obligations of firms with appointed representatives or FCA registered tied agents) and failing to adequately assess risks and information.
- Insufficient identification or monitoring of risk factors that could indicate a potential for consumer harm.
- Inadequate reporting to Boards and a lack of discussion of risks.
- Inadequate attention to contracts, such as clearly setting out the regulated activities an AR or IAR is permitted to do, and termination rights.
- Insufficient systems and controls, frameworks, reporting, MI, and documentation in place to effectively manage the AR arrangements and demonstrate action is taken when issues arise.

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Appointed Representatives

Potential areas to consider

Covering all the requirements in SUP 12.6 is a good start, but understanding the inherent risks of the AR model, its role in a sector, and sufficient data about the AR population will support a more targeted and effective risk framework. Some examples are:

- AR models can be attractive to those who would not meet the FCA’s standards for direct authorisation, for example individuals with poor advice records. Due-diligence should raise any issues, a strong risk appetite should guide actions to take on or reject an AR application. If taking on, additional controls and monitoring may be needed.
- Due-diligence should be thorough, for example, any evidence of prior directorships where companies have been dissolved, high numbers of complaints, or censure by any bodies should require careful assessment. ARs or IARs with overseas businesses may have higher risk profiles or may require additional effort to assess.
- Onboarding and ongoing oversight require a sufficient understanding of the ARs business (both financial sector regulated and unregulated activities, and other businesses). Good questions are what businesses does the AR operate? How does it make its money? These questions might extend to Directors of ARs and other businesses they operate. If the business is significantly larger or complex, it may present a significantly higher risk. Particularly if the principal is considerably smaller and reliant on fees from the AR. There may be other relevant regulations or regulators to consider, such as anti-money laundering regulations and ICO regulations.
- Changes to an ARs business, for example sudden growth, changes in leadership or high turnover, changes to other business activities, are all risk factors to monitor. It may trigger increased monitoring or investigation.
- Ongoing monitoring should be sufficiently regular and robust, covering a range of metrics to spot issues early. Actual testing of AR outputs such as advice, customer engagement, financial promotions, websites, or social media. Ensure consumer feedback or complaints go to the principal unfiltered.
- Relying on ARs to self-disclose, is not, as the FCA notes, sufficient as it is the principals, not the ARs duty to complete the annual assessment.
- In a three lines of defence model, onboarding, and ongoing monitoring of ARs activities should sit with the first line. A clear framework for determining risks or issues that require additional investigation, or monitoring will support clear and consistent decision making.
- A second line review may want to consider whether all elements of SUP12.6 are in place, the quality of risk identification and effectiveness of controls, and whether first line resources are sufficient (both number and competence) to conduct adequate monitoring. Monitoring is complex, those tasked with monitoring should be able to assess a broad range of information and make judgements about financial stability, business activities and potential for consumer harm.
- Governance, reporting and MI should be clear with active engagement of the Board. Evidencing active discussions and actions taken is an important discipline in demonstrating strong governance.
- Requirements for Introducer Appointed Representatives are less onerous, reflecting their more limited role. However, the risk assessment, onboarding and ongoing monitoring points are no less relevant. Principals of IARs should be equally diligent in their onboarding assessments of IARs and have sufficient resources to monitor IARs. A thorough risk assessment should determine if higher levels of monitoring are needed.

What should Internal Audit teams think about?

The FCA's recent guidelines on the oversight of Appointed Representatives (ARs) and Introducer Appointed Representatives (IARs) mean that internal auditors must ensure their organisations comply with these requirements and manage associated risks effectively. This involves internal audit performing an assessment of a firm's risk assessments due diligence, onboarding and ongoing oversight processes. Auditors should verify that monitoring mechanisms are in place, including actual testing of AR outputs and ensuring consumer feedback is directed to the Principal unfiltered. In addition, confirmation should also be sought that firms have sufficient resources and competent personnel to monitor ARs and IARs effectively, ensuring financial stability and minimising consumer harm.

If you require support or would like to discuss with any of these topics, please contact: Richard.Barnwell@bdo.co.uk or Nicola.Ball@bdo.co.uk

04

Corporate Governance

Corporate Governance

Addressing concerns about impending UK Corporate Governance Code changes readiness

A recent BDO survey revealed that 1 in 3 NEDs are concerned that the businesses that they represent are not sufficiently prepared for the impending changes to the UK Corporate Governance Code (the "Code"). This is a significant finding given the heightened scrutiny around corporate governance. The revised Code, aimed at enhancing transparency, accountability, and sustainability, requires businesses to act now to ensure they are not caught off guard when these regulations come into effect.

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For many businesses, these concerns reflect gaps in preparedness, governance frameworks, and strategic alignment with regulatory expectations. The challenge ahead is not only compliance but leveraging governance as a driver for long-term value creation. We set out below the suggested next steps for firms to do this.

Board training and education

One of the primary reasons for the unpreparedness highlighted in the survey is a lack of awareness and understanding of the changes. The revised Code emphasises broader aspects of Environmental, Social, and Governance (ESG) factors and the role of corporate culture. There is also a new requirement for Boards to issue an annual declaration over the effectiveness of material internal controls across financial, reporting, operational and compliance aspects of the business. Many boards are not fully abreast of the requirements set out by the Code and as a result are not well positioned to oversee and drive the required transformation in the business.

Conduct a governance gap analysis

Businesses may consider conducting a governance gap analysis to identify where current practices fall short in meeting the upcoming requirements. This analysis should focus on several key areas: risk oversight, reporting obligations, board diversity, and executive remuneration policies. Given that many of the changes to the Code involve more stringent requirements around accountability, transparency, and risk management, understanding where these gaps exist is a critical first step in developing an actionable plan.

It's essential that this gap analysis is not simply a compliance exercise. Rather, it should be an opportunity for boards to reflect on how their governance structures support the company's long-term resilience and reputation.

Enhance risk management and ESG reporting

The revised Code places heightened importance on Environmental, Social, and Governance (ESG) factors. Companies should review their risk management processes and ensure they integrate ESG risks into their wider risk frameworks. It is no longer sufficient to treat ESG issues as a side concern; they need to be at the core of decision-making and strategy.

Businesses must also refine their ESG reporting processes, ensuring that disclosures meet investor and stakeholder expectations around transparency and sustainability. Strengthening these reporting frameworks will not only help businesses comply with the Code but also build trust with stakeholders who are increasingly scrutinizing corporate social responsibility.

Improve board composition and diversity

Another critical area under the new Code is Board composition. The focus on diversity and inclusion means companies should take steps to review and enhance the diversity of their boards in terms of gender, ethnicity, skills, and experience. A diverse board is more likely to foster innovation, challenge the norm, and bring fresh perspectives on governance challenges.

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Corporate Governance

Strengthen stakeholder engagement

The revised UK Corporate Governance Code emphasises greater engagement with stakeholders, including shareholders, employees, suppliers, and communities. Businesses should proactively enhance their communication strategies and ensure that all stakeholders understand how the company is adapting to these changes. Effective stakeholder engagement builds trust and helps companies navigate periods of regulatory or operational change with more support and less friction.

Conclusion

The impending changes to the UK Corporate Governance Code are an opportunity for companies to not only comply with regulations but also strengthen their long-term value creation strategies. For the 1 in 3 NEDs who are concerned about their business's preparedness, the time to act is now. By prioritising board training, conducting a governance gap analysis, enhancing risk management, and improving board diversity, businesses can ensure they are ready to meet these new challenges head-on, safeguarding their reputation and future growth.

For more insights around key areas of focus for NEDs, take a look at BDO UK LLP's latest report, co-authored by Shrenik Parekh, CFA.

What should Internal Audit teams think about?

Internal audit functions should focus on several key areas to ensure businesses are prepared for the impending changes to the UK Corporate Governance Code. Firstly, they need to assess the adequacy of board training and education programmes. This includes reviewing the content, frequency, and effectiveness of training sessions, particularly those covering ESG factors and the role of corporate culture. Internal audit should also consider conducting a comprehensive governance gap analysis to identify areas where current practices fall short of the new requirements and supporting business with facilitation of their change programmes to ensure that any identified gaps are closed.

Additionally, internal audit functions should evaluate the integration of ESG risks into the wider risk management framework. This involves assessing the processes for identifying, managing, and reporting ESG risks, ensuring these issues are central to decision-making and strategy. In addition, consideration should be made to the diversity of the board in terms of gender, ethnicity, skills, and experience, examining recruitment processes and diversity targets. Finally, internal audit should evaluate the effectiveness of stakeholder engagement strategies, including communication strategies and feedback mechanisms, to ensure stakeholder concerns are addressed in governance practices.

Are you grappling with "Material Controls"?

"Material Controls" in the context of Provision 29 of the new Corporate Governance Code, is a key consideration for many Boards, Audit Committees and Senior Management.

In November and December, we are running three in-person workshops, providing an opportunity to discuss with peers how they are approaching this challenge.

London - Tuesday 05 November
- Find out more and register

Birmingham - Tuesday 26 November
- Find out more and register

Manchester - Tuesday 03 December
- Find out more and register

If you require support or would like to discuss with any of these topics, please contact:
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05

Compliance with mandatory TCFD requirements

Compliance with mandatory TCFD requirements

Sample survey finds over a quarter of mid-sized Asset Managers are failing to fully comply with mandatory TCFD reporting requirements

According to a sample survey conducted by BDO LLP, over a quarter (29%) of asset managers with between £5 billion and £50 billion in assets under management ("AUM") are failing to fully comply with mandatory reporting requirement under the Taskforce on Climate-related Financial Disclosures ("TCFD") framework, since becoming the latest cohort of firms subject to FCA rules.

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The reporting deadline for this cohort of asset managers was 30 June 2024 and applies at both entity and product level, with the former required to be publicly disclosed and the latter available to investors on demand. The largest asset managers (those with over £50 billion AUM) were required to report under TCFD a year earlier, by 30 June 2023. [1]

Our analysis

BDO LLP's research into 24 asset managers, analysed required entity-level reports under TCFD by 30 June 2024. Our analysis concluded:

- 29% of reports did not evidence compliance with all 11 of the TCFD recommendations;
- The most common recommendation that was not complied with related to the undertaking of quantitative climate-related stress testing and scenario analysis;
- 48% have not adopted a science-based target for decarbonisation of their business activity; and
- Only 13% have adopted a science-based target and disclosed a transition plan in accordance with the Transition Plan Taskforce ("TPT").

By comparison, when BDO researched 18 of the largest asset managers with >£50 billion AUM, our research concluded that all firms demonstrated compliance with all 11 TCFD recommendations with 78% adopting a science-based target for decarbonisation. However, disclosure against TPT remained low at 11%.

Reasons behind the numbers

Based on our knowledge and experience of working with asset managers between £5 billion and £50 billion AUM, we believe the most common reasons for non-compliance with certain TCFD recommendations, or for opting to explain rather than comply could be:

- **Materiality** – medium-sized asset managers often cite that the most severe climate-related stress would not materially impact their business, whether this is financially or non-financially. Nor would their individual activity materially impact the environment.
- **Resource** – medium-sized asset managers do not have the sufficient internal capacity to be able to conduct climate-related stress testing, scenario analysis and devise decarbonisation strategies, whether this be the appropriate and required level of resource, expertise or system-related capacity.
- **Data availability** – linked to the above, in the absence of a system or solution, medium-sized managers often lack the appropriate data to be able to conduct meaningful climate-related stress testing, scenario analysis, and devise and monitor decarbonisation plans.

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[1] According to the FCA's policy statement PS21/24, 34 asset management and 12 asset owner firms were subject to the 30 June 2023 reporting deadline, with total rising to 140 asset management and 34 asset owner firms reporting by 30 June 2024.

Compliance with mandatory TCFD requirements

Why is this significant?

Despite the above challenges, regulators, as well as other stakeholders, will increasingly expect asset managers to plug gaps in compliance with climate and other sustainability-related reporting. As evidenced by the FCA's commentary following previous thematic reviews of firms' TCFD reporting, they expect firms to comply with all elements of the TCFD framework, or, if not, explain why they have not done so. The FCA also stressed the importance of complete climate and other sustainability-related reporting in light of the forthcoming IFRS Sustainability Disclosure Standards, and the potential move from a "comply or explain" compliance basis to mandatory disclosure requirements. Failure to comply is likely to result in legal or regulatory punishment, and incomplete reporting may have detrimental commercial and strategic impacts too.

What should Internal Audit teams think about?

Internal audit should focus their reviews on ensuring that all 11 TCFD recommendations are met, particularly in areas like quantitative climate-related stress testing and scenario analysis. This could be conducted though a gap analysis against the regulations or an assessment of firm's project plans to implement the 11 TCFD recommendations. This should include whether their firms have adopted science-based targets for decarbonisation and disclosed transition plans in line with the TPT. It will be key for firms to evaluate the materiality of climate-related risks to the business, assessing the adequacy of resources and expertise available for compliance, and ensuring the availability and quality of data needed for meaningful climate-related analyses. Internal Audit should review the controls in place where firms are conducting these materiality assessments to ensure that the information and data is accurate and aligned with regulatory expectations.

If you would like to find out more about how we can help you with your TCFD reporting requirements, please contact;
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06

FCA publishes its ‘Market Watch 80’

FCA publishes Market Watch 80

In October 2024, the FCA published Market Watch 80 focusing on the market abuse risks posed by overseas aggregated accounts that obscure the identities of ultimate beneficial owners (“UBOs”). The report highlights key concerns and offers recommendations for how firms can enhance their compliance with regulations, particularly SYSC 6.1.1R which mandates firms to establish and maintain systems and controls to counter financial crime risks.

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Key issues raised in Market Watch 80

Obfuscated overseas aggregated accounts (“OOAAs”)
These accounts are managed by overseas entities, often in jurisdictions with less stringent market abuse controls. The FCA is concerned about the potential for these accounts to be used by individuals who have been barred by UK firms due to previous suspicious trading activity. In these cases, UBOs may continue to trade anonymously through these accounts, effectively bypassing restrictions previously imposed on them.

Market abuse risks
The FCA notes an increase in market abuse linked to leveraged equity products being traded via OOAAs. In some cases, individual UBOs can execute trades directly, without following advice from the account administrator. This makes it difficult for UK firms to detect patterns of suspicious behaviour, especially when the UBO’s identity is unknown.

Regulatory gaps
Although firms file Suspicious Transaction and Order Reports (“STORs”) when they detect potential market abuse, they may struggle to identify repeat offenders when they cannot see who is ultimately behind the transactions. This opacity, particularly in cross-border transactions, weakens the overall ability to maintain market integrity.

FCA's recommendations for firms

Enhanced due diligence
The FCA advises firms to apply enhanced due diligence when onboarding and trading with OOAAs. Firms should revise their risk frameworks to ensure they can handle the complexities of dealing with these accounts. This includes setting clear thresholds for offboarding clients who pose unacceptable risks of market abuse.

Systems and controls
Firms dealing with OOAAs should require these accounts to provide information about their internal market abuse prevention systems and controls. This might include:

- A description of market abuse surveillance arrangements, risk tolerance and risk framework;
- The nature of underlying clients (e.g., individuals, retail, professional, High Net Worth, corporate);
- The number of clients deemed high risk, and how these are identified; and
- Confirming whether OOAAs will provide the identities of relevant UBOs, if the FCA authorised firm is concerned about particular trades.

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FCA publishes its Market Watch 80

UBO sub-accounts
Where the identities of individual UBOs are masked, firms should require OOAAs to differentiate between trades for those UBOs by assigning each with a sub-account that includes a unique identifier code. This would allow firms to match suspicious trades to specific sub-accounts/UBOs. Firms could then require the OOAA not to route further trades from those sub-accounts through them.

Open communication
Firms should clearly communicate with OOAAs, informing them that they operate a zero-tolerance approach to market abuse. The FCA encourages firms to submit STORs for any suspicious trades and to maintain strong relationships with overseas regulators and law enforcement agencies to enhance cross-border cooperation.

Implications for Investment Management firms

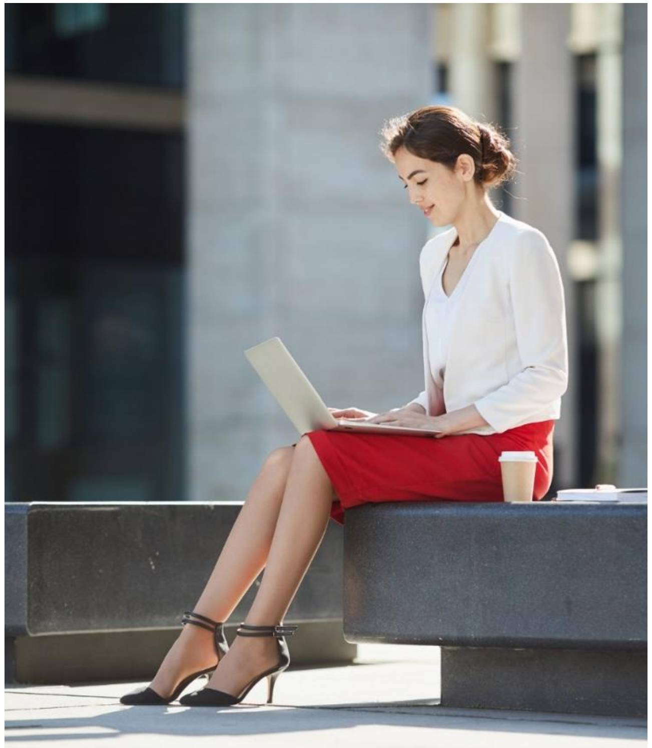
Market Watch 80 emphasises the need to be vigilant when dealing with aggregated accounts that do not provide sufficient traceability over the identity of their underlying clients. The guidance underscores the importance of having robust systems and controls to detect and prevent market abuse, even in cross-border situations where the risks are more difficult to manage.

Firms dealing with OOAAs will need to ensure that: they have carefully reviewed Market Watch 80; their market abuse prevention frameworks address and mitigate such risks; they are filing accurate and timely STORs; and that they maintain open lines of communication with both overseas and UK regulators.

The FCA’s focus on this issue reflects its broader commitment to maintaining market integrity and preventing financial crime. Firms that fail to adapt to these guidelines could face regulatory scrutiny, penalties, and potential reputational damage, making it crucial for them to strengthen their anti-abuse frameworks

What should Internal Audit teams think about?

Internal audit should focus on the risks associated with Obfuscated Overseas Aggregated Accounts (OOAAs) and the effectiveness of the firm's systems and controls in managing these risks. This includes evaluating the firm's due diligence processes, the adequacy of market abuse surveillance arrangements, and the ability to identify and manage high-risk clients. In addition, consideration should be given to the firm's compliance with the FCA's recommendations, such as requiring OOAAs to provide information about their internal controls and the identities of ultimate beneficial owners (UBOs).



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