INTERNAL AUDIT SUPPORT

BANKING & BUILDING SOCIETIES UPDATE

August 2022

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BDO FS INTERNAL AUDIT CONTACT POINTS

BDO's Banking & Building Societies Update summarises the key regulatory developments and emerging business risks relevant for all banks, building societies and, where flagged, for alternative finance providers (i.e. peer-to-peer lenders, card providers, E-money services providers and debt management companies).

Our FS Advisory Services team are working with more than 50 banks and building societies 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.

LEIGH TREACY
PARTNER

+44 (0) 7890 562 098
leigh.treacy@bdo.co.uk

RICHARD WEIGHELL
PARTNER

+44 (0) 7773 392 799
richard.weighell@bdo.co.uk

CHRIS BELLAIRS
PARTNER

+44 (0) 7966 626 128
christian.bellairs@bdo.co.uk

BRUK WOLDEGABREIL
ASSOCIATE DIRECTOR

+44 (0) 7467 626 468
bruk.woldegabreil@bdo.co.uk

CONTENTS

Click on a section below to take you straight there

REGULATORY INITIATIVES GRID

Banking, credit and lending regulatory developments on the horizon rated as "High" impact by the Financial Services Regulatory Initiatives Forum

Q3 2022

Diversity & Inclusion
Consultation paper on proposals to support improving diversity in financial services.

Q4 2022

Implementation of the remaining Basel 3 banking standards (Basel 3.1)
Consultation paper expected in Q4 2022.

Q4 2022

Authorised Push Payment (APP) scam prevention
PSR to propose how it will act in relation to mandatory reimbursement, in anticipation of the adoption of the legislative change needed to enable regulators to act.

Q4 2022

Confirmation of Payee (CoP)
Policy statement to be published for implementation of Secondary Reference Data (SRD).

JANUARY 2023

Operational Continuity in Resolution (OCIR)
Revised policy comes into force.

JANUARY 2023

Resolvability Assessment Framework (RAF)
January 2023: Deadline for mid-tier firms to meet resolution outcomes
October 2023: Reports due for largest firms.

2023

Buy Now Pay Later
FCA to consult once Government has laid secondary legislation to bring BNPL into the regulatory perimeter.

2024

Strong and Simple Prudential Framework for non-systemic banks and building societies
Consultations to follow in 2023/24.

MARCH 2025

Trading Activity Wind Down
Expectations to be met from March 2025.

MARCH 2025

Operational Resilience
Important business services remaining within impact tolerances.

IA PLANNING FOR 2022/23: WHAT ARE THE SECTOR'S HOT TOPICS?

PAUL GILBERT
DIRECTOR

+44 (0)113 290 6189
paul.gilbert@bdo.co.uk

The August / September period is typically audit planning season and each year seems to have even more issues and developments for consideration than the previous year.

Key to risk-based auditing is prioritising the high risk areas for the IA team's activities over the coming year and assessing, with the help of an assurance map, where other assurance providers in the firm can be relied upon, and coordinated, to appropriately provide oversight and assurance to the Board to maximise the firm's resources.

Below is a thematic capture of the hot topics that IA teams within banks and building societies should include as part of wider considerations for the audit plan. Almost all of the issues have been examined in this pack and its previous monthly editions (please do get in touch if you need prior articles); but lets first discuss best practice for the planning process.

▶ What does effective audit planning look like?

- **Risk Assessment**: fundamental to the planning process is a documented risk assessment of the firm-wide risks that could impact the firm's strategic objectives, with an articulation of the risks' impact and likelihood, to help prioritise risks. A risk heat map is ideal to visually capture the risk assessment for Board consumption and provide rationale for resource allocation on specific aspects of the audit universe (do remember, its impossible, and inefficient, to attempt to audit everything).
- **Think annual, update quarterly**: the concept on a once-and-done annual plan is fast becoming obsolete. To keep nimble to the firm's strategic objectives, which have to adapt to the continually evolving business, risk and regulatory landscape, its advisable to have an annual risk assessment inform an annual plan (the "trajectory") and updates incorporated on a rolling quarterly basis (the "tweaks"), or sooner for high risk / material issues, to ensure internal audit continuously adds value throughout the cycle.
- **Mapping the firm's assurance framework:** Internal Audit will likely be one of many other internal and external assurance providers for the firm's control framework, therefore owning the firm's assurance map and keeping it up to date can help plan the IA activities to complement (not duplicate) the assurance work of other specialists. Enhancing this aspect of the process to consider a 3-year horizon of the firm's assurance needs will also support the firm's transition into the anticipated BEIS-led audit reform requirement for an Audit and Assurance Policy.
- **Bring the business in:** audit planning must incorporate the expectations of senior management, therefore its important to schedule discussions early on with the business unit heads and examine their perspectives as risk owners. Facilitation of a control self assessment by the IA team, ahead of the planning process, could help unearth a wider set of issues and risks not yet captured by risk oversight teams. Maximising feedback from employee engagement surveys could also help identify risks closer to the frontline.
- **CIIA FS Code**: use of the CIIA's Financial Services Code of Practice (2021) should be considered as a benchmark of good practice and factored into the planning process. The Code should be applied proportionately, and therefore smaller firms should apply the principles on which the Code is based in light of the firm's size, risk profile and complexity of operations.
- **Benchmarking**: how does your planning process compare to industry peer teams? Discussion of current and best practices, within the sphere of industry and trade body forums (e.g., CIIA, UK Finance, BSA), can help introduce improvements. This is especially the case for open-ended aspects of your planning process, e.g., how much of all engagement planning and fieldwork should aim to use computer-assisted auditing techniques?

Credit risk and responsible lending

Treasury (including balance sheet management)

Change Management

Third party risk management

Cyber security

Conduct risk / consumer duty

Climate and ESG

Economic crime including fraud risk

Regulatory reporting

Model risk management

Managing resource gaps

FCA'S CONSUMER DUTY: FINAL RULES AND GUIDANCE

ALISON BARKER
SPECIAL ADVISER

alison.barker@bdo.co.uk

The FCA has published the final rules and guidance for the new Consumer Duty.

The Consumer Duty aims to improve the outcomes for retail consumers, including SMEs, setting clearer and higher expectations for firms' standards of care towards consumers by acting in good faith, avoiding foreseeable harm, and supporting customers in reaching their goals.

It goes much further than previous initiatives under Treating Customers Fairly.

► A new principle and new rules and guidance

The structure is unchanged from earlier consultations with a new Principle, three cross cutting rules and rules relating to four outcomes. Final Guidance provides examples and further detail.

The wording of the new Principle 12 will be "a firm must act to deliver good outcomes for retail customers". Existing Principles 6 and 7 will be disapplied where the Consumer Duty Principle applies but will be retained to apply to activities outside the Consumer Duty.

The cross-cutting rules provide more clarity on interpreting the new Principle and Rules and require firms to:

1. act in good faith toward retail customers
2. avoid foreseeable harm to retail customers
3. enable and support retail customers to pursue their financial objectives

► Four outcomes

The four outcomes represent key elements of the firm-consumer relationship to help ensure a comprehensive approach to achieving good consumer outcomes. Firms will need to understand and evidence how outcomes against each of these are being met. The four outcomes are:

- **Communications** – getting communications to consumers at the right time to equip customers to make effective, timely and properly informed decisions about financial products and services.
- **Products and Services** – to be designed to meet the needs of consumers; are sold to those whose needs they meet; and perform as expected.
- **Customer service** – that meets the needs of consumers, enabling them to realise the benefits of products and services and act in their interests without undue hindrance.
- **Price and Value** – to ensure that the price of products and services represent fair value for consumers.

► Deadlines for implementation

- New rules will be implemented on 31 July 2023 for all products and services currently on sale.
- Rules will be extended to closed book products (those that are no longer on sale) for implementation by 31 July 2024.
- FCA has required Boards to sign off on implementation plans by the end of October 2022 and maintain ongoing oversight of delivery.
- Manufacturers are required to share information with distributors by 30 April 2023 so that distributors can complete their implementation in time for the July deadline.

► Closed books

The FCA intends firms to bring closed book products up to the same standards as those currently available. This means closed books will be subject to all the Consumer Duty Rules on a forward-looking basis, i.e., the Consumer duty Rules will not apply retrospectively to past actions – the rules in place, at the time, will continue to apply.

The FCA has provided clarity on the application of the price and value outcomes for closed book products and expects firms to act where products do not meet the fair value standards.

There is no requirement on firms to amend vested contractual terms but consider alternative ways of achieving fair value such as amending (non-vested contractual) fees and charges and there is new additional guidance on this potentially challenging area.

► What should Internal Audit teams be thinking about?

- Internal Audit functions should have Consumer Duty impact assessment and implementation plans in scope to provide assurance to the Board that the firm is able to meet the implementation timescales.
- FCA supervisors will seek evidence of Board scrutiny. Boards are still required to attest that they meet the standards at the end of the implementation period. Therefore, IA teams should evaluate evidential sources of information of the Board's scrutiny over implementation plans, i.e. Board and committee discussion minutes, impact assessments produced by second line oversight functions, risks flagged by frontline teams – have these been incorporated into firm-wide risk assessment?
- Facilitating a Risk and Control Self Assessment, including all the functional areas to be impacted by the new Consumer Duty, could help unearth a number of issues to better inform the preliminary risk assessment for a review of Consumer Duty implementation.

FCA SME COLLECTIONS AND RECOVERIES REVIEW: LESSONS YET TO BE LEARNED

BRUK WOLDEGABREIL
ASSOCIATE DIRECTOR

+44 (0) 7467 626 468
bruk.woldegabreil@bdo.co.uk

▶ What was the recent FCA multi-firm review about?

- In July 2022, the FCA published its findings from a multi-firm review of 11 retail banks regarding their collections and recoveries practices for SME borrowers. SMEs were defined in the review as either a sole trader, small partnership or other "relevant recipient of credit" per the Consumer Credit Act
- The regulator examined files for SME borrowers with business as usual and/or Bounce Back Loan Scheme (BBLS) loans of £25,000 or less.
- Notwithstanding good practices found in the review, the FCA reported several themes that appeared to drive poor customer outcomes:
  - Gaps in policies and procedures;
  - Staff training that did not adequately cover conduct requirements;
  - Manual interventions within systems which appeared to make delivering fair customer outcomes more difficult;
  - Absence of outcomes testing or quality assurance that considered whether customers had received fair outcomes from the end-to-end treatment they received;
  - Poor record keeping. Some of the lenders could not provide complete customer files for the regulator to determine if the customer had received a fair outcome based on the available records;
  - Instances of customers providing information indicating characteristics of vulnerability that were not considered or suitably responded to by the lender.
- The FCA had also sent a "Dear Chair" letter to all retail banks with SME customers to ensure that lenders are meeting regulatory expectations and to inform the regulator if they are unable to do so.
- The recent review and the subsequent Dear Chair communication follow a June 2022 FCA letter to 3,500 regulated lenders reminding firms of the standards that they should meet as consumers face the substantial challenges brought about from the rising cost of living. The letter also reminds lenders that the FCA's "Tailored Support Guidance" for mortgages, consumer credit and overdrafts, produced in response to exceptional circumstances from the COVID-19 pandemic, was still relevant for addressing borrowers in financial difficulties due to cost of living pressures.

▶ Have we seen this all before? Yes, sort of…

- Cast your mind back to November 2019, when the PRA asked the Internal Audit function of 42 non-systemic banks and building societies to undertake a review of their collections function and relevant regulatory reporting. That thematic review covered three specific areas of interest:

1. Collection processes and control environment
2. Governance and oversight
3. Regulatory reporting

- The PRA published the review findings in a "Dear CRO" letter in April 2021. Again, notwithstanding good practices noted (as most of the IA recommendations were "minor" to "moderate" breaches of control procedures), the review did unearth a number of significant and materially significant control weaknesses.
- Materially significant control weaknesses included issues in regulatory reporting on forborne exposures and unsatisfactory execution of collections (including systems, capacity, resource planning and MI).
- Significant control weaknesses centred on:
  - Poor prudential policies and process documents: including lack of version control, process descriptions, up-to-date terms of reference, consistent terminology and clarity around delegated authority;
  - Weak collections control processes: controls appeared weaker for SME and Specialist BTL lending and were driven by system limitations and lack of second line oversight;
  - Weak collections MI and reporting: specific areas where additional work was required related to inclusion of risk appetite on arrears/forbearance and lack of Board reporting and awareness (25% of the firms reviewed did not report forbearance metrics to Boards). Only 3% of firms reported COVID19 deferral metrics to their Board/Executive Committee.
- **The recent FCA multi-firm review and the PRA's previous review of collections had some notable differences, e.g. sample sizes, scope, timing etc., but, fundamentally, their separate examinations of banking collections processes uncovered consistent themes which require careful consideration by Boards, senior management and Internal Audit activities well ahead of the incoming new Consumer Duty.** (*Continued overleaf*)

FCA SME COLLECTIONS AND RECOVERIES REVIEW: LESSONS YET TO BE LEARNED

What should Internal Audit teams be thinking about?

- Internal Audit should have planning considerations and potential scope areas.

Planning considerations

- The CIIA has provided a framework ("Auditing Collections") as part of its technical guidance for financial services firms. Drawing on the framework's key elements and expanding its focus to incorporate recent developments, firms should consider:
  - **Conduct**: consider the type of customer, affordability of the credit agreement and payment schedule, training and awareness of relationship managers to identify vulnerable customers and customers encountering distress, as well as the channels through which a customer could contact the firm when facing difficulties.
  - **Data:** consider what customer data is collected pre and post credit agreement, what data analytics the firm employs to help build a picture of the customer, processes in place to identify any "red flags" as early as possible, which parties have access to the data and the firm's compliance with data protection procedures.
  - **Regulatory requirements**: consider both FCA and PRA requirements applicable to the lending activities of the firm, e.g. Mortgages and Home Finance: Conduct of Business Sourcebook (MCOB), Consumer Credit Act, and Consumer Credit Sourcebook requirements, etc., and the incoming Consumer Duty rules and expected outcomes. Also consider industry best practice designed to support regulatory compliance, e.g. Lending Standards Board benchmark for good SME lending and collections practice.
  - **Forbearance**: consider the firm's forbearance policy and whether arrangements for borrowers currently in place comply with the firm's policy and risk appetite; the governance in place for approval of forbearance arrangements; the documentation processes in place so that customer files are updated to reflect arrangements and corresponding adjustment of payment schedules/terms take place swiftly to minimise risk of consumer harm.
  - **Fraud**: consider the impact of the current (and deepening) cost of living crisis and broader infrastructure bottlenecks (e.g. staff shortages in almost all sectors) that produce both motivation and opportunities for fraudsters to exploit the firm's treatment of vulnerable customers and forbearance policy.
- These, and all other considerations, will need to be formally documented and put on to file as part of the planning process, incorporating expectations from the senior management team (especially those within collections and its risk oversight team) to ensure the review is as value accretive as possible for the firm.
- **To build upon the framework, the IA team could then integrate regulatory feedback with the CIIA's technical guidance for potential scope areas:**

Potential scope areas

- **Policies and procedures:** is there any control documentation for collections activities (this is a valid question – FCA found some of the lenders did not have any control documentation in its recent review)? Have policies and procedures kept pace with the FCA's expectations on treatment of vulnerable customers and its 3-year business strategy? What manual interventions and 'work-arounds' are collections staff having to make to ensure customers have fair outcomes?
- **Governance and oversight:** are senior managers engaged with collections governance committees and management information (especially forbearance levels and trend analysis) from the floor to provide effective oversight and decision-making? Are the senior managers responsible for collections plugged into the discussions of frontline and oversight teams? Some firms often place collections teams at a distance to head office and its key personnel, and, therefore, often overlooked as a faceless portion of the organisation or outsourced issue.
- **Record keeping:** are customer files within collections complete (including all customer interactions with the firm), up to date and retrievable? On the basis of a customer file alone, can the firm evidence that fair outcomes have been delivered? Some lenders, following a history of M&A and divestments, have different departments and outsourced providers dealing with a customer and its critical that interaction along the journey is appropriately captured to evidence fair outcomes.
- **Staff guidance and training:** are collections teams appropriately trained to have effective conversations and exhibit empathy with customers? Are training guides and process summaries complete and up to date? Where staff have to follow a structured script for customer contact, do they have the confidence and support to identify a situation that requires supervisory intervention if the established process is not fit for purpose?
- **Outcomes testing and quality assurance:** does the firm have appropriate KRIs and KPIs for the collections activity? Do the metrics currently available support a robust process to test whether SME borrowers are receiving fair outcomes?
- **As a final point, the firm's Culture will have a huge influence in how the customer is seen from the Board to the shopfloor and, therefore, how they are treated from credit agreement to collections/final recovery. If the customer's fair outcomes are not at the heart of the business, deficiencies in all of the above areas will be symptoms of a larger, culture-based, root cause.**

FINANCIAL SERVICES AND MARKETS BILL

ALISON BARKER
SPECIAL ADVISER

alison.barker@bdo.co.uk

The new Financial Services and Markets (FSM) bill was laid before Parliament on 20 July 2022. Debates on the new proposals will not start until September. Its most significant purpose is to enable a comprehensive UK based financial services regulatory regime post Brexit and sets the framework for repeal and replace EU regulations (retained EU law

Strategically it is aimed at maintaining and growing the UK as a global financial services centre, fostering innovation and supporting the agenda for levelling up in the UK.

It will take some years for regulators to work through the body of retained EU law. In the majority of cases normal policy making processes will be followed with proposals for change put forward in consultation with the normal cost benefit analysis.

New objectives for the FCA and PRA

- In a drive to make UK financial services more attractive long term, both the FCA and PRA will have growth and international competitiveness as objectives, as well as 'have regard to' climate change and net zero targets when discharging regulatory functions. Competitiveness is not to be prioritised above financial stability or consumer protection.
- There are changes that make regulators have greater accountability to Parliament, strengthen the function of statutory Panels including placing the Listing Panel on a statutory basis and to create a Cost Benefit Advice panels. HMT will have power to direct regulators.

Main areas of change

- A new Designated Activities Regime which will allow activities not compatible with the scope of FSMA legislation to be included. An example would be short selling. Powers are provided to FCA to set out how the activity should be carried out and to enforce.
- MiFID - Nine changes to the MiFID II framework: (1) Removing the Share Trading Obligation; (2) Replacing the pre-trade transparency waiver regime and removing the Double Volume Cap; (3) Changing the definition of a systematic internaliser; (4) Removing restrictions on midpoint crossing for trades; (5) Aligning the Derivatives Trading Obligation with the EMIR Clearing Obligation; (6) Exempting for post-trade risk reduction services from the DTO; (7) Giving the FCA a permanent power to modify or suspend the DTO; (8) Simplifying the transparency regime for fixed income and derivatives; (9) Simplifying the position limits regime.
- Another area of retained EU law change will be the powers for UK regulators (Bank of England and FCA) to oversee financial market infrastructure which had been a preserve of EU regulation.
- Provisions are also set out to apply the SMCR regime to FMIs and credit rating agencies.
- **Financial promotions** - the existing financial promotions regime is complex and has proved difficult for the FCA to regulate resulting in misleading promotions of complex financial products. Proposals for tightening the regime will mean that those firms wishing to approve promotions of unauthorised firms will require permission from FCA. Firms will be restricted to approvals within their sphere of expertise.
- **Critical Third Parties** – the legislative framework for the new CTP regime is set out giving HMT powers to designate critical third parties. A Discussion Paper was jointly released by regulators providing thoughts on the new regulatory framework.
- **Access to cash** – There are concerns that closing branches or some free to use ATMs means consumer access to cash or deposit facilities is becoming restricted. The bill sets out provisions for HMT to designate firms to be subject to FCA oversight to ensure the provision of cash is maintained.
- **APP scams** – the Payments Systems regulator will be given powers to require mandatory reimbursement by payments systems providers to consumers subjected to authorised push payment fraud.
- **Credit Unions** – the bill enables changes to the activities Credit Unions can carry on which paves the way for changes recommended as part of the Woolard review to create a more sustainable unsecured credit market.

What should Internal Audit teams be thinking about?

- Heads of Internal Audit need to keep close to Board and Audit Committee discussions regarding strategic changes required to meet incoming regulatory expectations. Discussion now with the firm's legal counsel for its analysis of legislative changes, especially considering cross-border regulated activities, will prove useful in identifying the key risks facing the firm as each wave of supervisory and policy statements are published in due course.
- Second line oversight functions should be preparing for a period of change and maintaining an ongoing impact assessment to monitor proposals and impact of changes. Therefore, Heads of Internal Audit will need to evaluate the current and anticipated resource requirements for the IA activity to provide sufficient oversight of incoming regulatory developments.
- Given the substantial amount of regulatory developments expected over the coming years, this could prompt reassessment of the firm's assurance map. Coordinating the firm's various assurance providers for efficient and effective risk management over the next three-year horizon would maximise efforts and play well into the incoming requirement for an Audit and Assurance Policy as part of the anticipated Audit Reform bill requirements.

FCA MARKET WATCH 69: FCA OBSERVATIONS ON FIRMS' MARKET ABUSE SURVEILLANCE


ED NEWMAN
DIRECTOR

+44 (0) 7958 354 444
ed.newman@bdo.co.uk


BRUK WOLDEGABREIL
ASSOCIATE DIRECTOR

+44 (0) 7467 626 468
bruk.woldegabreil@bdo.co.uk

FCA Market Watch 69

- In 17 May 2022, the FCA published its latest Market Watch newsletter in which it summarised its observations from its supervisory engagements with small and medium-sized firms.
- The three main areas of focus for Market Watch 69 were:
  - Market abuse surveillance;
  - Policies and procedures to address criminal market abuse;
  - Investigations into potential market abuse by firms' employees and when firms should submit a suspicious transaction and order report (STOR).

What were the FCA's observations?

- **Front office**: FCA observed some firms that place a reliance on front office staff to identify potential market abuse, sometimes giving them sole responsibility for monitoring. In other instances, firms cited front office's role as mitigation for a limited or absence of surveillance in Compliance.
- **Outsourcing**: In a small number of cases, FCA found that UK Compliance teams had negligible understanding of the surveillance undertaken at group level (for overseas firms), and following FCA investigation, the regulator discovered the surveillance put in place by Group was ineffective for the UK business.
- **Policies & procedures**: FCA observed instances where policies and procedures are vague or have limited detail, such as directing analysts reviewing surveillance alerts to look for signs of market abuse, but with no guidance on what these signs might be, or what materials / information to use or consider.
- **Order & Trade surveillance:**
  - If a firm uses a common threshold in its alert scenarios for all instruments, it may struggle to ensure effective monitoring (the threshold is set too high/too low for some instruments), or it may generate a high amount of 'noise' (the alert is calibrated to the most sensitive of the instruments);
  - FCA observed instances where firms are not monitoring all orders and trades, including cancelled and amended orders;
  - FCA have seen some firms with weaknesses in their review of surveillance exception alerts.
- **MAR Risk Assessments:**
  - Some firms consider market abuse at a high level, as a single risk;
  - Some look at the risk by desk without assessing different types of market abuse;
  - Some assess only insider dealing and market manipulation, without considering how different levels of risk might apply to different sub-categories of these, such as layering and spoofing, wash trading and ramping;
  - Some firms whose business involves activity across a range of asset classes fail to distinguish between them when assessing for risk;
  - Some do not consider how different types of business activity, such as discretionary vs execution-only, or client vs house trading, might present different market abuse risks;
  - Some firms do not consider the method of execution (e.g., electronic vs voice-broked markets) or the nature of the platform where the trading takes place (e.g. lit vs dark books, central limit order book vs auction);
  - Some firms completely discount the risks in certain business areas because of low trading volumes, without considering the inherent risks.

What should Internal Audit teams be thinking about?

- **Policies and procedures:** are these clear and up to date with FCA's Market Watch findings? Do they factor in relevant guidance for business with overseas entities (e.g. FINRA for US counterparties)? What system of staff training is in place to ensure policies and procedures are understood, followed and its compliance monitored such that any deviations to controls are flagged as soon as possible? Are MAR controls embedded within the firm's Conduct Risk framework?
- **Risk Assessments:** its impossible to assess a risk for an undefined activity or behaviour. Given the wide variety and complexity of MAR compliant activities a firm can undertake, its critical that the business has appropriately categorised its universe of FCA-permitted activities and that Compliance has defined Market Abuse behaviours in relation to these activities. Only then can a robust risk assessment take place ahead of IA facilitating an objective review of MAR controls, putting priority on high risk areas, e.g. order and trade surveillance.
- **Outsourcing**: an opportunity to, where applicable, co-ordinate a review of outsourced MAR surveillance as part of the firm's third-party Outsourcing review.

ECONOMIC CRIME UPDATE

WILL WOODWARD
MANAGER

+44 (0) 7823 898 674
william.woodward@bdo.co.uk

▶ NCA Red Alert on Financial Sanctions Evasion Typologies: Russian Elites and Enablers

- In July 2022, the National Economic Crime Centre (NECC), a multi-agency unit in the National Crime Agency (NCA), and HM Treasury's Office of Financial Sanctions Implementation (OFSI), working in conjunction with law enforcement and financial sector partners as part of the Joint Money Laundering Intelligence Taskforce (JMLIT), issued a 'Red Alert.'
- The purpose of the 'Red Alert' is to provide information from law enforcement and the legal and financial services sectors about common techniques designated persons (DPs), individuals and entities subject to financial sanctions, and their UK enablers are suspected to be using to evade financial sanctions.

▶ What does the 'Red Alert' say?

- The 'Red Alert' explains how some DPs are using a range of techniques in order to evade sanctions impacting on their personal and commercial holdings. This activity is occurring shortly before the imposition of sanctions or soon after. DPs are transferring or selling assets, sometimes at a loss, and divesting investments to reduce ownership below 50% or relinquish controlling stakes.
- A DP may claim to have relinquished the asset, but the 'Red Alert' states that it is highly likely that they will retain their influence through trusted proxies and enablers. Enablers are individuals or businesses facilitating sanctions evasion and associated money laundering. Key enabler professions include:
  - Legal (barristers and solicitors)
  - Financial (relationship managers, accountants, investment advisors, wealth managers, payment processors, private equity, trust and company service providers)
  - Estate agents
  - Auction houses
  - Company directors, Intermediaries/agents and private family offices
- The 'Red Alert' lists 34 indicators for the detection of frozen asset transfers, detection of enablers and the detection of suspicious payments.
- Many of these cover existing risks like the abuse of trust structures, holding companies located offshore or in jurisdictions historically linked to the Soviet Union, and transactions by holding companies linked to DPs with Swiss bank accounts and BVI/Cypriot legal persons.
- The 'Red Alert' also mentions payments from offshore jurisdictions, the Middle East, East Asia or jurisdictions that still support the Russian government or express neutrality in international forums like the UN.
- In terms of what appear to be emerging trends, the 'Red Alert' notes the risk of payments via a Fintech (e.g. a payment service provider or electronic money institution) with Russian investor nexus.
- This could include customer transactions that are initiated from or sent to IP addresses that have non-trusted sources, or are located in Russia, Belarus, jurisdictions with FATF-identified Anti-Money Laundering (AML) deficiencies or comprehensively sanctioned jurisdictions.

▶ What should Internal Audit teams be thinking about?

The 'Red Alert' specifies six recommendations:

1. Arms-length transactions need to be documented and should not be taken at face value by firms. If they have any doubt, firms are advised to seek guidance from OFSI.
2. Paying particular attention to source of wealth and source of funds checks, especially if conducted by third parties.
3. Making a careful assessment of complex corporate structures as a key component of enhanced due diligence on high-risk customers.
4. Issues of aggregation of ownership can be further complicated where differing approaches to aggregation of ownership are applied across the EU, UK and US and more than one owner seeks to divest their shareholding. Firms are advised to seek guidance from OFSI if in doubt.
5. Where firms are presented with documentation that purports to present a change in ownership by a company linked to a DP, it is important not only to conduct enhanced due diligence, but to follow up with the relevant competent authority (OFSI in the UK) to understand if firms have reason to believe that ownership has not been transferred appropriately.
6. When companies have provided their own legal assessments regarding the transfer of ownership, firms should also carry out their own legal assessment in order to come to their own determination.

- The 'Red Alert' also reminds us that, as a tool of foreign policy, UK sanctions have jurisdiction both over England, Wales, Scotland and Northern Ireland, as well as the Crown Dependencies and Overseas Territories (which includes BVI).

ECONOMIC CRIME UPDATE

The 'Red Alert' focuses on the evasion of sanctions by DPs and the movement of funds or ownership shortly before, or immediately after, the imposition of sanctions.

Notwithstanding the recommendations made within the 'Red Alert', IA teams should also consider the following:

- Firms should re-visit their Business-Wide Sanctions Risk Assessments to ensure that they adequately consider the inherent risk of their businesses being exposed to attempted sanctions evasion by DPs or their UK enablers.
- Now is a good time for firms to examine the calibration and functioning of the firm's screening systems. This could also involve an assessment of how there have been changes to alert numbers and the quality of potential matches. Considering the current sanctions climate it is imperative that firms pay even closer attention to sanctions risks and the many complex ways that they present themselves.
- With sanctions lists being frequently changed and updated in the current circumstances, firms should also confirm that the third party providers supplying watchlist data are continuing to ensure that every amendment to the various lists of sanctioned entities is captured.
- Any firms which become aware of any information (as part of their business relationships) which is indicative of the typologies listed in the 'Red Alert' should consider submitting a Suspicious Activity Report (SAR) to the NCA.
- Further, (as noted in the alert) firms should also consider contacting the NCA with any other relevant information identified in light of the 'Red Alert'.

► FATF Report on Data Protection, Technology and Private Sector Information Sharing

- The Financial Action Task Force (FATF) released a report on 20 July 2022, which focuses on how responsible private-to-private collaboration can contribute to the effective implementation of AML/CFT and proliferation financing requirements.
- The report provides case studies that set out how members of the FATF and its Global Network have increased private sector information sharing within the legal requirements of their domestic data protection and privacy (DPP) framework.
- The report also provides non-binding recommendations to assist countries that are considering increasing private sector information sharing to design and implement such initiatives responsibly and effectively.

► What should Internal Audit teams be thinking about?

The FATF report makes a series or recommendations which are of relevance to banks and building societies:

- **Make use of privacy enhancing technologies**: privacy-enhancing technologies can help support compliance with data protection and privacy obligations. When considering the application of these technologies firms should think about the interoperability and accessibility of different technologies to promote broader engagement.
- **Ensure harmonised data**: data-sharing technologies, especially advanced analytics, work best with common data standards and formats. Firms could make use of existing data prepared in a structured format (e.g. SWIFT data fields) or implement data cleansing/structuring initiatives.
- **Pursue Data Protection 'by design'**: during the design phase of any initiative, firms should consider producing a data protection impact assessment, data sharing agreements/contracts, human rights impact assessments and a legitimate interest assessment to help data controllers evaluate the necessity and proportionality of anticipated data processing.
- **Establish early and ongoing engagement with data protection authorities**: Involvement of data protection authorities is critical for the success of any information-sharing project. Likewise, engagement with AML/CTF regulatory authorities can also be vital to a project's chances of success.
- **Identify metrics to measure success**: Setting clear performance indicators enables participants to assess whether the initiative is achieving its purpose and if the information sharing continues to be necessary, reasonable or proportionate in line with applicable DPP requirements. Sharing positive outcomes and results also helps build trust and encourage broader involvement. It is worth noting the former NCA deputy director's comments where he suggested that people should "dare to share." This quote related to his reflections about the challenges faced by both public and private sector stakeholders when establishing the now successful Joint Money Laundering Intelligence Taskforce (JMLIT).

A ROUNDUP FROM THE REGULATORS

REGULATOR	DATE	DOCUMENT	WHAT'S NEW?
FCA	27/07/2022	PS22/9	A new Consumer Duty: FCA's final rules
FCA	27/07/2022	FG22/5	A new Consumer Duty: FCA's final guidance
PRA	22/07/2022	CP13/22	Amendments to the PRA's approach to identifying other systemically important institutions (O-SIIs)
EBA	22/07/2022	Report	EBA publishes report on use of specific exemptions included in the large exposures regime
FCA/PRA/BoE	21/07/2022	DP22/3	Operational resilience: critical third parties to the UK financial sector
HMT	21/07/2022	Call for Evidence	HMT consultation on Payments Regulation and the Systemic Perimeter in response to the government's 2021 'Payments Landscape Review'
FCA/PRA/BoE	21/07/2022	Dear CEO letter	Transforming data collection – an update on progress and plans for 2022
PRA	20/07/2022	Speech	New tides – speech by Nathanaël Benjamin regarding the risks and challenges for investment banks
PRA	19/07/2022	Index	A new Prudential and Resolution Policy Index, which provides a list of policies relating to the prudential regulation
PRA	15/07/2022	CP8/22	Remuneration: proposed changes to unvested pay, Material Risk Takers and public appointments

A ROUNDUP FROM THE REGULATORS

REGULATOR	DATE	DOCUMENT	WHAT'S NEW?
PRA	14/07/2022	Speech	Speech by Victoria Saporta on why banks are reluctant to use liquidity and capital buffers and how the PRA is working to help firms
FCA	14/07/2022	Speech	How the UK will regulate for the future - speech by Nikhil Rathi
EU SRB	13/07/2022	Report	EU Single Resolution Board - 2021 resolvability assessment of banks within the European Union
FCA	12/07/2022	Review	FCA review of SME collections and recoveries across 11 retail banks
ECB	08/07/2022	Report	European Central Bank publishes the results of its 2022 Climate Risk Stress Test exercise for EU banks
BIS	07/07/2022	Report	Proportionality - Basel Committee on Banking Supervision publishes high level considerations
EBA	07/07/2022	EBA/Op/2022/08	EBA assesses implementation of its Opinion regarding the treatment of legacy instruments
EBA	01/07/2022	EBA/DC/453	EBA adopts decision on reporting of payment fraud data under Payment Services Directive 2
EBA	01/07/2022	Risk Dashboard	EBA published its quarterly Risk Dashboard and results of the autumn edition of the Risk Assessment Questionnaire (RAQ)
FCA	29/06/2022	FS22/4	Feedback statement which sets out the FCA's policy response for ESG integration in UK capital markets

FOR MORE INFORMATION:

RICHARD WEIGHELL

+44 (0) 7773 392799
richard.weighell@bdo.co.uk

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