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BDO Financial Services Quarterly Update

Q1 2025

BDO

Welcome to your Quarterly Financial Services Sector Update

BDO's Quarterly Financial Services Sector Update summarises the key regulatory developments and emerging business risks relevant for all financial services firms, including banks, building societies, investment and wealth managers, payments and insurance providers.

Our FS Advisory Services team works with a broad range of financial services firms as advisors, giving us an extensive 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 help inform your oversight and assurance activities over the firm's priority risks.

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.

Editorial team

Paul Gilbert
Partner

+44 (0)7890 323 336
paul.gilbert@bdo.co.uk

Bruk Woldegabreil
Director

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

Olivia Gledhill
Manager

+44 (0)7554 782 858
olivia.gledhill@bdo.co.uk

Adam Watson
Associate Business Development Manager

+44 (0)7443 373 993
adam.watson@bdo.co.uk

Your BDO Financial Services Advisory Team

Our Financial Services Advisory team provides consultative problem solving together with core regulatory, governance, internal audit, risk management and resourcing services to meet the needs of your business. Our team combines skills and experience from industry and regulatory backgrounds, enabling us to provide robust and proportionate advice to our clients. We strive to be a trusted adviser who can be relied upon to add value, provide ideas and to challenge and deliver a service which will contribute to your business' success.

Regulatory & Governance

Leigh Treacy
Partner, Head of FS Advisory

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

Richard Barnwell
Partner

+44 (0)7717 214 818
richard.barnwell@bdo.co.uk

Fiona Raistrick
Partner

+44 (0)7929 057 616
fiona.j.raistrick@bdo.co.uk

Mads Hannibal
Partner

+44 (0)7810 836 222
mads.hannibal@bdo.co.uk

Internal Audit & Assurance

Chris Bellairs
Partner

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

Luke Patterson
Partner

+44 (0)7929 058 083
luke.patterson@bdo.co.uk

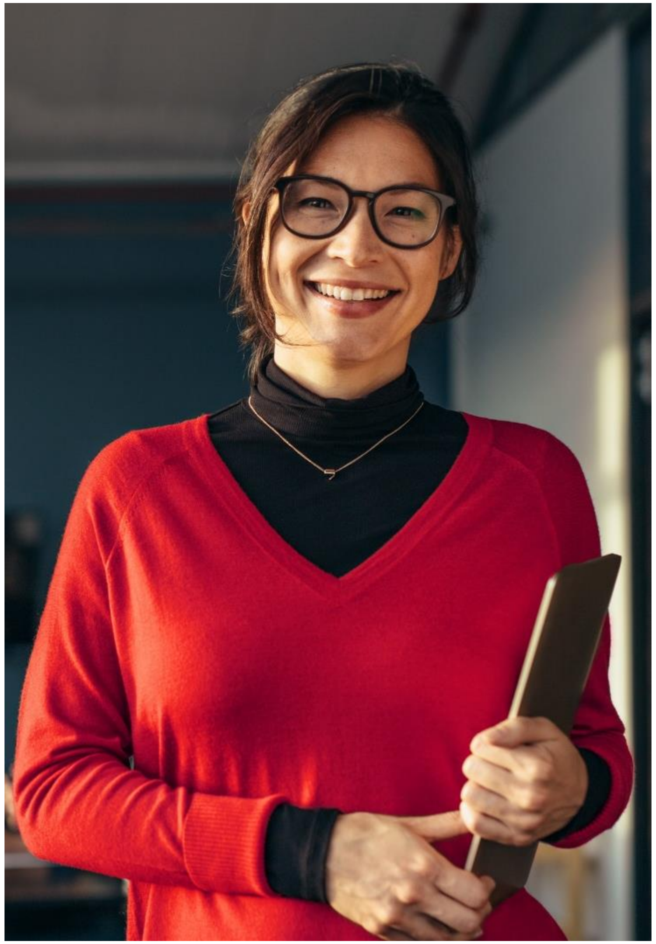
Sam Patel
Partner

+44 (0)7970 807 550
sam.patel@bdo.co.uk

Sam Cornish
Partner

+44 (0)7502 276 555
sam.cornish@bdo.co.uk

Your BDO Financial Services Advisory Team



North of England

Paul Gilbert
Partner

+44 (0)7890 323 336
paul.gilbert@bdo.co.uk

Scotland

Mick Campbell
Partner

+44 (0)7500 025 243
mick.campbell@bdo.co.uk

ESG & Accounting Advisory

Sasha Molodtsov
Partner

+44 (0)7581 478 087
sasha.Molodtsov@bdo.co.uk

Mark Spencer
Partner

+44 (0)7718 864 980
mark.spencer@bdo.co.uk

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All Financial Services

Recent Information Commissioners' Office enforcement action

An overview of the recent Information Commissioner's Office (ICO) enforcement action examining the broader data protection themes which are pertinent for Financial Services. Looking ahead to changes in the data protection regulatory landscape in the UK after the Labour Government unveiled the Data (Use and Access) Bill in the House of Lords, in October 2024, and what additional considerations Second and Third Line teams need to be aware of, including the link between data protection and ESG.

Christopher Beveridge
Managing Director,
Privacy & Data Protection

christopher.beveridge@bdo.co.uk

Louise Sadler
Senior Manager,
Privacy & Data Protection

louise.sadler@bdo.co.uk

In October 2024, the ICO fined two Manchester based financial and debt management companies a total of £150K for sending in excess of 7.5 million spam texts to people, without their consent.

The ICO investigation highlighted that the organisations which focused on PPI tax refunds and providing debt counselling advice services had purchased personal data from third party suppliers that did not obtain valid consent and subsequently sent millions of spam text messages to those individuals.

In December 2024, the ICO fined a further two financial services firms based in the North of England a total £290K and issued enforcement notices.

Both organisations were found to have made unsolicited marketing calls to potentially vulnerable individuals, again, without first obtaining consent.

It's worth noting that the majority of ICO enforcement action in the last year focused on organisations who did not meet UK GDPR and the Privacy and Electronic Communications (PECR) compliance requirements for direct marketing activity.

From the customer's perspective, it can be really irritating to be bombarded with unsolicited marketing and can damage consumer trust. Since the GDPR was enshrined in domestic law in 2018, individuals are more aware of their rights, and of their ability to lodge a complaint directly to the ICO if they feel that an organisation has not complied with the UK GDPR or PECR. To illustrate this, in 2023 alone, the ICO received 107,700 complaints directly from individuals which were specifically related to nuisance calls/messages and emails.

In view of recent enforcement action specifically in the financial services sector, combined with the ICO's focus on non-compliance in relation to nuisance marketing emails, firms should review consent arrangements, especially for B2C marketing.

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Recent Information Commissioners' Office enforcement action

Looking ahead - UK data protection, changes on the horizon?

In October 2024, the UK Department for Science Innovation and Technology unveiled new legislation in the form of the Draft Data (Use and Access) Bill, the Labour Government's latest take on modernising the UK GDPR.

The draft bill does not appear to be too dissimilar from the (now failed) draft Data Protection and Digital Information Bill, introduced by the previous government. However, there are proposed changes amongst others that could impact:

- The UK's approach to automated decision-making, the removal of consent requirements in relation to non-intrusive cookies, the introduction of a new UK adequacy test and changes to the ICO governance structure, including the modernisation of enforcement powers.

We wait for further detail regarding the specifics of the Bill, during its passage through Parliament. At the time of writing, the draft Bill is expected to pass through the House of Commons stages between January - March 2025 before receiving Royal Assent in the Spring/Summer 2025.

The Internal Audit Code of Practice - Principles on effective internal audit in the financial services, private and third sectors.

In September 2024, the Institute of Internal Audit (IIA) published the Internal Audit code of practice in the financial services, private and third sectors, which has been effective since January 2025.

The code includes 'Principle 8 - Scope of the internal audit', which specifically references two areas that relate to privacy and data protection:

- Principle 8C. Internal Governance – Internal audit should include within its scope the design and operating effectiveness of the process in line with customer interests, protection of customer data and applicable conduct regulation.
- Principle 8J. Technology, cyber, digital and data risks – Internal audit should include within its scope coverage of technology risks. This should include assessing the governance, risk management and control framework for managing IT general controls, cyber, cloud digital and data risks including the use of emerging technology such as artificial intelligence.

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Internal Audit teams should therefore ensure that the scope of internal audit work is regularly reviewed to take account of new and emerging risks and ensure that principles 8.c and 8.j are covered within internal audit plans.

Data Protection & ESG

Data Protection and ESG are inextricably linked, which will become increasingly important as organisations are required to report on ESG with the adoption of standards for sustainability disclosures, such as the EU's Corporate Sustainability Reporting Directive (CSRD).

Compliance with the UK and EU GDPR, which emphasises the principles of data minimisation and storage limitation, helps to address this and were summarised in a recent Picasso Privacy Labs White Paper across the E, S and G:

E - Environment - Exponential growth of data and its storage has a significant impact on ESG and data protection. The more data an organisation holds, the larger its carbon footprint, and this is particularly the case where organisations are implementing generative AI tools.

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Recent Information Commissioners’ Office enforcement action

This intersects with the storage limitation principle (a key principle in the UK and EU GDPR), whereby organisations should only retain personal data for as long as it is required

S - Social – Good data governance provides individuals with greater control over their personal data, which in turn drives better transparency and boosts trust and brand value.

G - Governance – Mature data governance programmes (including the management of data subject rights) strengthens compliance and the approach to risk and control management.

Non-compliance with data protection requirements is a key business risk, especially for organisations that operate B2C. Firms should, therefore, be aware of this linkage when developing their risk oversight and assurance activities.

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

christopher.beveridge@bdo.co.uk
or louise.sadler@bdo.co.uk

Auditing diversity equity and inclusion and socio-economic diversity

In November 2024, BDO LLP, Progress Together (an organisation driving socio-economic diversity at senior level across UK Financial Services firms) and the Chartered Institute of Internal Auditors (CIIA) brought together Heads of Internal Audit from across the Financial Services sector to discuss the crucial role they play in advancing Diversity, Equity and Inclusion (DEI) within firms.

Internal Audit teams play a unique role in advancing the DEI ambitions of firms. Whilst the **Chartered Institute of Internal Auditors guidance on approaching DEI audits** will help teams understand how to create meaningful scopes to get the most from an audit, there is still a large amount of upskilling and work to be done.

Sasha Molodtsov
Partner, FS Advisory

sasha.molodtsov@bdo.co.uk

BDO LLP and Progress Together welcomed Internal Audit leaders from across Progress Together's membership to discuss the challenges and benefits of auditing DEI with a deep dive into socio-economic diversity. As part of the discussion Progress Together member firms shared how they approach DEI-related internal audits, and the Chartered Institute of Internal Auditors launched their latest technical guidance, 'How to audit DEI'.

Sophie Hulm, CEO of Progress Together shared an update on Progress Together's annual data collection exercise. As evidenced in the 'Shaping the Sector' report, there has been an average increase in the representation of senior leaders from lower socio-economic backgrounds; from 26% in 2023 to 28% in 2024, for the member firms that have reported data two years in a row. Progress Together members are ahead of the curve in data collection on socio-economic diversity.

Drivers for embedding socio-economic diversity and broader DEI into audit plans

Sasha Molodtsov, Partner in BDO's ESG Financial Services Advisory team, shared insights into how firms were increasingly considering DEI as a non-financial risk, driven by increased regulatory focus (particularly the FCA, PRA and Lloyds of London), industry expectations and public commitments on specific diversity ambitions, as well as increased expectations on FS Boards by the FRC from a corporate governance perspective.

Recognising D&I as a non-financial risk in its recent Diversity and Inclusion Consultation Paper, the PRA calls out the role of risk, compliance and internal audit functions in contributing to the "firm's controls around the strategies, helping (firms) measure progress and assess how to improve over time." The FCA also sees the role of Internal Audit functions to "help Boards to ensure a higher degree of scrutiny, with senior management held accountable for delivering on D&I". This interest is not expected to slow as the PRA and FCA look to publish the final diversity and inclusion (D&I) respective policies in early 2025, raising the bar for the FS industry even higher.

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Auditing diversity equity and inclusion and socio-economic diversity

Practical guidance

Ann Brook, Head of Technical Content & Research at the Chartered Institute of Internal Auditors, commented on the expectations of the Internal Audit profession and the challenges teams face when thinking about the audit universe and how D&I and related issues of culture are integrated into the most meaningful way. Is DEI to be delivered as a standalone audit? Or is it reviewed thematically as a component of every single audit? Specific considerations include:

- The Assurance Approach: It is important to look at DEI more broadly. For example, the Global Internal Audit Standards, standard 9.5 – Coordination and Reliance, encourages Internal Audit teams to look at where else assurance is coming from and to think practically about the combined assurance approach for DEI, to ensure that Internal Audit can place their reliance on the firm's control framework. This would open up opportunities to engage with second line functions beyond Risk, such as HR. For integrating DEI into audits, it is important to assess the risks and to consider which are pervasive to the business. This could dictate whether DEI is integrated into other audits or whether it should be a standalone audit. The Global Internal Audit Standards, 11.3 and 14.3 have some focus on finding the root cause of the risk by looking across the business and its embeddedness. If the root cause can't be found, firms won't be able to get to the bottom of the problem.

This is acknowledged to be a challenging balancing act, given the finite resources that Internal Audit functions have. The Chartered Institute of Internal Auditors' new technical guidance for DEI discusses this balance and encourages Chief Audit executives to look at the assurance approach.

Pitching the Audit Plan: A catalyst for improvement is communicating the audit plan with what the business needs. This factors in a level of understanding of the maturity of the business and the separate business units. There could be benefits to conducting a similar maturity analysis approach for DEI.

- Eight elements that can help to structure the Assurance Approach: Internal Audit should consistently consider:

  1. Governance
  2. DEI Policy
  3. DEI Objectives
  4. DEI Risk Management
  5. DEI Process
  6. People
  7. Training and Awareness
  8. DEI Monitoring and Reporting.

These elements help to form a control framework that can be applied to DEI, and the newly published DEI guidance asks some key questions for audit professionals to consider for each element, noted above.

The guidance won't be able to answer all the questions, so the best-practice approach is to be practical and for key audit individuals to be the driver to help their firms on the DEI journey.

Common themes from the discussion emerged:

- **DEI is on audit plans, but socio-economic diversity (SED) is not always called out:** Firms seem to be at different stages of their DEI audit journeys. Questions over how audit teams ensure they are reviewing the 'right' risks and conducting DEI audits in the 'right' way, recognising context, maturity and proportionality is key. For some, DEI has been woven into other audits, such as culture audits, to bring DEI to life across the organisation. It seems that most firms have integrated DEI into the audit plan for 2025 in some way, which is a positive step.

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Auditing diversity equity and inclusion and socio-economic diversity

- **CEOs and Execs are important stakeholders:** As members of Progress Together, the 'Accountable Executive' plays a key role in governance, accountability and responsibility at the top, and how DEI and Socio-economic diversity factor into the governance framework that sets the 'tone from the top'. This will filter into sub-committees, succession plans, reward and remuneration policies linked to DEI ambitions and where relevant, workforce representation targets.
- **Strategic focus and target setting can help integrate DEI and Socio-economic diversity across a business and governance framework:** Some key questions to consider include whether the DEI strategy is achievable and is proportionate to the business. A DEI strategy should be accessible and form a part of the overall firm's strategy, which must filter down and influence policies and procedures. Business units can then draw on these policies, such as HR (recruitment and performance management). The entire Internal Audit function should also know the strategy so that audit teams are aware of the commitments made and can further integrate DEI into the audit cycle.
- **Future talent:** A quarter of the staff working within the Financial Services sector is estimated to leave within the next ten years. So, a key issue arises around talent, succession planning and skills, and where talent will come from in the future.

  Recruitment strategies should consider DEI and Socio-economic diversity specifically, and for many firms, access to students, apprentices and university talent is a key focus area. Briefing Executive Search firms and conducting due diligence on the recruitment firms' own DEI policies with regular management information/metrics can ensure diversity ambitions are being supported through the recruitment process.
- **Increasing data collection:** Progress Together member firms are seeing a steady rise in data collected on socio-economic background (49% average response rate in 2023 to 58% in 2024). Whilst this is encouraging, there are still challenges with employees being comfortable with disclosing personal data.
- Firms approach data collection differently; however, for most, it is voluntary, with either senior management or line managers leading the push. In some cases, a series of small nudges to fill out forms before attending work functions, during the benefits renewal process, or making charity donations has helped to improve engagement. There are also involuntary surveys with the option of 'prefer not to say'.
- Ensuring data collection gives executives visibility over non-financial risks relating to talent or groupthink. Progress Together members get support from their data partner, the Bridge Group, and through sharing best practices with peers.
- Data collection and risk assessment: Data challenges may affect how data can be integrated into the risk assessment. Data can be linked to the risk appetite and the strategy from the Board through metrics, and so data should be able to inform the inherent risk, residual risk, and controls of the risk assessment depending on the business maturity. There are fewer controls for less mature businesses, so the movement from inherent risks to residual risk is small. Data is crucial to the oversight of audit risks.

If you require support or would like to discuss this topics further, please contact:

sasha.molodtsov@bdo.co.uk

The UK Green Taxonomy Consultation

In November 2024, the Treasury launched a consultation on the UK Green Taxonomy, aiming to establish a framework for identifying environmentally sustainable economic activities. The outcome of the consultation will be of particular interest to investors and issuers of financial securities, who may wish to consider the specific design questions and reflect on whether the scope and user-friendliness of the proposals are appropriate.

Once the responses have been considered and the taxonomy finalised and implemented a sense of certainty should enable investors to integrate climate and other environmental factors into their capital allocation decisions.

Gloria Perez-Torres
Associate Director, FS Advisory

gloria.pereztorres@bdo.co.uk

Why is the Treasury consulting on this?
This initiative is part of the Government's broader strategy to support the transition to a greener economy and achieve its environmental objectives.

The main purpose of this consultation is to "establish whether a UK Taxonomy would be additional and complementary to existing policies" in meeting the aims of avoiding greenwashing and directing capital to align with the government's sustainability objectives. The consultation sought to gather views on "any market and regulatory use cases for a UK Taxonomy which would contribute to these objectives".

The government also sought feedback on how to "maximise the usability of a UK Taxonomy", if the response to the consultation demonstrates support for developing one.

Should the UK implement a Green Taxonomy?
The purpose of implementing a UK Green Taxonomy would be to provide clarity and consistency in defining what constitutes a sustainable activity. This would help guide investment towards activities that support environmental goals, such as climate change mitigation, adaptation, and biodiversity protection.

A Green Taxonomy could potentially contribute to:

- Facilitating the transition to a low-carbon economy
- Enhancing transparency and comparability for investors
- Supporting the development of green financial products; and
- Alignment with international standards, particularly the EU Taxonomy (which some of the FS sector may already have to comply with if they operate in the EU).

The EU taxonomy for sustainable activities, which is currently in operation, focuses on several environmental goals. Of these goals, the most commonly cited are climate mitigation and climate adaptation, but others include biodiversity and ecosystems, circular economy, pollution prevention and control, and sustainable use and protection of water and marine resources.

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The UK Green Taxonomy Consultation

Based on feedback from other taxonomies and the work of the Green Technical Advisory Group (GTAG), several potential use cases have been identified. For example:

- Supporting investor stewardship and engagement
- Informing the development of sustainability-focused financial products
- Application to investment fund and investment portfolio product disclosures.

On stewardship, potential investees which offer sustainability-related products may be in a better position to influence the decisions of investors if they are able to use a commonly accepted classification system as a reference point. A GTAG and Green Finance Institute Report has noted that "if there is demand for products aligned to the latest version of the UK Green Taxonomy, then this should incentivise the creation of new funds designed to meet the current criteria".

Who is this consultation relevant for?

The outcome of the consultation will be of particular interest to investors and issuers of financial securities, who may wish to consider the specific design questions and reflect on whether the scope and user-friendliness of the proposals are appropriate.

For example, firms may consider that the recommendation from the GTAG of using "quantified thresholds and recognised, science-based metrics where possible in criteria" could enable efficiency from an operational perspective, particularly where data is already being collected and / or reported on the topics that fall within the proposed UK taxonomy.

The consultation invites feedback from a wide range of stakeholders, including businesses, investors, and the public.

How would this work in practice?

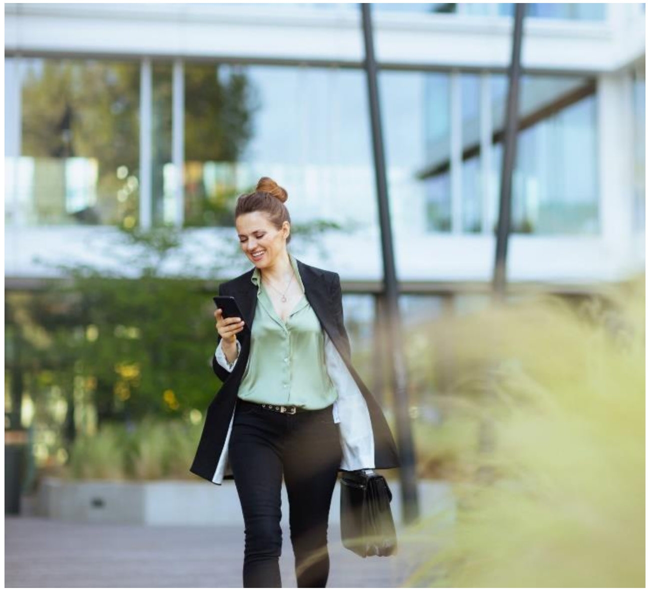
The Government is considering how it could implement a taxonomy effectively. This would require assessing potential regulatory requirements, existing reporting obligations, and the role of different stakeholders in the process; as part of this, they may assess the option of adopting equivalent requirements to the EU taxonomy. The government considers international interoperability to be a particularly important factor in any future development of a workable UK Taxonomy. Many UK-based firms and funds are subject to external taxonomies, such as the EU's Taxonomy Regulation.

The consultation noted that other jurisdictions update their taxonomies every three years and is considering whether a UK Taxonomy would require updates at a similar frequency.

What happens next?

The consultation closed on 6th February 2025.

Once the responses to the consultation have been considered, the taxonomy is finalised and implemented (depending on the route the government chooses to take), this should bring about a sense of certainty to companies and investors, enabling investors to integrate climate and other environmental factors into their capital allocation decisions.



The UK Green Taxonomy Consultation

Considerations for the Board and Senior Management

If and when a Green Taxonomy is implemented in the UK, depending on its scope and design, firms will need to consider assessing the current control environment, as well as any new processes and / or controls implemented in respect of the Green Taxonomy within the business.

For example, firms may need to take steps to ensure consistency in terms of metrics and thresholds, or whether any controls will need to be implemented to ensure alignment with the DNSH principle. This is likely to be particularly important where firms are not already subject to other taxonomies.

Watch out for our upcoming publications with a more in-depth analysis of the UK's approach to taxonomies.

If you require support or would like to discuss this topics further, please contact:

gloria.pereztorres@bdo.co.uk

Reminder: New Failure to Prevent Fraud Offence

Following guidance published by the Home Office on 6 November 2024 the new Failure to Prevent Fraud Offence will take full effect from 1 September 2025. Organisations now have less than eight months to develop and implement the required fraud prevention procedures.

The guidance focuses on the procedures that organisations can put in place to prevent their employees and persons associated with them from committing fraud offences. The new Failure to Prevent Fraud Offence in the UK applies to large organisations that meet two or more of the Criteria.

Sally Felton
Director, FS Advisory

sally.felton@bdo.co.uk

In our previous update, we outlined the importance of understanding any requirements firms may have in relation to the Economic Crime and Corporate Transparency Act, in particular the Failure to Prevent Fraud Offence. Now more than ever, it is vital for organisations who fall under the legislation to ensure they have reasonable procedures in place to prevent fraud.

Firms that meet two of the following three criteria will be required to comply with the new Failure to Prevent Fraud Act:

- Over 250 employees
- Over £18m in assets
- Over £36m in turnover.

For firms who meet the threshold, there are six principles that must be considered as part of the firm's reasonable procedures:

- Top level commitment
- Risk assessment
- Proportionate risk-based prevention procedures
- Due diligence
- Communication (including training)
- Monitoring and review.

Whilst many organisations will already have robust processes in place around the other two corporate "Failure to Prevent" offences of Tax Evasion and Bribery, it is important to remember that the approach to each differs slightly, and adherence to one will not automatically mean adherence to all three.

While an overlap does exist, some businesses should independently review their position for each of the three to ensure compliance with all required legislation.

Remember, if a firm falls within the criteria of the new Failure to Prevent Fraud Offence, the only acceptable defence will be that you can evidence that your firm has reasonable procedures in place to prevent fraud, should there ever be a case to answer.

You can find out more about the new Failure to Prevent Fraud Offence here.

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Reminder: New Failure to Prevent Fraud Offence

Considerations for the Board and Senior Management

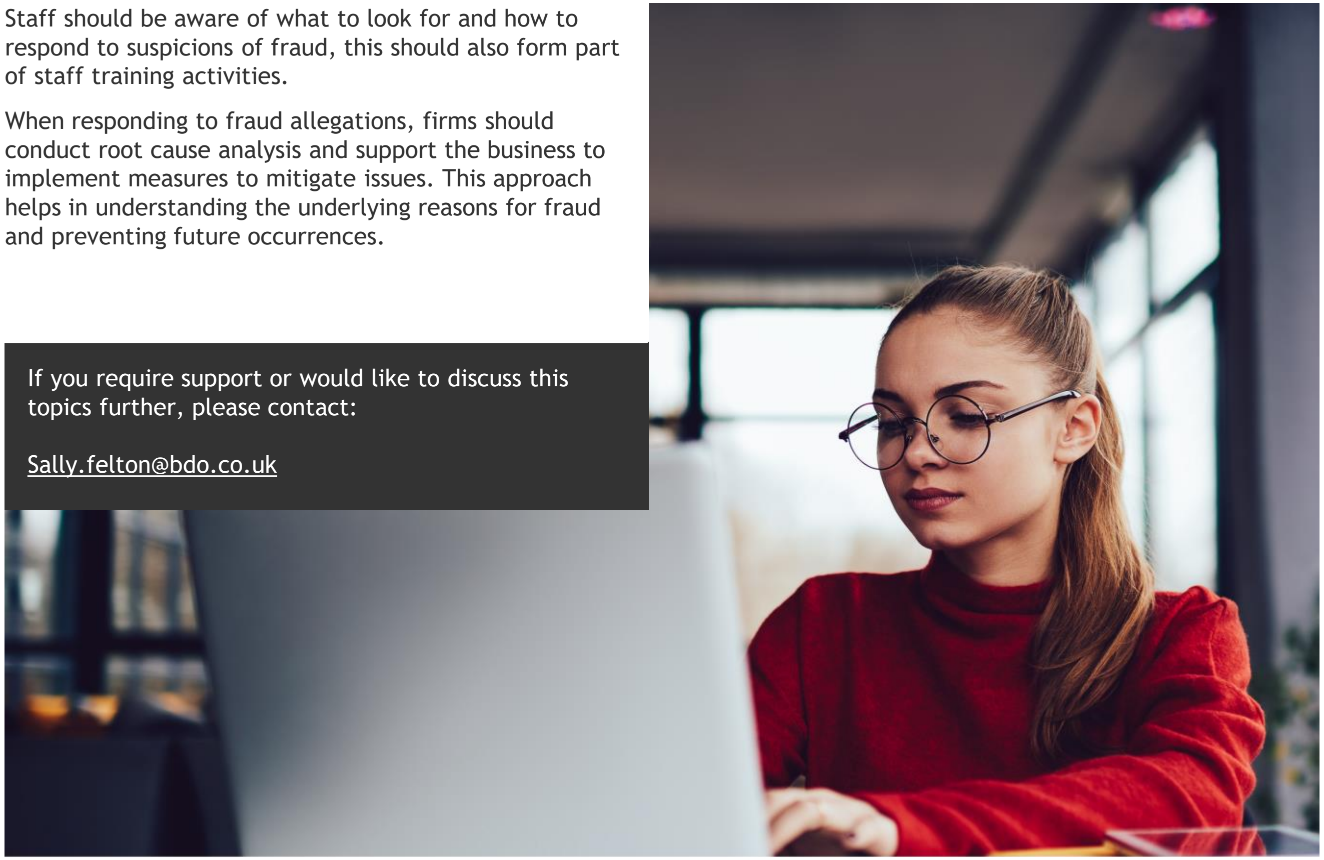
Second and Third Line teams should use this guidance to help strengthen their organisation's fraud prevention measures. Given the similarities between guidance on fraud, bribery, and tax evasion, organisations should already have a foundation to build upon.

Firms should have a detailed and robust Fraud Risk Assessment that covers both inward and outward fraud. This assessment is crucial for identifying potential vulnerabilities and areas that require attention. Additionally, it is important that the business has identified and defined associated persons under the scope of failure to prevent offences. This will help in understanding who might be involved in fraudulent activities and how to mitigate these risks. An assessment should be undertaken to evaluate the effectiveness of their controls in place to prevent and detect fraud for all the risks identified.

The organisational culture should support fraud prevention. Firms should assess the quality of fraud awareness training provided to staff and ensure it is effective in reducing fraud risk, review the organisation's fraud policy and check when it was last updated. It is important to ensure that the policy aligns with current legislation and best practices. Additionally, the effectiveness of whistleblowing arrangements should be assessed.

Staff should be aware of what to look for and how to respond to suspicions of fraud, this should also form part of staff training activities.

When responding to fraud allegations, firms should conduct root cause analysis and support the business to implement measures to mitigate issues. This approach helps in understanding the underlying reasons for fraud and preventing future occurrences.



If you require support or would like to discuss this topics further, please contact:

Sally.felton@bdo.co.uk

2024 Deals overview: Steady growth facing market challenges

2024 can be characterized by steady deal activity, though not spectacular. The stabilisation of the debt markets was helpful, although sponsor-driven platform investment and secondary activity remains difficult to execute across the space. At c.£30bn of deal value, 2024 is likely to end some 15-20% higher than 2023.

We believe mid-market FS activity has remained buoyant as the factors that make such businesses attractive to investors have not changed, despite such market uncertainty and increased regulatory scrutiny, notably with respect to consumer outcomes.

Duncan Chandler
Deal Advisory Partner, M&A

duncan.chandler@bdo.co.uk

Rahoel Patel
Deal Advisory Partner, Transaction Services

rahoel.patel@bdo.co.uk

Looking at specific subsectors:

- **Wealth & IFA buy-and-build strategies** continued their momentum, especially in the UK, backed by continuing access to debt, albeit the need to integrate platforms and replenish acquisition facilities has seen some consolidators pause for breath
- **Insurance intermediary** activity continued apace with some sizeable UK deals of note (e.g. Warburg /Temasek/Specialist Risk Group, NSM/AllClear, Markerstudy/Ardonagh) with wider efforts increasingly centred on earlier stage rollup plays across European and Scandinavian markets
- **Specialty finance investments**, despite macro-economic headwinds, remained active although opportunistic at best, the Pockit/Monese merger being a good example of a sector still working out how to bring together the disruptors and innovators seen in the fintech space
- **Banking** has seen three mid-sized takeovers (Coventry/Co-op, Nationwide/Virgin, Barclays/Tesco)
- Interestingly the other big mid-market M&A plays was the take privates of Hargreaves Lansdown and Mattioli Woods (by CVC and Pollen Street, respectively).

The one black mark on the overall FS space though is the discretionary commissions inquiry, which has had immediate effects on those with large motor books (e.g. LBG, Close), with important ramifications for the sector overall still being thought through.

However, as 2024 has drawn to a close and with debt markets fuelling further appetite for deal making, the wider FS market outlook for 2025 looks positive.

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2024 Deals overview: Steady growth facing market challenges

Outlook for 2025

The market is optimistic for 2025, though very conscious of the geopolitical uncertainties that lie ahead. Capital Markets remain challenged, but M&A pipelines continue to build up and should hopefully start to be opened. The following themes can be expected to emerge:

- **Wealth management buy-and-build:** This continues to underpin FS M&A, with perhaps half of all activity in the space relating to this. Bolt-on activity is expected to remain buoyant with many consolidators pressed to continue buying assets; meanwhile, we expect consolidators challenged by lower realization of synergies, difficult debt structures or just simple organic growth challenges to look to merge or find other solutions. The increasing scrutiny of the FCA on PE-backed consolidators also looms large over the industry.

- **Time to refinance:** This remains a key theme, particularly relevant for buy and build consolidators as well as those in speciality finance e.g. bridge finance and working capital lenders.

- **FinTech shake out:** The shake out of FinTech and neo-banks, who have not scaled to or towards profitability will continue to consolidate – the Klarna IPO slated for 2025 will be the inescapable bellwether.

- **PE dry powder driving deal flow**: The abundance of private equity dry powder - $2.6tn globally per S&P and Prequin estimates - is expected to bolster deal flow in 2025. Despite current trading challenges, there is optimism that conditions will improve. As in recent years, this influx of private capital is expected to be a driving force behind strategic platform investments and M&A in the sector.

- **Corporate disposals:** Non-core disposals will continue in 2025, as corporates continue to tidy up.

- **Professional services:** At time of writing, this is the sector with the most attention, following the sales of Grant Thornton and Smith & Williamson – expect tech investments into those already in PE hands, while the slide rule will be run over those remaining independents within reach.

2025 will be an interesting year, for sure. The continued focus on buy and build strategies, along with the abundance of private equity dry powder and seemingly improving macroeconomic conditions does point to an improvement in deal activity across the sector in 2025.

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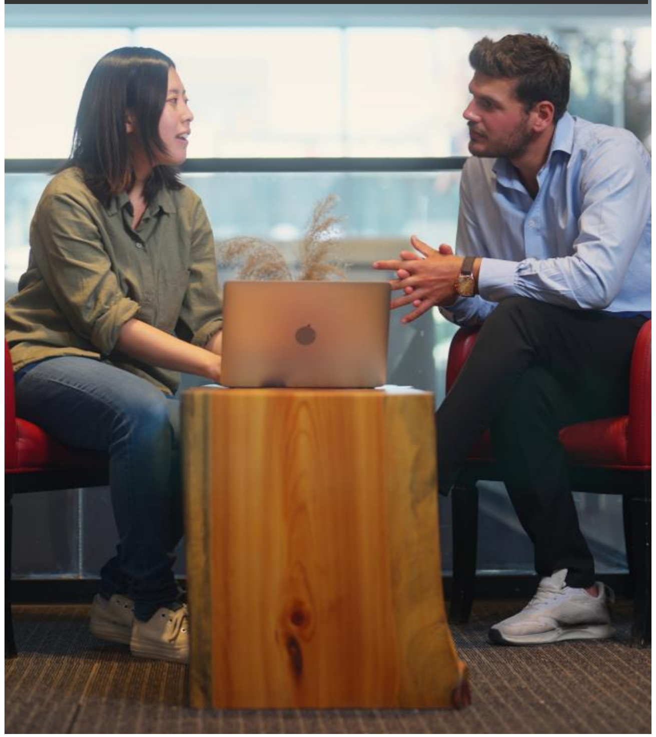
If you require support or would like to discuss with any of these topics, please contact:

duncan.chandler@bdo.co.uk or
rahoel.patel@bdo.co.uk



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Banking and Building Societies

The Motor Finance Industry is facing a challenging 2025

With the news that the Supreme Court will hear appeals in the case of Wrench, Johnson and Hopcraft, the hope is that certainty can be provided over the duties owed to customers by brokers and lenders. However, recent developments may extend the potential need for a review.

Whilst we await the outcome of the Supreme Court hearing and any further response from the FCA, there are actions firms should be taking to manage an influx of motor finance complaints as well as providing for potential redress payments. This is potentially a complex period as firms consider the outcomes and scenarios that they may need to manage.

Richard Barnwell
Partner

richard.barnwell@bdo.co.uk

The relief in Board rooms was palpable as the Supreme Court issued a brief statement that it will hear appeals to the Court of Appeal Judgements in the cases of Wrench, Johnson and Hopcraft. In this article we explore the current status of motor finance complaints.

Discretionary Commission Arrangement Complaints

There is still the issue of discretionary commission arrangement (DCA) complaints to be resolved. These are complaints where the broker had discretion over the interest charged by the lender, that in turn could increase the level of commission the broker received. The FCA banned DCA commissions from January 2021 after completing a market study where it found these types of commission arrangements were unfair. The FCA estimates there are around 335,000 such complaints although some commentators believe it is more.

The FCA senior officials have commented that a review process for DCA complaints is now highly likely. The FCA would consult on how a review should progress with two main options. A complaint led approach where consumers 'opt in' to a review by making a complaint, or an industry wide process where all consumers are included in a review.

The FCA has paused complaint handling deadlines for DCA complaints, now likely to be until after the Supreme Court process has concluded. The expectation is that motor finance lenders should be taking a number of steps, in anticipation of a review of DCA motor finance complaints. These steps include progressing complaints to a point where a decision can be made; dealing with customer enquiries; preparing for a potential review; assessing potential liabilities and making any appropriate disclosures.

Non-Discretionary Commission Complaints

The Court of Appeal Judgements in Wrench, Johnson and Hopcraft has opened the door to a wider number of complaints about fixed or non-discretionary commissions that were only partially disclosed to the customer or not disclosed at all (hidden or secret commissions). The issues all stem from the relationships and duties owed to the customer by the broker and lender.

The FCA requirements for disclosure were not as prescriptive as those determined by the Court of Appeal. It is now a complex position where regulation, industry practice and common law are not aligned.

The FCA has recognised this could significantly increase the numbers of consumer complaints lodged with motor finance lenders and brokers and overwhelm the Financial Ombudsman Service. Therefore, the FCA is consulting on a pause to complaint handling for these complaints, likely until after the Supreme Court judgement.

continued >

The Motor Finance Industry is facing a challenging 2025

The implications of this potential wave of complaints are more serious and is potentially a significant liability for motor finance lenders and brokers. Operationally, the FCA expects firms to put in place capacity and capability to handle an influx of additional complaints. Firms may also wish to consider the financial implications and strategies for addressing the potential scenarios from the judgements.

Outside of motor finance, the Court of Appeal judgements could apply more widely. It may be prudent for brokers and lenders to consider how commission is disclosed to consumers and revisit consumer journeys.

The Supreme Court has said the appeals will be heard in the Hilary Term, between 20 January and 28 March 2025. A judgement will be handed down after the conclusion of the appeals at a later date, hopefully sometime in late spring or the early summer.

There are three key take outs from the FCA's recent communications:

Firms should anticipate a new influx of complaints about fixed / non DCA commission motor finance lending.
This means being ready to receive additional complaints and carry out capacity planning to gear up operationally. Customers who have had a complaint rejected by a firm, because it was not a DCA complaint can now complain again because of the judgement. Therefore, steps such as updating websites and communications should help consumers find information they need.

Importantly, the FCA sets out its expectation that "firms will need to use the additional time provided to ensure they have the resources to investigate and issue final responses to complaints at the end of the proposed extension."

This means getting on with the processing of data gathering and investigations now and being able to issue a decision once the court actions conclude. This is potentially complicated as firms may need to run investigations with parallel decision-making outcomes anticipating potential conclusions from the courts.

Firms should be meeting the common law standards as well as FCA's own rules and guidance on a current and forward basis.
This means checking current processes and procedures meet the standards of disclosure and consent outlined in the judgement for all motor finance. This means clearly disclosing the commission and how it is calculated to the customer and obtaining consent. There is still an outstanding question about applying the Court of Appeal judgement to a wider suite of products, many firms may well be looking at this with their legal teams.

Financial impacts
Firms should be calculating provisions and ensure they have sufficient financial resources to meet threshold conditions. A useful approach is to use scenarios and assumptions to calculate potential redress liabilities.

All provisions should meet relevant accounting standards and will be bespoke to each firm. Separately, regulatory capital should ensure specific regulatory capital standards are met as well as sufficient financial resources retained to operate. Wind down plans should be adjusted to consider potential scenarios.

The Motor Finance Industry is facing a challenging 2025

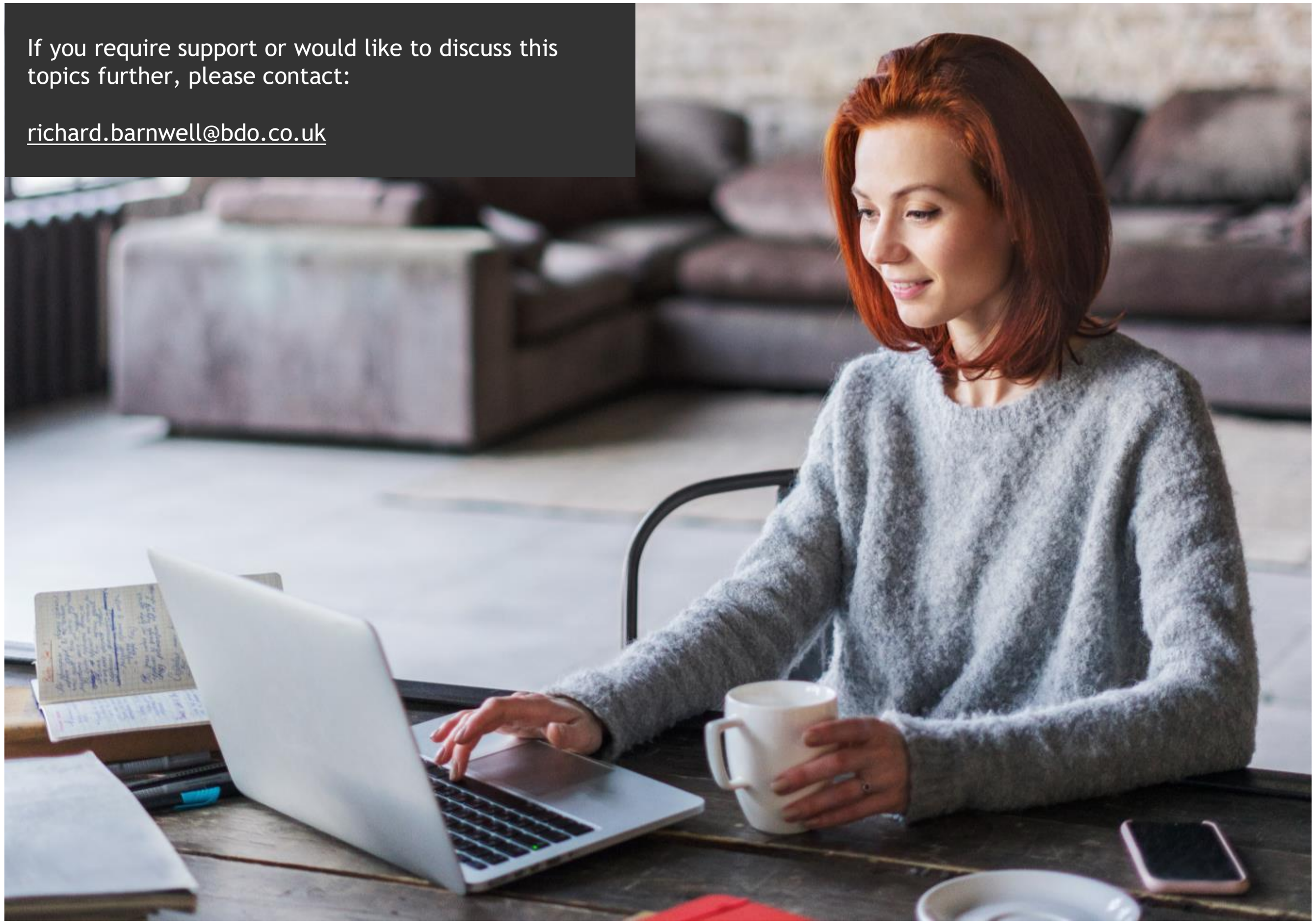
Considerations for the Board and Senior Management

The landscape of motor finance complaints is rapidly changing, as a result firms need to be agile on their approach to providing assurance over the processes and controls in place for handling the influx of complaints, regulatory changes and the financial impacts. Firms should ensure that the organisation's processes and controls are aligned with both common law standards and FCA regulations. This involves reviewing and assessing updated procedures for complaint handling, disclosure, and consent to ensure compliance and mitigate potential liabilities. Resource availability will be key in ensuring firms can handle the influx of complaints and ensure they are able to issue final responses at the end of the extension, the complaints data will feed into firms’ calculation and assumptions for the potential redress liabilities. Therefore, Risk and Internal Audit could conduct short reviews evaluating the capacity and capability of the firm's resources against the anticipated number of complaints to ensure the firm is equipped to handle this, or that the controls are in place for appropriately calculating provisions to ensure the firm has sufficient financial resource to meet the threshold conditions.

You can find out more about the questions facing motor finance lenders and how BDO can help here.

If you require support or would like to discuss this topics further, please contact:

richard.barnwell@bdo.co.uk



PRA priorities for UK deposit takers and international banks

On 21 January 2025, the Prudential Regulation Authority ("PRA") outlined its priorities for UK deposit takers, international banks and designated investment firms ("firms") in **letters** addressed to Chief Executive Officers. This letter highlights the key PRA areas of focus for 2025. Similar to previous years, the PRA's priorities aim to promote the safety and soundness of the banking sector and ensuring resilience and competitiveness.

Sam Cornish
Partner

sam.cornish@bdo.co.uk

Miselo Mumba
Manager, FS Advisory

miselo.mumba@bdo.co.uk

Gurkirat Saberwal
Manager, FS Advisory

gurkirat.saberwal@bdo.co.uk

Key priorities and how these impact active UK firms

Risk Management, Governance, and Controls

Firms are expected to have frameworks in place that are adaptive and resilient, leveraging stress and scenario analysis to inform risk management, strategy, and business planning. Senior management and Boards must ensure these frameworks are proportionate with the firm's business model and address the root causes of material weaknesses in the control environment.

Credit Risk

Firms need to adapt their credit risk management and measurement practices to changing conditions, including the impacts of climate change. The PRA will review how credit risk management practices have evolved, focusing on strategic growth areas, vulnerable and higher-risk portfolios, and key international portfolios. Firms should prioritise remediation of any shortcomings in model risk management ("MRM") and maintain high-quality models that capture risks and provide robust outputs, noting that the combination of credit risk factors impacting firms' credit portfolios could be different to those that their original credit risk models were built on.

Data Risk

Poor data quality is a root cause of many risks requiring remediation. Firms must improve their ability to aggregate data to support holistic risk management, robust Board decision-making, and accurate regulatory calculations. The PRA will place increasing reliance on data tools and analytics for efficient supervision and expects firms to submit complete, timely, and accurate regulatory returns.

Funding and Liquidity

Firms' Boards should seek assurance from their treasury and risk management functions about the effectiveness of balance sheet management. The PRA expects Firms to plan well in advance for repaying and refinancing maturing Term Funding Scheme with additional incentives for SMEs ("TFSME") drawings and to balance the use of collateral for market-based funding with maintaining sufficient pre-positioned collateral at the Bank of England.

continued >

PRA priorities for UK deposit takers and international banks

Operational Resilience
By March 2025, firms must demonstrate their ability to remain within impact tolerances for all important business services ("IBS") during severe disruptions. Firms should strengthen their response and recovery capabilities, address cyber threats, remediate vulnerabilities, and develop contingency procedures for third-party service disruptions.

Basel 3.1 Delay and Strong and Simple Framework
The implementation of Basel 3.1 has been delayed by 12 months from 1 January 2026 to 1 January 2027. Firms should continue to work through the potential impact and implications of the Basel 3.1 policy package with their Boards.

Considerations for the Board and Senior Management

Internal Audit can play a substantial role in providing the Board and Senior Management with assurance over the business' management of regulatory risks and controls. We note, below, a few areas for firms to consider based on our market experience.

If you require support or would like to discuss this topics further, please contact:

sam.cornish@bdo.co.uk, miselo.mumba@bdo.co.uk or gurkirat.saberwal@bdo.co.uk

Assessing Risk Management, Governance and Controls
As per the Chartered Institute of Internal Auditors ("CIIA") new Code of Practice, Internal Audit's reporting to the Audit Committee of the Board must include, at least annually, an overall opinion on the effectiveness of the governance, risk and control framework of the firm.

From our experience, we have noted that many firms are at varying stages of risk management maturity and, therefore, Internal Audit must assess the level of reliance that can be placed on Second Line assurance activities and facilitate growth in maturity through the Second Line function reviews as part of the audit plan, subject to Audit Committee approval.

Reviewing Credit Risk Management
Review the firm's credit risk management practices, particularly in strategic growth areas, adaptability to changing conditions and higher-risk portfolios. Internal Audit should ensure that models are high-quality and provide robust outputs considering changes in the market.

Ensuring Data Quality
Assess the firm's data aggregation capabilities and the accuracy of regulatory returns. They should ensure that data quality supports holistic risk management and decision-making. Internal Audit could consider the use of artificial intelligence ("AI") to improve data quality in firms, but a proportionate approach should be adopted considering current capabilities. The EU AI act has also introduced new obligations on organisations using AI, emphasising the importance of ethics, safety and transparency.

Evaluating Liquidity Resilience
Review the firm's liquidity management practices and preparedness for unexpected shocks. They should ensure that the firm has effective balance sheet management and contingency funding options.

Strengthening Operational Resilience
From our experience, we have noted that the most effective operational resilience frameworks are embedded within firms' overall enterprise-wide risk frameworks. Weaknesses have been identified when there is more of a 'tick box' approach to operational resilience and not embedded into the firm's overall risk culture. Further, due to resource constraints in small or medium sized firms, key person dependencies exist in teams who manage operational resilience. As a result, it is important to ensure that core elements, such as scenario testing, become business as usual and are reviewed regularly.

Monitoring Basel 3.1 and Strong and Simple Framework
Monitor the firm's progress in implementing Basel 3.1 and the Strong and Simple framework where applicable. Internal Audit should ensure that the firm is prepared for the potential impact and implications of these regulatory changes.

Internal audit should collaborate with the Second Line, where possible, to assess the level of maturity the firm has regarding the PRA's priority areas. Ultimately, Internal Audit should step forward in supporting the firm to achieve its business objectives by ensuring risk management practices are effectively embedded and ongoing measures are appropriately governed.

03

Investment and Wealth Management

Spotlight on vulnerable client regulations

The Financial Conduct Authority (FCA) has spotlighted the treatment of vulnerable clients in the financial services sector. Throughout 2024, the FCA reviewed how firms understand and respond to the needs of vulnerable customers, with findings due in Q1 2025. Firms are expected to provide their customers with a level of care that is appropriate to their characteristics, especially those with additional or different needs due to their circumstances. This article explores the FCA's regulations on vulnerable clients, the approach taken by wealth and asset management firms and the themes identified through our Internal Audit activity.

Simon Goldsmid
Senior Manager, FS Advisory

simon.goldsmid@bdo.co.uk

Ishita Clark
Senior Manager, FS Advisory

ishita.clark@bdo.co.uk

Background

The FCA defines a vulnerable client as “someone who, due to their personal circumstances, is especially susceptible to harm, particularly when a firm is not acting with appropriate levels of care.” They emphasise that 'vulnerability' should not be treated as a mere buzzword. Firms must understand customer vulnerability in context. In its guidance for firms, the FCA outlines four key drivers of vulnerability:

- **Health:** Conditions or illnesses that affect the ability to carry out day-to-day tasks
- **Life events:** Major life events such as bereavement, job loss, or relationship breakdown
- **Resilience:** Low ability to withstand financial or emotional shocks
- **Capability:** Low knowledge of financial matters or low confidence in managing money. Low capability in other relevant areas such as literacy or digital skills.

Characteristics of vulnerability may result in consumers having additional or different needs. This can limit their ability or willingness to make decisions, choices, or represent their own interests.

These consumers may be at greater risk of harm, especially if things go wrong.

Firms are expected to act in good faith by identifying vulnerable clients, understanding their needs, and providing appropriate support. This support should avoid foreseeable harm and enable them to pursue their financial objectives.

How are firms responding?

Wealth and Asset Management Firms have implemented measures to comply with the FCA's regulations, with some being more proactive than others. These include:

- Introducing training programmes to help staff to identify and support vulnerable clients effectively
- Enhancing their customer and conduct reporting, with specific KRIs and metrics, to provide a clearer line of sight into the treatment and outcomes experienced by vulnerable customers
- Including greater analysis in product and service assessments on the outcomes being experienced by vulnerable customers – particularly in the context of the utility and value of these products and services
- Undertaking monitoring to assess whether the needs of vulnerable clients are being met, and any new vulnerabilities are identified promptly.

continued >

Spotlight on vulnerable client regulations

On 15 March 2024, the FCA announced that it will review firms' treatment of customers in vulnerable circumstances. This review looks back at how firms have implemented its 2021 guidance and, particularly with the implementation of the Consumer Duty, it will expect firms to: (1) understand their vulnerable customer population; and (2) enhance the outcomes vulnerable customers receive. The findings are expected to be shared in Q1 2025.

Considerations for the Board and Senior Management

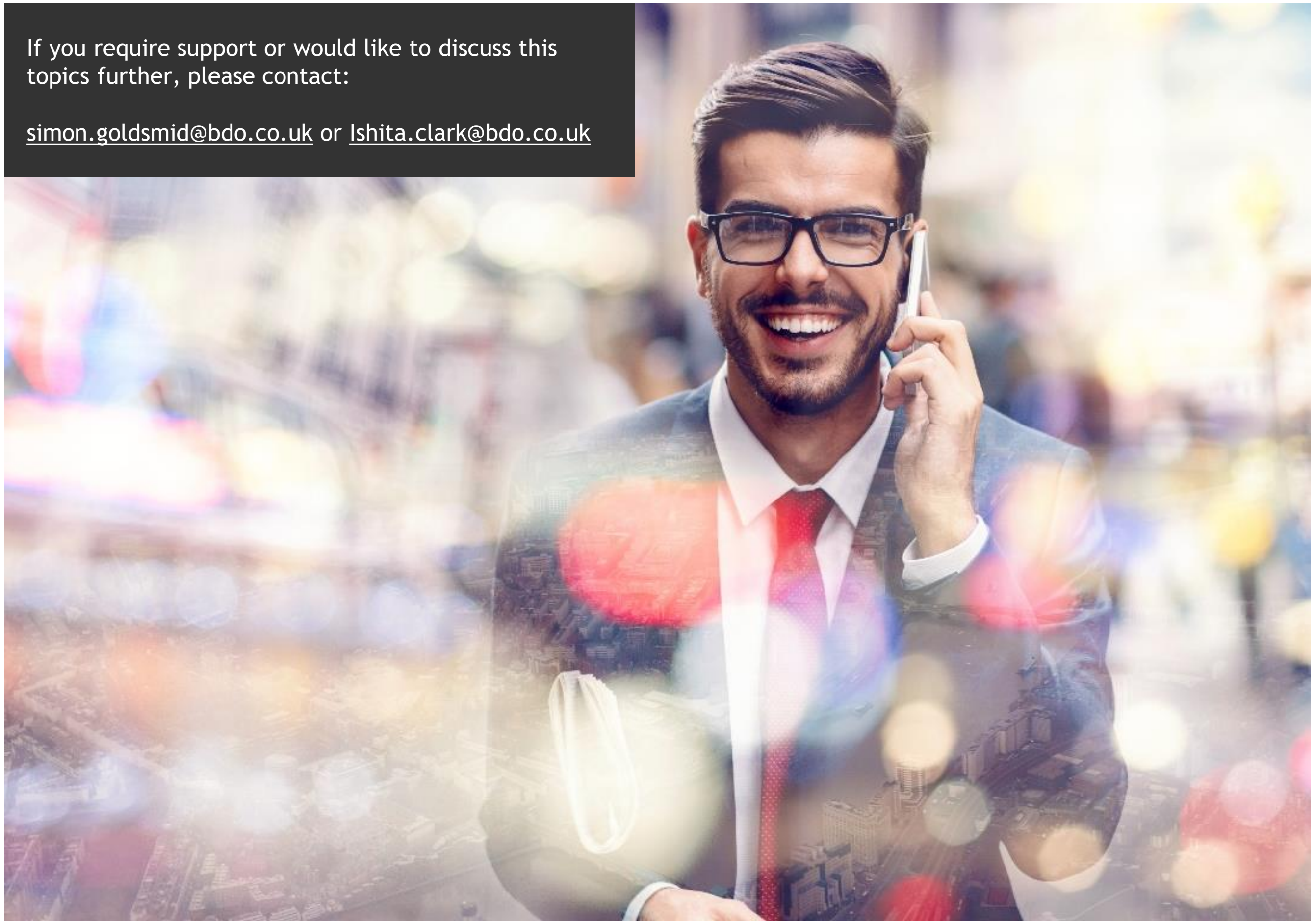
Firms should have a robust framework in place for treating vulnerable customers, considering the industry themes identified above. This includes assessing the firm's approach to ensure that staff have the appropriate skills and capability to recognise and respond to the needs of vulnerable customers throughout the customer journey, from product design to ongoing service and communications.

Third-Line teams should also assess the firm's process for identification and recording of characteristics of vulnerability as well as periodic monitoring and reporting undertaken to review whether the needs of vulnerable clients are being met.

Lastly, it is important to note that vulnerable customers are a key element of the FCA Consumer Duty regulation. Ensuring that products and services are designed to deliver fair value and good outcomes for all retail clients, including those who are vulnerable, should be a key consideration for any Consumer Duty work.

If you require support or would like to discuss this topics further, please contact:

simon.goldsmid@bdo.co.uk or Ishita.clark@bdo.co.uk



04

Payments & E-money

FCA priorities for payments firms: Staying ahead of the curve

The Financial Conduct Authority (FCA) recently outlined its priorities for payment firms in a letter addressed to the CEOs including Payment Institutions (PIs), Electronic Money Institutions (EMIs), and Registered Account Information Service Providers (RAISPs). This letter serves as a reminder that despite improvements in the industry, there is still significant work to be done to ensure high standards and consumer protection are met. As experienced professionals with a background both in practice and regulatory supervision, we know that these priorities will have a considerable impact on the future of your business. In this article, we will break down the FCA's key outcomes and explain how BDO's expertise can help your firm stay compliant, competitive, and secure.

Luke Patterson
Partner, FS Advisory

luke.paterson@bdo.co.uk

Zahra Ellahi
Associate Director, FS Advisory

zahra.ellahi@bdo.co.uk

The FCA's Key Priorities: what they mean for your firm
The FCA's letter identifies three primary outcomes that firms must focus on:

1. Effective Competition and Innovation to Meet Customer Needs
2. Ensuring Financial System Integrity
3. Keeping Customer Money Safe.

Let's dive deeper into each of these areas and explore why they are so crucial for your firm's growth, compliance, and long-term sustainability.

Outcome 1: Effective competition and innovation to meet customer needs
The FCA has placed a strong emphasis on ensuring that firms in the payments sector innovate in ways that benefit consumers and the broader financial market. With the rise of technologies like Open Banking, Open Finance, and digital currencies, the payment services sector is evolving rapidly.

The FCA expects firms to respond to customer needs and preferences, ensuring that the products and services they offer are aligned with consumer characteristics and objectives.

However, innovation must always be balanced with the need to maintain high standards of consumer protection. The FCA's recent review showed that while some firms have effectively implemented the Consumer Duty, many others still have significant gaps in meeting its requirements.

Why it matters:
Failure to innovate in a customer-centric manner can leave your firm behind competitors, risking both reputational damage and regulatory penalties. To avoid this, your firm must be vigilant in implementing the Consumer Duty and ensuring your products offer clear pricing, fair value, and transparent communication to customers.

How BDO can help:
BDO's deep expertise in payments compliance and regulatory frameworks can help you navigate these complexities.

FCA priorities for payments firms: Staying ahead of the curve

We'll assist in embedding the Consumer Duty, ensuring that your innovation strategies meet the FCA's expectations and deliver good outcomes for customers. We'll also help you assess whether your products are meeting consumer needs and whether your pricing is clear and fair, particularly in areas like foreign exchange services.

Outcome 2: Firms do not compromise financial system integrity

Maintaining the integrity of the UK financial system is critical, and the FCA has underscored the importance of reducing financial crime and enhancing operational resilience. With the ever-increasing threat of cybercrime and fraud, the FCA is closely monitoring how firms address these risks. This includes the need for robust financial crime controls and ensuring that firms have systems in place to manage fraud, including authorised push payment (APP) fraud and unauthorised fraud.

Why it matters:
Financial crime and operational disruptions can cause serious harm to your firm's reputation, disrupt service delivery, and lead to regulatory action. The FCA's letter highlights that firms must ensure their governance, risk management, and financial crime controls are proportionate to the risks they face.

How BDO can help:
At BDO, we can provide the necessary guidance to ensure your firm's systems and controls are compliant with the FCA's expectations.

Our team will help you build resilience against cyber-attacks, refine your financial crime management framework, and implement strategies that align with the FCA's latest requirements, including those related to APP fraud and payment delays.

Outcome 3: Firms keep customers' money aafe

Customer funds must be safeguarded appropriately, and the FCA has reiterated its focus on safeguarding mechanisms, particularly in light of some weaknesses identified in the sector. The FCA's expectations around safeguarding are clear: firms must ensure that customer money is appropriately protected, reconciled daily, and that any adverse findings in safeguarding audits are immediately addressed.

Why it matters:
Failure to keep customer money safe is one of the most serious breaches a firm can make. It not only exposes your firm to regulatory sanctions but also jeopardises consumer trust in your services.

How BDO can help:
BDO's specialists can guide you through the complexities of safeguarding and financial resilience. We'll help ensure your firm is meeting the necessary requirements for safeguarding customer funds and provide advice on how to manage and reconcile these funds accurately. Additionally, we will help you prepare for upcoming changes to safeguarding rules and assist in strengthening your financial resilience to safeguard against potential business disruption.

Preparing for the future

The FCA's priorities underscore the need for firms to be proactive in addressing compliance and operational challenges.

These areas are not only critical for regulatory compliance but also for ensuring that your firm remains competitive, secure, and trusted by consumers.

At BDO, we have extensive experience working with payments firms to address these challenges. We provide tailored advice to help you meet FCA requirements, enhance your governance and operational resilience, and ensure the safety of your customers' funds.

Contact us today to discuss how we can help your firm stay ahead of regulatory expectations, mitigate risks, and prepare for future changes in the payments landscape. With BDO's expertise, you'll be well-positioned to navigate the complexities of the FCA's priorities and continue to grow with confidence.

You can view the FCA's portfolio letter here.

If you require support or would like to discuss this topics further, please contact:

luke.patterson@bdo.co.uk or zahra.ellahi@bdo.co.uk

Improving Consumer Duty compliance for payments and e-money firms

The FCA's implementation of the Consumer Duty (the 'Duty') presents a significant challenge for payments and e-money firms, many of which are still grappling with how to fully comply with its stringent requirements. Firms face pressures to not only meet regulatory standards but also embed them into their operations in a way that delivers sustainable, positive outcomes for consumers. Since the Duty came into force on 31 July 2023, the FCA has closely examined how firms are implementing the new rules. Recent reviews have highlighted significant disparities in compliance, with some firms making substantial progress and others falling behind. Evidently firms that approach Consumer Duty with a systematic, customer-centric mindset are better positioned to both meet compliance and create long-term value for their business.

Luke Patterson
Partner, FS Advisory

luke.paterson@bdo.co.uk

Zahra Ellahi
Associate Director, FS Advisory

zahra.ellahi@bdo.co.uk

The FCA's Latest Findings: A Call to Action for Firms

The FCA's review of payments firms shows that while many businesses are meeting the basic compliance requirements, others are struggling to get their processes right. This review serves as a timely reminder that Consumer Duty is not a box-ticking exercise. The Duty demands real, actionable steps to assess and improve consumer outcomes across four key areas: products and services, price and value, consumer understanding, and consumer support.

What is particularly concerning is that firms which are not yet fully compliant face the risk of delivering poor consumer outcomes, a situation which could potentially lead to regulatory scrutiny, reputational damage, and even enforcement actions. The FCA has made it clear that where compliance gaps exist, firms need to take swift, effective action to close them, especially if these gaps pose a risk of harm to consumers.

Key Shortfalls and How to Address Them

From our collective experience in both the industry and at the regulator, it's clear that several common themes emerge when firms fail to meet the Consumer Duty standards. These include:

Inadequate Data Quality: Firms are required to monitor consumer outcomes through robust data collection and analysis. However, many firms are still struggling to collect sufficient, reliable data to draw actionable conclusions. Without quality data, it's impossible to monitor compliance effectively or implement meaningful improvements.

Lack of Effective Governance and Oversight: For many firms, the challenge lies not just in complying with the rules, but in embedding a culture of compliance at the highest levels. The FCA has highlighted poor governance structures as a significant issue, with some firms failing to ensure that their Boards are sufficiently challenging the implementation of the Duty.

Failure to Consider Vulnerable Consumer Groups: Consumer Duty requires firms to consider how their products and services affect different groups of consumers, including those with characteristics of vulnerability. Many firms, particularly in the payments sector, have not sufficiently addressed how they deliver good outcomes for these groups.

Improving Consumer Duty compliance for payments and e-money firms

Ineffective Communication and Consumer Support: The Duty demands clear, consumer-friendly communication, yet many firms continue to struggle with making their messages accessible and easy to understand. It's also crucial that consumer support services are readily accessible to those who need them most.

Considerations for the Board and Senior Management

If your firm is facing challenges in meeting the Consumer Duty's requirements, it's crucial to take proactive steps to improve your compliance framework. Here are a few key actions to consider:

Review your Governance Framework: Ensure that your Board and senior management are actively engaged in overseeing Consumer Duty implementation and that there is a clear process for monitoring outcomes.

Strengthen Data Collection and MI: Invest in robust management information systems that provide actionable insights into consumer outcomes. These systems should clearly identify areas of non-compliance, allowing you to take immediate corrective action.

Assess Vulnerability: Make sure that your policies and procedures are sensitive to the needs of vulnerable consumers. This includes having appropriate safeguards in place to ensure that they are not subject to poor outcomes or exploitation.

Improve Communication and Support: Focus on delivering clear, accessible communication that helps consumers understand your products and services. Review your customer support processes to ensure that they meet the diverse needs of your consumer base.

How BDO can help

At BDO, we have extensive experience supporting payments and e-money firms in navigating regulatory requirements and improving compliance. Our team has worked with firms of all sizes, helping them identify compliance gaps, implement effective strategies, and prepare for regulatory scrutiny.

If you are unsure whether your firm is fully compliant with the Consumer Duty or need guidance on improving your processes, we encourage you to get in touch with us. We can help you assess where your business may be falling short and provide tailored solutions to ensure you are meeting the FCA's high standards and delivering good outcomes for your customers.

Contact us today to discuss your Consumer Duty compliance strategy and take the next step toward securing long-term success for your business.

If you require support or would like to discuss this topics further, please contact:

luke.patterson@bdo.co.uk or zahra.ellahi@bdo.co.uk

Budget Reflections: Key takeaways for the payments sector

This article provides a detailed analysis of the latest Budget's tax announcements and their implications for businesses in the Payments and e-money sectors. It highlights the positive aspects, such as maintained reliefs and economic stability, as well as the challenges, including increased employment costs and changes to capital gains tax. The international context is considered, emphasising the UK's competitive position. Opportunities for businesses to optimise existing reliefs and plan for future changes are also discussed.

Ruari Doherty
Tax Director, Banking and Fintech

ruari.doherty@bdo.co.uk

The latest Budget has been significant from a tax perspective. As we approach the Spring Statement on 26 March and the new tax year on 6 April, it's worth reflecting on what the announcements mean for businesses in the Payment and e-money sector and their owners. Here's a breakdown of the key takeaways, challenges, and opportunities.

Positives for businesses

Investors, Shareholders, and Employees: The Budget maintained several key reliefs and incentives. The Seed Enterprise Investment Scheme (SEIS) and Enterprise Investment Scheme (EIS) reliefs were preserved, alongside the Enterprise Management Incentive (EMI), Company Share Option Plan (CSOP), Share Incentive Plan (SIP), and Save As You Earn (SAYE) schemes. Pension contributions remain NIC-free, despite speculation that this relief might be targeted.

Stability in Corporate Tax: The Corporate Tax Roadmap 2024 provides certainty for businesses. Key highlights include:

- **Corporation Tax:** The headline rate will be capped at 25%, with the Small Profits Rate and marginal relief unchanged for five years.
- **Full Expensing:** Full expensing of capital expenditure will continue, alongside the £1 million Annual Investment Allowance. The government will also consult on extending full expensing to assets bought for leasing.
- **R&D:** The merged R&D Expenditure Credit scheme and enhanced support for R&D-intensive SMEs will remain unchanged. The government has announced £20.4 billion in investment for UK R&D.
- **Innovation and Creative Reliefs:** The Patent Box regime and competitive Intangible Fixed Assets regimes will continue, as will audio-visual and video game expenditure credits.
- **International Tax:** The government remains committed to a territorial UK Corporation Tax regime, supported by exemptions for substantial shareholdings and dividends.
- **Advanced Certainty:** A new process will provide investors in major projects with increased advanced certainty, encouraging long-term investment.

Budget Reflections: Key takeaways for the payments sector

Impacts to businesses

Increased Employment Costs: From April 2025, employers' Class 1, 1A, and 1B NICs will rise by 1.2% to 15%. The threshold for employer NICs will drop from £9,100 to £5,000 per annum (frozen until 2028). Additionally, the National Minimum Wage has increased by between 6.7% and 17.9%, affecting businesses with younger or lower-paid workers.

Capital Gains Tax (CGT): From 30 October 2024, the main CGT rates increased to 18% for standard-rate taxpayers and 24% for higher-rate taxpayers (up from 10% and 20%, respectively). Business Asset Disposal Relief (BADR) and Investors' Relief (IR) will increase to 14% from 6 April 2025 and 18% from 6 April 2026. The £1 million lifetime limit for BADR remains unchanged.

Inheritance Tax (IHT): From 5 April 2026, the first £1 million of combined agricultural and business property will continue to receive 100% relief, with 50% relief on amounts above this threshold. However, business relief for unlisted shares, including AIM shares, will reduce to 50%, and the £1 million allowance will no longer apply to these shares. IHT relief on residual pension funds will be abolished from 6 April 2027.

Non-Dom Regime: The existing non-dom regime will be replaced with a residence-based test, introducing a four-year foreign income and gains regime and a ten-out-of-twenty-years residence rule for IHT on non-UK assets. This change also applies to UK doms who have been non-resident for more than 10 years, exempting them from IHT on non-UK assets.

R&D Restrictions: For accounting periods starting on or after 1 April 2024, new rules will make overseas R&D costs ineligible for R&D tax relief. Exceptions apply where work outside the UK is necessary due to geographical, environmental, social, or regulatory/legal requirements.

International Context

Revenue Generation: The Budget aims to raise £180 billion over the next five years, with c.68% (£122.3 billion) coming from the increase in employer NICs. Changes to IHT and CGT account for just 7% (£12.7 billion) and 5% (£8.9 billion), respectively. Businesses should prioritise mitigating the impact of increased employer NICs.

Global Comparison: The UK remains competitive among G20 nations, particularly for businesses in the Payments and e-money sector. The UK's infrastructure, culture, and trading links make it an attractive base for businesses and their owners.

Mobility Challenges: Relocating business activities is often more challenging than relocating personal residence. Access to top talent is critical for businesses in the sector and attempts to shift an existing talent base can cause significant disruption.

The Opportunities

Salary Sacrifice: With the rise in employer NICs, salary sacrifice arrangements for NIC and tax-efficient benefits, such as pensions, electric cars, and childcare vouchers, become more attractive.

Employment Status Review: While contract labour may seem appealing in light of increased NICs, HMRC is likely to focus on compliance in this area. Businesses using contractors, even through agencies or umbrella companies, should conduct a thorough review to avoid additional costs.

Innovation Incentives: The Patent Box regime offers an effective tax rate of 10% on profits from qualifying assets, making it an underutilised but valuable relief for innovative businesses. Additionally, businesses should reassess their R&D models in light of the new rules on overseas costs.

Exit Strategies: Selling a business to an Employee Ownership Trust remains a tax-free exit option, particularly relevant given the upcoming CGT rate increases and reductions in BADR.

Succession Planning: The impending IHT changes present an opportunity to revisit succession planning and potentially accelerate activities to mitigate future tax liabilities.

Budget Reflections: Key takeaways for the payments sector

Employee Equity Schemes: No changes were announced to the tax-advantaged employee equity schemes (EMI, CSOP, SIP, and SAYE), making them a valuable tool for incentivising and retaining key staff.

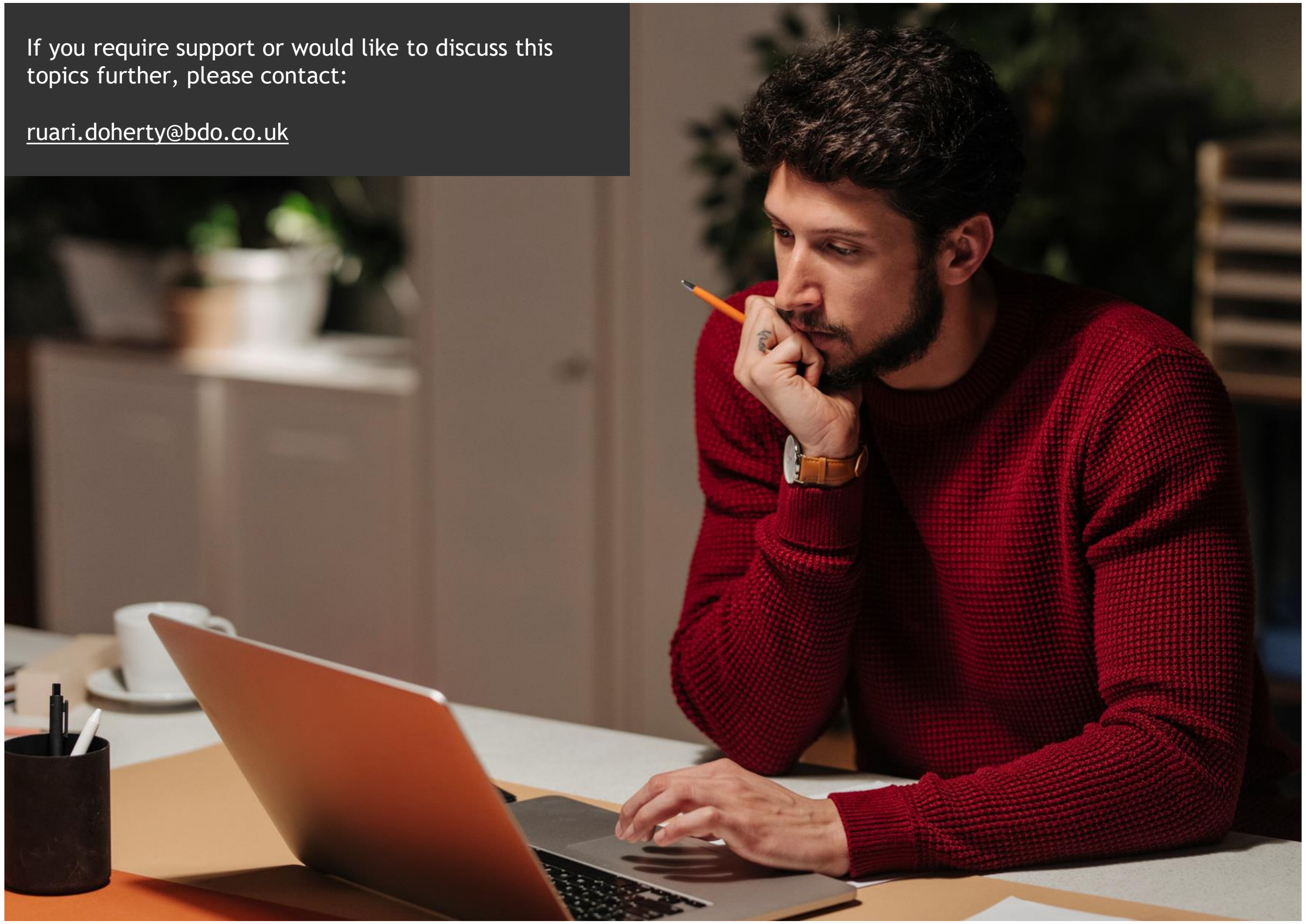
Non-Dom Repatriation Facility: Non-doms with unremitted income or gains realised before April 2025 can access a temporary repatriation facility, allowing them to bring funds into the UK at a reduced tax rate of 12% (between April 2025 and April 2027) or 15% (before April 2028). Those considering this option should seek advice promptly.

Considerations for the Board and Senior Management

While the Budget presents challenges, particularly around increased employment costs and changes to CGT and IHT, it also offers opportunities for businesses to optimise existing reliefs and incentives.

As the Spring Statement and new tax year approach, now is an ideal time to review strategies, explore tax-efficient arrangements, and plan for upcoming changes.

By taking proactive steps, businesses in the Payment and e-money sector can navigate the evolving tax landscape effectively.



If you require support or would like to discuss this topics further, please contact:

ruari.doherty@bdo.co.uk

Changes to the safeguarding regime and FCA safeguarding priorities

On 25 September 2024, the FCA issued its consultation paper (CP24/20) on the proposed rules to improve the safeguarding regime and ensure consumer money is safe. The consultation closed on 17 December 2024.

In addition, on 3 February 2025, the FCA further consolidated their focus on Safeguarding within the FCA priorities for payments portfolio firms.

It is expected that following the publication of the interim consultation response (H1 2025) firms will have a six-month implementation period before the interim rules are expected to be in place. As such firms should begin considering the structural changes needed for implementation in 2024 to ensure ability to meet the interim expectations.

Tiana Raviranjan
Director, FS Advisory

tiana.raviranjan@bdo.co.uk

Background
Payment institutions, e-money institutions and credit unions that issue e-money are required to protect funds received in connection with making a payment or in exchange for e-money issued (relevant funds). These requirements are there to protect consumers if a firm were to fail, and effective safeguarding processes and controls reduces, the risk of shortfalls in relevant funds, delays and difficulties in identifying consumer entitlements.

Current safeguarding requirements are set out in the Payment Services Regulations 2017 (PSRs) and E-Money Regulations 2011 (EMRs) and further detailed guidance issued in the FCA's Approach Document (November 2021) version 5, as well as various further publications such as Dear CEOs letters and the relatively more recent (March 2023) FCA Priorities for Payment Firms. Within the Consultation Paper, the FCA identified that there still remains "poor practice" across the industry and an increased number of supervisory matters related to safeguarding. The FCA have identified:

- An increasing number of supervisory cases relating to safeguarding issues- c15%
- For firms that became insolvent between Q1 2018 and Q2 2023, there was an average shortfall of 65% in funds owed to clients (i.e., the difference between the amount safeguarded and the amount owed to customers).

Within the FCA's priorities it is noted that within the last year, there have been improvements in some firms' financial resilience, though they still remain concerned that customer money may not always be safe if a payment firm fails. In addition, they highlighted 3 considerations:

- Appropriately identify which funds are relevant funds for the purposes of safeguarding. Including seeking advice if uncertain
- Ensure books and records and up to date and accessible, including undertaking reconciliations at least daily and notification if any material, adverse findings in your safeguarding audits
- When using the safeguarding insurance, considering potential changes in its availability and cost when assessing financial resilience.

Changes to the safeguarding regime and FCA safeguarding priorities

The FCA further highlighted that firms should be preparing for changes that need to be made following the consultation.

Within the Consultation Paper itself, the FCA have identified three main weakness they are looking to address in respect of the current safeguarding approach and to ensure consumer money is safe:

- Minimising shortfalls in safeguarded relevant funds
- Ensuring these funds are returned as cost-effectively and quickly as possible on insolvency
- Strengthening the FCA's ability to identify and intervene in firms that do not meet their safeguarding expectations to ensure these outcomes are met.

The below detailed consultation proposes two-fold changes:

1. Interim rules- to support greater compliance with existing requirements as set out in the PSRs/EMRs through supporting more consistent record keeping and enhanced reporting and monitoring to identify and correct shortfalls in relevant funds
2. End state rules- these will replace the existing safeguarding requirements of the EMRs and PSRs with a 'CASS' regime.

Timelines

The FCA proposes to give firms time between the rules being published and coming into force, so the necessary arrangements can be implemented:

- Six-month transition period to implement the changes in the interim rules for when the final version is published (expected H1 2025)
- An additional 12-month from the publication of the final-end state rules (with the FCA acknowledging more significant changes are likely needed for firm's to implement these).

Proposed rules will be set out in a new Chapter 15 of the Client Asset Sourcebook (CASS).

In the end state, the FCA propose to amend the rules in Chapter 15 of CASS which will replace the safeguarding requirements as set out in legislation (PSRs/EMRs), whilst also undertaking consequential amendments to the Approach Document to reflect the removal of Chapter 10. The proposals add new rules to the FCA's Supervision Manual (SUP) including new audit requirements for both reasonable and limited assurance engagements (SUP 3A) and the introduction of a new monthly regulatory return.

Considerations for the Board and Senior Management

The consultation paper outlines changes to safeguarding rules for firms, key items are summarised below:

Interim rules

- Improved books and records: Introduction of comprehensive rules to ensure firms carry out accurate and consistent (daily internal and external) reconciliations, this now include more detailed guidance on what should be included within the reconciliations. In addition, the introduction of a resolution pack
- Enhanced monitoring and reporting: Requirement to complete annual audits of compliance with safeguarding requirements (with the requirement for this to be completed by Firms able to be appointed Statutory Auditors) and the requirement to submit a new monthly safeguarding regulatory return; and
- Strengthening elements of the safeguarding regime: Additional requirements to consider the firm's approach to diversification and ensuring appropriate due diligence is undertaken on 3rd parties. Additional guidance on the use of an insurance/comparable guarantee and where firms invest relevant funds in secure, liquid assets.

Changes to the safeguarding regime and FCA safeguarding priorities

End State rules

- **Strengthening elements of the safeguarding regime:** More robust requirements on the segregation of relevant funds for both firms and agents/distributors and the use of template acknowledgement letters. This includes, relevant funds being received directly into a designated safeguarding account at an approved bank, with the exception of funds received through an acquirer or an account used to participate in a payment system.
- **Holding funds under a statutory trust:** Imposition of a statutory trust and additional details around the start and end point of the safeguarding obligation and unclaimed relevant funds.

Furthermore, on 5 December 2024, the FCA held a webinar where they delved further into the consultation paper, key takeaways from this included:

- The use of statutory auditors to undertake safeguarding audits, the FCA believe this will help raise standards across the market and acknowledged that this does not need to be the same firm that undertakes the financial statement audit. They also clarified that the proposed rules outline this occurs from the interim state rules coming into effect
- Investment permissions, the FCA clarified that they would expect firms to have investment permission to invest relevant funds unless an investment manager is appointed to carry this out on behalf of the firm
- Definition of a business day, the FCA clarified that if a firm is making/receiving payments on a weekend then processes and controls would need to be in place to manage this and any shortfalls and excess, although acknowledged that they would take away the nuisances and respond within the policy statement; and
- Appointment of a CASS/Safeguarding Officer, the FCA noted this was particularly important and an officer should be appointed to be responsible for a firm's safeguarding framework.

How BDO can help:

It is expected that following the publication of the interim consultation response (H1 2025) firms will have a six-month implementation period before the interim rules are expected to be in place. As such firms should begin considering the structural changes needed for implementation in 2024 to ensure ability to meet the interim expectations. Some ways we can support you with this are:

- Perform independent, annual required safeguarding audit, in line with expected scope
- Perform health check and GAP analysis against new requirements to ensure firms can quickly and clearly identify enhancements in the current safeguarding controls and process
- Support in remediation of deficiencies identified from annual safeguarding audits
- Provision of training on new rules and what they mean for you
- Assisting in support with the preparation of the resolution pack and monthly regulatory returns.

If you require support or would like to discuss this topics further, please contact:

tiana.raviranjan@bdo.co.uk

The FCA updates its Financial Crime Guide

In January 2025 the FCA published an updated version of it's Financial Crime Guide ("FCG") following a consultation which took place between April and June 2024. The changes aim to help firms better understand the FCA's expectations, assess the adequacy of their financial crime systems and controls and appropriately remediate any deficiencies identified.

Clarinda Woodford
Director, FS Advisory

clarinda.woodford@bdo.co.uk

The key changes are in the following areas:

- **Sanctions** – after Russia's invasion of Ukraine in 2022, the FCA conducted various assessments of firms' sanctions' systems and controls and has updated the FCG based on lessons learnt. We are updating the sanctions chapter to reflect lessons learnt.

- These include terminology clarifications, external reporting/FCA notification expectations, Customer Due Diligence ("CDD") good practice and clarifications around the scope of manual and automated sanctions screening

- Proliferation Financing ("PF") – following the explicit inclusion of PF in the UK Money Laundering Regulations ("MLRs") introduced in 2022, reference has now been made in the FCG throughout with respect to the expectations relating to PF especially in the context of PF Risk Assessments

- Transaction Monitoring ("TM") – guidance has been enhanced to support firms on how to implement and monitor effective TM systems, including the harnessing of technology through responsible innovation

- Consumer Duty ("CD") – since its enforcement across all products in July 2024, there has been a more outcomes-focused approach to consumer protection as well as explicit and high expectations for the standard of care that firms give retail customers. For those who service retail customers, the FCG has been updated to explicitly cross reference to CD requirements and excitations to help firms in balancing their CD obligations with financial crime obligations

- Clarification that Cryptoasset Businesses, which have been in scope for the MLRs since January 2020, are explicitly expected to refer to the FCG.

Firms should take action to undertake a gap analysis of their financial crime framework against the updated FCG guide to ensure that their frameworks are aligned to the updated standards. Firms should also take note of the 'good practice' and 'poor practice' examples contained within the FCG to ensure that they are implementing (or working towards implementing) the items considered to be 'good practice' and avoiding those considered to be 'poor practice'.

Considerations for the Board and Senior Management

In October and November 2024 respectively, the FCA fined Starling Bank and Metro Bank for financial crime failings. While these firms are both in the Banking sub-sector of the Financial Services industry, there are many lessons which can be learnt and translated into the Payments sub-sector.

The FCA updates its Financial Crime Guide

The key contributing factors to the Starling Bank fine, according to the FCA publication of it, were:

- Multiple breaches of an agreed FCA condition (VREQ) to not open accounts for high-risk customers
- Inappropriate usage of the firm's automated sanctions screening system.

The key contributing factors to the Metro Bank fine, according to the FCA publication of it, were:

- Inappropriate usage of the firm's AML transaction monitoring system.

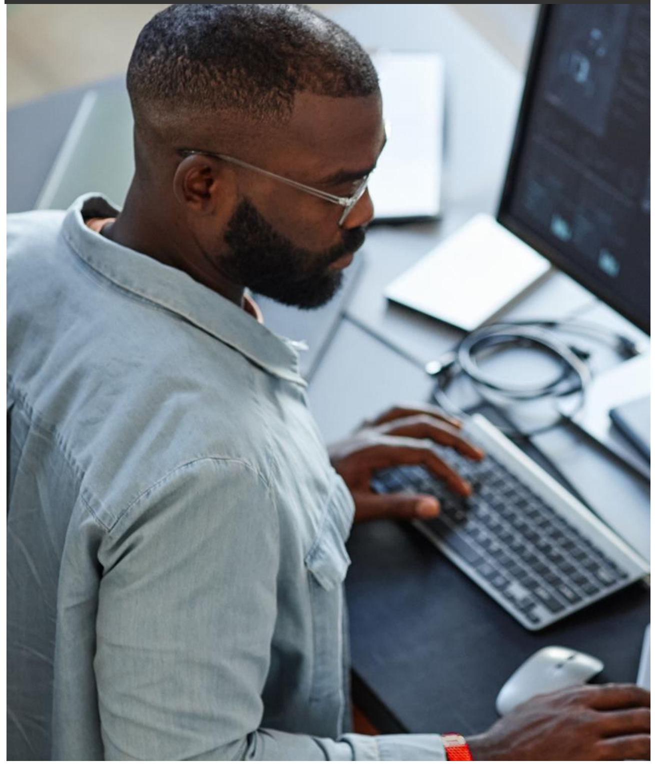
The FCA has also entered into VREQs of varying strictness with multiple Payment Service Providers ("PSPs") and Electronic Money Institutions ("EMIs") in the UK. According to the FCA Final Notice, a key factor which contributed to Starling failing to adequately monitor its compliance with the terms of the VREQ following its imposition was ineffective governance and oversight mechanisms. It is therefore vital that, if a PSP or EMI enters into a VREQ with the FCA, it deploys appropriate oversight over the monitoring of the firm's activities with respect to the VREQ to ensure that conditions are not breached.

With respect to screening and monitoring tools and technologies, in both the Starling Bank and Metro Bank examples the FCA Final Notices cite that the tools in questions were present/had been implemented but were not working effectively or as intended. This oversight led to risk exposures which were ultimately outside of the firms' (and FCA's) appetite.

It is therefore critical that PSPs and EMIs fully understand the design and operating effectiveness of their screening and monitoring tools and technologies and iteratively adapt these on an ongoing basis to continue to achieve the desired results.

If you require support or would like to discuss this topics further, please contact:

clarinda.woodford@bdo.co.uk



FOR MORE INFORMATION:

Paul Gilbert
Partner

+44 (0)7890 323 336
paul.gilbert@bdo.co.uk

Bruk Woldegabreil
Director

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

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