INTERNAL AUDIT SUPPORT

INVESTMENT AND WEALTH MANAGEMENT

June 2023

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BDO FS INTERNAL AUDIT CONTACT POINTS

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

Our FS Advisory Services team are working with more than 60 investment and wealth management firms, including platform providers and administrators, as internal auditors and advisors, giving us a broad perspective on the issues facing the sector. We have aggregated insights from our in-house research, client base, the Regulators and professional bodies, including the Chartered Institute of Internal Auditors (CIIA), to support your audit plans and activities.

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

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CONTENTS

01

2023 REGULATORY PRIORITIES

2023 REGULATORY PRIORITIES

FCA 'Dear CEO' letter to Asset Managers

REGULATOR	SECTOR RISK	FCA FOCUS
Product Governance	That the quality and value of product offerings, or the quality of communications with customers, do not deliver good outcomes for consumers or meet their needs, e.g., because the product carries excessive costs and charges, is not designed with the target audience in mind, or is distributed to the wrong type of investor.	FCA's expectation is that firms achieve the Consumer Duty requirements when they determine or have a material influence over retail customer outcomes. The regulator will follow-up on its 2021 Assessment of Value review findings and seek to identify outlier firms. It will also conduct another review in 2024 to assess the embeddedness of the Duty, with a focus on Price and Value.
Environmental, Social and Governance (ESG) and Sustainable Investing	Risks exist that some claims about ESG and sustainable investing are misleading or inaccurate. Inaccurate or misleading information June negatively impact the integrity of the UK financial disclosure regime and is likely to harm investment confidence.	The governance structures that oversee ESG and stewardship considerations, including whether firms deliver on the claims made in their communications with investors, and outlier firms that have been identified in previous supervisory activities or other ongoing surveillance. The regulator is keen to see that firms ensure their governance bodies are appropriately structured to oversee and review management information about product development, ESG and sustainability integration in investment processes, third-party and proprietary ESG information providers, and other ESG and sustainability claims made by authorised firms.
Product Liquidity Management	Open ended funds can have a liquidity mismatch between the terms at which investors can redeem and the time needed to liquidate fund assets to meet the redemption request. A variety of market and pricing shocks have caused liquidity issues for Liability Driven Investment portfolios, property funds, and money market funds. Firms have tools available to improve the quality of their liquidity risk management, but we have concerns that they June not always oversee them correctly or use them consistently.	The FCA is working with the Bank of England, and other regulators internationally, to strengthen resilience of money market funds, funds with significant liquidity mismatches, and transmission of risk from the non-bank financial sector to the wider market. The regulator is also in the process of completing a liquidity management multi-firm (thematic) review.

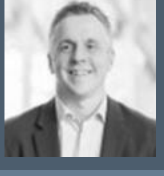
2023 REGULATORY PRIORITIES

FCA ‘Dear CEO’ letter to Asset Managers

REGULATOR	SECTOR RISK	FCA FOCUS
Investment in Operations and Resilience	Underinvestment in operations can lead to service disruption or failure, with consequential loss to investors and detriment to markets. Increased market volatility or stress June heighten the impact of disruption on consumer outcomes and market integrity. Poor investment in operations can hamper innovation, reduce efficiency and increase cost, and can result in service decline for investors. It June also result in business disruptions, or lead to vulnerabilities that can be exploited to control systems or inappropriately transfer information.	The FCA will complete a range of proactive programmes to monitor and test Asset Managers’ ability to meet operational resilience regulatory requirements. Firms June be selected for further regulatory review, including the FCA’s use of its cyber and operational resilience assessment tools, as well as intelligence-led penetration testing scheme (CBEST).
Financial Resilience	Disorderly firm failure has the potential to cause significant material detriment to consumers and markets.	The regulator will continue to assess firms' prudential health using internal and external data sources and, where necessary, will conduct targeted monitoring visits. Where firms are failing, or are likely to fail, the FCA will take appropriate actions to minimise the harm from failure. In H1 2023, the FCA aims to publish initial observations on firms’ implementation of the IFPR requirements, which should be considered by firms when reviewing and strengthening processes.

02

MEET THE TEAM



MICK CAMPBELL
Partner, Financial Services Advisory

MEET THE TEAM

Each month, we shed more light on our FS Internal Audit practitioners so that we can get to know the person behind the practice in 10 questions. This month, we get properly introduced to Mick Campbell.

1. What has been your career leading into BDO?

I joined a Big 4 firm in 2001 in its financial services (FS) risk advisory team and worked on a range of risk and regulatory related engagements across insurance firms, asset managers, retail banks and investment banks. After six years, I moved into another Big 4 firm to help establish and grow its FS risk advisory team within Scotland. During my 13 years with the firm, I led a wide variety of clients and engagements in Scotland, across the UK and internationally.

In 2019, I joined a prominent FS outsourced services firm to lead its second line of defence for its FCA-regulated entity. The switch from consulting to a role in industry enabled me to build on my experience and provided a broad range of exposure to operating at Executive and Board level, dealing with regulators and overseeing major transformation and re-platforming programmes.

I joined BDO in February 2023 to establish and lead our FS Advisory team and services in Scotland and support our strategic aims across the UK. I have really enjoyed my first four months at BDO, meeting people across the business and (re)connecting with clients and I'm looking forward to building the team and supporting our clients in Scotland and across the UK!

2. Describe your role in the FS Internal Audit team?

My role is varied, as I support growth of our FS Internal Audit and Advisory teams:

- I lead a portfolio of Internal Audit engagements, supporting clients in either outsourced or co-sourced internal audit across the FS sector;
- Developing our financial services risk management and regulation offerings, with a focus on enterprise risk management, risk governance and risk culture;
- Leading Skilled Person engagements, or supporting clients with preparations for Skilled Person reviews, where the focus is governance, risk management and / or regulatory compliance and effectiveness;
- Supporting BDO's internal Quality and Risk processes by acting as a sounding board for client take-on, due diligence, etc.;
- Working with other senior leaders in BDO to grow our insurance sector team and market offering.

I enjoy working with clients and supporting achievement of their strategic objectives. As advisers, it is essential we add value through our insight and experience to ensure client objectives are met, whether they be organisational or personal objectives for our stakeholders.

3. What's the most interesting thing you're working on right now?

Having recently joined BDO, my focus has been on meeting people across the UK firm and other international member firms to understand the wide range of experience and capabilities we have at BDO and I have been hugely impressed! I have been involved in number of interesting proposals recently, covering internal audit, third party assurance and governance effectiveness. One proposal related to supporting a client with enhancing their finance function operating model and associated processes. This involved working across several teams within BDO to ensure our team and approach was the best offering to the client.

4. Best thing about being part of the Internal Audit Team?

The best thing so far has been how welcoming everyone has been to me since I joined the firm. There is a strong culture of collaboration, and this has been demonstrated in everyone that I have met. The team has a wide and diverse range of backgrounds, experiences and technical capabilities and this helps us all work together and learn from each other. It also helps us to offer our clients a distinctive service and have some fun while doing so!

5. What drives you to do what you do?

Being part of a business that is growing, and having responsibility for contributing to that growth, is very motivational for me. My family also inspires me to keep improving and learning and this role enables that.

6. What's something that has surprised you about your Internal Audit career path?

My career path has not been a linear progression and there have been setbacks on the way. One thing that has surprised me is the importance of resilience as it has helped me to learn, grow and bounce back!

7. What's the best piece of professional advice you've ever received?

Be yourself.

8. How do you see internal audit changing over the next few years?

I think everyone is already thinking about how AI will impact business, what we do on a day-to-day basis across our lives, and internal audit is no different. Change is already happening and internal audit, along with other disciplines and the general way of doing business, will need to evolve rapidly to keep up.

My personal opinion is that I expect governments and regulators will be looking to seize the opportunities AI provides while also developing guidelines and regulation. The extent to which this can keep pace with the speed of AI development, and be applied effectively, remains to be seen.

9. What is your favourite thing to do when you're not working?

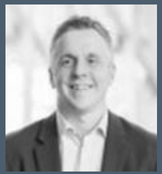
I like playing golf and watching football and most other sports. I enjoy running and try to get out before the working day starts.

10. If you were stranded on a desert island, what three items would you want to have with you?

Sunscreen, sunglasses and a jet ski!

03

TRANSFORMATION RISK AND COORDINATED ASSURANCE



MICK CAMPBELL
Partner, Financial Services Advisory

TRANSFORMATION RISK AND COORDINATED ASSURANCE

In this article, I build upon the insight from my colleague, Richard Weighell, regarding Transformation risks relevant for internal audit teams, published in September 2022, to share thoughts on the industry trends and experiences that I have gathered during my career. We will specifically discuss the two subjects which are common areas of challenge for financial services firms - and typically areas internal audit functions are requested to review:

1. **Transformation Risk; and**
2. **Three lines of defence model, specifically, how firms effectively allocate role and responsibilities across the three lines of defence to manage, monitor and review transformation risk.**

What is Transformation Risk?

Transformation risk is the risk associated with failure to deliver transformation activities in accordance with the budgeted time, cost and quality standards to the extent it may result in disruption to business operations, customer service, failure to meet strategic objectives, failure to meet the overall business case and may also result in reputational damage to the firm.

"Transformation" itself can be any activity for an organisation that is deemed material enough to transform, change, enhance and improve the current way of working. For example, this could be a customer services telephony system replacement and process engineering for a firm's customer contact centre, or it could be a major system replacement for an organisation who is seeking to replace legacy IT infrastructure to improve efficiency and enhance resilience of its operation. Materiality is typically defined by the organisation and is usually driven by cost, benefits to be derived from the programme and risk associated with delivery.

What are the roles and responsibilities of each of the three lines of defence?

Some organisations have found defining a structured, coordinated, approach to the oversight of programme risk can provide assurance to key stakeholders, such as Programme Steering Committees, Executive Committees and Boards, on the effective management of inherent risks to transformation programmes.

When defining detailed roles and responsibilities it is important to clarify and document the high-level responsibilities of each line of defence. For example:

TRANSFORMATION RISK AND COORDINATED ASSURANCE

1st line - Programme

- Maintain control and effective risk management across the programme through adoption of a consistent programme methodology and clear accountability for risk ownership and management;
- Perform self-review through continuous challenge, oversight and governance reporting of the programme risk profile. The approach should not be seen as an overhead, but an integral part of managing change and its related risks.

2nd line - Risk Function - Programme

- Define and document approach of the independent second line of defence activities across the programme;
- Split responsibilities by 'advisory' and 'assurance' activities. For example, advisory activities can include attending key working groups, decision fora, committees etc. to represent and contribute the second line of defence opinion. Assurance activities, can include performing thematic reviews as agreed with the Board, Exco and CRO with formal reporting output distinct from internal reviews;
- Compliance monitoring plan may include a review of transformation activities affecting, or likely to affect, the compliance risk universe.

3rd line - Internal Audit

- Define and deliver an internal audit plan over the transformation programme, approved by the Audit Committee;
- May include engaging with co-source partners for access to specific skill sets where appropriate.

Delivering effective and co-ordinated assurance over transformation programmes

Transformation programmes are inherently complex, costly and risky and they often fail to deliver within planned timescales, budgets or planned benefits. However, when they deliver, there can be benefits for customers in the form of a better service, for employees in the form of improved ways of working, as well as longer-term risk profile and financial benefits.

WHAT SHOULD INTERNAL AUDIT TEAMS THINK ABOUT?

IA teams should first consider the common obstacles to implementing effective and co-ordinated assurance activities across complex programmes of activity such as:

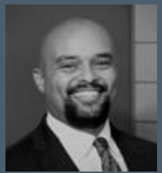
- **Assurance and oversight of the risk profile is seen as the job of the risk function and/or internal audit**: Programme budgets should ensure there is a proportion allocated to first line resource to support embedding of risk and control management within the programme. If this is absent, there will be additional cost to budgets and/or delays to delivery timelines as resources intended to support delivery may need to be reallocated to other activities to deliver effective programme risk management. There needs to be clear accountability for delivery of programme risk management for this to work.
- **Assurance providers do not co-ordinate activities resulting in multiple reviews targeting the same areas or missing key areas of risk due to lack of clarity of scope coverage**: It is essential assurance providers coordinate their plans and delivery activities to mitigate this risk. This can include stakeholders such as Programme Leadership, PMO, first line risk, second line risk and compliance, internal audit and external assurance providers meeting to share and agree planned activities, and then convening on a frequent basis to share key findings and recommendations from reviews. The stakeholder matrix can be complex across transformation programmes, it is, therefore, essential there is regular sharing and discussion of assurance activities and their output at formal governance meetings.
- **Reporting is extensive and stakeholders can feel overwhelmed with detail**: This is a common pitfall – as noted previously, these programmes can be complex, costly and risky. Subsequently, there can, on occasion, be a tendency for assurance providers to ensure their review passes the 'weight test', i.e., it is lengthy enough to justify the amount of time and budget spent on the review. Assurance providers need to ensure their findings and recommendations are provided in the context of the programme risk profile and actions are rated by priority and complexity as this will help stakeholders conclude where they need to focus attention to resolve issues.

04

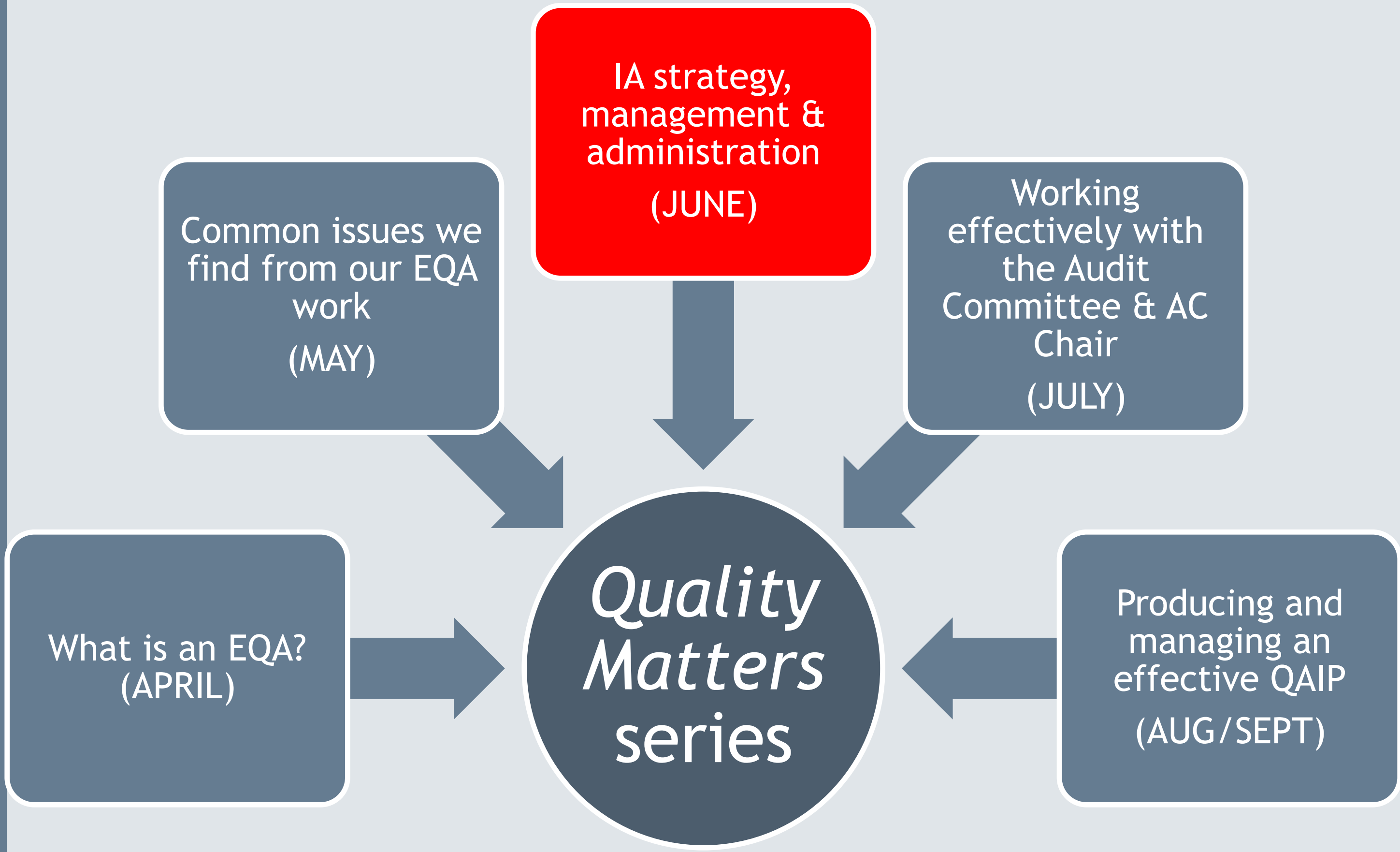
QUALITY MATTERS
PART 3

IA STRATEGY, MANAGEMENT & ADMINISTRATION

SAM PATEL
Partner



BRUK WOLDEGABREIL
Associate Director



QUALITY MATTERS – PART 3

IA strategy, management and administration

In our May pack, we explored the common challenges and issues we've observed from our External Quality Assessments (EQA), as well as our insights on matters arising from a general Internal Audit (IA) perspective and not linked to a specific aspect of the guidance or standards.

This month, we delve deeper into the IA strategy, management and administration findings we've typically picked up on from our EQA engagements.

While most IA functions have a sensible strategy and good working relationship with the first and second lines, as well as the statutory (external) auditors, there are often some simple good practices missing within strategy setting and the key administrative matters, such as demonstrating independence, that hold the IA team back from achieving its full potential.

STRATEGY AND VISION

In some IA functions we have worked with, the Head of Internal Audit (HoIA) has incorrectly interpreted the IA Charter as the IA function's strategy. The IA Charter is vital to enshrine the function's position in the firm and its authority to access the firm's records, personnel, and physical assets; but it is not a strategy document.

If we start from the CIIA's Technical Guidance for "Auditing Strategy", we can best understand "organisational strategy" as how the firm will want to move from where it is now to where it wants to be. Underpinning that strategy would be a set of clearly defined objectives to help move the firm to its aspired destination, which comprise the firm's:

- Mission - what the firm wants to achieve today;
- Vision - what the firm wants to achieve or become in the future; and
- Actions - what the firm will have to do to get there (firm objectives, targets, goals etc.).

The IA function's strategy needs to be a reflection of the firm's strategy so that priority risks are assured and organisational value is enhanced, best articulated as the IPPF's Mission of Internal Audit:

"To enhance and protect organisational value by providing risk-based and objective assurance, advice and insight."

The Mission should include the IA Charter (effectively, IA's badge of authority), the annual audit plan approved by the Audit Committee (AC), the IIA standards, guidance and FS Code with which to undertake internal audit work. So once an IA function is clear on its Mission, its needs an articulation of its Vision and the actions required to move the function to its aspired position.

Let's start with Vision for the IA function. The HoIA should have a good sense for where they would want their function to be by the end of this annual plan, by the end of the 36-month cycle and a broad idea of what the function could look like in five years' time. This is not about achieving the plan of audit reviews, rather this is a consideration of how the IA function needs to be fit now for future risks (and opportunities) and from our assessment work this should include IA's:

- **Purpose** – what will be the purpose of Internal Audit in the future? Increasingly, control functions in the second line are professionalising their assurance activities, goaded on by increased regulation and the growing expectations from senior management for cost functions to better demonstrate their "value add". This could potentially leave the IA function squeezed into a thin peripheral layer coating the various control reviews and testing undertaken by Compliance, Risk, Finance, Legal, etc. The HoIA needs to differentiate and define the IA function's purpose based on the uniquely objective and independent standpoint that it has relative to other teams and maintain this visibility on a continuous basis by drawing unparalleled insight from its assurance activities. **The IA's assurance activities should therefore be a means, not an end, for IA to add value into the firm**. Underpinning this meaningful purpose is the HoIA regularly and proactively speaking with the AC Chair, Board, senior management, and client-facing teams on what they would wish for from the IA function to help make the firm's clients happier and business teams more efficiently achieve the firm's objectives. We don't always see this in some IA functions, and this typically leads to IA being perceived as "siloed", bureaucratic, fading into the background and forgotten about when the firm's strategic discussions take place. Such views tend to come through in EQA surveys or interviews with senior managers about their perception of the IA function and its value to the firm;

QUALITY MATTERS – PART 3

IA strategy, management and administration

- **Technology** – we are living through a transformational period in which national governments are having to debate whether the full potential of artificial intelligence should be unleashed. For the Internal Audit function, if there is not now an active debate as to how newly released open access tools will impact day-to-day operations over the next five years, e.g., GPT 4 to deliver the majority of report writing, then the option to consider this development will soon be taken out of the HoIA's hands by the firm's own strategic realignment to incorporate deep learning technology. IA needs to at least document a SWOT analysis for how incoming technological advancements, including full digitalisation of the IA function, could impact IA operations. A lot of firms have already been developing power BI reporting – is this already a thing of the past?;
- **Resources** – thinking about the quantum and quality of technical skills the IA function will need over the next five years is difficult as it would be premised on the anticipated technology, purpose of the IA function and the business risks which the firm forecasts on the horizon that need to be assured by the IA function. There is no one-size fits all approach as Resourcing requires its own strategy, which we have covered extensively in our March Pack;
- **Quality Assurance** - an effective Quality Assurance and Improvement Programme (QAIP) today will support the IA function's internal growth as a value-accretive component of the firm's control environment. The evolution that the IA function should now consider is taking its specialist skill for self-assessing, monitoring and enhancing quality factors to proactively offer other teams across the wider firm the opportunity to learn from IA on how they can develop their own QAIP and, thereby, elevate IA's role as a "Quality Champion" for the whole firm (not just its own IA function). While the current practice is for IA to facilitate a department's Risk and Control Self-Assessment, the future will likely place IA's advanced skillset for quality assurance as an educational asset to coach business teams to most effectively work with the outputs they draw out from their technology-based continuous risk monitoring systems in the near future (they will soon arrive, if not already here in some larger or technology centric firms).

Documenting the IA function's strategy is likely to be more straightforward. The CIIA have provided Technical Guidance ("Writing an Internal Audit Strategy") so that IA functions can follow the procedural steps to help bring out the future fit considerations explored above; the most important of which being consultation with a wide variety of stakeholders to help incorporate the expectations of senior management, the Board and heads of business teams. You would be surprised at how many EQAs we've delivered whereby the HoIA hasn't asked their key stakeholders what they want from IA. Just because they say it, doesn't mean it has to be done – but at least expectations are then rationalised.

Once a coherent strategy is in place for the IA function, the IIA's Supplemental Guidance – "Developing the Internal Audit Strategic Plan" – is a helpful resource to consider the common triggers for a review of the IA function's strategic plan. The IA function's strategic plan should be a dynamic document if it's to achieve its intended purpose and, therefore, needs to be revisited frequently to align with:

- the firm's review of its strategic plan;
- significant impact on the IA's resourcing strategy (e.g., merger or business disposal);
- significant changes to the firm's applicable regulatory framework (you may remember the years of preparation for Brexit?);
- leadership changes at the Board level; and
- recommendations following an EQA.

QUALITY MATTERS - PART 3

IA strategy, management and administration

INDEPENDENCE

Independence is at the core of the IA function's mission and should be incorporated into the IA's regular administration activities. However, once independence requirements are documented in the IA Charter, we have found in some functions that independence typically receives a superficial review (if at all) on an annual basis and not much more is discussed about it thereafter.

Independence needs to be considered on an organisational basis for the function (AS 1110 – Organisational Independence) and for individual auditors (AS 1120 – Individual Objectivity); the issue we come across more often is that the independence of the HoIA and members of the IA function's senior management that have been with the firm for a considerable amount of time are not proactively examined for any perceived impairments to independence on a periodic basis or challenged on certain assurance engagements where reviews of an auditable entity are routinely carried out by the same auditor. The risks from an impairment to independence or objectivity do not generally leap out at a point in time; they tend to creep in slowly over time if left unchecked.

Our assessment work has consistently shown us that effective IA functions put sufficient efforts in place to proactively maintain independence, for example, through rotating cyclical audits across different team members so that the team's familiarity with a business area is mitigated. Well run functions also tend to document independence on a regular basis, either on a semi-annual basis to assess individual auditors for potential conflicts that crop up in the audit cycle (e.g., a work-based relationship between an IA colleague and a team member from a business team is recorded by HR), or more routinely by establishing an independence workbook for each engagement to collate independence attestations from each auditor to be involved in an assignment. The method to maintain and document independence will need to be proportionate to the size and complexity of the IA function, but it needs to be demonstrable to evidence that the independence and objectivity obligations of the function agreed to in the Charter are being adhered.

With respect to the organisational independence of IA functions in smaller firms, the central issue we have found is the IA team being drawn into first- and second-line activities. It's a difficult balancing act, but IA functions at the very edge of independence can only facilitate, not participate, in the activities for which they will need to assure. A helpful tool to demarcate IA's sphere of activities is an Assurance Map to articulate what each assurance provider is responsible for and where IA's specific input will be expected by the AC. We generally see some form of assurance planning between IA, second- and first-line teams, but it's not always documented in one place and, when it is documented, it's not routinely reassessed alongside changes to the IA strategic plan, annual audit plan, internal reorganisation of the firm or made sufficiently visible to senior management on a periodic basis.

We look forward to sharing the next instalment of our "Quality Matters" series in July where we explore ways of working effectively with the Audit Committee and its Chair based on insights gathered from our EQA and quality assurance work.

05

DIVERSITY AND INCLUSION (D&I) IN FINANCIAL SERVICES

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D&I IN FINANCIAL SERVICES

Since the killing of George Floyd in 2020, the global pandemic, Russia's war in Ukraine, the cost-of-living crisis, climate change (and everything in between), social agendas have dominated corporate conversations, keeping Audit and Risk Committees busy. According to Harvard Business Review, "fairness and equity will be the defining issues for organisations" and as pressure for accountability and transparency grows, coupled with increased supervision by Financial Services' Regulators (PRA and FCA), diversity and inclusion (D&I) has become a fundamental risk facing Financial Services firms. And as a result, Internal Audit teams have been called to arms – a point we covered in detail within our December 2022 pack.

In February 2023, the Chartered Institute of Internal Auditors (CIIA) published its updated technical guidance on Auditing Diversity and Inclusion, clearly articulating the important role Internal Audit teams play in advancing D&I in their organisations. More too, in its recent 2023 Risk in Focus report, which surveyed 834 Chief Audit Executives across Europe, the business case for D&I mounts, the CIIA reporting citing "human capital, diversity, and talent management" as the second highest risk ranked by Internal Audit leaders (after Cyber risk).

As a more common feature on 2023/24 Internal Audit plans, we are seeing D&I typically feature alongside broader culture, talent and ESG audits or increasingly, as standalone reviews driven helping Boards and Executives assess the design and effectiveness over governance arrangements, risk management over their D&I programmes and appropriateness of their D&I plans, in context of the Regulatory expectations.

The first is the FCA's Policy Statement (PS22/3), which marked the first requirement for in-scope firms (which are primarily UK listed firms) to formally report on D&I data within their annual financial reports. More too, in-scope firms are required to disclose in annual reports from financial years starting on 1 April 2022 if they meet the following benchmarks, on a comply or explain basis:

- At least 40% of the board are women.
- At least one of the senior board positions (Chair, Chief Executive Officer ("CEO"), Senior Independent Director ("SID") or Chief Financial Officer ("CFO")) is a woman.
- At least one member of the board is from a minority ethnic background (which is defined by reference to categories recommended by the Office for National Statistics ("ONS")) excluding those listed, by the ONS, as coming from a White ethnic background).

In February 2023, the latest Regulatory Initiatives Grid, framed as a cross-sector ESG priority, showed next steps for Diversity and Inclusion in FS, with an imminent consultation paper expected, followed by a Policy Statement towards the end of 2023.

In anticipation of this new D&I policy development, in April 2023, the Investment Association announced the launch of its inaugural Equity, Diversity & Inclusion Data Survey (responses due 7 June) which asks firms to complete 64 questions focusing on four key areas of diversity and inclusion:

- Monitoring Diversity.
- Demographics and Intersectionality.
- Interventions and Initiatives.
- Inclusion/Belonging.

The output of this survey is estimated to launch later in the year, at the Investment Association Culture conference. More details can be found here.

Fair to say, things are swiftly moving and the investment management industry is keeping pace.

D&I IN FINANCIAL SERVICES

At BDO, we continue to support our clients and financial services communities on their D&I journey. A practical way BDO has been supporting Internal Audit teams explore D&I risks with senior management is by running D&I short briefing sessions and half day workshops. We are also supporting Compliance and Internal Audit teams conduct and/or support D&I reviews (on an outsourced or co-sourced basis). Typical scope areas include governance, oversight and sponsorship arrangements of D&I strategy and plans, maturity and appropriateness of D&I plans, employee lifecycle from a D&I perspective, data disclosure and targets, reporting and MI.

We have also been working with Boards; providing D&I training on some of the newer diversity considerations and the link between D&I strategy and broader ESG materiality and risk assessments.

In April 2023, at an event for FS Non-Executive Directors, BDO explored three key diversity hot topics with the following industry trailblazers:

- Sophie Hulm, CEO of Progress Together, discussing social economic diversity across the financial services sector.
- Anna Lane, CEO of Women in Banking and Finance (WIBF), sharing WIBF and LSE's latest thought leadership 'Good Finance Framework' focused on retention and attraction of women in mid-senior leadership.
- Professor Charlotte Valeur, Founder of Board Apprentice, sharing practical solutions to increasing diversity on FS Boards.

There were a number of key themes, challenges and ideas discussed, including the following:

- The Financial Services industry has the highest class pay gap of all industries.
- D&I is not about changing people – it's about optimising processes (although changing of mindsets can also be required).
- The Chair of the Board is key to ensure D&I is on the Board agenda and holding Executives to account to ensure that progress continues to be made.
- Data collection should not only be quantitative. It is vital firms understand lived experiences of individuals and take these into account (which includes consideration of intersectionality and nuanced challenges).
- There is no ambition gap – just is an opportunity gap.

WHAT SHOULD INTERNAL AUDIT TEAMS THINK ABOUT?

From the perspective of the senior management team, it should not simply be about increasing representation and setting the diversity targets that Internal Audit teams will assess (although that is definitely a part of it). Regulators firmly believe that diversity of thought, driven by diversity of characteristics, experiences and backgrounds and inclusive healthy cultures, will drive market performance, promote competition, and protect consumers.

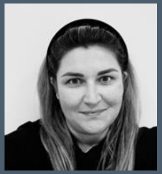
In December 2022, the FCA gave clear signals (Understanding approaches to D&I in financial services) that the financial services industry has work to do when it comes to diversity and inclusion. With this in mind, Internal Audit teams should consider the following key findings from the regulator's review to drive the planning of D&I assurance work:

- Most firms had not recognised D&I as a fundamental culture issue;
- Gender and ethnicity are receiving the primary focus and, for some firms, gender alone;
- In many cases, diversity is still being considered at a senior level and primarily for recruitment purposes, with a lack of focus for internal progression and career development paths;
- Many firms had an overreliance on D&I training, as opposed to other meaningful actions and D&I is often still seen as a Compliance 'tick-box' exercise;
- Some firms appeared publicly committed to D&I; however, strategy, embeddedness at all levels and adequate monitoring of success measures were found to be lacking.

For more information on how BDO can support your firm on its D&I journey, please speak to Sasha Molodtsov and Jennifer Cafferky.

06

ECONOMIC CRIME UPDATE



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ECONOMIC CRIME UPDATE

WHISTLEBLOWING - FCA SETS OUT STEPS TO IMPROVE WHISTLEBLOWER CONFIDENCE

The FCA has recently published its commitment to improve the confidence of whistleblowers. The FCA recognises the importance whistleblowing disclosures play in providing the FCA with unique insights into the firms and markets that it regulates. Between April 2021 and March 2022, the FCA received 1,041 whistleblowing disclosures, which led to:

- significant action to manage harm in three cases which may include enforcement action, a Skilled Person review, or restricting a firm's or individual's permissions;
- action to reduce harm in 96 cases which may include writing to or visiting a firm, asking it for more information, or asking it to attest to complying rules; and
- 99 cases informing the FCA's work including harm prevention, but with no direct action.

In January 2022, the FCA contacted firms who had engaged with the Whistleblowing team to take part in a qualitative assessment survey to understand how whistleblowers had found their interactions with the Whistleblowing team. Of the 68 participants invited, 21 completed the survey. The survey consisted of 25 questions, which focused on the FCA's key contact points, and, overall, the results have provided some key insights on how the FCA's whistleblowing arrangements have been perceived. Of the 21 respondents:

- 13 answered that the reason for reporting to the FCA was because the respondent had made an internal compliant that was ignored;
- 12 were dissatisfied with the FCA Whistleblowing team in relation to listening;
- 15 were dissatisfied with the FCA Whistleblowing team in relation to exploring the issues reported. In particular, a number of the respondents did not feel that there had been enough dialogue with them to ensure that their concerns had been understood.
- 15 were dissatisfied with the FCA's handling of their whistleblowing report.
- As part of the reporting process to the FCA, a respondent can choose to be kept informed of the outcome of the review of the disclosure by the Whistleblowing team. 17 of the respondents surveyed elected to be kept informed, of which 10 answered that they did not find the Whistleblowing team's progress updates to be sufficiently reassuring. Respondents felt that the updates provided 'lacked substance', 'no real information was given' and 'didn't say if the FCA was investigating or not'.
- 8 of the 9 respondents who had received final feedback were dissatisfied with the outcome that they had received. Some respondents said that they did not understand how the FCA had used their information. Some respondents felt that their concerns had been 'brushed aside', and some felt that there were 'no real consequences' for wrongdoers.

ECONOMIC CRIME UPDATE

Overall, the FCA have said that they are disappointed with the level of dissatisfaction expressed by many of the respondents. The FCA will look to improve the feedback provided to whistleblowers when they are provided with conclusive communications. Feedback from the regulator will also include the measures taken, the rationale for those measures, as well as the reasons behind no action being taken on the basis of the whistleblowing report to ensure the outcome is as clear as possible.

What should internal audit teams think about?

Whistleblowing disclosures from firms remain an important regulatory tool for the FCA and we expect there to be continued focus on the systems and controls firms have in place to enable employees to make an internal disclosure through a firm's Whistleblowing process, as well as the FCA.

SYSC 18.3.1 requires firms to establish, implement and maintain appropriate and effective arrangements for the disclosure of reportable concerns by whistleblowers.

With this in mind, Internal Audit teams should evaluate the firm's Whistleblowing framework to ensure that arrangements :

- are capable of handling disclosures where the whistleblower has requested confidentiality or has chosen not to reveal their identity.
- allow for disclosures to be made through a range of communication methods.
- support the effective assessment and escalation concerns, where appropriate, including to the FCA or PRA.
- Include a mechanism to provide feedback to a whistleblower, where this is feasible and appropriate.

When planning assurance work for the firm's management of Conduct Risk, it is recommended that IA teams consider including a review of the whistleblowing arrangements to ensure that there is a clearly documented framework in place and all employees are aware of the process, should they have a concern.

UK FRAUD STRATEGY

On 3 May 2023, the UK government published its long-awaited Fraud Strategy, with the aim of reducing fraud and cybercrime by 10% by 2025. Delivery of this strategy is to be phased over a 3-year programme of work to the end of 2025, which will be led and governed by the Home Office.

The key measures to be introduced include:

- establishing a new National Fraud Squad with over 400 new posts and making fraud a priority for the police through the Strategic Policing Requirement.
- deploying the UK intelligence community and leading a new global partnership to pursue fraudsters, wherever they are in the world.
- replacing Action Fraud with a new state of the art system for victims to report fraud and cybercrime.
- banning cold calls on all financial products so fraudsters cannot dupe people into buying fake investments.
- enabling payment service providers to adopt a new risk-based approach to provide additional time for potentially fraudulent payments to be investigated.
- legislating to enable the Payment Systems Regulator ("PSR") to require reimbursement of all authorised fraud victims by all PSR-regulated payment service providers.
- requiring the FCA to undertake assessments of the fraud systems and controls within financial services firms.
- working with industry to make sure that intelligence is shared quickly with law enforcement.
- overhauling and streamlining fraud communications so that people know how to protect themselves from fraud and how to report it.
- making the tech sector put in place extra protections for its customers, via the Online Safety Bill and an Online Fraud Charter and introducing tough penalties for those firms that do not.

What should internal audit teams think about?

Assurance over fraud risk management needs the internal audit team to ensure:

- that the business-wide risk assessment sufficiently considers the fraud risks associated with the business model.
- a review of the fraud risk controls is on the plan and that the assessment is in line with the exposure fraud risks. Where any weaknesses are identified, a remediation plan should be put in place to address these.
- there is a clear message and top-level commitment from the senior management regarding the firm's fraud prevention agenda.
- there is a robust Fraud Response Plan in place and that it is periodically assessed in order to ensure that it remains up-to-date and appropriate.
- that annual training plans include fraud awareness/prevention training which incorporate the latest known regulatory guidance and industry good practice.

FOR MORE INFORMATION:

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