

A woman with short brown hair, wearing a red button-down shirt, is shown from the chest up. She is looking upwards and to the right with a thoughtful expression, holding a pair of thin-rimmed glasses in her right hand, which is resting on her chin. She is wearing a gold ring on her right ring finger and small gold hoop earrings. The background is dark grey. On the left side of the image, there are two vertical red bars: one at the top and one at the bottom, both slanted to the right.

INTERNAL AUDIT SUPPORT

# INVESTMENT AND WEALTH MANAGEMENT

September 2023

IDEAS | PEOPLE | TRUST

**IBDO**



# BDO FS INTERNAL AUDIT CONTACT POINTS

We hope you had a very enjoyable summer! Welcome to the Planning edition of our monthly packs. In this issue, we explore the sector's Hot Topics to be considered for the 2024 plan and revisit some of the regulatory priorities we've covered, such as Operational Resilience, to help Internal Audit teams appropriately address risks in their annual planning process.

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

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

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



**LEIGH TREACY**  
Partner

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



**RICHARD WEIGHELL**  
Partner

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



**CHRIS BELLAIRS**  
Partner

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



**BRUK WOLDEGABREIL**  
Associate Director

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



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# 01

## MEET THE TEAM



**LEIGH TREACY**  
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 Leigh Treacy.

### 1. What has been your career leading into BDO?

After completing my university degree and qualifying as a Chartered Accountant, I joined KPMG in South Africa to complete my training contract, having worked for the firm over a number of years during my university holidays which gave me a great insight into professional services and the work I would be doing for the next three years and beyond.

I was absorbed into the world of banking and financial services, undertaking mostly external audit but also had some significant internal audit clients and special projects which gave me a view about solving client problems which was interesting and rewarding. I became a partner at KPMG in Johannesburg in 2006 and worked on large global accounts, which provided an international view in the lead up to the global financial crisis.

In 2010, I reached a point in my career where I was ready to make a change and moved to the UK where I joined Mazars as a partner and was involved in leading work on governance and culture in the Irish banking sector post-crisis which was fascinating and gave me a real flavour of advisory and consulting work.

I was approached to join BDO in 2014 to help build out the banking practice and took over the leadership of FS Advisory a couple of years later. The opportunity the firm offered me has been brilliant and has provided a great platform for me personally and for our business. I am now a member of the Advisory Executive which provides oversight and leadership of the One Advisory strategy across BDO, with responsibility for growing the FS business and executing our growth and investment plans, which are exciting.

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

I act as outsourced head of internal audit for some of

our largest banking internal audit engagements as well as a large wealth and asset manager, amongst others. I also lead a number of co-sourced engagements. I work closely with audit committees and executives to help them solve business, risk and governance related issues. Quality delivery and introducing the right BDO teams to our clients is key for me - for us to be trusted business partners.

Beyond IA, I act as Skilled Person on a range of S166s and as QA partner, particularly in the risk, governance and prudential arenas, and also provide advice on risk and governance related matters.

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

I am in the process of refreshing the FS Advisory strategy, growth and investment plans and looking ahead to the next five years. Our multidisciplinary practice is hugely interesting with significant growth potential and thinking about how market changes, technology and regulatory influences keeps me on my toes. Key for me is ensuring we are thinking ahead, making sure we have the right people to deliver what our clients need - now and in the future - recruiting and retaining the best people to help us deliver. People are at the heart of our business and helping them develop their careers at BDO, and within FS Advisory in particular, is very close to my heart.

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

We have a great business and great people and continuing to build on the work we do is rewarding. We have a great reputation and I am proud of that.

### 5. What drives you to do what you do?

I am a driven person, and that means for me that I am focused on leading a successful part of the BDO business and supporting my partners and teams to achieve personal success - whatever that looks like for each of them. The BDO strapline - 'helping you succeed' - resonates with me, both for our people and our clients.

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

Each day in professional services is different, and that really is the beauty and attraction of it. There is simply no opportunity to stand still or be bored! I look back sometimes and reflect on the last 25 or so years and the variety and range of interesting work and people I have dealt with really has added colour to my career and professional and personal experience and learning. It continues to be a brilliant journey.

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

Always be sure to understand the facts, prepare thoroughly and work hard and the results will follow. Your reputation is everything, and is built on the quality of work you deliver and the professional relationships you build.

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

Data analytics and technology are developing at pace, as well as other AI related tools. We need to understand these and adapt our methodologies to leverage the efficiencies they bring as well as the ability to benchmark and draw insights. These developments offer us the opportunity to add even greater insights for our clients.

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

If I was to choose three things, they would probably be gardening, cooking and travel. I have four grown up stepchildren and three grandsons (with another on the way) so keeping in touch with them is often a weekend highlight.

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

A means of escape! My husband, Tony, who is very practical and prepared for anything, a powerful boat and a good tent.

# 02

## AUDIT PLANNING

### HOT TOPICS TO BE CONSIDERED FOR THE 2024 PLAN



**KARUNA BHANDERI**  
Director







# AUDIT PLANNING

## Hot Topics to be considered for the 2024 plan

Topic	Overview	Drivers	Indicative Scope Areas
Consumer Duty - Post-Implementation	Assessment of firm's advisory activities with clear understanding of clients' preferences to ensure that the advice given, and products offered are aligned with clients' expectations.	Significant shift in Consumer Duty expectation by FCA. The Duty comes into force on 31 July 2023 for new and existing products or services that are open to sale or renewal (31 July 2024 for closed products or services). Firms need to ensure compliance with Consumer Duty aspects such as robust onboarding process to create an in-depth client profile as well as reliable data on products for achieving clients' objectives. Importantly, this data must be readily available for the purpose of demonstrating compliance with the regulation.	<ul style="list-style-type: none"> <li>Assess firm's process to maintain in-depth client profile, including preferences, products and services offered at onboarding and ongoing basis.</li> <li>Assess process of clear and timely client communication.,</li> <li>Assess adequacy of client support and personalised service based on client profiles, including ability to demonstrate fair value.</li> <li>Assess process to identify where and why a client may not be receiving a good or desired service, and proactively address any risks or issues identified during this process.</li> </ul>
Product Governance	Assessment of the design and operating effectiveness of the product governance framework and arrangements in place to meet regulatory requirements.	Product governance continues to be subject to regulatory focus and other regulatory changes incl. Consumer Duty and ESG rely on a solid Product Governance framework.	<p>Assessment of the overall product life cycle with a specific focus on:</p> <ul style="list-style-type: none"> <li>On-going product performance monitoring and due diligence</li> <li>Depth of product monitoring and MI</li> <li>Product change management process</li> <li>Quality of the product risk assessment incl. consideration of the Consumer Duty and ESG matters</li> </ul>
Operational Resilience	Assessment of a firms operational resilience framework to prevent, adapt, respond to and recover from operational disruption	By the 31 March 2025, firms must be able to evidence they can remain within the impact tolerances for each of their important business services. A review in Q4 2024 would give sufficient time to assess readiness and time to meet any findings before the deadline.	<p>Key audit areas to be assessed are;</p> <ul style="list-style-type: none"> <li>Approach / Methodology</li> <li>Self-Assessment including: <ul style="list-style-type: none"> <li>Important Business Services</li> <li>Mapping (People / Processes / Technology etc.)</li> <li>Impact Tolerances</li> <li>Scenario Testing</li> </ul> </li> <li>Policies &amp; Procedures</li> <li>Governance Arrangements including SMCR implication e.g. SMF24 oversight &amp; responsibility.</li> </ul>



# AUDIT PLANNING

## Hot Topics to be considered for the 2024 plan

Topic	Overview	Drivers	Indicative Scope Areas
Suitability	Assessment of suitability and appropriateness of the process in accordance with FCA COBS rules for firms who provide Investment and Financial Planning Advice.	Continued risk of unsuitable advice to clients particularly relevant considering the Consumer Duty and cost of living crisis.	<p>Key scope areas for considerations are:</p> <ul style="list-style-type: none"> <li>• Assessment of client's preferences and objective</li> <li>• Assessment to ensure and able to demonstrate fair value to client.</li> <li>• Assess process to ensure transparency of advice given to clients and that the clients understand associated risks and be able to afford potential losses.</li> <li>• Assessment of product information provided to clients, including details on its target and negative target markets in order to ensure suitability of clients in the target market.</li> <li>• Assessment of process to monitor suitability of advice on an ongoing basis.</li> </ul>
ESG	Assessment of the plan / strategy developed by Management in relation to identifying & developing investment products under an ESG lens	Increased consumer, market and regulatory focus, awareness and scrutiny on ESG matters.	<ul style="list-style-type: none"> <li>• Assess ESG framework in place and that firm's vision, values and strategy is aligned.</li> <li>• Assess adequacy of ESG reporting including environmental, social, and governance aspects of a business. Social to include D, E &amp; I.</li> <li>• Assess whether investments are in line with clients' ESG expectations and industry benchmark.</li> <li>• Review firm's assessment of ESG related risks and KPIs.</li> <li>• Assess adherence to ESG regulations and related reporting requirements, such as FCA's Task Force on Climate-related Financial Disclosures (TCFD), Companies Act 2006, Modern Slavery Act 2015 and Equality Act 2010.</li> </ul>
Outsourcing	Assessment of the controls in place to manage the risks associated with outsourcing activities particularly for those considered 'critical' in accordance with regulatory requirements.	Continued scrutiny in light of operational resilience requirements, PRA Supervisory Statements and letters to firms.	<ul style="list-style-type: none"> <li>• Assess the end-to-end outsourcing / vendor management process</li> <li>• Gap Analysis / Evaluation of framework vs regulatory requirements</li> </ul>





# AUDIT PLANNING

## Hot Topics to be considered for the 2024 plan

Topic	Overview	Drivers	Indicative Scope Areas
Mergers, Acquisitions & Integration	Design and effectiveness assessment of the key controls in place to support acquisition & integration activity.	Over the past 12-18 months we have seen an increase in M&A activity within this market sector and there continues to be appetite for organic growth based on Mgmt. conversations held.	<b>Pre-Acquisition:</b> Review of the Target Operating Model, Governance arrangements incl: prioritisation of opportunities, completeness and accuracy of due diligence activity, quality of MI <b>Integration:</b> Programme management to monitor completeness of integration activity into BAU. Governance arrangements post integration to monitor performance inc. contractual agreements & setting of metrics.
CASS	Adherence to applicable client money regulations to ensure that a firm can adequately protect its clients' custody assets / money when providing regulated business on behalf of their clients and can ensure that custody assets / money can be swiftly returned to clients if the firm fails and/or exits the market.	Observed an increase in CASS breaches across the client portfolios	<ul style="list-style-type: none"> <li>CASS Control Effectiveness (CORF) [Key rules and mapping]</li> <li>Governance Arrangements and Quality of MI</li> <li>CASS Breaches Process: identification, logging, and remediation of CASS breaches. Can consider data analytics to assess compliance with the policy and comparison to industry practice e.g. end to end timeframe till closure.</li> </ul>
Financial Resilience (IFPR / ICARA)	Adherence to FCA's requirement under Investment Firms Prudential Regime (IFPR), wherein firms must hold sufficient financial resources to support on-going activities and wind-down in an orderly manner, as required by the Overall Financial Adequacy Rule (OFAR). Including firm's Internal Capital Adequacy and Risk Assessment (ICARA) process to check whether it complies with the OFAR.	Heightened expectation on data quality and the accuracy of regulatory reporting continues to be a focus area for the regulator. Further, senior management is expected to be able to provide regulator a clear and consistent overview that demonstrates how business activities and performance deliver both internal and regulatory objectives.	<ul style="list-style-type: none"> <li>Assess quality and accuracy of IFPR / ICARA reporting.</li> <li>Assess senior management understanding of IFPR/ICARA processes and regulatory expectations.</li> <li>Assess adequacy of risk oversight and adherence to IFPR/ICARA requirements, including stress testing, Early Warning Indicators (EWIs), Key Risk indicators (KRIs), appetite framework arrangements, monitoring and firms' approach to wind-down planning and assessment.</li> </ul>
Transaction Reporting	Adherence to regulatory requirements under FCA's UK MiFIR that firms must report accurate and complete transaction report in timely manner.	FCA's focus on use of transaction reports to detect and investigate suspected market abuse.	<ul style="list-style-type: none"> <li>Assess adequacy of transaction reporting process, including accuracy, completeness and timeliness of transaction reporting.</li> <li>Assess effectiveness of Approved Reporting Mechanism (ARM) if the firm is using a third party for transaction reporting.</li> </ul>

# 03

## QUALITY MATTERS

### PART 5

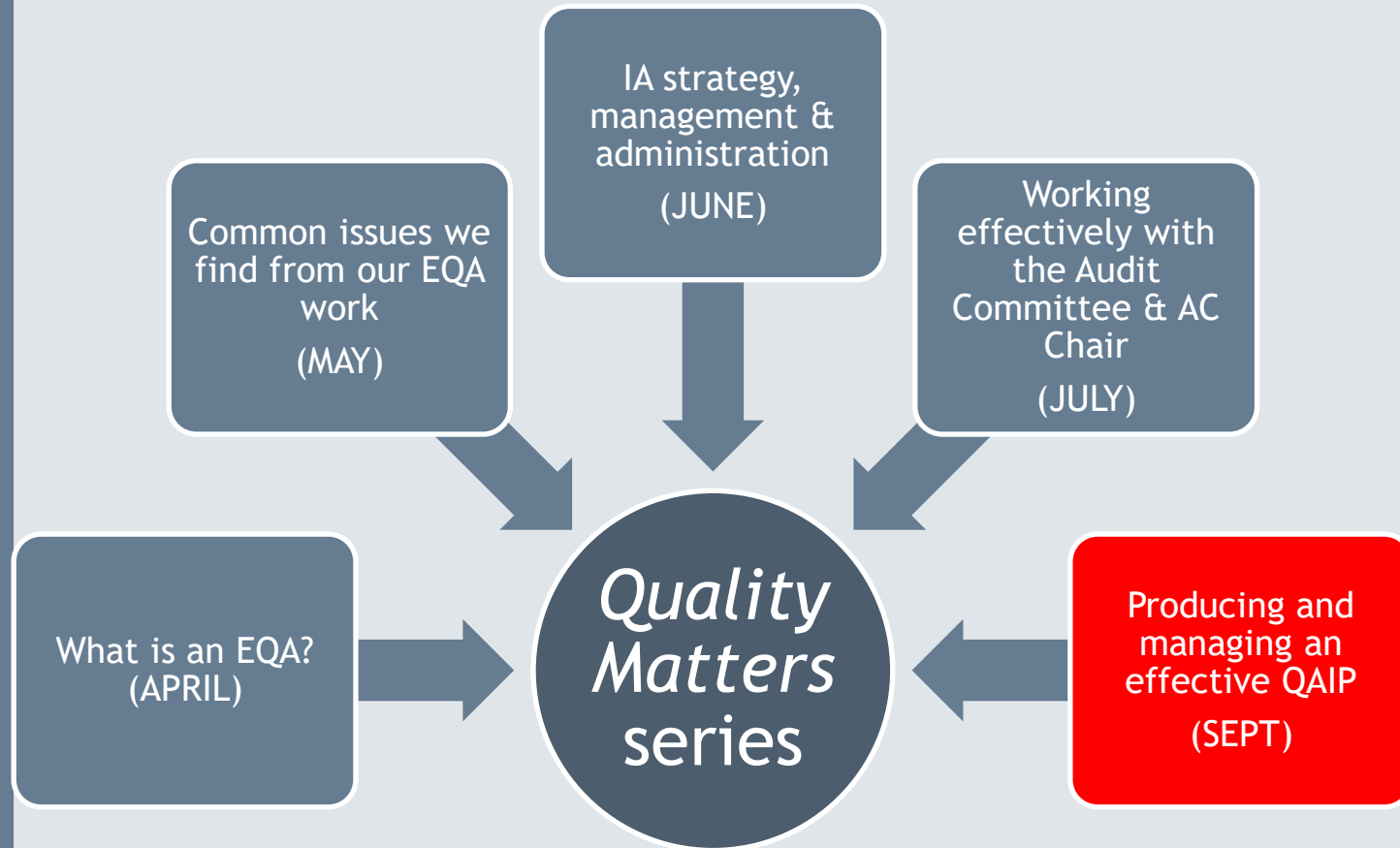
#### PRODUCING AND MANAGING AN EFFECTIVE QAIP



SAM PATEL  
Partner



BRUK WOLDEGABREIL  
Associate Director







# QUALITY MATTERS - PART 5

## Producing and managing an effective QAIP

In our [July](#) pack, we explored the dynamic relationship between the Head of Internal Audit (HoIA) and Audit Committee (AC), especially the AC Chair, that we've typically picked up on from our EQA engagements.

This month, we explore good practices for producing and managing a Quality Assurance and Improvement Programme (QAIP) based on insights gathered from our EQA and quality assurance work.

In essence, the QAIP is a programme of activities designed to evaluate the IA activity's conformance with the Standards, the Definition of Internal Auditing and how individual auditors apply the Code of Ethics. Aside from conformance measures, the QAIP also assesses the effectiveness and efficiency of the IA activity (i.e., is it landing the IA strategic objectives as much as delivering the plan) and identifies opportunities for continuous improvement.

### BREAKING A QAIP INTO ITS KEY COMPONENTS AND GETTING THE TOOLS READY

As a refresher, the Head of Internal Audit:

**"...must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity"** (AS 1300 - emphasis added).

To better understand the scope and scale of activities expected within such a programme, we should unpack the key components of this Standard as follows:

- ▶ Development;
- ▶ Maintenance;
- ▶ Its applicability to all aspects of the activity.

Before we explore each of these aspects in greater detail, further below, we should first identify all the relevant sources of information and tools to appropriately prepare a HoIA before a QAIP is produced.

#### Must have (mandatory)

The "mandatory" elements of the International Professional Practices Framework (IPPF) which includes the IIA's:

- ▶ Standards;
- ▶ Code of Ethics;
- ▶ Core Principles (can you remember all 10 of them?); and
- ▶ Definition of Internal Auditing.

For UK financial services firms, there are additional requirements from the CIIA's FS Code (specifically Part G) which adds further guidance on the QAIP to drive an effective Internal Audit activity.

#### Should have (recommended)

Outside of the mandatory elements, there is the IIA's:

- ▶ Implementation guidance for Attribute Standards 1300, 1310, 1311, 1312, 1320, 1321 and 1322;
- ▶ Supplemental guidance; and
- ▶ Practice Guides - there are quite a few. Some may appear a bit dated, but you'll see from review that the key principles for auditing today have stood the test of time. Below are a couple that should be prioritised for recommended reading:
  - "Quality Assurance and Improvement Program" (US spelling for a US title)
  - "Assisting Small Internal Audit Activities in Implementing the International Standards for the Professional Practice of Internal Auditing" (very useful advice for applying proportionate conformance to Standards for small IA functions- more on this below)



# QUALITY MATTERS - PART 5

## Producing and managing an effective QAIP

### Could have (going all in for best in market practice)

The IIA also has a Quality Assurance manual based on the current 2017 Standards. It is comprehensive, at nearly 400 pages, with recommended process flows, roadmaps, templates etc as well as the mandatory elements, noted above.

Whether a HoIA feels they need this manual should first assess the complexity and scale of their IA activity to ensure a proportionate approach is applied. In most small to medium sized IA functions, there is a significant challenge in getting the basic (mandatory) elements of the QAIP in place due to limited staff, resources and time available just to deliver the audit plan.

This article will focus principally on the mandatory components and some of the good practices noted from our work with clients on EQAs that we can reference within IIA guidance.

### DEVELOPMENT OF THE QAIP

The QAIP should include:

- ▶ **Ongoing monitoring** - day-to-day supervision and review of auditing activity at the engagement level, i.e., planning, fieldwork and reporting follow established policies and procedures (which themselves conform to the Standards);
- ▶ **Periodic self-assessment** - which can either be an in-house self-assessment or a self-assessment with independent validation, which would include an independent third party to help facilitate an effective self-assessment. The benefit of an independent third party is that it can apply the objectivity and independence that comes with a fresh pair of eyes on the IA activity's self-assessment and, dependent on the experience of the QA provider, an opportunity to benchmark expectations against comparable functions elsewhere;
- ▶ **External Assessment** - principally EQAs, but could also encompass a variety of outsourced QA support, such as ongoing sample and review of audit files to the IA activity's quality expectations. This could be hugely beneficial for small IA teams, e.g., less than 5 staff members, that need a proportionate QA of files but are stretched to prioritise delivery of the plan. Outsourced assessors can also facilitate knowledge transfer through post-QA training to staff which can incorporate the good practices gathered from other IA functions the assessor has worked with.

- ▶ **Continuous Improvement of the QAIP** - which is the feedback loop to incorporate the findings, recommendations and follow-up activities from QA work back into the programme, thereby evolving the management of quality over time (much like a turbo charger injecting exhaust back into the car engine to increase power).

The HoIA will need to develop the programme, and reporting of its outputs to the AC, in line with scale and complexity of the IA activity and budget. As we've explored in previous editions of this monthly update, where resources are limited in delivering the audit plan these limitations (including the resources required for a proportionate QAIP) must be communicated to the AC as soon as practicable.

There would be no point in delivering an audit plan only to find that there were little to no safeguards in place to assure the quality of the function's operations and outputs.

### MAINTENANCE OF THE QAIP

While aspects of the programme can and, in most cases, should be outsourced to experienced QA providers, the maintenance of the QAIP sits squarely with the in-house HoIA and (ideally) their successor in waiting.

From our EQA experience, an IA activity that has developed an effective QAIP is generally maintaining it with some external expertise and a deputy / successor to the HoIA being delegated to lead its operation, especially supporting the HoIA in driving the continuous improvement activities and appropriately evolving the IA strategy. For the HoIA, this would have two clear benefits:

- ▶ Empowers a deputy/successor keen to take on more responsibility, receive senior coaching and development from the HoIA and develop the technical expertise to support their case for taking on the HoIA role if the opportunity arises;
- ▶ Provides the HoIA capacity to take a 50,000ft view of the programme and reflect strategically on what the QAIP assessment outputs are telling him/her about their function, i.e., is it effective, efficient, adding value above and beyond audit reports, is meeting the expectations of senior management and the Board?





# QUALITY MATTERS - PART 5

## Producing and managing an effective QAIP

### QAIP - ITS APPLICABILITY TO ALL ASPECTS OF THE ACTIVITY

The programme should encompass three critical aspects of the IA activity:

- ▶ **IA Governance** - which includes the Charter, IPPF, CIIA FS Code requirements, independence and objectivity requirements, and the resourcing strategy;
- ▶ **IA Professional Practice** - which brings together risk-based auditing (the function's manual, procedures), reliance on other assurance providers, delivery on the basis of the established procedures (planning and fieldwork), auditor proficiency and due professional care and QA activities, e.g., file reviews, post-review supervisory appraisals or auditee feedback surveys;
- ▶ **Communication** - including reporting of results, action tracking and closure and the quality of stakeholder engagement.

The focus we have found in some IA functions is on the professional practice areas, where evaluation against established audit policies and procedures is relatively straightforward, i.e., assessing a file against a checklist of consistent requirements to see if all the “boxes have been ticked”. But this misses the value from periodic review of Quality within the critical areas we have explored in this series of articles, including:

- ▶ [April](#) - Audit planning and action tracking
- ▶ [May](#) - Maximising the benefits of an external assessment
- ▶ [June](#) - IA strategy, management and administration matters, including challenges to independence in smaller IA activities
- ▶ [July](#) - Stakeholder engagement, especially with the AC Chair and AC

### WHY QUALITY MATTERS - WHAT SHOULD HEADS OF INTERNAL AUDIT THINK ABOUT?

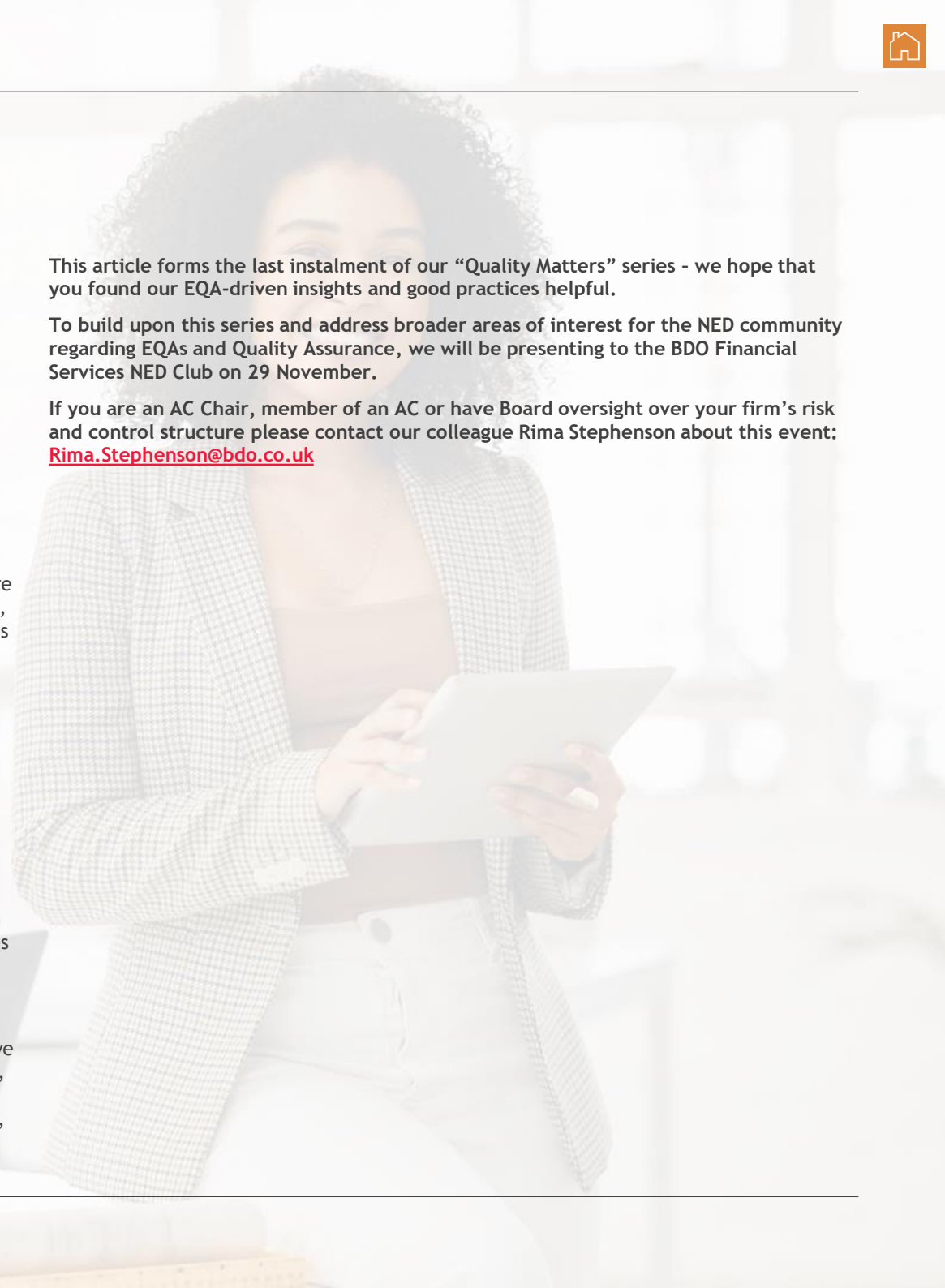
We'll conclude this series as it began: “Quality” could be defined as the degree to which a product or process meets its expectations. Therefore, it's no surprise that the IIA places substantial emphasis on the importance of a well-established QAIP, including periodic self-assessments, and an external assessment at least every five years to ensure that the IA function is operating to a sufficient level of quality.

Just before the COVID pandemic, the former Global IIA President, Richard Chambers, gave a useful speech in which he emphasised the various benefits of EQAs. Within his remarks, he cautioned against the perception, or use, of EQAs as “weapon against practitioners who are simply doing their jobs”; EQAs, as well as other forms of outsourced QA support, should signify to stakeholders that an internal audit function operates at a high level of ethical and professional competencies.

This article forms the last instalment of our “Quality Matters” series - we hope that you found our EQA-driven insights and good practices helpful.

To build upon this series and address broader areas of interest for the NED community regarding EQAs and Quality Assurance, we will be presenting to the BDO Financial Services NED Club on 29 November.

If you are an AC Chair, member of an AC or have Board oversight over your firm's risk and control structure please contact our colleague Rima Stephenson about this event: [Rima.Stephenson@bdo.co.uk](mailto:Rima.Stephenson@bdo.co.uk)



# 04

## OPERATIONAL RESILIENCE - WHERE ARE WE NOW?



KARUNA BHANDERI  
Director





# OPERATIONAL RESILIENCE

In our last update on this topic (July 2022), we set out some key areas for firms and their Internal Audits to be thinking about when considering their arrangements for Operational Resilience and how this relies on a robust framework for Outsourcing.

Subsequently, firms have continued to operate in a complex environment both in the UK and in the wider geopolitical context. The increase in digitalisation, and rapidly expanding use of AI, present higher hurdles to firms' operating environments and operational risk management. Regulators remain clear that severe and prolonged disruptions to important business services will not be tolerated.

Although the next regulatory deadline specifically linked to Operational Resilience is over a year away, there remains work to be done to ensure this can be met. Firms have until March 2025 to complete their Operational Resilience mapping with a view to be able to remain consistently within their approved impact tolerances. This can be a straightforward exercise for IBSs that are undertaken internally; however, where third-parties are involved, this can present a challenge as these relationships can be more complex, deeply rooted, long-standing or intra-group.

## RELIANCE ON OUTSOURCED AND THIRD-PARTY SERVICE PROVIDERS

As a reminder, to meet regulatory expectations, firms are expected to:

- ▶ Include relevant third parties within the firm's operational resilience mapping;
- ▶ Assess them for potential vulnerabilities; and
- ▶ work with them to ensure the validity of the firm's scenario testing or, to the extent they rely on the suppliers' testing, to ensure the suitability of the methodologies, scenarios and considerations adopted to carrying out testing.

The possibility of a cyber-attack is a key threat that the FCA has emphasised within its expectations of firms' scenario testing plans. Therefore, it is logical to consider this a critical area of regulatory focus to identify any possible vulnerabilities faced by outsourced and third-party service providers. Firms should understand the nature and depth of the cyber security arrangements and scenario testing that the third party may have completed themselves and satisfy themselves that it is sufficient.

The FCA has confirmed that if firms are unable to obtain sufficient information and assurance from a third-party supplier to satisfy themselves that the third party can operate within the determined impact tolerance(s), then the firm should review and, if necessary, change its outsourcing arrangements.







# OPERATIONAL RESILIENCE

## WHAT SHOULD INTERNAL AUDIT TEAMS THINK ABOUT?

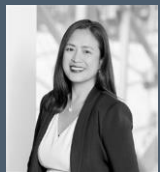
- ▶ **Ongoing Implementation / Project Management:** Many firms implemented Operational Resilience via a regulatory change project to meet the March 2022 deadline, but firms are approaching the transition period differently. Some firms have transitioned these activities to be completed as part of BAU while others are moving to a new project, or second phase to meet the March 2025 deadline. Irrespective of approach, the FCA were very clear that firms should not wait until the end of transitional period to be able to remain within their impact tolerances, but rather remain within them as soon as reasonably practicable within the 3-year transition period. Internal Audit reviews in the latter half of 2024 will be crucial to assess whether the requirements will be met in time for the deadline and leave sufficient time for potential enhancements to be implemented.
- ▶ **Impact of combined or multiple disruptions:** Firms should be considering scenarios where there might be disruption to multiple resources underlying an IBS and what the collective impact of these might be. Inadequate resource mapping or narrow scenario testing may not cover concurrent failures, and this could lead to a firm not being able to remain within tolerances.
- ▶ **IBS Mapping:** An assessment of the depth and coverage of the mapping completed for each IBS will be crucial to evidence that due consideration has been given not just to internal processes but also to outsourced, and third-party providers. If not already planned, internal audit reviews of outsourcer and third-party management would support ongoing operational resilience work. The FCA believe they have provided an appropriate amount of time to allow firms to embed the changes that may be necessary within their business, including to make appropriate investment to help embed operational changes. It should also be noted that the March 2025 is a hard deadline and a firm that is not making reasonable effort to remain within its impact tolerances during this transition period would be in breach of the FCA's rules.
- ▶ **Scenario testing:** Scenario testing will be an on-going activity and expected to be conducted on a rolling basis depending on a combination of factors tailored to the scale and complexity of the firm. These factors are likely to include the associated risk, likelihood of failure, or be event driven. We expect that the regulators will be looking for a scenario testing plan that is on a schedule with clear rationale as to the frequency and nature of testing. Looking ahead will provide comfort that appropriate coverage, focus, and resource will be allocated to this activity. Lessons learned are also a key part of this and properly scheduled scenario testing can tell a strong story of refinements to the control environment.





# 05

## PRUDENTIAL RISKS



AIZA MARIE SACE  
Senior Manager







# PRUDENTIAL RISKS

On 3 February 2023, the FCA published a 'Dear CEO' letter (Our Asset Management Supervision Strategy) addressed to asset managers. The letter outlined its supervisory strategy for 2023 while also highlighting its perspectives on the key risks posed to customers and markets.

One of the key areas emphasised for the attention of Asset Managers was Financial Resilience.

## FINANCIAL RESILIENCE

Certain parts of the global financial system remain susceptible to pressures, with threats arising from a weak economic outlook, persistent high inflation, and geopolitical tensions. Recent market volatility has increased financial, credit, and operational risks, with operational or counterparty risks sometimes leading to novel or elevated market risk in volatile environments.

In late September 2022, UK financial assets faced severe repricing, primarily affecting long-dated UK government debt. This volatility affected sectors, particularly firms operating Liability Driven Investment (LDI) strategies. The 30-year nominal gilt yield rose by 160 basis points in just four days, and LDI funds' liquidity buffers proved insufficient. Firms faced challenges, including deficiencies in risk management, which contributed to market dysfunction and financial stability threats.

Firms that are under the prudential regulation of the FCA have a significant role in maintaining a well-functioning economy. Especially in times of difficulty, these firms have to fulfil their duty by preparing in advance and effectively managing their financial assets. This involves taking necessary measures to safeguard their capital and devising strategies to manage demands for liquidity. Stress testing also serves as a crucial instrument used by asset and wealth managers to highlight their ability to withstand challenges, which is important for various parties, including regulators.

## REGULATORY FOCUS

The FCA is introducing a new financial resilience regulatory return for solo FCA-regulated firms which will be referred to as 'FIN073 - Baseline Financial Resilience Report'. This will replace the current FCA Financial Resilience Survey ("FRS") data collection (formerly "COVID-19 Impact Survey"). The main goal of the FCA is to ensure that it promptly identifies firms facing financial or other stress that could lead to failure and to ensure corrective measures are taken to minimise the adverse effects.

IFPR is a new set of rules for MiFID investment firms such as fund managers, asset managers, trading firms, amongst others. It became effective on January 1, 2022, and includes a requirement to undertake and document a firm's ICARA process.







## PRUDENTIAL RISKS

IFPR in-scope firms are expected to identify and manage risks that could harm customers and markets, and ensure they hold sufficient financial resources at all times to either operate on an ongoing basis or wind-down their business in an orderly manner.

The FCA also released a Discussion Paper ("Updating and Improving the UK Regime for Asset Management") on February 20, 2023, seeking input on the current system for regulating funds and the asset management sector. A part of the FCA's consideration is whether portfolio managers should consider the risks they pose to financial stability due to liability-driven investments, despite not being subject to specific regulatory requirements.

### WHAT SHOULD INTERNAL AUDIT TEAMS THINK ABOUT?

In light of the recent instability, firms should be re-examining their financing strategies with a view to increasing flexibility through the diversification of funding types, sources, and markets, as well as focusing on efficient capital allocation, to increase the resilience of their business models.

To better understand and manage liquidity risk, firms are also revising their liquidity policies and plans, reviewing their forecasting techniques, and assessing their early warning indicator and stress testing frameworks.

These initiatives should have appropriate assurance coverage from the internal audit team in plan for 2024.

The protection of a firm's value requires effective financial and operational risk management. In light of current and recent market events, many organisations are reviewing how well their business and operating structure manages crisis, and internal audit teams are either implementing financial resilience testing or enhancing existing testing frameworks on account of the increasing regulatory focus on financial resilience.

Earlier this year, the FCA also published its initial observation on how firms are implementing requirements on the internal capital adequacy and risk assessment (ICARA) process and reporting under the Investment Firms Prudential Regime (IFPR).



# 06

## 2023 REGULATORY PRIORITIES










# 2023 REGULATORY PRIORITIES




## FCA 'Dear CEO' letter to Asset Managers

 <b>REGULATOR</b>	 <b>SECTOR RISK</b>	 <b>FCA FOCUS</b>
<b>Product Governance</b>	<p>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. We have covered this subject in our <a href="#">April pack</a>.</p>	<p>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.</p>
<b>Environmental, Social and Governance (ESG) and Sustainable Investing</b>	<p>Risks exist that some claims about ESG and sustainable investing are misleading or inaccurate. Inaccurate or misleading information may negatively impact the integrity of the UK financial disclosure regime and is likely to harm investment confidence. Our monthly packs provide regular coverage on climate change financial risk developments.</p>	<p>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.</p>
<b>Product Liquidity Management</b>	<p>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 may not always oversee them correctly or use them consistently. We have covered this subject in our <a href="#">April pack</a>.</p>	<p>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.</p>



# 2023 REGULATORY PRIORITIES

## FCA 'Dear CEO' letter to Asset Managers

 <b>REGULATOR</b>	 <b>SECTOR RISK</b>	 <b>FCA FOCUS</b>
<b>Investment in Operations and Resilience</b>	<p>Underinvestment in operations can lead to service disruption or failure, with consequential loss to investors and detriment to markets. Increased market volatility or stress may 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 may also result in business disruptions or lead to vulnerabilities that can be exploited to control systems or inappropriately transfer information.</p> <p>We have covered this subject in our <a href="#">March pack</a>.</p>	<p>The FCA will complete a range of proactive programmes to monitor and test Asset Managers' ability to meet operational resilience regulatory requirements. Firms may 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).</p>
<b>Financial Resilience</b>	<p>Disorderly firm failure has the potential to cause significant material detriment to consumers and markets.</p> <p>This subject is covered, above, in this edition.</p>	<p>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.</p>

## FOR MORE INFORMATION:

**RICHARD WEIGHELL**

Partner

+44 (0)7773 392 799

[richard.weighell@bdo.co.uk](mailto:richard.weighell@bdo.co.uk)

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