

Supervisory Statement | SS7/14

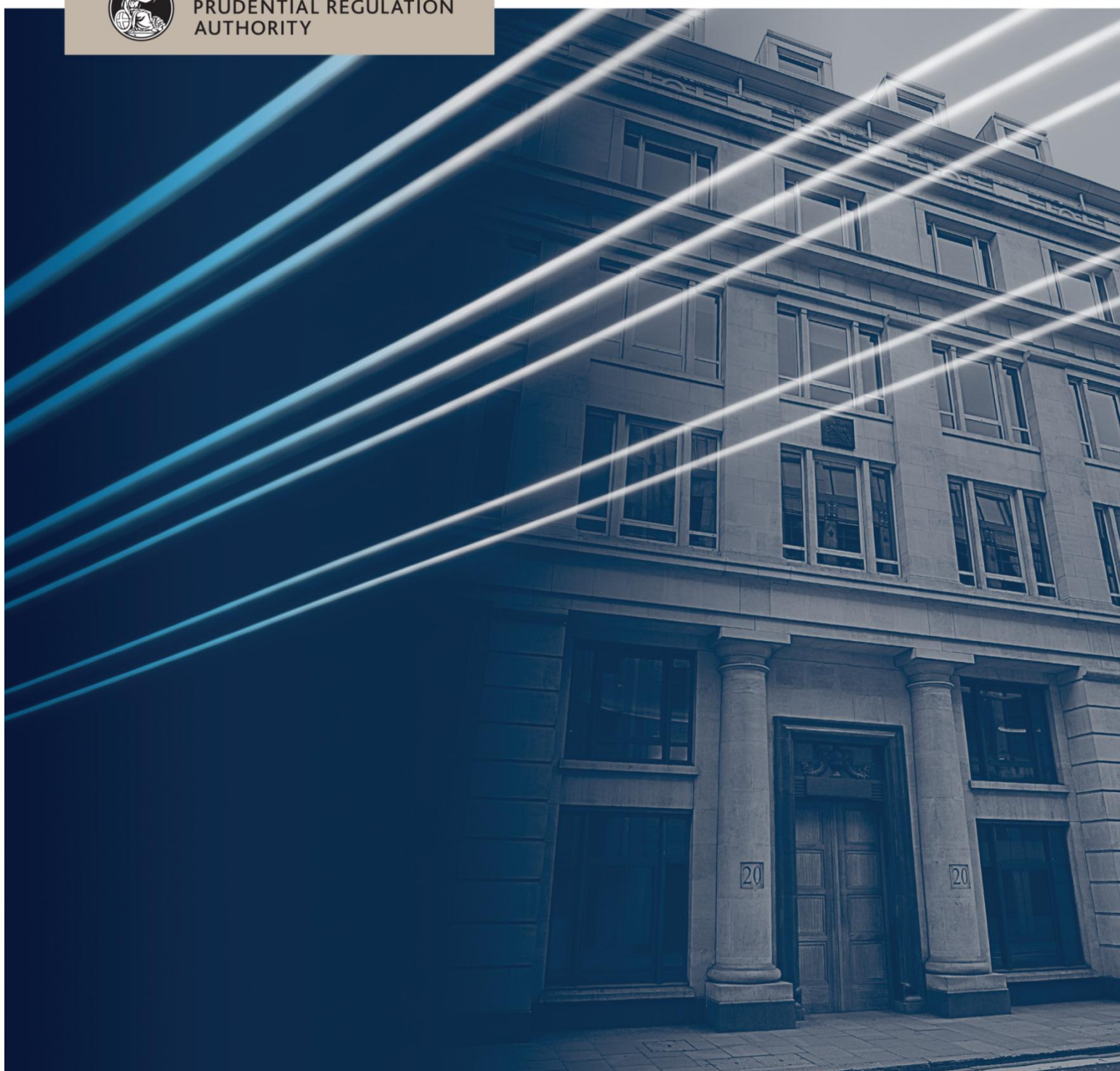
Reports by skilled persons

June 2014

(Updated September 2015)



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY



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1 Introduction

1.1 This supervisory statement is addressed to all firms regulated by the Prudential Regulation Authority (PRA). Its purpose is to set out the PRA's policy on and expectations for the use of the following powers as supervisory tools:

- (i) section 166 (Reports by skilled persons) of the Financial Services and Markets Act (FSMA); and
- (ii) section 166A (Appointment of skilled person to collect and update information) FSMA.

1.2 This statement is intended to be read together with the Use of skilled persons Part of the PRA Rulebook which sets out rules on the contract with the skilled person, and associated delivery and costs. Firms are also advised to read sections 166 and 166A of FSMA.

Update: On 30 September 2015 the PRA updated this statement to provide greater clarity on the use of skilled persons in its supervisory approach, in particular as a discretionary supervisory tool. The statement has also been updated to alert firms to the possibility of avoiding the costs that would otherwise arise if the firm and the PRA both wish to commission work from an external party on the same, or broadly the same, matter. Paragraphs 2.3 – 2.5 have been deleted, and paragraphs 1.7A, 1.7B, 1.7C and 4.4A have been added. Paragraphs 2.2(v) and 2.9 have been updated.

Who may be required to provide a report under sections 166 and 166A FSMA?

1.3 Under section 166 FSMA, the PRA may, by giving notice, appoint a skilled person to provide it with a report, or require any of the following persons ('relevant persons') to provide it with a skilled persons report:

- (i) an authorised firm ('firm');
- (ii) any other member of the firm's group;
- (iii) a partnership of which the firm is a member; or
- (iv) a person who has at any relevant time been a person falling within (1), (2) or (3); but only if the person is, or was at the relevant time, carrying on a business.

1.4 Under section 166A of FSMA, the PRA may require a firm to appoint, or may itself appoint, a skilled person to collect or update information.

The use of skilled persons as a supervisory tool

1.5 The appointment of a skilled person to produce a report under section 166 FSMA is one of the PRA's supervisory tools. The tool may be used:

- (i) for diagnostic purposes: to identify, assess and measure risks;
- (ii) for monitoring purposes: to track the development of identified risks, wherever these arise;
- (iii) for preventative action: to limit or reduce identified risks and so prevent them from crystallising or increasing; or

(iv) for remedial action: to allow the PRA to respond to risks when they have crystallised.

1.6 The use of the tool could be prompted by:

- (i) a specific requirement by the PRA for information;
- (ii) an analysis of information undertaken by the PRA;
- (iii) an assessment of a situation by the PRA;
- (iv) expert advice or recommendations received by the PRA; or
- (v) a decision by the PRA to seek assurance in relation to a regulatory return.

1.7 The tool may also be used as part of the supervisory programme applicable to a firm, or the result of an event or development in relation to a firm, that is prompted by a need for verification of information provided to the PRA or part of the PRA's regular monitoring of a firm.

1.7A The tool is used to support supervisory intervention first and foremost but on occasion the PRA might choose to obtain a report to support enforcement action being contemplated. It may also be the case that a report provided by a skilled person to support supervisory intervention is relied on in subsequent enforcement action taken by the PRA.

1.7B The use of skilled persons in an enforcement context is rare and it is more likely that in an enforcement context the PRA will use its direct enforcement powers such as section 167 of FSMA or section 168 of FSMA.

1.7C The PRA encourages firms to speak to their supervisors before commissioning any external review on subject matters which may be of interest to the PRA. This may avoid the firm incurring unnecessary costs where the PRA wishes to make use of skilled persons on the same, or broadly the same, matter.

Collecting and updating information as a supervisory tool

1.8 The appointment of a skilled person to collect and update information under section 166A FSMA is another one of the PRA's regulatory tools. It may be used where the PRA considers that a firm has failed to collect, and keep up-to-date, information required by the PRA.

2 PRA considerations

2.1 When determining whether to use powers under section 166 or section 166A, the PRA will consider a range of factors relevant to the specific case. These factors include those covered under the headings below.

Circumstances relating to a firm

2.2 The PRA will consider circumstances relating to a firm, including, for example:

- (i) **the attitude of a firm:** whether the firm is being co-operative;
- (ii) **history of similar issues:** whether similar issues have arisen in the past and, if so, whether timely corrective action was taken;

- (iii) **quality of a firm's systems and records:** whether the PRA has confidence that a firm has the ability to provide the required information;
- (iv) **objectivity:** whether the PRA has confidence in a firm's willingness and ability to deliver an objective report;
- (v) **conflicts of interest:** where the subject matter of the report is such that the firm and the PRA would benefit from the view of an external third party; and
- (vi) **knowledge or expertise available to a firm:** whether the firm has the required technical expertise.

Paragraphs 2.3 to 2.5 have been deleted.

Cost considerations and objectives

2.6 Information about the number and cost of reports by skilled persons is published by the PRA on its website¹, and its Annual Report respectively.

2.7 The PRA will be mindful of costs, particularly because a firm will normally have to pay for the services of the skilled person, irrespective of whether the skilled person is engaged by a firm or contracts directly with the PRA.

2.8 The PRA will take into account relevant factors when considering costs, including, for example:

- (i) whether a firm may derive some benefit from the work carried out and recommendations made by the skilled person (eg a better understanding of its business and its risk profile, the operation of its information systems, or improvements to its systems and controls);
- (ii) whether the work to be carried out by the skilled person is work that should otherwise reasonably have been carried out by a firm, or by persons instructed by a firm on its own initiative, for instance a compliance review or the development of new systems;
- (iii) whether a firm's record keeping and management information systems are poor and:
 - a. the required information and documents are not readily available; or
 - b. an analysis of the required information cannot readily be performed without expert assistance;
- (iv) the extent to which there appear to be risks that could threaten the safety and soundness of a firm or the protection of policyholders; and
- (v) the perceived probability and seriousness of possible breaches of regulatory requirements and the possible need for further action.

¹ www.bankofengland.co.uk/prs/Pages/supervision/activities/reportsskilledpersons.aspx

Considerations relating to PRA resources

2.9 When deciding whether to use skilled persons, the PRA will consider whether it has the necessary expertise, whether the resources required are available within the PRA to conduct the review itself, and whether the exercise will be the best use of PRA resources at that time.

3 Appointment of the skilled person

Appointment

3.1 When the PRA is contracting directly with a skilled person it will itself appoint the skilled person. Where it is considered appropriate for a firm to contract with a skilled person, the PRA may nominate the skilled person or where the firm is asked to propose a skilled person, the PRA will direct the firm to the skilled persons in the relevant lot(s) on the Panel and ask the firm to submit a shortlist of nominees for the PRA to approve. Where the firm is contracting with a skilled person, it remains a firm's responsibility to assess the individual appropriateness of the skilled person.

Panel

3.2 To enable the PRA to use its power to appoint a skilled person in line with the European Procurement Directive and the Public Contracts Regulation 2006, a panel of skilled persons ('the Panel') has been developed for use by the PRA.

3.3 Where the PRA is contracting directly with the skilled person, the PRA will conduct a tender process, where appropriate, to identify the most suitable skilled person. This will include the considerations detailed below.

Skills, resources and conflicts of interest

3.4 When considering whether to nominate, approve or appoint a skilled person, the PRA will consider the circumstances of the case, including whether the proposed skilled person appears to have:

- (i) **the necessary skills and any relevant specialised knowledge:** relating to the business model of the firm and the particular subject matter area;
- (ii) **sufficient resources:** to complete the report or collect or update the information within the time expected by the PRA;
- (iii) **any professional difficulty, potential conflict of interest, or insufficient detachment:** such matters would include:
 - a. matters already reported on by the skilled person (for example, on the financial statements of a firm or in relation to their systems and controls);
 - b. matters that are likely to be contentious and may result in disciplinary or other enforcement action against a firm, its management, shareholders or controllers; or
 - c. matters that the skilled person has been involved in, in another capacity (for example, when a skilled person has been involved in developing an information system it may not be appropriate for them to provide a subsequent opinion on the adequacy of the system).

4 Expectations of skilled persons

4.1 The PRA expects a skilled person to clarify or discuss any matters that are raised by the PRA regarding a contract before it is finalised.

4.2 The PRA expects the skilled person normally to give a periodic update on progress and issues during the engagement, the frequency of which is to be discussed with the PRA. This should allow for a re-focusing of the report if necessary.

4.3 The channel of communication would normally be directly between the skilled person and the PRA. The skilled person would usually be expected to keep the firm informed of any communication between the skilled person and the PRA. It may be appropriate for the skilled person to communicate matters of material significance to the PRA set out in the rule in Use of skilled persons 3.1(1)(b), without first informing the firm.

4.4 If the PRA is considering asking for additional information during the engagement, it will take into consideration the cost of the skilled person complying with the request and the benefit that the PRA may derive from the information. In most cases, the PRA will not need to request a skilled person to give it source data, documents and working papers. However, the PRA may do so when it reasonably believes that this information will be relevant to any investigation it may be conducting, or any action it may consider taking against the firm.

4.4A In the relatively rare situation where enforcement action is anticipated as a likely outcome the PRA would normally signal this to the skilled person prior to work commencing, as this will impact the type of evidence which should be provided in support of the findings in the skilled person report.

Scope of report

4.5 The PRA will normally contact the relevant persons to discuss the PRA's requirements before finalising its notice to require a report or the updating or collection of information by a skilled person.

4.6 The PRA will give written notification to the relevant persons of the purpose of the report or collection or updating of information, its scope, the timetable for completion and any other relevant matters. The PRA will state the matters which the report is to contain, or the information which is to be collected or updated, as well as any requirements as to the report's format.

4.7 The PRA attaches importance to there being a timetable for each report and to the skilled person, with the co-operation of the relevant persons keeping to that timetable.

Reporting

4.8 Where the skilled person is appointed by a firm, the PRA will normally require the skilled person to report to the PRA through that firm. Where the skilled person is to be appointed by the PRA itself, the skilled person will report directly to the PRA.

4.9 The skilled person is expected to provide the PRA with identical copies of any draft report or relevant information at the same time they are issued to the firm. The PRA expects that a firm will be given the opportunity to provide written comments on the report or the collection of the relevant information prior to its final submission to the PRA.

4.10 The PRA will normally specify a time limit within which it expects the skilled person to deliver the report or collect or update the relevant information.

4.11 If the skilled person becomes aware that the report, or collection or updating of the relevant information may not be delivered on time, they should inform the PRA and the firm as soon as possible. Where the skilled person is appointed by a firm and if the skilled person becomes aware that there may be difficulties delivering the report, or collecting or updating the relevant information within cost estimates, the skilled person should advise the firm may also wish to discuss the final report with the skilled person but without the regulated firm.

4.12 The PRA may meet with the firm and the skilled person together to discuss the final report. The PRA may also wish to discuss the final report with the skilled person but without the regulated firm.

5 Assisting the skilled person

5.1 firm is expected to provide reasonable assistance, which should include:

- (i) access at all reasonable business hours for the skilled person to a firm's accounting and other records in whatever form;
- (ii) the provision of such information and explanations as the skilled person reasonably considers necessary or desirable for the performance of his duties; and
- (iii) permitting a skilled person to obtain such information directly from a firm's auditor as he reasonably considers necessary or desirable for the proper performance of his duties.

5.2 In providing reasonable assistance, a firm should take reasonable steps to ensure that, when reasonably required by the skilled person, each of its appointed representatives or where applicable tied agents waives any duty of confidentiality and provides reasonable assistance expected of a firm.

6 Confidential information and privilege

6.1 Within the legal constraints that apply, the PRA may pass on to a skilled person any information which it considers relevant to the skilled person's function. A skilled person, being a primary recipient under section 348 FSMA (Restrictions on disclosure of confidential information by PRA), is bound by the confidentiality provisions in Part XXIII FSMA (Public record, disclosure of information and co-operation) as regards confidential information the skilled person receives from the PRA or directly from a firm or other person.

6.2 A skilled person may not pass on confidential information without lawful authority, for example, where an exception applies under the FSMA (Disclosure of Confidential Information) Regulations 2001 (SI 2001/2188) or with the consent of the person from whom that information was received and (if different) the person to whom the information relates. The PRA will indicate to a skilled person if there is any matter which cannot be discussed with the firm.