

Responding to a S166 Requirements Notice

Lee Werrell and Nick Hawke presented a talk at the BBA on 17th January 2013 on “**How to Respond to a S166**”. The talk was attended by numerous heads of departments, legal counsel and compliance staff from major banking and asset management organisations as well as other consultants.

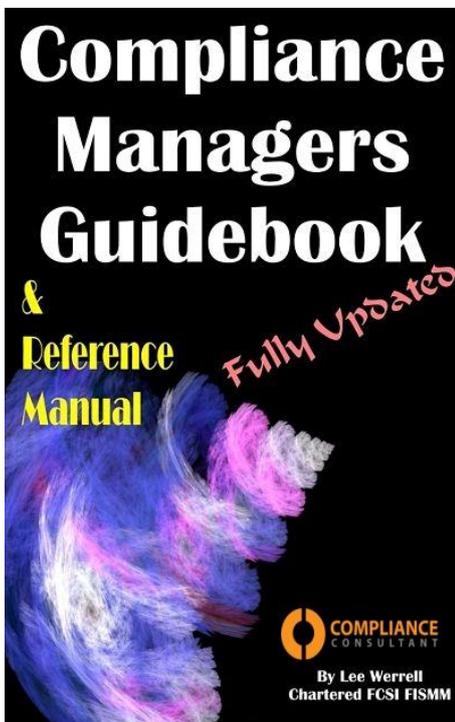
Using this and other talks we have compiled a Frequently Asked Questions (FAQs) list.



“Regulatory enforcement is like a car crash in slow motion, the right compliance consultant is your ABS. You don’t know where you will end up, but at least you can steer through it.”

Tony Woodward

Chartered Fellow of the CISI



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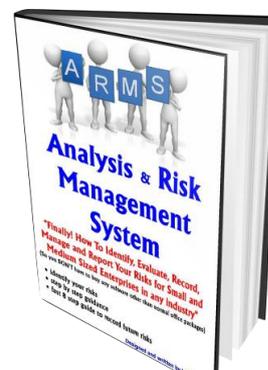
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FAQs

What are S166s?

Section 166 of FSMA (Financial Services and Markets Act 2000, revised 2010) gives the FSA the power to **require firms to provide reports by skilled persons** as one of its regulatory tools.

These can be used for **diagnostic** purposes: to identify, assess and measure risks; for **monitoring** purposes: to track development of identified risks; for **preventive** purposes: to limit or reduce identified risks; or for **remedial** actions where the firm has been unable to get its affairs in order.

Who can conduct S166 Reports?

A nominated **skilled person** can be an accountant, lawyer, actuary, or person with relevant business, technical or technological skills. The type of skilled person will depend on the scope of the report that is listed in the requirement's notice that you will receive when the S166 is requested.

Why do the regulators need the skilled person's reports (SPR)?

A SPR is normally prompted by a specific requirement for information, analysis, expert advice, or by a decision to seek assurance in relation to a regulatory return. The FSA cannot conduct these in-depth and evidence based investigations because they do not have the resources or the infrastructure to do so.

Is the use of these SPRs likely to diminish?

As the FCA and PRA take over from the FSA there are no indications that they are likely to reduce in number and following the "credible deterrence" initiative mentioned in various speeches their frequency and scope may very easily be increased. The only reduction in these is likely to be when all the firms adopt a level of practice with more transparent systems and controls and clearer use of all the information they should seek, to run their businesses in a more compliance way.

Who pays for the SPR?

The firm contracts with the SPR to provide the investigation and the report in alignment with the requirements provided by the regulator. The firm is effectively paying for the service and should use it as an opportunity to make their processes more effective.

Does the SPR cover all of the areas within a firm?

The SPR requirements notice itemises the areas that the regulator requires the skilled person to investigate and this may be limited to specific sections or areas, depending on the size of the firm. If there are many different areas of concern then multiple S166's may be issued together or separately. In the 2011/2012 fiscal year 17 firms had to pay for more than one report over the period and the maximum number of report per firm was four.

Can you get another S166 after one is completed?

It is unlikely that most firms would be subjected to this but it is possible. The SPR requirements notice itemises the areas that the regulator requires the skilled person to investigate and this may be limited to specific sections or areas, depending on the size of the firm. If there are many different areas of concern then multiple S166's may be issued together or separately. Another way could be if the firm was totally uncooperative with the skilled person or regulator, and it was felt that there was only limited disclosure of the information then a second or subsequent S166 could be issued with broader scope than the initial. The firm would then be required to pay for both.

How many S166's get issued?

In recent years the number has been increased substantially with 18 conducted in the 2006/2007 year and a similar number being added to each year as time progressed. In the 2011/2012 year there were 111 conducted. In the first half of the 2012/2013 year 68 reports were conducted.

How do we know if we are going to get a S166?

Normally, following a regulatory visit of some kind like an ARROW or themed visit, you will have a good idea that things are perhaps less than they should be.

Sometimes if you are very pro-active and start taking steps before any requirements notice is issued, the regulator may allow you to continue the work. They will normally provide areas of concern for the consultancy and ask that findings and enhancements are evidenced to them or anything else they consider necessary.

Often you will have received a S165 Request for Additional Information which should start the alarm bells ringing.

What is the first thing we do when we receive the S166 Requirements Notice?

Initially you will receive a draft notice and this means in the majority of cases it is likely to happen. In rare occasions the S166 has not been proceeded with.

The first thing to do is obviously to read and understand what is causing concern for the regulator. If you are not sure, get experienced advisers to help you. Circulating it internally for other people's opinions often serves to generate anxiety and fear as well as enormous (often incorrect) speculation or worry.

Next thing is to issue a firm-wide document preservation order ensuring that no documents are disposed of, deleted, destroyed or otherwise disposed of until further notice. Normal archiving and BAU processes can of course continue, as long as the documents are retrievable. The point here is that there should be no holes in any audit trail or anything that cannot be explained. The last thing you need is for shredding machines to be suddenly working around the clock like Enron.

Why are they likely to select an area for a SPR that we review on a regular basis?

The problem with doing anything purely internally is that although you are looking at what you consider are important controls or efficient systems; they may not be doing the job in the best way. Additionally the principal-agent problem is a very real issue in any organisation can be harmful at any level.

With an external investigation or assessment these issues can be identified and appropriate action can be taken to mitigate any risks or issues well before you get a regulatory visit.

What is the typical cost to a firm if they get a S166?

The cost to any business is high and these will vary depending on the scope of the report. The total costs over the last two years have exceeded **£30** Million pounds. There are hidden costs as well to consider;

- Ⓜ Financially – the actual cost of the skilled person and their team to conduct the investigation and prepare the report.
- Ⓜ Productivity – BAU will suffer as your staff will be disrupted as well as unsettled if the process is not handled sympathetically.
- Ⓜ Significant impact on senior management time and involvement. This is often multiplied if not handled in the right way.

The good news is that you can take steps to avoid this if you are very pro-active and start taking steps before any requirements notice is issued, the regulator may allow you to continue the work. They will normally provide areas of concern for the consultancy and ask that findings and enhancements are evidenced to them or anything else they consider necessary.

If that's not an option, you can significantly mitigate the impact by implementing the right approach and using consultants that have been through the SPR process from both sides and seen good and bad practices.

Finally, after a S166 there is often a Risk Mitigation Programme (RMP) whereby certain elements have to be rectified and proven and the evidence provided to the regulator in specific ways. The entire RMP process can be done poorly or effectively. Getting this part right can save further regulatory scrutiny and establish good relations with the supervisor and the regulator overall.

Much of the regulator's communications are grey and woolly; what does the S166 Requirements Notice actually say?

This will depend primarily on the areas of concern but the instructions will be for the skilled person to work out the precise requirements from the systems and controls, governance, regulatory or other reporting, sales, or other areas. Experienced consultants can assist in "reading between the lines" to establish the issues and items that will need addressing. It is vital to extract all of the information out of the document so that you can manage the supply of information.

Can we challenge the findings?

The entire SPR will be an evidence based investigation and report. The scope, the method used and the findings will be listed in the report along with recommendations of how it is suggested that you remediate any issues. It is unlikely that you will want to dispute the findings as they will be evidence based. You may dispute the actual conclusions or there may be instances where the remediation suggestion would not be appropriate in your specific business or would need to be altered in some way, and these would be the areas to include in your management response within the report before it is sent to the FSA.

There are, of course, ways to respond in the best possible way to provide the regulator with some comfort that you are treating the issues seriously.



Can we run the Risk Mitigation Programme (RMP) internally?

There is absolutely no reason why you shouldn't conduct the RMP internally, however there are very few companies who could spare the resource to operate a project with fairly aggressive timescales or whether they would have the necessary experience in managing the workload, building the right governance around the project, coordinating the work streams, preparing the deliverables for final approval and delivery to the FSA, and all the other things we have seen involved with an RMP.

Also, it is a good idea to use external advisers who bring with them industry best practices and normally a wealth of experience in the area.

There is no reason or expectation for you to use the same firm that conducted the S166 to complete the RMP as well. Some consultancies use this to then start a "land grabbing" exercise and you can end up paying large amounts of money for other areas that you may not currently need.

What are the best ways to run a S166 and resultant RMP?

Obviously there are key elements to operating an effective project and providing robust and long lasting solutions to the work. A key part of the S166 process is often overlooked by many firms and that is the final element of embedding, but more importantly how you evidence the embedding and how to manage that when you are next tested by the regulator.

Key points are;

- Communicate honestly and openly with the regulator at all times.
- Have a co-operative approach; don't be defensive
- Understand what and why you are being asked
- Be realistic
- Don't over-promise, but do make sure you are working with, not against, the
- Have systems and records which provide the required information in the best way regulator
- Ensure you have the knowledge and expertise to work with the Skilled Person to provide the Report
- Ensure you know the best ways to respond to the supervisory visits and the responses to the RMP

What are the regulator looking to achieve?

- > Whatever the cause of the intervention, the regulator's concerns are for a reduction in risk.
- > They want to confirm that you are managing your risk with a sound strategy and risk framework
- > They ultimately want to see you enhancing your risk and performance framework to become more effective to the market, your customers and your stakeholders as well as to alleviate and future enforcement likelihood

Other than the actual change itself, what would help towards providing a good RMP result?

Running an effective RMP can be like herding cats, especially if you have to consider your day job as well. Other than ensuring the operations or other business areas conclude their work on time and in sequence, there are other considerations to be made. These will include;

- Establish and respect the communication protocols with the regulator
- Before anything is delivered it must be reviewed and approved by the Head of Compliance and the relevant Committee
- Be aware of lead times. If an outcome is due at the end of the month, make sure that sufficient time is factored in to allow for the production of evidence and internal sign-off

These are a selection of the questions asked at our events and you may find that you have others. If you would like to discuss your needs in the areas of

- Pre-emptive review work – a health check on areas of your firm
- S166 advice and preparation assistance – someone to help and explain the process and oversee the responses.
- RMP management and effective delivery – experienced delivery identification, management, governance, work stream dynamic execution, collation and communications as well as the final sign off and delivery of all the RMP points, as well as preparation of an embedding schedule.

The Presenters

Lee Werrell Tel: 07092 289901

Lee is compliance professional with over 25 years' experience in the financial services industry, including roles at board and senior executive level for a bank, bancassurer and a major IFA. Lee has also advised numerous businesses on Financial Services Authority regulatory issues and developments including how to modify and adapt their strategy and procedures accordingly.

With a range of expertise provided to FTSE 100 institutions and a variety of banks and retail operations, working with governance, risk and compliance functions and has been nominated as a skilled person by the FSA. Lee has set up a foreign sponsored bank and worked with local authorities.

Lee is Fellow of Chartered Fellow of the Chartered Institute for Securities & Investment and a Fellow of the Institute for Sales & Marketing Management, and a Member of the Association of Professional Compliance Consultants.

Nicholas Hawke Tel:0207 921 0022

Nicholas Hawke is a risk and performance consultant with 13 years practical and proven experience working in investment banking and risk management, including market, credit, liquidity and operational risks. Nick has run several regulatory response projects including one of the City's largest Section 166s and is accustomed with the intricacies of managing the relationship with the regulator.

Nick has been the global head of risk for an international software and consultancy firm and is now part owner of Manigent, a specialist risk and performance consultancy, delivering risk based solutions to the financial services industry.



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