

Financial Conduct Authority

Internal Audit final report

A review of authorisation processes for dual-regulated firms

Findings identified	
Major	1
Moderate	3
Minor	0

14 August 2014

1 Executive Summary

1.1 Summary and opinion for Audit Committee

Scope

The scope of this Internal Audit review was limited to the following four authorisation processes for dual-regulated firms:

- New authorisations – An application is submitted by firms that wish to conduct regulated financial service activities in the UK but are not yet authorised to do so.
- Waivers and modifications – A request is submitted by firms to have Handbook rules waived or modified where a rule is considered unduly burdensome or would not achieve its purpose.
- Change in Control – A request is submitted by firms seeking approval to acquire, increase or decrease control in a regulated firm.
- Significant Influence Functions (SIF) within Approved Persons – An application is submitted for an individual who wishes to perform a role where they will exercise a significant influence on a firm's affairs.

This is because of either the significance of the decision whether or not to approve an application at the gateway or because of the high volume of applications received. Additionally, as part of this review we considered some of the key controls supporting the operation of the Dual Regulated Department (DRD) which performs these processes. The key supporting controls included:

- setting and oversight of objectives and strategy;
- people management; and
- management information.

We did not consider Variations of Permission, Passporting or Cancellations within the scope of this review as these were considered to be lower risk by the management of the Authorisations Division.

Background

The Authorisations Division is responsible for protecting the 'gateways' to regulation through effective assessment, good regulatory decisions, and processing applications efficiently. In the dual regulatory structure, deposit-taking institutions, insurance firms and a small number of designated investment firms are regulated by both the PRA for their prudential requirements and the FCA for the way they conduct their business.

Within the Authorisations Division, the DRD is the FCA decision maker for the key authorisation processes for dual-regulated firms. The exception to this is the assessment of SIFs in existing dual-regulated firms where the Approved Persons, Passporting and Mutuals Department (APPM) is the decision maker. To make these decisions, the DRD and APPM work with other divisions across the FCA to complete the authorisation processes for dual-regulated firms. The dual authorisation processes also require close interaction with the PRA in an independent but coordinated manner. During this review we observed that controls over the escalation of issues between the FCA and PRA were operating as designed.

The Authorisations Division is currently undertaking a programme of process improvement and staff training initiatives to develop "*professional and motivated staff*"¹ required to apply judgement consistently and within the Division's risk appetite. Management informed us that this programme of work is expected to be completed in 2016.

In addition, the Authorisations Division will adopt the new INTACT system (from October 2014 which they are aiming to utilise to achieve further efficiencies across the authorisation processes). The INTACT system is not included in the scope of this review.

Management of the Authorisations Division is aware of some of the concerns highlighted in

¹ DRD Departmental Strategy 20130514

this Internal Audit report and has indicated that they intend to incorporate our observations in their programme of process improvement and staff training.

Findings and conclusion

We identified weaknesses in key controls throughout the lifecycle of the four authorisation processes. We consider that the weaknesses limit the level of assurance that we are able to give with respect to the adequacy of the control environment to mitigate the risks to achieving the local vision of “*good decisions, made efficiently, by professional and motivated staff*” and to the FCA’s operational objectives. We have raised one Major and three Moderate findings to this regard. Of these findings, the first finding relates to the FCA Significant Influence Function (SIF) interview process. The second finding relates to the DRD vision and findings three and four apply to all four authorisation processes for dual-regulated firms that were reviewed during this audit.

Finding 1

The first finding is applicable to the SIF process for both existing and new firm applications. There is a need for greater clarity over the purpose of the SIF interview process, which is a part of the overall FCA SIF process, improvements to the training provided to FCA staff conducting SIF interviews and to the minimum standards of documentation required from firms submitting applications for SIF assessments. We consider that a lack of clarity over the purpose of the SIF interview process.

Finding 2

The second finding highlights the lack of connectivity between the local Authorisations vision and Divisional purpose and visibility of how the DRD portfolio contributes to the FCA’s operational objectives. It is also unclear how management in the Authorisations Division is able to determine if it is successful in delivering against the FCA’s operational objectives and the externally stated approach.

Finding 3

We also saw weaknesses in the evidencing of management oversight. Consequently, we consider these weaknesses could collectively jeopardise the achievement of the Division’s vision of “*good decisions made efficiently*” and could impact the FCA’s ability to protect the integrity of the ‘gateway’.

Finding 4

The fourth finding highlights that there is a need to strengthen and structure the training provided to staff performing the four authorisation processes. We identified weaknesses in the controls over staff training which could increase the risk of poor decisions being made and jeopardise the Division’s realisation of its vision of “*good decisions, made efficiently, by professional and motivated staff.*”

We anticipate that, while the scope of this Internal Audit review was limited to four authorisation processes for dual-regulated firms, our observations should be considered for other authorisation processes for both solo and dual-regulated firms. Management should consider the broader implications of our observations and take any appropriate action to address these.

1.2 Overall management comments

We agree with the report’s findings. However we have struggled to see the level of risk identified in Finding 2 (Alignment of local vision to the FCA’s objectives and measurement of successful delivery), and consider there to be a well understood link between “good decisions” and the FCA objectives. The actions we have set out for this finding will strengthen

those links and will be implemented, where possible, at times which are associated with our natural cycles of MI, budgets and objective setting.

Whilst we would prefer the issues highlighted did not exist, we are encouraged that the findings did not raise too many new issues. The majority of findings are already known issues within the areas reviewed and work is already ongoing in most cases to resolve them. We also accept that whilst the review has been limited to the SIF and DRD processes, it is possible that these or similar issues will be mirrored in other processes across the Division. These findings will, therefore, also be considered in time across the remainder of the Division.

1.3 Schedule of findings

Ref	Findings	Rating
1	<p>Greater clarity is required over the purpose of the SIF interview process and tools to support the aims of the overall SIF process should be strengthened</p> <p>There is a need for greater clarity over the purpose of the Significant Influence Function (SIF) interview process, for improvements to the training provided to FCA staff conducting SIF interviews and to the minimum standards of documentation required from firms for the overall SIF process.</p>	Major
2	<p>Alignment of local vision to the FCA's objectives and measurement of successful delivery</p> <p>It is difficult to see a clear connection between the local vision and Divisional purpose and visibility of how the DRD portfolio contributes to the FCA's operational objectives. It is also unclear how management in the Authorisations Division are able to determine if they are successful in delivering against the FCA's operational objectives and the externally stated approach.</p>	Moderate
3	<p>Inadequate oversight</p> <p>We also saw weaknesses in the evidencing of management oversight.</p>	Moderate
4	<p>Improvements required to ensure that staff are appropriately skilled to make key decisions</p> <p>There is a need to strengthen and structure the training provided to staff performing key authorisation processes.</p>	Moderate