

In Practice

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What are “skilled person reviews” and why are they relevant?

The Financial Services and Markets Act 2000 (FSMA) gives the UK’s Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) a range of powers that either may use to gather information about an authorised firm. This includes the power to commission a “skilled person report” in accordance with s 166 of FSMA.

This In Practice article sets out what a skilled person report is, what a skilled person report can be commissioned for, what the consequences are for an entity in practice and considers how often skilled person reports are commissioned by the regulators.

WHAT IS A SKILLED PERSON REPORT (SPR)?

Under s 166 of the Financial Services and Markets Act 2000 (FSMA), the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) are afforded the power to instruct (or require a relevant person to instruct) an independent third party (a “skilled person”) to investigate certain aspects of a firm’s activities and provide their view (in the form of a report) on that aspect. For example, a skilled person may be instructed to review a firm’s procedures for handling client money. The skilled person will investigate and eventually produce a report on their findings.

The regulator can take one of two approaches to appoint a skilled person. The regulator can either:

- require the relevant entity subject to an skilled person report (SPR) to select a skilled person and, provided the regulator approves of the selection, contract with the skilled person directly; or,
- appoint and contract with a skilled person directly itself. In such cases the skilled person will typically be selected from the FCA’s Skilled Person Panel. The regulator will generally involve the relevant entity in the selection process but will nonetheless require the relevant entity to pay the skilled person’s fees.

The relevant entity may be an authorised firm or can be any other member of the firm’s group; a partnership of which the firm is a member; or a person which has at any relevant time, been in one of those categories.

WHAT CAN AN SPR BE COMMISSIONED FOR?

It is important to note that an SPR should not be commissioned as a fishing exercise. Section 166 FSMA states the regulator may commission an SPR in relation to “any matter”. While this is still very broad, it necessitates that there is a particular “matter” concerned. Section 166A FSMA also permits the regulator to commission an SPR if an authorised firm “has contravened a requirement to collect, and keep up to date, information of a description specified in the rules”.

TABLE 1: ILLUSTRATION OF NUMBER OF SPRs COMMISSIONED

ANNUAL REPORTING YEAR	SPRs COMMISSIONED BY THE FCA	SPRs COMMISSIONED BY THE PRA
2017/2018	29 10 focused on Conduct of Business; 11 focused on Financial Crime.	16 7 focused on Prudential Requirements for Deposit-takers, recognised clearing houses and PRA-designated investment firms.
2018/2019	34 14 focused on Financial Crime.	17 7 focused on the Prudential regime for Insurance.
2019/2020	59 13 focused on Controls and Risk Management Frameworks; 15 focused on Conduct of Business; 16 focused on Financial Crime.	29 12 focused on Prudential requirements for Deposit-takers, recognised clearing houses and PRA-designated investment firms.
2020/2021 (quarters 1-3 only)	45 12 focused on Conduct of Business; 11 focused on Controls and Risk Management Frameworks; 11 focused on Financial Crime.	15 7 focused on Controls and Risk Management Frameworks.

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It is worth noting that the regulators have other tools available to them – including obligating relevant entities to provide certain information. Accordingly, both regulators have stated that their approach to the use of SPRs is:

- for diagnostic purposes: identifying, assessing and measuring risks;
- for monitoring purposes: tracking the development of identified risks;
- for preventive action: limiting or reducing identified risks, preventing them from crystallising or increasing; and
- for remedial action: responding to crystallised risks.

WHAT DOES THIS MEAN FOR THE RELEVANT ENTITY?

SPRs are costly in terms of fees, and internal human resource and management energy. The skilled person may ask for copies of specific documents and request explanations on processes and procedures – which often involves an exchange of questions and answers over an extended period of time. This requires a person (or persons) at the relevant entity considering and responding accordingly.

Further, there is something to be said about the strain of SPRs psychologically on those involved. The commissioning of an SPR can make the firm/individuals responding feel targeted and pressured. In practice, the firm should communicate with its regulator(s) to understand the scope of the review and should explore whether alternative steps could be taken, thereby achieving the same objective.

WHAT TOPICS DO SPRs COVER AND HOW OFTEN ARE THEY COMMISSIONED?

Both regulators publish data on the number of SPRs commissioned per year and what topics those SPRs focused on. The focal point is referred to as the “Lot” of the SPR. The available Lots are:

- Lot A: Client Assets;
- Lot B: Governance and individual accountability;
- Lot C: Controls and risk management frameworks;
- Lot D: Conduct of Business;
- Lot E: Financial Crime;
- Lot F: Prudential – Deposit takers, Recognised Clearing Houses and PRA-designated investment firms;
- Lot G: Prudential – Insurance;
- Lot H: Prudential – credit, market, pension and liquidity risk within investment firms, intermediaries and Recognised Investment Exchanges;
- Lot I: Prudential – operational risk, recovery and resolution and wind-down within Investment Firms, Intermediaries and Recognised Investment Exchanges;

- Lot J: Technology and Information Management;
- Lot K: Threat Intelligence;
- Lot L: CBEST Threat Intelligence;
- Lot M: Penetration Testing; and
- Lot N: CBEST Penetration Testing.

Based on publicly available information, we set out in Table 1 the number of SPRs commissioned in recent years and the “Lots” the majority of the SPRs were attributed to by the FCA or PRA. The data highlights that for the FCA, Financial Crime has consistently been a focal point as well as Conduct of Business. For the PRA, Prudential requirements for Deposit takers, recognised clearing houses and PRA designated investment firms.

In addition to the number of SPRs commissioned and the relevant Lot, data has also been provided by the FCA on which FCA Sectors have been the focal point of SPRs. The available FCA Sectors are:

- Retail Banking;
- Retail Lending;
- Retail Investments;
- General Insurance and Protection;
- Pensions and Retirement Income;
- Investment Management; and
- Wholesale Financial Markets.

So far for 2020-2021, 10 SPRs have been commissioned in each of the following Sectors – Retail Banking; Retail Lending and Wholesale Financial Markets. In 2019-20; the majority of the FCA’s SPRs that were commissioned focused on the Retail Lending (18) and Retail Banking (14) Sectors. In 2018-2019, the majority were concentrated in the Wholesale Financial Markets (13) Sector.

Interestingly, in a letter to the Chairperson of the Treasury Committee in 2014, then FCA chief executive Martin Wheatley stated:

“Whilst some industry commentators express concern that the FCA is substantially increasing its use of Skilled Person Reviews that is not borne out by the facts ... and it is not our strategic aim to significantly increase the use of s 166s going forward.”

Fast forward seven years, and the data says otherwise. The FCA has become more focused on conduct in recent years and will continue to be as we move out of the COVID 19 environment. Whether the increasing trend is due to a strategic move or is incidental to the regulatory landscape in recent years is yet to be ascertained. What is certain is that SPRs remain a constant part of the regulator’s arsenal. ■