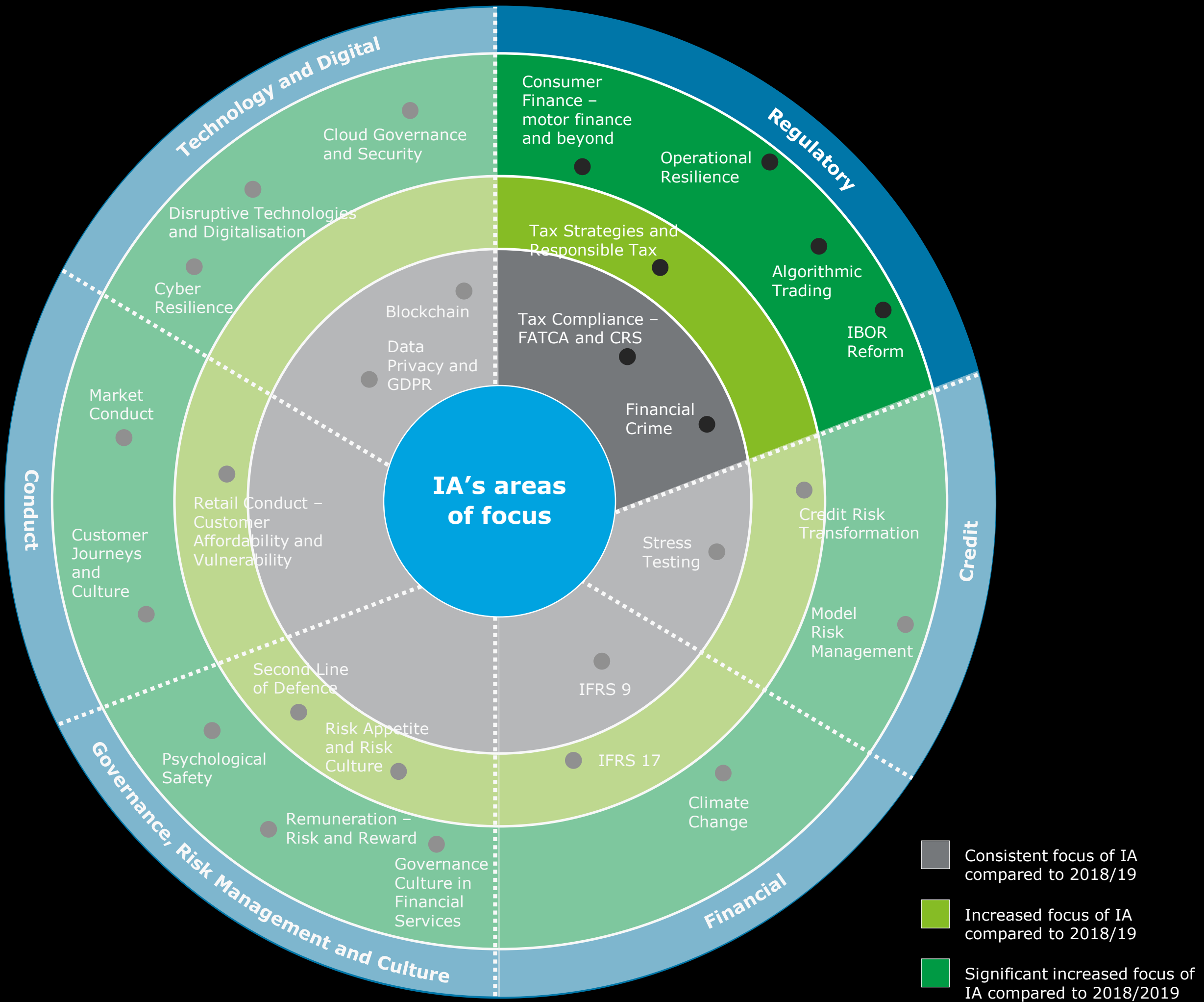
Financial Services Internal Audit
Planning Priorities 2020 – Regulatory Hot Topics

Introduction

Ten years after the financial crisis most post-crisis prudential policies have now been decided, and banks in particular are now much better capitalised and more liquid than before the crisis. Nonetheless, regulatory scrutiny remains heightened across financial services. Firms need to be prepared to respond to the ever-changing focus of the regulator.



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1.1 IBOR Reform

Why is it important?

The clock is ticking for firms using key interbank offered rates (IBORs) and market participants exposed to them, due to the transition away from IBORs to Alternative Reference Rates (ARRs) such as SONIA. The Financial Conduct Authority (FCA) will not compel the panel banks who contribute to LIBOR to continue beyond 2021 meaning the viability of LIBOR continuing beyond that date cannot be guaranteed; other benchmarks such as Euro Overnight Index Average (EONIA) will also be reforming to €STR ('Euro Short Term Rate') by 2022. Working Groups from each of the Central Banks for the UK, US, Eurozone, Switzerland and Japan have been tasked to drive consensus and establish market standards to ease the transition away from LIBOR. The replacement of IBORs will have a major impact on existing financial contracts, on the type of financial products being offered and the risk management approaches adopted by financial institutions.

What's new?

- The European Union Benchmark Regulation (EU BMR) will continue to be applicable. Benchmarks require authorisation and registration by a National Competent Authority (NCA) to protect users and ensure the integrity and reliability of published benchmarks.
- The FCA has secured panel bank support to continue submitting to LIBOR, but only until 2021.
- There has also been interest from other international regulatory bodies in the US, Switzerland, Hong Kong, Singapore and Sweden who have been identifying and developing risk-free rates (RFR) to replace IBORs.
- In June, the FCA and Prudential Regulatory Authority (PRA) provided feedback to the market in the form of a 'Dear CEO Letter' sent to large banks and insurance firms on LIBOR reform. The focus of the feedback was on the identification and quantification of LIBOR and the management of associated risks. Similar exercises have begun in other jurisdictions including Netherlands, Australia, Singapore and Hong Kong.

What should Internal Audit be doing?

Area of focus	Description
Firm readiness (IBOR)	Challenge the readiness of the project and whether the work to be completed for the transition is achievable by the end of 2021.
Risk Management Frameworks (IBOR)	The transition away from IBORs could bring significant conduct risks to firms. The identification and management of these risks are crucial for firms to navigate through the transition. IA should challenge the appropriateness of these risks and the mitigants identified.
Governance Framework (IBOR)	Review the effectiveness of the governance framework depending on the size and needs of the firm. Internal Audit should ensure key roles and responsibilities are defined and fulfilled from audit & risk committee and business level management.
Challenging Management (IBOR & BMR)	Challenge management on their planning for LIBOR transition and ability to understand and map EU BMR risks through risk management frameworks.

1.1 IBOR Reform

Are there any potential challenges?

Challenge	Description
Brexit	After Brexit, LIBOR will be designated as a third country benchmark. With no transitional Brexit arrangements, a third country benchmark administrator will need to apply for recognition or endorsement or the UK regulatory environment will need to achieve equivalence with EU BMR by the European Securities and Markets Authority (ESMA). Non-EU benchmark administrators need to meet one of the three options (Equivalence, Recognition or Endorsement) under the third country regime. However, compliance requirements are still unclear, making internal audit planning a challenge.
Uncertainty	Internal Audit should understand the complexity of the LIBOR transition and EU BMR. IBOR reform challenges include uncertainty as to when certain products are going to end and whether new products have the liquidity to be used by market participants.
Resourcing	Internal Audit teams need to be sufficiently resourced in terms of scale and the need for specialist and SME's to ensure appropriate Internal Audit support is available for such specialised audits.
Systems, processes and controls	The transition may necessitate changes to a swathe of internal systems, processes and controls. The ability to alter scope and plan will be challenging.

What Internal Audit skills are required?

- Specialist knowledge of benchmark changes/transitions and regulatory and legal requirements in varying jurisdictions (possibly).
- Ability to understand which articles of regulation are in scope for the firm and ensuring the necessary steps are in place to meet the requirements.
- Ability to manage stakeholders, including ensuring all stakeholders, from senior board and executive management to business unit leaders, are clear on their roles and responsibilities in respect of LIBOR transition and EU BMR planning.

What's next?

- Firms should continue working to transition away from LIBOR across all relevant tenors and currencies on the basis LIBOR will be discontinued at the end of 2021.
- Other IBORs are also going through the process including Canada (transitioning from CDOR to CORRA).
- To help firms design and guide their IBOR transition programmes, Deloitte have developed the IBOR Watch tool to support firms at each stage of transition planning.
- The extension of the transitional arrangements for critical and third country benchmarks has moved the timeline but has not altered the requirements that administrators, contributors and users have to comply with. Firms should use this time wisely, in raising awareness and making plans to help ensure compliance well in advance of 2022.

Find out more

- https://www2.deloitte.com/content/campaigns/uk/ibor/ibor/iborreform.html#potential-impacts
- https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/financial-services/deloitte-uk-libor-transition-ibor-benchmark-report-digital.pdf
- https://blogs.deloitte.co.uk/assurance/2019/04/eu-benchmark-regulation-eu-bmr-kicking-the-can-down-the-road-the-implications-of-the-extension-of-th.html

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1.2 Consumer Finance – motor finance and beyond

Why is it important?

Consumer borrowing to fund 'lifestyle events' (e.g. cars, short-term credit, rent-to-own) has increased since the global financial crisis and provides regular income for many mainstream and new firms. Without solid governance, poor lending practices can become ingrained and result in poor business, increased risk of consumer harm and regulatory breaches. Ongoing regulatory intervention is high profile and poses reputational and financial risk. Where intervention requires changes to the existing business model, this can be costly and disruptive. Unfair treatment of customers, or potential consumer harm can manifest in a number of different ways including poorly-designed products which do not consider the needs and circumstances of consumers, non-identification of potentially vulnerable consumers and unsuitable or unfit distribution channels which increase the risk of mis-selling.

What's next?

- The Financial Conduct Authority's (FCA) thematic review into motor finance uncovered issues with point of sale disclosure, affordability assessments and unfair commission structures. Policy intervention is under consideration following a cost benefit analysis by the FCA.
- The FCA's thematic review into general insurance distribution indicated the sale of products which were not suitable and on which the commission element of the total premium exceeded 50%.
- The FCA's continued mission is to increase the level of protection afforded to the consumer. Extension of SMCR to non-mainstream financial institutions in December 2019 and consultation over the imposition of a possible new duty of care indicate the current direction of the regulator's focus.

What should Internal Audit be doing?

Area of focus	Description
Affordability assessments/ lending decisions	Review the accuracy of changes to systems for alignment with the updated CONC 5.2.
Commission income	Consider the commission element of premium income to ensure that customer value is not eroded by lengthy distribution chains.
Sales disclosure	Review of existing disclosure to consumers at the point of sale, covering both written and verbal delivery.
Culture	Assess whether the prevalent culture within firms, especially where remuneration is linked to performance, is promoting poor sales practice.
Monitoring/ Controls	Review existing processes and controls to assess whether there is adequate oversight and reporting of the compliance of the sales process with relevant regulatory standards.

1.2 Consumer Finance – motor finance and beyond

Are there any potential challenges?

Challenge	Description
Ensuring that affordability assessments have been updated for new CONC 5.2	Changes to CONC 5.2 went live in November 2018. Internal Audit need to tailor their assessments to ensure the new CONC 5.2 requirements are covered.
Review of brokers/ intermediaries	Regulation makes clear that lenders must take reasonable steps to monitor those brokers and intermediaries acting on their behalf. Currently no set definition exists for what constitutes 'reasonable' steps, which can be challenging for Internal Audit to assess.
Data availability	Where lending decisions are made according to standard underwriting criteria there may be little information available to verify the thought processes. Algorithmic decision-making will require specialist skills to investigate.

What Internal Audit skills are required?

- Credit risk experience in defining and measuring the suitability of lending arrangements.
- Conduct risk experience in assessing the quality and accuracy of the information delivered to the consumer at point of sale.
- Regulatory experience to ensure that the provision of the updated CONC and other relevant regulations are operating in all areas of the business.

What's next?

- Policy intervention is likely before the end of 2019 to ban/limit certain commission structures in motor finance. For those institutions which rely on commission income as a key part of the business model, fundamental changes may be required to ensure viability.
- Continued regulatory focus on repairing the imbalance between the consumer and financial institutions will promote further investigations from the FCA and potentially lead to new regulation and enforcement action against those found to be in non-compliance.

Find out more

- https://www.fca.org.uk/news/speeches/financial-conduct-regulation-restless-world
- https://www.fca.org.uk/news/press-releases/fca-acts-address-unclear-and-excessive-motor-finance-costs
- https://www.fca.org.uk/publications/thematic-reviews/tr19-2-general-insurance-distribution-chain

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1.3 Algorithmic Trading

Why is it important?

Algorithms are increasing in their capability, prevalence and complexity. They have the potential for unexpected and unintended results. The risk of algorithms malfunctioning has wide-ranging consequences for all stakeholders involved; which could involve the possibility of financial loss, harming firms' reputations and causing severe disruption to financial markets. Regulators are placing a greater scrutiny on firms to ensure proper compliance with the regulations.

What's new?

There is a heightened regulatory focus over algorithms. The requirements of Markets in Financial Instrument Directive RTS6 (MiFID II RTS 6) in conjunction with various publications by the Financial Conduct Authority (FCA), the Prudential Regulatory Authority (PRA) and FICC Markets Standards Board (FMSB) require detailed consideration by firms, including:

- Self Assessments: The FCA are likely to place greater scrutiny on quality of annual self assessments being performed this year. In 2019, FCA will also publish its thematic review on Asset Managers' compliance with MiFID II. There will be additional work for some Asset Managers on their self-assessments in response to the review.
- Algorithm regulation: The regulation is evolving. For example, the US Algorithm Accountability Act 2019 is expected to place additional requirements on a host of algorithms, not just those in relation to Financial Services.

What should Internal Audit be doing?

Area of focus	Description
Compliance with regulations	Evaluate if firms have documented the necessary policy and procedures to meet relevant regulatory requirements.
Governance Framework	Review the governance framework. Ensure the key roles and responsibilities are clearly defined and fulfilled at each level including audit and risk committees, algorithm steering committee and business level management.
Managing risks	Challenge management on their ability to understand and map exposure to algorithm trading risks through risk management frameworks.
Control Framework and self assessment process	Assess the adequacy of the control framework with regards to algorithm trading including: • Adequacy of the approach to algorithm validation. • Effectiveness of testing and deployment of algorithmic trading. • Adequacy of the annual self-assessment process. • Controls over approach to real-time monitoring of algorithms.

1.3 Algorithmic Trading

Are there any potential challenges?

Challenge	Description
Documentation	Ensuring all the correct documentation with regards to the regulatory requirements or internal trading procedures are in place can be challenging.
Oversight	Given the complexity of algorithm use, Internal Audit need to have the right skillset to both test and challenge management.
Resourcing	Many firms are rapidly increasing their use of algorithms so Internal Audit needs to be sufficiently resourced in order to manage the oversight of algorithm use.
Flexibility	Algorithm trading strategies are continuously changing and evolving, therefore the ability to alter the audit scope and plan is quite challenging.

What Internal Audit skills are required?

- Strong understanding of the technical requirements as well as mathematical and IT skills.
- Ability to interpret and understand relevant regulation in scope.
- Ability to understand commercial/business rationale for algorithm use and therefore ability to assess risk versus benefit.
- Collaborating with other teams in areas such as Cyber and Data management can help in detecting threats internally as well as externally.

What's next?

- As the usage and capabilities of algorithms increases so will the regulatory landscape. Regulators will want to ensure that firms cannot use algorithms to manipulate the market or create disorder. Both Europe and US regulators are considering regulation that would ensure algorithms are used fairly in regards to privacy, diversity and data governance.
- Investment managers are increasingly automating the client-facing side of the investment management lifecycle. Suitability assessments and service disclosures apply equally to algorithmically-based investment advice. Regulators globally are implementing policies and giving guidance on their expectations of 'what good looks like' in this space.
- Cyber security is also a key risk consideration when dealing with algorithms as investment firms need to be aware that they are susceptible to threats internally and externally.
- The use of algorithms is extending clearly beyond just banking. There will be an increase in the deployment of algorithms across the media (i.e. internet search engines and social media) and the public sector (the health service, HMRC and the Department for Work and Pensions).

Find out more

- https://blogs.deloitte.co.uk/assurance/2019/05/mifid-ii-rts-6-requirements-annual-self-assessment-guiding-your-firm-through-uncertainty.html

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1.4 Tax Compliance – FATCA and CRS

Why is it important?

The Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS) regimes are now fully implemented in the UK (and in many other jurisdictions) and reporting is now in its third or fourth year. In previous years, tax authorities have focused on implementation activities and have to some extent accepted 'best endeavours' compliance. From 2019 onwards, however, those authorities are shifting their attention to the adequacy of compliance and monitoring activities. If firms are not confident in their procedures and governance regarding these regimes they run the risk of suffering penalties and reputational damage.

What's new?

- The Organisation for Economic Co-operation and Development (OECD) published the second edition of its CRS Implementation Handbook, instructing tax authorities to put in place regimes to assess the compliance of Financial Institutions (FIs) with the regime.
- Tax authorities worldwide stepped up their review and enforcement actions. For instance:
  - HMRC launched its first enquiries into FATCA and CRS returns.
  - Revenue Jersey assessed multiple late or incorrect return penalties.
  - French tax authority opened compliance audits.
  - Luxembourg issued late return notices threatening fines of up to EUR 250,000.
- With the OECD expecting authorities to provide evidence of audit procedures, we expect the pace of enforcement action to increase over the second half of 2019 and into 2020.

What should Internal Audit be doing?

Area of focus	Description
Historic reporting	During the implementation of FATCA and CRS reporting, businesses often followed a tactical approach to reporting. With tax authorities now demanding accuracy in compliance Internal Audit should consider performing reviews of historical reporting.
Policies and procedures	Review of policies and procedures that firms have in place to assess the robustness of the documentation.
Governance	Review the governance framework and assess if firms have planned the integration of FATCA and CRS governance into their overarching governance frameworks.
Ongoing monitoring Due diligence	Tax regimes require ongoing monitoring of changes in circumstance. This will likely be a particular area of interest to tax authorities. Internal Audit should develop a rolling plan of ongoing monitoring to assess the compliance with various tax legislations even when circumstances change.

1.4 Tax Compliance – FATCA and CRS

Are there any potential challenges?

Challenge	Description
Auditability	Many businesses took a tactical approach to FATCA and CRS compliance in previous reporting years. The audit trails may be hard to follow and implementation teams may have moved on.
Timeliness	FATCA and CRS reporting is an ongoing annual process. Internal Audit will need to take this into account when planning their procedures.
Scoping	Defining a clear project scope can be challenging for Internal Audit as some businesses have reported very large amounts of data. Internal Audit will need to determine how to review this.
Resourcing	There may be insufficient understanding of FATCA and CRS within Internal Audit. Internal Audit will need to plan the resourcing well in advance before commencing this audit.

What Internal Audit skills are required?

- Accounting and taxation experience in evaluating the financial risks leading to financial loss and penalties.
- Understanding which legislations are in scope for the firm and ensuring necessary steps are in place to meet the requirements.
- The ability of Internal Audit to use the data sampling tools and techniques.

What's next?

- The trend to accelerate a focus on accuracy in compliance by Tax authorities is expected to accelerate over the coming 18 months.
- Authorities are now analysing three or four years' worth of reporting data which is expected to lead to targeted enquiries.
- The push for tax transparency will not slow down. It is possible that FATCA and CRS will form the basis of future, more onerous information reporting regimes, such as the EU Mandatory Disclosure Rules – Directive on Administrative Cooperation (DAC6).

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1.5 Tax Strategies and Responsible Tax

Why is it important?

Financial Services' firms are at the forefront of a complex and rapidly evolving tax environment. In addition to a focus on tax positions taken by firms, HMRC is also interested in tax advice given to customers which means that policies, processes and controls need to manage the associated compliance, financial and reputational risks. Following the Thathiah v HMRC [2017] case taxpayers are expected to not only have adequate policies and processes in place to ensure tax compliance, but also to regularly test those policies and processes. Internal Audit has a role in ensuring firms are in compliance with regulatory requirements.

What's new?

There are a number of recent and upcoming regulatory changes which means tax should remain a focus area for Internal Audit, for example:

- HMRC's new business risk review approach brings in new expectations for large businesses around tax governance.
- Making Tax Digital for VAT (MTDfV) took effect for many businesses on 1 April 2019, although there are deferrals to later in the year for more complex organisations.
- Directive on Administrative Cooperation (DAC6) – Implementation of the latest EU DAC6 on 1 July 2020. Detailed local implementing legislation is expected later in 2019.
- IR35 – proposed reform to the taxation of personal service companies (PSCs) in the private sector is due to be implemented from 6 April 2020.

What should Internal Audit be doing?

Area of focus	Description
Compliance with changing legislation	Understand the approach taken by tax functions to determine the way in which new rules will impact firms and assess and manage associated risks. Use this understanding to prioritise Internal Audit activity.
Governance Framework	Review governance framework around policies, risk registers and monitoring solutions to changes in tax rules.
Rolling programme of testing	Develop a risk-based audit plan for auditing different areas, including rotation/coverage by tax territory.
Leverage subject matter expertise	Subject matter assistance with necessary expertise should be used to perform audit planning and carry out testing.

1.5 Tax Strategies and Responsible Tax

Are there any potential challenges?

Challenge	Description
Complexities	Complexities in tax rules can result in many judgemental decisions which are difficult to test and carry high associated risks with non-compliance (financial, regulatory and reputational). Internal Audit should ensure the firm has appropriately involved SMEs and implemented effective governance over complex and/or judgemental areas.
Evolving legislation	Tax legislation changes frequently and it is important that Internal Audit remains independently up-to-date with the changing legislation in order to ensure audits are timely and relevant, and to allow for any potential gaps in compliance to be identified.
Difficulty in testing	Tax functions do not always have well-defined controls, which makes testing harder. Internal Audit needs to factor this into testing plans, and may need to allow more time to gather sufficient information, identify the controls and then request data accordingly to test the tax controls.
Global coverage	Multi-national/global firms face a significant challenge with coverage given country-specific legislation. Clear roles and SME involvement is required to ensure audits are prioritised to meet regulatory requirements (e.g. mandated tax audits) and prioritised by risk.

What Internal Audit skills are required?

- Ability to interpret and understand relevant legislations and to ensure necessary steps are in place to meet the requirements.
- Ability to manage stakeholders and grasp and challenge the firm's exposure to regulatory and reputational risks.
- Ensure teams are resourced with necessary specialists in tax legislation in all jurisdictions, augmented by external SME resource as required.

What's next?

- The sophistication of tax authorities will rapidly increase leading to more real time reporting of accounting and tax information, driving a need for effective and timely processes and controls.
- More reporting will become public (e.g. country-by-country reporting) leading to increased need for confidence over data and the way it interacts with other regulatory disclosures.

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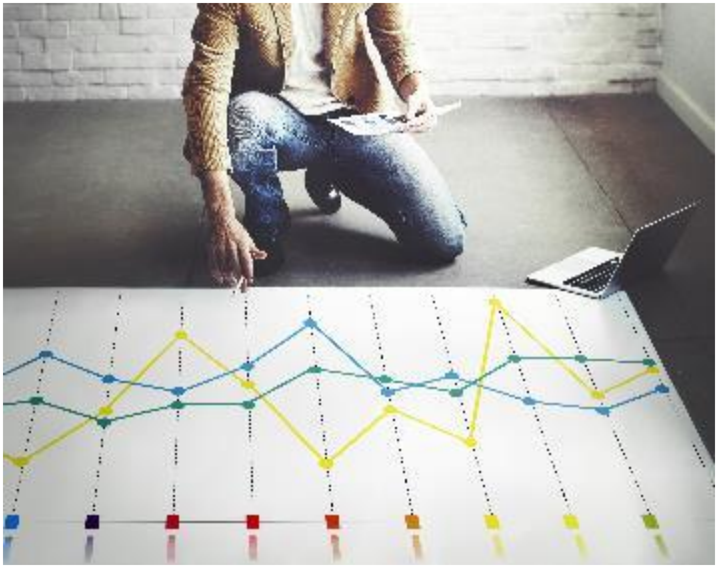
1.6 Operational Resilience

Why is it important?

Operational resilience is critical to achieving systemic stability. The Prudential Regulatory Authority (PRA) has expressed concern at the growing number of operational failures and outages, the increasing number of cyber attacks, and growing reliance on IT outsourcing and/or the cloud. Being able to demonstrate that a firm is operationally resilient is likely to become as important as demonstrating its ability to assess financial risk.

What's new?

- DP1/18 was released jointly by the Bank of England (BoE), the PRA and the Financial Conduct Authority (FCA). It applies to Banks, Investment Firms, Insurers and FMIs.
- The related consultation paper will be released later this year and will establish the draft rules that firms will be required to follow.
- The PRA has asked the Internal Audit functions within a number of firms to undertake an operational resilience audit.
- The PRA requires firms to establish communication plans for dealing with internal and external stakeholders during a crisis in order to handle situations and minimise harm to customers and market participants (including customer redress protocols).



What should Internal Audit be doing?

Area of focus	Description
Governance and Framework	Review the firm's governance arrangements for operational resilience, its approach to setting risk appetite and its establishment and oversight of the programme to achieve operational continuity.
Preparation	Understand and challenge the firm's process to identify their most important business services in order to prioritise their work and investment in operational resilience. Ensure that the firm has set appropriate impact tolerances for their important business services. Challenge the ability of the firm to demonstrate substitutability or the capability of processes to deliver a level of acceptable service during disruption. This, in turn, requires that firms demonstrate evidence of scenario testing against impact tolerances.
Recovery	Firms need to be able to adapt and recover from operational disruption and be able to do so in order to ensure continuity of service at a level that minimises harm. Internal Audit should review how firms have interpreted the regulation and actions taken in response.
Communications	Assess communication plans against the PRA's expectations.

1.6 Operational Resilience

Are there any potential challenges?

Challenge	Description
Emerging regulation	The regulation itself is still at the discussion paper stage, although many of the related areas are well-established. This may curtail Internal Audit's ability to perform a review against the new regulation, and the path to full compliance may take an extended period.
Outcome-focused	The operational resiliency discussion paper is more qualitative and outcome-focused which may increase the difficulty of reaching objective opinions and may create challenges in Internal Audit's ability to assess compliance.
Breadth	Operational resilience covers a wide range of disciplines and it may be challenging to review all elements at a single time. A cyclical/staged approach to Internal Audit activities may therefore be appropriate.

What Internal Audit skills are required?

- Expertise in non-financial risk management including:
  - Operational risk.
  - Recovery and resolution planning.
  - Business continuity planning.
  - Operational continuity.
  - Cyber crime.
  - Systems and controls.
  - Governance.
- Familiarity with auditing against regulatory requirements.

What's next?

- The PRA and FCA are likely to publish the Consultation Paper and draft Supervisory Statement later this year, which will then be formally implemented through a Policy Statement.
- Given that this is a high priority area for the regulator, firms should draw up their plans to meet the aims of the operational resiliency initiative.

Find out more

- https://blogs.deloitte.co.uk/financialservices/2018/07/bank-and-fca-up-the-ante-on-operational-resilience-expectations.html
- https://www.bankofengland.co.uk/prudential-regulation/publication/2018/building-the-uk-financial-sectors-operational-resilience-discussion-paper

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1.7 Financial Crime

Why is it important?

The FCA continues with its unrelenting focus on financial crime. As reiterated in its 2019-2020 Business Plan, one of the FCA's main priorities is combating financial crime and improving anti-money laundering practices, in particular by enhancing the use of technology and data, as well as engaging with multiple agencies and government bodies. In addition, the FCA's thematic review on 'Understanding the Money Laundering Risks in the Capital Markets' (June 2019) urges the adoption of public-private partnerships in the battle against financial crime in an increasingly complex landscape of global trades coupled with multiple players.

What's new?

- There is tougher enforcement action in the UK by the FCA, HM Revenue & Customs ("HMRC"), and the Gambling Commission, as well as across the globe. There have been an increasing number of s166 Skilled Person Reports commissioned in the UK, and larger fines issued for inadequate anti-financial crime controls, as demonstrated by the recent fines on Countrywide Estate Agency, Daub Alderney, Standard Charted and UBS. The direction of travel in the regulatory domain shows no signs of decline, and firms should take the opportunity to re-assess their financial crime systems and controls and look for methods to increase information-sharing and drive a proportionate approach to combat financial crime.
- The level of uncertainty associated with changes in legislation and regulation in the run up to Brexit has been mounting over the past 12 months. The UK enacted the Sanctions and Anti-Money Laundering Bill in 2018, to give the UK the power to introduce its own AML and Sanctions legislation post-Brexit. There has also been the increasing political tension between the US, EU, Iran, China and Russia, with increased scope and breadth of international sanctions as the preferred tool to enforce political agendas.
- Given the advanced use of technologies and data intelligence in recent years, digital money in the form of cryptocurrencies and virtual assets can frequently be used by money mules or criminals and therefore seen as an emerging threat. Governments are making efforts to develop a global regulatory framework, and regulators in APAC have already taken proactive steps in virtual asset regulation.

What should Internal Audit be doing?

Area of focus	Description
Holistic assessment of financial crime risks	Internal Audit can support effective "integrated" financial crime risk management by conducting thematic audit reviews across the financial crime domains including assessing whether: • There is effective integration of all financial crime domains including tax evasion. • Integrated systems have been developed that allow data analysis of customer types and transactional activities across business lines. • A non-binary approach to customer risk assessment exists. • The financial crime risk management framework has been tailored to the firm.
Robust approach to enterprise-wide risk assessments	Effectiveness review of risk assessments including determining whether they are comprehensive, whilst remaining proportionate to the nature, scale and complexity of business activities and help to drive robust understanding of the financial crime risks faced and subsequent tailoring of the control framework. Review of governance framework over enterprise-wide risk assessment activities.
Impactful audit insights	Internal Audit should adopt various data analytics models and work together with data science and analytics professionals to improve audit processes, reporting and service delivery.

1.7 Financial Crime

Are there any potential challenges?

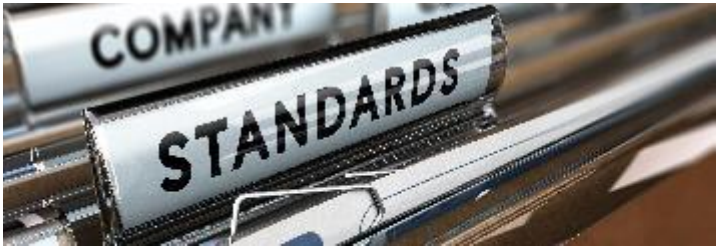
Challenge	Description
Unforeseen regulatory changes (e.g. sanctions)	Internal Audit may need to be more proactive in the face of a changing regulatory climate by taking steps to re-assess audit risks and revisiting previously audited financial crime domains in their planning to ensure a fully informative and comprehensive risk-based Internal Audit plan.
Organisational restructuring	The uncertainty in the run up to Brexit may lead to organisational restructuring, which in turn can impact the size and location of the functions, requiring firms to consider the implication of this on resourcing and budgeting. For multinational organisations, internal restructuring of legal entities or branches may also create additional challenges when managing the design and implementation of local procedures.
Business activities and customers	US trade policy uncertainty and the impact of Brexit may affect the volume of business trades, the geographical locations of products and services, and the nature of the customer base. This may lead to regulatory scrutiny in assessing compliance with trade-related regulations. Internal Audit need to conduct independent reviews of the risks and impact of new trade agreements and build this into their audit plans.
Limited and dated guidance in the age of fast-moving digital technologies	Rapidly evolving digital technologies can create more opportunities for criminals, with the implementation of mitigating controls playing catch up. The Joint Money Laundering Steering Group (JMLSG) guidance on identity verification was written in an age focused on physical documents with limited guidance over electronic verification. This raises challenges for Internal Audit when auditing standards are incorporating new and evolving technologies.

What Internal Audit skills are required?

- Due to the ever-changing regulatory environment in financial crime, adaptability and flexibility are key to an effective Internal Audit function.
- The ability to accurately and pragmatically interpret law, regulation and guidance and to identify gaps in application through review and testing of policies, procedures, processes, systems and controls is also a key skill required for Internal Audit professionals. Ongoing training and management oversight should be exercised to ensure quality and consistency.
- In order to support a holistic financial crime risk management framework, it is crucial for Internal Audit to work collaboratively (yet independently and objectively) with Compliance and other internal business stakeholders to consider innovative ways to enhance financial crime data sharing and security.

What's next?

- The recently published FCA thematic review on 'Understanding the Money Laundering Risks in the Capital Markets' (June 2019) highlighted capital market-specific money laundering risks, such as insufficient AML risk assessments, lack of visibility of underlying customers and ultimate beneficial owners, ineffective transaction monitoring, and inadequate customer due diligence and source of assets. The review also highlighted that the participants in this review, including investment banks, exchanges, trade bodies, clearing and settlement houses, inter-dealer brokers and trading firms, are generally at the early stages of their thinking in relation to money-laundering risks and there is much more that the firms need to do to fully understand their exposure to money laundering risks.
- Accordingly, these types of institutions will continue to be under close scrutiny of the FCA in the coming years. Internal Audit can support these efforts by ensuring that the relevant systems and controls are tested with adequate frequency, to ensure early identification and mitigation of issues.



Find out more

- https://www2.deloitte.com/uk/en/pages/financial-services/topics/financial-crime.html

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