Internal Audit. Expect More

2018 Internal Audit Planning: Insurance and Asset & Wealth Management

September 2017

Contents

Applicability of section:

AM Asset and wealth management

Ins Insurance

Br Insurance Broker

Executive summary

Stakeholder expectations

As regulators increase the focus on senior manager, executive and non-executive director accountability across all parts of financial services, the expectations of stakeholders on Internal Audit (IA) is increasing. This is evidenced in part by PwC's 2017 State of the Profession Survey, where 48% of IA's stakeholders want IA to be trusted advisors, but only 9% of respondents consider IA to be there. In addition, year on year survey results show that there is a 10% drop in stakeholders who believe that IA are adding significant value (44% in 2017).

We do not believe that IA are adding less value than in 2016, but that stakeholder expectations are increasing. So how can IA close this gap and keep pace with its stakeholders? The survey publication explores a number of solutions boiling down to having access to the right skill sets and the risk assessment that drives IA's activities.

IA skill sets

The skills in the IA team are core to being seen by its stakeholders as value adding. This goes beyond the valuable auditing skills and independent mind set, requiring IA to house a complimentary team with gravitas, subject matter expertise, and a commercial pragmatism that can walk the line between working with management while being a strong 3rd Line of Defence.

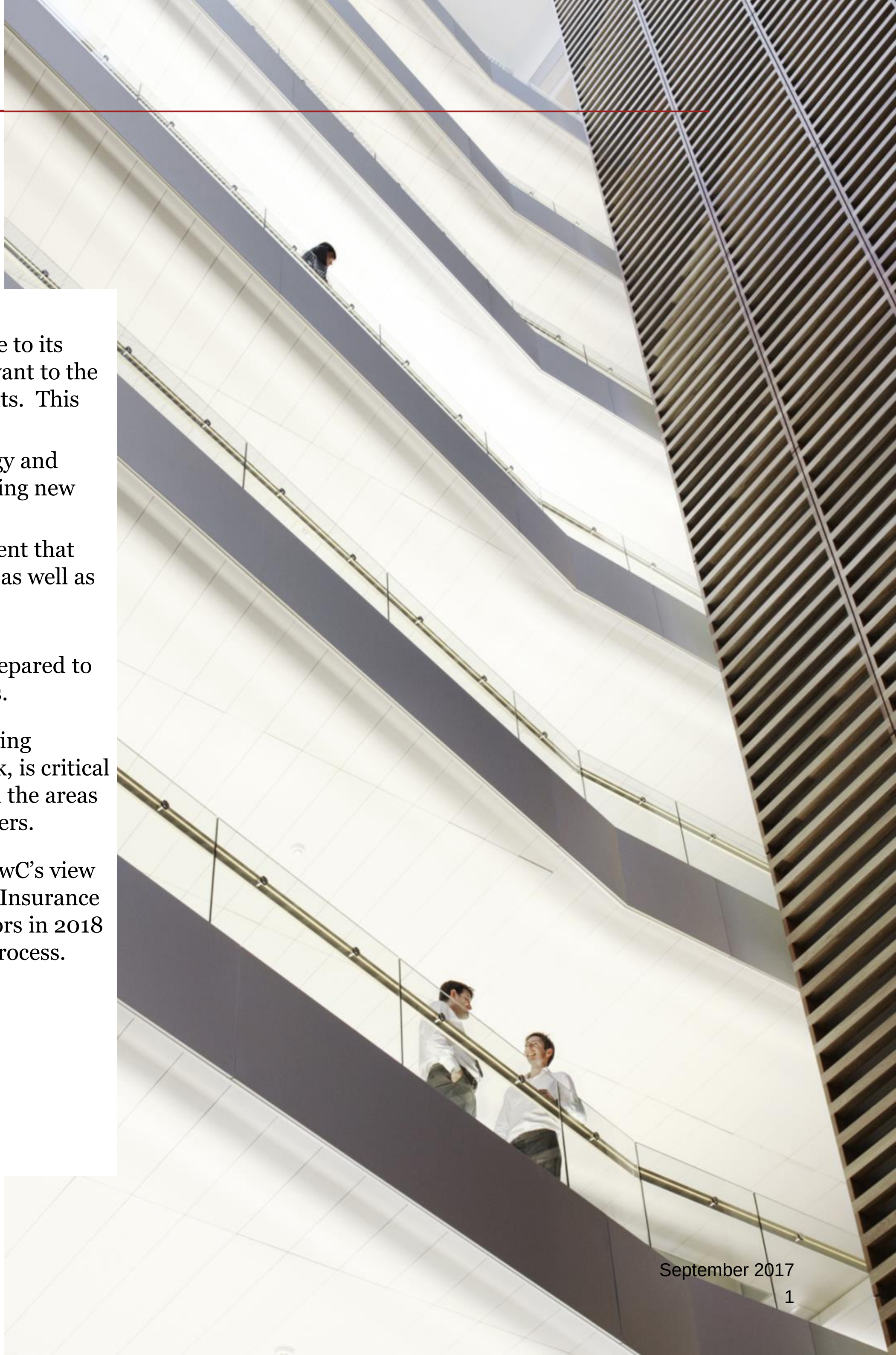
Risk assessment

So how do IA keep pace in adding value to its stakeholders? It's all about being relevant to the business and providing valuable insights. This requires three actions from IA:

- Understand the business, its strategy and potential market disruptors (including new regulations);
- Undertake a thorough risk assessment that captures the impact of these events as well as those arising from a bottom up risk assessment; and
- Stay close to the business and be prepared to adapt your IA plan to change events.

The risk assessment process, and ongoing monitoring of emerging / changing risk, is critical to ensuring that IA's plan is focused on the areas that will add real value to its stakeholders.

This paper seeks to provide you with PwC's view on the market issues impacting on the Insurance and Asset & Wealth Management sectors in 2018 to support your own risk assessment process.



Market

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Brexit

With the UK committed to leaving the EU in March 2019, firms need to ensure they understand how their business will be impacted and put plans in place to manage this where necessary. With political negotiations continuing and little clarity as to what the UK-EU relationship will comprise post March 2019, firms are being urged by the regulators to 'hope for the best but plan for the worst' in terms of the potential Brexit scenarios that could occur.

Key risks

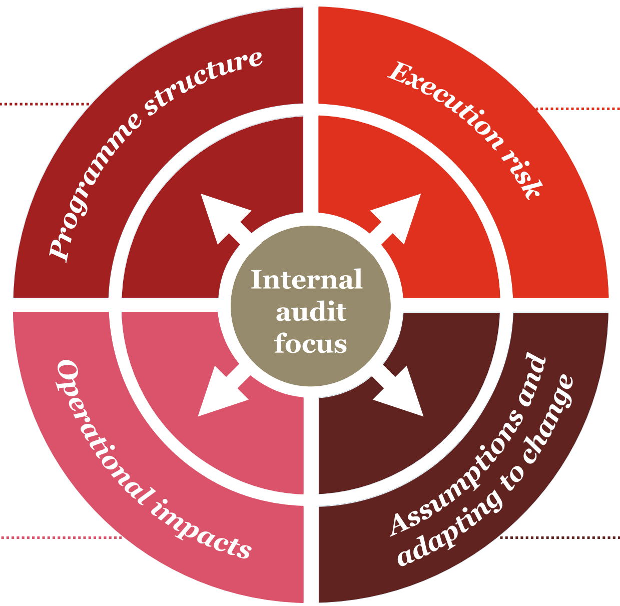
- The right to sell into the EU market, influencing legal and regulatory structure.
- The ability to fulfil existing contracts.
- Disruption to supply and distribution chains.
- Potential loss of competitive position.
- Operational disruption, including staff uncertainty.
- Execution risk of Brexit projects.

Programme structure

Is the firm's Brexit programme set up for success? Does this include sufficient Board engagement as expected by regulators?

Execution risk

Are the key risks within the firm's Brexit project known and are they being effectively monitored and managed? What are the implications of not completing certain actions by March 2019 and what are these dependent on?



Operational impacts

Has the firm's Brexit plans been worked through to identify and plan for all impacts to the business, does this include operational impacts such as accounting and financial reporting, capital management, employment, governance, compliance?

Assumptions and adapting to change

Is the firm really planning for the worst scenario or are assumptions being made about what will get negotiated? Given the evolving political environment, can the firm adapt as it may need to, including as and when aspects of a EU-UK deal are struck?

Financial reporting

Ins

IFRS 17 Insurance contracts

- IFRS 17 will be effective from 1 January 2021 with prior comparative reporting required. The standard will impact all aspects of the business and early planning is key. The General model (Building Block Approach or 'BBA') measurement approach is the default model for all insurance contracts under IFRS 17, and although the changes are more complex when using this approach, insurers using the optional Premium Allocation Approach ('PAA') for their short-term contracts will still experience significant change. Although most insurers will be able to defer IFRS 9 adoption to 1 January 2021, they will need to carefully plan the interaction between the two standards.
- We have seen many insurers already complete impact assessments and commence large implementation programmes. Internal audit functions will have a significant role to play in ensuring effective governance and providing programme assurance of the IFRS 17 implementation process. Internal audit functions should be challenging the business on the steps taken to ensure readiness for IFRS 17.

Key risks

- Business as usual is impacted by the expenditure and distraction of the implementation project.
- Leaving planning and implementation late is likely to cost the business more.
- Ongoing system and data projects have not appropriately built in IFRS 17 implications.

- The financial impact of the standard is not effectively planned for. Changes to financial results will drive new KPIs, require enhanced disclosures.
- IFRS 9 may increase volatility unless carefully managed with matching elections under IFRS 17.

- The operational impacts are not appropriately planned for. The IFRS 17 measurement model introduces greater levels of system complexity and cost.
- Inadequate data requirements and additional load on infrastructure (processing and storage capacity) resulting in a need to redesign or replace systems.

Internal audit focus

- Programme assurance/project governance – Given the significance of implementation programmes to insurers, IA functions should challenge the business now and insurers should consider special IA projects on providing programme assurance at the beginning, and throughout, implementation.

- Data and systems – Challenge the business on the plan for developing an information model and a robust data framework, which will enable the transition by preparing/cleaning legacy data and providing new data where necessary. Ensure the business designs a clear systems plan for the most efficient end state to accommodate the additional requirements.
- Controls – As implementation develops, controls across the business including around data capture, security, modelling and financial reporting will need to be revised for changes in processes.

- Wider business impact – The business's new product development processes and controls incorporate consideration of the IFRS 17 implications including the impact on long term incentive planning, budgeting and forecasting in a new IFRS world.

Regulation

Timeline and key dates

2016 Q4 (Oct, Nov, Dec)

- Pillar 3 disclosure – Basel Phase 1 guidance implemented

2017 Q1 (Jan, Feb, Mar)

- European Market Infrastructure Regulation (EMIR) – Certain provisions take effect
- CRD IV buffers – 1.25% capital conservation buffer
- LCR – 80% (EU), 90% (UK), 100% (US)

29 March 2017: UK triggers Article 50

31 March 2017: EU council publishes draft Brexit guidelines

2017 Q2 (Apr, May, Jun)

- MLF4 applies from 26 June 2017
- Adoption and publication of IAIS International Capital Standard version 1.0 for confidential reporting

29 April 2017: EU27 summit adopts European Council's Brexit guidelines

7 May 2017: Second round of French presidential election

8 June 2017: UK general election

21 June 2017: Queen's Speech

19 June 2017: Formal negotiations between the UK and EU begin

2017 Q3 (Jul, Aug, Sep)

- 14 July 2017 – Deadline for banks, insurers and designated investment firms with EU/UK cross-border activities to inform PRA of Brexit contingency plans

Q3 2017: Italian national election likely

24-27 September 2017: Labour Party Conference

September 2017: German federal elections

2017 Q4 (Oct, Nov, Dec)

- SEPA instant payments 'go live' date
- Pillar 3 disclosure – Basel Phase 2 guidance to be implemented. EBA Pillar 3 Phase 1 to be implemented
- PRIIPs Regulation applies from 31 December 2017
- Due date for 2017 IAIS International Capital Standard confidential reporting process

1-4 October 2017: Conservative Party Conference

December 2017: EU27 summit to agree major principles for exit agreement (citizens' rights, UK financial contributions and border issues)

2018 Q1 (Jan, Feb, Mar)

- MiFID II applies from 3 January 2018
- MAR/MAD II – Provisions of MAR relating to concepts under MiFID II apply
- IDD effective from 23 February 2018
- European Benchmarks Regulation – Applies from 1 January 2018
- Payment Accounts Directive – Provisions on transparency and comparability of fee information take effect
- PSD2 – Applies from 13 January 2018
- CRD IV buffers – 1.875% capital conservation buffer
- Basel Committee risk framework – IRRBB rules effective
- Liquidity – LCR 100% and implementation of pillar 2 changes

January 2018: UK-EU negotiations begin on future trade relationship

Q1 2018: UK expected to notify EEA of intention to leave, to align with EU exit in Q1 2019

2018 Q2 (Apr, May, Jun)

- GDPR takes effect on 25 May 2018

2018 Q3 (Jul, Aug, Sep)

- AIFMD – National Private Placement Regime ends

2018 Q4 (Oct, Nov, Dec)

- Senior Managers and Certification Regime (SM&CR) – SM&CR rolled out to all financial services firms by end of 2018 (date to be confirmed)
- Due date for 2018 IAIS International Capital Standard confidential reporting process
- EC to complete review of Solvency II implementing measures

October 2018: Conclusion of exit negotiations and start of ratification process

2019 Q1 (Jan, Feb, Mar)

- CRD IV buffers – 2.5% capital conservation buffer
- CRD V – Implementation date for the majority of changes
- BRRD – UK G-SIBs required to meet FSB TLAC standard
- UK Banking reform – Deadline for retail bank ring-fencing

31 March 2019: Deadline for conclusion of exit negotiations. UK leaves EU

2019 Q2 (Apr, May, Jun)

- 1 April 2019: Earliest date for EU to consider UK's equivalence

2019 Q3 (Jul, Aug, Sep)

- Due date for 2019 IAIS International Capital Standard confidential reporting process

2019 Q4 (Oct, Nov, Dec)

- Adoption of ComFrame, including IAIS International Capital Standard version 2.0

Underlined: **See overview in following pages**

Brexit negotiations

Other political events

Regulation

AM Ins Br

Insurance-based investment products

In implementing MiFID II, the European Commission acknowledged the need to align investor protection for substitutable products, such as unit trusts and unit-linked insurance. To achieve this, aspects of MiFID II protection will be introduced as part of the IDD for investments packaged under insurance contracts, such as investment bonds. The FCA is due to provide further detail on how it will implement changes to its rules brought about by the IDD in late September. This is likely to include clarification on rules regarding training and competence of sales and advice staff, consumer disclosures, intermediary remuneration, charges, suability of advice and product governance and oversight.

Ins Br

Insurance Distribution Directive ('IDD')

The IDD will replace the Insurance Mediation Directive ('IMD') and insurers and intermediaries will have until 23 February 2018 to implement the new regime. The FCA released its first consultation paper (CP17/7) in March and its second consultation in July (CP17/23). A third consultation is due out at the end of September 2017.

AM Ins

Packaged Retail and Insurance-based Investment Products ('PRIIPS')

PRIIPs aims to harmonise disclosures across packaged retail and insurance-based investment products, which fall within the scope of MiFID. PRIIPs requires that a standardised Key Investor Information Document ('KIID') is presented to investors pre-sale; KIIDs will replace UCITS KIIDs from 31 December 2019.

Key risks

Insurance-based investment products

- Failure to have carried out any form of gap analysis is likely to attract regulatory censure including potential enforcement action.

Insurance Distribution Directive ('IDD')

- There are a number of areas where the IDD goes beyond current FCA rules. Firms will need to assess how FCA implementation of IDD affects their current business models and practices.
- Those UK firms operating elsewhere in the EU will need to additionally consider how each EU Member State plans to implement IDD.

Packaged Retail and Insurance-based Investment Products ('PRIIPS')

- Readiness for the implementation deadline.
- Incorrect reporting to PRIIPs manufacturers/ distributors.
- Incorrect calculation summary risk indicator (SRI), performance scenarios and costs.

Internal audit focus

Insurance-based investment products

- Ensuring that the business have identified an effective gap analysis, linking overlapping relevant regulations, (including any new rules introduced by the FCA).
- Assurance over the project governance and technical implementation.

Insurance Distribution Directive ('IDD')

- Assurance over the project governance and technical implementation of IDD to ensure that the project is appropriately addressing all in scope areas for the business model.
- Post implementation review to ensure that IDD is operating as designed.

Packaged Retail and Insurance-based Investment Products ('PRIIPS')

- Assurance over the project governance and technical implementation of PRIIPS.
- Post implementation review of the a) Accuracy of data and calculations (SRI, performance scenarios, costs); b) KIID compliance with template and rules; and c) KIID lifecycle (ad hoc and regular updates).

Regulation

The Markets in Financial Instruments Directive ('MiFID II')

AM Ins

MiFID II enhances and widens the scope of MiFID. It strengthens both investor protection regimes and market structure rules for investment firms. It introduces new product governance rules and extends existing reporting regimes. AIFMs/UCITS ManCos are impacted by some aspects due to FCA 'gold plating' and where they have MiFID permissions as part of their licence.

Key risks

- Readiness for 3 January 2018 implementation deadline.
- Incorrect transaction reporting. FCA has said it will focus both on over and under reporting.
- Insufficiently robust conflicts framework for avoidance of conflicts (over-reliance on disclosure).
- Incorrect reporting to clients (e.g. costs and charges).

Internal audit focus

- Conflicts of interest and inducements.
- Transaction reporting.
- Record keeping (including telephone recording).
- Disclosures to clients, counterparties and other intermediaries.

The Alternative Investment Fund Managers Directive ('AIFMD')

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The AIFMD was implemented in 2013 and introduced a harmonised framework for the authorisation and oversight of hedge fund managers, private equity firms and other alternative investment managers.

Key risks

- Breach of local marketing restrictions where using private placement or relying on reverse solicitation (e.g. for third country AIFMs).
- Incorrect Annex IV reporting and breach of risk limits disclosed to the regulator.
- Lack of robust valuations process, especially for hard to value assets.

Internal audit focus

- Valuations (fair value, hard to value assets).
- Annex IV reporting.
- Risk management framework.
- Liquidity management.
- Process for marketing sign off and record keeping.

Client assets

AM Ins Br

Client Asset ('CASS') rules are in place to protect investors from the risk of loss in the event of a firm's insolvency. Since the financial crisis, this has been a particular area of focus for the FCA and has contributed significantly to the overall level of FCA fines and skilled person reviews in the last five years.

Key risks

- Complex rules are often difficult to interpret and are challenging to align to existing operational processes, leading to unidentified breaches.
- Changes in products and business models lead to the scope of the CASS rules changing and not being identified by the firm.
- Inadequate governance and oversight arrangements, in particular in relation to third parties performing operational processes.

Internal audit focus

- Applicability of the CASS rules to the business and how this is controlled.
- Whether key operational areas such as reconciliations align to the specific requirements of the CASS rules.
- The adequacy of governance and oversight arrangements, including third party administrators.

Regulation

General Data Protection Regulation ('GDPR')

AM Ins Br

GDPR is the most significant change in data protection laws in a generation. The regulation will be enforced from 25 May 2018 onwards. This landmark piece of legislation will impact every entity that holds or uses European personal data.

New obligations include data portability, mandatory breach disclosure and right to be forgotten.

Gartner study suggests 50% of companies affected will not be in full compliance by the implementation deadline.

Key risks

- Operational ability to enable classification of data and to report breaches within 72 hours.
- Potential fines up to the greater of EUR20m or 4% of global turnover for non-compliance.
- Reputational damage.

Internal audit focus

- Assess readiness to comply with GDPR regulation, and adequacy of the programme scope.
- Operational assurance to assess processes for ongoing compliance after the enforcement date.
- Adequacy of governance and oversight arrangements, including third parties, over personal and sensitive data.

Treatment of longstanding customers

Ins

In 2016, the FCA published the findings of its thematic review into the treatment of long-standing customers in the life assurance market. The findings raised a number of areas of poor practice, in customer disclosure, investment performance, exit charges, and governance and oversight. Of the eleven firms reviewed, six were referred to the FCA's enforcement division for further investigation, with five of these still ongoing. The regulator has said it expects all life insurance firms with closed books to consider the implications of the review findings.

Key risks

- We expect the FCA to ask firms that were not part of the review on how they have responded and the actions they plan to take.
- Failure to have carried out any form of gaps analysis is likely to attract regulatory censure including potential enforcement action.

Internal audit focus

- Assess the robustness of management's assessment of exposure to this conduct risk.
- Review the framework for identifying customer conduct gaps and remediation actions (1st and 2nd line).
- Embed the risk into future product development / governance reviews, or audits on conduct.

Conflicts of interest

AM Ins Br

The FCA has been ramping up its activity across all sectors on effective management of conflicts of interest. This incudes aspects of conflicts, such as inducements, that feature heavily in recent European directives such as MiFID II and the IDD. The regulator's concerns extend beyond 'gifts and hospitality', with the FCA showing a willingness to challenge conflicts within firms' core strategy and business model, such as vertically integrated business.

Key risks

- Firms unable to demonstrate how they manage or mitigate conflicts risk facing major regulatory interventions, including restrictions on permissions to wholesale restructuring of the business and governance structure.

Internal audit focus

- Review of the framework. A clearly defined framework should be in place, including governance and monitoring.
- The Framework should demonstrate firms have considered all forms of conflicts of interest within their business, including inherent conflicts.
- Detailed testing in vulnerable areas relating to conflicts.

Capital and liquidity

Asset and liability matching, hedging and illiquid assets

Ins

Insurers are increasingly investing in illiquid unrated assets to provide a better cashflow match for the long-term insurance liabilities, particularly annuity liabilities. The persistent low interest rate environment has seen insurers pursuing high yielding illiquid assets including lower-rated fixed-income securities and often unrated real economy assets such as equity release mortgages, commercial real estate and infrastructure. On a Solvency II basis, a matching adjustment benefit is often held in respect of these illiquid assets.

Key risks

- Illiquid assets can be complex and may lack observable market prices as well as external credit ratings, making it difficult to assess the credit risk firms are exposed to.
- Increased regulatory focus, with the PRA planning to perform more intensive reviews of asset quality including credit risk management capabilities.

Internal audit focus

- Credit risk associated with illiquid assets is understood and managed relative to the assets held, risk appetite and the liabilities they back.
- Compliance with PRA approved matching adjustment methodology, including ongoing trading/asset restructuring.

Stress testing

AM Ins

Stress testing of firms' financial stability is a key tool to assess the resilience of the business to potential adverse events on the profit and loss, balance sheet and ability of the organisation to meet its regulatory capital requirements. The ongoing political and economic uncertainty associated with Brexit may give rise to some of these adverse events. The outcome of the stress testing allows management to determine the impact on capital plans and the management actions which may be required to manage the resulting potential impacts.

Key risks

- The risks resulting from potential adverse events are not appropriately managed leading to financial loss and/or regulatory censure.
- Insufficient capital to meet regulatory requirements and adverse events.

Internal audit focus

- Design and operating effectiveness of controls and governance over stress testing.
- Stresses are appropriate to the risk exposures and the economic environment in which the business operates.
- Alignment of content and timing of stress testing with business planning and strategy.

EBA prudential regime for investment firms

AM

The current prudential regime for Investment Firms is based on rules that were designed for banks. With the input from European Competent Authorities, the EBA is designing a new prudential regime that will be specific for investment firms. The proposed rules are due to be published at the end of September. The regime will result in a number of significant changes in the prudential arrangements for investment firms.

Key risks

- The new rules may result in a higher capital requirement for firms.
- Some forms of capital which are currently eligible may not be in the future.
- Investment will be required in establishing new regulatory reporting processes.

Internal audit focus

- Review of project plan to ensure impact from the regulation has been adequately considered and incorporated to comply with the new rules once they have been issued.
- Gap analysis against the rules.
- Governance arrangements to ensure ongoing compliance with the rules.

Financial crime

AM Ins Br

Financial crime

Financial Crime is an increasing concern for all insurance and investment market participants, from the largest global organisations to the smallest syndicates and partnerships. As the risks and potential impacts of Financial Crime continue to evolve with recent changes to legislation and increasing globalisation, the risk for market participants who do not put in place effective risk governance and controls frameworks extends well beyond monetary losses to reputation and brand damage, reduced employee morale, and constrained business relations.

AM Ins Br

4th Money laundering directive

On 26 June 2017 the Money Laundering Regulations 2017 ('the 2017 Regulations') came into force, transposing into UK law the Fourth Money Laundering Directive ((EU) 2015/849). The key shift in the 2017 regulations is the codification of the requirement for a firm's AML controls to be risk based. This was previously seen as best practice but the 2017 regulations make this a legal obligation for regulated firms.

Key risks

- **Bribery and corruption:** Every UK-incorporated organisation has an obligation to comply with the Bribery Act (2010). This includes failing to prevent bribery by any of its employees (and associated persons) which is then enforced as a corporate offence. The past 24 months has seen examples of Bribery Act enforcement actions.
- **Sanctions:** Sanctions put in place by a number of national (UK/US) and supranational bodies (EU/UN) have become the foreign policy tool of choice for placing economics or trade restrictions on individuals, entities, goods and services, and increasing the regulatory burden on companies. Global enforcement activity has also increased, resulting in USD 14bn fines by UK and US enforcement against financial service companies since 2010.
- **Fraud:** All companies face the risk of fraud. Recent statistics suggest that fraud is the most common crime in England and Wales. The risk is particularly relevant to the insurance market with the Association of British Insurers quoting that in 2014 there were £1.32 billion worth of fraudulent insurance claims. However, recent unauthorised trading and market manipulation scandals expose the risks faced by investment firms.

- All regulated firms must have their AML compliance framework informed by an enterprise risk assessment. This risk assessment must consider a range of factors and be specific to the entities business. Historically, regulated firms have struggled in performing this exercise and ensuring their controls are aligned accordingly.
- The 2017 regulations create new offences, including where a reckless statement is made in relation to a request from a supervisory body. This move could indicate that breaches of the requirements of the 2017 Regulations will be treated with increased severity by Supervisors. This is supported by the FCA's business plan which has indicated that AML will once again be a priority area.

Internal audit focus

- Financial Crime framework design/effectiveness review.
- Look back of claims and claims fraud history.
- Review of associated parties and accompanying controls.
- Investigation support.

- Enterprise risk assessment and refresh.
- AML framework design review.
- AML framework effectiveness.
- Customer Due Diligence evaluation/remediation.

Technology

Cloud

AM Ins Br

All organisations will, at some point move to the cloud. Cloud provides a number of benefits around scalability, cost reduction and agility. However, cloud also presents a number of risks including skills and capabilities, reliance on third parties, lack of a coherent cloud strategy and governance model.

Resilience

AM Ins Br

Technology resilience is an area that is still of interest to the regulator, following banking IT issues several years ago. Whilst their attention was on the banks, it is moving toward other FS firms.

The Insurance and Asset management sectors often have serious issues in this space, with management unaware of the technical risk they are facing. It can range from poor operational processes and technical approach that leads to unstable IT services, to resilience solutions that can only be used in a very small number of situations. In a small but significant number of cases, firms have developed IT Disaster Recovery ('ITDR') capability at great expense, that does not work, with management unaware of the residual risk.

Cyber

AM Ins Br

Cyber risks continue to grow in frequency, variety, and potential harm they can inflict on organisations, their trading partners, and their customers. This creates increased pressure on boards and senior management to stay on top of current and emerging risks, for which they increasingly require specialised Assurance.

Stakeholder groups expect Internal Audit to 'look deeper and see further', acting as a lever for supporting an organisation's strategic agenda and compliance requirements.

Key risks

Cloud

- Whether the organisation has the right capabilities to govern and operate the cloud environment?
- Have management responded to the FCA 16/5 Guidance Paper on Management of Cloud risks?
- Is there a cloud strategy and how is aligned to the business and IT strategy?

Resilience

- Regulatory and contractual non-compliance.
- Unstable IT services impacting overall business performance.
- ITDR and resilience technical capability that does not protect the business from outages.

Cyber

- Direct Compromise of internet accessible systems.
- Denial of service attacks on internet accessible systems.
- Leak of sensitive information by trusted insider.
- Online fraud directly targeting customers.
- Financial system risk, market manipulation, insider trading.
- Compromise of endpoint security through malware infection.

Internal audit focus

Cloud

Review the key risk areas that could impact the delivery of moving to the cloud and ensure that appropriate activities are in place to address them. This includes:

- Cloud governance;
- Cloud operations; and
- Cloud security.

Resilience

- Full IT resilience review (includes IT Service Management, ITDR, New Service Introduction and Technology strategy).
- ITDR review (including controls and technical).
- Specific Incident review.

Cyber

- Cyber risk universe and risk-based prioritisation and contextualisation of the need for controls.
- Adaptability of the controls framework to address the increased agility in cyber attacks.
- Extent and nature of the firm's real-time detect & respond capability to proactively manage cyber risk.

Operations

AM Ins Br

Outsourcing/Third party management

Across the industry, organisations are looking to outsource their back office functions increasingly as a way of reducing operational costs and achieving a lean operating model. This has resulted in organisations' critical services becoming more inextricably linked to third parties. As a response, regulators around the globe are applying more focus and challenge over organisations' ability to manage their third party and outsourcing risk.

Key risks

- Poor management of data loss, cyber attacks and interruption to the continuity of critical services, increasing their likelihood and impact on business operations.
- Increasing regulator scrutiny and changing requirements (e.g. GDPR), resulting in additional costs and burden on staff involved in maintaining compliance over legacy outsourced arrangements.
- Poor performance and service delivery through lack of effective oversight.

Internal audit focus

- Consistent approach applied across the organisation driven by a clear strategy and risk appetite.
- Consistent and proportionate oversight of third party arrangements.
- Management of wider third party arrangements including 'Intra-Group' arrangements.

AM Ins Br

Change programmes (technology, regulatory and business)

All organisations will, at some point, undertake significant change activities – e.g. a system implementation; a response to regulation (e.g. MiFID or s.166); to manage Brexit; or to undertake an organisational re-structure. By nature change is high risk, of strategic importance and is delivered by activities/resources/budgets outside of BAU.

Key risks

- The scope of the required change are not defined, leading to a change programme which does not achieve the original goal and objectives.
- Change as a result of the programme is not sustainable.
- The change programme is not set up for success with sufficient planning, governance and oversight.

Internal audit focus

Identify the key risk areas that could impact the change and ensure that appropriate activities are in place to address them.

- Programme 'healthchecks'.
- Deep dive reviews into specific technical areas.
- Provision of ad hoc advice and observation (e.g. at Programme Steering Committees).

AM

Front office controls

The FCA currently has a keen interest in front office controls, particularly in relation to best execution and fair allocation. The regulator has promised follow-up work to review how firms have responded to previous FCA publications in this area, with possible sanctions for those that have not responded appropriately.

Key risks

- Firms need to have arrangements in place (processes, oversight and record keeping) that allow them to demonstrate that they achieve best execution. Where firms identify that clients have paid too much for execution, clients need to be compensated.
- Ideas and trades need to be fairly allocated. Without adequate processes and oversight, there is a risk that some clients may be preferred over others, disadvantaging certain clients.

Internal audit focus

- Are systems and processes established to support best execution and fair allocation?
- Are there sufficient record keeping arrangements to demonstrate that best execution and fair allocation have been achieved?
- Does robust oversight promptly identify issues and ensure changes are made, and compensation paid, when necessary?

Operations

Pricing

Ins Br

Insurers are starting to utilise machine learning applications and in some cases replace often very complex pricing processes. The PRA are becoming concerned that pricing disciplines and controls are slipping.

Underwriting in a soft market

Ins Br

With rates continuing to remain low, insurers are looking to underwrite new risks in different lines of business that they feel are adequately priced. However, some insurers are being overly optimistic on risks for which they have no or limited historical claims data, and for which previous risk carriers have declined due to being unprofitable.

Claims management

Ins Br

Conduct risk has been a focal point for the FCA for several years and clear improvement across the industry needs to be instigated to ensure 'good customer outcomes'. Whilst the eventual outcome of the claim is very important, so is the customer journey/experience throughout the handling of the claim.

Key risks

Pricing

- New processes give rise to significant control risks and could result in errors in pricing.
- Limits and line sizes together with other terms and conditions could be softened to the extent that this results in a material deterioration on loss ratios.

Underwriting in a soft market

- Insurers not adequately managing their exposures so that they are unable to identify and quantify the risks being covered and estimate likely claims costs under different loss scenarios.
- Insurers underwriting risks with limited or no specialist claims expertise to support the claims handling process.

Claims management

- The customer journey/experience is not sufficiently considered within the claims handling process.
- Appropriate controls, MI and reporting are not in place or sufficient to guard against poor claims handling.
- Lack of governance and oversight of third party suppliers to support the claims handling process.
- Insufficient intelligence is available to support continued improvement in key processes and the overall performance of the claims function.

Internal audit focus

Pricing

Pricing review to include:

- Analysis of average premiums offered and written;
- Reconciliation checks on data flows through the pricing process; and
- Investigation into average line sizes, terms and conditions changes and how these are picked up in peer review process.

Underwriting in a soft market

- Review the underwriting controls in place to determine the level of risk management and oversight in operation for new lines of business.
- Evaluate the claims expertise available to ensure new lines of business are adequately resourced with experienced claims personnel.

Claims management

- Evaluate the customer experience, throughout the journey of the claim to determine whether good conduct is at the heart of the process.
- Review the use of third parties to ensure alignment with the interests of the insurer.

Culture and governance

AM Ins Br

Senior manager and certification regime ('SM&CR')

The FCA are extending the SM&CR regime to all FCA firms and to amend the existing insurance and banking regimes. The rules will come into effect in 2018.

Governance and culture are a key priority for the regulator. The regimes will replace the existing Approved Persons Regime, and seek to drive individual accountability in senior staff.

AM Ins Br

Remuneration code

Solvency II has introduced remuneration rules to align the insurance sector with similar regulations to those in place across financial services sectors. Regulators are now keen to explore how these remuneration rules have been implemented.

AM Ins Br

Risk management in a cost cutting environment

Financial services organisations are under increasing pressure to cut costs and increase efficiency. In an environment of low interest rates, disintermediation and increasing automation, this pressure become ever more acute. But in cutting costs, organisations often lose sight of the additional risk they are taking on, especially on operational risk.

Key risks

Senior manager and certification regime ('SM&CR')

- Inappropriate allocation of Senior Manager functions may cause the regulator to take action.
- Quality of documentation of governance processes and controls is insufficient.

Remuneration code

- Employees who are Material Risk Takers ('MRTs') are not correctly identified and there is insufficient documentation, process and framework to support the identification.
- Variable pay pool decisions do not reflect all risks the firm is exposed to.
- Inadequate governance and oversight processes are in place relating to the operation of remuneration policies.

Risk management in a cost cutting environment

- Increased likelihood of error, driven by reduced resilience in the IT environment, fewer people, less onerous checks and reviews, and an overall less robust controls environment.
- Assurance activity may be reduced.
- Pressure to grow to reduce fixed costs as a proportion of revenue may lead to unintended risks being taken on.

Internal audit focus

Senior manager and certification regime ('SM&CR')

- Allocation of Senior Manager Function holders (H2 2018).
- Appropriateness of HR systems to record the information required for certification.
- Appropriateness of systems and procedures in place to record Senior Managers' responsibilities.

Remuneration code

- Interpretation and application of relevant criteria to identify MRTs and how this is documented.
- Whether all financial and non-financial risks have been taken into account in variable pay pool decisions, and how these have been taken into account.
- Adequacy of governance and oversight processes in place relating to the operation of remuneration policies.

Risk management in a cost cutting environment

- Effectiveness of lines of defence and risk functions' ability to challenge the business.
- Effectiveness of control environment, particularly front office controls.
- Application and monitoring of risk appetite in practice.

Tax

AM Ins Br

People movement

Following the Organisation for Economic Co-operation and Development ('OECD') Base erosion and profit shifting ('BEPS') initiatives we are seeing tax authorities (both HMRC and overseas) increasing their efforts to track people movements in order to identify whether there is taxable activity taking place.

AM Ins Br

Tax loss relief and interest restrictions

New rules are being introduced in the UK

- Limiting the deductibility of interest expenses for corporation tax purposes.
- Restricting the offset of tax losses against 50% of profits emerging in the period.

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Transfer pricing

New rules have been introduced by the OECD for 2016 onwards requiring multinational organisations to prepare detailed transfer pricing reports at a group and local level.

Large organisations are also required to file with the tax authorities a country by country breakdown of the tax, revenue and people activities in all the territories where they operation.

Key risks

People movement

- Creation of a branch (taxable permeant establishment) in UK or overseas for corporation tax.
- Staff working overseas creating local PAYE and income tax liabilities.
- Supplies being deemed to be made from an overseas location triggering a requirement to register for VAT.

Tax loss relief and interest restrictions

- The new rules are complex and could lead to an error in the corporation tax return.
- There may be potential options to mitigate the impact of the new rules that are not identified.

Transfer pricing

- Non compliance with new reporting obligations.
- Error in the calculation and submission of country by country reporting ('CBCR') reports.
- Master/Local file data incomplete leading to risk of tax authority enquiry/penalties.

Internal audit focus

People movement

- Identify appropriate tax/HR policies and ensure they meet the rules in the territories where you operate.
- Track people movements using travel systems or other data.
- Review activities in these jurisdictions for high risk areas.

Tax loss relief and interest restrictions

- Impact assessment of how the organisation will be affected.
- Identify whether new rules have been considered and implemented in reporting/compliance processes.
- Review potential mitigation strategies and confirm these have been actioned by the business.

Transfer pricing

- Review approach/programme to comply with new regime.
- Walkthrough calculation of CBCR.
- Review master/local file preparation.
- Test intra group transactions have been charged and appropriate mark up has been applied.

Appendix – Contact details

Paul Pannell
Internal Audit Partner

T: +44 (0) 7725 068 227
E: paul.pannell@pwc.com

Alison Morris
Internal Audit Partner

T: +44 (0) 7714 226 313
E: alison.c.morris@pwc.com

Aaron Oxborough
Internal Audit Director

T: +44 (0) 7711 562 170
E: aaron.oxborough@pwc.com

Pete O'Brien
Internal Audit Director

T: +44 (0) 7776 081 944
E: peter.obrien@pwc.com

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