THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

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Your ref:

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Dear Karin

CONSULTATION PAPER 07/15: EXTERNAL ASSURANCE ON REGULATORY RETURNS.

The Institute of Chartered Accountants in England and Wales (the 'ICAEW') welcomes the opportunity to comment on the Financial Services Authority's (FSA) Consultation Paper 07/15: External Assurance on Regulatory Returns.

The ICAEW operates under a Royal Charter, working in the public interest. As a world leading professional accountancy body, we provide leadership and practical support to over 128,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The ICAEW is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.

The ICAEW's Financial Services Faculty was set up in 2007 to become a world class centre for thought leadership on issues and challenges facing the financial services industry, acting in the public interest and free from vested interests. It draws together professionals from across the financial services industry and from the 25,000 ICAEW members specialising in the sector. This includes those working for regulated firms, in professional services firms, intermediaries, and regulators.

We have reviewed the Consultation Paper 07/15: External Assurance on Regulatory Returns and are pleased to submit our comments.

General Comments

1. The ICAEW supports any initiative that promotes regulatory consistency and that utilises risk-based approaches to focus resources.

2. The ICAEW supports the decision to streamline the process and standardise the format of reports to enable the FSA to use more effectively the powers under section 166 of the Financial Services and Markets Act to review a firm's regulatory returns. We look forward to working with the FSA to develop any necessary guidance for skilled persons.

3. To ensure effective and systematic use of s.166 Return Assurance Reports (s.166 RARs), we recommend that the FSA articulates more fully the criteria that will be used to trigger the requirement for a s.166 RAR.

4. The FSA will wish to ensure that there remains an adequate pool of suitably skilled resources to carry out the s.166 RARs and the thematic Return Assurance Reports (thematic RARs). This will require continuing dialogue with firms supplying these resources on the impact of the proposals once implemented.

Specific Questions

Q1. Do you have any comments on our intention to deregulate the mandatory routine audit of regulatory returns for non-BIPRU investment firms?

We agree with the decision to bring consistency in regulatory requirements across regulated firms. However, the experience of our members is that the audits of regulatory returns of small firms regularly reveal errors. The FSA will need to be mindful that those firms who are not subject to an external audit are likely to be at higher risk of submitting incorrect regulatory returns. You may wish to take this into account as you plan the early thematic review programme.

Q2. Do you have any comments on our intention to retain the routine audit of regulatory returns for insurers?

The regulatory returns of insurers are public documents whilst the returns for other regulated entities are private submissions to the FSA. The CP does not address the inconsistency behind this position in sufficient detail and in our view the FSA should consider this in more detail now. In support of such differences, we acknowledge that the existence of the insurance regulatory return as a public document is well established and it is widely used as a valuable source of comparative data between insurers. In addition, it forms the basis of certain tax legislation. Therefore there are significant users, other than the FSA in its regulatory capacity, for the regulatory returns of insurers.

We note that the FSA intends to review the requirement for routine audits of regulatory returns in the light of changes to the returns as a result of Solvency II. We would consider an earlier review is appropriate. We should not delay a move towards a more risk-based approach unless there is a clear cost benefit case for doing so, taking account of the value of maintaining public confidence in the sector through the publication of externally audited insurance returns. Such a review should also look at the streamlining of the returns in the period before implementation of Solvency II and the opportunity afforded by thematic reviews to inform the development of future approaches to assurance.

As the FSA starts considering the approach to regulatory reporting under Solvency II, we suggest that the retention of routine audits on the basis of the need to maintain confidence in public reporting would be inconsistent with the FSA's decision to rely on market discipline for the disclosures required of banks and investment firms under Pillar 3 of Basel II and the Capital Requirements Directive. This would require a clear cost benefit case to be articulated.

Q3. Do you have any comments on our intention to retain the routine audit of regulatory returns for credit unions?

We support the proposal for the reasons outlined in the CP.

Q4. Do you have any preliminary comments on devising high level principles for the client asset report?

The key choices available to the FSA include:

- Retain the same rules, and audit against these.
- Retain the same rules, but reduce the level of assurance required.
- Have fewer rules, with a commensurate reduction in the amount of audit work required.
- Replace detailed rules with principles.

It is difficult to see how client money audits can be simplified if the rules are left unchanged; the key issue with firms is the rules rather than auditing compliance with them.

The approach to auditing compliance with the rules ultimately depends on the level of assurance that is required. For instance, if the auditor is required to confirm that systems are adequate or to report all breaches, then it is these requirements that will drive the approach to auditing.

In respect of client asset reports, if high level principles are adopted, the auditing profession is likely to seek a continuing dialogue with the FSA on desired outcomes-focused criteria to report against.

Q5. Do you have any comments on the CBA?

The basis of the costs used within the CBA needs clarifying. Costs – both direct and indirect – of undertaking s.166 RARs and thematic RARs will vary depending on whether the skilled person appointed is the firm's auditors or not, and also whether the report date coincides with the firm's year end. If the basis of costs used in the CBA is based on current costs, this may need reviewing.

Due to the difficulty some small firms have in completing the regulatory returns accurately, there will be some firms that retain the use of auditors to support their assurance process and hence cost savings may be overstated.

Draft Handbook Text

Within the draft handbook text, it appears that 'Annual Financial Returns' will still be required. We had anticipated that the returns would be brought into line with BIPRU firms, where the annual return was effectively switched-off (SUP 16.7.36 requires an annual return and transitional provision SUP TP 1.2 12J then switches it off). For UCITS and non-BIPRU firms that submit quarterly returns we are unclear what the value of an annual return would be going forward as the data will be at the same date as for the 4th quarter return. If there is a specific reason for firms that submit quarterly returns to also submit an annual return, such as to identify differences that might arise following the audit of financial information, we would recommend that an explanation and a cost benefit case are prepared and published.

If you would like further information or to discuss any aspects of this response, please contact me at philippa.scott@icaew.com or on +44 (0)207 920 8432, or Iain Coke at iain.coke@icaew.com or on +44 (0)207 920 8674.

Yours sincerely

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