

Bank of England PRA

Appendix 5 to CP26/23 – Reports by skilled persons: Critical Third Parties

Supervisory statement

December 2023

Draft for consultation



Bank of England | Prudential Regulation Authority

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1: Introduction

1.1 This supervisory statement is addressed to critical third parties (CTPs). A critical third party (CTP) is an entity that has been designated by HM Treasury (HMT) by regulations made in exercise of the power in s312L(1) of the Financial Services and Markets Act 2000 (FSMA) as amended by the Financial Services and Markets Act 2023 (FSMA 2023). It sets out the PRA and the Bank's policy on and expectations for the use of the following powers as supervisory tools as applied s312P (5) & (6) FSMA:

- (i) section 166 (Reports by skilled persons); and
- (ii) section 166A (Appointment of skilled person to collect and update information).

1.2 This statement is intended to be read together with the Cost of Skilled Persons Reports and Contracts with Skilled Persons and Delivery of Reports parts of the PRA and Bank rules for CTPs. CTPs are also advised to read sections 312P, 166, and 166A of FSMA.

Skilled Persons

1.3 Under s166 FSMA, the PRA and/or Bank may, by giving notice, appoint a skilled person to provide it with a report, or require any of the following persons to provide it with a skilled persons report:

- (i) a critical third party; or
- (ii) a person connected with a critical third party.¹

1.4 Under s166A(2) FSMA, the PRA or Bank may require a CTP to appoint, or may itself appoint, a skilled person to collect or update information.

The use of skilled persons as a supervisory tool

1.5 The appointment of a skilled person to produce a report under s166(3) FSMA is one of the PRA and the Bank's supervisory tools. The tool may be used for any matter including:

- (i) for diagnostic purposes: to identify, assess, and measure risks;
- (ii) for monitoring purposes: to track the development of identified risks, wherever these arise;

¹ Person connected with a CTP is defined in s. 312P(1) FSMA and includes both as a member of the CTP's group and, a controller (s. 422 FSMA) of the CTP.

(iii) for preventative action: to limit or reduce identified risks and therefore prevent them from crystallising or increasing; or

(iv) for remedial action: to allow the PRA and the Bank to respond to risks when they have crystallised.

1.6 The use of the tool could be prompted by any matter, including:

- (i) a specific requirement by the PRA and/or Bank for information;
- (ii) an analysis of information undertaken by the PRA and/or Bank;
- (iii) an assessment of a situation by the PRA and/or Bank;
- (iv) expert advice or recommendations received by the PRA and/or Bank; or
- (v) a decision by the PRA and/or Bank to seek assurance in relation to a regulatory return.

1.7 The tool may also be used as part of the oversight programme applicable to a CTP or the result of an event or development in relation to a CTP, that is prompted by a need for verification of information provided to the PRA and/or Bank as part of ongoing monitoring of a CTP.

1.8 The tool is used to support supervisory intervention first and foremost but on occasion the PRA and/or Bank might choose to obtain a report to support enforcement action being contemplated. It may also be the case that a report provided by a skilled person to support supervisory intervention is relied on in subsequent enforcement action taken by the PRA and/or Bank.

1.9 The PRA and Bank encourage CTPs to speak to their named contact at the PRA or Bank before commissioning any external review on subject matters which may be of interest to the regulators. This may avoid a CTP from incurring unnecessary costs where the PRA and/or Bank wishes to make use of skilled persons on the same, or broadly the same, matter.

Collecting and updating information as a supervisory tool

1.10 The appointment of a skilled person to collect and update information under section 166A(4) FSMA is another one of the PRA and Bank's regulatory tools. It may be used where the PRA and/or Bank considers that a CTP has failed to collect, and keep up-to-date, information required by the PRA and/or Bank.

2: PRA and Bank considerations

3.1 When determining whether to use powers under section 166 or section 166A, the PRA and Bank will consider a range of factors relevant to the specific case. These factors include those covered under the headings below.

Circumstances relating to a CTP

3.1 The PRA and/or the Bank will consider circumstances relating to a CTP, including, for example:

- (i) **The CTP's relationship with the PRA and/or the Bank:** whether the CTP is being co-operative;
- (ii) **history of similar issues:** whether similar issues have arisen in the past, and if so, whether timely corrective action was taken;
- (iii) **quality of a CTP's systems and records:** whether the PRA and/or the Bank has confidence that the CTP has the ability to provide the required information;
- (iv) **objectivity:** whether the PRA and/or the Bank has confidence in the CTP's willingness and ability to deliver an objective report;
- (v) **conflicts of interest:** where the subject matter of the report is such that the CTP and the PRA and/or the Bank would benefit from an external third party;
- (vi) **knowledge or expertise of the supervisory authority or the CTP:** whether the PRA, the Bank, or the CTP has the appropriate technical expertise or skills.

Cost considerations and objectives

3.1 The PRA and the Bank will be mindful of costs, particularly because a CTP must pay for the services of the skilled person, irrespective of whether the skilled person is engaged by a CTP, or contracts directly with the PRA and/or Bank.

3.1 The PRA and the Bank will take into account relevant factors when considering costs, including, for example:

- (i) whether a CTP may derive some benefit from the work carried out and recommendations made by the skilled person (eg a better understanding of its business and its risk profile, the operation of its information systems, or improvements to its systems and controls);

- (ii) whether the work to be carried out by the skilled person is work that should otherwise reasonably have been carried out by the CTP, or by persons instructed by a CTP on its own initiative;
- (iii) whether a CTP's record keeping and management information systems are poor and:
 - a. the required information and documents are not readily available; or
 - b. an analysis of the required information cannot readily be performed without expert assistance;
- (iv) the extent to which there appear to be risks that could threaten the regulators' objectives; or
- (v) the perceived probability and seriousness of possible breaches of regulatory requirements and the possible need for further action.

Considerations relating to PRA and the Bank resources

3.1 When deciding whether to use skilled persons, the PRA and the Bank will consider whether they have the necessary expertise, whether the resources required are available within the regulators to conduct the review itself, and whether the exercise will be the best use of regulatory resources at that time.

3: Appointment of the skilled person

Appointment

3.1 When the PRA and/or the Bank is contracting directly with a skilled person, it will itself appoint the skilled person. Where it is considered appropriate for a CTP to contract with a skilled person, the regulators may nominate the skilled person. Where a CTP is asked to propose a skilled person, the PRA and/or the Bank will direct the CTP to the skilled persons in the relevant lot(s) on the Panel and ask the CTP to submit a shortlist of nominees for the PRA and/or the Bank to approve. Where a CTP is contracting with a skilled person, it remains the CTP's responsibility to assess the individual appropriateness of the skilled person.

3.2 Where a person connected to a CTP appoints a skilled person the PRA and Bank expect that they would include similar contractual terms to those set out in the Contracts with Skilled Persons and Delivery of Reports Parts of the PRA and Bank rulebooks.

Panel

3.2 To enable the PRA and/or the Bank to use its power to appoint a skilled person a panel of skilled persons ('the Panel') has been developed for use.

3.3 Where the PRA and/or Bank is contracting directly with the skilled person, they will conduct a tender process, where appropriate, to identify the most suitable skilled person. This will include the considerations detailed below.

Skills, resources, and conflicts of interest

3.4 When considering whether to nominate, approve, or appoint a skilled person, the PRA and/or the Bank will consider the circumstances of the case, including whether the proposed skilled person appears to have:

- (i) **the necessary skills and any relevant specialised knowledge** – relating to the material services provided by the CTP and the particular subject matter area;
- (ii) **sufficient resources** – to complete the report or collect or update the information within the time expected by the PRA and/or the Bank; and
- (iii) **any professional difficulty, potential conflict of interest, or insufficient detachment** – such matters would include:

- a. matters already reported on by the skilled person;

- b. matters that are likely to be contentious and may result in disciplinary or other enforcement action against a CTP, its management, shareholders, or controllers; or
- c. matters that the skilled person has been involved in, in another capacity.

Expectations of skilled persons

3.5 The PRA and the Bank expect a skilled person to clarify or discuss any matters that are raised by either regulator regarding a contract before it is finalised.

3.6 The PRA and the Bank expect the skilled person normally to give a periodic update on progress and issues during the engagement, the frequency of which is to be discussed with either regulator. This should allow for a re-focusing of the report if necessary.

3.7 The channel of communication would normally be directly between the skilled person and the PRA and/or the Bank. The skilled person would usually be expected to keep the CTP informed of any communication between the skilled person and either regulator. It may be appropriate for the skilled person to communicate matters of material significance to either the PRA and/or the Bank set out in chapter 12 of the CTP Part of the PRA and Bank rulebooks, without first informing the CTP.

3.8 If the PRA and/or the Bank is considering asking for additional information during the engagement, it will take into consideration the cost of the skilled person complying with the request and the benefit that the regulators may derive from the information. In most cases, the PRA and the Bank will not need to request a skilled person to give it source data, documents, and working papers. However, the PRA and/or the Bank may do so when it reasonably believes that this information will be relevant to any investigation it may be conducting, or any action it may consider taking against the CTP.

3.9 In the relatively rare situation where enforcement action is anticipated as a likely outcome, the PRA and/or the Bank would normally signal this to the skilled person prior to work commencing, as this will impact the type of evidence which should be provided in support of the findings in the skilled person report.

Scope of report

3.10 The PRA and the Bank will normally contact the relevant persons to discuss the regulatory requirements before finalising its notice to require a report or the updating or collection of information by a skilled person.

3.11 The PRA and the Bank will give written notification to the relevant persons of the purpose of the report or collection or updating of information, its scope, the timetable for completion and any other relevant matters. The PRA and the Bank will state the matters

which the report is to contain, or the information which is to be collected or updated, as well as any requirements to the report's format.

3.12 The PRA and the Bank attach importance to having a timetable for each report and to the skilled person, with the co-operation of the relevant persons, keeping to that timetable.

Reporting

3.13 Where the skilled person is appointed by a CTP, the PRA and/or the Bank will normally require the skilled person to report to the regulator through the CTP. Where the skilled person is to be appointed by the PRA and/or the Bank itself, the skilled person will report directly to the regulator(s). Regardless of how the skilled person is appointed, they will usually be in regular contact with the Bank and/or PRA throughout the process.

3.14 The skilled person is expected to provide the PRA and/or the Bank with identical copies of any draft report or relevant information at the same time they are issued to the CTP. The PRA and the Bank expects that the CTP will be given the opportunity to provide written comments on the report or the collection of the relevant information prior to its final submission to the regulator.

3.15 The PRA and the Bank will normally specify a time limit within which it expects the skilled person to deliver the report or collect or update the relevant information.

3.16 If the skilled person becomes aware that the report, or collection or updating of the relevant information may not be delivered on time, they should inform the PRA and/or the Bank and the CTP as soon as possible. Where the skilled person is appointed by a CTP and becomes aware that there may be difficulties delivering the report or collecting or updating the relevant information within cost estimates, the skilled person should advise the CTP that they may also wish to discuss the final report with the PRA and/or the Bank but without the CTP.

3.17 The PRA and/or the Bank may meet with the CTP and the skilled person together to discuss the final report. The PRA and/or Bank may also wish to discuss the final report with the skilled person but without the CTP.

4: Assisting the skilled person

4.1 A CTP is expected to provide reasonable assistance, which should include:

- (i) access at all reasonable business hours for the skilled person to a CTP's records that relate to the provision of a material service in whatever form;
- (ii) the provision of such information and explanations as the skilled person reasonably considers necessary or desirable for the performance of their duties; and
- (iii) permitting a skilled person to obtain such information directly from a CTP's auditor as they reasonably consider necessary or desirable for the proper performance of their duties.

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5: Confidential information and privilege

5.1 Within the legal constraints that apply, the PRA and/or Bank may pass on to a skilled person any information that they consider relevant to the skilled person's function. A skilled person, being a primary recipient under section 348 of FSMA (Restrictions on disclosure of confidential information by the PRA), is bound by the confidentiality provisions in Part XXIII of FSMA (Public record, disclosure of information and co-operation) as regards confidential information the skilled person receives from the PRA or directly from a CTP or other persons.

5.2 A skilled person may not pass on confidential information without lawful authority, for example, where an exception applies under the FSMA (Disclosure of Confidential Information) Regulations 2001 (SI 2001/2188) or with the consent of the person from whom that information was received and (if different) the person to whom the information relates. The PRA and/or Bank will indicate to a skilled person if there is any matter which cannot be discussed with the CTP.

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