



Non-bank payments firms
– the evolving role of internal audit
How do you support sustainable growth?

July 2023

Non-bank payments firms – recent FCA spotlight on leadership, governance arrangements and internal controls

Recent FCA spotlight on non-bank payments firms – driving considerations around the need for robust leadership, governance and internal audit coverage

Dear CEO Letter - priorities for payments firms (March 2023)

The growing numbers and types of non-bank payment firms, complexity of the payments transaction chain, and reliance on outsourcing have resulted in an increased regulatory focus on Payment Institutions (PIs), E-Money Institutions (EMIs) and Registered Account Information Service Providers (RAISPs). The Financial Conduct Authority's (FCA) Dear CEO letter highlights that many payments firms do not have sufficiently robust controls and as a result some firms present an unacceptable risk of harm. The FCA raises three key outcomes requiring firms to i) ensure consumer money is safe, ii) ensure firms do not compromise financial system integrity, and iii) deliver high quality and innovative products through a focus on implementing consumer duty requirements.

The letter highlights a number of focus areas including in particular around: the **need for ongoing adequacy of internal controls, leadership and governance arrangements** for firms in a fast paced and innovative environment; how firms ensure **safeguarding** of customer funds; **prudential risk management** practices; **operational resilience** considerations for business model; **AML / Fraud** considerations; **wind-down planning**; and the implementation of **consumer Duty**. **The focus on these areas turn up the temperature on regulatory expectations to prevent consumer harm** (in line with the FCA strategy released during April 2023) and the FCA expects firms to be able to **demonstrate how they are managing and controlling these risks**.

Dear CEO Letter - implementing Consumer Duty in payments firms (February 2023 – with an implementation date of July 2023)

The FCA has set out higher expectations for the standard of care that PIs, EMIs and RAISPs provide to their customers. The letter focuses on the application of the Duty across all products offered to retail customers along with considerations for firms having a material influence over customer outcomes (including firms selling products via distributors) and not just those with a direct customer relationship. The FCA is currently developing a strategy to embed the Consumer Duty in their supervision work and expects PIs, EMIs, and RAISPs of all sizes to be ready for FCA to include them in engagement.

Discussion Paper - impacts of 'big tech' entry and expansion in Financial Services (October 2022)

The FCA published a discussion paper (DP 22/5) focussing on the potential impact on competition arising from the expansion of Big Tech firms in the payments, deposit taking, consumer credit and insurance sectors. The paper forms part of a broader set of policy initiatives relevant to digital markets that the FCA is developing with other financial services and cross-sector regulators. These include the proposed oversight regime for Critical Third Parties and the FCA's joint work with the Digital Regulation Cooperation Forum on online and algorithmic harms. A feedback statement from FCA is expected during the first half of 2023 setting out their response and how FCA will develop a regulatory approach.

Draft Consultation Paper - buy now pay later (BNPL) firms (February 2023 (Relevant where non-bank payments firms offer BNPL products))

HMT released the draft legislation for BNPL agreements on 14 February 2023, seeking industry views on the proposed draft legislation that will bring most BNPL products into the financial services regulatory perimeter under the FCA's supervision. The FCA will need to draft and tailor rules to ensure a proportionate application to these agreements. Ultimately, currently unauthorised firms offering BNPL will need to be authorised and regulated, and all firms offering BNPL (including those already FCA regulated for other activities) will need to demonstrate a strong risk and control framework.

The recent 'Dear CEO' letter outlining priorities for payments firms (March 2023) makes it clear that the FCA expects businesses to perform an assessment of how the key risks they highlight are being managed and whether appropriate controls exist to support ongoing risk mitigation. The FCA also expects firms to regularly review whether their governance arrangements remain appropriate, such as the Three Lines of Defence governance model. Where issues are identified by the FCA they have explicitly stated that they will 'take swift and assertive action to protect customers and ensure market integrity'.

Internal audit has a key role to play in providing independent assurance around the effectiveness of key controls and to support the business in giving confidence to the FCA that an appropriate governance and control framework is in place.

The Dear CEO letter on priorities for payments firms specifically states: 'Inadequate governance and oversight is a root cause of many of the regulatory issues in the payments portfolio. We continue to see **significant issues with governance, oversight and leadership** in the portfolio including:

- a **lack of appropriately knowledgeable and experienced personnel** to provide payments services and issue e-money, including amongst key functions such as Money Laundering Risk office and other compliance staff;
- governance arrangements, **risk procedures and controls that are not comprehensive and proportionate** to the nature scale and complexity of the business. Including a **lack of appropriate Board oversight arrangements** in some firms; and
- **inadequate meaningful due diligence before onboarding agents and distributors** and a lack of ongoing monitoring'.

Non-bank payments firms – the evolving role of internal audit

Internal audit has a key role to play as the FCA increases its focus on risk, control and governance

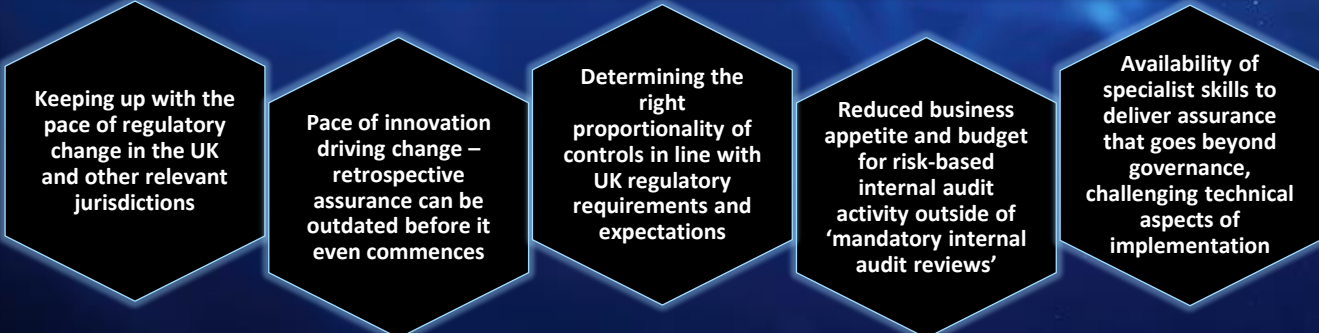
The FCA welcomes competition and innovation in the payments sector and the improved value and choice this can provide for consumers, however, remains concerned that payments firms do not have sufficiently robust controls presenting an unacceptable risk of harm to customers and to the financial system integrity. We believe that:

- **Internal Audit has a key role to play, supporting the Executive and Board to provide confidence to the regulator.**
- **In a rapidly growing and innovate sector, internal audit's role to assure, advise, anticipate risk, and act as an agent to help accelerate positive change within the business is critical.**
- **A risk-based and structured approach to rotational audit coverage will be key to providing holistic assurance.**

New entrants to the UK payments sector and established UK firms applying for PI, EMI or RAISP permissions are expected to be able to demonstrate a **proportionate and established 3LOD model from Day 1** of being authorised and demonstrate effective critical governance capabilities. For global businesses with a UK-based subsidiary undergoing the application process or those that already have FCA authorisation, it is also critical to demonstrate **robust UK level leadership and decision-making capability** that will ensure UK operations grow and evolve in line with UK regulatory expectations. We believe that:

- **Demonstrating that you have robust internal audit capability within the business as part of your Regulatory Business Plan (RBP) and the FCA application process is emerging as an expectation, it's no longer a choice.**
- **The breadth of internal audit skills and capability are key to providing effective assurance to UK Boards in this sector, with rapid innovation and increasing regulatory scrutiny.**
- **Understanding UK regulatory expectations and challenging compliance is important - there is a role for both Group and UK Internal Audit functions to play in global businesses.**

Typical challenges for internal audit functions



What should internal audit be doing?

Payments firms are **re-assessing the role, operating model and skills of the internal audit function** to help them meet **growing expectations around governance and controls within their business**, particularly in response to the recent Dear CEO letter on priorities for payments firms (March 2023). The FCA expects a response on request to the recent letter around how the business is managing relevant risks and ensuring robust controls are in place to reduce the **risk of consumer harm**. As a result, the **demands on internal audit's role and its effectiveness are greater than ever** in providing this assurance to the FCA. In response, internal audit functions should consider the following areas to elevate their impact and depth and breadth.

1 Internal audit profile and purpose – have you developed a vision for the function now and for the future which is aligned to the organisation's strategic goals and risk appetite? We believe that a purpose that is aligned to the business strategy can elevate the profile and impact of internal audit and develop high performing and stable internal audit teams. Internal audit should **demonstrate how internal audit activity is relevant to key business objectives**, including regulated entity launch, growth, critical change activity and ongoing resilience in the business. For more details refer to [Internal Audit 4.0 | Deloitte Global](#).

2 Operating model to deliver impactful assurance (outsourced or co-sourced) – how do you right-size your internal audit coverage? Agility and the right level of depth in assurance is key and demonstrating robust internal audit coverage is an expectation from the FCA. A **robust approach to establishing an internal audit universe and plan development that highlights both mandatory and rotational key risk based reviews** will be critical to demonstrate appropriate controls are in place within the business. A number of firms initially outsource their internal audit function with a phased strategy to develop an in-house team with a co-source partner providing on demand subject matter expertise, training, coaching and benchmarking activity around coverage. A co-source partner can also provide innovative insights in relation to the assurance approach taken by the business.

3 Blended core internal audit and specialist skills – how do you ensure your activity sufficiently challenges experts in the First and Second Line? Boards are demanding more detailed implementation and operating effectiveness assurance activity and whilst governance and oversight is a critical element of the control environment and should be tested, the **range of specialist skills necessary to challenge the First and Second Line of Defence moves into the spotlight**. For businesses that are undergoing licensing with the FCA and mergers and acquisition activity, **phased real time reviews** prior to Go / No Go decisions are increasingly becoming a core part of Internal Audit's role and therefore skillset and specialist knowledge to challenge the build of critical processes is key.

Please refer to the following page for some of the key areas and current focus areas for the FCA upon which internal audit could focus in annual risk-based planning.

Non-bank payments firms – key focus areas for internal audit

We have outlined below the key areas that internal audit could focus on in their risk-based plans, highlighting recent focus areas for the FCA. *The areas noted below are not intended to represent a complete internal audit universe and their relevance should be considered in the context of your business model and product offering.*



☆ Internal audit hot topics and recent focus areas for the FCA

Contacts

If you would like to hear more about our internal audit capabilities or discuss any of the points highlighted in this document, please reach out to the contacts below.



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