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Transcript: Mitch Hubble podcast

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Introduction

This is a transcript of the podcast, "Mitch Hubble from Pathlight Associates on Skilled Person Reviews," a discussion between GRIP's commissioning editor, Jean Hurley, and Mitch Hubble of Pathlight Associates.

Transcript

Jean Hurley: Hello listeners, I'm Jean Hurley, Commissioning Editor at GRIP. Today on the GRIP podcast, we are joined by Mitch Hubble of Pathlight to discuss FCA's Skilled Person Reviews and client experience. Welcome Mitch. I'm delighted you could join us. Please introduce yourself to our listeners and give us a brief overview of what you do and your expertise.

Mitch Hubble: Thanks for having me, Jean. It's good to be here. So I began my career in retail banking with the Commonwealth Bank in Australia, eventually moving into their wealth management division, where I was a client adviser for several years.

Following the Royal Commission into misconduct in banking in Australia, which is the equivalent of a public inquiry here in the UK, I joined Deloitte, where I helped another big four Australian bank with their response and remediation to the Royal Commission, mainly focusing on fair value and suitability of products. I then joined Pathlight last year as a principal consultant, where I work alongside our partners as project leads on advice and skilled person work as the overall field work lead.

The majority of my work at Pathlight is focused on Skilled Person Reviews, with Pathlight on five panels, which include among others, client assets, governance, conduct of business and financial crime.

Jean Hurley: Thank you. So should we start with Skilled Person Reviews? What are they and can you explain how they are used by the FCA?

Mitch Hubble: Yeah, sure. So a Skilled Person Review, also known as a s166 or a section 166, which is the section of the regulation that it pertains to, it's an independent investigation of a regulated firm carried out by an external third party expert. There are tools that are used by the regulators, so the FCA and the PRA, when they have concerns about a firm's activities and require a deeper understanding of specific aspects of its business.

If you go back, say, 10 years, Skilled Person Reviews were less frequent and generally triggered by fairly significant concerns. Regulators now use them more frequently as part of their regular supervisory activities. So this could include things like detailed fact-finding exercises, obtaining expert opinions on proposed changes at a firm, or proactively assessing a firm's compliance with specific regulations.

It’s important to note that the regulator has broad discretion in deciding when to initiate a review, and it doesn’t necessarily indicate serious problems at a firm. They may be more detailed fact-finding, as I said, than a regulator has resources to undertake, for obtaining expert opinions on proposed changes at a firm, and proactively assessing a firm’s compliance with specific regulations as well.

Jean Hurley: So how is it that you’ve been appointed a skilled person? Is it by the firm, or does the FCA approach you directly?

Mitch Hubble: Yeah, so either is possible. Most Skilled Person Reviews are appointed by a firm, subject to the approval of a contract between the firm and the skilled person by the regulator. In this case, the regulated firm puts forward a shortlist of usually three possible skilled-person firms, and its preferred choice for the regulator to approve. It’s unusual for a firm’s choice not to be approved, especially when the preferred choice is on the regulator’s panel.

Once approved, the firm contracts directly with the Skilled Person firm, but the skilled person actually has contractual liability and obligations to the regulator. In the firm-appointed case, the skilled person does not have to be on the regulator’s panel. Sometimes, relatively rarely, the regulator will decide to select and contract directly with the skilled person. These can be for several reasons. And for example, based on our experience, it’s generally around reviews of board-level strategic decisions, or board governance and effectiveness, or its matters may set wider thematic trends in sectors.

Jean Hurley: OK, so talking about trends, what are the current trends you’re seeing, why is the FCA seeking a Skilled Person report?

Mitch Hubble: Yeah, so as I mentioned before, we’re seeing skilled person reviews being more widely used, and becoming a more integral part of ongoing supervision. So one trend is that they are becoming more common, and not necessarily always relating to serious regulatory failures.

In terms of subjects covered by reviews, some areas are regular and stable. For example, financial crime and CASS are quite regular and stable subjects that we see. The key point on CASS that is quite interesting is a lot of reviews are focusing on valuers to reconcile assets money properly, and weaknesses in CASS governance and contracting.

Other areas will vary based on regulatory strategy and market conditions. So you won’t be surprised to know that over the past year, we’ve seen many more reviews focusing on Consumer Duty-related issues that have been in the press such as ongoing advice, discretionary commissions and the like. We’re increasingly seeing scrutiny on firms’ Consumer Duty compliance frameworks, including product and wider governance, fair value and so on.

Hand in hand with that, we’re also seeing skilled person oversight on past business reviews and redress, and these tend to follow headline trends several months and even years or so later.

Jean Hurley: So it’s interesting what you said that now there’s more prevalence of skilled person reports because I would have thought, you know, as a firm, if that was going to happen, I’d be worried it was going to be an investigation leading to an enforcement. So in general, what are clients’ concerns when they hear they’re to be subjected to a review?

Mitch Hubble: Yeah, there’s a few possible concerns, and I’ll mention a few and sort of indicate my experience and how much sort of real risk there is for each of them as well. So I guess dealing with the most alarming first, as you said, some clients worry that a Skilled Person Review is part of a process leading to enforcement action. In our recent experience, this is rarely the case.

So Skilled Person Reviews are, as I said, supervisory tools, not enforcement. An enforcement is a very separate and distinct FCA process. Having said that, where the regulator has concerns, that a firm carries too much risk to customers, they may restrict a firm's activity through things like a V-REQ, which is a voluntary requirement – sometimes before a Skilled Person Review starts, and sometimes they'll get 'not normal' in response to an adverse Skilled Person Report. So those restrictions can vary quite dramatically, so it could be restricting a client taking on, or onboarding new customers. It could be as dramatic as a restriction on doing business itself.

So, severe restrictions can be serious for firms impacting revenue and reputation in a damaging way. A real positive, often not appreciated by firms, is that favourable skilled person reports often relax these restrictions and reset the relationship that they have with the regulator as well. So, they can be a really positive thing for firms to go through. Other concerns, naturally costs and impact and management time and business, as I said, reputation as well. Costs are inevitable.

With Skilled Person Reviews, the cost is geared by the regulated firm, not the FCA or the PRA. So, and they are generally higher than a similar scope, non-skilled because additional time requirements regulator liaison and more formal reporting requirements as well.

Although Skilled Person Reviews are confidential, counter parties and potential recruits may ask firms and firms may have little choice but to disclose. One mitigant is that with reviews becoming more commonplace the adverse reputational impact is reducing, which is always a good thing.

Jean Hurley: Thank you. So, can people look at them? Are they published anywhere, the skilled person reports? Or are they just for the firm and for the FCA?

Mitch Hubble: Yeah, so they are confidential between the firm and the regulator. So, you can't search and there's no sort of database where the FCA will publish who's had a Skilled Person Review. And certainly, we wouldn't be discussing that with any of our clients. The FCA does publish, I think it's quarterly, details around what Skilled Person Reviews have been undertaken in sectors. So, whether it's, for example, governance or financial crime, they won't publish specific details around the firm or types of firms that have had skilled person reviews.

Jean Hurley: Thank you. So, do you have any tips for firms? At the beginning, when they hear there's going to be a review and during the review, so it runs smoothly?

Mitch Hubble: Yeah, so look, to quote Douglas Adams from The Hitchhiker's Guide to the Galaxy, "Don't panic." That's the number one key. Before review, the key step is obviously selecting the right skilled person for you and for the firm. If I were a buyer, my key requirements would be technical competence, obviously, and relationship with the skilled person firm and yourself and your regulated firm. Technical competence should be pretty easy. For more common review areas, all firms on the skilled person panel will be competent in that area.

Assessing the relationship sort of takes a bit more effort, but I think it's really worth it. Often, there will be a real difference between a successful and painful review. I'd look for a firm that took a constructive and collaborative approach that I felt would work well with me to achieve regulatory compliance efficiently and, more importantly, sustainably for my firm as well. I wouldn't want a very remote skilled person. This would likely delay remediation and increase costs.

Obviously, cooperation is going to be within the constraint of reporting and objectively against regulatory standards, but early effective communication and information sharing by a skilled person really help the firm resolve issues, and sooner. I would insist on meeting prospective skilled persons in person, including assignment leads and field works at a minimum and ideally face-to-face. Also checking skilled person candidates and staffing availability fit regulations and your own timetable can offer flexibility, for example, in remediation work – remediation work gets delayed.

Many firms will get anxious about timelines and timetables set out in the requirement notice by the regulator. This can be quite demanding if you are not ready to start the work immediately, especially if you don't have existing relationships with potential skilled persons.

My advice here would be to contact potential skilled person firms straight away as soon as you get a requirement notice from the regulator because you'll need to leave time for a response as well. Obviously, insist on a proper proposal from the skilled person firm to sort of build that rapport and understand their proposal and that relationship. I would also meet the firm where possible in person or if not remotely at least once during the selection period to be ready to share the requirement notice and any related feedback letters that you've received from the regulator as well. They're essential for an accurate budget. Be realistic with who you contract. Big four firms don't do small projects.

Finally on this, if you need more time, again, don't panic but ask the regulator early. They will usually accommodate a request for a few extra days to make the right decision. They don't want to make this rushed. So if you need more time, just ask. Moving through to the execution of the Skilled Person Review, be prepared while awaiting the proposal.

What I would do is make sure that you're collecting documents that the skilled person may need when the review starts. These are things like policies and procedures, terms of reference, governance papers and the like. These are all very common across all Skilled Person Reviews. I would make sure that you start to work on getting those documents together because that makes for a quicker process and a quicker start when you actually execute the review.

Finally on reporting, the crux of the review and something you need to get accurate. Try and avoid a skilled person doing this too much on an ivory tower, by which I mean avoid skilled persons who seem to work like this and then ensure your input is planned and agreed at initiation. While a skilled person can't share a formal draft report with a firm without copying the regulator, they can do a robust accuracy and sense checking workshop while drafting the report to ensure the formal draft the regulator sees is accurate.

It's hard to de-escalate regulator concerns raised by inaccurate skilled person draft reports and sometimes skilled-person firms don't like admitting they're wrong, which makes it even harder. So be pushy about robust accuracy checks and make sure they are completed because it really, really helps.

Jean Hurley: Yeah, I can imagine. That's some really great advice there. You mentioned earlier that you'd noted the FCA were adding in an extra element. They're asking about the Consumer Duty. Can you tell us more about that?

Mitch Hubble: Yeah, sure. So a skilled person assignment touches on any part of the consumer value chain, whether a specific product or advisory practice, we're seeing more and more focus on needing to review Consumer Duty arrangements. And this is the case not just for firms who are advising or selling products to customers, but firms who may manufacture products and may end up in the retail market.

So if you're a firm that has any relationship to a retail customer and you are subject to a Skilled Person Report, there's a strong possibility that how you have embedded Consumer Duty will be part of it. And given we are now more than a year from the 2023 deadline, the expectation is that Consumer Duty will be embedded into practice and not still in the development or implementation stage.

In the past year, we're seeing many skilled person requirements include a brief review of Consumer Duty arrangements. This includes reviews of subject areas such as financial crime and CASS as I described earlier.

In other words, the FCA is using the opportunity of a Skilled Person Review to take a look at this priority area. The message for firms here is that Consumer Duty is all about putting the customer at the heart of the agenda and identifying and mitigating foreseeable harm, and therefore Consumer Duty is indirectly impacted by weaknesses in the firm's many other areas of systems and controls. As I mentioned before, with the deadline over 12 months ago, we are now seeing specific Consumer Duty Skilled Person Reviews, and we expect this to continue across all sectors in the retail market.

Jean Hurley: So it sounds like we need to look further at the Consumer Duty. What does "good" look like and how do you know if it is "good enough"?

Mitch Hubble: Yeah, so this is a really good question and this is a question that we're seeing a lot from our clients and it's a difficult one to answer as well. So the challenges that everyone is wrestling with are twofold.

One, what good looks like in their market and two, integrating Consumer Duty considerations into thinking, culture and practices of all individuals in the firm. It's really important for firms to understand and think this is all about good outcomes, not purely about trying to be fair. It's more than that. A good outcome means proactively supporting clients, understanding your clients to a greater level than historically and being able to demonstrate you are doing everything you can for them. It's not about being the cheapest or fastest, but it's about being able to demonstrate value and being able to explain why there is value.

So for example, the key to effective prevention and harm to customers is one, understanding your customer segments and two, having data and information that enables you to understand how your products and services interact with those customer segments. So I'll give you an example. So you may offer a similar product to a competitor and your product may be more expensive, but it's not necessarily reducing price, but assessing whether or not the cost is justifiable. So it may be justifiable if you're offering a different level of service, different benefits, or different levels of tailoring as well.

The key is being able to demonstrate, one, your products and services are only offered to people to whom they are appropriate, that the price charge represents value for the benefit they can get, and also is proportionate to what it costs the firm to manufacture, distribute and govern those services. And two, the environmental factors such as interest rates, economic drivers and the like are factored into when considering how products continue to interact with customer segments.

So I know you asked what does good look like? As most people should hopefully know by now, there's four outcomes with Consumer Duty, price and value, consumer understanding, consumer support and products and services. Now I just gave an example on price and value. So what about the three other areas?

Look at products and services. The key here is consistency and alignment across all elements of products and services delivered. That is, the need for the product is researched, designed in line with that research, marketed in line with the design and governed appropriately. Looking at consumer understanding, this is all about: is the sophistication, awareness and knowledge of the client segment understood and literature provided in a language and medium that is suitable.

So this could include things like foreign language, plain language as well, so not using any jargon or large font, so on and so forth. You also want to make sure here that consumer understanding is tested both before the product is launched and during the life cycle of the product. This could be through things like focus groups, surveys are a good one here as well, or any other sort of reach out mechanisms are really good to test those.

And lastly, customer support. So you want to provide proactive engagement that allows customers to make informed decisions using feedback and other customer engagements to continually drive up levels of service and using other tools to test support mechanisms such as mystery shopping. So the key to preventing foreseeable harm is identifying potential risks to good customer outcomes and data here is key.

People regularly use such things like complaints, which is important, but effective data goes far beyond that. For example, customers invoking cooling off periods could indicate pressure selling. Increases in customer queries could point to gaps in explanations of products to customers and significant increases in reductions to revenue generated by particular products, or services could point to that product being used either for segments it was not targeted to or not being offered to clients who may find it beneficial. So data needs to be tailored to the consumer risk inherent to each firm's business model, but needs to be used to drive proactive products, review, work and provide updates to governance.

Jean Hurley: So when you're actually doing a Skilled Person Review, can you provide some examples of good practice that you've seen?

Mitch Hubble: Yeah, so I'll provide some examples. It's difficult to cover all segments. We'll start with price and value. So a good example of price and value would be a firm calculating costs per product to manufacture and distribute and then determining the delta for that value. Another example would be firms holding weekly front office meetings to discuss client engagement and feedback and identifying any potential areas for improvement from those meetings. It's really what you're looking at here is looking at using the duty as a commercial lens. A lot of firms hold front office meetings but don't go the extra step and stop and ask how could Consumer Duty be part of this?

Another example would be embedding Consumer Duty considerations within business process change and strategic planning cycles such as intended or unintended consequences of change on consumers are considered. So I guess my overriding comment here would be a universal regulatory point. If it's not documented, it doesn't exist or happen in the inevitable view of the regulator. And if you can't find the documentation promptly, the regulator will assume it either didn't exist, or has just been created, or it wasn't being used.

Regulators look at outcomes as well as inputs, especially with the Duty. That is its purpose. So you absolutely need the inputs, product governance, fair value assessments, management information that demonstrate the value and service is being delivered in practice. But you also need to ensure that these are living documents leading to behavioral change in your firm.

At a very basic level, this is relevant information going to the board. It is being meaningfully discussed and relevant actions proposed tracked and closed when completed.

Jean Hurley: Thank you. There's some great examples there. So what about weaknesses in firms?

Mitch Hubble: There's a few here where I think firms could use some help on. Time-bound is a big one. That is, for example, annual product reviews without consideration to data, indicators of risk or other factors that may influence the need for a review. Formulaic governance with Consumer Duty is considered to be a regulatory project rather than integrated into the organization's board and committee framework. Lack of ownership at an executive level is another one with compliance or risk teams considered to be accountable rather than all staff including front office and senior management.

Another one is weak data, which is not aligned to the risks inherent in the firm's business or data which is not considered in the consumer duty context and analyzed thoroughly. Some other areas that we see is sort of not understanding the breadth of potential customer vulnerability and proactively acting to support the clients with greater needs. A good example that we've seen here is one firm who created a point-of-sale literature in multiple languages to support a local population, but future communications which may have changed the terms of the product were not always sent in the same language as the original literature.

So the first part of that is good practice, but then you have to follow it through and that can put a burden on the systems and controls to maintain.

So I guess the important thing there to remember is if the firm cannot maintain the systems and controls, then they should not offer that product upfront. So it's making sure that you think about if you're going to implement something upfront like in this example different literature, you can follow that through should the need arise.

Another common area of trouble is where the value chain is complex. For example, co-manufacturing of products or independent regulated third parties in the value chain such as payment firms or asset managers as well. So problems here are firms which don't believe they have a duty obligation when they do and inconsistencies or gaps and overlaps between firms collectively responsible for the overall product and service. In these situations, it's easy to see how commercially firms want to minimise their costs and service obligations, assuming others are responsible, yet a lack of communication or clarity between these partner firms exposes them to FCA action.

Jean Hurley: Changing tack a little bit. There was a recent survey done by the FCA around firms' non-financial misconduct. This was so they could better understand allegations such as bullying, sexual harassment and discrimination. Do you find these types of conduct crop up when you're reviewing firms?

Mitch Hubble: Yeah, we have on several occasions. Often these issues lead to reviews of firm culture, board level governance as well, especially where firms' response to the initial incidents don't appear robust. There is a jeopardy here that boards or independent directors as well as executives. The area of non-financial misconduct is complicated in that there are often associated employment tribunals and standalone criminal or civil law cases, and these may take precedence to regulatory scrutiny for a firm and its cultural behavioral deficiencies.

So while both the PRA and the FCA take non-financial misconduct matters very seriously, in our experience, they often have to respond in terms of a Skilled Person Review some time after the alleged incidents or other legal processes are concluded. I'm sure this frustrates them. Of course, they can both exert more direct pressure on firms, as can reputational damage. So we often find that there has been considerable remedial action taken, including board changes before we conduct non-financial misconduct related reviews. The review is then focused on the completeness and embedding sustainably the changes that have come about from that.

Jean Hurley: So if we're going to look to the future, what developments will cause the FCA most concern?

Mitch Hubble: Look, I think AI is obviously a pretty obvious one. It's something that's building a lot of backing behind. So I think inevitably AI and machine learning becomes increasingly widespread, that issues will arise with how it's used, its impact on customer outcomes or market conduct, for that matter. If you're going to use AI, you need to understand what you want it to do and phase it in over time and deploy it wisely. I don't think it'll be a surprise when the intersection of Consumer Duty and AI causes regulatory scrutiny.

One obvious issue, which the regulators have already published some views on, is the transparency of decisions made by AI applications based on machine learning datasets. Inevitably there will be circumstances where validity of datasets used for machine learning will be questioned, whether in terms of hidden bias or lack of robustness on minority segments, such as vulnerable customers. Outside the financial sector, we've already seen unforeseen circumstances illustrated spectacularly. For example, social media AI bots becoming so abusive within hours of becoming active that they've had to be disabled.

Equally, we've seen great success in some applications, especially where the requirement is well-defined and good data is available. For example, some areas of medical diagnostics. The trick for firms will be the quality of AI training, much as it is for human intelligence, but there will also be a need for convergence of views on what amounts to adequate transparency of AI decision-making processes, as well as comprising between efficiency of operations and management information to allow audibility, bias-checking, et cetera. We shouldn't forget the potential regulatory upside of AI and machine learning. For example, training transaction monitoring systems, which can lead to substantial reductions in false positives while still identifying true positives.

Again, there'll be inevitable discussions and perhaps disagreements or transparency of decisions and audibility. For regulators in some applications, perhaps like transaction monitoring, there'll be good logic for industry standards in data sets. But this levels out the functions of apps, which their designs will want to keep unique and proprietary to increase profits.

So perhaps standardized industry standard tests or proving data sets will become a feature with minimum performance levels defined. Again, we've seen evidence of the FCA thinking through these issues.

Jean Hurley: Thank you, Mitch. In fact, there was a survey that was just published today, a joint survey by the Bank of England and the FCA, which said 75% of firms are already using AI with a further 10% planning to use AI over the next three years. Do you think they could do a Skill Persons Review?

Mitch Hubble: Well, yes, you never know. You never know. I wouldn't be surprised if that comes about, but no, that's some very interesting numbers.

Jean Hurley: I think it'll always be the job of the consultants and the compliance people to go through whatever the AI comes out with. And it also maybe will be about writing the prompts to get the right information. So we'll see.

Mitch Hubble: Exactly, exactly. There's a lot to do with AI. There's a lot of learning and I'm excited to see what the future holds for it. But it's definitely here and it's only going to get bigger.

Jean Hurley: Thank you, Mitch. It's been great having you on the GRIP podcast. Thank you for your time and showing your insight in Skilled Person Reviews, Consumer Duty, non-financial misconduct and the use of AI. And finally, thank you to our listeners. If you're hearing this, you probably know about us, but please tell your friends about GRIP. You can find us at GRIP.globalrelay.com and you can follow us on LinkedIn. Until our next podcast or article, farewell.