Implementing the recommendations from the Independent Reviews – update

2 December 2021

Introduction

This report sets out the work we have done to implement the recommendations and lessons from the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc (the Gloster Report) and the Independent Review into the FSA and FCA's handling of the Connaught Income Fund Series 1 and connected companies (the Parker Report). This work has also been undertaken as part of our transformation programme. We discussed this in more detail in our Business Plan 2021/22 and in our last update on 15 July 2021. As we said in response to the Reports, there are a number of things we could have done better in our supervision and both reports highlight the need for the FCA to continue to change to better protect consumers from harm. The work undertaken in the past year, and set out in this report, has significantly improved our organisation's approach.

We need to continue to learn and embed these lessons in the organisation through the transformation programme. Our intent is to do this while recognising we must continue to prioritise resources against a wide and growing range of risks, including bad actors, while striking the right balance between tougher action and consumer choice in a digital market.

In summary, over the past 12 months, we have:

Improved the knowledge and capability of our staff, leading to a more assertive approach

We have increased our skills in identifying financial irregularities, fraud and how we police the perimeter of what we regulate. We have done this by upskilling our staff with new and better training and hiring more specialists to strengthen our regulatory oversight. This is now enabling staff to better assess firms holistically.

We are applying our standards more robustly at the gateway. In the year to 2 December 2021, 1 in 5 firms (up from 1 in 6 when we last reported) which applied to us for authorisation were refused, rejected or withdrew their application after discussions with our Authorisations Division. We base this approach on the risk profile of the firm’s business model, as illustrated by the strong actions we are taking with registration or authorisation of firms such as crypto asset exchanges and firms that market retail contracts for difference.

We have used increased financial resilience capability to rapidly increase the financial data we collect on firms and triage approximately 49,000 FCA solo regulated firms on the basis of their financial resilience. As a result, we have been able to identify and target supervisory resource on reducing the potential harm in failure of over 400 firms who have signs of financial resilience risks.

Robust action to combat fraud

We are taking a better coordinated approach to tackling the significant harm that fraud causes through prevention, protecting consumers and pursuing and disrupting fraudsters. We continue our work with anti-fraud partners to maximise our collective fight against the growth in fraud. We have set out more details in our evidence to the Treasury Committee’s inquiry into Economic Crime.

We have worked closely with online platforms to ensure they do more to deliver on their public commitments to stop the harm from online advertising. We have continued our campaign work to help consumers identify fraud and scams, through our ScamSmart programme. In October 2021 we launched our new InvestSmart campaign which is designed to empower consumers to make better informed investment decisions. We have also created a new Financial Promotions and Enforcement Taskforce, combining parts of our Supervision and Enforcement divisions. The Taskforce is delivering a new cross-FCA strategy to tackle breaches of the rules governing financial promotions, issues that straddle the perimeter and online harms. It is already using data more effectively, applying new technology and advanced detective techniques to identify potential consumer harm more quickly and accurately. In addition, in our latest Consumer Investments data review, we reported we had 31 ongoing investigations involving authorised firms and/or individuals where consumers have invested in scams or higher risk products and 50 investigations ongoing into unauthorised business, most of which involve scams.

Reinforced our data capability to get better insights, enabling more effective supervision and enforcement

We appointed our first Chief Data, Information and Intelligence Officer, Jessica Rusu, whose remit is to build the framework we need to fully become a data-led regulator, while expanding and protecting the intelligence and data assets we hold. To achieve this, we're investing significantly into our own capabilities – the way we collect data, the way we use it, and the way we turn it into interventions at scale. Jessica set out her early thinking in a recent speech.

We have also launched our Single View of Firm and Portfolio (a group of firms with similar business models) dashboard. This will initially cover several sectors. The dashboard combines data from multiple sources and is already reducing the time our frontline staff spend locating and analysing different intelligence sources.

As we invest significantly to strengthen the authorisation processes and supervision for small firms, building on changes made last year to our fees schedule, we are consulting on aligning minimum firm fees for small firms to ensure the cost of ongoing supervision is better reflected in the fees that are paid.

LCF Recommendation 1: The FCA should direct staff responsible for authorising and supervising firms, in appropriate circumstances, to consider a firm's business holistically.

We have taken a range of actions to address this recommendation, including:

- Setting the baseline expectation for holistic assessments of firms' business models. This is now being embedded across the organisation. It recognises the diverse range of firms we regulate and provides a consistent foundation for staff's decision-making on how and when to act.
- Updating our training guides to ensure that it is clear how staff should consider a firm and its business model holistically.
- Ongoing delivery of a range of training packages that have upskilled our staff's ability to assess a firm holistically.
- Reviewing and updating our approach at the gateway, increasing our scrutiny based on the risk profile of the firm's business model and putting in place the governance to ensure this happens consistently.
- Implementing the 'Use it or lose it' programme to better identify and intervene against firms that have reported no income from regulated activities for the last 12 months. As a result, 166 firms have had their permissions cancelled and a further 33 have agreed to a Variation of Permission since May 2021.
- Developing our QA framework approach to holistic assessments to help us consistently monitor progress and share learning across the organisation.

Holistic assessments and policies

We have now clearly defined what is expected from our holistic assessments. We are revising our policies so that staff are clearer about their responsibility to ensure they carefully consider the firm's unregulated activities, alongside the regulated activities. We will apply greater scrutiny to a firm's unregulated activities when these are financial services-like in nature, as misleading information could confuse consumers about whether they have protection if they buy these services.

For example, we have acted quickly to stop the risk that consumers were misled as to the regulated status of high-risk investments. A foreign exchange training provider that is regulated as it offers a credit facility was also offering a potentially high-risk investment product through a similarly named entity. We engaged with the firm's Principal who removed the appointed representative taking away their regulated status and a consumer warning was issued within days.

Another example was a situation where we had concerns about a credit broker that was accepting deposits from customers to purchase cars on their behalf but failing to provide the service. We acted quickly to stop the firm from carrying on any regulated activities as well as those that consumers may have believed to be regulated activities. We also required them to publish a number of statements on their websites explaining the impact of our actions.

Training

We have retrained our staff on business model analysis that underlines the need to consider a firm holistically. Over 95% of staff in Authorisations, Supervision and Enforcement had completed their regulatory refresher training by January 2021 and 80% of new starters have completed their 'How Firms Operate' course, which went live in July 2021. By mid-December 2021, relevant staff in Authorisations and Supervision will have had case-led training that demonstrates how a holistic approach ensured we focused on firms' unregulated activities that helped inform the action we took. We will measure the improvements in our staff capability and the outcomes we achieve through our ongoing quality assurance. We are already seeing evidence of staff using our holistic assessments to identify and escalate more business model risks. A recent example in Authorisations involved us being concerned with a broking firm that earned the majority of its revenue from an unregulated loan product it provided for the purchase of property (not a regulated mortgage). Authorisations believed that customers may be misled about what the FCA's remit covered and therefore required the firm to make it clear to consumers in all their written material and sales practices what the FCA's remit covers and what statutory protections were available to consumers.

We have appointed more financial analysts who have market expertise in key areas and are helping to train and mentor other staff. We expect these changes to further strengthen the gateway and are already seeing examples of where this expertise means we make different decisions than previously. These steps should make it less likely that problems arise soon after authorisation.

We are piloting an Early Oversight Function, testing oversight of the 'transition' stage, post authorisation, to monitor and support firms which are new to regulation to understand their obligations and meet the required conduct standards. This oversight and support model will help manage and reduce any risks or concerns we identified during the authorisation process or that appear in the first few years of trading. We expect to approve more firms 'with requirements', rather than unconditionally. This will, for example, limit the scope of their activities and the scale and nature of their business, require them to report more frequently or hold greater capital.

<u>'Use it or lose it'</u>

Regulated firms that do not use their permissions should apply to remove them. Incorrect or out-of-date permissions increase the risk of harm to consumers as they can mislead consumers about the level of protection offered or give unregulated activities unjustified credibility - the so-called 'halo effect'.

Following the publication of our 'Use it or lose it' proposals, we have identified those firms on the FCA Register that have not used their regulatory permissions to earn any regulatory income for over a year. We have subsequently taken proactive and decisive action to persuade firms to voluntarily cancel these permissions, or to cancel them ourselves. We have cancelled permissions of 166 firms since May 2021, reducing the risk of the halo effect. We have also initiated a further 226 proactive cancellations of now dormant companies. This work is ongoing.

<u>Building capacity in Authorisations</u>

To further enhance the regulatory gateway our Business Plan included a material increase in headcount for key Authorisations teams along with increased delegation of decision making to ensure swift and effective oversight of prospective new entrants.

LCF Recommendation 2: The FCA should ensure that its Contact Centre policies clearly state that call-handlers: (i) should refer allegations of fraud or serious irregularity to the Supervision Division, even when the allegations concern the non-regulated activities of an authorised firm; (ii) should not reassure consumers about the nonregulated activities of a firm based on its regulated status; and (iii) should not inform consumers (incorrectly) that all investments in FCA-regulated firms benefit from FSCS protection.

We previously agreed that our Supervision Hub (Contact Centre) policies needed to be clearer about when staff should refer allegations of fraud or serious irregularity for further consideration. We have made several improvements through 2021.

Policies

We have amended our Contact Centre processes and training guides on the non-regulated activities of a regulated firm and where Financial Services Compensation Scheme (FSCS) protection applies. These changes ensure staff can clearly explain to customers the distinction between firms' regulated and unregulated activities, and whether these activities qualify for FSCS protection.

Training

We have trained all our Contact Centre supervisors in line with our policy changes, including new training which focuses specifically on identifying fraud. We have also trained these supervisors on when to escalate allegations of fraud and serious irregularities to the relevant departments. For example, our first line checks show that staff now refer 98.5% of all allegations of fraud and serious irregularities at point of contact, and the remaining 1.5% were referred after a second check using our data analytics tool. In October 2021, 32% of calls to our consumer line related to potential scams, and we made 1,810 referrals to the Financial Promotions and Enforcement Taskforce (FPET).

Quick transfer to the FSCS

We now have a direct transfer process for FSCS enquiries which means supervisors can transfer calls directly to the FSCS. This gives consumers prompt, direct access to the FSCS. For the 12-month period October 2020 to October 2021, we have transferred 532 calls to the FSCS ensuring the consumer receives appropriate information from one call. 37% of calls related to deposit products, 23% investment products and 14% pension products. 26% is a combination of all other products which includes mortgages, insurance, etc.

As part of our transformation programme, we are reviewing our approach to consumer engagement and have started discussions with the FSCS and the Financial Ombudsman Service, the agency best able to respond to consumers' specific questions. Our aim is to enable consumers to seamlessly contact the agency best able to respond to their query. This will put the consumer at the centre of our processes to ensure they get prompt and improved outcomes. We are looking at running a proof of concept in early 2022, and recently changed the options on our existing Interactive Voice Response to start gathering data for this. The early evidence confirms our belief that the Interactive Voice Response is an effective way of distinguishing between FOS complaints, FSCS and other calls.

LCF Recommendation 3: the FCA should provide appropriate training to relevant teams in the Authorisation and Supervision Divisions on how: (i) to analyse a firm's financial information to recognise circumstances suggesting fraud or other serious irregularity; and (ii) when to escalate cases to specialist teams within the FCA

In response to this recommendation, we invested in developing the capabilities of Authorisation and Supervision staff through training programmes focused on strengthening financial literacy and analysis, and by recruiting more financial resilience specialists.

Financial literacy and analysis training

At the start of 2021 we introduced financial literacy training for all Supervision and Authorisation staff. Its aim is to make sure all relevant staff have a fundamental level of knowledge in being able to understand and interpret firms' financial accounts. Over 1,400 Supervision and Authorisations staff have been trained.

We have since developed and implemented advanced training programmes for relevant staff in Authorisations and Supervision. In Authorisations, the training focused on those case-officers (including their Managers, Technical Specialists and Heads of Department) involved in new firm authorisations and variation of permissions. It strengthens case-officers' capabilities in assessing firms' financial arrangements to help identify potential irregularities and how financially resilient firms are. A total of 189 staff have completed this training. In Supervision, the classroom training aims to make sure supervisory leaders (Managers, Technical Specialist, and Heads of Departments, a total of 139) have the knowledge to identify potential financial irregularities in firms' financials accounts and other financial data, as well as risks to financial resilience. Critically, by training the leaders involved in the review of supervisory and authorisation cases we are helping embed the importance of considering financial risks in the FCA's culture. We are supplementing this training with specific financial risk workshops for 13 supervisory departments whose portfolios of firms we believe have potentially higher financial resilience risks.

We developed and rolled out the advanced training in the second half of 2021. In the medium term, we are assessing the success of this training by looking at trends in case escalation, quality assurance findings and real case outcomes. Early indications are that this investment in capability-building is already leading to better and more prompt outcomes. As an illustration, in a recent authorisation case we identified high value debt financing which was unusual for the proposed type of business. This prompted a series of questions and assessment about the necessity for the size of balance sheet and whether the firm had adequate resources. In another example, we uncovered poor financial health of an applicant's parent which helped to explain the motivations of the unregulated parent for the application. Following our scrutiny, the firm withdrew its application.

More specialist expertise

We have recruited more financial resilience specialists and expect to recruit more. We have increased the Financial Resilience Department by approximately a third, with additional specialists in Authorisations, and we are planning to expand the numbers of specialists further. In Authorisations, these specialists have created a new baseline expectation of staff when reviewing financials and have developed and delivered training to staff. They are a point of escalation for staff and provide expert judgement and support in assessing financials. An example of Authorisations using the new base line is a variation of permission application where the case officer referred an issue they had identified to specialists who confirmed that the firm has most likely been misreporting its capital in its regulatory returns and therefore has been in breach of its capital requirements throughout 2021. Supervision are now taking appropriate action with the firm. In total 10% of applications referred to Authorisations' financial specialists have been withdrawn by the firm following their feedback.

The increased number of specialists in the Financial Resilience Department has given more support for supervisory staff seeking an expert judgement on potentially complex cases. It has also developed greater capability to proactively assess firms' financial resilience. As part of monitoring the potential impact of the pandemic on firms' financials, we used this increased capability to rapidly increase the financial data we collect on firms and assess it to decide on firms' financial resilience. As a result, we have been able to identify and target supervisory resource on reducing the potential harm in failure of over 400 firms who have signs of financial resilience risks.

LCF Recommendation 4: The senior management of the FCA should ensure that product and business model risks, which are identified in its policy statements and reviews as being current or emerging, and of sufficient seriousness to require ongoing monitoring, are communicated to and appropriately taken into account by staff involved in the day-to-day supervision and authorisation of firms.

Our business planning process, as well as the consumer and wholesale market strategies currently under preparation, alongside our regular "portfolio assessments" are intended to ensure that overarching priorities are appropriately reflected in the allocation of our supervisory, authorisation and wider resources.

Portfolio assessments help to ensure that day-to-day supervision and authorisation activity appropriately reflects current and emerging product and business model risks. They enable us to draw from expertise across the organisation to identify product and business model risks and key harms in a particular portfolio (group) of firms, review them at appropriate intervals to prevent risk analysis becoming out of date, and help staff in supervision and at the gateway to prioritise accordingly. We have amended our processes for these assessments to reinforce our confidence that we effectively communicate the changes to product and business model harms we identify to relevant teams across Supervision and Authorisations. We have made changes to make the information in these assessments even more easily available to relevant staff and ensure that systems are updated in line with these assessments, so that evidence of these risks materialising can be tracked. We have also completed an exercise to validate that the systems used by supervisors reflect the latest product and business model risks from our portfolio assessments. We have ensured that there is a continuous feedback loop between authorisations so that portfolio risks remain aligned and up-to-date.

To support these changes, we have also reviewed and updated our internal processes, such as how portfolio and business model risks are reflected in our risk tolerance framework in Authorisations. Authorisation applications, such as new firm authorisations, variations of permission, registrations under the Money Laundering Regulations 2017 and change in control notifications, are triaged into risk channels under this framework. We have assessed the potential for harm in each risk channel across portfolios and have intensified the scrutiny of applications accordingly, implementing the training set out in Recommendation 1 into case assessments. We have refreshed our 'How to' guides for supervisors to set out our expectations on staff that supervise different firms and business models. We are also updating our existing quality assurance processes to validate that these changes are having an impact.

LCF Recommendation 5: The FCA should have appropriate policies in place which clearly state what steps should be taken or considered following repeat breaches by firms of the financial promotion rules.

A key element of our response has been to ensure we take assertive and timely action against firms breaching the financial promotion rules. We have set up a new department bringing together specialists from across the FCA to deliver an integrated approach to tackling scams, breaches of the perimeter and non-compliant financial promotions. We have increased our intervention activity and consumer alerts and are taking steps to improve the regulatory framework so that fewer consumers invest in higher risk products.

<u>New Financial Promotions and Enforcement Taskforce (‘FPET’)</u>

FPET went live in October 2021 as a joint taskforce between Enforcement and Supervision. It has blended the skills and experience across these teams, leading to more and earlier interventions. FPET will deliver an end-to-end and more assertive approach to financial promotions breaches and use data and technology to more quickly identify firms that straddle the perimeter.

As well as developing its own investigations, cases are referred to FPET by Supervision and Authorisations. Authorisations seeks to stop at the gateway any firm which has a regulatory history of approving concerning financial promotions. This might be when asked to consider an application by the firm to vary permissions or where the firm is seeking to become directly authorised having previously been an appointed representative. Our new process means these firms are referred to FPET for closer scrutiny. Where that scrutiny substantiates the concerns, Authorisations works with FPET to refuse these applications.

<u>Firms that repeatedly breach our financial promotions rules</u>

Together with establishing our new department, we have overhauled our approach to firms breaching financial promotions rules ensuring we review any potential breaches holistically leading to a more interventionist approach resulting in requirements being placed on a number of firms preventing further activity.

We are also taking a tougher stance with serious cases on a first breach, to deter repeat breaches in future. We continue to identify repeat breaches (in line with the Review’s recommendation), agreeing a threshold for action and providing guidance for supervisors and Authorisations staff so that we apply a consistent approach. We will be alert to new potential threats and continually review this process to ensure it is fit for purpose. In line with our Financial Promotions strategy and to ensure a robust and assertive end to end process within FPET, we have a regular pipeline of live intervention and Enforcement investigations involving breaches for both authorised and unauthorised firms. These cover a range of serious misconduct by multiple firms and individuals, including breaches of section 21 FSMA (approving financial promotions), potential investment scams involving authorised firms and criminal prosecutions into section 21 FSMA breaches by unauthorised firms. For example, as at September 2021, 31 investigations or proceedings were ongoing involving multiple authorised firms and/or individuals where consumers have invested in scams or higher risk products. In our latest Consumer Investments data review, we reported we had 50 investigations ongoing into unauthorised business, most of which involve scams.

<u>Supporting consumers</u>

On 20 October 2021, we launched our InvestSmart campaign to help consumers to make better informed investment decisions. The campaign is running across social media, digital display, search (Pay Per Click), online video, PR, partnerships and influencers, as well as through a new website designed to be more engaging and easier to navigate. The high-profile campaign launch included Charlotte Worthington, an Olympic Freestyle BMX gold medallist, delivering a simple message about the sense of competitiveness that can drive

investing in high-risk assets, while also highlighting the risks and the need for sufficient research when undertaking any high-risk activity.

We took a 2-step approach to influencer marketing, which is a first for the FCA. In Phase 1 we worked with 8 influencers on TikTok to promote the launch of the campaign, with our article highlighting 5 questions to ask before you invest. In the second phase we hosted a panel-style Instagram Live broadcast event, answering questions on investing from a range of financial influencers. So far, we've seen around 3,500 people watch the event and have driven over 35,000 clicks to the site through our advertising.

We are reviewing and optimising the campaign on an ongoing basis and are now preparing for the next phase, where we aim to drive more people to the website. We will carry out a full evaluation of this initial campaign phase in Q1 2022.

<u>Online Platforms</u>

We have worked closely with online platforms to ensure they deliver on their public commitment to prevent harm from online advertising.

We have ongoing discussions with Google, Microsoft and Facebook/Instagram at a senior and working level. As a direct result of this work, Google made a public commitment to introduce tighter restrictions around the placement of financial promotions on its platform, and we are encouraging other platforms to do the same. Google's new policy went live in September and, while still in its early stages, is helping to drive a fall in the number of harmful advertisements on Google reaching consumers.

We have worked directly with Google and Microsoft to enable both firms to subscribe to the Warning List Really Simple Syndication feed ("RSS") that provides daily updates on new additions to the Warning List and the ScamSmart tool in a standardised, computer-readable format. We can now also directly request that Facebook/Instagram and TikTok suspend user accounts which are creating content in breach of legislation and their policies.

Our Executive Director for Enforcement and Market Oversight gave evidence to the Joint Committee in October, setting out our concerns and views on the Online Safety Bill (OSB). We have stated publicly that including investment fraud paid-for advertising and designating fraud as a 'priority' harm in the OSB would be a critical tool to prevent consumers being scammed online. We continue to believe that a targeted change to the Bill that extends the existing requirements for user-generated content to paid-for advertising (for those platforms in scope of the Bill) would be a significant step forward in tackling online harms. This is a decision for the Government and Parliament.

<u>Regulatory framework</u>

The FCA CEO will meet the EST on 15 December 2021 to discuss this year's Perimeter Report, which contained updates and recommendations on a number of perimeter issues relevant to our work on this LCF recommendation.

The Perimeter Report is an annual process between the FCA and the Treasury to ensure that the FCA's views on the perimeter are taken into account. From page 27 of the report we explain our concerns about unauthorised persons increasingly relying on the Financial Promotions Exemptions regime and we set out the changes we believe are necessary. On the following pages we explain our approach to Non-Transferable Debt Securities ('NTDS') and the Treasury's proposal to introduce a new regulatory gateway for firms approving financial promotions. The report also sets out how we are tackling online harms in relation to which we have been working closely with the Treasury on the OSB.

In addition, our recent discussions with the Treasury suggest that the wholesale review of retail disclosure will be confined in scope to just Packaged Retail Investment and Insurance-Based Products ("PRIIPs"). We had hoped that the review of disclosures would reframe the purpose of disclosure and ensure future disclosure frameworks engage and inform consumers. We believe this is a lost opportunity to address the inconsistencies across the various retail disclosure frameworks, such as MiFID or DMD.

LCF Recommendation 6: The FCA should ensure that its training and culture reflect the importance of the FCA's role in combatting fraud by authorised firms

Our overall approach to fraud has made significant progress since the Independent Reviews and it will continue to be a priority in our transformation programme. This has included work to ensure our training and culture reflects the importance of our role in combatting fraud by authorised firms. We have sought to tackle the issue of fraud holistically, by also developing a more coordinated approach to our counter-fraud work as a whole. This approach prioritises and strengthens those workstreams we had already identified as key to reducing the harm suffered by consumers.

Approach to fraud

As we set out in our 2021/22 Business plan, we focus our work to combat fraud on the areas where our powers and remit mean we can have the most impact, including:

- keeping fraudsters out of financial services at the gateway
- stopping the firms we regulate from facilitating fraud
- detecting and pursuing fraudsters who are FCA-supervised
- detecting and pursuing improperly unauthorised/unapproved fraudsters
- informing and empowering the public to protect themselves

Sarah Pritchard joined in June as an Executive Director in Supervision, Policy and Competition, having most recently served as a Director of the National Economic Crime Centre. This appointment bolsters our leadership capability and expertise on financial crime. The FCA leadership is focused on making sure that there is a coordinated and whole FCA approach to fraud between Authorisations, Supervision, Policy and Enforcement, bringing together and strengthening our response. We will incorporate this approach into our Consumer and Wholesale Strategies, which we are developing as a multi-year plan.

Preventative and protective work

Alongside our pursuit of individuals and firms involved in fraud, we have an important role in preventing fraud and protecting consumers. We describe some of our preventative and protective work under Recommendation 5. We are aiming to achieve a substantial reduction in scam/fraudulent advertising through our work with social media firms, proactive monitoring to capture suspicious advertising and our Warning List which is updated daily to include sites and firms carrying out potential or suspected regulated activities without permissions. The number of consumer alerts we published rose from 573 in 2019 to 1,184 in 2020 and as of 25 November 2021 has already reached 1,243. We update the Warning List daily and anyone can search it. We have also implemented a new fast-track process which enables us to add to the Warning List more quickly and, where appropriate, we now act on a single piece of information where there appears to be a breach. Our target is that we will now issue 90-95% of warnings within 24-48 hours.

We continue to pursue firms and individuals involved in fraud. Most of this work is against unauthorised activity operating beyond the perimeter where we see most scam activity occurring.

Working with partners

We coordinate and implement our approach with our partners, by liaising closely and effectively as part of a combined multi-agency UK approach to combat fraud and reduce harm suffered by consumers, firms and the UK economy as a whole. We cannot take the action necessary to disrupt and punish fraudsters by acting in isolation.

Financial Crime Training

To help ensure that our staff understand our role in combatting fraud by authorised firms, we have now updated our organisation-wide Financial Crime training to include a specific section to cover this. All staff have now completed this training. As a result, all of our staff should have a better understanding of what fraud is and what the FCA's role is in taking actions against it, and that any reported potential fraud incidents are appropriately handled.

Perimeter Training

It is also important that our staff understand what powers we have to intervene in activities outside the perimeter where we see potential fraud or other serious irregularities. So we have introduced our FCA perimeter training for all existing employees and new joiners so that they have an improved awareness of the importance of the perimeter, and the FCA's powers to intervene outside it where necessary. We developed a new e-module, 'Unregulated activities & our powers', and all staff in regulatory functions have now completed this. This training is now part of the mandatory learning programme for anyone joining in a regulatory division.

LCF Recommendation 7: The FCA should take steps to ensure that, to the fullest extent possible: (i) all information and data relevant to the supervision of a firm is available in a single electronic system such that any red flags or other key risk indicators can be easily accessed and cross-referenced; and (ii) that system uses automated methods (e.g. artificial intelligence/machine learning) to generate alerts for staff within the Supervision Division when there are red flags or other key risk indicators.

We appointed our first Intelligence & Digital Director, Ian Phoenix, whose remit is to develop and expand the intelligence and data assets we hold to improve our speed and ability to detect harm and intervene at scale. We will also look to build more digital intelligence tools whilst strengthening our technical capabilities as a regulator.

We have made a significant investment in improving the availability of our organisation's data to our front-line staff in Authorisations and Supervision. This will enable us to better identify emerging risks or red flags. We have delivered this through the following initiatives.

Single View of Firm

The Single View of Firm (SVoF) has already been rolled out for some portfolios and will show staff in the FCA a picture of every firm we regulate. It includes data we've received on complaints about the firm, historic cases or issues involving the firm, and key risk indicators, such as how many financial promotions breaches the firm has had. The SVoF is accessible, clear and user-friendly. We have agreed key risk indicators and have trained staff on its use to support its deployment.

We believe the SVoF could transform the way we regulate to be more data led, a key transformation objective. So far, we have tested its application on a number of areas, and it has already had a positive impact. For example, it has led to a reduction in time spent by front-line staff locating and analysing multiple separate data sources.

In addition to the SVoF capability, we have developed a similar dashboard tool to enable a portfolio overview, Single View of a Portfolio (SVoP). This enables those overseeing portfolios to identify emerging trends and priority areas for resource by ranking firms in the portfolios based on key risk indicators.

To support the rollout of this new capability, we have developed operational management information which provides assurance that SVoF and SVoP are being used correctly and consistently in pilot areas. The first iteration of the assurance framework has been agreed and the operational MI provides assurance, these will be further refined and improved with operational business leaders.

Key risk indicators and Training

We have defined and agreed triggers for our new tools. This has led to an increased 'automation' capability to raise red flags and other internal MI as well as a reduction in time between trusted data becoming available and relevant supervisors getting information from it that they can take action on. Firms with similar characteristics to LCF are now being supervised in a more assertive way.

We want to ensure our tools are used effectively and consistently across the organisation. To this end, we have also developed training and guidance on using the SVoF tool, which includes escalation procedures to senior leaders. This has led to increased confidence amongst front line staff in their awareness, understanding and utility of the SVoF.

LCF Recommendation 8: The FCA should take urgent steps to ensure that all key aspects of the DES Programme that relate to the supervision of flexible firms are now fully embedded and operating effectively.

<u>Flexible Firm Portfolio Analysis and Strategy</u>

Since we implemented the Delivering Effective Supervision programme (DES) in 2017, and in response to the LC&F Review, we have substantially strengthened our approach to supervising flexible firms. This has included:

- Improving the mechanisms through which we categorise and assign to portfolios the more than 50,000 firms we flexibly supervise.
- Introducing Portfolio Strategy Forums and Portfolio Strategy Updates as key internal governance points through which we set, review and challenge portfolio strategies and progress in delivering them.
- Creating portfolio dashboards which bring together key relevant information from a range of sources to support ongoing portfolio assessment. Establishing portfolio-specific Key Risk Indicators has further increased the value these dashboards bring, and a common KRI Register captures best practice for reuse across portfolios.
- Changes to the process through which we bring together intelligence collected at the gateway on firm applications, and relevant information on the policy, economic and competition landscape to inform portfolio strategies and coordinate work programmes.
- Agreeing the risk rating of portfolios based on potential harm to drive the frequency with which portfolios are reviewed, and level of governance through which they are overseen.
- Establishing Portfolio Roundtable meetings as a mechanism for bringing staff together from across the organisation to share best practice and embed changes to our portfolio approach.

These improvements mean we can develop and maintain better informed strategies for tackling actual and evolving harms across flexibly supervised firms by drawing on sources from across the FCA, and to hold ourselves accountable for the delivery of the underpinning work and outcomes.

<u>Assurance</u>

Alongside further embedding and continuous evolution of the DES approach to flexible firm supervision, as outlined above, our second and third lines of defence (Risk and Compliance Oversight and Internal Audit divisions) are carrying out their own, independent, reviews of aspects of the approach and these reviews will seek to identify where key aspects of the DES programme that involve supervising flexible firms are fully embedded and are operating effectively.

LCF Recommendation 9: The FCA should consider whether it can improve its use of regulated firms as a source of market intelligence.

Our recently appointed Chief Data, Information and Intelligence Officer has responsibility for building the FCA's framework to ensure we become a data-led regulator while expanding and protecting the intelligence and data assets we hold. This is a key part of our broader transformation aims. Over the past 12 months, we have created more user-friendly digital content to improve our engagement with the wider financial services industry and improved our whistleblowing processes and procedures, both key sources of intelligence.

More user-friendly digital content

Information sent to us by industry sources is crucial to our work. Most individuals working in financial services are keen that we stop those who give their industry a bad name. In 2020 we received 1,073 separate whistleblowing disclosures, covering nearly 3,000 separate allegations. We also receive vital information from people working in the industry and we speak widely with firms and trade bodies as part of our supervision and policymaking. In the last year we have taken several steps to improve how we capture, record and use this type of intelligence. We outline the improvements to our whistleblowing approach below.

Earlier in the year, we revised our 'Contact us' web page to make it clearer and more user friendly. We also introduced a webpage with guidance for firms and professionals who want to report suspected wrongdoing to us. The web page encourages reports from industry professionals, distinguishing them from whistleblowing reports and explains how they can contact us. In just over 4 months since launch there have been 1,477 visits to the page, and we have received over 50 reports using the linked webform. We have received positive feedback on the clarity of the information and guidance and have recently refined the page and webform to make it even easier for those who want to make a report to do so 24 hours a day.

We receive industry intelligence through a variety of channels as well as the webform. We have identified all of these and are revising our approach so that we consistently record, assess and, where appropriate, action the intelligence however it is received. Once fully embedded, these changes will mean we can identify industry reports of misconduct more easily. This in turn will make it easier to feed the intelligence into our Single View of Firm and Portfolio dashboards, fast track the intelligence for action as required and identify themes in the reports which highlight emerging issues, or which might help inform future strategy. We will continue to develop our approach to this intelligence through our data strategy and transformation work as we connect different intelligence to identify new risks, benchmark firms against peers, identify outliers and take appropriate action.

Whistleblowing

Whistleblowing intelligence is a uniquely valuable source of information in identifying actual and potential harm and markets that are not working well. We are committed to continuously improving our approach to whistleblowing and have taken the following steps as part of that commitment.

In March, we launched our first external whistleblowing campaign, 'in confidence, with confidence' and published material for firms to share with employees. We have used these in several events and will continue to use them in future events to highlight the campaign and encourage individuals to have confidence to step forward, if they need to. Since the launch of the campaign, we have seen an increase in the number of unique views of our whistleblowing pages and our campaign materials have been downloaded over 3500 times.

We have improved the information on our website about our whistleblowing service and the approach we take to whistleblowing, so that potential whistleblowers better understand the journey and to provide reassurance, clarity, and confidence in our whistleblowing service. Our pages now feature a decision tree that makes it easy to understand where and how you can report concerns to us. We have also introduced a new web form reporting tool; this means whistleblowers can report with ease 24 hours a day. This has quickly become our most popular reporting method and we are pleased that the form is working well for potential whistleblowers. We have received positive feedback for the clear information in our updated pages and will continue to regularly review these webpages to ensure they remain up to date, that featured case studies are topical and that we consider all feedback.

We continue to receive approximately 1,000 new whistleblowing cases per year, most of which require assessment in our Supervision division. The cases we open based on whistleblowing intelligence often take longer to conclude compared with other types of cases, due to the sensitive and complex nature of the allegations. We have considered how to improve our approach to assessing whistleblowing cases including how we interact with whistleblowers and use the information they provide. We have recently undertaken a deep dive review of the handling of whistleblowing cases within Supervision which has highlighted improvements we can make in several areas, including case management, governance, and MI enhancements. We will be implementing these improvements throughout 2022.

We have also reviewed the content of the feedback we provide to whistleblowers. While there are legal limitations to the extent of feedback we can provide, we are amending our approach to ensure that we consistently provide as much information to whistleblowers as the law allows. We are also considering how we can improve the communication we have with whistleblowers about the actions we are taking on their case when it is under assessment.

In addition to the improved information on our website outlined above, we increased the detail on whistleblowing in our 2020/21 Annual Report and, in November, published our first quarterly data report that shows the volume of whistleblowing cases received, how whistleblowers are speaking with us and the top allegations within their reports. This data will be published on our website each quarter and we will keep under review the data that we publish, and what further information we can share to increase transparency.

In early 2022 we will contact a sample of our whistleblowers to learn more about their experience. We have worked with our consumer partnership and research experts to design an online questionnaire which covers all aspects of the whistleblower's journey including our webpages and interactions with members of our dedicated whistleblowing team. We will carefully consider the responses to this survey and publish any findings which lead to changes to our approach to whistleblowing as a result. We will also continue to engage with key stakeholders as we continue to develop and invest in our approach to whistleblowing.

Quality assurance across recommendations

Quality assurance plays an important role in testing how well we have embedded the significant changes we have implemented over the last 12 months and is relevant to a number of the recommendations above.

Some of the QA work we have done includes:

- We are making proportionate changes to our existing QA frameworks in both Supervision and Authorisations to enable us to test the embeddedness of our holistic assessments. These changes will provide the appropriate ongoing assurance that staff are now considering firms holistically in their decision-making and judgements
- Reviewing and updating our QA process for the contact centre for both the referral and triage process to ensure that our team are operating effectively and using appropriate feedback mechanisms

- Currently implementing changes to the existing QA framework for Authorisations to ensure the training on financial irregularity is being implemented effectively.
- Regarding product and business model harms, we have updated existing QA frameworks to provide ongoing assurance that Supervision and Authorisation cases are considering these aspects in their decision-making and judgements.

Connaught Lesson 1: Issues were caused by a lack of clarity about the role of operators and other market participants and the nature and extent of the regulatory perimeter.

As outlined above, we have carried out revised training of all our regulatory staff to improve our organisation’s understanding of how to manage issues involving the regulatory perimeter. For example, staff now have deeper knowledge on our powers to intervene against firms outside our perimeter which is enabling us to be more assertive.

We also recently launched our latest InvestSmart campaign which focuses on warning people aged 18-40 about the dangers of investment harm. These marketing campaigns seek to build awareness of the risks of investment and pension fraud. We work with a range of partners including Action Fraud, banks, pension providers, the Pensions Regulator, Money and Pensions Service and consumer groups. We also recently announced our Consumer Investments Strategy. This sets out our three-year strategy which incorporates a range of actions such as a new Consumer Duty with clearer and higher expectations for firms’ standards of care towards consumers, as well as work to improve the advice pensions customers receive. We want to see a consumer investment market in which consumers can invest with confidence, understanding the risks they are taking, and the regulatory protections provided.

Connaught Lesson 2: The Regulator should continue to improve information sharing between departments and its related IT systems and processes.

This has been a significant aspect of our work in responding to both independent reviews and remains a key part of our ongoing transformation work. We have improved our information sharing through a combination of training and improvements to our MI. On MI, we have designed a Single View of Firm tool that is being rolled out across portfolios with data on every firm we regulate. This tool serves as a dashboard summary of data we hold on a firm and enables our staff to more quickly understand a firm’s status and any significant changes or outlying data. This has already led to a reduction in time spent by front-line staff locating and analysing multiple data sources and allows for a greater focus on the firms that pose the greatest risk to our objectives. On training, as well as the modules described above which reinforce the need for collaboration across the organisation, we are designing a Regulatory Judgement ('join the dots') module for all areas of the FCA. This training specifically seeks to reinforce the need for staff to reduce the risk of working in silos.

As discussed earlier, we appointed our first Chief Data, Information and Intelligence Officer earlier this year to reflect the importance of maximising our use of data and intelligence to drive better outcomes. As part of these changes, we are moving the organisation’s data fully to the cloud to enable us to get better information and insights, and more effectively supervise firms.

Connaught Lesson 3: The importance of effective coordination and oversight across different teams.

As we have previously reported to you, one of the main aspects of our response has been to combine our Policy, Supervision and Competition functions under two new Executive Directors to build a strong, coordinated regulatory framework. We appointed a new Executive Director of Authorisations who is now overseeing our Authorisations Division, the gateway for firms and individuals applying to undertake regulated financial services.

This is already leading to better collaboration between distinct departments, addressing one of the key aspects of the Independent Reviews.

We recently launched our Financial Promotions and Enforcement Taskforce department as a joint venture between Enforcement and Supervision. The new department is responsible for delivering a new cross-FCA strategy to tackle financial promotions breaches, issues that straddle the perimeter and online harms. Our view is that putting these teams together will enable us to move more swiftly to identify and act against bad actors, and we will carefully monitor its results.

In addition to our Single View of Firm dashboards, we also have data dashboards at a portfolio level that enable us to move more quickly to identify firms and individuals who are most likely to cause harm. Regarding oversight, we have expanded our QA approach and in those areas of the organisation that deal with casework QA processes are now embedded. We are regularly reviewing and improving our QA framework to ensure it continues to identify inconsistencies and weaknesses as our processes also evolve.

Connaught Lesson 4: Continue to invest in and update systems regarding whistleblowers.

As outlined above against Recommendation 9, we are committed to continuously improving our approach to whistleblowing. In the last year we have made improvements in several areas with more planned in 2022. This will not be the end of our work and we will continue to look for ways we can improve our approach through engagement with whistleblowers, key stakeholders and our transformation programme.

Connaught Lesson 5: The culture of the regulator.

All of the actions we have taken in response to the Independent Reviews represent an aspect of our work to achieve an improved culture that drives accountability and better meets the expectations of the public we serve.

As part of the transformation work already underway to help ensure we can perform to a consistently high standard – to ensure we are an adaptive, innovative and assertive regulator, as set out in our Business Plan in July 2021 – we are proposing changes to the offer we make as an employer.

Our career offer consists of fair pay at all levels, recognition of strong and exceptional performance and open conversations where performance does not meet expectations. We need to ensure that all our people can develop to their potential with the opportunity to progress. We are working to ensure that we have structures which support collaboration, mobility and agile working.