Quarterly Consultation
No 22

Consultation Paper
CP18/24*

September 2018

How to respond

We are asking for comments on this Consultation Paper (CP) by 7 October 2018 for Chapter 3 and 7 November 2018 for Chapter 2.

You can send them to us using the form on our website at www.fca.org.uk/cp18-24-response-form.

Or in writing to:

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Regulatory Affairs
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Chapter 3
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Supervision Division
Telephone: 020 7066 1727

If you are responding in writing to more than one chapter please send your comments to Colin Shields in the Handbook Editorial team, who will pass your responses on as appropriate.

All responses should be sent to:

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takes you to helpful abbreviations

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1 Overview

Chapter No	Proposed changes to Handbook	Consultation Closing Period
2	Changes to regulatory reporting requirements	2 months
3	Changes to our supervisory principles in SUP 1A in line with our Approach to Supervision	1 month

2 Changes to reporting requirements in the Supervision manual

Introduction

2.1 We collect regulatory data to inform and support our supervision of firms. Our data reporting requirements are set out in the FCA Handbook, predominantly in the Supervision manual (SUP). We use internal feedback and feedback directly from firms to clarify and improve these requirements.

2.2 This chapter of the consultation paper (CP) will be of interest to authorised payment institutions (APIs).

2.3 The proposed changes to the Handbook text itself, and the statutory powers they will be made under, are set out in Appendix 2 of this CP.

Summary of proposal

2.4 **To alter the Gabriel validation rule and FCA guidance on form FSA056 (capital adequacy for APIs) for element 32B (own funds requirement)**

2.5 Element 32B in form FSA056 requires the reporting of an API's own funds requirement if they are using Method C to calculate it. The current validation rule in Gabriel and the guidance in SUP 16 Annex 27D on how to calculate element 32B can result in the wrong outcome.

2.6 We therefore propose to change both the validation rule in Gabriel and the wording in our guidance to clarify how the calculation should be completed. Firms should perform the following calculation for element 32B:

Own funds requirement [Element 32B] = Multiplication factor [Element 30B] x Scaling factor [Element 31B]

Q2.1: **Do you have any comments on our proposed changes to form FSA056 and its associated guidance?**

Cost benefit analysis

2.7 We are not required to publish a CBA in respect of the exercise of our powers under the Payment Services Regulations 2017 (PSRs) or the Payment Account Regulations 2015 (PARs). Under Regulation 106 of the PSRs, we are required to have regard to the principle that a burden or restriction which is imposed on a person should be proportionate to the benefits. We have considered whether these proposals impose costs on payment service providers that are beyond those inherent in the PSRs. We also considered proportionality in respect of the exercise of our powers under the PARs.

2.8 As the changes proposed under the PSRs and PARs are designed to clarify the existing reporting obligations, we consider it unlikely that there will be an increase in cost. If there is an increase in cost, we expect this to be of minimal significance only.

Impact on mutual societies

2.9 Section 138K(2) of FSMA requires us to provide an opinion on whether the impact of proposed rules on mutual societies is significantly different to the impact on other authorised persons. We are satisfied that the proposed changes in this chapter do not impact mutual societies any differently to any other authorised persons.

Compatibility statement

2.10 Section 1B of FSMA requires us, so far as is reasonably possible, to act in a way that is compatible with our strategic objective and advances one or more of our operational objectives. We also need to carry out our general functions in a way that promotes effective competition in the interests of consumers.

2.11 The proposed changes in this chapter will allow us to collect more accurate firm data. In turn, this will allow more effective and efficient supervision of firms which will help us to advance our consumer protection objective.

2.12 We do not believe that the proposed changes will have an impact on competition. The changes are expected to impose no or minimal costs on firms and do not affect firms' incentives or ability to compete in the market.

Equality and diversity

2.13 We do not believe that the proposals in this chapter adversely impact any of the groups with protected characteristics specified in legislation, ie age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment.

2.14 We will continue to consider the equality and diversity implications of the proposals during the consultation period, and, if necessary, will revisit them when we publish the final rules.

2.15 We welcome any feedback to this chapter of the consultation on our equality and diversity assessment.

3 Changes to our supervisory principles

Introduction

3.1 Our Approach to Supervision consultation document (the 'Approach to Supervision'),[1] published for consultation in March 2018, set out the purpose of, and our approach to, supervising firms and individuals, and the public value that supervision delivers.

3.2 Our existing supervisory principles are found in SUP 1A.3.2G of the FCA Handbook ('the Handbook'). The Approach to Supervision proposes eight updated supervisory principles to guide our supervisory work. These reflect many elements of our existing approach, while also considering developments not previously reflected in published supervisory principles, such as our focus on individual accountability.

3.3 We propose to replace the supervisory principles in SUP 1A.3.2G with those set out in the Approach to Supervision consultation document. Updating our supervisory principles in this way will provide clarity to firms and individuals about how the supervisory principles guide our supervisory work.

3.4 The proposed changes to the Handbook text itself, and the statutory powers they will be made under, are set out in Appendix 3 of this CP.

Summary of proposals

Changes to the Supervisory principles in the Handbook

3.5 We propose to replace our existing supervisory principles in SUP 1A.3.2G with the supervisory principles detailed in Chapter 2 of our Approach to Supervision. We consulted on our Approach to Supervision between March and June 2018 and plan to publish the final version in Winter 2018-19. We plan on making the changes to SUP 1A at the same time, to align with the publication of this final version.

3.6 As described in our Approach to Supervision, our operational objectives to protect consumers, enhance market integrity and promote competition form the basis of our supervisory approach. To advance these objectives we have refined some of our existing supervisory principles and developed some new supervisory principles to guide our supervisory work and help us prioritise our interventions.

3.7 The supervisory principles outlined in our Approach to Supervision reflect the way we intend to carry on our supervisory activity.[2] Many of the updated supervisory principles are similar in letter and spirit to those already contained in SUP 1A.3.2G, such as the

1 FCA Mission: Our Approach to Supervision (March 2018) www.fca.org.uk/publications/corporate-documents/our-approach-supervision

2 In some cases the proposed new supervisory principles will not result in a change to the way in which the FCA undertakes some of its supervisory work. This will be the case where existing supervisory principles are carried forward.

principle to be forward looking[3] (proposed new Principle 1) and the principle to focus on firms' strategy and business model[4] (new Principle 2).

3.8 Some of the recent changes to the FCA supervisory approach reflected in our updated supervisory principles include:

- the focus on the individual as well as firm accountability (see proposed new Principle 4) which reflects how we will approve and hold to account the most senior individuals, whose decisions and personal conduct have a significant effect on the conduct of their firm, particularly in light of the Senior Managers and Certification Regime, and
- the increasingly interconnected nature of the FCA's work with other regulators in the UK and abroad (see proposed new Principle 7). As a supervisor of global firms and markets, we work with other regulators overseas to supervise those firms and on issues which are common across national borders

3.9 Our existing supervisory principles set out how the FCA is consumer centric (see existing supervisory Principle 3) and views poor behaviour in all markets through the lens of impact on consumers (see existing supervisory Principle 8). Our proposals for an updated set of supervisory principles do not include a specific consumer-centric supervisory principle. This is because the Approach to Supervision as well as our other published documents (in particular the Approach to Consumers and the Mission) already describe our focus on consumers, which is also reflected in one of our three operational objectives. We do not therefore believe it necessary to re-state consumer centricity as a further supporting supervisory principle.

Other proposed changes to SUP 1A to better reflect our Approach to Supervision

3.10 As part of our work on the Mission and the Approach to Supervision document, we have identified a number of consequential changes that are necessary to ensure that SUP 1A (which outlines our existing approach to supervision in our Handbook provisions) is consistent and aligns with our Approach to Supervision. These consequential changes relate to:

- the way we describe our regulatory tools
- the time periods around when firms will be contacted, and
- the language related to steps we take to make decisions

3.11 To ensure alignment between the guidance in SUP 1A and the final version of our Approach to Supervision, and to reflect the way in which the FCA supervises in practice, we propose making the following consequential changes to SUP 1A:

- SUP 1A.3.3G (scope of the supervision model for firms) makes reference to some firms being contacted only once every four years. The Approach to Supervision states that we will communicate to firms our programme of work, our view on the main risks of harm and the steps we will require firms to take on a regular basis. As the frequency of this will be driven by the circumstances in each portfolio of firms, we propose to reflect this revised approach to firm communications.

3 See existing supervisory principle (1) in SUP 1A.3.2G.
4 See existing supervisory principle (7) in SUP 1A.3.2G.

- **SUP 1A.3.4G** (supervision model) describes a three-pillar approach to our supervision tools: (1) 'Firm Systematic Framework', (2) 'Event-driven work', and (3) 'issues and products' – 'thematic work on sectors of the market or products'. The Approach to Supervision does not reference the 'pillar' framework and we believe the pillar terminology is now misleading given its parallels with other prudential regulation such as the Capital Requirements Directive IV and the Solvency II Directive. We propose simply to refer to three types of work which we undertake: proactive, reactive and thematic.

- **SUP 1A.3.6G** also draws on the three pillars approach when referring to 'pillars of supervision'. We also intend to update this reference so that it refers instead to our 'supervisory work'.

- **SUP 1A.4.2G** (tools of supervision) describes our supervisory tools as: diagnostic, monitoring, preventative and remedial. This terminology has become inconsistent with the decision-making framework outlined in both the FCA Mission and the Approach to Supervision. Importantly, it does not mention evaluation tools used to assess the effect of our supervisory work and to measure public value delivered by our activities. We propose to update this aspect of SUP 1A.4.2G so that it refers to the supervisory tools under the four parts of our decision-making framework: identify, diagnose, remedy and evaluate.

Application of updated supervisory principles

3.12 To avoid any regulatory confusion, our aim is to apply the updated supervisory principles from the date the final version of the Approach to Supervision is published. At present our intention is to publish the Approach to Supervision in Winter 2018/19, ie between the start of December 2018 and the end of February 2019. Following the close of this consultation, we will provide an update on when we expect the Approach to Supervision to be published and so when we intend to make the Handbook changes to SUP 1A. Until SUP 1A.3.2G is amended our existing supervisory principles will continue to apply.

Equality and diversity

3.13 We do not believe that the proposals in this chapter adversely impact any of the groups with protected characteristics specified in legislation, ie age, disability, sex, marriage or civil partnership, pregnancy and maternity, race, religion and belief, sexual orientation and gender reassignment.

3.14 We will continue to consider the equality and diversity implications of the proposals during the consultation period, and, if necessary, will revisit them when we publish the final rules.

3.15 We welcome any feedback to this chapter of the consultation on our equality and diversity assessment.

Annex 1
List of questions

Q2.1: **Do you have any comments on our proposed changes to form FSA056 and its associated guidance?**

Q3.1: **Do you agree that our proposed changes to the supervisory principles will help to ensure that the supervisory principles better reflect the FCA's approach to supervising firms? Please support your answers with evidence or examples as appropriate.**

Appendix 1
Abbreviations used in this paper

APIs	authorised payment institutions
CBA	cost benefit analysis
CP	Consultation Paper
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000
Gabriel	GAthering Better Regulatory Information ELectionically
PARs	Payment Account Regulations 2015
PSRs	Payment Services Regulations 2017
SUP	Supervision manual

Appendix 2
Changes to reporting requirements in the Supervision manual

SUPERVISION MANUAL (REPORTING No X) INSTRUMENT 2018

Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Payment Services Regulations 2017 (SI 2017/52) ("the Regulations"):

(1) regulation 109 (Reporting requirements); and
(2) regulation 120 (Guidance).

Commencement

B. This instrument comes into force on [*date*].

Amendments to the Handbook

C. The Supervision manual (SUP) is amended in accordance with the Annex to this instrument.

Citation

D. This instrument may be cited as the Supervision Manual (Reporting No X) Instrument 2018.

By order of the Board
[*date*] 2018

Annex

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

16 Reporting requirements

…

16 Annex 27CD Authorised Payment Institution Capital Adequacy Return

FSA056 Authorised Payment Institution Capital Adequacy Return

…

Part One: CAPITAL REQUIREMENT

…

	Multiplication Factor	
25	10% of the first €2.5m of the total relevant indicator	
26	8% of the total relevant indicator between €2.5m and €5m	
27	6% of the total relevant indicator between €5m and €25m	
28	3% of the total relevant indicator between €25m and €50m	
29	1.5% of any remaining amount of the total relevant indicator	
30	~~Total~~ Multiplication Factor	
31	Scaling factor	
32	Own funds requirement	
33	Total capital requirement (higher of initial capital and own funds requirement)	

…

16 Annex 27DG Notes on completing FSA056 (Authorised Payment Institution Capital Adequacy Return – SUP 16 Annex 27CD)

FSA056 Authorised Payment Institution Capital Adequacy Return

…

Part One: CAPITAL REQUIREMENT

…

Multiplication Factor

…

Element 32B: This figure is calculated by multiplying ~~‘Element 24B’ by~~ ‘Element 30B’ and ‘Element 31B’.

…

Appendix 3
Changes to our supervisory principles

SUPERVISION MANUAL (SUPERVISORY PRINCIPLES AMENDMENT) INSTRUMENT 2018

Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the powers in section 139A (Power of the FCA to give guidance) of the Financial Services and Markets Act 2000.

Commencement

B. This instrument comes into force on [*date*].

Amendments to the Handbook

C. The Supervision manual (SUP) is amended in accordance with the Annex to this instrument.

Citation

D. This instrument may be cited as the Supervision Manual (Supervisory Principles Amendment) Instrument 2018.

By order of the Board
[*date*]

Annex

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

1A.3 The FCA's approach to supervision

Purpose

1A.3.1 G …

1A.3.2 G ~~The overall approach in the *FCA* supervision model is based on the following principles:~~

~~(1)~~ ~~forward-looking and more interventionist;~~

~~(2)~~ ~~focused on judgment, not process;~~

~~(3)~~ ~~*consumer*-centric;~~

~~(4)~~ ~~focused on the big issues and causes of problems;~~

~~(5)~~ ~~interfaces with executive management/Boards;~~

~~(6)~~ ~~robust when things go wrong;~~

~~(7)~~ ~~focused on business model and culture as well as product supervision;~~

~~(8)~~ ~~viewing poor behaviour in all markets through the lens of the impact on *consumers*;~~

~~(9)~~ ~~orientated towards *firms* doing the right thing; and~~

~~(10)~~ ~~Externally focused, engaged and listening to all sources of information.~~ [deleted]

Supervisory principles

1A.3.2A G The following supervisory principles will guide the *FCA's* supervisory work.

(1) Forward-looking – the *FCA* will aim to pre-empt or address poor conduct so that risks do not arise and any associated harm does not materialise or if the harm is likely to materialise to ensure it does not cause significant harm to *consumers* or the *UK financial system*.

(2) A focus on strategy and business models – the *FCA* will assess a *firm's* business model to:

(a) identify emerging risks of harm and to ensure that the *FCA's* supervisory activity is tailored to the mitigation of the risks identified; and

(b) develop a strong understanding of a *firm's* business model for the purposes of identifying whether there is poor alignment between a *firm's* profit incentive and the interests of *consumers* and the relevant markets functioning well.

(3) A focus on culture and governance – the *FCA* will:

(a) look at what drives behaviour within a *firm*: for example, the *firm's* purpose as it is understood by the *firm's employees*, the attitude, behaviour, competence and compliance of the *firm's* leadership, the *firm's* approach to managing and rewarding people (e.g. staff competence and incentives), and the *firm's* governance arrangements, controls and key processes (e.g. for whistleblowing or complaint handling);

(b) in relation to governance, assess effectiveness, and not merely design. The *FCA* will pay particular attention to a *firm's* conduct risk framework. For example, whether the *firm* has effective governance arrangements in place to identify the risk of harm to *consumers* or the *UK financial system* and whether the *firm* has a strategy in place to manage and mitigate those risks; and

(c) seek to address any drivers of behaviour which are likely to cause harm.

(4) A focus on individual as well as *firm* accountability – the *FCA* will:

(a) approve and hold to account the most senior individuals whose decisions and personal conduct have a significant effect on the conduct of their *firm*; and

(b) as part of the Senior Managers and Certification Regime, expect *firms* to take responsibility for certifying the competence and integrity of those *employees* who have the potential to cause significant harm.

(5) Proportionate and risk-based – the *FCA* will:

(a) use its understanding of the *UK financial system* and *firms'* business models to target those *firms* where misconduct would cause the most harm (especially to vulnerable *consumers* or important markets) and those *firms* where misconduct is most likely to be significant; and

(b) systematically use intelligence to target its engagement from a broad set of sources, including complaints data, whistleblowers, the *FCA's* contact centre, regulatory returns, other regulators and competitors.

(6) Two-way communication – the *FCA* will:

(a) engage directly with *consumers* and their representatives to better understand issues they face and target *firms* that may be causing harm;

(b) engage with industry, *firms* and market participants to understand how they are responding to market-wide events, *firm*s-specific events and the regulatory framework and to adjust the *FCA's* opinions and approach where appropriate;

(c) be clear with *firms* and individuals about good and poor practice that the *FCA* observes; and

(d) be as transparent as possible about the *FCA's* work and its priorities for the coming year.

(7) Co-ordinated – the *FCA* will:

(a) ensure its Supervision teams work closely with those in its Authorisations, Market Oversight, Policy, Competition and Enforcement functions to reach robust decisions and to share information and provide consistent messages;

(b) share intelligence with other regulatory bodies such as the Bank of England, Payment Systems Regulator, the *Financial Ombudsman Service Limited* and the Pensions Regulator; and

(c) as a supervisor of global firms and global markets, work with regulators overseas to supervise these firms and markets on issues which are common across national borders.

(8) Put right systematic harm that has occurred and stop it happening again – the *FCA* will:

(a) where it sees systematic harm, move quickly to stop harm occurring. For example, through imposing an Own Initiative Requirement (OIREQ) on the *firm* and, where appropriate, ensuring that the *firm* looks to modify the drivers of culture and its business model and strategy to prevent a recurrence;

(b) where it suspects serious misconduct, refer to its Enforcement Division for an enforcement investigation; and

(c) seek to make sure that affected *consumers* are redressed appropriately. The *FCA* may, for example, seek to put this right by requiring a *consumer redress scheme* or by working with other authorities such as the *Financial Ombudsman Service Limited*.

The scope of the supervision model for firms

1A.3.3 G The *FCA* supervision model ~~risk assessment process~~ applies to all *firms*, although the ~~detail required~~ application of the model may vary from *firm* to *firm*. ~~For example, some *firms* may experience a highly intensive level of contact although others may only be contacted once every four years. *Firms* judged as high impact are likely to require a more detailed assessment. A peer review process within the *FCA* assists consistency and will be focused on *firms* and sectors of the industry that could cause, or are causing, *consumers* harm or threaten market integrity~~ For all *firms*, whether supervised with a dedicated supervision team or supervised as part of a portfolio, the *FCA* will complete analysis and assessment and communicate to *firms* on a regular basis its programme of work, view on the main risks of harm and the steps it, the *FCA*, will require *firms* to take.

1A.3.4 G The supervision model is based on three ~~pillars~~ types of work:

(1) ~~the Firm Systematic Framework (FSF) – preventative work through structured conduct assessment of *firms*~~ proactive – pre-emptive identification of harm through review and assessment of *firms* and portfolios: this includes business model analysis and reviewing the drivers of culture;

(2) ~~event-driven work – dealing with problems that are emerging or have crystallised, and securing consumer redress or other remedial work (e.g. to secure the integrity of the market) where necessary~~ reactive – dealing with issues that are emerging or have happened to prevent harm growing; and

(3) ~~issues and products – thematic work on sectors of the market or products within a sector that are putting or may put *consumers* at risk~~ thematic – wider diagnostic or remedy work where there is actual or potential harm across a number of *firms*.

…

1A.3.6 G (1) The *FCA* intends to communicate the outcomes of its ~~pillars of supervision~~ supervisory work to each *firm* within an appropriate time frame. In the case of *firms* in which risks have been identified which could have a material bearing on the *FCA* meeting its *statutory objectives*, the *FCA* will also outline a remedial programme intended to address these.

…

…

1A.4 Tools of supervision

1A.4.1 G …

1A.4.2 G These tools may be usefully grouped under four headings:

(1) ~~diagnostic: designed to identify, assess and measure risks~~ identify – identifying instances where the *UK financial system* or *firms* are harming *consumers*, have the potential to do so, or where the *UK financial system* is working poorly and not providing sufficient benefit to *consumers*;

(2) ~~monitoring: to track the development of identified risks, wherever these arise~~ diagnose – diagnosing potential harm, including its cause, extent and potential development;

(3) ~~preventative: to limit or reduce identified risks and so prevent them crystallising or increasing~~ remedy – assessing the range of the *FCA's* available regulatory tools and making a judgement about whether these tools can remedy or mitigate the harm cost-effectively; and

(4) ~~remedial: to respond to risks when they have crystallised~~ evaluate – for the *FCA's* largest interventions, the *FCA* will test how effective these were and publish analysis after the event.

…

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