

FCA Mission: Approach to Supervision

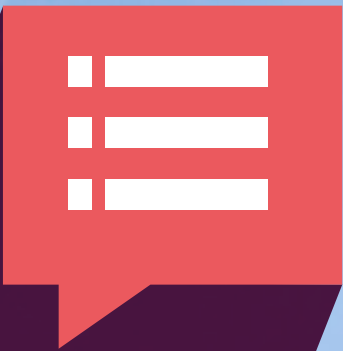
April 2019



FCA Mission: Approach to Supervision

Contents

	Introduction	5
1	Why we supervise	7
2	Our supervisory principles	8
3	Our priorities and focus	10
4	How we supervise	13
	1. Identification of harm	14
	2. Diagnostic tools	17
	3. Remedy tools	18
	4. Evaluation	20
	Annex 1: Feedback Statement for Our Approach to Supervision consultation	21
	Annex 2: Firm Assessment Model	32





Introduction

Every day the UK population relies on a range of financial services, from basic bank accounts to car loans, mortgages, pensions and complex investment products.

Consumers need to have confidence in these services and the firms that provide them. They expect the market to be fair, open and competitive. They also have high expectations of those who regulate these firms.

Parliament created the FCA to regulate the conduct of the UK's financial services. The FCA is also the prudential regulator for all firms apart from banks, building societies, credit unions, insurers and large investment firms. These are authorised by the Prudential Regulation Authority (PRA) and regulated by both the PRA and the FCA.

Parliament gave the FCA a single strategic objective – to ensure that relevant markets function well – and three operational objectives:

- protect consumers – to secure an appropriate degree of protection for consumers
- enhance market integrity – to protect and enhance the integrity of the UK financial system
- promote competition – to promote effective competition in consumers' interests

The aim of our regulation is to serve the public interest by improving the way the UK financial system works and how firms conduct their business. By doing this, it benefits individuals, businesses, the economy and so the public as a whole.


We add public value by: enhancing trust in markets, improving how they operate, delivering benefits through a common approach to regulation, working to prevent harm from occurring and helping to put things right when they go wrong.

To deliver our objectives, Parliament gave us a range of tools and independent powers to make decisions about how best to use them.

This document explains the purpose of, and our approach to, supervising firms and individuals and the public value it delivers.

It sets out:

- our role in ensuring fair and honest markets
- why and how we prioritise our supervision work
- how, in practice we supervise the firms and individuals we regulate



**We supervise around
58,000 firms serving
retail and wholesale
consumers**



Chapter 1

Why we supervise

We define supervision as the continuing oversight of firms and of individuals controlling firms to reduce actual and potential harm to consumers and markets.

We use judgment to supervise against a framework of principles and rules that represent minimum standards of conduct. The firms that we regulate and their people are responsible for ensuring that they act in accordance with our principles and rules. We expect firms and their employees to meet these standards and hold them to account when they fail to meet them.

We take a forward looking and strategic approach in our supervisory work. This includes looking both at the conduct of individual firms and, more widely, at how retail and wholesale markets are evolving. To supervise effectively, we need a thorough understanding of the business models and strategies of the firms we regulate.

We also know that firms' culture shapes the conduct outcomes for consumers and markets. We therefore aim to assess and address the drivers of culture. This includes looking at firms' leadership, purpose, governance and approach to managing and rewarding its employees.

We supervise around 58,000 firms serving retail and wholesale consumers as well as users of many of the world's largest and most significant global markets. These firms vary greatly in size, complexity and in the risks of harm they pose to consumers and market integrity. To make the best use of our resources and deliver the greatest public value,

we take a proportionate approach to supervising firms.

We use information from a wide range of sources – this includes feedback from consumers and consumer organisations, data and intelligence from firms and their trade associations, insight shared with other regulatory organisations, information from MPs and from whistleblowers. This enables us to identify problems rapidly and, where necessary intervene swiftly to address harm to consumers or markets.

Supervision by portfolio

We supervise most firms as members of a portfolio of firms that share a common business model. We analyse each portfolio and agree a strategy to take action on firms posing the greatest harm. We communicate our expectations, priorities and examples of good or poor practice.

Dedicated supervision teams

We dedicate a supervision team to the firms with the greatest potential impact on consumers and markets. This team has a view of the whole firm across all sectors it operates in. The team assesses the potential harm that the firm may cause and agrees a strategy to reduce or prevent it.



We take a forward looking and strategic approach in our supervisory work





Chapter 2

Our supervisory principles

Underpinning all our work are some key supervisory principles. These principles guide our operational objectives to protect consumers, enhance market integrity and promote competition and form the basis of our supervisory approach. From these we have developed some key supervisory principles which guide our work and help us to prioritise our interventions in order to deliver those objectives. The supervisory principles are complementary to the Principles for Businesses which outline our expectations of firms.

These supervisory principles are:

Forward looking:

- We aim to pre-empt or address poor conduct so that the risk and any associated harm does not materialise or if harm is likely to materialise to ensure it does not cause significant harm to consumers or markets.

Focus on strategy and business models:

- We assess firms' strategies and business models to identify emerging risk of harm and to ensure our supervisory activity mitigates the risk they present.
- A strong understanding of firms' business models allows us to identify where there is poor alignment between firms' profit incentive and the interests of consumers and markets functioning well.

Focus on culture and governance:

- We look at what drives behaviour in a firm. We address the key drivers of behaviour which are likely to cause harm. These include the firm's purpose (as it is understood by its 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).

- When it comes to governance, we assess effectiveness, not merely design. We focus on a firm's conduct risk framework, whether the firm has effective governance arrangements in place to identify the risk of harm to consumers and markets, and whether they have a strategy in place to manage and mitigate those risks.

Focus on individual as well as firm accountability:

- We approve and hold to account the most senior individuals whose decisions and personal conduct have a significant effect on the conduct of their firm.
- We introduced the Senior Managers and Certification Regime (SM&CR) to deposit takers in 2016 to make all financial services employees more accountable for their conduct and competence.
- As part of the SM&CR, we also



expect firms to take responsibility for certifying the competence and integrity of employees with the potential to cause significant harm.

Proportionate and risk-based:

- We use our understanding of markets and firms' business models to target firms where misconduct would cause the most harm, (especially to vulnerable consumers or important markets) and firms where misconduct is most likely to be significant.
- We systematically use intelligence to target our engagement from a broad set of sources. This includes complaints data, whistleblowers, our firm and consumer contact centre, regulatory returns, other regulators and competitor firms.

Two-way communication:

- We engage directly with consumers and their representatives to understand issues they face and target firms that may be causing harm.
- We engage with industry, firms and other market participants to understand how they are responding to market-wide events, firm-specific events and/or the regulatory framework and to adjust our opinions and approach where appropriate.
- We are clear with firms and individuals about good and poor practice that we observe.
- We are as transparent as possible about our work and our priorities for the coming year.

Co-ordinated:

- We ensure supervision teams work closely with those in its Authorisations, Market Oversight, Policy, Competition and Enforcement functions to reach robust decisions and share information and provide consistent messages.

FX

When we discover that harm is happening, we act swiftly and decisively to prevent it going any further. For example, when we fined 6 firms for attempts to manipulate the foreign exchange market in 2014, we also set up a wider programme involving 70% of the total market to help them identify root causes. We then published the findings to help drive tangible market-wide improvements.

- We share intelligence with other regulatory bodies such as the Bank of England, the Payment Systems Regulator and the Financial Ombudsman Service and the Pensions Regulator
- As a supervisor of global firms and global markets, we work with regulators overseas to supervise these firms and markets and on issues which are common across national borders.

Put right systematic harm that has occurred and stop it happening again

- Where we see systematic harm, we will move quickly to stop the harm occurring – e.g. through imposing an Own Initiative Requirement (OIREQ) on the firm. We then work to ensure that the firm addresses the drivers of culture and its business model and strategy to prevent a recurrence.
- Where we suspect serious misconduct, we will refer to our Enforcement Division for an enforcement investigation.
- We seek to obtain redress for affected customers – we may put this right ourselves by requiring a redress scheme, or by engaging directly with the firm, or by working with other authorities such as the Financial Ombudsman Service.



Chapter 3

Our priorities and focus

Our Mission, published in 2017, describes the main types of potential and actual harm that we aim to identify, prevent, reduce or correct. Harm manifests itself in different ways across retail and wholesale markets and we shape our priorities accordingly.

Cross-market priorities

We prioritise several issues that are common across both retail and wholesale sectors. We aim to ensure that firms and markets:

- are stable and resilient, for example that they can defend themselves against a cyber-attack or technological failure, or recover quickly
- are not used as conduits for financial crime, such as money laundering
- maintain effective control over personal data that they hold
- do not fail in a disorderly way causing harm to markets or consumers – and protect consumers' and market participants' assets in the event of a firm failure.
- not receiving appropriate support when they are vulnerable or in financial difficulty
- not receiving adequate help where things go wrong – such as not receiving timely responses to insurance claims or complaints about products
- being misled by firms or not being given enough information to understand a product's total cost or the risks and obligations they may be taking on
- market integrity: preventing misconduct to maintain the cleanliness and stability of our financial markets. We intend to publish a document setting out 'Our Approach to Market Integrity' later in this Financial year.

The focus of our supervisory approach

Business models, culture and prudential soundness are key areas of focus in our supervisory approach.

The role of business models

We use business model analysis to identify aspects of a firm's business model that indicate higher levels of risk. This analysis also helps us anticipate problems in individual firms and markets.

Business models can create risk of harm to consumers or markets in several ways. A business model under significant pressure for performance or on the verge of failure can create risks to consumers. The business may be tempted to go to extraordinary lengths to improve performance, such as engaging in higher risk lending or aggressive sales practice. This in turn leads to greater conduct risk. If a firm fails in a disorderly manner it might involve loss of client money. Indicators of this kind of risk include rapid decline or low levels of profitability.

Retail markets

Within retail markets, our supervisory priority is to protect retail and small business consumers from harm. We give much greater detail in our Approach to Consumers document but the sources of harm we prioritise include consumers:

- being sold products that are unsuitable for their needs
- being given credit that they cannot afford to repay
- user protection: in particular managing conflicts of interest, ensuring participants are clear about the capacity they are acting in and so the obligations they owe to others.

Wholesale markets

Wholesale markets are international in nature and many participants in those markets operate across international boundaries. We supervise UK and global wholesale firms to ensure markets are fair, effective, efficient, transparent, competitive and work well for their users. We often work alongside overseas regulators to pursue our supervisory priorities.

When supervising participants in wholesale markets, we particularly focus on the following areas:

- user protection: in particular managing conflicts of interest, ensuring participants are clear about the capacity they are acting in and so the obligations they owe to others.



Cyber and resilience

Technology is fundamental to how we do business in a modern world. Our rules require firms to have appropriate systems and controls to manage and mitigate the risks of harm. These systems and controls help to ensure firms are resilient in the advent of a cyber-attack or a technology failure.

Cyber threats are evolving quickly and are unpredictable. To be resilient firms must have effective processes to identify, manage, monitor and report the risks to which they could be exposed. These processes should ideally prevent attacks succeeding. But we know successful attacks will occur. Therefore, our rules require firms to have adequate business continuity policies. These would enable them to detect successful attacks and know how to respond to and recover from an attack. They could also contain any disruption, restore lost service or protect vital data.

Disruption from cyber-attacks or technology failures can cause significant harm to consumers or markets through lost personal or confidential data, financial

loss from fraud, disruption to services or ability of the financial system to function on a day to day basis. Equally, innovation can bring benefits from increased efficiency and new services.

Our work in this area includes:

- working with the Bank of England to assess the resilience of our largest firms which affect the resilience of the whole system
- conducting risk based assessments for other significant firms
- delivering a communications programme to provide support and advice on national cyber standards for our smallest firms
- acting usually as the first responder and coordinating with other authorities, including Her Majesty's Treasury, the BoE, PRA and government agencies in the event of a significant incident affecting the financial services industry

More fundamentally, we seek to understand the strategy of firms and the competitive dynamics of business models in a market. In particular, what creates competitive advantage, the reasons why some customers, products and services are profitable and others are not, the role of cross subsidies and how customers choose between competing offerings.

A strong understanding of firms' business models allows us to identify where there is poor alignment between firms' profit incentive and the interests of consumers and markets functioning well.

Some typical indicators of risk include aggressive proactive selling or cross-selling; products with unclear or complex features and pricing; and conflicts of interest. Through this understanding of the business model, we can develop a supervisory strategy for the firm. This will prioritise the outcomes

targeted for consumers and markets and outline the best way to achieve those through our work plan.

The role of culture and individuals

We focus on the drivers of behaviour and the role individuals play within firms. A firm's managers are responsible for the firm's culture, and for preventing harm.

We provide feedback and challenge on the behaviour we observe through our supervisory engagement. We look at the purpose of a firm to understand what it is trying to achieve in practice, not just what is written in its mission statement.

For firms to which the SM&CR applies, we have clearly set out our expectations of firms and the behaviour of their employees. As part of this, most employees will be subject to 5 conduct rules that represent minimum standards of

behaviour. They must:

- act with integrity
- act with due care, skill and diligence
- be open and cooperative with the FCA, the PRA and other regulators
- pay due regard to the interests of customers and treat them fairly
- observe proper standards of market conduct

Senior managers have a special role to play, because they make important decisions, for example on the strategy and business model of a firm and because they oversee the decision-making of others. They lead the organisation and shape its culture. As a result, they will need our approval to ensure that they are fit and proper to perform their role and that they meet our minimum standards.



Each senior manager in scope of the SM&CR must also have an agreed Statement of Responsibility which clearly sets out the areas of the business for which they are accountable. The SM&CR is a fundamental change to the landscape. We will pursue individual responsibility rigorously.

Below senior management, the Certification Regime applies to employees whose roles give them the scope to cause significant harm to a business unit of a firm or its customers. These people don't need to be approved by us, but firms need to check and certify annually that they are fit and proper to perform their role. Senior managers in firms are responsible for this.

The role of prudential supervision

As described in the Mission, our supervision work aims to avoid disorderly failure and minimise the harm to consumers or the integrity of the UK financial system. This harm can be a loss of money, or a loss of confidence and participation in financial markets. For example, services provided are not easily replaced by other firms, and the firm is unable to return client money or cannot pay redress.

Understanding a firm's financial risks, its proximity to failure and how harm is minimised in failure is an important component of our supervisory work. To minimise harm, we can set and enforce the minimum level of capital or liquidity that the firm is required to hold.

We are the prudential supervisor for approximately 46,000 firms regulated by the FCA. Within this 18,000 firms have a prudential regime, which provides more detail on the standards that need to be met. Firms that have no minimum financial resource requirements must still ensure they have adequate resources, as outlined in the FCA Handbook threshold conditions.

To determine adequate resources, we consider:

- the business model
- the risks to the continuity of the services provided
- quantity, quality and availability of resources
- the impact of other members of the firm's group on the adequacy of its resources

We also require the approximately 5,500 firms that hold client assets to maintain arrangements that protect those assets in the event of firm failure. See www.fca.org.uk/about/principles-good-regulation.

We ask firms to have credible wind-down plans in place, because we accept that some firms will fail. Where we identify failure would result in harm to consumers or markets we help to ensure that it is managed in an orderly way. For some of these firms, we carry out this work with the Bank of England.

The PRA prudentially supervises banks, building societies, credit unions, insurers and large investment firms. The PRA has 2 primary objectives: to promote the safety and soundness of the firms it regulates; and an objective specific to insurance firms, to contribute to ensuring that policyholders are appropriately protected. There is also a secondary competition objective. While we do not prudentially supervise these firms, we do supervise their conduct. So many of the factors relevant to the PRA's prudential objectives are important to ours.

For example, poor financial performance or unsustainable business models in firms can create pressures which incentivise poor conduct, such as prioritising short-term revenue generation over consumer interests. Understanding a firm's underlying business models, governance, control frameworks,

and financial circumstances are therefore significant to the aims of both authorities. As a result, we:

- regularly share information with colleagues at the PRA to ensure both authorities are sighted on matters that affect their objectives
- always seek the PRA's input when setting our supervisory strategy for the firms it also regulates
- co-ordinate with the PRA on authorising individuals, where required. A PRA-FCA Memorandum of Understanding sets out in more detail how we fulfil our statutory duty to co-ordinate our work in a way that supports our objectives: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/243452/9781909096967.pdf

Chapter 4

How we supervise

Meeting threshold conditions

When we authorise a firm, we assess whether it meets a set of minimum standards that apply to all firms. These are known as the Threshold Conditions and are set out in [Schedule 6 to the Financial Services and Markets Act 2000 \(FSMA\)](#).

Once authorised, firms need at all times to meet threshold conditions to remain authorised. Assessing whether firms continue to meet threshold conditions is an important role of supervision.

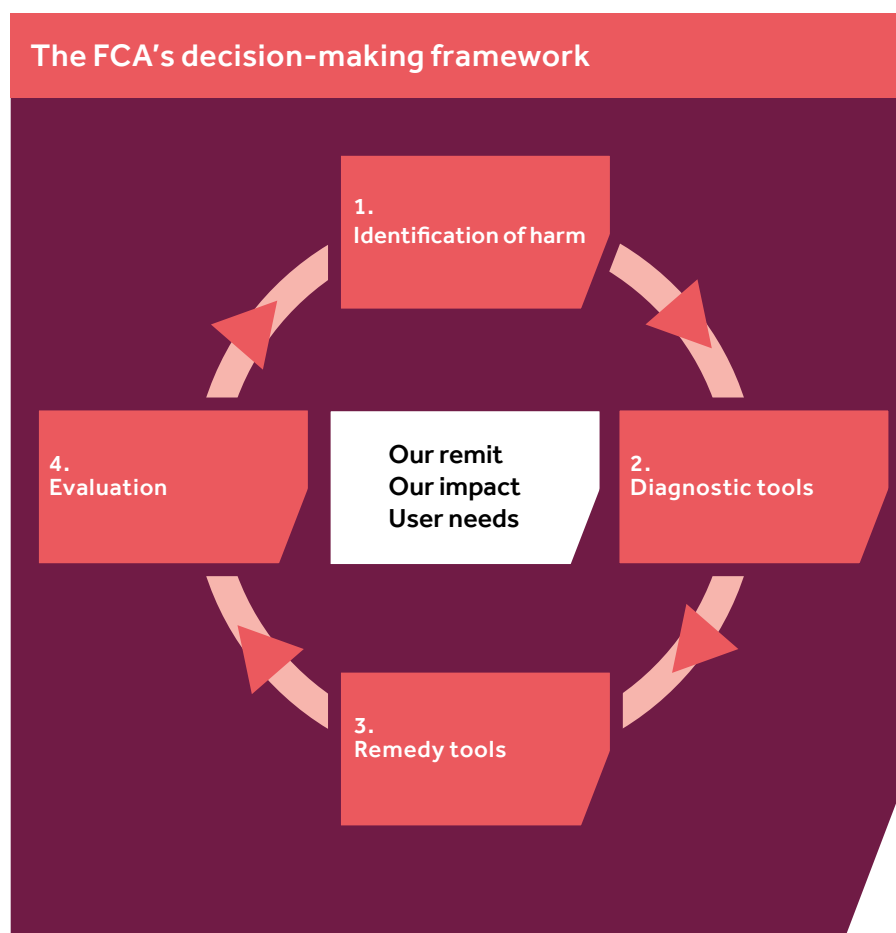
Even where a firm meets Threshold Conditions we nevertheless seek to identify risks of harm in the firm's business model or culture and engage with firms to mitigate the risks.

You can find more detail about our approach to assessing firms at authorisation in our '[Approach to Authorisation](#)' document and our approach to dealing with rule breaches is explained in our '[Approach to Enforcement](#)'. The following sections explain how we identify and diagnose harm, how we address actual and potential harm

and how we evaluate the impact of our intervention.

Making decisions

To help us use our regulatory tools efficiently and cost-effectively we have a decision-making framework. It guides how we identify and mitigate the risk of harm. We use this framework in other areas of the FCA in our other 'approach' documents. Here, we set out how we use the framework to shape and prioritise our supervision work.





1. Identification of harm

Pre-emptive identification of harm

Business model analysis and the assessment of the drivers of culture are central to our pre-emptive identification of harm for all firms. This allows us to anticipate potential problems in firms and markets.

To identify areas of potential harm, we use a firm assessment model. This sets out the 9 key areas of a firm we make a judgement on. Each of these has specific elements we consider in this judgement.

This assessment shows how likely we think the firm is to cause harm to consumers and markets. The 'Firm Assessment Model' can be found in Annex 2. A similar model is used to assess portfolios of firms. The assessment model for portfolios sets out the same nine key areas. Elements and questions are phrased slightly differently for portfolios. This assessment helps us to identify the key risks of harm and set a supervisory strategy, for a

firm or portfolio, aimed at reducing potential harm.

To support our assessment of firms, we use a variety of analyses. These include:

- market analyses in our sector views
- market studies (which is a non-supervisory tool used where we believe the drivers of harm might go further than the conduct of firms and may arise due to how the market itself functions)
- business model analyses (analyses completed on both the individual business models of higher impact firms, and on the common business model in a portfolio of firms).

We also gather real-time intelligence from our interactions with firms and consumers.

Sector and portfolio views

Markets and the strategies of firms are reacting at an ever faster pace to

the influence of changing regulation, new technology, and shifting consumer demographics, attitudes and behaviours.

Our approach to supervision gives us a clear view of how the financial system works as a whole and within individual sectors and markets. We look at possible scenarios and identify risks of harm to consumers and to markets, based on our understanding of current business models.

To develop this view, we divide the system into sectors and monitor and regularly analyse the trends. We use these [Sector Views](#) to inform our proactive supervision, and feed insights from this supervisory work back into the production of Sector Views.

We also divide each sector into a series of portfolios, with each portfolio comprising firms with similar business models. These portfolios are not static and adapt as business models change. At present,

High Cost Short Term Credit (HCSTC) and affordability

Through our analysis of HCSTC firms' business models we identified trends of high arrears, re-lending rates and fees. Though profitable to the firms they can cause harm to consumers. Further analysis of the larger HCSTC firms identified that a potential driver for such trends was inadequate affordability assessments. This resulted in a risk that customers could not afford the loans they were taking out.

In view of the risk to customers, we intervened and worked with the four largest HCSTC firms to raise standards across the market. Our

intervention resulted in firms agreeing to Voluntary Requirements to implement immediate measures to improve their affordability assessments while they overhauled their underwriting operations.

We subsequently worked with the firms to ensure their revised operations met our standards before lifting the Voluntary Requirements. In addition, the firms agreed to provide redress to remedy the detriment caused by unaffordable lending. As a result, we have seen changes in business models.



we group financial services firms into approximately 40 portfolios.

We use a combination of business model analyses, firm regulatory histories and assessments of their financial soundness to regularly develop portfolio analyses. We are also guided by our sector experts and other specialists. In some cases, we may ask for additional information from firms to support these. We identify the key risks of harm in each portfolio and individual outlier firms which may present a heightened risk of harm and warrant direct supervisory engagement.

Every firm should be able to understand our view of the main risks they pose and what we expect from them. Following our analysis, we will share with firms our programme of work, our view on the main risks of harm and the steps we will require firms to take. Work may include individual or multi-firm supervisory work and may also include other regulatory tools such as enforcement or competition tools – e.g. market studies.

Proactive engagement on the drivers of behaviour

As described previously, the role of culture and individuals is critical to our supervisory work. Examples of how we put this into practice include:

- assessing a firm's business model and strategy to understand how they align with the firm's purpose and drive appropriate behaviour
- looking at whether senior managers have the capabilities to make well-informed decisions, take accountability for their actions and communicate effectively to deliver appropriate outcomes
- assessing how firms ensure their remuneration policies and practices do not have the potential to cause harm

- ensuring that firms are considering the risks of harm themselves and have taken steps to mitigate the risks

We place the application of our Public Sector Equality Duty and Diversity & Inclusion at the heart of our activity. Firms that have a healthy regard for these factors tend to perform better. We bear this in mind as we engage with firms, their Boards, management and employees.

Identifying harm that is already occurring

We aim to deal with emerging issues or past events quickly and efficiently to prevent the harm growing.

We identify actual harm using several sources. In 2016, we received over 16,000 pieces of intelligence about firms, each of which we assessed, categorised and prioritised for analysis, investigation or action. We get this information from sources including:

The general public

Consumers frequently tell us they have been poorly treated by firms. The Financial Ombudsman Service deals with individual complaints and awards redress as appropriate. However, consumers who contact us directly with their complaints are a rich source of information about systematic issues in firms or markets.

Members of Parliament also write to us to highlight issues that have affected their constituents. This is similarly helpful to us in identifying systematic harm.

Regulated firms

Firms make us aware of problems, either in their own firm or in other firms, often with action plans for rectifying the issue. We expect firms to contact their supervisor when things go wrong. Firms with a culture of wanting to do the right thing see complaints and other identified issues as opportunities to make systematic improvements.

Firms regularly report financial, operational and sales data to us, which we analyse and use to inform our work. We also analyse the data on complaints about firms and notifications of conduct rule breaches.

Whistleblowers

Employees and other individuals, who may need to have their identities protected, tell us about poor practice within their firm. These whistleblowers can be a vital source of information for us.

Whistleblowers

- **Whistleblowers are critical to our work and we have a responsibility to deal with cases properly. To make sure they are confident in reporting to us, we handle them and their information sensitively.**
- **We protect whistleblowers by restricting those colleagues who have full access to the intelligence, and tracking and monitoring whistleblowing cases to get back to whistleblowers quickly. All parts of the FCA work closely together to ensure whistleblowers feel safe to work with us. Our Senior Management has clear accountability for these cases, so the FCA acts justly, consistently, proportionately and efficiently.**



Other bodies or organisations

The Consumer Panel, Practitioner Panels and Markets Panels of the FCA are made up of consumer and industry representatives. They give us regular updates on industry and consumer perspectives and intelligence. Trade bodies and consumer groups similarly liaise with us and send us information.

We share intelligence with other domestic Regulatory bodies such as the Bank of England, Prudential Regulation Authority (for dual regulated firms), the Payment Systems Regulator, the Financial Ombudsman Service and the Pensions Regulator.

The same is also true of other international regulators, many of whom we engage with bilaterally (often as facilitated by formal cooperation agreements) or through our membership of international supervisory 'colleges'. This is especially important given the cross-border nature of many financial markets and firms. The intelligence we receive from these other bodies is used to identify emerging harm and inform our sector views, and we engage regularly with them to improve the quality of data we hold and share.

The recently published [joint regulatory strategy](#) between the FCA and the Pensions Regulator serves as a further example of our coordination with other regulatory bodies. It underpins our cooperation with those agencies in those parts of the pensions sector which fall within our respective remits.

We continue to work with the FSCS to improve the quality and timeliness of data about firms declared in default, claims made to the FSCS, the types of investments involved

and individuals who may have given poor advice. We use this information to take action against individuals involved and seek to prevent future losses to consumers.

Where we can, we share the outcome of our work so that those groups can understand our views and share them with relevant stakeholders. Statutory constraints do mean that in many cases our firm-specific work must remain confidential. For example, section 348 of FSMA restricts the ability of the FCA to share information which under this section is regarded as 'confidential information'.



2. Diagnostic tools

Acting on intelligence

Every piece of intelligence is relevant to a firm or to a sector. We assess all the intelligence that we receive.

We take several factors into account when deciding what type of action to take. We first look at the quality of the intelligence. We then assess the scale and severity of the potential harm and, importantly, the seriousness of the potential misconduct.

Where we have prioritised an issue for further work, we use a range of tools to diagnose harm and its impact on consumers or markets.

Which supervision diagnostic tool we use depends on whether there are concerns about a single firm or several firms.

Where we have concerns about a single firm, we will look at the root causes of issues. We will identify the senior manager responsible for the relevant business area and assess what steps they have taken to prevent, or reduce, the harm. We will expect an immediate change to the business model and will use our tools to ensure that change persists.

Sometimes our diagnostic work raises suspicions of serious misconduct or that a firm no longer meets the Threshold Conditions. Enforcement investigation will then usually be appropriate. For more on how we use our Enforcement investigatory powers and the remedies available after a finding of misconduct see our '[Approach to Enforcement](#)' document.

Where we identify potential harm across several firms, we will undertake wider diagnostic work. This includes larger projects that we announce in our annual Business Plan and report on publicly. These

have been titled 'Thematic Reviews' in our business plans. We use the data already available to us and may also request additional information. We can:

- analyse data provided as part of regulatory returns, or other reporting requirements
- ask for information, including compelling firms to provide data using our statutory information gathering powers (under section 165 of the Financial Services and Markets Act 2000)
- do desk-based reviews
- visit firms and meet management
- appoint, or require firms to appoint a suitably skilled person to undertake a review on our behalf and report to us on their findings

If we identify potential failures in the way competition works, this may trigger further investigatory work. This may include a call for input, market study, or Competition Act 1998 investigation. See '[Approach to Competition](#)' document to find out how we meet our operational objective to promote effective competition in the interests of consumers.

We use a broad range of expertise in our diagnostic work. Day-to-day supervision is done by sector-dedicated supervisors. We support their work with specialist supervision departments where needed. The specialist departments have in-depth technical expertise in topics such as financial promotions rules, client assets rules, cyber defences and anti-money laundering controls.

Finally, we work closely with other organisations, domestically and internationally, on issues that

affect our shared objectives. These could be market-wide issues which cross the remit of multiple regulatory bodies such as pensions or on issues in firms which operate internationally.



Every piece of intelligence is relevant to a firm or to a sector. We assess every piece of intelligence that we receive





3. Remedy tools

Rule breaches, big and small do happen, and can be a result of mistakes rather than malicious intent. In the first instance, it is the firm's role to try to prevent breaches and to remedy them where they occur. When a mistake has been made, and the firm becomes aware of it, we expect it to notify us and to take prompt action to put things right.

We have 4 main objectives when things go wrong:

- to stop actual harm as quickly and proportionately as possible, e.g. preventing firms selling inappropriate products to customers, especially if those customers are vulnerable
- to ensure firms have put things right (including redressing customers affected)
- to address the root causes of potential harm, e.g. requiring firms to remedy poor anti-money laundering systems
- to hold the firm and/or individuals in the firm to account, where there has been misconduct this could involve enforcement action

Our responses are tailored to the harm we see and we may respond with more than one remedy and act across several firms at once.

Stopping actual harm quickly and proportionately

Where we identify that the behaviour of an individual firm is causing or may cause harm we can vary permissions granted (under part 4A of FSMA), impose requirements or change individuals' approvals on our own initiative. See our 'Approach to Enforcement' document for more on this.

In instances where we have evidence that firms are not meeting our standards, we may invite firms to sign a voluntary requirement ('VREQ') which would prevent ongoing harm to consumers or markets. For example, where we have evidence that a firm has inadequate systems and controls, we may invite the firm to sign a VREQ that they will not accept new business until the issue is addressed. Where firms do not voluntarily agree to such a requirement, we may choose to impose an Own Initiative Requirement ('OIREQ') on the firm in order to stop harm.

For solo-regulated firms which fall under a prudential regime with detailed standards (such as CRD IV firms), we have additional powers available to us. Where we identify a risk of harm from inadequate financial resources for the circumstances of a firm, we can set and enforce the minimum level of capital and/or liquidity that the firm requires.

Ensuring firms have put things right

When things go wrong, we expect firms to take prompt action to put things right and conduct a root cause analysis and take steps to prevent it happening again. Where the issues that have gone wrong are significant we expect firms to tell us as soon as possible.

Where individual consumers suffer harm, they should first complain to the firm itself to have things put right. We monitor the adequacy of firms' complaints handling, to ensure the handling process is effective and transparent, and that complaints are dealt with reasonably, promptly and fairly. The firm should engage with customers on an individual basis to

address any harm caused. We will monitor the success it has in doing this on an aggregate basis.

Where the consumer does not receive a satisfactory response from the firm, they can bring the case to the Financial Ombudsman Service to adjudicate. The Financial Ombudsman Service is operationally independent of the FCA. Its decision is binding on the firm if it is accepted by the consumer, and it has the power to ensure the consumer gets redress where appropriate.

We ensure that firms abide by the decisions of the Ombudsman and we take failure to pay an award very seriously. Our supervisory teams will follow up in such cases. Firms should not view each award in isolation and should be alert to any other wider failings in the business. We aim to ensure that where an award is upheld against a firm, that the firm considers the implications for both its wider business and other consumers.

As well as having the power to award redress to individuals, the Financial Ombudsman Service collaborates with us to identify issues which are systematic in a firm or a market. We use the intelligence we acquire to inform our supervisory work. Where we identify consumer detriment across a market, we may also conduct our own redress scheme.

The Financial Services Compensation Scheme (FSCS) steps in for cases of financial loss because of a firm's misconduct, where the firm is unable, or is likely to be unable, to pay claims against it. This will generally be because a firm has stopped trading and has insufficient assets to meet claims. Both the Financial Ombudsman Service and the FSCS are free for consumers to use.



Intervening to address the root causes of potential harm

Much risk of potential harm can be remedied through ongoing dialogue with firms. Typically, we set out what good practice looks like and highlight the risks that a firm's business models present. We also draw the firm's attention to rules, guidance or the details of recent enforcement outcomes.

We may do this by having our dedicated supervisory team contact the firm direct or by communicating with a group of firms, through a range of different channels, including:

- letters to senior individuals within firms
- publications like our monthly 'Regulation Round-up' email or 'Market Watch' newsletter
- calls from our Contact Centre
- speeches by senior FCA staff
- engagement with firms at public events such as our 'Live and Local' programme

Where issues may be systemic or recurring, we may need to adjust our rules or our approach to authorising or supervising firms or activities. If we want to change our rules, we usually consult and ask for feedback on our proposals. Any changes to our approach during authorisation or within Supervision will be assessed and agreed by relevant management, including the Board where necessary.

Where we think the harm or potential harm we have identified is significant, we enhance the level of supervisory oversight we apply to the firm that is causing the harm or likely to cause the harm. This oversight will include:

- requiring an action plan for the firm to address root causes including cultural failings, e.g. in governance, and the fitness and propriety of senior managers
- requiring supervisory monitoring, overseen by FCA senior management, of the firm's action plan and progress
- formal commitments from the Board, where appropriate, and – at a minimum – requiring the firm's Board to identify the senior individual(s) responsible

Holding individuals to account

In line with our emphasis on individual as well as firms' accountability, our responses to harm will focus on ensuring senior individuals are answerable for the remedial work firms undertake. Where appropriate we use attestations by senior managers to obtain a personal commitment that a specific action will be or has been taken. In some cases, following an enforcement investigation, we may take action against individuals including prohibition or fines.



4. Evaluation

We evaluate our supervisory activities regularly. For example:

Firm evaluation – For our largest firms we complete regular firm evaluations. This will agree the FCA's view of the firm, agree the firm's work programme and gauge the effectiveness of the previous work programme. Where harm is not being mitigated we will assess whether the supervisory tools we have used were effective. We will use this evaluation process to inform our future choice of tools.

Portfolio evaluation – We complete regular portfolio analyses. The outcome of each analysis will be individual portfolio strategies which will be agreed internally and shared with the portfolio of firms. As part of this work, we evaluate the effectiveness of the previous work plan and any changes to the harm or potential harm faced by that group of firms.

Evaluating the effectiveness of our client assets programme

The FCA has a specialist supervisory programme for large firms holding client money over £1 billion or £100 billion of custody assets in connection with investment business. These firms are known as CASS Large firms and the programme is designed to improve their compliance with their client assets obligations. In aggregate, CASS Large firms represent over 90% (approximately £14 trillion) of client assets held by firms subject to the FCA client assets regime.

We use a number of data sources to evaluate the effectiveness of our supervisory programme on firms. These include the annual independent external auditor reports on client assets, coupled with other tools such as targeted reviews led by the FCA or independent specialists. The FCA programme has included the improvement of the independent auditor reporting on client assets (see CP10/20 and PS11/5).

In instances where it has been identified that potential harm has not been mitigated adequately by the firm, the FCA has considered its supervisory approach, changing the choice of tools as appropriate. We evaluate the effectiveness of our client assets supervisory programme over the long term, assessing improvements in and drive innovation to promote better outcomes for consumers. The Unit gives these firms the information and materials they need to navigate the process of becoming a bank, as well as focused supervisory resource during the early years post-authorisation. We are taking a similar approach with our new Asset Management Hub, which we launched earlier this year.

Annex 1

Feedback Statement for Our Approach to Supervision consultation

Introduction

1. Our Approach to Supervision 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. We asked for feedback in a consultation that ran from 21 March to 21 June 2018. Following that consultation, we subsequently consulted on changes to our existing supervisory principles in Chapter 1A of the Supervision Manual (SUP). Following that subsequent consultation, we are now publishing a revised edition of the 'Approach to Supervision'. The final revised supervisory principles are outlined in Chapter 2 of this document and can also be found in the Supervision Handbook. The revised supervisory principles will apply from 24 April 2019. This feedback statement explains how we have taken into account the consultation feedback.

Responses

2. We received 21 responses from a range of stakeholders who represent the interests of consumers and firms. Whilst we are not able to respond to every comment individually, this feedback statement summarises the key points made in the consultation responses, and explains how we are dealing with the feedback received.
3. We have updated the following sections in the 'Approach to Supervision' document:
 - How we identify harm – to include more detail around the emphasis we place on understanding a firm's business model and strategy along with drivers of culture. We have also included our 'Firm Assessment Model' which is the practical tool we use in Supervision to assess firms.
 - Other bodies or organisations - clarity on our work with other regulatory bodies.

Questions we asked in the consultation

4. We asked the following questions in the 'Approach to Supervision' consultation:

Q1: *Has this document set out the FCA's approach to supervision clearly?
Are there other issues relating to our approach to supervision that could benefit from further clarification?*

Key themes to feedback

5. Most of the responses we received directly addressed the questions in our consultation. The key themes were about:
 - how our approach identifies harm
 - how we communicate and engage with the firms we supervise



- how we evaluate our work and how we promote transparency in relation to our findings
- how we ensure our staff are suitably qualified
- how we coordinate with other regulatory bodies
- our ability to supervise specialist areas including Financial Crime, FinTech and Out-sourcing
- our approach to Thematic work
- how we supervise firms whose activities span multiple regulated sectors

How our supervisory approach identifies harm

6. Generally, respondents welcomed our approach but some asked for more detail regarding how we identify harm.

Response

We take a forward looking and strategic approach in our supervisory work. This includes looking both at the conduct of individuals and firms, and more widely at how retail and wholesale markets are evolving. To supervise effectively we need a thorough understanding of the business models and strategies of the firms we regulate.

We also know that a firm's drivers of culture shape the impact it has on consumers and markets. So, we aim to assess and address the drivers of culture including firms' leadership, purpose, governance and approach to managing and rewarding its employees. Business model analysis and the assessment of the drivers of culture are central to our pre-emptive identification of harm for all firms, allowing us to anticipate potential problems in firms and markets.

To identify the types of harm firms could cause, we use a firm assessment model which sets out the nine key areas of a firm we make a judgement on, each of which has specific elements we consider in this judgement. This assessment shows how likely we think the firm is to cause harm to consumers and markets.

The 'Firm Assessment Model' can be found in Annex 2. A similar model is used to assess portfolios of firms. This assessment helps us to identify the key risks of harm and set a supervisory strategy, for a firm or portfolio, aimed at reducing potential harm.

To support our assessment of firms, we use a variety of analyses. These include market analyses we undertake within our sector views, market studies (which is a non-supervisory tool used where we believe the drivers of harm might go further than the conduct of firms and may arise due to how the market itself functions) and business model analyses (analyses completed on both the individual business models of higher impact firms, and on the common business model in a portfolio of firms).

We also gather real time intelligence from our interactions with firms, market participants, other domestic and international agencies, and consumers.

How we communicate and engage with the firms we supervise

7. Some respondents wanted clarification about how we communicate and engage with firms when there is no dedicated supervision team. Some felt that some firms do not experience enough engagement with us.

Response

To make the best use of our resources and deliver the greatest public value, we take a proportionate approach to supervising firms. We have to prioritise the work we do and the way we engage with firms. We supervise all firms as members of a portfolio of firms that share a common business model. Except for firms with greatest potential impact on consumers and markets, individual firms do not have dedicated supervisory teams. However, portfolios of firms have a designated portfolio lead supervisor, who has oversight of the firms in the portfolio and will communicate with firms in their portfolio on relevant issues. Our communications will set out our supervisory approach for the portfolio, our priorities and make clear our expectations of firms. Depending on the strategy for a given portfolio, we will perform additional engagement with selected firms within that portfolio on a sample basis through a variety of activities.

We recognise the importance of continuing communication with firms and commit to doing this through a range of different channels including:

- Letters to senior individuals within firms,
- publications such as our monthly 'Regulation Round-up' email or 'Market Watch' newsletter,
- proactive outbound calls from our Contact Centre and supervisory teams,
- hosting Industry round table events,
- speeches by senior FCA staff and engagement with firms at public events such as our 'Live and Local' programme. 'Live and Local' is a regional programme of events for regulated firms held across the UK. These generally focus on a specific sector, however we also run ad hoc sessions for various sectors featuring our Executive Committee as well as additional events focussing on priorities in our Business Plan.

How we evaluate our work and how we promote transparency in relation to our findings

8. Some respondents wanted to know how we evaluate our work and felt that this evaluation should be made public. One respondent felt that we could be more transparent with our findings following supervisory intervention.

Response

Evaluating the impact of our work is a critical part of getting our interventions right and helping us improve our performance. However, while we evaluate our supervisory activities regularly, the results of this work cannot always be published. For example, publishing the results of our work in a particular case may undermine market integrity or undermine the



effectiveness of our future work. Statutory constraints also mean that in many cases our firm specific work must remain confidential. For example, section 348 of FSMA restricts the ability of the FCA to share information which under this section is regarded as 'confidential information'. For firms with the greatest potential impact on consumers and markets we perform regular firm evaluations. We use these to review our assessment of a firm, evaluate the effectiveness of the supervisory work undertaken in respect of it, and determine our future work programme. Where harm is not being mitigated, we assess whether the supervisory tools we have used (or others available to us) could have been more effective. We use this evaluation process to inform our future choice of tools.

We also perform regular portfolio analyses for each portfolio. Each analysis results in a supervision strategy tailored to a portfolio of firms. As with individual firm evaluations, as part of this portfolio analysis process, we evaluate the effectiveness of the previous supervisory work when determining what further work to perform in future.

At an organisation level, our Mission www.fca.org.uk/publication/corporate/our-mission-2017.pdf outlines how we will test the effectiveness of our remedies to help us make better decisions, and add more public value. Testing effectiveness also increases transparency: we want to be clear about what regulatory interventions have been effective and which have not. By being open where things haven't gone well, we seek to ensure that we learn and improve future outcomes.

However, post-implementation analysis is not cost free. Additionally, the dynamism and complexity of the market means it is often difficult to isolate the impact of our actions against other factors, such as macroeconomic or technological change, or the response of firms or consumers.

For our largest interventions, we will test their effectiveness and publish analysis after the event. Here is a link to our published ex post impact evaluations.

www.fca.org.uk/publications/corporate-documents/evaluating-our-work

Where it is less cost-effective to conduct detailed analysis, we will examine and publish key indicators that help to demonstrate the impact of our interventions.

More details on how the FCA operates transparently can be found here: www.fca.org.uk/about/transparency

How we ensure our staff are suitably qualified

9. Some respondents raised concern over the turnover of staff in supervision teams and how we ensure supervisors have the relevant skills.

Response

All parts of the FCA work closely together to ensure we have sufficient, appropriately skilled staff to meet demands. We aspire to build capabilities that are fit for the future and we recruit accordingly.

In Supervision, we focus on the application of skills to develop supervisory capability. For example, supervisors have access to Subject Matter Experts for processes and skills, mentor support, peer reviews of work and quality assurance checks. Wherever possible we will offer supervisors the opportunity to broaden their skill set and experience by working in different roles.

In addition, we support supervisors through a programme of formal training. This includes a customised 'Learning Pathway' for all supervisors. These training plans consist of formal learning activities that are relevant to a supervisors department, and are split into Foundation and Intermediate level. All new supervisors are required to complete the foundation plan within six months of joining. Supervisors will cover topics such as Business Model and Strategy Analysis, Drivers of Culture, Financial Accounts and Risk Management. The intermediate plan is elective and supervisors may pick and mix specific modules based on individual learning needs. The Plans are a blend of e-learning, classroom and work-based assignments. As part of performance management, we closely track the levels of capability across Supervision, implementing training solutions where we have gaps. For example, we have recently refreshed our Business Model and Strategy Analysis and Drivers of Culture courses to align with our pre-emptive approach to identifying harm.

All supervisors have access to the 'FCA Academy', a programme that allows supervisors to access external learning and qualifications.

How we coordinate with other regulatory bodies

10. Some respondents asked how we coordinate with other Regulatory bodies; particularly in relation to the sharing of data.

Response

We share intelligence with other domestic regulatory bodies such as the Bank of England, Prudential Regulation Authority (for dual regulated firms), the Payment Systems Regulator, the Financial Ombudsman Service and the Pensions Regulator. The same is also true of other international regulators, many of whom we engage with bilaterally (often as facilitated by formal cooperation agreements) or through our membership of international supervisory 'colleges'. This is especially important given the cross-border nature of many financial markets and firms. The intelligence we receive from these other bodies is used to identify emerging harm and inform our sector views, and we engage regularly with them to improve the quality of data we hold and share.

As part of the FCA's wider role in consumer intelligence we are in the process of establishing an information sharing function within the Regulatory Family, which includes the Financial Ombudsman Service, the Financial Services



Compensation Scheme and the newly formed Money and Pensions Service. Subject to legal restrictions, this initiative will provide a mechanism whereby the respective organisations can share insights and data to better carry out their objectives. Strong relationships already exist within the Regulatory Family and useful information is already shared, often on a local level. For example, we liaise regularly with the Financial Ombudsman Service on both a regular and more ad hoc basis regarding our own work where possible and what it is seeing; firms of interest, new issues/activity, emerging trends. We also directly monitor the Ombudsman complaint levels and case uphold rates for products and firms. We use this data and insight (combined with that provided by other organisations) to help inform our case, project and policy work. While this two-way sharing of information is invaluable, the FCA and the Financial Ombudsman Service are both independent and any decisions and actions taken by either are done so independently.

The recently published joint regulatory strategy between the FCA and the Pensions Regulator serves as further example of our coordination with other regulatory bodies, and underpins our cooperation with those agencies in those parts of the pensions sector which fall within our respective remits.

We continue to work with the FSCS to improve the quality and timeliness of data about firms declared in default, claims made to the FSCS, the types of investments involved and individuals who may have given poor advice so that we can proactively act against individuals involved and seek to prevent future losses to consumers.

Our ability to supervise Specialist Areas: Financial Crime

11. A respondent expressed a view that anti money laundering supervision was an area of concern and that the FCA should have a more robust approach to supervision in this area.

Response

We apply a risk-based approach to the supervision of firms to ensure they meet their requirements under the Money Laundering Regulations and our financial crime handbook. This approach incorporates a wide range of supervisory activity, which focusses on the quality and adequacy of firms' systems and controls. Specific activities include: a systematic anti-money laundering programme, which covers approximately 78% of the UK retail banking market and 79% of the UK wholesale banking market; a proactive anti-money laundering programme covering approximately 150 other high risk firms over a four-year time frame; thematic reviews to test the systems and controls of financial institutions in a particular industry or undertaking a specific activity, e.g. money laundering and terrorist financing risks in the e-money sector (2018), www.fca.org.uk/publication/thematic-reviews/tr18-3.pdf; approximately 100 risk assurance reviews of largely randomly selected firms from various sectors, which gives us confidence that we are focusing our resources on the highest risk firms and activities (to date this work has confirmed that 97% of firms not in the first two tiers of our supervision are low risk); and a proactive call campaign to approximately 100 randomly selected firms each month to assess their AML controls.

Where we find that firms do not have adequate systems and controls and have not met the high standards we expect, we have a range of

interventions to remedy the situation. These include enforcement actions, which are detailed in chapter 2 of the FCA handbook <https://www.handbook.fca.org.uk/handbook/EG/2/12.pdf> and apply to firms and individuals. For example, in December 2018 FCA fined (subject to tribunal decision) the former CEO of Sonali Bank ('SBUK') for acting without due skill, care and diligence and for being knowingly concerned in a breach by SBUK of its obligations to maintain effective anti-money laundering (AML) systems www.fca.org.uk/news/press-releases/fca-publishes-decision-notice-against-former-ceo-sonali-bank

There is more detail on our approach to AML in our AML annual report, the latest version is available on our [website](#). We have also produced a document, which complements H.M. Treasury approved guidance produced by the Joint Money Laundering Steering Group (JMLSG), called Financial Crime: A guide for firms that is published in the FCA online handbook and provides examples of good and poor practices on how to meet the anti-money laundering obligations in the MLRs and our broader financial crime obligations: www.handbook.fca.org.uk/handbook/FCG/

Concerns about any wrongdoing by firms or individuals can be reported confidentially to our whistleblowing team. Details on this can be found via the following link: www.fca.org.uk/firms/whistleblowing

In December 2018, the Financial Action Task Force published the results of its mutual evaluation of the United Kingdom (www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-Kingdom-2018.pdf). The report is generally positive about our approach to supervision. It sets out some areas where we should consider making improvements to the way we carry out supervision, and we will be acting on these.

Our ability to supervise Specialist Areas: FinTech

12. A respondent expressed a view that we do not have the ability to supervise FinTech. They recommended further investment in technologies and increasing our internal resources to be in a better position to supervise and enforce.

Response

We regulate and supervise firms based on the regulated activities they perform, taking account of the firm's size, scale and complexity to inform our risk-based supervisory approach. When carrying out regulated activities, the FinTech community is subject to the same rules and requirements as any other firm carrying out those activities. We don't regulate specific technology, but rather the activities they facilitate and the firms carrying out these activities. However, we recognise that some aspects of how a business operates will change through their use of technology which may have implications on the way we supervise firms. Therefore, as a regulator we need to understand the impacts of technology, to improve our own use of data and technology to keep pace with industry and potentially to reduce the burden of regulation.

Our Innovation division has carried out a range of activity that encourages the development of new technologies that have the potential to help firms and the FCA to overcome regulatory challenge. Our Regulatory Sandbox



has enabled us to better understand how technology is changing the way consumers interact with financial products and services, and we use this activity to inform the wider FCA about these developments. We engage with the fintech ecosystem and colleague regulators domestically and globally, supporting firms to understand and manage the impacts on consumers, and to assist international regulators develop innovation friendly regulation. 'TechSprints' have been one of the techniques we have used to explore how technology can make regulation more effective and efficient, with regulatory reporting and anti-money laundering and financial crime current areas of focus.

Through the recent establishment of a centre of excellence for data and advanced analytics, we are exploring how innovative technology and techniques, including artificial intelligence and machine learning can be applied internally. These efforts fall into three broad categories; automation of manual processes, adoption of population review rather than sampling, and development of predictive analytical models of potential harm. We have already begun to use some of these in our day to day supervisory activity.

Here are links to our recent supervisory publications in this area:

- [Wholesale banks and asset management cyber multi-firm review findings \(December 2018\)](#)
- [Cyber and Technology Resilience: Themes from cross-sector survey 2017-18 \(November 2018\)](#)

Our ability to supervise Specialist Areas: Outsourcing

13. A respondent wanted more clarity regarding how we supervise outsourced activities.

Response

Our approach to the supervision of a firm's use of outsourced and third-party service providers is risk-based and proportionate, considering the nature, scale and complexity of a firm's operations. The overall aim of the high-level regulatory obligations relating to a firm's use of outsourced and third-party service providers, and the detailed requirements that underpin them, is that a firm appropriately identifies and manages the associated operational risks throughout the relationship lifecycle, including undertaking due diligence before deciding on outsourcing. Regulated firms retain full responsibility and accountability for discharging all their regulatory responsibilities. Firms cannot delegate any part of this responsibility to a third party.

The regulatory obligations relating to a firm's management of its operational risks and use of outsourced and third-party service providers is dependent on the regulated services provided by the firm. For those firms subject to FSMA, general outsourcing requirements are detailed in our Senior Management Arrangements, Systems and Controls sourcebook (SYSC), www.handbook.fca.org.uk/handbook. However, firms may also be subject to other specific requirements, including directly applicable EU obligations, that may apply to them based on their business. For example, the MiFID Org Regulation, <https://ec.europa.eu/transparency/regdoc/rep/3/2016/>

EN/3-2016-2398-EN-F1-1.PDF, contains detailed outsourcing provisions for investment firms and the Solvency II regulation, <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A32009L0138>, includes specific outsourcing obligations for insurance firms.

The regulatory framework has evolved in recent years and continues to develop. Key developments are:

- To clarify the requirements of firms when outsourcing to the 'Cloud' and other third-party IT services, we issued Guidance FG16/5 ('FCA Cloud Guidance') in 2016 <https://www.fca.org.uk/publications/finalised-guidance/fg16-5-guidance-firms-outsourcing-cloud-and-other-third-party-it>, which the PRA publicly endorsed.
- The European Banking Authority (EBA) issued recommendations on outsourcing to cloud service providers (EBA/REC/2017/03) https://eba.europa.eu/documents/10180/2170125/Recommendations+on+Cloud+Outsourcing+%28EBA-Rec-2017-03%29_EN.pdf/e02bef01-3e00-4d81-b549-4981a8fb2f1e on 20 December 2017. The EBA guidelines clarify the EU-wide supervisory expectations for firms who outsource to the cloud to enable them to leverage the benefits from using cloud services while identifying and managing any related risks appropriately.
- The EBA is preparing guidelines for firms who use services provided by an outsourced service provider. Consultation on the guidelines <https://eba.europa.eu/documents/10180/2260326/Consultation+Paper+on+draft+Guidelines+on+outsourcing+arrangements+%28EBA-CP-2018-11%29.pdf> took place during 2018 and a revised version is expected to be published and come into force in 2019. When they do come into force, they will replace those issued by EBA's predecessor, the Committee of European Banking Supervisors, in 2006 and the EBA Guidelines on Outsourcing to the Cloud.
- Jointly with the Bank of England and Prudential Regulation Authority, we published a Discussion Paper, DP01/18, 'Building the UK financial sector's operational resilience', <https://www.bankofengland.co.uk/news/2018/july/discussion-paper-building-the-uk-financial-sectors-operational-resilience> in July 2018. In the paper, we noted that changing business models and increased use of outsourced service provision has increased the dependence of participants on others, including, in some cases, a limited number of technology providers, which gives rise to concentration risk. While outsourcing can enable firms to manage some risks more effectively and at a reduced cost, it can also give rise to new risks for which they remain responsible. Boards' and senior managements' oversight needs to include identification and understanding of the firm's reliance on those service providers who supply services which are critical to the continuous and adequate functioning of the firm's operations. Such services could include, for example, information technology, telecommunications and messaging services.

Our Approach to Thematic Work

14. A respondent wanted clarification around what mechanisms are in place to maintain consistency across different parts of the market, the difference between cross-firm and thematic work and how Supervision informs policy work. They suggested that we should publish the programme of thematic work.



Response

We use Thematic Reviews as a way to maintain consistency across the market and inform policy work. Where we identify potential harm across a number of firms, we will undertake wider diagnostic work. This includes Thematic Reviews that we announce in our Annual Business Plan and report on publicly. Thematic reviews tend to be larger pieces of work and are also referred to as 'cross-firm' work.

Thematic work is done by people with specialised expertise. This enables us to tackle complex issues by using our resources appropriately and efficiently, aiming for better results. Our thematic teams deliver the outcomes through extensive desk-based review of information and site visits. The teams also work closely with industry practitioners and trading professional bodies, where appropriate.

Details of our thematic reviews are published on the FCA website and can be found here:

[Browse a list of our thematic reviews](#)

[Current and planned thematic work and market studies](#)

Multi-firm work seeks to mitigate a particular risk in a targeted set of firms, which are likely to sit in a particular portfolio. It may also be used to address particular knowledge gaps. It does not seek to mitigate or understand the extent of a particular risk across a whole market; however, findings may be leveraged to drive improved behaviours using communication tools. Multi-firm work will generally be shorter than thematic projects. Multi-firm work is a key element of proactive supervision for portfolio firms.

Both thematic and multi-firm work can also result in a policy response if that is an appropriate tool.

Thematic and multi firm tools differ from a market study, which is a non-supervisory tool aimed to investigate market dynamics and diagnose market failure. We undertake market studies where we consider that the drivers of harm go further than firm conduct and arise due to how the market itself functions. For example, due to how consumers interact with the market or the way in which the market, in terms of entry and exit, is developing. A market study may result in a change or amendment to policy

How we supervise firms whose activities span multiple regulated sectors

15. Some respondents wanted clarification on how firms whose activities span multiple regulated sectors are supervised, particularly regulated firms with unregulated subsidiaries.

Response

We dedicate a supervision team to each of the small number of firms with the greatest potential impact on consumers and markets. That team has a view of the whole firm across all sectors in which it operates, assesses the potential harm that the firm may cause and agrees a strategy to reduce or prevent it.

The lead supervisor within the dedicated supervision team will be accountable for risk identification and the work programme across the entire firm / group. In practice, this means drawing on the intelligence from all the relevant sectors and specialist teams to 'join the dots' across a number of different portfolios and provide a summary of the key potential harm and priorities for that group. Those sectors and specialist teams are accountable for thematic work and are expected to consult and agree any firm specific mitigating actions that impact a particular group with the lead supervisor.

Our jurisdiction arises from the need for firms to be authorised to carry out certain activities. These activities are set out in legislation and we focus on activities within this regulatory 'perimeter'. Authorised firms also carry out activities that sit outside of the perimeter and which affect our objectives. If we believe an issue is serious and the relevant activity falls outside of the perimeter or wider powers, we may still have an interest.

For example, under limited circumstances a number of our Principles for Businesses may apply to firms carrying out unregulated activities.¹ In addition, we may be able to hold individuals to account who carry out unregulated activities under the SM&CR. We can also act against an individual if we decide that they are not fit and proper to perform functions in relation to regulated activities carried on by an authorised firm.

Financial services markets are dynamic, so defining where and how we might act outside the perimeter is not straightforward. More detail about our jurisdiction and unregulated activities is set out in the Mission and our Approach to Enforcement.

Where unregulated subsidiaries carry out activities which impact or relate to regulatory activities of affiliates, for example outsourcing, we supervise the regulatory entities' oversight of these affiliates. Regulated firms retain full responsibility and accountability for discharging all their regulatory responsibilities. Firms cannot delegate any part of this responsibility to a third party.

¹ Principles 3 (Management and Control), 4 (Financial Prudence) and 11 (Relations with Regulators) can apply to unregulated activities in certain circumstances. However, the other Principles for Businesses do not apply to unregulated activities. This includes Principle 6, which sets out that a firm must pay due regard to the interests of its customers and treat them fairly.



Annex 2

Firm Assessment Model

1. In our Approach to Supervision, we outline the focus we place on business models and culture as the key drivers of harm in firms. To identify the types of harm a firm could cause, we use a firm assessment model which sets out the nine key areas of a firm we make a judgement on, each of which has specific elements we consider in this judgement. This model is used on an ongoing basis to assess individual firms and as part of the Firm Evaluation process. A similar model is used to assess portfolios of firms both on an ongoing basis and as part of our regular Portfolio assessment.

Assessment Category	Assessment Group
Business Model & Strategy	How significant could the influence of external factors be on the firm's business model?
	Is the firm's business model viable and sustainable?
	How significant are the inherent drivers of harm in the firm's business model and strategy?
Culture	How effective is the firm's purpose in reducing the potential harm arising from the firm's business model?
	How effective is the firm's leadership in reducing the potential harm arising from the firm's business model?
	How effective are the firm's people policies in reducing the potential harm arising from the firm's business model?
	How effective is the firm's governance in reducing the potential harm arising from the firm's business model?
	How effective are the firm's systems & controls in reducing the potential harm arising from the firm's business model?
	How effective is the oversight of the business in reducing the potential harm arising from the firm's business model?



12 Endeavour Square London E20 1JN

Telephone: +44 (0)20 7066 1000

Website: www.fca.org.uk

All rights reserved