

# FCA Mission: Our Approach to Supervision

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# 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

## Consultation

We are consulting on this document, seeking feedback on whether it clearly sets out the FCA's approach to supervision.



**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 market. So we aim to assess and address the drivers of culture including 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 make use of 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 by 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 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 it operates in, 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

Our operational objectives to protect consumers, enhance market integrity and promote competition form the basis of our supervisory approach. From these we have developed some key supervisory principles which guide our work and help us prioritise our interventions in order to deliver those objectives. The supervisory principles are complementary to the Principles for Businesses<sup>1</sup> 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 is tailored to the mitigation of 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 within 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 (eg, staff competence and incentives), and the firm's governance arrangements, controls and key processes (eg for whistleblowing or complaint handling).

- When it comes to governance, we assess effectiveness, not merely design. We pay particular attention to a firm's conduct risk framework, i.e. 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 with the aim of making 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 those employees who have the potential to cause significant harm.

<sup>1</sup> [www.fca.org.uk/about/principles-good-regulation](http://www.fca.org.uk/about/principles-good-regulation)





### Proportionate and risk-based:

- We use our understanding of markets 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.
- We systematically use intelligence to target our engagement from a broad set of sources including complaints data, whistleblowers, our firm and consumer contact centre, regulatory returns, other regulators and competitors.

### Two-way communication:

- We engage directly with consumers and their representatives to better 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 work closely with our colleagues in Authorisations, Market Oversight, Policy, Competition and Enforcement to reach robust decisions, to share information and to provide consistent messages.
- We share intelligence with other regulatory bodies such as the Bank of England, Payment Systems Regulator, the Financial Ombudsman Service and the Pensions Regulator.

## 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.**

- 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 – eg, through imposing an Own Initiative Requirement (OIREQ) on the firm. We then work to ensure that the firm looks to modify the drivers of culture and/or 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 make sure that affected customers are redressed appropriately – we may put this right ourselves by requiring a redress scheme, or by engaging directly with the firm and/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 a number of 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 are able to defend themselves against and quickly recover from a cyber-attack or technological failure
- 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. Linked to this, we seek to ensure consumers' and market participants' assets are appropriately handled and safeguarded 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 fully understand a product's total cost or the risks and obligations they may be taking on
- Market integrity: the prevention of misconduct to maintain the cleanliness and stability of our financial markets.

#### 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 and to improve our effectiveness as a forward-looking regulator to anticipate problems in individual firms and markets.

Business models can create risk of harm to consumers or markets in several ways. A business model which is under significant pressure for performance or is 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, which in turn lead 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 Future 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

#### 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 the management of 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<sup>2</sup> 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 able to remain resilient eg 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 are or might 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 that would enable them to, for example, detect attacks that are successful and know how to respond to and recover from an attack; to 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 for example, 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 without which the prosperity of our economy can suffer.

Our work in this area includes:

- working with the Bank of England to assess the resilience of our largest firms which impact 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 Bank of England, 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 incentives and the interests of consumers and markets functioning well. Some typical indicators of risk include aggressive pro-active selling or cross-selling; products with unclear or complex features and pricing; and conflicts of interest. Through

this understanding of the business model, we are able to develop a supervisory strategy for the firm to prioritise the outcomes targeted for consumers and markets and 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 and its management are responsible for its own culture, and preventing harm it may cause.

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

For those firms to whom 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<sup>3</sup> 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

<sup>2</sup> For example, see the general requirement in relation to systems and controls in SYSC 4.1.1R and 4.1.2R, business continuity in SYSC 4.1.6 to 4.1.8 and the rules relating to risk control in SYSC 7.1.

<sup>3</sup> COCON 1.1.2R sets out who COCON applies to.



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(s). 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 make it possible for them 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 manifest itself as loss of money and loss of confidence and participation in financial markets. For example, services provided are not easily replaced by other firms; the firm is unable to return client money or cannot pay redress.

So 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 and/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 threshold conditions.<sup>4</sup>

To determine adequate resources we consider:

- the business model
- the risks to the continuity of the services provided
- quantity, quality and availability of resources
- and 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.<sup>5</sup>

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.<sup>6</sup> 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 also 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<sup>7</sup>

We will set out our prudential approach in more detail later in 2018.

<sup>4</sup> See COND 2.4 Appropriate resources in the FCA Handbook.

<sup>5</sup> See Principle 10 of the Principles for Businesses which states: a firm must arrange adequate protection for clients' assets when it is responsible for them.

<sup>6</sup> 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.

<sup>7</sup> 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: [www.bankofengland.co.uk/about/Documents/mous/prastatutory/moufcapra.pdf](http://www.bankofengland.co.uk/about/Documents/mous/prastatutory/moufcapra.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.

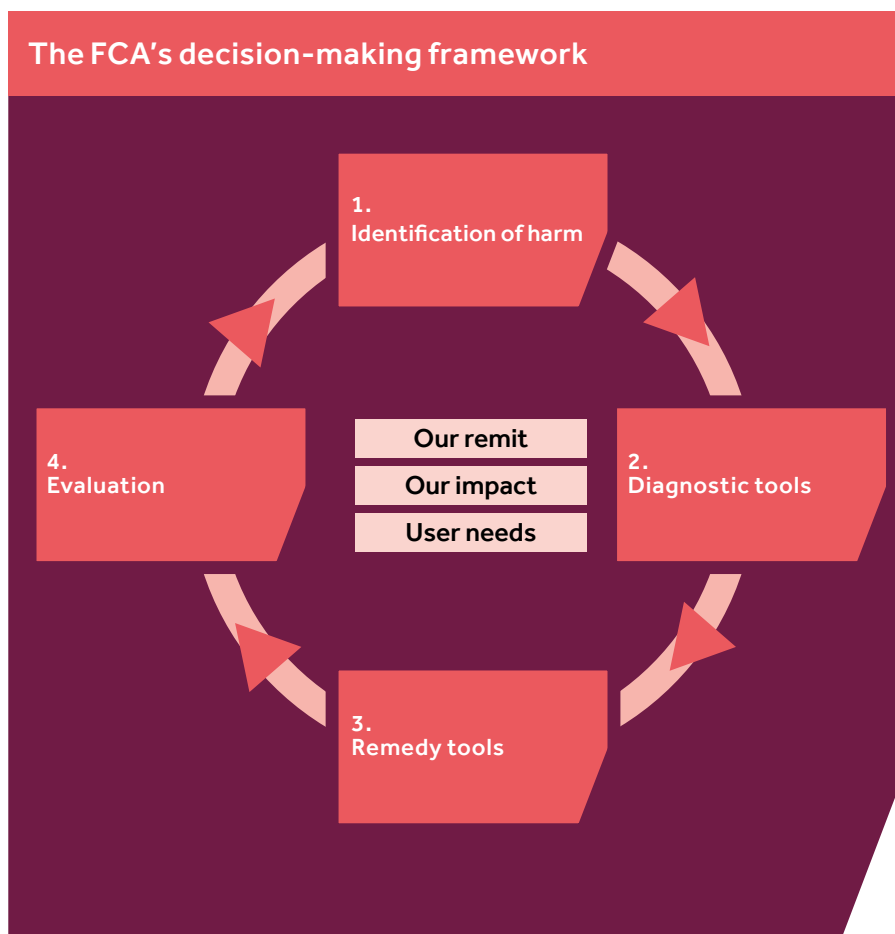
Even where a firm meets Threshold Conditions we nevertheless seek to identify risks of harm in the firm's business model or culture and engage with firms to mitigate the risks.

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. You can see how 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, allowing us to anticipate potential problems in firms and markets.

We use a variety of analyses. These include market analyses we undertake within our sector views, market studies and the business model analysis done on individual higher impact firms or on lower impact firms through portfolio analyses. 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. Based on an understanding of today's business models we look at possible scenarios and pre-emptively identify risks of harm to consumers and to markets. 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, we group financial services firms into approximately 40 portfolios.

Supported by our sector experts and other specialists we use a combination of business model analyses, firm regulatory histories and assessments of their financial soundness to regularly develop portfolio analyses. 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 communicate to the 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 – eg market studies.

## 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 which could be profitable to the firms but cause harm to consumers. Further analysis of the larger HCSTC firms identified that a potential driver for such trends was inadequate affordability assessments resulting 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 in order 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 firm agreed to provide redress to remedy the detriment caused by unaffordable lending. As a result of our interventions, we have seen changes in business models with a different mix of products being offered including a shift towards longer term loans, a reduction in the amount of sequential re-lending and lower arrears rates across the sector.



### 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; and 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

As well as pre-emptive work, we aim to deal with issues that are emerging or have happened as quickly and efficiently as possible 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. While the Financial Ombudsman Service deals with individual complaints and awards redress as appropriate, consumers who contact us directly with their complaints are nevertheless 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 which have 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, make us aware of poor practice within their firm. These whistleblowers can be a vital source of information for us.

### 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 perspectives and intelligence. Trade bodies and consumer groups similarly liaise with us and send us information. Other

regulatory bodies, such as other international regulators, the Financial Ombudsman Service, Trading Standards and law enforcement are also key sources of information for us. Our dialogue with these groups is two-way: we use the information we receive to inform our focus and priorities. 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 has to 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".

### 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.
- Working in partnership with colleagues in Enforcement, 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. Our Senior Management has clear accountability for these cases, so the FCA acts justly, consistently, proportionately and efficiently.



## 2. Diagnostic tools

### Acting on intelligence

Every piece of intelligence is relevant to a firm or to a sector. We assess every piece of 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 a number of 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 information 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 a number of firms, we will undertake wider diagnostic work. This includes larger projects that we announce in our annual Business Plan and report on publicly.<sup>8</sup> 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<sup>9</sup>

If we identify potential failures in the way competition works, this may trigger further investigatory work such as a call for input, market study, or Competition Act 1998 investigation. See our '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 undertaken 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.**

<sup>8</sup> These have been titled "Thematic Reviews" in our business plans.

<sup>9</sup> See section 166 of FSMA for the powers we have in connection with the appointment of a skilled person.





## 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 do its best 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, eg, 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, eg, requiring firms to remedy poor anti-money laundering systems.
- To hold the firm and/or individuals in the firm to account as appropriate 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 a number of firms at once.

### Stopping actual harm as quickly and proportionately as possible

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.<sup>10</sup> See our 'Approach to Enforcement' document for more information 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 on-going harm to consumers or markets. For example, where we have evidence that shows 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 as a result of 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 to 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 in an effort 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 response they regard as satisfactory from the firm, the consumer can bring the case to the Financial Ombudsman Service (which is operationally independent of the FCA) to adjudicate. 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.

<sup>10</sup> The power to impose an own initiative variation of permission is contained in s.55J(2) FSMA, an own initiative requirement in s.55L, and an own initiative variation of approval in s.63ZB.



The Financial Services Compensation Scheme (FSCS) steps in for many individuals and others who have suffered 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 presents, as well as drawing 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 directly 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
- requiring an action plan for the firm to address root causes including cultural failings, eg, 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.

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 – asking 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:

### 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 FCA's work programme for that firm and also evaluate 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 for each portfolio. 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 in excess of £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.<sup>11</sup> 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<sup>12</sup>, coupled with other tools such as targeted reviews led by the FCA or independent specialists.

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 compliance by firms across the market and informing our programme's future development.

<sup>11</sup> In aggregate, CASS Large firms represent over 90% (approximately £14 trillion) of client assets held by firms subject to the FCA client assets regime.

<sup>12</sup> The FCA programme has included the improvement of the independent auditor reporting on client assets (see CP10/20 and PS11/5).



## Annex 1: Question

### 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?**

### How to respond

We are asking for responses to these questions and comments on the paper by 21 June 2018.

You can send them to us using the form on our website at:  
[www.fca.org.uk/approach-supervision-form](http://www.fca.org.uk/approach-supervision-form)

Or in writing to:  
Supervision  
Financial Conduct Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

**Email:**  
[approachtosupervision@fca.org.uk](mailto:approachtosupervision@fca.org.uk)



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