Chapter 1A

The FCA's approach to supervision

1A.1 Application and purpose

Application

1A.1.1 G This chapter applies to every *firm*, except that its relevance for an *ICVC* is limited as the *FCA* does not intend to carry out an assessment of an *ICVC* that is specific to that *ICVC*.

Purpose

1A.1.2 G The *Act* (section 1L) requires the *FCA* to "maintain arrangements for supervising authorised persons". Section 1K of the *Act* also requires the *FCA* to provide general *guidance* about how it intends to advance its operational objectives in discharging its general functions in relation to different categories of *authorised person* or *regulated activity*. One purpose of this *guidance* is to discharge the duties of the *FCA* set out in sections 1L and 1K of the *Act*. The *FCA's* approach to supervision is also designed to enable it to meet its supervisory obligations in accordance with requirements arising otherwise than under the *Act* (for example, *onshored regulations*).

1A.1.3 G The design of these arrangements is shaped by the *FCA's statutory objectives* in relation to the conduct supervision of *firms* as well as the prudential supervision of *firms* not supervised by the *PRA*. These objectives are set out in Chapter 1 of the *Act*. The *FCA* has one *strategic objective*: ensuring that the relevant markets function well. In discharging its general functions, the *FCA* must, so far as is reasonably possible, act in a way which is compatible with its *strategic objective* and which advances one or more of its three operational objectives:

(1) securing an appropriate degree of protection for *consumers*;

(2) protecting and enhancing the integrity of the UK financial system; and

(3) promoting effective competition in the interests of *consumers* in the markets for regulated financial services (or services provided by a recognised exchange in carrying on regulated activities in respect of which it is exempt from the general prohibition by virtue of section 285(2) of the *Act*).

1A.1.3A G (1) The meaning of "UK financial system" when used in Chapter 1 of the *Act* includes *regulated claims management activities*.

(2) The term "regulated financial services" when used in Chapter 1 of the *Act* includes services provided by an *authorised person* in carrying on any *regulated activity*. Accordingly, for the purposes of Chapter 1 of the *Act*: a *regulated claims management activity* is a "regulated financial service" and a *customer* of a *firm* carrying on a *regulated claims management activity* is a "consumer" for the purposes of the *FCA's consumer* protection and competition *statutory objectives*.

1A.1.4 G

(1) In designing its approach to supervision, the *FCA* has regard to the regulatory principles set out in section 3B of the *Act*. In particular, the *FCA*'s regulatory approach aims to focus and reinforce the responsibility of the senior management of each *firm* (section 3B(1)(d) of the *Act*) to ensure that it takes reasonable care to organise and control the affairs of the *firm* responsibly and effectively, and develops and maintains adequate risk management systems. It is the responsibility of management to ensure that the *firm* acts in compliance with its regulatory requirements.

(2) The *FCA* will have regard to the principle that a burden or restriction which is imposed on a *firm* should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction (section 3B(1)(b) of the *Act*). The *FCA* will, so far as is compatible with acting in a way which advances the *consumer* protection or the integrity objective, discharge its supervisory functions in a way which promotes effective competition in the interests of *consumers*.

1A.2 Introduction

1A.2.1 G

(1) The Supervision manual (*SUP*) and Decision Procedure and Penalties manual (*DEPP*) form the Regulatory Processes part of the *Handbook*.

(2) *SUP* sets out the relationship between the *FCA* and *authorised persons* (referred to in the *Handbook* as *firms*). As a general rule, *SUP* contains material that is of continuing relevance after *authorisation*.

(3) *DEPP* is principally concerned with and sets out the *FCA*'s decision making procedures that involve the giving of *statutory notices*, the *FCA*'s policy in respect to the imposition and amount of penalties, and the conduct of interviews to which a direction under section 169(7) of the *Act* has been given or the *FCA* is considering giving.

1A.2.2 G

For a *firm* which undertakes business internationally (or is part of a *group* which does), the *FCA* will have regard to the context in which it operates, including the nature and scope of the regulation to which it is subject in jurisdictions other than the *United Kingdom*. For a *firm* with its head office outside the *United Kingdom*, the regulation in the jurisdiction where the head office is located will be particularly relevant. As part of its supervision of such a *firm*, the *FCA* will usually seek to cooperate with relevant *overseas regulators*, including exchanging information on the *firm*.

1A.3 The FCA's approach to supervision

Purpose

1A.3.1 G The *FCA* will adopt a pre-emptive approach which will be based on making forward-looking judgments about *firms*' business models, product strategy and how they run their businesses, to enable the *FCA* to identify and intervene earlier to prevent problems crystallising. The *FCA*'s approach to supervising *firms* will contribute to its delivery against its objective to protect and enhance the integrity of the *UK financial system* (as set out in the *Act*). Where the *FCA* has responsibilities for prudential supervision, its focus will be on reducing the impact on customers and the integrity of the financial system of *firms* failing or being under financial strain. In addition, when *consumer* detriment does actually occur, the *FCA* will robustly seek redress for *consumers*. This approach will be delivered through a risk-based and proportionate supervisory approach.

1A.3.2 G [deleted]

Supervisory principles

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

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

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

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

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

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

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

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

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

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

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

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

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

(a) use its understanding of the *UK financial system* and *firms'* business models to target *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; and

(b) systematically use intelligence to target its engagement from a broad set of sources. This includes complaints data, whistleblowers, the *FCA's* Supervision Hub, regulatory returns, other regulators and competitor *firms*.

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

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

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

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

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

(7) Co-ordinated – the *FCA* will:

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

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

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

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

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

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

(c) seek to obtain redress for affected *consumers*. The *FCA* may, for example, seek to put this right by requiring a *consumer redress scheme*, engaging directly with the *firm*, or by working with other authorities such as the *Financial Ombudsman Service Limited*.

The scope of the supervision model for firms

1A.3.3 G The *FCA* supervision model applies to all *firms*, although the application of the model may vary from *firm* to *firm*. For all *firms*, whether supervised with a dedicated supervision team or supervised as part of a portfolio, the *FCA* will complete analysis and assessment and communicate to *firms* on a regular basis its programme of work, view on the main risks of harm and the steps it, the *FCA*, will require *firms* to take.

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

(1) proactive – pre-emptive identification of harm through review and assessment of *firms* and portfolios: this includes business model analysis and reviewing the drivers of culture;

(2) reactive – dealing with issues that are emerging or have happened to prevent harm growing; and

(3) thematic – wider diagnostic or remedy work where there is actual or potential harm across a number of *firms*.

1A.3.5 G In order to create incentives for *firms* to raise standards and to maximise the success of the *FCA's* supervisory arrangements, it is important that a *firm* understands the *FCA's* evaluation of its risk so that it can take appropriate action.

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

(2) The *FCA* considers that it would generally be inappropriate for a *firm* to disclose its *FCA* risk assessment to third parties, except to those

who have a need or right to be aware of it, for example external auditors. *FCA* risk assessments are directed towards a specific purpose - namely illustration of the risks posed by a *firm* to the *FCA's statutory objectives* and to enable the *FCA* to allocate its resources accordingly. Using a risk assessment for any other purpose has the potential to be misleading. The *FCA* therefore discourages *firms* from disclosing their assessments, unless they are required to make them public under relevant disclosure obligations.

The nature of the FCA's relationship with firms

1A.3.7 G As many *firms* will not have dedicated, fixed portfolio resource, the first point of contact for many issues for such *firms* will be handled by the *FCA's* Supervision Hub, with the aim being that fewer issues and queries will need to be referred to the supervisors. To support all *firms* the *FCA* will also provide regional workshops and road shows to clarify its expectations on these risks and issues that are particularly important to the *FCA*.

The nature of the FCA's relationship with the PRA

1A.3.8 G While respecting each regulator's different *statutory objectives* and mandates, in undertaking its supervisory activity the *FCA* will co-ordinate and co-operate with the *PRA* as required and necessary in the interests of the effective and efficient supervision of regulated *firms* and individuals. Both regulators will coordinate with each other as required under the *Act*, including on the exchange of information relevant to each regulator's individual objectives. However, the *FCA* and *PRA* will act independently from one another when engaging with *firms*, reflecting an independent but co-ordinated regulatory approach. Maintaining effective working relationships with the *PRA* will be vital to achieving the *FCA* vision. To this end, and as required under the *Act*, the *FCA* will maintain a memorandum of understanding with the *PRA* which will set out how the two organisations will work together.

1A.4 Tools of supervision

1A.4.1 G In order to meet the *statutory objectives* and address identified risks to those objectives, the *FCA* has a range of supervisory tools available to it, including the power to impose financial penalties.

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

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

(2) diagnose – diagnosing potential harm, including its cause, extent and potential development;

(3) remedy – assessing the range of the *FCA's* available regulatory tools and making a judgement about whether these tools can remedy or mitigate the harm cost-effectively; and

(4) evaluate – for the *FCA's* largest interventions, the *FCA* will test how effective these were and publish analysis after the event.

1A.4.3 G Tools may serve more than one purpose. For example, supervisory powers can be used to address risks which have materialised or to assist in preventing risks from escalating. In the first instance they are remedial; in the second, preventative.

1A.4.4 G Some of these tools, for example the use of public statements to deliver messages to *firms* or *consumers*, do not involve the *FCA* in direct oversight of the business of *firms*. In contrast, other tools do involve a direct relationship with *firms*. The *FCA* also has powers to act on its own initiative to impose or vary individual *requirements* on a *firm* (see SUP 7) and to ban or impose requirements in relation to specific *financial promotions*. The *FCA* may also use its general rule-making powers to ban or impose requirements in relation to specific products, types of products or practices associated with a particular product or type of product. The use of the *FCA*'s tools in its oversight of market practices, in ensuring the protection of client assets and for prudential supervision of *FCA*-only *firms*, will also contribute to the integrity and orderly operation of the financial markets.

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1A.4.5 G The *FCA* uses a variety of tools to monitor whether a *firm*, once *authorised*, remains in compliance with regulatory requirements. These tools include (but are not limited to):

(1) desk-based reviews;

(2) liaison with other agencies or regulators;

(3) meetings with management and other representatives of a *firm*;

(4) on-site inspections;

(5) reviews and analysis of periodic returns and notifications;

(6) reviews of past business;

(7) transaction monitoring;

(8) use of auditors; and

(9) use of *skilled persons*.

1A.4.6 G The *FCA* also uses a variety of tools to address specific risks identified in *firms*. These tools include:

(1) making recommendations for preventative or remedial action;

(2) giving other individual *guidance* to a *firm*;

(3) imposing individual *requirements*; and

(4) varying a *firm*'s *permission* in another way.

1A.4.7 G For further discussion of the *FCA*'s regulatory approach, see publications on the *FCA*'s website.