

Chapter 1A

The FCA's approach to supervision



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.