

**LEGAL CUTOVER (SUPERVISION OF AUTHORISED FIRMS)
INSTRUMENT 2013**

WHEREAS:

- A. The Authority has, in accordance with Article 5 of the Designation Order, appointed persons to exercise functions referred to in Article 5(1) of the Designation Order, which include the function of the Financial Conduct Authority of making rules, giving guidance and issuing codes.
- B. By virtue of Article 5(3)(a) of the Designation Order the persons appointed may discharge the relevant functions as if they were the governing body of the Financial Conduct Authority.
- C. By virtue of Article 7(1) of the Designation Order this Instrument shall be treated as if it had been made by the Financial Conduct Authority acting through its governing body.
- D. Article 2(1)(c) of the Early Commencement Order commenced certain of the Financial Conduct Authority's rule making and other powers for the purposes specified in Part 3 of the Schedule to that Order.
- E. The Financial Conduct Authority wishes to replace Chapter 1 of the Supervision Manual in the Handbook and so that chapter is not being designated by the Authority and will cease to have effect on the Commencement date.

Interpretation

1. In this Instrument (including the Recitals):
 - (1) "Designation Order" means the Financial Services Act 2012 (Transitional Provisions) (Rules and Miscellaneous Provisions) Order 2013 (SI 2013/161);
 - (2) "Early Commencement Order" means the Financial Services Act 2012 (Commencement No. 1) Order 2013 (SI 2013/113);
 - (3) "the 2000 Act" means the Financial Services and Markets Act 2000;
 - (4) "the 2012 Act" means the Financial Services Act 2012;
 - (5) "the Authority" means the Financial Services Authority; and
 - (6) "Financial Conduct Authority" means the body corporate referred to in section 1A of the 2000 Act as amended by section 6 of the 2012 Act.

Rules etc. made, given or amended by the Financial Conduct Authority

2. In accordance with Article 2(1) of the Early Commencement Order and in the exercise of the powers and related provisions specified in paragraph 3, the Financial Conduct Authority makes or gives each provision in the Annex to this Instrument.
3. The Financial Conduct Authority makes or gives the provisions in the Annex to this Instrument in exercise of the following powers and related provisions of the 2000 Act, as amended by the 2012 Act:
 - Section 139A (Power of the FCA to give guidance).

Commencement: Financial Conduct Authority

4. The Financial Conduct Authority directs that this Instrument comes into force on the 1 April 2013.

Amendments to the Handbook

5. The Supervision manual (SUP) of the FCA's Handbook of rules and guidance is amended in accordance with the Annex to this Instrument.

Citation

6. This Instrument may be cited as the Legal Cutover (Supervision of Authorised Firms) Instrument 2013.

By order of the persons appointed under Article 5 of the Designation Order to discharge specified functions of the Financial Conduct Authority as if they were its governing body

19 March 2013

Annex

Amendments to the Supervision manual (SUP)

The FCA makes SUP 1A as set out below. This text is all new and is not underlined.

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 *EU* legislation, where applicable, including in relation to requirements arising otherwise than under the *Act* (for example, directly applicable *EU* 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 financial services *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.1.4 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*. Different arrangements apply for an *incoming EEA firm*, an *incoming Treaty firm* and a *UCITS qualifier*. The arrangements applying for an *incoming EEA firm* and an *incoming Treaty firm* are addressed in *SYSC* Appendix 1. For *UCITS qualifiers* see also *COLLG*.

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 The overall approach in the *FCA* supervision model is based on the following principles:

- (1) forward looking and more interventionist;
- (2) focused on judgment, not process;
- (3) *consumer*-centric;
- (4) focused on the big issues and causes of problems;
- (5) interfaces with executive management/Boards;
- (6) robust when things go wrong;
- (7) focused on business model and culture as well as product supervision;
- (8) viewing poor behaviour in all markets through the lens of the impact on *consumers*;
- (9) orientated towards *firms* doing the right thing; and
- (10) externally focused, engaged and listening to all sources of information.

The scope of the supervision model for firms

1A.3.3 G The *FCA* supervision model risk assessment process applies to all *firms*, although the detail required may vary from *firm* to *firm*. For example, some *firms* may experience a highly intensive level of contact although others may only be contacted once every four years. *Firms* judged as high impact are likely to require a more detailed assessment. A peer review process within the *FCA* assists consistency and will be focused on *firms* and sectors of the industry that could cause, or are causing, *consumers* harm or threaten market integrity.

1A.3.4 G The supervision model is based on three pillars:

- (1) the Firm Systematic Framework (FSF) – preventative work through structured conduct assessment of *firms*;

- (2) event-driven work – dealing with problems that are emerging or have crystallised, and securing customer redress or other remedial work (e.g. to secure the integrity of the market) where necessary; and
- (3) issues and products – thematic work on sectors of the market or products within a sector that are putting or may put *consumers* at risk

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 pillars of supervision 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 Contact Centre, 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) diagnostic: designed to identify, assess and measure risks;
 - (2) monitoring: to track the development of identified risks, wherever these arise;
 - (3) preventative: to limit or reduce identified risks and so prevent them crystallising or increasing; and
 - (4) remedial: to respond to risks when they have crystallised.
- 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* of financial services, 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.
- 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.