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Financial Conduct Authority

Conduct Regulation in the UK
CILA II

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Financial Conduct Authority

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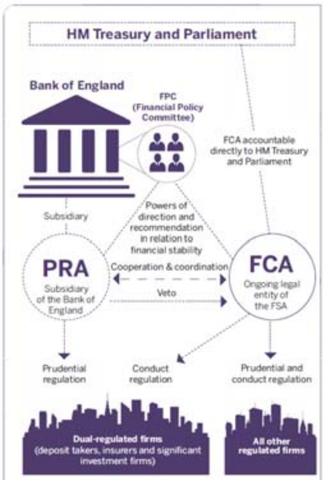
The Financial Conduct Authority (FCA)

Strategic objective

- ensuring the relevant markets function well

Operational objectives

- promoting effective competition in the interests of consumers;
- securing an appropriate degree of protection for consumers; and
- protecting and enhancing the integrity of the UK financial system.



New regulatory system

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The FCA aims to be a judgement based, forward-looking and pre-emptive regulator

The FCA's approach will emphasise 5 elements:

- be more **forward-looking** in assessment of potential problems – looking at how we can tackle issues before they start to go wrong;
- **intervene earlier** when we see problems and before they cause consumer detriment or damage to market integrity;
- **tackle underlying causes** of problems, not just the symptoms, as this will be more effective and efficient in the longer term for consumers and firms;
- **secure redress** for consumers if failures do occur; and
- **take meaningful action** against firms that fail to meet our standards through levels of fines that have a deterrent effect.

To do this, we have some new powers in addition to those available to the FSA. These include the ability to:

- temporarily ban products or restrict sales for up to 12 months;
- stop misleading financial advertising;
- impose requirements on firms; and
- subject to consultation, tell the market earlier about enforcement action.

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How will we achieve our objectives?

Co-ordinated approach between our different areas throughout the regulatory lifecycle.

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How will we achieve our objectives?

Protecting the perimeter

The FCA's aim is to ensure that **the right firms, run by the right people, selling the right products to the right consumers, are approved to do business.**

To achieve this, the FCA will continue the FSA's conduct requirements but add some new elements to the authorisation process, including:

- new **business model threshold condition**, to ensure firms have a viable and sustainable business model appropriate for the nature and scale of business they intend to carry out;
- a risk-based approach to approving controlled functions; and
- a streamlined process for dual-regulated firms.

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How will we achieve our objectives?

Supervision of firms

The FCA is responsible for the retail and wholesale conduct supervision of c.25,000 firms across all sectors of the financial services industry and the prudential supervision of c.23,000 firms (i.e. those that are not prudentially regulated by the PRA). This covers the following sectors:

Custodian Banks	Fund Managers	Credit Unions	Retail Banks	Building Societies	Life Insurers	London Markets	Retail GI
Insurance Intermediaries	Mortgage Intermediaries	Mortgage Lenders	Financial Advisors	Platforms and SIPPs	Wealth Managers	Wholesale Firms	

Aim of Supervision

To ensure firms have the interests of their customers and the integrity of the market at the heart of how they run their business.

How will we do this?

By influencing, persuading and, where appropriate, using formal powers to achieve a significant transformation in firms' conduct behaviours.

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How will we achieve our objectives?

Supervision of firms - Approach

Our approach is based on 10 Principles:

- More forward-looking and pre-emptive;
- Focused on judgement, not process;
- Greater focus on business models and culture of firms;
- Focused on big issues and root causes of problems, not just the symptoms;
- More consumer focused;
- Quicker resolution of event-driven work, as well as more robust when things go wrong;
- Orientated towards firms doing the right thing for their customers;
- Greater emphasis on individual accountability at firms;
- Externally focused, engaged and more transparent; and
- Joined-up approach internally.

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How will we achieve our objectives?

Supervision of firms – Three Pillars

1. Firm Systematic Framework

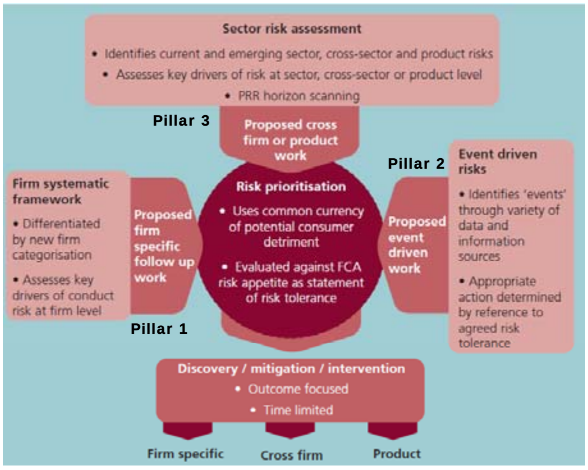
Forward looking preventative work through structured conduct assessments and regular engagement with firms to assess whether the firm is being run, currently and prospectively, in a way that results in the fair treatment of customers.

2. Event-Driven Supervision

Addressing the causes of potential or actual detriment that occur outside of Pillar 1, which have a direct impact on consumer protection or market, securing customer redress or other remedial work where necessary. This will cover issues that occur outside the firm assessment cycle, and will use better data monitoring and intelligence.

3. Issues and Products Supervision

Forward looking, fast, intensive campaigns on sectors of the market or products within a sector that are putting or may put consumers at risk.



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How will we achieve our objectives?

Supervision of firms – Pillar 1: Firm Systematic Framework

Purpose: to identify and mitigate the key drivers of conduct risk within firms which could lead to poor outcomes for consumers, or risks to market integrity.

Key question it is trying to answer: *'does the firm have the interests of its customers and the integrity of the market at the heart of how the business is run?'*

Three stages:

1. Analysis of business model and strategy of firms.
2. Proactive firm assessment of how the firm embeds fair treatment of customers and ensures market integrity in the way it conducts its business (frequency, scope and intensity determined by firm category); which
3. May result in a programme of action required of the firm.

Example: Review of product design in high growth business areas.

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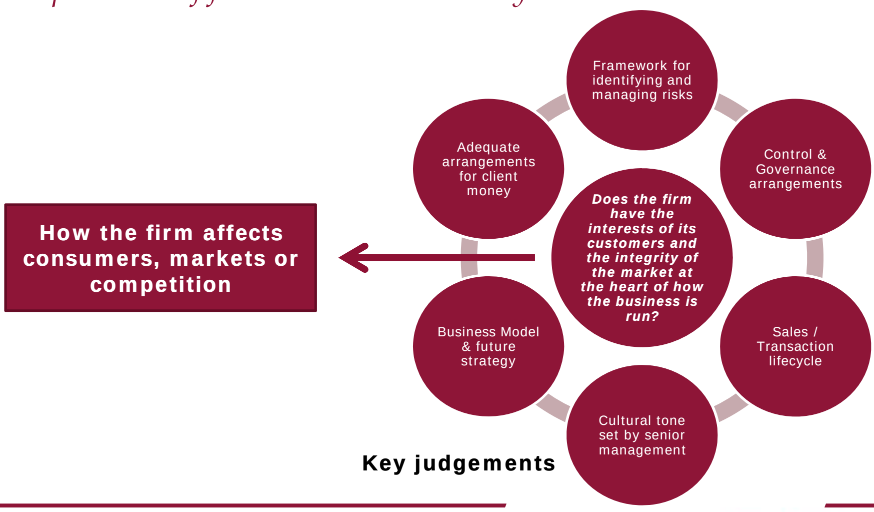
How will we achieve our objectives?

Supervision of firms – Pillar 1: Firm Systematic Framework



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How will we achieve our objectives?
Supervision of firms – Pillar 2: Event-driven Supervision

What is Pillar 2?

Supervision activity to address cases of potential or actual detriment that occur outside the Firm Systematic Framework, which will have a direct impact on consumer protection or market integrity.

The FCA's aim is to take faster, more decisive action based on our supervisory judgement of the risks posed.

Example: Acting on whistleblowing intelligence quickly with the firms involved.

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How will we achieve our objectives?
Supervision of firms – Pillar 3: Issues & Products Supervision

What is Pillar 3?

Addressing our key conduct priorities at the issue and product level.

Key features:

- Forward looking – driven by sector risk analysis of current / prospective poor outcomes
- Draws on analysis, intelligence and input from firm assessment process
- Flexible approach – projects employ bespoke methodologies
- Often uses in-depth reviews to understand risks and root causes
- Uses specialist resource to deliver work
- Co-ordinated and complementary with other supervisory work

Example: Thematic work on quality of investment advice, using mystery shopping tools.

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How will we achieve our objectives?

Supervision of firms – Enhanced focus on Wholesale Conduct

The FCA's focus is to ensure the integrity and resilience of wholesale markets, rather than to seeking to introduce concepts of detriment and redress that we use in retail markets.

Additionally, as activities in wholesale and retail markets are often interconnected, we will also focus on risks caused by poor conduct in wholesale markets which are transmitted to, and have adverse consequences in, retail markets.

The FCA will place more emphasis (and take a more assertive and interventionist approach) in three particular areas:

- where behaviours in wholesale markets can reduce the integrity of markets;
- where wholesale products are distributed to or have an impact on retail consumers; and
- where market structures can result in participants being disadvantaged or the market being inefficient.

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How will we achieve our objectives?

Supervision of firms – Prudential Supervision

Although primarily a conduct regulator, the FCA is the solo regulator for firms not prudentially regulated by the PRA.

Approach	Key Features
• Starting principle is that firms should be allowed to fail, therefore, our focus is on mitigating the impact on retail customers and market integrity of firms failing or under financial strain. • Our approach is to ensure that any failure is orderly by ensuring that customers assets and money are protected. • Prudential supervision is graduated according to prudential significance. • On-going dialogue with PRA where we both have prudential responsibilities for a **group**.	**Prudential Classification** – based on the impact that the disorderly failure of a firm could cause in terms of market disruption and market failure. **Setting Capital & Liquidity Financial Resource Requirements –** assessing financial resources requirements for our most prudentially significant firms. **Regulatory Return Monitoring –** pro-actively reviewing returns for the most significant firms and acting on alerts for other firms. **Thematic Work** – cross-firm capital / liquidity work (including smaller firms)

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How will we achieve our objectives?
Taking action against firms that don't meet our standards

The FCA will continue the FSA's credible deterrence strategy, meaning:

- more enforcement cases where needed;
- tougher penalties;
- holding senior management to account;
- criminal sanctions; and
- greater compensation for consumers, where applicable.

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How will we achieve our objectives?
Identifying emerging risks

The Policy, Risk and Research Division will act as the FCA's 'radar' to:

- gather data and intelligence to identify and assess risks; and
- use that information to drive our actions.

Published our first Conduct Risk Outlook (April 2013), noting the following 5 priority risks:

- Firms do not design products and services that respond to real consumer needs or are in consumers' long-term interests.
- Distribution channels do not promote transparency for consumers on financial products and services.
- Over-reliance on, and inadequate oversight of, payment and product technologies.
- Shift towards more innovative, complex or risky funding strategies or structures that lack adequate oversight, posing risks to market integrity and consumer protection.
- Poor understanding of risk and return, combined with the search for yield or income, leads consumers to take on more risk than is appropriate.

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How will we achieve our objectives?
Approach to Competition

New competition mandate gives the FCA an operational objective to promote effective competition in the interests of consumers, as well as a duty to do so when exercising general functions (making rules, guidance, codes and policies). We can use existing regulatory toolkit to promote competition, including general rule-making powers and firm-specific orders, as well as a new power to refer issues to the OFT.

Progress so far:

- We have set up a dedicated Competition Department, led by Mary Starks and Deborah Jones, both from the Office of Fair Trading.
- First market study is underway, looking at competition in sales of add-on general insurance products - results are expected in the Autumn.
- Further work announced such as market study into cash savings

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How will we achieve our objectives?
Co-ordination with the PRA

Dual-regulated firms are regulated by two separate regulators – the FCA and the Prudential Regulation Authority (PRA). Both operate under a different set of objectives, although there is an MoU in place between the two setting minimum co-ordination standards, including:

- Domestic supervisory colleges, with frequency depending on categorisation of firm;
- Regular exchange of information, including material conduct risks, internal models, and capital and liquidity requirements;
- Notification of findings of Pillar 3 work;
- Consultation on SIF applications;
- Expressing independent views on Part VII transfers; and
- Specific requirements for with-profits businesses.

The supervisory teams will strive to co-ordinate where possible, but firms should adapt to dealing with two different regulators with different objectives.

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What should firms expect from the FCA?

- Greater intensity and focus of conduct supervision;
- More focus on whether their business model delivers the right outcomes for consumers and behaviours in the markets they operate in;
- A greater expectation of a strategic approach to the conduct agenda and senior management and board engagement in it;
- Greater appetite for pre-emptive intervention;
- More purposeful engagement through systematic assessment and issues and product work delivered by a range of sector-skilled supervisors;
- More focus on causes of problems that we see;
- A greater expectation that firms demonstrate they have resolved issues promptly (not FCA devoting resources to monitoring this);
- More engagement of FCA senior management, especially for larger firms; and
- A predictable and committed regulator, which works with industry in a balanced way.