Effectiveness assessment of the FCA approach to flexible firm supervision

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1. EXECUTIVE SUMMARY

The FCA's approach to flexible firm supervision was implemented in 2015, partially in response to the inclusion of consumer credit firms which led to a significant increase in supervisory responsibilities, as well as a range of new functions that Parliament had asked the FCA to take on*. By working in this way, the FCA aims to supervise firms and markets more flexibly and better allocate resources to those firms presenting the greatest risk to consumers and to the financial system in general.

To do this, the firms under the FCA's remit have been split into "fixed" and "flexible" populations, with those fixed retaining one-to-one, proactive supervision while those in the flexible portfolio are overseen by the monitoring of market based risks and crystallised risk events.

Supporting this framework are "House Views" and sector strategies. The House Views, introduced in 2015 as a "baseline view" are intended to represent the collated views of all relevant FCA departments on the priorities for each sector based on a wide collection of data sources and opinions. Each House View should set the priorities that form the basis for the FCA – including Supervision – for each sector and for both fixed and flexible firms, as well as informing the risk prioritisation and mitigation across Supervision.

The revised approach aims to enable the FCA to supervise firms and markets in a more flexible way and be better equipped to distribute resources to firms and issues presenting the most substantial risks. The updated supervision model explicitly aims to put decision making as close to the frontline as possible. This includes the responsibility for defining and monitoring risk appetites, creating plans to deliver against that appetite and the mitigation of key risks within sectors. The accountability for these processes lies with the Sector Director or Sector HoD.

Nearly six months on from the implementation of this approach, the FCA has engaged PA to assess its effectiveness in practice. While some parts of the approach are still being embedded across Supervision, this assessment looks at how the Supervision risk and management framework supports the new approach to flexible firms and where further development may be necessary in order to make it fully effective, focussing on the flexible population.

In summary the review identified that some of the key objectives of the flexible firm strategy have not been fully achieved to date. One of the aims of the framework was to provide flexibility to sectors. While the aim of providing flexibility has been achieved, there remain a number of issues and opportunities for improvement. Sectors recognise the need for balance between the level of autonomy and the consistency that can be provided through a more structured approach to the planning process. Further clarity on the expected outputs from the planning process will aid the production of sector plans that can be compared and contrasted across sectors. In addition, the current governance frameworks within and across sectors are informal and generally unstructured. Our specific finding related to application of the flexible framework and governance can be summarised under two broad areas:

The lack of a standard set of definitions and expectations has led to an inconsistent application of the flexible supervisory framework across the organisation. The flexible firm supervision strategy has allowed the sectors considerable flexibility in how it is implemented in each area. However, a standard set of expectations and definitions of sector "strategies" and "plans" have not been provided. Consequently, there is at times a lack of understanding about the direction, responsibilities and

* As stated in the FCA's "Our Strategy" document of 2014, Parliament had asked the FCA to take on a whole range of new functions, concurrent competition powers and the new Payments Systems Regulator – an ever increasing waterfront to police – which meant the FCA had to be smart about how it made best use of its resources

processes in each sector. As a result the Executive Directors are in some cases unable to obtain a consistent view of sector plans or ensure that the flexible strategy is being executed effectively in each sector and in line with FCA priorities.

There is no single system of governance that supports the approach to risk management. Similarly to the derivation of sector strategies and plans, each sector has implemented governance in a different way. This has contributed to a mixed picture regarding the visibility of sector decision making at Executive Director level. This impacts the ability of senior management to ensure that decisions are being made in line with the supervisory strategy and the FCA priorities. In addition, there is lack of robust and formal structured interfaces across supervisory and non-supervisory teams. This has contributed to a lack of coordinated and consistent collaboration and knowledge sharing across the organisation. As a result planning and decisions are often being made without input from all regulatory parties.

Beyond the issues above that have arisen as a result of the inconsistent application of the flexible approach there are more fundamental issues that have hindered the flexible firm strategy in achieving its objectives.

The flexible firm supervision strategy requires supervisors to focus on market based risks, rather than proactive, one-to-one firm based supervision. This focus is dependent on the FCA's ability to be able understand the market based risks based on its collective intelligence. However limitations with the availability of quality data and the inadequate use of internal intelligence directly impacts the ability of the FCA to collate appropriate intelligence across many sectors. In addition, the disparate approach to risk identification and measurement across the organisation further compounds the impact on the FCA's ability to identify and mitigate risks and meet the objective of the flexible firm strategy. Our specific findings related to data and risk management can be summarised under two broad areas:

In some sectors, Supervision does not have data of sufficient quality to allow the consistent identification, measurement or monitoring of sector and cross-sector risks. Due to the lack of conduct related data that is received from firms as part of the regulatory returns process the FCA is restricted in its ability to consistently define conduct related market risks in some areas. The collation and interpretation of market based risk is further impacted by instances in which sectors are not utilising all potential data sources or data that may not be the most appropriate to support decision making

There are inconsistencies in how risks are measured, monitored and reported Risk appetites have not been effectively translated and embedded into operational processes. This has created a disconnect between the risk appetites and actual work being undertaken across Supervision. In addition, risks are identified and defined in an inconsistent fashion across sectors which means that it is difficult to compare and contrast risks across sectors. The lack of consistent risk identification, monitoring and reporting means that the organisation is limited in its ability to 'connect the dots' and be confident that it is able to identify emerging risks.

This report sets out our detailed findings in each of these areas.

Overall assessment

It is clear that the sectors have embraced the flexibility that has been provided to them as part of the new approach to the flexible firm population. While this has resulted in some positive impacts on supervision a number of operational complexities have surfaced which directly impact the management of sector and cross-sector risk. Some of these issues could be addressed by the introduction of a degree of structure coupled with a refresher exercise on the application of the flexible approach across the organisation. In addition, the introduction of a formalised governance structure will aid communication and visibility across sectors and divisions as well as up to Executive Director level.

The area of data and intelligence will require a focused review, and there is a data strategy being developed. However, the current deficits in the data that the FCA receive and its subsequent utilisation would benefit from a cross-sector review (potentially as part of the work to define the new data strategy) to ensure that data becomes a key enabler to the identification and monitoring of market based risk.

2. THE DESIGN OF THE FLEXIBLE SUPERVISORY FRAMEWORK

The lack of a standard set of definitions and expectations has led to an inconsistent application of the flexible supervisory framework across the organisation.

Although a logical innovation, there is a lack of clarity as to the expectations placed on sectors as a result of the change in flexible firm supervision. This has resulted in the inconsistent application and in some cases a lack of confidence in the implementation of the framework between Supervisory teams, other FCA departments and senior stakeholders

A central tenet in the newly implemented approach to the supervision of flexible firms is the flexibility afforded to sectors to derive their own strategies and structures. Sectors have responded by making changes to risk appetites, the definition of fixed and flexible firms and the specific actions to be taken in the supervision of flexible firms.

While these innovations are felt to have improved the supervision of flexible firms within some sectors, the flexibility has been used to respond to deficiencies or uncertainties in the framework and has led to increased complexity in its application:

- Some variations in the framework's interpretation are a result of a lack of understanding or confidence rather than a response to sector needs;
- There is no universal understanding of the purpose of sector strategy documents or their relationship with House Views;
- There is no best practice standard for sector strategy documents, leading to inconsistency in the documents produced;
- While autonomy is advantageous for processes which emphasise the importance of sector knowledge and expertise, sectors have expressed a desire for an increased level of conformity around the expected outputs for planning and supervision; and,
- Operational complexities have arisen as a result of the variable interpretation of the framework that are currently not managed in a structured way.

When addressing these concerns the positive innovations resulting from the autonomy afforded to sectors should be maintained.

The focus of improvement should be on providing a more detailed standard set of guidelines for the application of the framework, including the production of sector strategies and definition of fixed and flexible firms.

In addition, introducing an improved operational relationship between the House View and sector strategies will improve visibility of FCA objectives and increase confidence in their realisation with senior stakeholders and other FCA departments.

Supporting material:

- Collated Sector Strategy & Operational Planning process flows
- Appendix 3 – Level 1 Sector Strategy & Operational Planning SIPOC and process flow

Background

The updated supervision framework expressly aims to put decision making as “close to the frontline as possible”, with accountability at Sector Director or HoD level. This responsibility covers:

- Defining and monitoring risk appetites;
- Creating strategies to deliver against that appetite;
- Mitigating key risks within sectors; and,
- Governance and decision making processes.

The drive for flexibility and sector based decision making has empowered sector leadership to be innovative in the ways their flexible portfolios are supervised. This section explores the resulting variations, aims to highlight areas of positive practice but also those leading to operational issues in the approach to supervision. This section considers the following:

- The variations between sectors in the application of the framework (e.g. the definition of fixed vs flexible firms and the contents of the sector strategies created);
- The appropriateness of the balance between autonomy and conformity across sectors; and
- The expectations of each sector and their understanding of the new supervisory framework.

The resultant governance and operational complexities from the variable application on the framework are noted and are detailed further in section 3 of this report.

The autonomy provided to sectors has resulted in some positive outcomes but there are also variations that suggest a misunderstanding or lack of confidence in the flexible supervision framework

As mentioned above, the flexibility afforded to sectors as part of the supervisory approach has given sectors considerable autonomy in developing strategies to manage risk in their flexible portfolio. Sectors have used this autonomy to implement some logical and effective improvements to supervision, including:

- The variable definition of fixed and flexible firms depending on sector or sub-sector characteristics or the data available to the sector team;
- The customisation of risk appetites across sectors with qualitative decision criteria reflecting specific sector characteristics. These include specific responses to payment systems outages or pension scams. It should be noted however that while this innovation is positive, there are consequences to this variation that require further attention. These are discussed in section 3;
- Approaches to thematic or market based work are driven by the data available to each sector and provide a basis for better understanding flexible firms; and
- Innovative approaches to data gathering and analysis have been devised in response to the specific characteristics of the sector or the data available.

In particular, there are several notable sector specific improvements in the management of supervisory risk:

- The flexibility in adjusting risk appetites has allowed Retail Investments to mandate that risk events linked to pension scams and pension transfer suitability are always acted upon. This has allowed the sector to respond to a specific risk to their market through the management of risk events;
- Investment Management has undertaken an analysis of the sector and concluded that sectoral characteristics such as the approach to investment (active vs passive) or the risk associated in the investment strategy of a fund should be included in the definition of fixed and flexible firms rather than simply size or assets under management alone.
- Mortgages and Mutuals is able to leverage the rich data sources available to focus on multi-firm interventions rather than just thematic analyses. It can directly manage market risks through targeted firm based interventions resulting in more effective risk management; and

- Consumer Credit has devised a sequence of working group sessions with other teams in Supervision and those across the FCA to gather information on emerging risks within their sector. It has also tailored its Pillar 2 data to align to risk types.

Table 1 below summarises the innovations and variations in the approach to flexible firm supervision undertaken by each sector and the rationale behind them.

Sector*	Fixed / Flexible criteria	Approach constraints / rationale for variation
Consumer Credit	2 level definition – Fixed & Flexible *Investigating options for fixing a larger population*	• **Data –** do not have product / financial regulatory return data. OFT data is available but not easily accessible • **Size of population –** largest flexible population with limited data make supervision at a firm level difficult • **Transfer from interim to full permissions –**firms having not completed a full authorisations process puts further strain on supervision as quality of conduct is unknown
Mortgages and Mutuals	2 level definition – Fixed & Flexible	• **Data –** Strong data sources allow firm based supervision in the flexible portfolio and reduces the need for thematic work
General Insurance & Protection	**4 level definition** 2 fixed / 2 flexible	• **Size of population –** Sector has a large flexible portfolio but one of the largest fixed portfolios also
Retail Investments	Standard 2 level definition - Fixed & Flexible, some flexible firms subject to regular contact	• **Data –** Currently do not collect data on the products their firms advise on so do not know the risk profile
Pensions & Retirement Income		• **Flexible firm characteristics –** Many large firms in the flexible portfolio in terms of market share
Investment Management	**3 level definition** Fixed, Flexible & Higher priority flexible	• **Firm characteristics –** Focused the definition of fixed and flexible firms on risk, rather than just size of firm or AUM. As a result, firms can be fixed due to the type of business model they pursue
Retail Banking	**3 level definition** Fixed, Flexible & "Priority flexed"	• **Flexible firm characteristics –** Many large firms in the flexible portfolio – implemented "Priority flexible firms" • **Data –** FCA regulatory return data is prudential focused rather than conduct related, limiting understanding of market trends and product information. • **Size of population –** Large fixed population, reducing resource available for flexible supervision • **Group supervision –** has impacted supervision of retail banks specifically due to their size and breadth
Wholesale Banking	**3 level definition** Fixed, Flexible & "Priority flexed"	• **Flexible firm characterisation –** There are many large firms in the flexible portfolio, globally systemic or with complex business models. • **Data Strategy –** To fill the key gaps that in house information cannot provide
Infrastructure and Trading Firms (ITF)	2 level definition – Fixed & Flexible	• **Operating Model –** Different model due to nature of regulated firms – all Authorisations, Events & prudential risks managed in team. • **Authorisations –** All flexible firms exc. MTFs undergo standard authorisation • **Flexible firm characteristics –** >200 firms are "730k", requiring resource that could be allocated to P3 work

Table 1: Summary of variations in the interpretation of the framework * 8 sectors with retail lending split into Consumer Credit & Mortgages & Mutuals due to their different characteristics

While a number of the sector variations are largely positive, there are some instances in which the activities and associated rationales represent a lack of confidence in, or understanding of, the framework. Some notable examples include:

A lack of confidence

- Four of the eight sectors examined have defined additional strata of the fixed and/or flexible firm population (see table 1). The rationale for this approach varies across the sectors and is driven by sector characteristics including the size of specific firms and the relative size of the fixed and flexible pools. Specific examples include:
    - In some sectors, "priority flexible firms" have been identified in order to maintain closer communication with some flexible firms. This is mainly due to a lack of confidence in the ability to carry out effective market based supervision and to rotate the fixed portfolio and retain a wider view of firms in the flexible population. For example Wholesale Banking carry out "mini-ASM" visits with flexible firms to maintain contact.
    - In some sectors, particularly those with large flexible firms, there is a lack of confidence in the ability to effectively supervise large flexible firms and this poses a risk to specific sector objectives. For example, Retail Banking define "high priority" flexible firms as they are not comfortable reducing the FCA's visibility of these firms. This has led to a proactive approach being adopted which the sector believes is not permitted under the flexible approach e.g. undertaking visits so as to increase the level of understanding in these firms. This approach has also been influenced by the introduction of Group Supervision which has a bigger impact on Retail Banking aligned firms than other types of firms.
- In some sectors, there is a lack of visibility of Event Supervision data due to either a perceived difficulty in the production of the data or a lack of quality data which is covered further in section 4. Sectors have attempted to address this by adjusting the risk appetite statement and making specific ad-hoc requests to the events team for the escalation of events associated with specific firms, risk types or sources.

Misunderstanding

- There is variable understanding as to the types of work available to the supervision of flexible firms. In some sectors, only Pillar 2 work is carried out in the flexible portfolio, whereas in others proactive supervision is undertaken in this population as a whole or a sub-set defined as "priority" firms.

Conclusion

The flexibility afforded to sectors in the definition of their approach to flexible supervision has yielded some positive innovations. These include the creative alignment of fixed and flexible status and adjustments to the risk appetites to reflect sector needs. These are positive innovations and should be noted when applying good practice across Supervision.

However, there are also examples of variations that highlight a number of concerns that have not been addressed by the framework. These activities have highlighted some deficiencies in the framework and the level of understanding across sectors that require addressing. These include:

- Sectors with large, high risk flexible firms (e.g. Retail Banking and Wholesale Banking) lack confidence in their ability to manage risk without increased visibility and contact. The sectors believe that a strict fixed / flexible structure as designed does not allow them to effectively monitor and manage the risks associated with high risk flexible firms.
- The level of understanding across sectors of the tools and data available to support the monitoring of flexible firms varies considerably. This in turn directly affects the approaches that are adopted by sectors to manage and monitor risk.

It should be noted that the lack of confidence in the framework and the ability to appropriately supervise large, structurally important flexible firms can be interpreted as a lack of resource in the sector to carry out the proactive, Pillar 1 supervision that would otherwise be undertaken. When reviewing the options below to address this concern, the resourcing assigned to sectors to carry out the appropriate level of supervision should be considered.

There are several options to be considered when addressing these concerns, depending on the level of flexibility deemed appropriate at a sector level. These options include:

- Review of the fixed / flexible definition criteria, including the link of these definitions to the overall risk appetite for each sector. This should address the level of risk being taken on by those sectors with large, structurally significant flexible firms as a result of the removal of fixed supervision.
- Review of the toolkit available to sectors in the supervision of large, "priority flexible" firms. This should include guidance on possible advanced flexible supervisory techniques (as well as non-supervisory tools – policy, competition actions etc..) to address firms either transitioning from fixed to flexible and tools to increase the level of engagement and / or direct communication with a sub-set of the flexible population.
- Implementation of regular, structured communication of best practice fixed population definitions used across sectors and the tools used across Supervision to engage with flexible firms.

A lack of clear direction has resulted in confusion as to the role of sector strategies and House Views

Although autonomy and flexibility is an explicit objective of the framework, a "how to" guide has been provided to sectors. In the *"Approach to supervising flexible portfolio firms"* document, October 2015, guidance is given as to the purpose of the sector strategy document, the relationship with the House View process, the expected scope of contents, governance, review timescales and other information.

The accompanying schematic process flow is shown in figure 1, below. However, sectors are not currently adhering to this process and in many cases are unaware that this is the expectation or the role of the sector strategy. It should also be noted that some sectors have yet to complete a House View and therefore cannot adhere to this process or expectation.

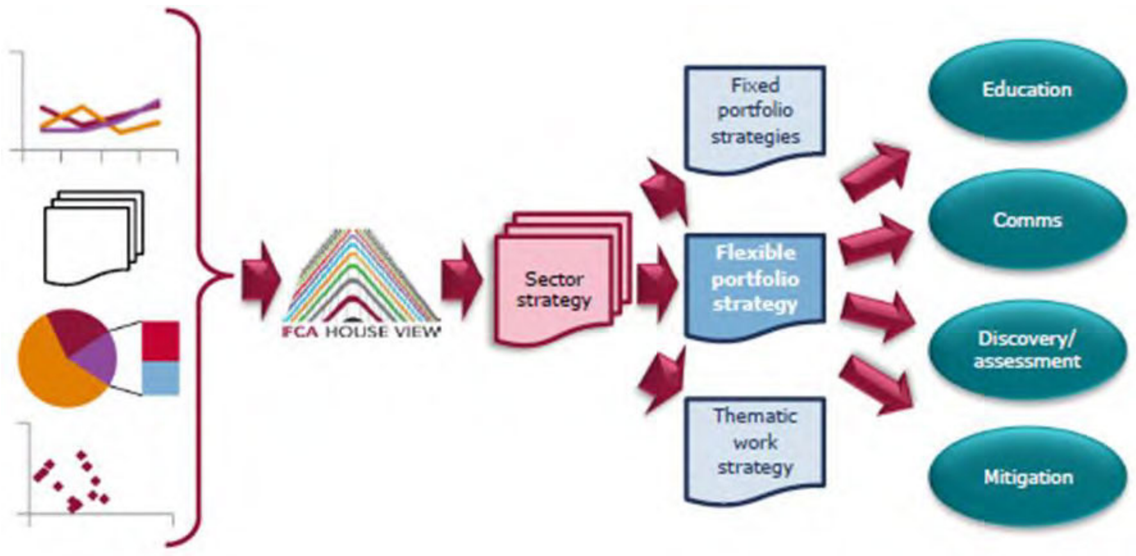


Figure 1: High level process for definition of sector strategies Source: Approach to supervising flexible portfolio firms, October 2015

Differences in the interpretation and application of this guidance has led to the production of sector plans that differ markedly in content and in some cases provide little visibility of the actual supervisory approach that the sectors intend to adopt to address risks and how these link to the relevant House View(s).

Specifically, this variable understanding surrounds the following factors:

- **The overall purpose of the sector strategy document.** Although each sector and sub-sector has taken a different view, there are broadly three interpretations as to the purpose of the sector strategy document:
    - A “budget statement” – a broad statement of the thematic and market based work to be undertaken and the resourcing required to complete it. For example, Retail Investments
    - A “mission statement” – a high level statement of the strategic aims of the sector or sub-sector, the key risks present in the sector, the strategy for thematic, market based and communicative work to be carried out, a high level work plan for its completion and broad statement of goals for the sector. For example, Retail Banking
    - A “project plan” – a detailed expression of the risks present in the sector, both the key risks expressed in the House View but also those of lower priority and how they will be addressed. This includes a market analysis to set context, a link to the House View risks and priorities, a detailed work plan including dependencies with other departments, a communication plan and measures of success. For example, Consumer Credit
- **The relationship between the sector strategy and House View.** The risks and priorities expressed in the House Views completed to date are seen by some as being of limited relevance to the derivation of Supervisory sector plans. This is for a number of reasons:
    - The House Views were developed out of sequence with sector plans – some House Views were completed after sector plans so there is limited link between them.
    - The risks identified are broad and of a high level, lacking the requisite detail to inform action planning at a sector level.
        - For example, Pensions is a stated priority resulting from the House View process. This could legitimately cover all risks in the Pensions and Retirement Income sub-sector. This does not give the necessary detailed direction to drive the prioritisation of lower level risks in the sector.
        - Another example is that of Retail Lending, which incorporates two very different sectors – Mortgages and Mutuals and Consumer Credit.
    - Some sub-sectors have a number of relevant House Views informing action planning and it is therefore not clear how they are to be incorporated or balanced. For example, Retail Investments is subject to two House Views without any guidance as to how to prioritise between them.

This lack of clarity in the approach to sector Supervision planning has led sectors to focus on the aspects of supervision within their direct control – namely the identification, and mitigation of sector based risks with, in some cases, limited interaction with the House Views and other FCA departments. Figure 2 (on the following page) shows a high level schematic of the current sector planning process.

The figure overleaf also documents some notable differences in the approach taken by sectors, compared to the suggested process laid out in the approach document:

1 The process is largely contained at sector level. Although each sector’s risk process is different, they uniformly lie within the sector. Although external teams are invited and engaged with at the risk identification stage, in many cases there are limited interfaces at the stage of developing actions to mitigate them. As can be seen above, the development of the sector strategy is influenced by the House View and other departments and teams are invited to contribute**.** However, the decision making responsibility for risk identification, measurement and prioritisation, as well as initiative development and sign off lies with the sector.

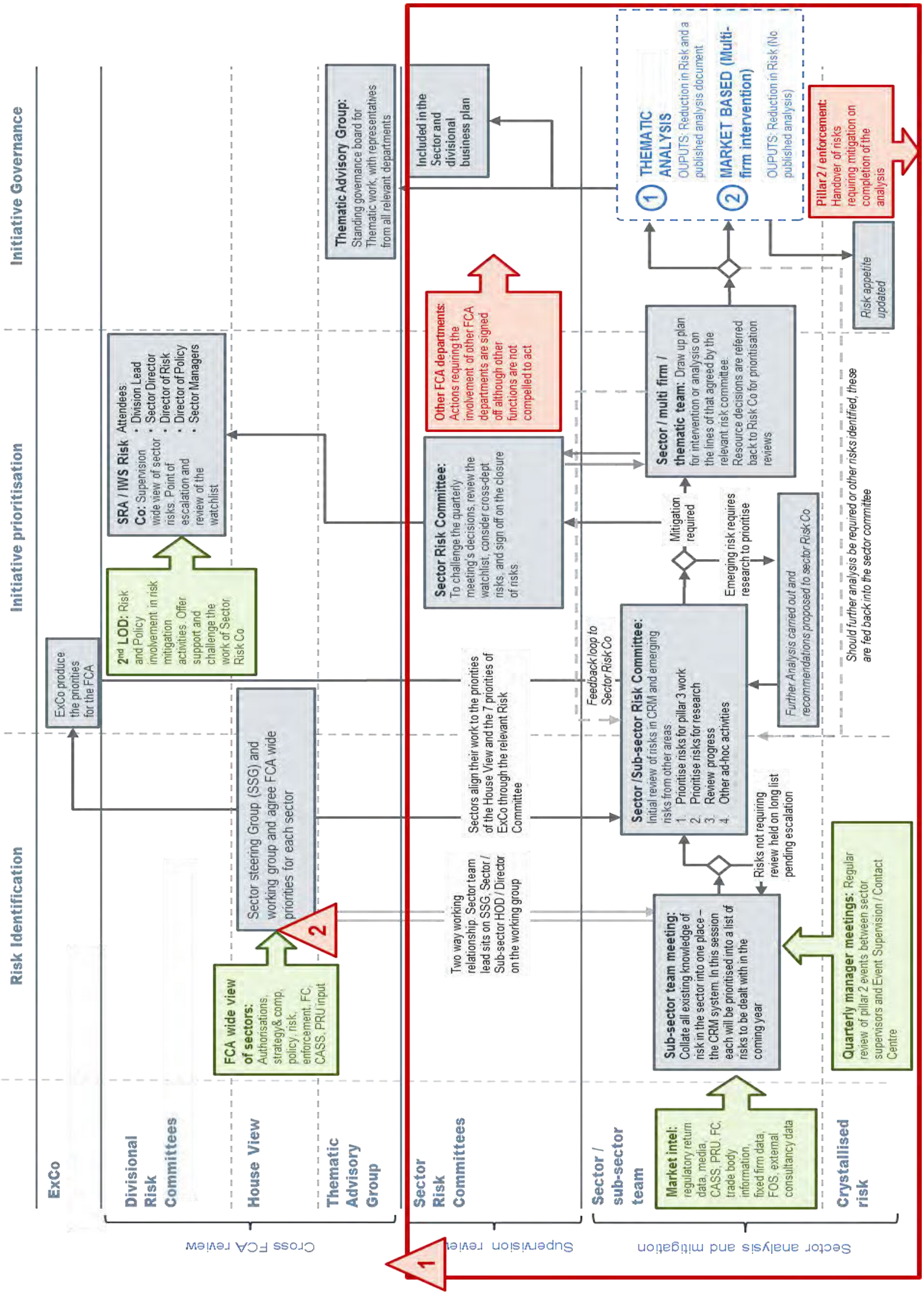


Figure 2: The generalised sector planning process currently undertaken by sectors. See Appendix 3.

There is often limited or partial reference to the House View in the definition of supervisory actions – as documented in the Supervisory sector plan. As discussed above, the House Views are currently perceived by some as being too high level in detail to directly influence the mitigation of lower level sector based supervisory risks and therefore do not play an active part in directing sector level activity. As a consequence, sector plans are generated without explicit link to FCA priorities**.** The resultant activities are not directly linked to them. There is consequently a lack of confidence that the FCA priorities are being addressed effectively in some sectors.

Conclusion

There is no common understanding across sectors of the expectations on them under the framework as currently designed. As a result, sectors design their work based on what is under their control, namely sector based risk management. The consequences of this are:

- House Views are not being consistently used as the driver of sector activities and in some cases, FCA priorities are not explicitly acted upon or reported against;
- In some areas there is a lack confidence that FCA objectives will be realised;
- Although risks are often identified collaboratively the associated sector Supervision plans and activities are not always generated and executed via a collaboration across supervisory and non-supervisory teams;
- There is a lack of visibility as to sector activities for senior stakeholders and non-supervisory departments; and
- There is a loss of transparency and confidence at senior levels and with customers of Supervision (e.g. Enforcement) in the framework as designed.

The overall objective, linkage of House views, sector planning and ultimately the link to the supervisory approach needs to be recommunicated and refreshed across the FCA. There are a number of improvements available to address these concerns:

- Define a standard output for sector strategy documents taking into account the various sector characteristics but defining the elements required across all
- Increased education and communication of the role of the sector strategy documents and how they are to be used to communicate FCA priorities and the actions taken at sector level to address them**.**
- Clarify the role of the House View in the development of sector strategies. This is a broad point**,** but the following activities could be considered:
    - Clarify the level of risk addressed at House View level and the expected alignment to sector level risks, so as to reinforce the link between FCA priorities, House View risks and the actions taken at sector level to address them. Risk definition is detailed further in section 6.
    - Clarify the expected use of the sector strategies in communicating sector priorities to Supervision and non-Supervision teams. For example, clarify how Enforcement are to prioritise action on risks from one sector or another. Interfaces with other departments are discussed further in section 3.
    - Increase visibility of sector strategies at senior level through structured sign off and governance. Governance is discussed further in section 7**.**
    - Provide structured guidance as to the frequency of review and alignment to BAU sector activity – namely updates to CRM of sector based risks.
    - Institute robust tracking of activities once aligned to FCA priorities and House View risks. This should include objective measurement of risks and changes over time so as to increase visibility as to progress towards FCA objectives

	Market analysis	Risk trends	Fixed / Flex definition	Risk appetite statement	Strategic aims	Sub-Sector strategies	Sector challenges	Multi-year view	High Level risk map	Complete risk map	Baseline view risks	House View risks	Quantified risks	Prioritised risks	Deprioritised risks	Crystallised risk analysis	Activity in principle	Pillar 3 Workplan	Pillar 1 & 2 workplan	Interactions w/ FCA depts	Comms plan	Trade bodies comms plan	List of firms involved	Target risk outcomes	Measures of success	Governance plan	Resourcing plan
Consumer Credit	(✓)	(✓)	✓	(✓)	✓	(✓)	✓	✓	✓	(✓)	✓	✓	(✓)	✓		✓	✓	✓	✓	(✓)	(✓)	(✓)		(✓)	(✓)		(✓)
Mortgages and Mutuals	✓	✓		(✓)	✓		✓	✓	✓	(✓)	✓	✓		✓	✓		✓	✓	✓	(✓)	(✓)	(✓)			(✓)		
General Insurance and Protection	(✓)	(✓)	✓	(✓)	✓	✓	✓	✓	✓	(✓)	✓	✓	(✓)	✓	✓	✓	✓	✓	✓		✓	✓	✓				
Retail Investments	(✓)	(✓)	(✓)	(✓)	✓	(✓)	(✓)		(✓)	(✓)	(✓)	(✓)		(✓)	(✓)			(✓)	(✓)		(✓)	(✓)		(✓)	(✓)		
Pensions and retirement Income	(✓)	(✓)	(✓)	(✓)	✓		✓		✓	(✓)	(✓)	(✓)	(✓)	(✓)	(✓)	(✓)	✓	✓	✓					(✓)			(✓)
Investment Management*			✓	(✓)					(✓)	(✓)	(✓)	(✓)		(✓)	(✓)			(✓)	(✓)								
Retail Banking	(✓)	(✓)	✓	(✓)	✓		✓		✓	(✓)	(✓)	(✓)		(✓)	(✓)		✓	✓	✓	✓	✓		(✓)	(✓)		✓	✓
Infrastructure and Trading Firms	✓	✓	✓	(✓)	✓	(✓)	✓		✓	(✓)	(✓)			(✓)				✓	(✓)	(✓)	(✓)	(✓)		(✓)	(✓)		(✓)

** IM and Wholesale Banking have not completed full sector strategies at time of writing*

✓ *Included in the sector strategy document*

(✓) *Partly included, included in other documents or planned for the future*

Figure 3: Summary of the contents of sector strategy documents

Sectors require greater clarity and guidance on the outputs expected under the framework, while retaining autonomy over the processes of risk management

The understanding of the purpose of sector strategies varies across sectors. As a consequence, the sector strategy documents themselves also vary between sectors. It should be noted that much of the information that could or should be in a sector strategy is available to sectors but has not necessary been reflected in the sector strategy document. Figure 3 overleaf summarises the information documented in each sector strategy (for those sectors having completed one)

While it is appropriate for sectors to maintain the accountability for the process for identifying, measuring, monitoring, mitigating and reporting on sector risks there are significant advantages in standardising some aspects of the expected outputs of the approach.

These include:

- Ease of identification and management of cross-sector risks by communicating in a common way
- Ease of communication of best practice strategy definition between sectors. This includes the best practice approaches to data requirements, risk measurement processes, risk prioritisation and measurement of success.
- Ease of communication of priorities between sectors as they are expressed in the same way by a clear prioritisation process.
- Ease of coordination with non-Supervision departments, in particular Enforcement, where cross-sector prioritisation is required. The ability to do this based on a common baseline will improve the working relationship between teams.

This is view is shared by the sectors themselves. Figure 4 below shows the sector view of the appropriate level of autonomy in four aspects of the interpretation of the framework, explained below:

A **Fixed / Flexible definition.** The autonomy afforded in the definition of which firms are fixed, which are flexible, the criteria for their allocation and any additional strata to be defined

B **Thematic work to be carried out.** The autonomy to define, design and deliver the Pillar 3 work in each sector

C **Contents of the sector strategy**. Autonomy over what is included in the sector strategy document

D **Risk Management processes.** The level of autonomy to design the process of identification, measurement, monitoring and reporting of risks.

Each measure has been judged on a five point scale, 1 being complete autonomy without any centralised guidance or oversight and 5 reflecting a centrally mandated and governed approach with sign off required for any variation from the approach.

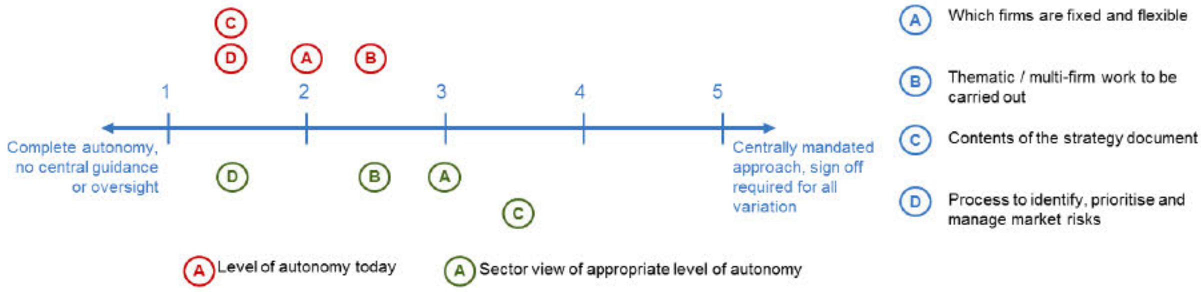


Figure 4: Level of autonomy viewed as appropriate by sectors

This analysis highlights a distinction in the type of autonomy viewed as positive and appropriate by sectors. The analysis confirms:

- **The autonomy of process and decision making is positive and appropriate in the management of supervisory risk:** Sector teams have the required expertise, knowledge and understanding of sector supervisory risks as so to effectively identify key risks as well as the external knowledge and other inputs required to prioritise them. The definition of the process of risk identification and the design of thematic work are correctly under the responsibility of sector teams
- **There is insufficient conformity of output both in terms of flexible firm definition and sector strategy documents:** As detailed above, sectors are in agreement that there are advantages to the creation of detailed standard guidelines for the output of the sector strategy process, both in terms of the rationale for defining fixed and flexible firms but also the contents of the sector strategy document.

Conclusion

There is a consensus view across sectors that the standardisation of sectoral strategy documents would be beneficial to the overall supervision of flexible firms and in the creation of a defined set of criteria for the definition of fixed and flexible firms. This would provide a consistent goal for each sector strategy document, allow the comparison and contrast of plans and ease coordination across the sectors. However, sectors believe autonomy over the specific process of risk identification, prioritisation and management is appropriate as currently designed.

Specifically, the production of standardised guidelines on the expected content of a sector strategy document would aid the production comparable sector strategy documents. Specific content suggestions have been suggested, however a further review and detailed design is required to support alignment to House Views, meet any sector specific requirements as necessary and also allow input from the suppliers of Supervision (e.g. Enforcement).

Case Study: Variations in resolution of crystallised risk – Event Supervision and sector based triage functions (Consumer Credit, Infrastructure & Trading Firms and CASS)

In addition to variations in the development of sector strategies, there are several differing approaches to the resolution of crystallised risk within Supervision. Consumer Credit and ITF have dedicated triage functions while the remaining sectors are serviced by Event Supervision, a shared triage function. Beyond this, there are also customised approaches for specialist supervision in some cases, although Prudential alerts are handled by Events for all flexible firms.

Figure 5 below shows parallel process flow diagrams for the triage functions in Event Supervision and Consumer Credit, focussing on the resolution of discretionary event

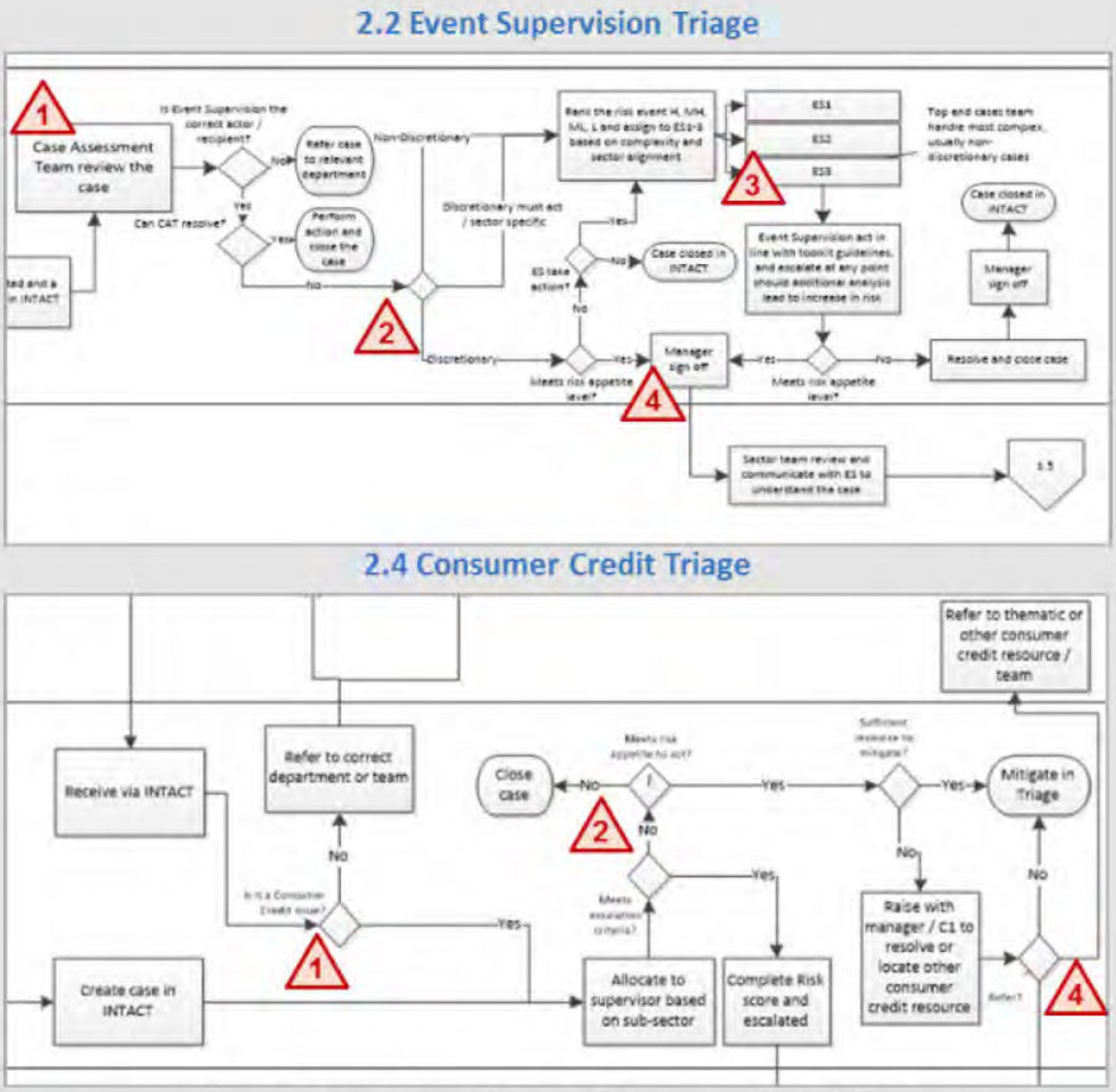


Figure 5: Event Supervision and Consumer Credit Triage

1. Case assessment is carried out in both triage functions but the specific sector knowledge allows cases to be more accurately understood

2. Discretionary and non-discretionary distinctions are the basis for escalation in Event Supervision, but not in local triage functions. Sector specific escalation criteria are used

3 In Event Supervision, case teams are divided roughly by complexity of cases into ES1 to3, with ES3 or the “top end cases” team responsible for discretionary cases. In local teams, case workers are divided by expertise, along sub-sector lines

4 When escalating cases, the local triage functions benefit both from being situated with case teams but also in having the expertise themselves to resolve many issues. Therefore escalation is a question of “who has time to do this” rather than “should we act on this”

Conclusion

The shared, Event Supervision triage function achieves economies of scale and efficiency of operations when working cases that can be repeated often with little variation and without the need for deep sector based expertise, whether discretionary or otherwise.

A centralised triage function can also balance seasonal demand between sectors that may be felt as large spikes in demand by certain local teams. These demand spikes could correspond to business cycles, tax years or regulatory return demands

However, when extended to the resolution of those cases that require deeper, sector based expertise, local triage functions have advantages that allow for more appropriate and timely resolution of risk events. Local functions also can work closely with sector case teams to escalate cases more effectively. Finally, the narrower scope allows them to identify trends and market based risks more effectively than a shared triage.

It should also be noted that local triage functions have distinct structural advantages due to a smaller scope and narrower field of expertise required. Event Supervision require broad experience and knowledge and cannot be expected to have deep, sector expertise across all five sectors that it services.

To address some of these challenges, a number of options could be considered:

- Review the types of cases assigned to Event Supervision and those to sector case teams to align those cases best suited to a shared, process driven triage function to maximise the resource efficiency while assigning cases better suited to sector experts to sector case teams
- Align Event Supervision case teams to sectors. This is under way and may result in sufficient expertise being available in Event Supervision such that further restructuring is not required. Progress should be reviewed on an on-going basis to gauge its effectiveness.

3. GOVERNANCE, COLLABORATION AND WAYS OF WORKING

There is no single system of governance that supports the approach to risk management.

Following changes to the organisational structure of supervision and the implementation of the flexible firm strategy, there are variations in the structures and controls across the sectors and no single system of governance underpinning the approach to risk management. This has limited the level of visibility (and in some cases the level of confidence) that Executive Directors, ExCo and the Board have on the impact and effectiveness of the framework.

Following the implementation of the flexible firm strategy, autonomy was granted to sectors to establish the sign-off process for risk prioritisation or sector planning. This flexibility and the lack of defined structures and escalation processes at Executive Director level has led to a lack of visibility to senior leadership. As a result, there is at times a lack of confidence in the sector supervision strategy planning and decision-making. This has impacted the ability of the Executive Directors to ensure that supervisory priorities are aligned with FCA priorities and House Views.

The lack of governance structures at the sector level has resulted in a number of issues that fall outside of any mandated governance frameworks, including the way sectors interact with specialist supervision and Event Supervision, and the co-ordination of cross-sector work and group supervision across fixed and flexible firms.

Further to this, the lack of formal governance structures also results in a model that is reliant on individuals or sectors proactively interacting with other supervisory teams, including Authorisations and Event Supervision, and non-supervisory teams (including Strategy and Competition). The lack of mandated processes and forums has resulted in a varying level of interaction between these teams. As a result, there is a lack of knowledge sharing across teams, and a lack of input from non-sector teams in the planning process.

Finally, there are varying levels of collaboration between Event Supervision, the Contact Centre and sector teams. This has resulted in a disparate approach to Pillar 2 supervision and the possibility that emerging risks and issues in the flexible firm population may not be identified.

A governance framework that provides some standardisation in the way risk prioritisation, sector planning and Pillar 3 work is governed, and also defines the type of information that is provided to the Executive Directors for sign-off/review will provide more transparency to the Executive Directors.

Consideration should be given as to how better collaboration between supervisory teams, and with non-supervisory teams could be promoted. This should include mandating wider input and review by teams such as Events, Authorisations and non-supervisory teams.

Supporting Material:

- Collated Sector Strategy & Operational Planning process flows
- Collated Crystallised Risk process flows (1.2, 1.4 & 1.5 in particular)
- Appendices 3, 4 & 6 – Sector Strategy & Planning SIPOC and process, Crystallised Risk SIPOC and process and Retail Lending Sector Strategy & Planning SIPOC and process flow

Background

Following on from the changes to the structure of supervision and the implementation of the flexible firm strategy last year, amendments to supervisory governance have also been made. The implementation of the Senior Managers Regime in the FCA has resulted in the single Divisional Risk Committee (DSRC) being devolved into two forums of governance for SRA and IWS. Governance reviews have also resulted in the committee designed to review Pillar 2 risk events being disbanded (SREC).

The revised approach to flexible supervision has provided autonomy to the sector Directors and HoDs. There are no guidelines as to how the governance of sector planning should be structured or how risks should be presented and escalated to senior stakeholders.

There is currently uncertainty on how the governance of flexible supervision should be implemented and the future of historic forums and escalation channels. For example it remains to be seen if Divisional Risk "Away Days" will be reinstated. Collaboration between supervisory teams, including Specialist Supervision, Event Supervision, Authorisations and non-supervisory teams (Competition, Enforcement, etc.) has not been mandated in the operational processes to date.

The current interaction between these teams is a result either of specific sectors proactively implementing cross-FCA forums, or as a result of personal relationships. Consumer Credit, in particular, has maintained the governance and interface structures that were put in place as part of the initial consumer credit project.

A review of a subset of the governance processes and decision making is ongoing – it has been recognised that there is a lack of a decision making framework within the organisation, and the result of this work is likely to address some of the findings identified here.

This section considers the following:

- The governance of the operational consequences from the changes to the flexible supervisory framework.
- The effectiveness of escalation of risks to senior stakeholders.
- The extent to which effective collaboration is taking place between supervisory and non-supervisory teams.

The governance framework varies across each sector. In some cases this has led to a lack of visibility, transparency and confidence in the framework at Executive Director level

The flexibility afforded to sectors as a part of the flexible supervisory framework includes responsibility over governance processes. As a result of this, sectors have defined individual sector specific governance arrangements for the following processes and outputs:

- Risk identification, measurement and prioritisation;
- Sector strategy and plan development and sign-off; and
- Multi-firm and market based Pillar 3 work.

Figure 6 overleaf shows the data and governance flow for the risk management and sector supervision planning process and documents the sign off stages for risk prioritisation, sector strategy development and the tracking of multi-firm and thematic work on an on-going basis.

This generic process flow does not include the various different forums, meeting structures, attendees and recurrence schedules across sectors.

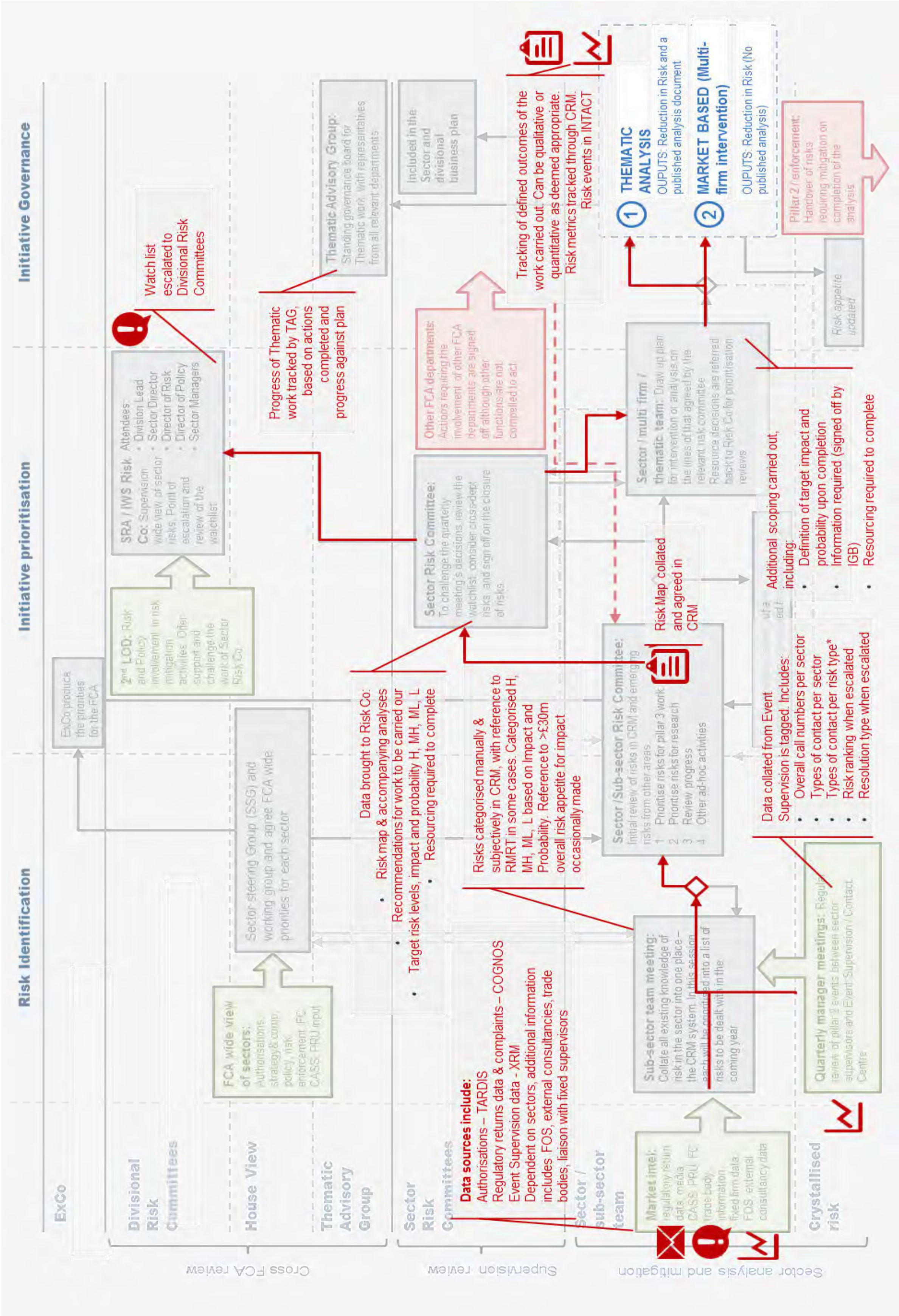


Figure 6: Data flow throughout the risk management and sector planning process

However, it highlights the limited governance structures beyond the Sector level. It shows that the sector HoD or Director is responsible for signing off:

- The CRM risk map showing the high priority risks in each sector and those prioritised for mitigation or further analysis through thematic or multi-firm, market based Pillar 3 work;
- The risk appetite statements related to the resolution of risk events;
- The definition of success criteria of Pillar 3 thematic work;
- Progress of Pillar 3 work, through sector based governance forums and criteria; and
- Closure of risks in CRM, either following successful Pillar 3 work or through natural degradation of risk priorities.

Figure 7 below is a governance map setting out the forums across the divisions and sectors that are currently used for the governance of risk identification, initiative prioritisation and initiative governance. It highlights the different governance approach across the sectors in the consideration of supervisory risk.

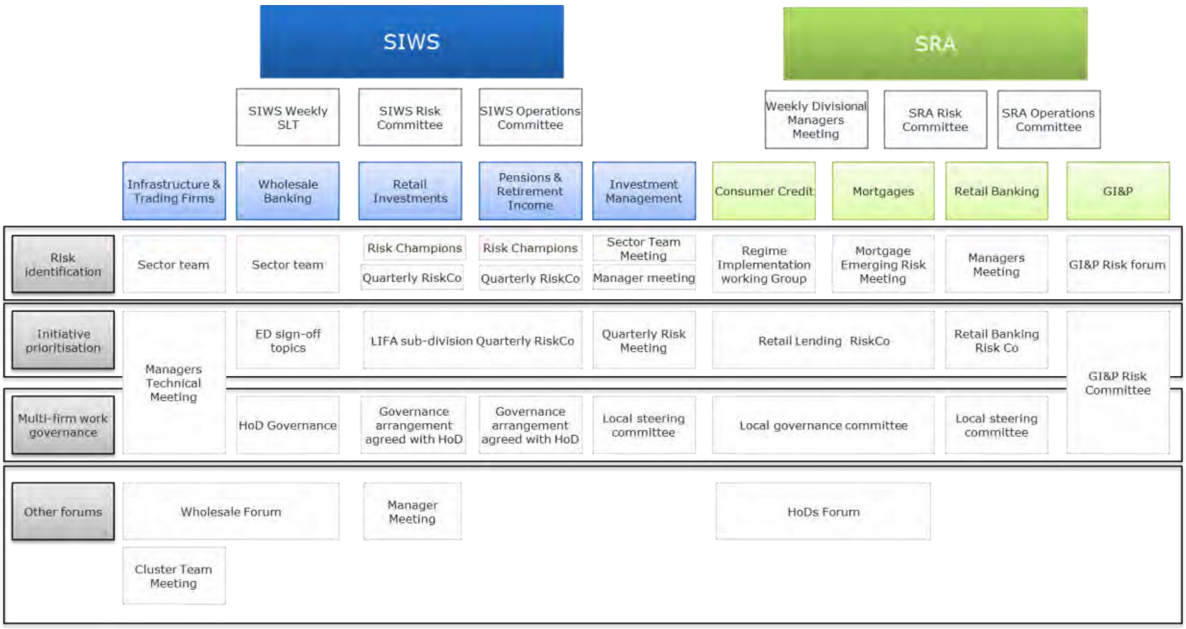


Figure 7: Sector planning governance map

In comparison, at the Executive Director Level the only formal associated governance relates to the sign off of actions taken against “watch list” firms. Any further visibility at Executive Director level of actions taken to identify, measure, prioritise, monitor or report sector risks is based on individual sector discretion, ad-hoc requests or through escalation of risks requiring action above sector level.

Without a mandated governance process, the Executive Directors do not have a consistent view of the planning and prioritisation across sectors and divisions. This impacts their ability to ensure that strategy and planning is conducted in line with the FCA objectives and the House View. This also inhibits the identification and governance of cross-sector work.

Furthermore, the lack of standardised governance processes means that other teams, both in supervision and across the wider FCA, don’t consistently have a clear view of sector strategy plans or prioritisation.

Conclusion

The flexibility given to supervision in the governance of the risk management processes and sector supervision strategy development has given rise to a situation where limited visibility is provided to the

Executive Directors. The lack of a clear decision-making and escalation framework that includes Executive Directors limits the ability of senior leadership to have confidence that the right decisions are being made. In addition, the lack of visibility also impacts the Executive Directors ability to ensure that resourcing is being distributed appropriately according to the strategies across the sectors.

The implementation of a decision-making framework to clearly define the type of decisions that should be made by each level of supervision, including the decisions that should be made by the Executive Directors, would provide a level of transparency and oversight for senior leadership. Further to this, a baseline governance structure – e.g. standard forums across sectors – should be considered to attempt to achieve more consistency and visibility of decision-making within each sector.

The different interpretations of the flexible supervision framework have led to operational complexities that currently do not have governance structures to manage them

Sectors have made use of the flexibility afforded to them by the revised approach to the supervision of flexible firms to implement changes to their approach.

- **Interactions with Specialist Supervision.** The overall supervisory approach for some firms is made up of a combination of specialist and sector supervision. To maintain a coordinated supervisory approach specialist and sector supervision must collaborate effectively. There is currently no formal, mandated process to support this collaboration.
    - In the case of the “hybrid model” undertaken in Financial Crime supervision, the interaction between sectors and specialists for flexible firms requires additional structure. The lack of a named supervisor for flexible firms (as is the case for fixed firms) means the current one-to-one interaction no longer applies and a flexible interaction model is not yet in place to link the specialist supervisor to case workers in the sector teams.
    - Of particular concern are prudential risk events for firms defined as flexible within sectors are managed within Event Supervision. This includes those firms ranked as P1 – those of largest prudential risk. It is critical that when a P1 fixed firm is reassigned to the flexible portfolio that the P1 status is communicated to Event Supervision. Again, there is currently no formal process to support communication.
- **Additional Requests on Event Supervision.** Sectors actively adjust the escalation criteria employed by Event Supervision. Additional requests for escalation add operational complexity and require balancing with those of other sectors. This complexity, unless properly managed can impact Event Supervision’s ability to deliver the efficiencies for which it is designed.
- **Coordination of firm interactions in Group Supervised firms**. Flexible firms can be dealt with by several departments across the FCA including specialist supervision, sector supervisors, thematic and multi-firm work. While the Group Supervision model is still relatively new, there is a risk that without effective communication between these departments a firm can be contacted without the knowledge of all interested parties leading to reputational damage to the FCA and ineffective supervision. Structured communication is also required to gather the correct information across the group and coordinate interactions with the firm as a whole

These operational issues are not currently managed in a structured way that is uniform across sectors and is largely dependent on sectors, event supervision and specialist supervision working collaboratively on an informal basis. While in some cases there are governance mechanisms at an immature stage (e.g. review and audit of interactions with Event Supervision) collaboration is not currently structured and robust.

Conclusion

There are operational consequences of the different approaches to flexible supervision across sectors that currently rely on ad-hoc collaboration. Often this functions as a result of personal relationships between staff and teams, rather than a robust and consistent governance framework.

These examples all relate back to the lack of existing interfaces and the importance of effective governance to mitigate these risks:

- Communication between Specialist Supervision on the fixed and flexible firm population and their relevant specialist categorisation, particularly for prudential;
- Ad-hoc requests on Event Supervision reducing their ability to realise the economies of scale for which it is designed; and
- The differences in Group Supervision of the fixed and flexible parts of the group

Consideration should be given to how governance and interface structures should operate between the impacted teams mentioned in this section.

The quality of interactions between teams varies which directly impacts cross-sector and cross-organisation knowledge sharing, risk mitigation and planning

Across the FCA the interaction between teams and divisions is largely informal and unstructured. This isn't necessarily an issue in itself – there are examples of where the informal interfaces that have been established within the teams are effective:

- Risk identification – In general, the sector teams have been effective in incorporating non-supervisory teams in the risk identification process. This has ensured that the widest range of knowledge and expertise is leveraged. This is particularly true of Consumer Credit, in which a parallel planning process - through a series of working groups - has been implemented to mitigate deficiencies in the data available. This process is shown in figure 8 below.

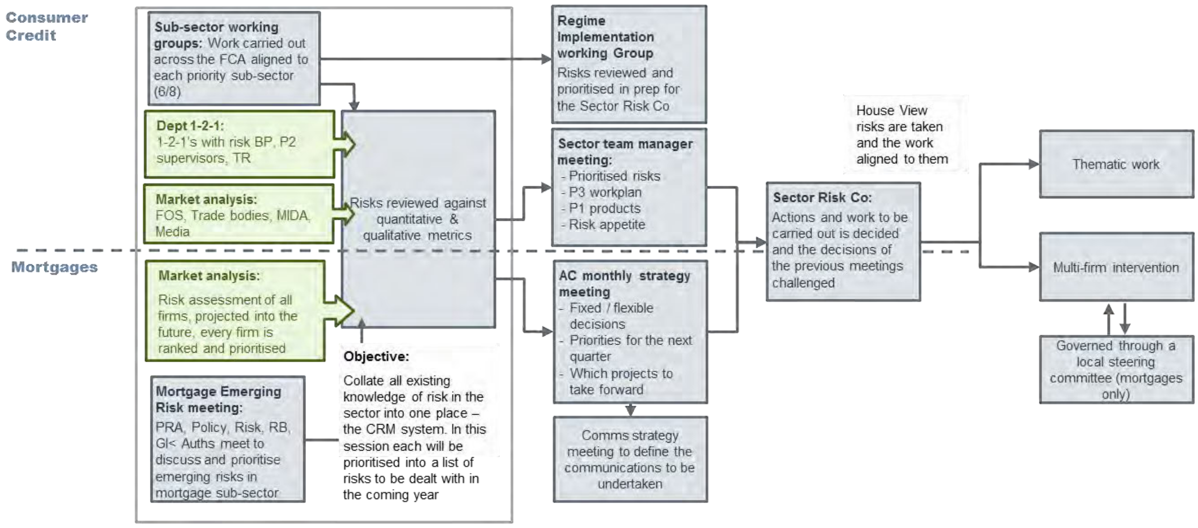


Figure 8: The Retail Lending Risk Identification and Prioritisation process. See Appendix 6 for full process flow

- The Consumer Credit area has effective interaction across Authorisations, Event triage and Sector Supervision and feedback has indicated that this facilitates good knowledge sharing and planning. This has been supported by the structure of having specialised Authorisations and Events teams dedicated to Consumer Credit, and by the legacy of programme management governance structures.
- Wholesale, including the Wholesale Banking and Infrastructure and Trading Firms sectors have good interaction on issues that relate to both sectors, as well as good interfaces outside supervision – for example with Market Monitoring.

There are, however, areas where the communication and knowledge sharing between teams breaks down:

- **The planning process**: while all supervisory teams have a role to play in firm supervision, including Authorisations, Events, the Contact Centre and the Specialist teams, they aren't always being represented during the planning process that will prioritise risks and set the strategy for the firms they are interacting with.
- **Risk prioritisation and mitigation:** Currently other sector teams and non-sector supervisory teams aren't always contributing to the planning of actions to mitigate risks or take the appropriate actions. This is particularly true of the mitigation of cross-sector risks. For example, should a policy change be required to effectively mitigate a priority risk for supervision, there is no structured method of interaction to ensure these changes are made. This decision will have to be made by the appropriate governance structure with the Policy team.
- **Enforcement**: There are joint ventures in place to coordinate the interactions between supervision and enforcement. However, the difference in prioritisation criteria between the two departments restricts effective collaboration. Specifically, although Supervision prioritise risks based on impact and probability of occurrence, Enforcement prioritise interventions based on these and additional factors, for example, the likelihood of successful action. The burden of evidence required is often more difficult to secure in flexible firms where there is limited interaction with firms.
- **Authorisations:** Apart from Consumer Credit, the interaction between Sector teams and Authorisations is often limited. There is often little collaboration in defining risk appetite statements which can lead to differences in the interpretation and application of the risk appetite.
- **Specialist Supervision:** Specialist teams operate separately, with varying levels of interaction with the Sector Supervisors. CASS operate an outsourced model with sector supervision, while Financial Crime operate a hybrid model in which the responsibility for the supervision of Financial Crime issues is split between sectors and specialist supervision. The lack of structured collaboration has limited the visibility of what actions are taken by which team and therefore the FCA wide actions on specialist risks and the accountability for those actions is often unclear.

For areas where the interfaces are informal, there are good interactions and communication taking place, but this is typically dependent on individual relationships or where a sector is more proactively facilitating cross-supervision communication.

Conclusion

In general the interfaces, between supervisory teams and non-supervisory teams, are informal and unstructured. While this approach appears to be working well in some cases the informal approach does not ensure consistent interaction across teams.

The lack of formality and structure results in key areas of the supervisory divisions being left out of important risk and planning discussions. In addition, the structured interfaces that do exist, such as those between Supervision and Enforcement, are not as effective as they could be due to the lack of common priorities and approach.

Consideration should be given to how collaboration can be improved between sectors, including whether structured forums for cross-supervisory and cross-FCA review of risk prioritisation and sector planning would be appropriate. In other cases, where forums already exist, a review of these could help identify where they are working and what areas should be improved.

A lack of structured interfaces between Sector Case teams and the Contact Centre and Event Supervision has impacted operational efficiency and the effective management of risk

Pillar 2 supervision is reliant upon open and efficient communications between key parties, and the interaction between Event Supervision and sectors is critical. The current ad-hoc nature of the interface between Event Supervision and sectors results in variable responses to the mitigation of risks. In situations where there is standard, structured communication, the escalation rate is higher which leads to the right level of expertise being engaged. This is not the case when the interaction is less structured.

Furthermore, when compared to the local approach undertaken in Consumer Credit with a dedicated triage function as part of the sector supervisory team there is a noticeable difference both in terms of resource efficiency but also risk management effectiveness. Some notable examples have been listed below:

- The application of sector expertise and a close working relationship between the Consumer Credit triage function and the Contact Centre has lowered the volume of cases reaching the sector case team incorrectly from close to 40% to less than 30% today.
- The level of interaction between case teams within sectors and Event Supervision directly affects the escalation rate and the appropriateness of mitigation action. The sectors with direct collaboration as part of the escalation process (Retail Lending and Investment Management) see the highest referral rate of risk events from Event Supervision, 20% and 27% respectively. These sectors mandate communication being passed between the sector and Event Supervision in the escalation of every case. This is compared with the lowest rate of referral (7% - Retail Banking) belonging to the sector without any structured collaboration as part of the process. While this is a good proxy measure, it should be noted there are several possible causes for this variation and additional analysis is recommended to verify this conclusion fully.

Conclusion

There are a number of factors that influence the referral metrics, including the level of risk appetite in each sector and the relative importance of the flexible population, but there is evidence to suggest that the level of collaboration between sectors and events teams can have an impact on the resolution of Pillar 2 risk events.

As mentioned in previous sections, consideration should be given to whether structured governance forums would be appropriate to improve collaboration across teams. It may also be appropriate to review whether a sector-aligned approach to Event Supervision might also improve operational efficiency without detracting from the benefit of having a central team to process events.

A more effective collaborative approach could deliver:

- Improved resource efficiency in sector teams and triage due to the timely intervention of sector based expertise to close risk events efficiently
- More appropriate risk mitigation actions are applied to those risk events benefiting from a structured escalation processes between Event Supervision and Sector case teams.

4. DATA AND MARKET INTELLIGENCE

In some sectors Supervision does not have data of sufficient quality to allow the consistent identification, measurement or monitoring of sector and cross-sector risks

Inappropriate regulatory returns and in some sectors a lack of accessible, high quality, internally derived data means Supervision cannot consistently identify, measure and monitor market based risks across its flexible portfolio.

The FCA's remit requires appropriate data be gathered from the firms under its supervision to oversee proper conduct in the market. The approach to flexible firm supervision requires that conduct related risks be identified, measured, monitored and reported on a market or sector basis, rather than at a firm level as was historically the case.

Supervision requires that the data available to sector teams is related to products, business models and the conduct of firms. Furthermore the organisation should have the ability to interrogate and analyse the data to generate pan sector insight above strictly firm based concerns.

Currently, the data available to Supervision is in some sectors neither of the correct nature or structure to make this possible. Specifically:

- The data received through firms' regulatory returns is largely prudential in nature and therefore of limited relevance to conduct supervision in many sectors.
- The data generated internally is aligned to firm risks and is not structured in a way to derive market wide insight.
- Validated data sources (both internal and external) have not been developed to their full potential.
- Internally generated data – in particular that from the consumer Contact Centre – although valuable for its unstructured nature is raw and non-validated. It is at times and by some sectors being used to derive sector wide insight without the appropriate caveats.
- The lack of a suite of standardised MI and intelligence has led to the sectors embarking on various internal sector specific data exercises.

These constraints and deficiencies have a direct impact on the supervision of flexible firms as they do not support sectors' understanding of firms under their supervision and more generally, the overall risks in their sectors. They have also resulted in some sectors resource being assigned to Pillar 3 activities being carried out expressly to better understand markets and products. This resource could be focused on risk mitigation or communication activity.

To improve the incoming data available in those sectors lacking data, a robust strategy is required to provide the foundation of regulatory data required to monitor conduct across sectors.

In the meantime, existing internal data should be adjusted to include cross-sector risk types rather than firm based risks as is currently the case.

Finally, the introduction of standard suite of MI and intelligence that is provided to all sectors should be considered. This could cover areas that should be reported in consistent fashion such as risk event MI but should not restrict the ability of sectors to produce sector specific intelligence.

Supporting Material:

- Collated Data Sources and uses
- Collated Crystallised Risk process flows (2.1, 2.2 & 2.4 in particular)
- Appendices 4 & 5 – Crystallised Risk SIPOC and process & Data Sources

Background

The changes to the remit of the FCA, focussing on conduct related activity, has led to changes in the data and intelligence required to effectively supervise both fixed and flexible firms. Increased emphasis is placed on information concerning consumer complaints, selling and marketing activity, product characteristics and other detailed activities inherent in the business models of the firms under the FCA's remit.

Furthermore, in the case of previously C2-C3 firms, the introduction of the flexible supervisory approach limits the sectors' ability to monitor firms on a one-to-one basis. In place of the detailed, firm specific information gathered from one-to-one interaction, sectors now rely on the identification of emerging and crystallised market risks on the basis of sector information and extrapolating reduced firm based information across a wider population.

This has put additional emphasis on the data relating to market trends and maximising the firm based data to draw conclusions on sector wide issues. This section considers:

- The availability and appropriateness of the existing data gathered by the FCA
- The ability of the FCA to utilise internally generated data
- The variation in the use of data between sectors and its consequences
- The ability of the FCA to identify market trends and risks within the flexible population on the basis of available data
- The extent to which the internal data capability is able to manipulate the available data to derive relevant insight into the flexible population

The data received through firms' regulatory returns is not consistently aligned to the balanced prudential and conduct remit of the FCA and does not support the ability of sectors to define market risks effectively

The change in the remit of the FCA towards conduct related supervision in addition to prudential oversight has not been accompanied by a change in the data gathered from firms in order to carry out this remit. Significant time and consultation is required to make these changes. It should also be noted that there is work under way to address this issue, with specific data requests in many sectors.

However, in the meantime this situation presents sectoral supervision with challenges in overseeing good conduct in their markets through intelligence better suited to prudential issues.

Currently, regulatory returns data varies in quality and relevance across sectors. In some cases – notably Mortgages and Mutuals and Investment Management – the prudential and financial information is aligned to conduct risks and provides a strong basis for profiling firms and market risks. Also, in CASS, a dedicated return (CMAR) enables the department to achieve a robust view of the market. However, in large part the available data is not appropriate for the regulation of conduct in the majority of sectors.

Notable examples of deficiencies in the data gathered include, but are not limited to:

- The level of detail supplied in many regulatory forms is not detailed enough to fully derive the market based intelligence required. For example, there is no product level information in some sectors. This makes it difficult to understand the underlying trends in firms, such as identifying what is driving profit growth.

- The data is not forward looking which inhibits the ability to forecast trends.
- Firms do not report in the same way, particularly larger firms consisting of several departments. For example, [redacted] will submit figures that do not include their credit card portfolio, whereas other firms will include these portfolios in their submissions, therefore returns are not easily comparable.
- Firms submit errors on their regulatory returns. This often causes alerts to be triggered incorrectly, and subsequently alerts are often ignored.
- Consumer Credit – The sector not only lacks structured regulatory return information fit for conduct supervision but also 80% of consumer credit is limited permission. This effectively limits the information available further.

These sector specific deficiencies present sectors with challenges that in some cases detract from their ability to supervise both fixed and flexible firms. The risk to supervision of flexible firms is exacerbated however by the lack of direct contact with firms and the subsequent ability of supervision to gather firm data directly. In response, sectors have developed a number of short term initiatives to derive intelligence on their flexible populations. These tend to be tactical solutions that are owned and managed within the sectors. This creates an extra burden on FCA resource and effectively prevents other Pillar 2 or 3 work being carried out. There are 4 broad responses under way:

- Bringing together knowledge of other FCA departments to fully utilise the available expertise. For example, Consumer Credit run a series of working groups for this purpose and to inform their sector strategy (see section 3 for further details)
- Leveraging existing internal data to derive any insight available to the FCA without redefining regulatory return information. For example, GI&P are extending their use of Contact Centre data to derive further insight despite its raw nature.
- Using Pillar 3 work to generate data in a one-off or short term basis. Retail Investments and Wholesale Banking use Pillar 3 work to implement a one-off, or short term data gathering exercise in order to better understand high risk flexible firms and identify important characteristics to form the basis of a “profile” of risky flexible firms.
- Define a data strategy and new regulatory return data. For example, Pensions and Retirement Income are currently defining a data strategy to restructure the regulatory data received from firms.

Conclusion

The data collected from firms in regulatory returns forms the foundation for supervision across both fixed and flexible firms. This data is of increased importance to flexible firms due to the lack of one-to-one contact and oversight. In some cases regulatory returns form the only regular contact with flexible firms and the only opportunity to review their conduct.

Currently, the data gathered in this form is not aligned to the FCA’s expanded conduct remit and is therefore not fit for the purpose for which it is now used. This has several consequences for flexible firm supervision:

- Knowledge of the flexible firm population is limited to aspects not entirely relevant to conduct supervision;
- Event Supervision are required to respond to alerts raised by breaches of thresholds not relevant to conduct. This adds to its remit and reduces their ability to respond to conduct issues; and,
- Sectors use their limited resource to gather other data not supplied through regulatory returns information.

While it is a lengthy process to define an updated data strategy and a thorough regulatory return framework – involving detailed design, consultation with firms and potential restrictions put in place by the Enterprise & Regulatory Reform Act 2013 – the absence of it presents significant challenges to sectors and detracts from the effective supervision of flexible firms in particular. Furthermore, there is a balance to be struck as to the amount of data gathered, without being disproportionate in comparison to the risks being mitigated.

Specifically, the following actions are recommended:

- Review of returns: Sector teams should identify their analysis and regular reporting needs. The review should address whether these needs can be answered by the existing data, what data would be needed to address these gaps, whether the data can be collected, and if not, what proxy data could be used. The review would identify consistent needs across sectors and inform what should be delivered by the regulatory returns.
- Review the formats of submissions to reduce firm errors and provide further guidelines on completing.

Risk event data is aligned to firm risks, restricting the ability of sectors to derive insight into market trends

In response to lacking regulatory return data relevant to conduct issues, some sectors have looked to the data gathered by the FCA directly through Event Supervision to derive insight into risks and trends in their sectors. This data is not currently structured for this purpose and presents challenges in deriving market trends.

Currently, cases in the Contact Centre and risk events handled in Event Supervision and the Consumer Credit and Infrastructure and Trading triage functions are allocated to firms or legal entities through Intact and are escalated as required on this basis.

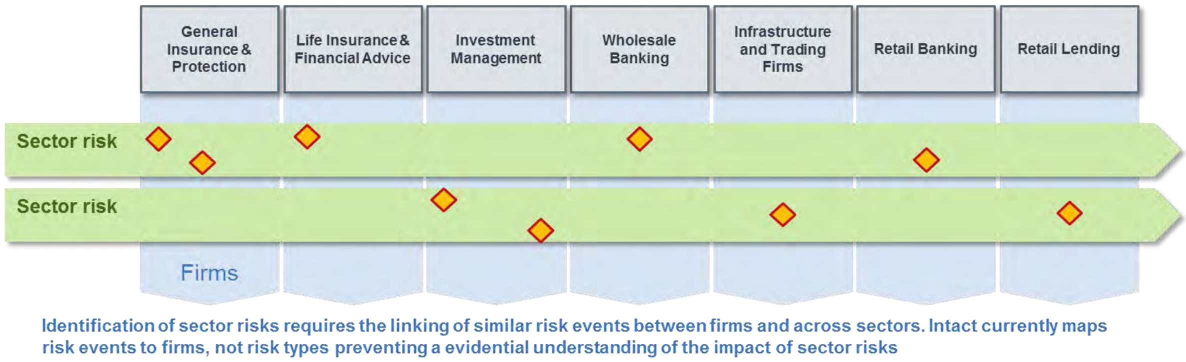


Figure 9: Schematic relationship between sector risks (green) and risk events (orange)

However, when investigating risk events across firms within a sector or between sectors it is necessary to link risk events by the characteristics of the risk, rather than just the firm. Figure 9 above shows a schematic representation of the analysis required. To understand sector risks, specific events must be linked together between firms and sectors. Only then can detailed and relevant insight be drawn as to the scale, impact, root cause and precise nature of the sector risk.

Currently, the information stored within Intact prevents this from being analysed in a structured way. There are several underlying reasons for this:

- The “tagging” of risk events to a risk type is not always sufficiently granular to derive meaningful insight. The current groupings available are at a high level and do not provide enough clarity as to the precise risk type – for example “Governance” or “Culture” are potential tags but are not detailed enough to derive insight into market trends.
- The expertise of Contact Centre or Event Supervision staff is not sufficient to accurately provide granular risk information based on limited interaction with consumers or information on the risk event, particularly given the limited information available to them.

- Tags are not currently uniform across sectors, meaning risks common to multiple sectors cannot be tracked with sufficient clarity. For example, miss-selling cannot be tracked across the multiple sectors and products for which it is relevant.
- The tags are not always used correctly. Consumer Credit use a workaround by putting a code in the subject line to identify consumer credit type.

Further to the recording of risk events in Intact, the events aligned to risk types are not always mapped to the sector risks used to define sector strategies and plans. This is due in part to sector risks being stored in CRM while risk events are stored in Intact. This is detailed further in section 5. This presents a number of practical constraints for sectors in the identification, measurement and reporting of sector risks and their mitigation:

- Sector risks cannot be linked to risk types in Intact effectively, meaning it is not possible to track the growth (or degradation) of sector risks through the information directly collected by the FCA.
- Sector risks cannot be tracked in fixed and flexible firms as risk event information is stored in different systems.
- A mapping exercise is therefore required to link risk event data between fixed, flexible firm risks and sector risks in CRM.

Conclusion

The approach to flexible supervision now in place demands that market risks can be identified, measured, monitored and reported across populations of firms and sectors without the need for firm by firm intervention.

Currently, Intact is not structured in this way and this directly affects the ability of sector teams to view, understand and derive insight into the impact and probability of sector risks common to a large selection of firms. The consequences of this include:

- Sector strategies and everyday sector supervision actions are not aligned to the risk events being reported by consumers to the FCA as these events cannot be used to derive sector risks.
- Sectors naturally continue to approach supervision on a firm by firm basis as this is how data is presented to them. This prevents them from successfully moving to a market led approach as the flexible strategy dictates.
- The actions taken to mitigate sector risks cannot be tracked objectively through the information directly available to the FCA. The FCA therefore cannot use its own information to provide evidence that its objectives are being met.

It should be noted that action is under way to address this concern through the implementation of risk tags in Intact so as to track sector risks through the associated risk events. This is necessary but not sufficient to meet the needs of sectors and Supervision more generally.

Further to this initiative, the following actions are recommended:

- Tags development should cover all sectors and provide a foundation to compare risks across different sectors and between those responding to risk events in local triage functions. For example, a miss-selling risk event could be compared across sectors as it shares characteristics not specific to one sector or sub-sector. It is therefore required that risk events with this tag be understood in the same away across sectors and have a definition across products and markets.
- Tags should be representative and mapped to sector based risks to ensure that the growth or degradation of sector risks can be monitored in a robust fashion.
- Robust, standards processes for updating tags should be designed and implemented. This should incorporate the definition of periodic review, roles and responsibilities for the ownership and updating of tags, their mapping to sector risks and any ad-hoc requests in response to Pillar 3 studies should they be required.

Although valuable due to its unstructured and unprompted nature, the data gathered through the consumer Contact Centre is also raw and therefore should be used with caution when deriving market insight

The data gathered from consumers through the Contact Centre is often based on small amounts of information and / or short interactions with those involved. In some cases the quality of information gathered at this stage is limited. While not all sectors make use of this data – and in some cases unstructured data can be used effectively – it is important that when using this information this constraint is acknowledged and the derived insight is appropriately caveated.

It is important to note at this stage that this is not a comment on the efficiency of the Contact Centre. Often consumers contact the FCA for reasons other than to report risk events or examples of misconduct. For example, they contact the FCA because they believe they are contacting the firm involved or the Financial Ombudsman Service. In some cases they require advice or guidance as to whom they should contact. The amount of information that the Contact Centre can access is often small and they are required to make decisions not only with this constraint but also when lacking the expertise to interrogate what information they have efficiently.

Furthermore, the data gathered from the firm Contact Centre is a valuable source of information regarding firms' experience of regulation and that from the consumer Contact Centre is an important tool for gathering unstructured, unprompted consumer contact. By interrogating the data, a number of significant innovations have been piloted that could be considered for extension across the organisation:

- Voice analysis: All calls are recorded through the Contact Centre and therefore voice analysis can be used to derive key words being used and from that trends in the reasons for consumers and firms to call the FCA.
- Text analysis: Due to the need for the Contact Centre to document information in free text fields, standard tagging can be problematic. With robust text analysis, trends in key words and firm names could be derived that – like voice analysis – point to emerging trends in the market.

There are currently limitations to the insight derived from the volumetric analyses carried out currently using the consumer Contact Centre information in particular.

Figure 10 shows a volumetric analysis of the cases escalated from the Contact Centre and other sources, through Event Supervision to the sector teams. The width of lines represents the relative number of cases at each stage of the process and the grey line highlights the closed cases at each stage without any further action being taken. When interrogating this analysis it is important to note:

- Data corresponds to the year April 2015-March 2016 and has been drawn from 3 sources – Contact Centre, Event Supervision & Consumer Credit MI;
- Event Supervision volumes have increased in the last year due to the on-boarding of larger flexible portfolio firms
- Closure reasons do not align in all cases – Consumer Credit and Event Supervision "no breach" closure reasons are not used defined in precisely the same way (Events close as 'no breach' where a case has been raised and subsequent analysis and investigation shows there has been no regulatory breach. This may involve contact with the firm in some situations. Consumer Credit use this closure reason to signify cases where no analysis, investigation or action has been taken); and,
- Event Supervision risk event volumes do not include approximately 2,500 non-discretionary cases, MP letters, FOIA requests or requests for information from other organisations

This analysis highlights a number of important points to note when deriving insight and intelligence from the Contact Centre data:

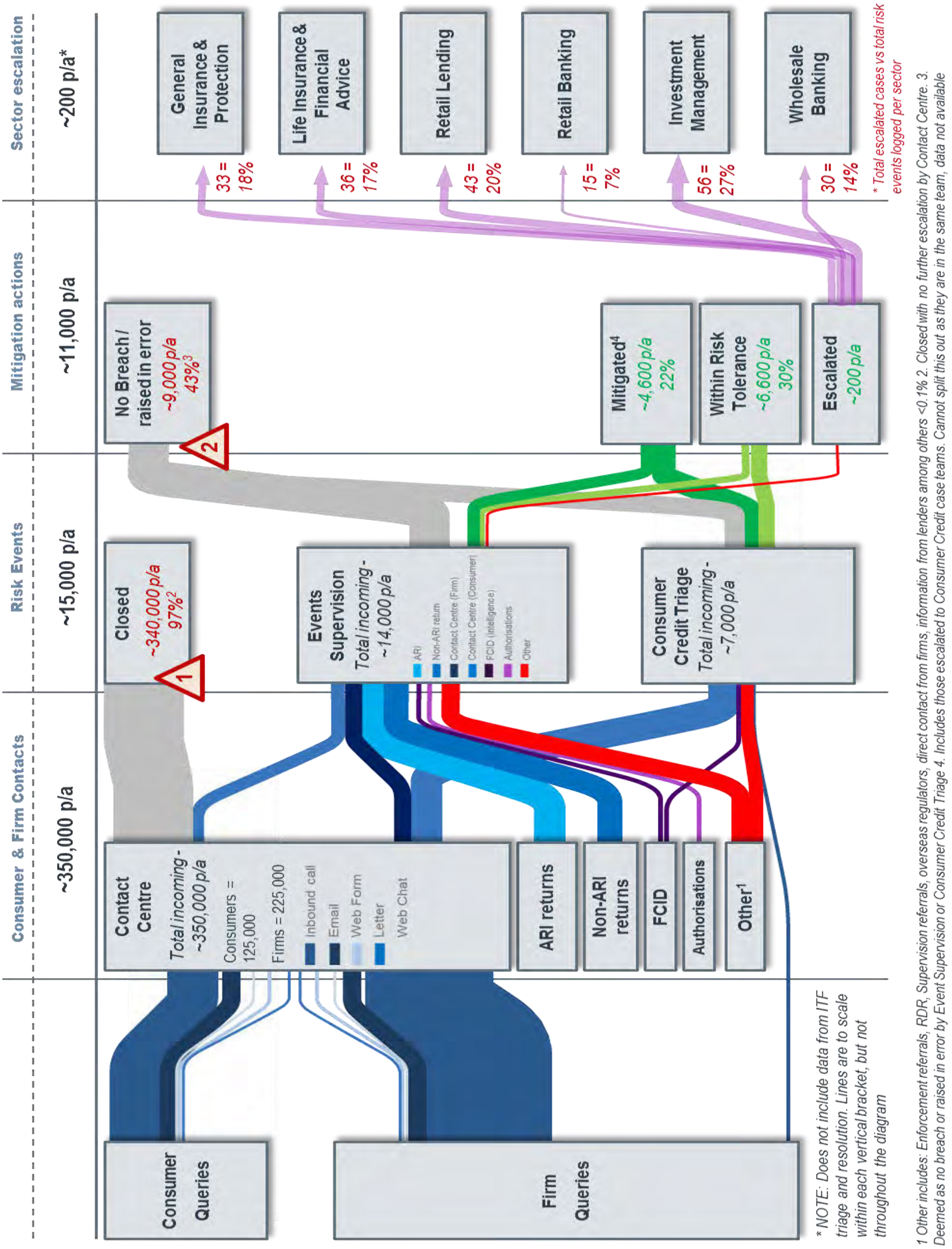


Figure 10: A volume flow of crystallised risk cases and risk events. Sources: Risk Event data 2015-16

1 97% of all cases that reach the Contact Centre are closed without escalation to a risk event. This does not necessarily mean no action was taken as the Contact Centre often offer advice or direction to firms or consumers. This indicates the number of queries made of a sector, firm or product by consumers but does not give an indication as to the risks present in a sector.

2 Even those cases escalated to Event Supervision or the Consumer Credit triage functions are often not actionable and provide limited insight. In Consumer Credit triage – who have made considerable efforts in cleaning the data from the Contact Centre and have provided guidance in data quality – approximately 30% of cases are closed with no action taken or no breach found.

Figure 11 shows the data and decision flow through the crystallised risk process. It shows the evolving nature of the data available to associates and the relative value of the MI produced.

1 Initial contact by consumers and firms. As discussed above, data at this stage is raw and is based on limited interactions with customers and firms. Data at this stage is of limited value to the identification of risks

2 Once Event Supervision have assessed and scored each risk, cases can be identified, classified and scored, all be it at an approximate level only. Volumes of cases at this stage give an indication of the scale of risk volumes, rather than merely consumer contact volumes

3 Upon escalation, the risk appetite has been applied twice. Cases at this stage have been verified as risk events and form a solid basis for deriving insight into the volumes of cases appropriate to each risk type

4 At this stage, further action and analysis has been undertaken by either Event Supervision or Sector supervisors. Risk event volumes at this stage are a good reflection of the nature of the risk and associated specific. As an example, the evidence that resulted in [redacted] where Event Supervision played a key role in identifying an emerging risk across several firms.

Conclusion

Contact Centre data is valuable due to its unprompted and unstructured characteristics. The data is raw and non-validated. Therefore it does not necessarily align to risk events or market intelligence. The lack of other available data coming to the FCA has driven some sector teams to interrogate the MI available from the Contact Centre to derive insight into market trends.

This practice has several consequences that may detract from the supervision of flexible firms:

- False conclusions could be drawn. Trends apparent in consumer Contact Centre data are not guaranteed or often not likely to represent trends in underlying market risks
- The availability of Contact Centre data has led some sectors to focus on this date rather than develop validated data sources. For example, sectors do not actively work with Event Supervision to implement MI based on clean, verified data.
- Given the lack of verified information available to Contact Centre associates, there are limited actions that can adjust the resulting MI. The associated limitations of Contact Centre MI should be recognised and understood by all parties using it.

The following actions could be considered:

- Review the use of Contact Centre data to define the positive outcomes and appropriate use of the information.
- Review the possible extension of voice and text analysis to maximise the insight available from the unstructured data available

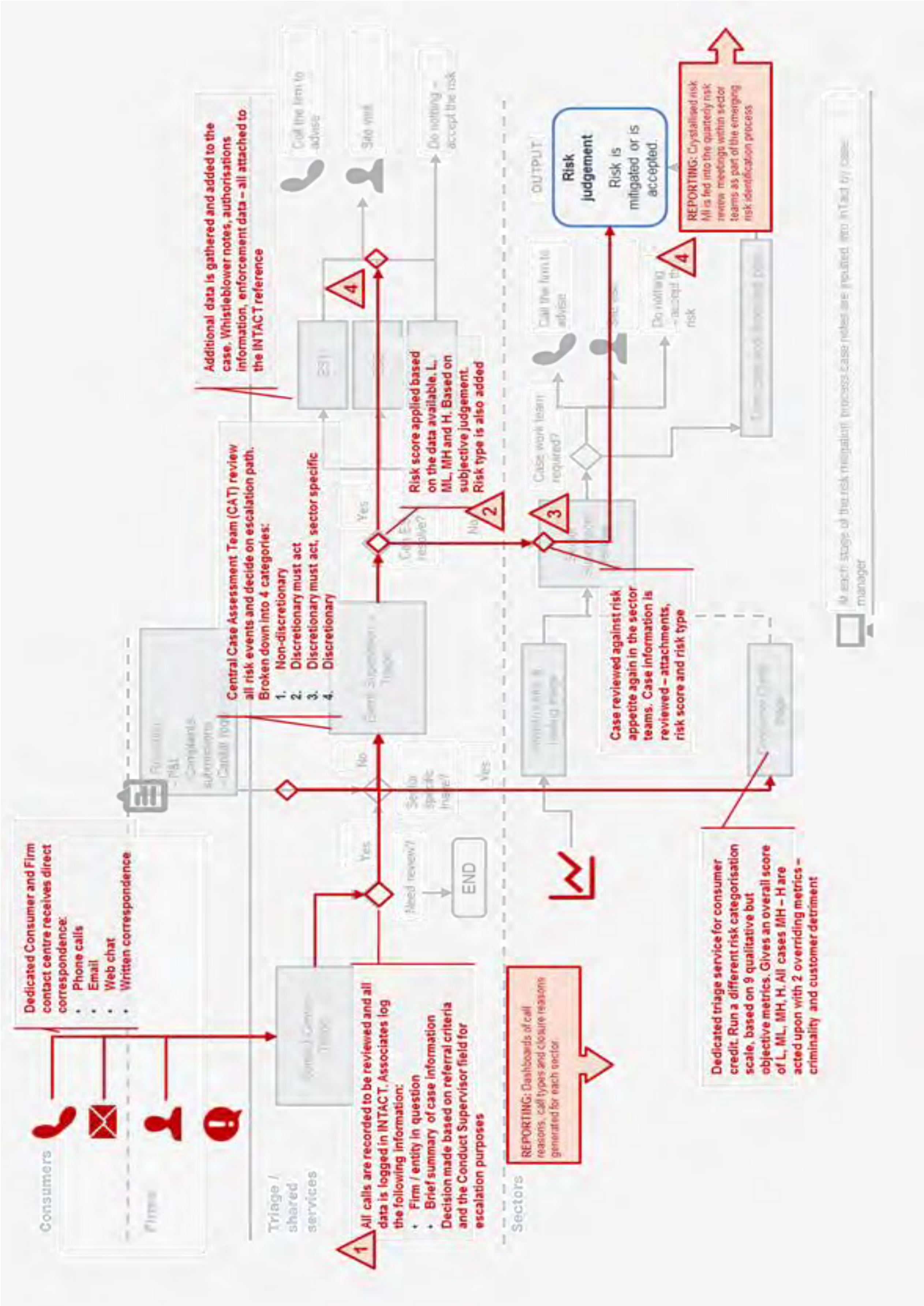


Figure 11: Data flow in crystallised risk

Validated data sources, both internal and external have not been developed to their full potential

There is a large amount of clean, validated data potentially available to sectors. However this is not being fully utilised due to a lack of knowledge of what is available and how best to use and interpret the data. Therefore there is intelligence not being used to inform sector planning and identify potential risks. This could result in market risks not being identified and mitigated.

Validated data sources include, but are not limited to the following:

- **Event Supervision risk events**. This information has been reviewed, analysed and assessed for cleanliness and accuracy. It has also been scored for potential impact.
- **Financial Ombudsman Service**. Like Event Supervision, the data available to the FCA through a robust connection to the FOS offers clean, validated and assessed information directly related to financial conduct
- **Firm Complaint data**. This data is directly related to firm conduct and to the products offered by firms. Used correctly, data directly submitted from firms can provide primary evidence as to conduct issues arising the market.
- **Authorisations data.** This data can provide information on new firms entering the market, and insights on the direction of growth in the market

There are a number of constraints currently preventing sectors from making full use of these validated data sources in their analyses that can be addressed through short to medium term actions. These include, but are not limited to:

- A lack of official link and understandable process to access the data. In the case of the FOS, the data is in some cases referred to but not on a structured and coordinated basis that ensures risk types are measured and monitored across sectors.
- A lack of understanding as to how to access the data. Complaints data is currently stored in BI / COGNOS and not all sectors understand how to access it. It is also firm specific so requires interrogation to derive risk specific insight.
- A lack of visibility. Event Supervision have only recently begun publishing systematic MI on risk events and their resolution.
- Poor risk type tagging. As detailed above, Event Supervision data in particular has in some cases been avoided due to a lack of linkage to sector risk types
- Inconsistent use of sector tags. For example sector tags are not used in authorisations, which make it difficult to link back to risk within sectors.
- Data is stored in multiple warehouses. The existing systems limit the sectors ability to join up multiple data sources to create a holistic view of the market. Teams must manually extract data and conduct separate pieces of analysis. This is resource intensive, and limits the sectors ability to conduct market wide analysis.

In the specific case of Event Supervision, there appears to be a reluctance or a lack of understanding on the part of sectors to work with them to generate standard, relevant and timely MI to support the risk identification and measurement processes. While in some cases sectors have approached Events in order to gather useful data, there have also been several others actions taken to either gather the information by different means or gather proxy metrics and data as a substitute.

These are often not optimal and include:

- Referring to raw, unstructured data instead. As discussed below, some sectors are referring to the raw data available to the FCA as a substitute for cleaner risk event information.
- Requesting specific risk event types be escalated directly to sector case teams. Instead of monitoring MI, some sectors have asked specific case types to be escalated to them without Events taking action – irrespective of risk score – so as to maintain visibility of certain risk types.

- Ignoring risk event data altogether. The lack of relevance, timeliness or perceived low quality as caused some sectors to avoid using risk event data in their analysis of sector risks altogether

Conclusion

Validated data sources are available to the FCA without the redefinition of regulatory returns data or undertaking specific data gathering exercises. These include both internally generated data, for example Event Supervision and complaints data but also external data in the form of that gathered and actioned by the Financial Ombudsman Service.

The consequences of these sources not being developed includes:

- Lower quality data sources are used instead. As detailed above, the use of Contact Centre data in particular has potential negative consequences to supervision
- The understanding of risk types across the flexible portfolio is reduced, directly affecting supervision
- Resource is spent interrogating low quality data

To address these concerns and improve the overall quality of data available to sector teams, the following recommendations should be considered:

- Education on all internal sources of information, so sectors understand the existing intelligence within the FCA. Following this, a review of the internal intelligence by sector to identify how the data sources can be used in market analysis and risk identification.
- Regular compliance reporting to ensure the data is kept up date and data fields are completed.
- Review of existing alerts by sector
- Definition of a standard approach to extracting data across sectors and systems
- Clear owner of each system for quality controls purposes
- Up to date data dictionary of available sources, fields and systems that sector teams can use as a reference to understand the available data.

The longer term solution would be to have all data stored in the same system with unique identifiers to link firms. As part of the data strategy, the existing systems are being reviewed and a central warehouse is being created in amazon cloud.

The quality of data stored in Intact is impacted by inconsistent practices and structural issues

In addition to the constraints on data analytics and the quality of intelligence derived from it discussed above, there are specific practices involving the use of Intact itself that restrict data quality. The review undertaken has not dealt extensively with the direct use of Intact by associates but a number of concerns have been raised concerning how cases are recorded and documented which further limit the ability of other teams to interrogate the data and draw insightful conclusions. These include but are not limited to:

- Case information is often of low quality and difficult to understand.
- The data inputted into the subject line of cases is inconsistent and does not give caseworkers sufficient information to act accordingly.
- Little or no record is kept of the risk type or the area of policy to which the case is referencing, restricting the ability of case workers to understand the nature of the case.
- Cases requiring no action are forwarded, including cases of consumers thanking the FCA for advice or calling back to give updates on forwarded cases to the FOS.

Furthermore, there are several structural issues affecting Intact data quality. These include:

- Multiple departments have access to Intact, and the quality of data and language entered into the system can be inconsistent across departments. For example, the Contact Centre record entries at firm level whereas supervision record risks and firms by legal entity. Therefore it is difficult to link data within the same system.

- Firms may have several legal entities and / or various permissions denominated by codes in Intact. To correctly assign a case to the appropriate entity for review a case worker requires a level of detailed understanding of Intact, the firm in question and the appropriate legal entity which to apply a case not available to Contact Centre staff. For example, [redacted] has more than 6 codes in Intact, only one of which is the correct entity for the majority of cases. Without knowing this in advance, cases may well be documented incorrectly.

Conclusion

Intact offers a rich source of potentially validated consumer and firm information, should this information be gathered and recorded accurately and in a structure that allows sectors in quickly understand the issues, make connections between cases and derive market risk insight from it. Currently, the inconsistent use of Intact is preventing sectors from appropriately making use of this information. This has the following consequences:

- Information on consumer cases cannot be escalated and acted upon accurately
- Risk events cannot be accurately identified from the information attached to consumer contact cases in Intact
- Risk events cannot be accurately attached to firms and therefore linked across firms and sectors

To address these concerns a combination of education, standard data entry practices but also structural changes to Intact should be considered. Specifically, the following actions are recommended:

- Implement a robust audit and quality control process where customers of the process (Event Supervision, Consumer Credit and ITF triage and sector case teams) feed back to the Contact Centre and better define the information captured when dealing with customers
- Extensive, standard training to be undertaken covering staff in the Contact Centre, Event Supervision, Sector case teams but also sector teams so as to build an understanding of the data available, methods to interrogate it and the MI available.
- Extension of mandatory fields in Intact to cover the data required by Events, Sector case teams and sector triage functions

The lack of standardised intelligence across sectors has led to the sectors embarking on various sector specific data exercises

As detailed above, sectors face challenges both in terms of the lack of available data and also interrogating the data that is applicable to the identification and measurement of sector based risks.

There is limited resource within the central team to implement standard reporting and intelligence. The central team have produced initial risk and performance reporting. However, the central team does not have the extensive knowledge of the sector teams on the underlying trends in the data and therefore are reliant on sector teams to provide sector specific insight.

Some generic reports exist, however these are not always fully utilised as the information is not applicable to all sectors. For example the Contact Centre has created reports that are designed to be used across departments, but as detailed above, this information is of limited value to sectors.

In response, sectors have assigned resource to developing their internal data capability, aligned to the specific requirements of each market. These efforts vary across sectors, but individual initiatives include:

- Consumer Credit have set aside Pillar 3 resource to complete a detailed analysis into the sector. The exercise aims to generate data and information on their firms due to a lack of information available to them through regulatory returns. They have also assigned a specific resource to improving access to data and data quality in the sector

- GI&P have assigned specific resource to the analysis of Contact Centre, Whistleblowing and Parliamentary affairs information
- Mortgages and Mutuals are in the first iteration of producing regular sector analysis MI to identify and review market trends split by intermediaries and lenders
- Wholesale banking receives profit and loss information directly from their fixed and priority flexible firms. This is used for quarterly peer analysis and a monthly scorecard dashboard to monitor changes and performance across firms. In addition, the flexible team has manually populated the key contact details and business lines of our target population (c200 legal entities) as part of their Data Strategy

While these efforts are laudable and will yield some results, the development of sector specific data requirements and / or improvements highlight several potential risks to cross-sector supervision:

- Inefficient application of resource – each sector working in isolation does not have the scale, capability or resource available to drive the changes required to improve data quality sufficiently.
- The application of central standards to the analysis of common data sources across sectors is beneficial and is constrained by individual sectors working in isolation. In particular, standardising the following aspects would be of benefit:
    - Risk event MI and reporting across sectors and risk types.
    - Sector risk scores and scoring methodology – see section 5 for further details of risk measurement methods.
    - Collaborative forums between sectors and Event Supervision or other triage functions.
    - Group Supervision – those firms spanning several sectors would benefit from standard reporting of data applicable to them across sectors.

The lack of standardised data used and training in the use of Intact data in sectors has resulted in the over-reliance on qualitative metrics to support decision making in many sectors, noting Mortgages and Mutuals as an exception due to the granular data present.

This has manifested itself in a number of ways during risk management and sector planning processes:

- Sectors will share intelligence via discussion and meetings without the use of regular reports. Sectors have said that information from the Contact Centre or Event Supervision is shared during forums, but standard reports are not used to inform these discussions. Therefore there is limited quantitative evidence to support decisions.
- Sectors rely on the knowledge and experience of particular people. This knowledge is easily lost when experienced team members move on and does not permit the tracking back of decisions to key data.

Conclusion

There is an appetite to improve data use in sector teams and a realisation that the use of data can and should be improved. However, there is a lack of the required central resource to improve data use and data quality present in sectors and there is not sufficient central oversight to drive the change required across supervision.

This results in the overreliance on qualitative metrics and collaboration between knowledgeable experts in decision making processes. The consequences include, but are not limited to the following:

- Derivation of non-standard data improvements across sectors.
- Inefficient, small scale changes are being derived rather than the supervision wide improvements required.

To address these concerns, the following actions are recommended:

- Review of data and variables needed for each sector to determine if standard reports can be identified to automate intelligence making it easier for sector teams to utilise all available data.
- Standardise the approach on sharing information across department to evidence decisions and risk identification.
- Review data analytics capability across sectors. Following this, a review of how the support function(s) can fill the gaps – including MIDA, central supervision support etc..

5. RISK IDENTIFICATION AND MANAGEMENT

There are inconsistencies in how risks are measured, monitored and reported

A key aspect of the flexible firm supervision strategy is to not conduct pillar 1, one-on-one firm based activity, but to act upon risk events and address market based and case specific crystallised and crystallising risks in the flexible firm population. A fundamental part of executing this strategy effectively is the ability to accurately identify emerging and crystallised risks in the industry and mitigate them accordingly in a timely manner.

We have found however, that the organisation is unable to identify, measure, monitor and report risks consistently in a way that would effectively support this aspect of the strategy.

We believe that risk appetites are not sufficiently well defined across the sectors to inform operational activities and plans. As a result of a lack of a central view or direction for risk appetite, the sector appetites are inconsistent, lack meaningful detail for the sector supervisors and have been implemented in the operational processes in a way that causes confusion and operational complexity.

Further to this, the way that risks are measured and recorded is subjective and therefore inconsistent, not just across Sector and Event Supervision, but between crystallised risk events, firm-specific risks and sector risks, and between fixed and flexible firms. This problem is compounded by the different systems, and the different parts of the systems used to record the risks.

As a result, the risk information reported lacks the ability to provide the intelligence needed by the supervision leadership team to understand and compare risks for the purposes of planning, risk prioritisation or escalation. The current data does not easily provide a view of the trends and emerging risks that would allow the FCA to effectively address risks in the flexible firm population.

Risk appetites should be reviewed to ensure that they link back to a central view of the FCA's priority risks and can effectively be applied to the operational processes in the Contact Centre and Event Supervision. A review should also ensure that the risk appetites provide an effective tool for supervisors to prioritise work.

Furthermore, by implementing improvements in the way risks are identified and recorded across supervision, the risk intelligence available to senior leaders should improve their ability to plan, prioritise and monitor risks for flexible firm supervision. It will also ensure that the organisation is able to 'join the dots' in the information they receive to identify trends and emerging risks in the flexible firm population and ensure the effectiveness of the flexible firm strategy.

Supporting Material:

- Collated Data Sources and uses
- Collated Crystallised Risk process flows (1.1, 1.2, 1.4 & 1.5 in particular)
- Appendices 4 & 5 – Crystallised Risk SIPOC and process & Data Sources

Background

There have been a number of changes to how supervision record and report risk. Intact has been rolled out across supervision, and as it has been implemented, it has changed which risks are recorded where, and the types of information that needs to be recorded. CRM (renamed the FCA Risk Register during this review, although it will be referred to as CRM in this report) remains in place as the central risk register for sector risks, as well as operational risks with Intact the risk register for firm specific risks. The House Views have also been introduced, which aim to draw together information from across the organisation to provide a consolidated view on sector risks.

Additionally, as part of the implementation of the flexible firm strategy in 2015, an exercise was conducted to ensure each sector had a documented risk appetite. These short documents set out what the supervision team should and should not look at or act upon. They effectively act to provide a view of the priorities and tolerances of the sector teams. These risk appetites are used to inform the referral criteria used by the Contact Centre to refer cases onto supervision, and by the Event Supervision team to refer events to Sector Supervision. They also provide guidance to Sector supervisors on work that should be prioritised when defining sector plans and activity.

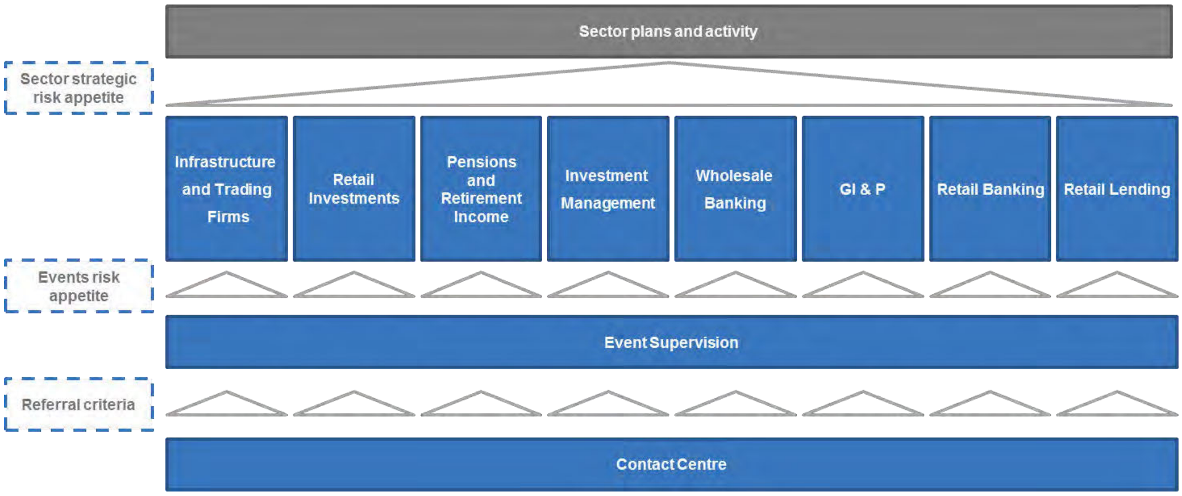


Figure 12: The use of risk appetite statements across Supervision

This section looks at our findings in relation to how risk is identified, measured, monitored and reported, taking into account:

- Risk appetites, including how they are defined, and how they are applied to operational processes;
- How risk is measured and recorded, depending on the type of risk and the team; and
- How the risk information informs planning, risk prioritisation and escalation, as well as the how the information supports identification of emerging risks.

The risk appetite statements lack a central view of risk appetite and are not sufficiently well defined to aid consistent decision making

Risk appetites have been developed for each sector and consist of qualitative high level guidance setting out the following information:

- where supervisors will and won't look,
- where supervisors will and won't act, and
- how supervisors will act.

The one page statements also include limited quantitative measures. The statements set out the risk appetite for both fixed and flexible firms covering firm-specific, reactive and multi-firm activity. The current statements were produced by each sector and signed off in 2015, when the flexible firm strategy was implemented. We have noted the following issues:

- **There is a lack of clear guidance on key priorities and areas of risk**. The risk appetite statements have been documented individually by each sector based on their view of their sector risks, and as mentioned in section 2 of this report, has led to useful, sector specific customisation. However, they lack direction and linkage to a centralised, high level risk appetite that provides clear guidance on the key priorities and risk areas. This has contributed to the inclusion of high level statements in the risk appetite which should be updated to link back to a central view of priority risks for the FCA.
- **The quantitative measures and triggers included in the risk appetite statements do not support the application of the risk appetite in practice**. Quantitative sizing measures and indicative triggers have been included in most of the sector risk appetite statements. Some of the sectors have included sector specific measures, such as Infrastructure and Trading Firms. An over-arching measure has been applied to sectors with retail activity. This includes Retail Banking, Retail Lending, General Insurance and Protection, Retail Investments, Pensions and Retail Income and Investment Management. The standardised quantitative measure is an amount of customer detriment greater than £5M and impacting more than 2000 consumers. In practice, this measure has proven to be ineffective, as it is often irrelevant to the event and is overridden by local interpretation of the high level qualitative criteria in the risk appetite statements. Sectors with a high number of smaller organisations or low impact customer transactions, such as consumer credit, would rarely, meet this criteria. This leads to Consumer Credit risks only being addressed based on the qualitative criteria in the risk appetite.
- **There is additional confusion on how to apply the quantitative measures included in risk appetite statements**. The guidance provided to support the risk appetite statements does not make the distinction between the treatments of individual or aggregated events. For retail activity, it is unclear whether the consumer detriment threshold should be measured for a single event – e.g. a single event exceeding £5M as opposed to the aggregate of a number of smaller events which, when considered together, exceed £5M. In addition, where the individual events are not meeting the £5M threshold, they are currently being closed without further action. As a consequence aggregated areas of risk may not be identified.

Conclusion

The objective of the risk appetite statements that have been developed for each sector was to prioritise the activities of the sectors on the high risk areas. The current statements do not clearly link to a central view of risks and lack clearly defined priorities. This has resulted in risk appetite statements that look and feel generic and at times do not reflect the sector.

The application of the risk appetite is hindered by the lack of sector specific quantitative triggers that directly reflect the key risks and priorities of each sector. The quantitative measures that have been developed are often not useful for specific sectors. This results in the need to apply judgement based on the interpretation of the high level qualitative measures. Judgement heavy approaches often lead to a larger number of risks being actioned as risk de-prioritisation becomes more subjective.

The risk appetite statements should be reviewed and updated to include:

- A clear link between the risk statements of each sector to the overall direction of the FCA
- The introduction of sector-specific quantitative measures which map to a central view of risks and priorities for the sector
- Detailed guidance on how the risk appetite statement should be employed to support operational activities including addressing aggregated events and risk de-prioritisation.
- This will ensure the FCA priorities are reflected, while preserving the autonomy of the sectors.

Operational activities have been complicated by the lack of a clearly defined risk appetite

Attempting to embed the risk appetites into operational processes and activities has led to further confusion and inefficiencies. The translation of the risk appetite statements from the sectors into a set of decision criteria to support operational processes in the Contact Centre and Event Supervision has created further confusion.

The Sector risk appetites have been used in some sectors to produce the referral criteria used by the Contact Centre. The Contact Centre use these referral criteria to review a case and determine which action should be taken and by whom, i.e. where it should be referred. The referral criteria are complex and vary between sectors. Contact Centre associates do not have supervisory expertise and the complexity of the referral criteria often leads to events being passed to on to supervision inappropriately. In addition, the supporting information recorded is frequently inadequate for supervision to understand the underlying issue. For example, up to 30% of the cases that are referred to the Consumer Credit team have been referred with no breach or in error. All referred events are further reviewed by a member of the Consumer Credit triage team which creates an unnecessary burden.

The risk appetites should also provide clear guidance as to where supervisors can and should deprioritise work when it does not meet the risk appetite thresholds. As a result work is not being deprioritised and this directly impacts resource capacity. When risks arise, supervisors should refer to the risk appetite statement to drive any subsequent activity. However, due to the ambiguity and lack of detail in the statement, supervisors struggle to deprioritise work. In addition, there is a general feeling that the “risk sits with me” within supervision. This contributes to risks not being de-prioritised.

In addition, there are circumstances where an event is referred to Sector Supervision from Event Supervision based on the decision criteria set out by the risk appetite statement. The Sector supervisors, however, don’t have resource capacity and close the event without action – meaning that in these cases, events which should be addressed, according to the risk appetite, are not being actioned.

The Events team have recently undertaken work with the Sector supervisors to improve the decision criteria based on risk appetites, and this has reportedly resolved some inefficiencies relating to the uncertainty of how the Events team should action events. However, the team still have to type in free text into Intact to support how they have applied the risk appetite.

Conclusion

The lack of a clearly defined and well understood risk appetite statement is affecting operational decision making. Specifically, the referral processes that have been driven by the risk appetite statements have resulted in complex instructions for the Contact Centre. Complex referral criteria increase the likelihood of calls being recorded incompletely and subsequent inappropriate referral to sector teams.

Additionally, the risk appetites lack sufficient detail to allow supervisors to make decisions about prioritisation. Supervisors feel that they own and should be accountable for risk. Due to the lack of clear guidance in the risk appetite statements risks, supervisors do not feel empowered to proactively de-prioritise actions and/or supervisory risks.

These issues have a direct impact on resource. In some circumstances resource is targeted at performing tasks due to a lack of confidence in the activities performed by other teams and in others resource is focused on risk areas that can and should be de-prioritised.

Risk appetites should be reviewed to ensure they are effective in supporting operational processes such as the Contact Centre referrals. The review should focus on simplifying the Contact Centre referral criteria and considering how Intact can support the Events decision and referral processes.

Sectors should consider how to develop a level of detail to support their supervisors in deciding what to action and having confidence to deprioritise work.

Risks are inconsistently measured and recorded. This is further compounded by the use of multiple recording systems for risk

Across supervision, risks are recorded using the FCA risk framework scoring model. Risks are scored on their probability and impact to create an overall score on a nine point scoring system. Different risks are recorded in different systems, using this framework:

- Sector (known) risks are recorded in CRM by sector teams, using ten-point scoring.
- Firm-specific risks – known risks for the fixed firms – are recorded in Intact (in the firm-specific section), using ten-point scoring.
- Risk events (Pillar 2) for fixed firms are recorded in Intact (in the firm-specific section), using ten-point scoring.
- Risk events for flexible firms are recorded in Intact (in the flexible firm event section), using four-point scoring

While this framework is used across supervision, the risk identification and scoring process is subjective and as a result, there is no consistency in the risks identified and recorded across supervision. The recorded risks will be scored and prioritised in different, subjective ways and therefore will not be comparable. This lack of comparability and consistency in how risks are recorded and measured is evident for Pillar 2 events and emerging risks, as well as known sector risks.

To complicate things further, Event Supervision apply the risk framework differently. They only score probability on a four point scale, in a 'cut-down' version of the wider risk framework. This approach is only used for flexible firms, for sectors serviced by the Event Supervision team.

This problem in variation in measuring and reporting risks is compounded by the different systems used for recording risk information. CRM is used to capture sector risks. Intact captures firm-specific risks for the fixed firm population and risk events for both fixed and flexible firms.

Figure 13: systems for recording risks for Pillar 1, Pillar 2 and sector risks for fixed and flexible firms

Within Intact risk events are recorded separately for fixed and flexible firms, which restricts reporting on crystallised risk events and complicates the risk event history for firms who move between fixed and flexible. For example, a flexible firm may have a number of risk events in Intact, but if that firm moves into the fixed portfolio, the risk events recorded before that move will not be evident or easily available.

There are further issues with the way risks are measured and recorded across the organisation:

- **In Intact, it is difficult to clearly record comparable risk information for Pillar 2 events**. Information is recorded in free text fields and therefore lacks the detail that would enable reporting and trend analysis on the event information. Risk tags have been introduced in an attempt to improve risk reporting, but there still remain some issues, as discussed previously in section 4.
- **The FCA priority risks are not considered in consistent fashion across sectors**. There is no consistency or a centralised view of priority risks reflected in the sector risk reporting in CRM.

Conclusion

The FCA impact and probability risk framework is used across the organisation, but is too subjective and does not support the consistent recording of risks. As a result, it is difficult to compare and analyse the risk information across the organisation. This problem is compounded by the different systems used and the information recorded in those systems. The lack of a robust scoring framework and a centralised recording system impacts the ability of the FCA to produce meaningful cross-sector views on risk.

Consideration should be given to a clearer definition of how risks can be related and compared across sectors as well relevant house view or priority risks for the FCA. This will support the ability to map risks to priorities and also monitor cross-sector market risk. It would also allow standardisation in the way risks are recorded in the system across teams to support and improve risk reporting and intelligence.

The FCA lacks the necessary risk information to support planning processes. This impacts the ability to 'join the dots' to identify emerging risks

Risk information is a key component to support planning, risk prioritisation and escalation. One of the first steps of the planning process is to understand all the available information to identify and prioritise risks.

The information used for this should facilitate an aggregated view of:

- Risks identified in proactive fixed firm supervision,
- Risks identified in the Pillar 2 risk events for fixed and flexible firms; and
- Risks identified by sector analysis of fixed and flexible firms, horizon scanning and other intelligence gathering.

As set out in the previous finding, the usefulness of the existing risk intelligence is limited as a result of the way risks are measured, recorded and reported differently across supervision. Without the consistent and standardised recording of risk data, the organisation is unable to effectively analyse risk information and understand the risks in a wider context. This means the risk prioritisation process does not provide an accurate starting position for the purposes of planning.

One key gap in the current review of risks and the prioritisation process is being able to understand trends in the sector. A key aspect of the market risk approach to the flexible firm strategy is being able to join the dots in the available information to identify risks emerging in the flexible firm population. Supervision should be able to review and analyse trends in risk events to ensure they understand emerging risks, but due to the findings set out in this report they currently lack the ability to produce meaning full trend intelligence. The following issue all contribute to the current lack of trend reporting:

- Lack of consistency in recording and reporting risks
- Different parts of Intact are used for recording fixed and flexible events
- The closure of small events without action, although they may need to be considered in aggregate

Conclusion

The way in which risks are identified, measured and recorded results in a lack of usefulness or insight for the purposes of planning, escalation and understanding risks in a wider context. A key aspect of the approach to flexible firm supervision is to not supervise proactively, but to only act upon crystallising risks. For this to be successful, however, it is critical to ensure that the organisation is certain of its ability to identify these risks, for both individual risk events and when events point to an issue when considered in aggregate. Currently the organisation lacks the ability to be certain of their ability to recognise emerging risks in the flexible firm population and take a true market risk view.

By improving risk measuring and monitoring, as proposed in the previous section, more effective reporting and intelligence will be available for the purposes of planning and prioritisation. Sectors should then consider how to monitor this information to ensure risks are being recognised and incorporated into the risk management framework.

Improved measurement and reporting will also serve as a basis for defining clearer decision-making and escalation criteria to ensure senior leadership are informed of and can make decisions on wider risk.

APPENDICES

Appendix 1 – Approach

The FCA selected PA Consulting to support the review of the new supervision approach for flexible firms. The following report reviews the effectiveness of the approach in supervising flexible firms in particular. It considers the processes involved, the data and business intelligence available to the FCA to in the supervision of flexible firms, the governance of the approach and the interactions between Supervision and other departments. Figure 14 below shows (in blue) a schematic representation of the activities, departments and interfaces in scope for this review and their interaction with one-another. This is not a representation of the FCA's organisational model or process landscape.

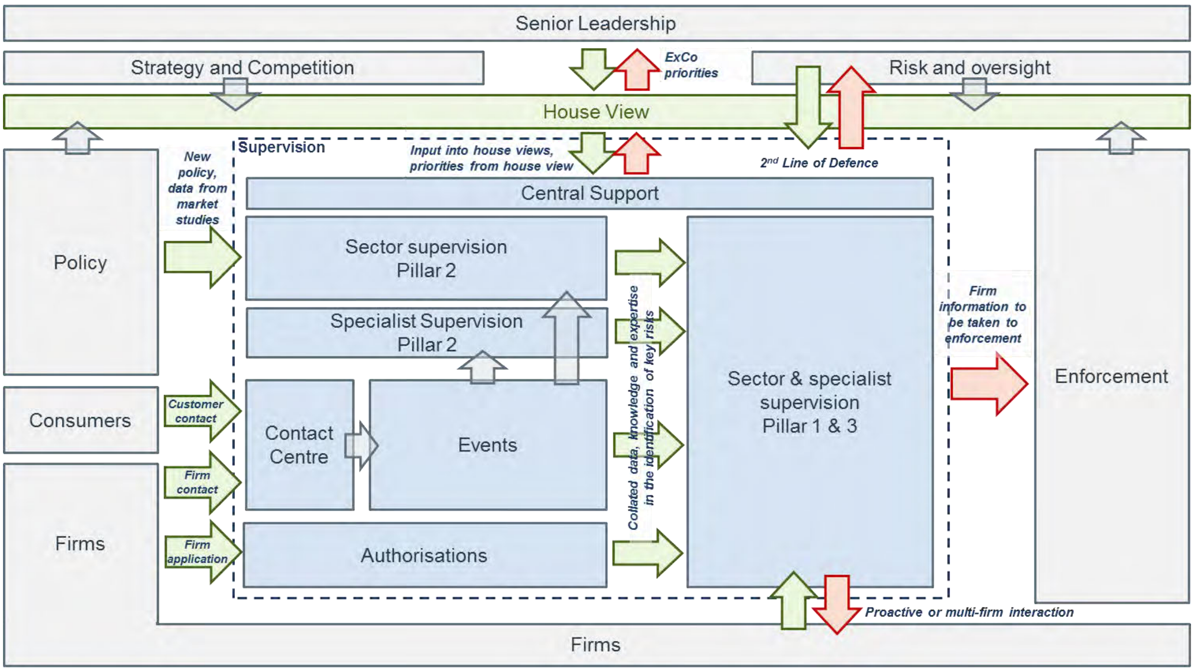


Figure 14: The scope of this review in the context of the FCA's updated structure and high level processes

Figure 14 above shows (in blue) a schematic representation of the activities, departments and interfaces in scope for this review and their interaction with one-another. The assessment covers Pillar 2 and 3 supervision of flexible firms, but references Pillar 1 supervision of fixed firms where relevant to the overall strategy and/or the approach to flexible supervision. It includes Specialist Supervision, Authorisations, the Contact Centre, Event Supervision and Central Support. Interfaces are detailed in terms of the collaborative interactions of other departments with Supervision. This includes joint forums and the decision making processes.

The review focused on three key areas of the approach to flexible firm supervision. These were:

- Sectoral Strategy and Operational Planning
- Sourcing, Analysis and Use of Intelligence of Management Information
- Management of Core Regulatory Processes and Communication across FCA Departments

In approaching the review the PA team engaged with sector Directors, Heads of Departments (HoDs), Sector Team Managers and associates, Pillar 2 Supervisors and members of the Sector Teams. Within Supervision more broadly PA engaged with specialist supervisors from Client Asset Supervision (CASS), Financial Crime (FC), Prudential Supervision, Authorisation staff and those dealing with risk events within the Contact Centre, Event Supervision and sector based triage functions within Consumer Credit and Infrastructure and Trading Firms (ITF).

To assess the effectiveness of engagement and collaboration with non-Supervisory departments, staff from Policy, Risk, Enforcement, Strategy and Competition, MIDA and Customer Insight were engaged also.

To provide a basis of understanding of the current state and develop the detailed findings contained in this report, PA carried out the following activities and analyses:

- More than 60 interviews with the aforementioned stakeholders (see Appendix for a full interview list). Additional interviews were conducted focusing on the data available to supervision, its structure and accessibility.
- A process mapping exercise was conducted delivering a suite of current state maps and SIPOC summaries for each stage and sector variation. This was completed for the following processes:
    - **Sector strategy and operational planning.** This includes the identification, measurement, prioritisation and reporting of sector risks, the development of sector strategy documents, the integration of the House Views, the governance of both the risk management process and the resulting Pillar 3 work and the interfaces with other FCA functions
    - **Crystallised Risk identification and mitigation.** This includes the triage stages in the Contact Centre, Event Supervision and sectors (Consumer Credit and ITF), resolution both in Events and within Sectors and the governance of the process end-to-end
- Two workshops on 'Crystallised Risk' and 'Sector Strategy and Planning' were conducted to validate process maps as well as to identify and rank the risks/gaps that had been highlighted through interviews. These sessions were also employed to further investigate the flexibility and balance between sector autonomy and cross-sector conformity, the use of sector plans, the use of data and interfaces between sectors.

Appendix 2 – Interviewees

Listed below is a complete list of interviewees during this review.

No.	Name:	Position/Title
1	[redacted]	[redacted]
2	Alex Atkinson	Governance & MI SME
3	Alison Barker	Infrastructure & Trading - HoD
4	[redacted]	[redacted]
5	Alison Walters	General Insurance & Protection - Sector Manager
6	Andrea Konrath	Sector manager - Pensions & Retirement Income and retail investments
7	[redacted]	[redacted]
8	[redacted]	[redacted]
9	Azhar Rizvi	Risk Specialists - Manager
10	[redacted]	[redacted]
11	Barbara Kubis-Labiak	Technical Specialist, General Insurance & Protection Supervision
12	[redacted]	[redacted]

13	Brian Corr	Competition Dept 2 - Retail Sectors -HOD
14	[redacted]	[redacted]
15	Caroline Gardner	Pensions & Retirement Income HoD
16	[redacted]	[redacted]
17	[redacted]	[redacted]
18	Clive Gordon	Retail Investments - HoD
19	Clive Parker	Central Support SME
20	David Geale	Policy SME
21	Deneesh Jhugroo	Life Insurance and Financial Advice: Retail Investments
22	[redacted]	[redacted]
23	[redacted]	[redacted]
24	Emma Jones	Sector manager - Retail Banking
25	Emma Krygier	Contact Centre
26	Emma Smithies-Barnett	RCO Framework - Manager
27	[redacted]	[redacted]
28	Glenn Redemann	Part VII Transfers - Manager
29	Hilary Bourne	Authorisations SME
30	[redacted]	[redacted]
31	James London	Financial Crime specialist supervision
32	Jane Savidge	Event Supervision Sector Manager
33	[redacted]	[redacted]
34	[redacted]	[redacted]
35	[redacted]	[redacted]
36	[redacted]	[redacted]
37	[redacted]	[redacted]
38	Jonathan Davidson	Supervision – Retail & Authorisations – Executive Director
39	Jonathan Phelan	Consumer Insight
40	[redacted]	[redacted]
41	[redacted]	[redacted]
42	[redacted]	[redacted]
43	Kate Damania	Retail Lending - Sector Manager - Consumer Credit
44	Lee Hooker	Pensions & Retirement Income – Manager
45	[redacted]	[redacted]
46	[redacted]	[redacted]
47	Lisa Sturley	Client Assets
48	Lucy Castledine	Authorisations - acting HoD
49	[redacted]	[redacted]
50	[redacted]	[redacted]
51	Marina Souyioultzi	Wholesale Banking - Sector Manager
52	[redacted]	[redacted]
53	Megan Butler	Investment, Wholesale & Specialists – Executive Director

54	[redacted]	[redacted]
55	Natalia Aralova	Strategic Risk Analysis - Technical Specialist
56	Natasha Oakley	MIDA
57	[redacted]	[redacted]
58	Naussica Delfas	Specialist supervision – Director
59	Neil Marshall	Competition and Strategy – Manager
60	Nick Cook	Analysis & Insight SME
61	[redacted]	[redacted]
62	Nick Smith	Life Insurance and Financial Advice Sector Team – Technical Specialist
63	[redacted]	[redacted]
64	[redacted]	[redacted]
65	[redacted]	[redacted]
66	Paul Mountjoy	Competition & Strategy – Technical Specialist
67	Paul Ullah	Central Support SME
68	Paul Williams	Retail Lending – Pillar 2 supervisor
69	Peter Fox	Retail Banking - Pillar 2 supervisor
70	[redacted]	[redacted]
71	Philip Salter	Retail Lending – Acting Director
72	Richard Sutcliffe	Client Assets Lead
73	Simon Walls	Investment Management – HoD
74	Robert Grupetta	Financial Crime Lead – HoD
75	Robin Jones	Prudential Risk Lead – HoD
76	[redacted]	[redacted]
77	[redacted]	[redacted]
78	[redacted]	[redacted]
79	[redacted]	[redacted]
80	Simone Ferreira	Event Supervision - HoD
81	Simone Lobo	Infrastructure & Trading Firms - Sector Manager
82	[redacted]	[redacted]
83	Susanne Gahler	Investment Management - Sector manager
84	Tracey Tibos	Risk and Compliance – Manager
85	Val Smith	Credit Authorisations - Acting Director

Appendix 3 – Level 1 Strategy & Operational Planning process

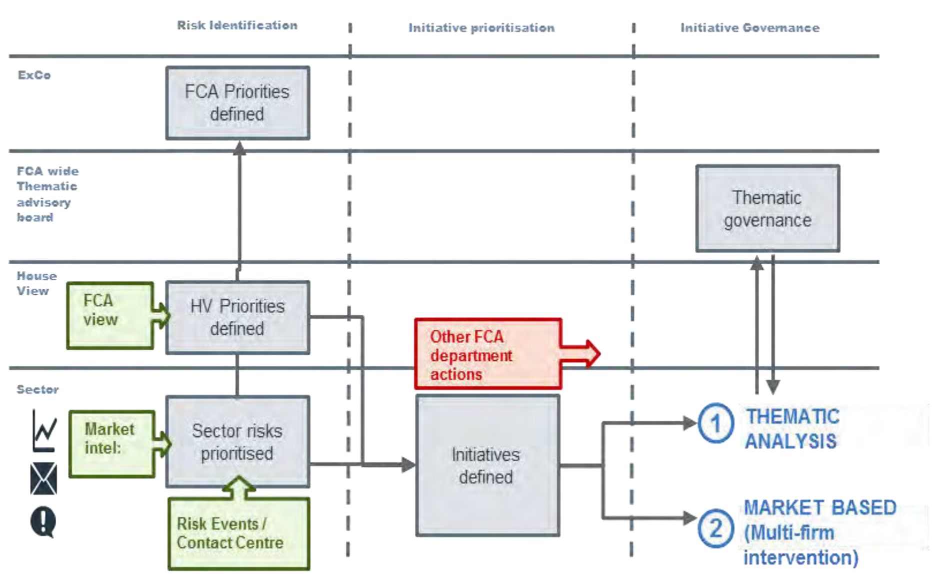
Below is the Level 1 SIPOC summary for the Strategy and Operational Planning process

Process Name	1. Sector strategy & operational planning	**Process Description:** The consolidation of risks identified by sector teams and by the House View process into a coherent sector strategy for their mitigation. Includes all data inputs relevant, the incorporation of the House Views into the planning process and the definition of resourcing required to carry out the actions identified. Does not include the carrying out of the work defined but does include the governance of them and tracking against progress and outcomes.
Reference #	1	
Process Owner	Sector HOD / Director	

Inputs:

1. Regulatory return data
2. Events supervision
3. Authorisations
4. Specialist Supervision
5. Fixed Supervisors
6. FOS
7. Contact Centre
8. Trade body data
9. Media reports
10. MIDA
11. House Views
12. Resourcing planning information

Process schematic

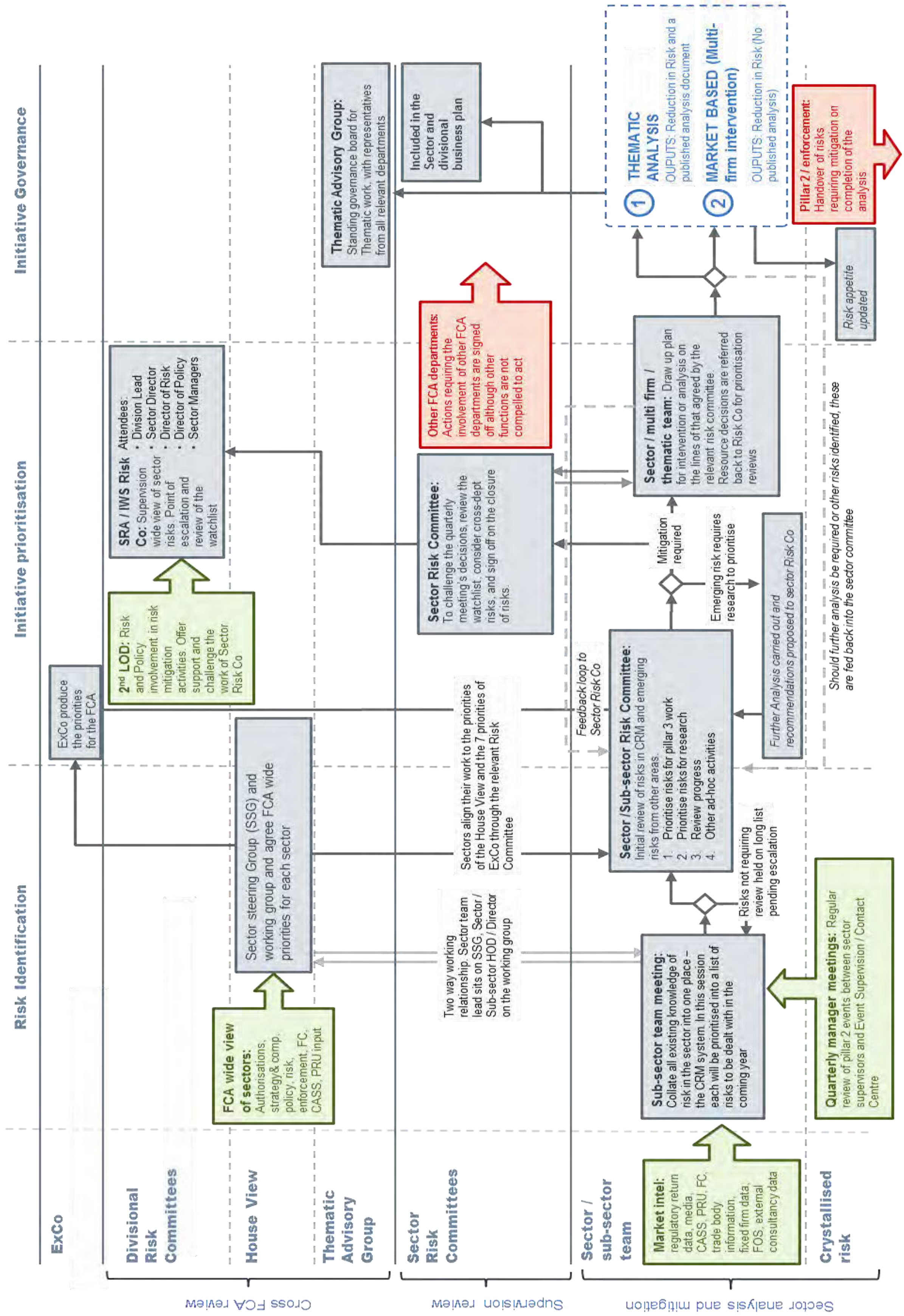


Outputs:

1. Priority risks to be mitigated
2. Thematic analyses to be carried out
3. Plan for execution
4. Updated Risk Appetite statement
5. Actions for other departments
6. Enforcement actions to be taken

Suppliers	Actors	Data used	Forums	Interfaces	Governance	Customers
• Sector Supervisors • Event Supervision • Contact Centre • Authorisations • Policy • House View team • Governance & MI • Legal	• Sector Teams • House View team • Sector Supervisors • Governance & MI • Associates • HODs / Directors	• CRM risk information • Event Supervision data • Regulatory returns data • Authorisations data • Policies incoming • House Views	• Risk Identification forum (several) • Risk Co x2 • Planning and prioritisation meeting • Comms strategy meeting	• Event Supervision • Enforcement • Communications • House View team	Thematic work • Through FCA wide thematic advisory council Multi-firm • Local, sector governance forum	• Enforcement • Group Supervision • Sector supervisors

Below is the validated generalised process flow for the Strategy and Operational Planning process



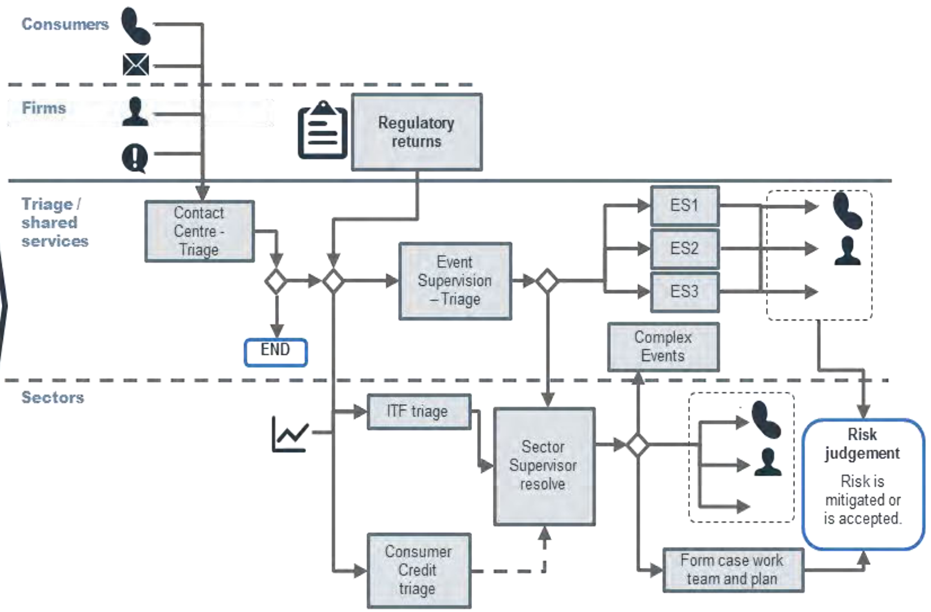
Appendix 4 – Level 2 Crystallised Risk process

Below is the Level 2 SIPOC summary for the end-to-end crystallised risk process

Process Name	Crystallised risk identification & mitigation	**Process Description:** The receipt of event information from FCA customers (consumers and firms), the identification of issues, the escalation of relevant priority events through a shared triage Event Supervision service to the appropriate actor to resolve (sectors, event supervision). Through reference to risk appetites within sectors and event information, the relevant action is taken to resolve the event using one or more of the tools available.
Reference #	1	
Process Owner	Various	

Inputs:

- Consumer contact, phone, email or written correspondence
- Firms contacting requesting assistance
- Firms self reporting issues
- Whistleblowing
- MPs letters
- Regulatory returns
- Market data (suspicious trades etc) – *Infrastructure and trading triage only*
- Media scanning information
- Trade bodies / associations referrals
- Foreign regulator referrals
- Authorisations referrals
- Fixed supervisor referrals
- MIDA / CMI referrals

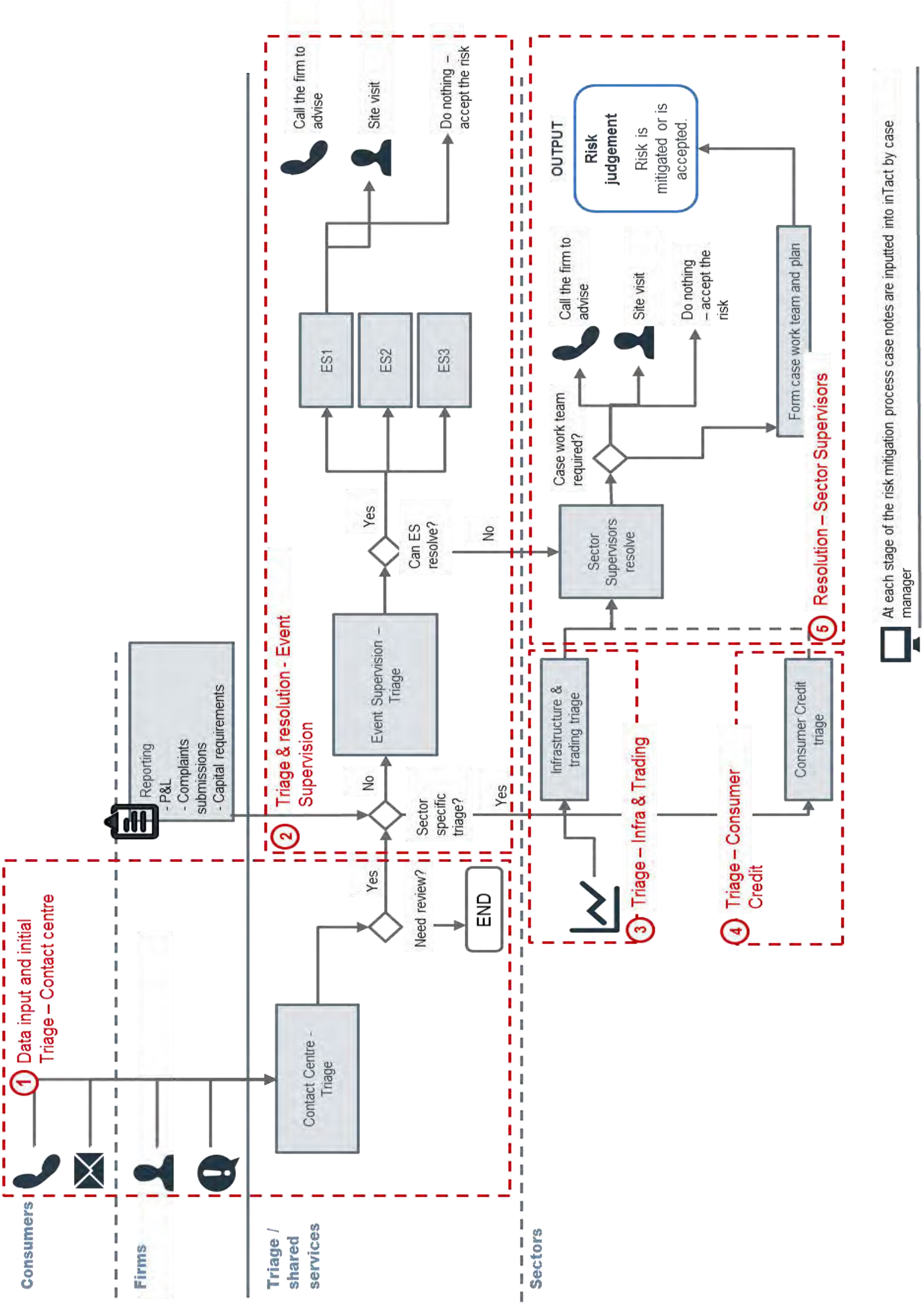


Outputs:

- Mitigated risk events in the form of actions taken and risk judgements made to confirm a risk is accepted or mitigated
- Contact with firms
- Site Visits
- Risks updated in INTACT

Suppliers	Actors	Data used	Controls	Interfaces	Escalation	Customers
• Sector teams • ARIE • Fixed Supervisors • Firms • Consumers • Foreign Regulators • MPs • Authorisations • MIDA / CMI • Trade bodies / associations	• Contact centre • Event supervision triage – CAT • Event supervision teams (ES1, ES2, ES3) • Infrastructure & trading triage • Consumer credit triage • Sector supervisors	• INTACT data and records • COGNOS regulatory returns data • TARDIS authorisations data • Capital Markets team risk report • Risk appetite statements • KnowledgeBASE	• Quality team • Audits and QA between ES and sectors • Sign off for closed cases • Sign off for escalated cases	• Enforcement • Sector teams	• Manager escalation • Managers technical meeting • Policy • Enforcement • Sector supervisors • Weekly note	• Enforcement • Sector supervisors • Sector teams • Firms • Consumers • Government

Below is the level 1 crystallised risk process schematic overlaid with the breakdown of the process into the 5 level 2 process flows documented as part of this review.



Appendix 5 – Data Sources

The FCA receives data from multiple sources. The types of data received can be broadly categorised into 3 areas.

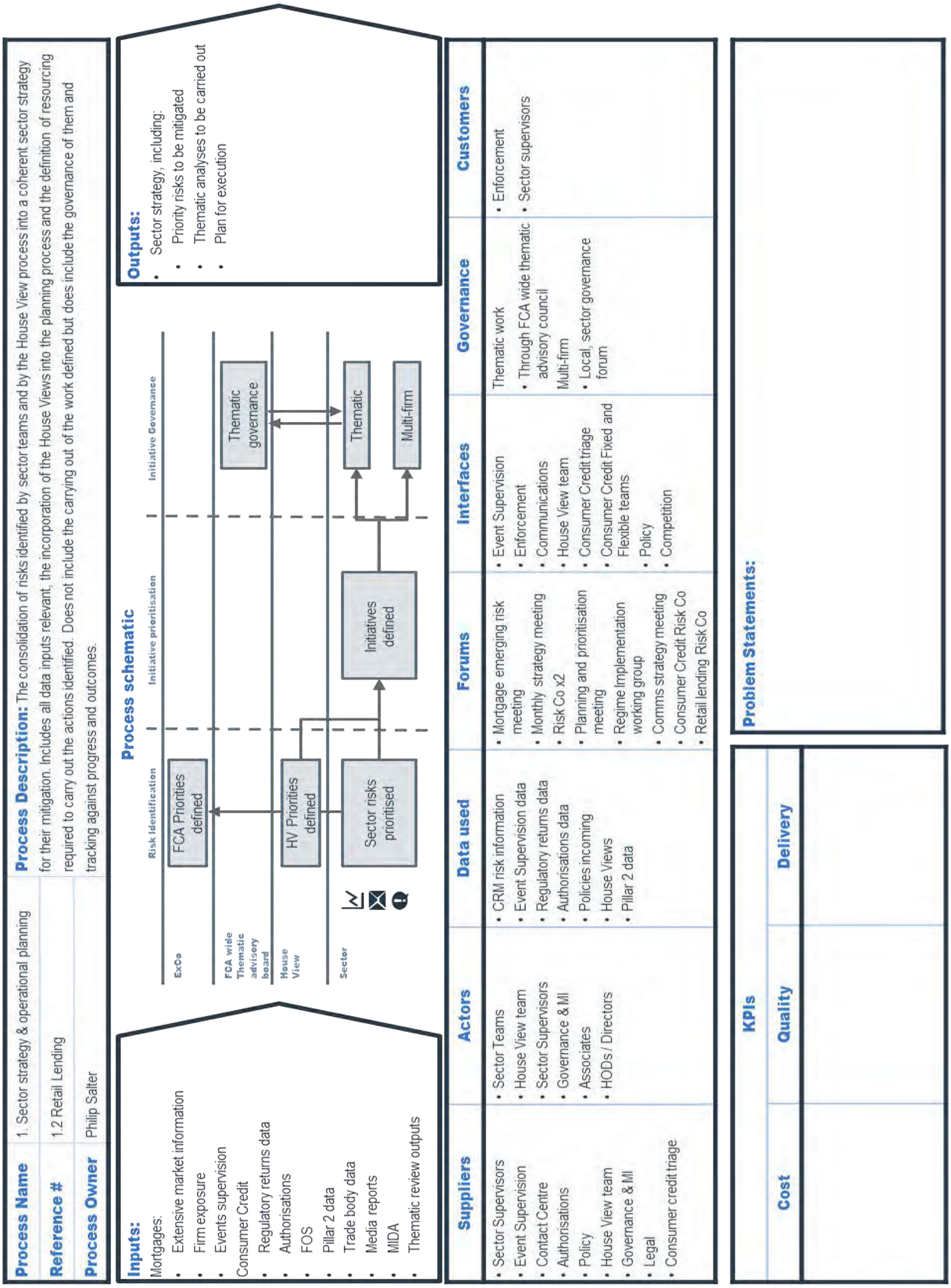
- Firm submissions. These are returns that firms are required to provide under regulatory conditions. The frequency and fields supplied by firms varies depending on the regulatory permissions of each firm
- Internal intelligence. This intelligence collected and stored within the FCA, such Contact Centre and supervision knowledge
- External market data. Data received from external sources which tends to be aggregated data

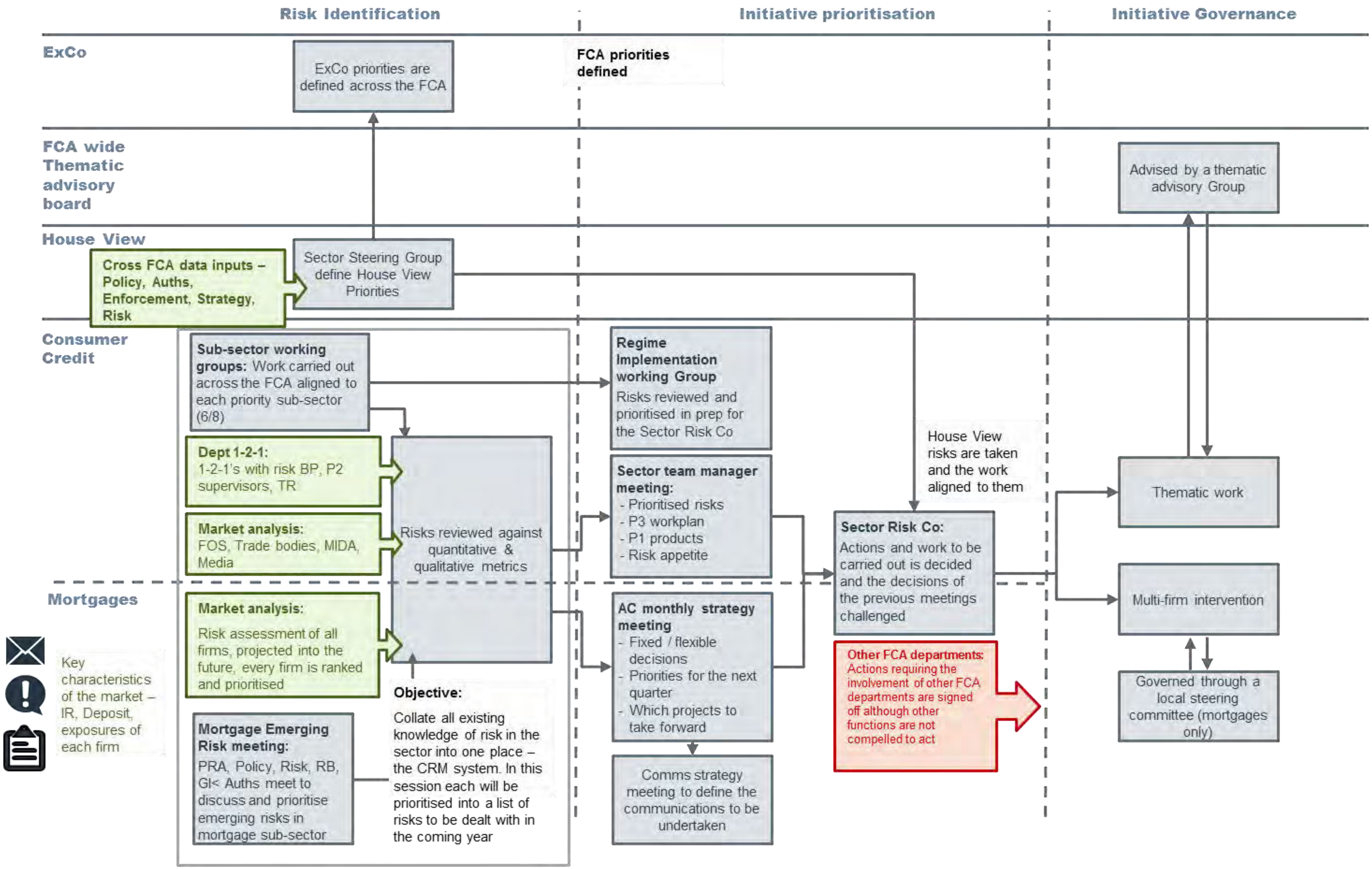
The table below provides a high level summary of the data sources available and the systems in which it is stored.

Data Type	Data Source	System	Example of Data Variables
Regulatory Returns	Firm responses	Gabriel	Balance sheets, Profit and loss, Complaints, Capital, client assets
Complaints	Firm responses	Gabriel	Number of complaints firms received
Consumer surveys	Consumers		Various surveys to consumers to gain consumer feedback
Consumer charities	Consumer charities	No system	Qualitative insight on consumer issues from charities and forums
Authorisations	Firm applications	INTACT	Number of firms, Staff turnover, Country of firm, Balance sheets, number of M&A
Supervisions	Supervisor input	INTACT	Firm strategy, Firm risk scores, Actions, Meeting records
Events	Supervisor input	INTACT	Crystallised risk
Contact Centre	Consumers and firms	INTACT	Whistleblower, Enquiries from firms and consumers
Supervisions	Supervisor input	CRM	Strategy plans
Firm Reference Dataset		TARDIS	Reference dataset of firms that FCA regulate
Alerts	Set by sector teams	AARI	Alert that trigger when automatic risk threshold are violated
Transactions	Firm responses	Zen	Derivatives, prices
External	Various	Various	Suspicious transactions, aggregated data on buy to let, advertising spend, house pricing index

Appendix 6 – Retail Lending Sector Strategy SIPOC and process

As referenced in section 4, below is the SIPOC and process flow documenting the Retail Lending sector strategy and operational planning process





Risk Identification
Initiative prioritisation
Initiative Governance
ExCo
FCA wide Thematic advisory board
House View
Consumer Credit
Mortgages
ExCo priorities are defined across the FCA
FCA priorities defined
Advised by a thematic advisory Group
Cross FCA data inputs – Policy, Auths, Enforcement, Strategy, Risk
Sector Steering Group define House View Priorities
Sub-sector working groups: Work carried out across the FCA aligned to each priority sub-sector (6/8)
Dept 1-2-1: 1-2-1's with risk BP, P2 supervisors, TR
Market analysis: FOS, Trade bodies, MIDA, Media
Market analysis: Risk assessment of all firms, projected into the future, every firm is ranked and prioritised
Mortgage Emerging Risk meeting: PRA, Policy, Risk, RB, GI< Auths meet to discuss and prioritise emerging risks in mortgage sub-sector
Risks reviewed against quantitative & qualitative metrics
Objective: Collate all existing knowledge of risk in the sector into one place – the CRM system. In this session each will be prioritised into a list of risks to be dealt with in the coming year
Key characteristics of the market – IR, Deposit, exposures of each firm
Regime Implementation working Group
Risks reviewed and prioritised in prep for the Sector Risk Co
Sector team manager meeting:
- Prioritised risks
- P3 workplan
- P1 products
- Risk appetite
AC monthly strategy meeting
- Fixed / flexible decisions
- Priorities for the next quarter
- Which projects to take forward
Comms strategy meeting to define the communications to be undertaken
House View risks are taken and the work aligned to them
Sector Risk Co: Actions and work to be carried out is decided and the decisions of the previous meetings challenged
Other FCA departments: Actions requiring the involvement of other FCA departments are signed off although other functions are not compelled to act
Thematic work
Multi-firm intervention
Governed through a local steering committee (mortgages only)

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