Planning ahead: the FCA's 2017/18 Business Plan priorities and strategic framework

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Hogan Lovells

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Introduction

The FCA's latest Business Plan demonstrates a commitment to pushing forward on both existing and new initiatives across sectors, focused on maintaining fair consumer outcomes in the rapidly changing UK financial services landscape.

For the first time, the Business Plan is accompanied by Sector Views covering all the markets the FCA regulates. This new document aims to put the regulator's chosen priorities into context by giving an insight into how those markets are working and evolving.

Another first is the Mission statement, which sets out the framework for the FCA's strategic decisions.

In this briefing, we take a look at some highlights from the FCA's priority work for 2017/18.

Firms' culture and governance

Extending the Senior Managers Regime and reviewing the remuneration rules

The FCA continues to focus on culture and governance in financial services. This is intended to encourage firms to deliver appropriate outcomes for consumers and markets, and to foster competition.

The FCA's planned activities for 2017/18 include:

- Consultation on extending the Senior Managers and Certification Regime (**SMCR**). The FCA will consult on the extension of the SMCR to all authorised firms in 2017 and will implement the extended regime from 2018.

  According to the FCA, the new regime for all authorised firms is intended to be:

  - **Simple**. The new regime should be "simple and practicable" for firms to understand and implement.
  - **Proportionate**. The regime will be tailored to reflect the different risks, impact and complexity of firms.
  - **Clear**. The rules should make it clear how the different components of the regime apply to different kinds of firms.

- Continued review of regulatory framework governing remuneration: The FCA recently amended its Remuneration Code for dual-regulated firms (that is, firms regulated by the FCA and the Prudential Regulation Authority (**PRA**)). The FCA plans to continue to review the regulatory framework that governs remuneration, including by helping firms to understand and implement the remuneration regime.
- Supervisory focus on the Certification Regime: The FCA will focus on culture and governance in its supervisory work. In particular it plans to look at how firms have embedded the Certification Regime.

Financial crime and anti-money laundering (AML)

An area of continuing priority

Financial crime and AML remains a key area of focus for the FCA and both the FCA and firms will be very busy in 2017 as they implement the Fourth Money Laundering Directive.

The FCA still has concerns about the strength of some firms' money laundering controls and has warned that the current uncertain economic climate must not lead to firms skimping on checks and controls or taking higher risks when chasing profits.

It wants to promote the use of new technology for AML compliance, including real-time monitoring and customer due diligence. It will publish a report on how technology can improve AML compliance.

The FCA will analyse the responses from its Financial Crime Annual Data Return, launched in 2016, in order to focus its supervision – and enforcement. Where a firm has poor controls, the FCA's position is that it will not hesitate to use its civil – or criminal – enforcement powers.

The FCA's Sector Views have identified a number of other concerns:

- For retail banking, although firms are improving, there are still concerns that some banks have poor controls in relation to high-risk customers. However, the FCA does not want to see banks de-risk and exclude customers unnecessarily.
- The FCA remains concerned about push payment fraud, so this is a priority for action.
- For the insurance sector, there is a risk that counterparties may put pressure on firms to relax their financial crime and AML controls, and that the complex relationships between parties in the sector may inhibit compliance.
- The FCA is also concerned about the opacity of the wholesale financial markets because it may hinder compliance efforts. It is also concerned that cross-border activity may lead to lower standards in the UK. However, it has seen significant improvements in systems and controls, with more senior management engagement.

Promoting competition and innovation

Encouraging competition by supporting innovation, especially in FinTech

The FCA recognises that FinTech can drive change and increase competition in the financial sector. However, the FCA also believes that, if not managed well, it can introduce or exacerbate risks in the financial system.

The FCA will continue with existing work supporting FinTech through Project Innovate and the use of the regulatory sandbox. It is also planning the following activities for 2017/18:

- <u>Helping firms develop automated advice services (also known as "robo-advice")</u>: The FCA set up its Advice Unit in 2016, and will continue to offer support for firms planning to offer robo-advice to the mass market. The FCA plans to publish resources to help firms develop robo-advice services, based on feedback from the Advice Unit.
- <u>Supporting international ties and regional hubs</u>: The FCA will continue to build relationships with other FinTech regulators internationally, as well as engaging more closely with regional and Scottish FinTech clusters.
- <u>Encouraging RegTech innovatio</u>n: The FCA wants to encourage new technologies to increase regulatory compliance and drive down costs. In particular, the FCA is interested in exploring how RegTech can help

firms with regulatory reporting, increase access to financial services, and improve real-time monitoring and surveillance.

- New bank start-ups: The FCA set up the New Bank Start-Up Unit in January 2016 to help support firms new to the banking sector, and plans to continue offering assistance in 2017/18.

Technological change and resilience

Ensuring that new technologies are adopted safely, and protecting against cyber risks

A significant theme in this year's Business Plan is the need to balance the risks and opportunities posed by rapid technological change. The FCA cites examples of market opportunities created by new technologies, such as the potential use of distributed ledger technology in storing customer data for the purposes of anti-money laundering compliance, or the use of application programming interfaces (**APIs**) to allow third party access to customers' bank account data in accordance with the Second Payment Services Directive (**PSD2**). Consumers themselves are making greater use of digital and mobile solutions, leading to an increased volume of online traffic, with annual global IP traffic expected to increase threefold over the next five years.

However, the FCA notes that these opportunities are tempered by growing risks posed by technological change. The FCA has emphasised the need to ensure firms' good governance of their IT systems and proper implementation of change management projects, especially when dealing with legacy systems. There is also a growing threat from cyber attacks and fraud. According to ONS figures cited by the FCA, there were 2.11 million victims of cyber crime reported in 2015/16, with vulnerable consumers often the target of cyber scams. In addition, the use of growing volumes of data may result in greater risks of data loss or theft, as well as the potential for misuse. The FCA has also warned that new market entrants are sometimes not regulated by the FCA, and may be unaware of the scope of their regulatory obligations.

The FCA plans to:

- build its expertise in new technology and resilience and keep up-to-date with developments;
- engage with firms where cyber attacks or outages occur, and support firms in improving their resilience;
- establish cyber coordination groups to bring firms together to share experiences; and
- consider resilience risks in other areas, such as ringfencing, providing resilience information to consumers, and the impact of PSD2.

Treatment of existing customers

Sharing the rewards of more competition and innovation

The FCA will continue to prioritise firms' treatment of existing customers in 2017/18. It is keen to ensure that long-standing customers are able to take full advantage of the opportunities that increased financial services competition and innovation bring. Planned activities focusing on existing customers across sectors include:

- More work on response to the Competition and Markets Authority's (**CMA**) recent review of retail banking: The FCA will continue its research into measures to improve transparency for overdraft users, improve service information indicators and prompt increased customer engagement. Alignment with the broader CMA remedies package and the FCA's own work on high-cost credit and overdrafts, as well as a new strategic review of retail banking business models (see further the 'Retail lending' and 'Retail banking' sections below), will be key.

- Completion of work on pensions 'wake-up' packs: Linked to its work on encouraging shopping around and switching in the pensions market, the FCA aims to finish looking at how consumers react to 'wake-up' packs sent out in the approach to retirement as a prompt to take action on their retirement income options.
- Maturity of interest-only mortgages: Treatment of borrowers whose interest-only mortgages are approaching maturity (including those due for repayment by 2020) will be looked at in a thematic review in 2017/18 to ensure a fair approach.
- Treatment of customers with long-term mortgage arrears: The number of mortgages with long-term arrears of over five months rose from 49,000 in 2008 to over 61,500 in June 2016. The repossession rate fell significantly over the same period. The FCA is concerned that long-term forbearance may not always be in the customer's best interests and may in fact lead to an increase in debt. This potentially signifies a significant policy shift. It will look at how forbearance is being used by firms to deliver fair customer outcomes in a thematic review to complete by Q4 2018/19.

Consumer vulnerability and access

Putting vulnerability issues on the FCA priorities map

The financial services needs of vulnerable consumers and ease of access to those services is a theme that runs through the Business Plan as one of the FCA's cross-sector priorities. Going forward, understanding vulnerability will be part of the FCA's intervention framework rather than a separate process.

'Vulnerability mapping' will be introduced to identify the relative importance of the FCA's competing priorities to vulnerable customers. This will help it to assess when it could act to prevent harm where it might not otherwise have done so. The initial step in the mapping process will be an information gathering exercise, facilitated by publication of its 'Consumer Approach' in summer 2017. This will set out an overarching FCA strategy for addressing UK consumers' needs to meet its consumer protection objective over the next 3-5 years.

Consumer access issues are linked to the FCA's innovation work on how new products and services could both help vulnerable consumers and increase access to financial services more generally. The FCA wants outcomes which, among other things, see firms developing innovative financial products that are 'clear, easy to understand, and easy to access'. It maintains an emphasis on the fundamental importance of treating customers fairly when taking business decisions that will affect access.

The Business Plan highlights how a number of planned activities within the FCA's sector-based work focus on vulnerability and access issues, for example its spotlight on high-cost credit and overdrafts in the consumer credit sector and planned work looking at customers with long-term mortgage arrears and interest-only mortgages in the mortgages sector (see further the 'Retail lending' section below).

A new duty of care to consumers?

The Mission document acknowledges that there are different views on the merits of introducing an obligation on firms to exercise reasonable skill and care in providing financial services, as set out in its October 2016 'Our Future Mission' consultation. For example, a duty was proposed by the House of Lords Select Committee on Financial Exclusion in its March 2017 recommendations, but feedback on the FCA's Mission consultation included comments to the effect that, when exercised properly, the existing Principles provide an appropriate framework within which firms should operate. The FCA is therefore planning to publish a Discussion Paper to explore the issue as part of a wider Handbook review to take place once the outcome of the Brexit negotiations is known.

Wholesale financial markets

Maintaining clean and effective wholesale financial markets

The FCA is planning the following key activities for 2017/18 in relation to the wholesale financial markets:

- Preventing market abuse through MAR and MiFIR: The FCA will work on embedding the Market Abuse Regulation (**MAR**) and preparing for the transaction reporting regime in the Markets in Financial Instruments Regulation (**MiFIR**).
- Advancing resilience, integrity and competition through MiFID II: The FCA will also prepare for the implementation of the Markets in Financial Instruments Directive II (**MiFID II**) more generally.
- Encouraging competition in investment and corporate banking: Following its market study on investment and corporate banking in 2016, the FCA is continuing the implementation of remedies to encourage competition in the sector (for example by proposing a ban on certain restrictive contractual clauses).
- Overseeing primary and secondary markets: The FCA will adapt its approach to supervising primary and secondary markets by responding to market developments and new regulations such as MAR and MiFID II.
- Effectiveness of primary markets: The FCA will issue final policy statements and may issue further consultations following its review of the UK's primary markets in 2016/17.
- Supervising exchanges and administrators of benchmarks: The FCA will continue to supervise exchanges to ensure that they promote fair, orderly and efficient markets. It will also continue to supervise the administration of benchmarks and the submission of LIBOR.
- Enhanced resilience to technology and cyber risk: The FCA is concerned about the

resilience of firms' systems to cyber risks, especially given the pace of technological change.

- Improved culture, accountability and governance: The FCA has introduced the "5 Questions" strategy for wholesale banks, which are intended to help firms identify and deal with conduct risks.

Investment management

Making competition work and upholding market integrity

A major regulatory issue in the asset management sector has been the outcome of the FCA's Asset Management Market Study, and the FCA's proposals following its forthcoming final report will be a focus for asset managers in 2017.

- Intervention in the asset management sector: The FCA published its interim report on its Asset Management Market Study in 2016. The interim report found that price competition was weak, and that investors may not be clear about fund objectives, and fund performance was not always reported against an appropriate benchmark. The FCA will publish its final report in Q2 2017, and will consult on proposed remedies and interventions.

- Reviewing policy options in relation to fund liquidity: The FCA is concerned about the liquidity management of funds, highlighted by the suspension of open-ended property funds after the EU referendum vote in June 2016. Following its Discussion Paper in February 2017 on illiquid assets and open-ended investment funds, the FCA will review its policy options in 2017/18.

- Custody banks strategy: The FCA will continue to ensure firms meet the standards in the Client Assets sourcebook (CASS), support the PRA's work to evaluate critical infrastructures in firms, assess custody banks' resilience and resistance to cyber attacks, and evaluate the quality of their product governance and controls.

Pensions and retirement income

Embedding pensions reform and assessing competition

The pensions sector has gone through major changes since the UK Government's introduction of pensions reforms in 2015. Much of the FCA's work during the last two years has involved handling the impact of these reforms. The FCA proposals for activities for 2017/18 include the following:

- Encouraging shopping around and switching: The FCA consulted in November 2016 on requiring annuity providers to tell their customers how much they could gain from shopping around and switching providers. Depending on the results of the consultation, the FCA may introduce new rules.

- Assessing the market for non-workplace pensions: The FCA is planning to carry out initial work to find out if the non-workplace pensions market is sufficiently competitive.

- Reviewing non-advised drawdown sales: The FCA launched the Retirement Outcomes Review in July 2016 to assess the impact of pension reforms on competition in the retirement income market. The FCA plans to publish an interim report in summer 2017, followed by the final report at the beginning of 2018. Among the concerns of the Review is the need to support customers who do not get advice on taking drawdown.

Retail banking

Smoothing the path of change for 'consumers' main gateway into financial services'

In a period of significant and rapid change in retail banking, the FCA will concentrate in particular on implementation of core new regulation already in the pipeline in order to reduce implementation risks (eg to consumers and market integrity) by helping firms to embed the required structural changes effectively.

UK implementation of PSD2 remains a priority, along with the FCA's work as an Observer on the Open Banking Implementation Entity. Preparing for ring-fencing will include engaging with the wider banking and payments industry to ensure payments changes made as a result of ring-fencing are well managed. In the countdown to the August 2019 PPI complaints deadline, the FCA will periodically assess how the related communication campaign is performing and make any necessary changes, as well as working with firms on preparation for the new PPI rules and guidance.

A new strategic review of retail banking business models is also on the horizon. The FCA points out that the CMA's retail banking market investigation was limited to services provided to personal current account holders and small and medium-sized enterprises (**SMEs**). It now wants to look at business models across the whole sector to enhance its approach to current and future regulation of retail banks. Work will include examining the impact of free-if-in-credit banking on different groups of consumers. The FCA plans to complete the review in 2018/19. With the potential for new entrants and new business models in this market following the implementation of PSD2, the larger retail banks may have been hoping for a respite from continued regulatory focus on their core business areas as the market adapts to the changes being implemented through the CMA remedies and PSD2.

Retail lending

A watchful eye in the context of increased household borrowing

The Business Plan's Risk Outlook identifies the issue of consumers being at risk of taking on unsustainable levels of debt if affordability assessments do not take account of broader circumstances as one factor that might potentially inhibit the regulator's statutory objective of making the financial services market work well. The retail lending Sector View also identifies the treatment of consumers in financial difficulty (including the overlap with vulnerability) as an area of focus.

The FCA's continued emphasis on its work on high-cost credit, overdrafts and the high-cost short-term credit (**HCSTC**) loans price cap review therefore comes as no surprise. It is eager to examine all high-cost products to be able to make a fully informed decision on any further intervention. It is also pushing ahead with tackling persistent credit card debt, starting with implementation of the remedies set out in its April 2017 consultation. The main thrust of the remedies is to help consumers take control of their finances and avoid long-term debt and related charges.

The regulator thinks there is room for improvement in the mortgage market too, even after the significant change introduced by the mortgage market review. Next steps include an interim report on the current market study looking at consumers' ability to make effective choices in the first charge residential mortgage market, due in summer 2017. It will include any potential remedies. The final report will follow in early 2018. This is in addition to new planned work on issues around the maturity of interest-only mortgages and treatment of customers with long-term mortgage arrears.

Other areas of focus are the debt management sector, point of sale fees and charges and motor finance.

General insurance and protection

Spotlight moves from consumer issues to market structures, incentives and distribution

The Business Plan identifies a general shift in focus towards market structures, incentives and distribution and away from issues directly affecting retail/SME consumers (though the FCA will continue to monitor and review its previous work in this area).

The Business Plan identifies three specific general insurance initiatives:

- Market study on wholesale insurance market: The study will assess how effectively competition is working in the wholesale market, including how firms ensure practices do not create market integrity risks or conduct risks.
  Following publication of the market study in 2018/19, the FCA will consider appropriate remedial actions.
- Value in the distribution chain: The FCA's previous review into delegated authority and outsourcing in the general insurance market showed that insufficient focus and consideration has been given to how the interests of customers might be impacted by outsourcing.
  Accordingly, the FCA intends to conduct a further review to understand the "end-to-end" relationships in the distribution chains. This review is scheduled to complete in early 2019.
- Firms' pricing practices: In September 2016 the FCA published its Feedback Statement on its Call for Inputs on Big Data in retail general insurance.
  Building on this, the FCA now intends to look (during 2017/18) at pricing practices in a limited number of retail general insurance firms to gain a better understanding of how these developments are affecting the market.

  In particular, the FCA will look at how firms' pricing approaches and rating factors work in practice, as well as the drivers and the types of systems and data firms use to decide the final price for consumers.

  Following this, the FCA will consider whether any further steps need to be taken.

The FCA has also identified a number of issues and risks affecting the general insurance sector. Chief among these is IT resilience and the risk that IT failures, data protection issues and cyber-attacks may lead to customer detriment. In particular, the FCA notes that the use of legacy systems and the rise in outsourcing of functions all contribute to a level of complexity that increases the risk of poor consumer outcomes.

Retail investments

Focussing on the implementation of FAMR and MiFID II and assessing the risks from platforms

The FCA will concentrate on the following issues in 2017/18:

- Implementing the Financial Advice Market Review (**FAMR**): The FAMR was launched in 2015 to deal with concerns that the market for financial advice was not working well for consumers. The FCA published a consultation in March 2017 on guidance on streamlined advice, fact finds, and sales that do not involve a personal recommendation. The FCA plans to publish its final guidance later in 2017.

- Carrying out a market study on investment platforms: The FCA is planning a market study to explore whether platforms enable retail investors to access investment products that offer value for money. This will also allow the FCA to study any competition problems in the market.

- Assessing robo-advice: The FCA will monitor developments in automated advice models. Depending on the speed with which this area grows, the FCA may test the suitability of advice given by firms offering automated advice.

- Assessing risks in the contract for differences (**CFD**) market: The FCA issued a consultation paper in December 2016 proposing policy measures to protect retail clients and limit the risks of CFDs. The FCA will publish a policy statement later in 2017. The FCA is also planning follow-up work, focussing on failings in appropriateness tests and on compliance with the guidance on Responsibilities of Providers and Distributors for the Fair Treatment of Customers (**RPPD**).

- Encouraging P2P firms to understand the client assets regime: The FCA wishes to ensure that crowdfunding and peer-to-peer (**P2P**) lending firms are aware of their obligations under the client assets regime. The FCA may engage directly with firms, or review audits and engage with firms' auditors.

Investigations and enforcement

Prevention is still better than cure

The FCA has moved in recent years from a focus on "credible deterrence" to "constructive deterrence". There is much greater emphasis on prevention rather than cure. Indeed, the FCA's firm view is that strong regulation is required to support sustainable growth, so we do not expect concerns about the UK's attractiveness to the financial services sector to lead to a drop in enforcement activity.

As part of the publication of its Mission, the FCA has committed to clarifying its approach to enforcement later this year. It has also confirmed that it recognises that it should not try and create a zero-failure regime, and that customers may suffer loss without anyone being at fault.

The FCA is looking at improving transparency by publishing anonymised examples of where enforcement action has been taken (or not taken).

It will also consult on its use of private warnings later this year.

The FCA's SMCR came into force for banks in March 2016. We have not yet seen any enforcement action under the SMCR, but the FCA will no doubt be keen to show that the regime is having an impact on culture and conduct, ahead of its possible extension to other regulated firms.

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