Implementing the recommendations from the Independent Reviews - update

15 July 2021

Introduction

We are setting out the work undertaken to July 2021 to implement the Recommendations and Lessons from the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc (the Gloster Report) and the Independent Review into the FSA and FCA's handling of the Connaught Income Fund Series 1 and connected companies (the Parker Report). This work should be seen in the broader context of our transformation programme, which we give further details about in our Business Plan 2021/22. We aim to demonstrate:

- **We apply our standards robustly to prevent bad actors entering the regulated sector**: In the year to March 2021, one in six firms which applied to us for authorisation were refused, rejected or withdrew their application after engagement with our Authorisations Division. This demonstrates the robust and holistic approach to our assessment of firms which we are increasingly taking at the Authorisations gateway. Our approach is proportionate to the risks of the firm's business model, as we have demonstrated by the intensive actions we are taking in respect of firms such as cryptoasset exchanges and firms marketing retail contracts for difference.

- **For firms which are authorised, this robust approach should continue through our Supervision and Enforcement functions**. We are taking robust action so that firms which hold an FCA permission use it for the purpose intended, reducing the risk of a 'halo' effect, and that where appropriate we increasingly look at firms' business models holistically. We are embedding our approach to supervising high-risk portfolios of firms and backing it with technology investment to give a single view of the data and intelligence we hold on firms. Our Business Plan shows how we will demonstrate the outcomes we achieve through this approach, by publishing regular performance metrics. For example, we now publish quarterly data on financial promotions: in the first quarter of 2021 alone, 105 promotions were amended or withdrawn as a result of our interventions.

- **We take robust and effective action against fraud and scams:** Across the FCA, our activities to combat fraud and scams are at an unprecedented level. In the year to March 2021, we opened over 1000 supervisory cases involving higher risk investments or potential investment scams. In the same period, there were over 180 cases where we took further action including enforcement action in respect of higher risk investments or potential investment scams (these figures have been updated following review). Nearly 200 firms and individuals are currently under investigation for unauthorised financial business. This level of activity is supported by training programmes, a data strategy and technology investment to support intelligence sharing, overseen by our newly appointed Chief Operating Officer and Chief Data, Information and Intelligence Officer.

LCF Recommendation 1: The FCA should direct staff responsible for authorising and supervising firms, in appropriate circumstances, to consider a firm's business holistically.

In the year to March 2021, one in six firms which applied to us for authorisation were refused or withdrew their application after engagement with our Authorisations Division. This demonstrates the robust and holistic approach to our assessment of firms which we are taking at the Authorisations gateway. Our approach is proportionate to the risks of the firm's business model, as we have demonstrated by the intensive actions we are taking in respect of firms such as cryptoasset exchanges and firms that are inappropriately targeting contracts for differences products at retail customers.

We are taking robust action so that firms which hold an FCA permission use it for the purpose intended, reducing the risk of a 'halo' effect, and that where appropriate, we increasingly look at firms' business models holistically. We are embedding our approach to supervising high-risk portfolios of firms and backing it with technology investment to give a single view of the data and intelligence we hold on firms.

To support this robust approach, we have designed and are delivering a programme of updates and refresher training, to ensure Supervision and Authorisation staff understand when and how to consider a firm holistically. We are also bolstering our Authorisations function with a significant hiring programme in London and Edinburgh to ensure we have the right skills and capacity to deal with the volume of applications processed at the gateway.

Training

2,600 frontline Supervision, Authorisations and Enforcement staff have completed mandatory training on 'FCA Powers and Unregulated Activities', 'Financial Accounting' and 'Business Model Analysis'. We have continued to regularly update and improve training and support for all relevant staff to increase their ability to spot unusual business models and indicators of financial crime.

We are amending our existing policies and guidelines across Authorisations and Supervision to identify the circumstances where Supervision and Authorisation staff should review a firm holistically. We are planning to deliver a rolling programme of updates and refresher training, to ensure Supervision and Authorisation staff understand when and how to do this. This will be a proportionate approach which includes, when appropriate, a review of intelligence (both for regulated entity and their wider groups). We are putting in place guidance for staff, and their managers, to adopt.

We are taking a similar approach when intelligence is received that may affect similar types of firm (portfolio). This is to ensure that where there are any systemic issues we identify, investigate and take appropriate action.

We are currently delivering our new 'How Firms Operate' training to staff across Authorisations and Supervision. This, alongside other existing training, helps staff to consider a firm holistically when developing a Supervision strategy. This will enable us to be more efficient and effective when mitigating harm. We will be rolling out further training in July to support Supervision and Authorisations staff to understand the full range of interventions available to deal with firms which fall short. This training will also help Supervision and Authorisations staff make more informed judgements about the most appropriate intervention to deploy in order to reduce or prevent harm.

Impact of holistic assessment

We have a number of examples of Authorisations taking prompt and robust action to prevent firms either gaining access to the perimeter or expanding the scope of their permissions. These examples include a number of contracts for difference firms inappropriately targeting retail consumers where the risk of harm is high. Authorisations have used available information to form a view of the firm and prevented potential harm to consumers.

The FCA does not regulate cryptoassets, but the law requires cryptoasset businesses that undertake specific activities in the UK to register with us for money laundering and terrorist financing supervision purposes. We identified potential concerns about the activities being undertaken by certain cryptoasset firms when assessing the firms' business models as part of their registration applications, following which, firms have withdrawn their applications for registration. We have also imposed own-initiative requirements on affiliated UK entities where appropriate and issued Consumer Alerts to mitigate consumer harm. We are actively cooperating with international partners on this work, recognising the significant cross-border dimensions of this activity.

'Use it or lose it' pilot

Incorrect or out-of-date permissions increase the risk of harm to consumers as they can mislead consumers about the level of protection offered or give credibility to unregulated activities, the so-called 'halo effect'. We committed to take action to remove permissions for regulated activities that are not being actively used where we consider the out-of-date permissions may cause harm to consumers. Our 'use it or lose it' programme is focused on:

- identifying and intervening against firms that have reported no income from regulated activities for the last 12 months, with a view to these firms surrendering their permissions or demonstrating that they are using them
- and, in a second phase, identifying and intervening in relation to firms reporting activity in some, but not all, of their permissions.

We have completed our pilot. As a result, some firms have already applied to remove or vary their permissions. By mid-July we will have begun contacting our next cohort as well as analysing responses from the pilot. We operate a dedicated phone line staffed by an experienced team who are using the lessons from the pilot to develop training for other staff as we expand the programme.

Use it or lose it will become part of the FCA's existing business-as-usual suite of strategies to cancel the permissions of firms that do not conduct the regulated activities for which they have permission, as well as those that do not pay their fees or that fail to provide required information. The new abbreviated administrative cancellation powers just introduced by the Financial Services Act 2021 will enable us to do this more quickly. This work will also help us incentivise more accurate reporting by firms of regulatory data.

LCF Recommendation 2: The FCA should ensure that its Contact Centre policies clearly state that call-handlers: (i) should refer allegations of fraud or serious irregularity to the Supervision Division, even when the allegations concern the non-regulated activities of an authorised firm; (ii) should not reassure consumers about the nonregulated activities of a firm based on its regulated status; and (iii) should not inform consumers (incorrectly) that all investments in FCA-regulated firms benefit from FSCS protection.

Changing policies

We have changed our Consumer Hub policies which reference non-regulated activities of a regulated firm and Financial Services Compensation Scheme (FSCS) protection. In line with these changes we provided briefings and training to our Consumer Hub staff and reflected these changes in our induction training programmes for new starters and we are in the process of implementing changes to our Quality Assurance reviews.

Quick transfer to the FSCS

We have established a direct transfer process for FSCS enquiries which enables staff to transfer calls directly to the FSCS. All Consumer Hub staff have been trained to direct the caller to the FSCS using the direct transfer process. This gives consumers prompt, direct access to the FSCS. In the period October 2020 to June 2021, we have transferred 382 calls to the FSCS ensuring the consumer receives appropriate information from one call.

We are also reviewing our approach to consumer engagement and have started discussions with the FSCS and the Financial Ombudsman Service to form a 'consumer investment coordination group'. Our aim is to improve the consumer journey to enable consumers to seamlessly contact the agency best able to respond to their query, issue or concern. This initiative will put the consumer at the centre of our processes to ensure prompt and improved outcomes.

Identifying and escalating potential fraud

We have updated our procedures and process guides, and have trained all Consumer Hub staff on when to escalate allegations of fraud and serious irregularities.

Across the organisation, we have trained 3,629 staff to understand financial crime awareness including fraud, revised our Financial Crime Awareness training to specifically include a chapter on Fraud and delivered this to staff across the Supervision and Consumer Hubs of our contact centre. In addition, all frontline staff in the Supervision Hub have received additional training in appropriate questioning techniques to help identify potential fraud and serious irregularities.

There has been a 24% increase in the number of cases referred to our Unauthorised Business Department in the last year. This can be attributed to a number of factors including campaigns such as ScamSmart and Google pay-per-click advertising.

LCF Recommendation 3: The FCA should provide appropriate training to relevant teams in the Authorisation and Supervision Divisions on how: (i) to analyse a firm's financial information to recognise circumstances suggesting fraud or other serious irregularity; and (ii) when to escalate cases to specialist teams within the FCA.

More specialist expertise

In addition to the frontline training in Recommendation 1, we are increasing the number of specialist resources across Authorisations and Supervision to bolster our existing skills in respect of financial analysis. Our prudential specialists assist with making judgements on firms' financial position when required.

Improving financial analysis

The understanding of financial statements and financial analysis is a core skill of our Authorisation and Supervision staff. We have rolled out a Financial Analysis knowledge check which will be completed by end of July, and this will be supplemented with classroom training for those Supervisors who require it.

At the start of the pandemic, Supervision staff completed a financial literacy training programme to boost further their capability. Our financial training programme also includes provision for staff who require advanced financial analysis skills in the form of further classroom training and additional job-related learning. This investment in our Authorisations and Supervision staff ensures they can expertly scrutinise a firm's financial information to identify indicators of serious financial irregularities. We continue to recruit into these important roles to ensure that we have the right capacity in this area.

We are also currently supporting 80 staff to achieve Degree/MSc level qualifications aligned to Financial Accounting/Actuarial or Compliance and Regulation.

Outcomes

These capabilities and expertise helped our response to the pandemic, as we have been monitoring the effects of the economic downturn on firms' solvency by rapidly increasing the financial data we collect on firms. We have used this data to provide more detailed monitoring across the majority of the 49,000 firms we prudentially regulate to give an early warning about weaknesses in their financial resilience. We also undertook regular, detailed analysis of the largest firm's liquidity positions. Getting early visibility of potential financial distress in firms has enabled us to work with firms to help ensure that if they do fail, they do so in an orderly way and minimise harm to consumers and disruption to markets where possible. We have taken action to reduce the harm in failure on over 700 firms since the pandemic began.

We published the results of our financial resilience survey in January 2021.

LCF Recommendation 4: The senior management of the FCA should ensure that product and business model risks, which are identified in its policy statements and reviews as being current or emerging, and of sufficient seriousness to require ongoing monitoring, are communicated to and appropriately taken into account by staff involved in the day-to-day supervision and authorisation of firms.

Ensuring focus on key risks

We have reviewed and strengthened existing guidance to ensure FCA business priorities and harms identified across all FCA business areas are factored into our portfolio reviews. We have regular review points for all portfolios, to ensure new and emerging risks that could cause harm to consumers, are considered in our work.

We identify specific sector priorities through our portfolio analysis. We are reviewing and updating our procedures and processes for sector specific priority product labels on our case management system. This will ensure they reflect our current sector and portfolio priorities, produce Management Information and highlight where trends are emerging. This is on track for completion by the end of July.

We have also recently reviewed all the portfolios across Supervision to ensure that they are appropriately treated within our Authorisations activities to ensure that portfolios that are higher risk receive greater scrutiny at the gateway.

Improving management information

We have further enhanced our capabilities to detect, assess, monitor and take appropriate supervisory action through developing our regular management information, including key risk indicator trends for escalation to senior management within Supervision. These dynamic, interrogative tools allow us to take a more holistic approach, leading to more informed judgements. We continue to make significant investments in this area, ensuring data is valid, timely and accurate. Further enhancements are outlined under recommendation 7.

LCF Recommendation 5: The FCA should have appropriate policies in place which clearly state what steps should be taken or considered following repeat breaches by firms of the financial promotion rules.

Repeat breachers

The FCA has implemented new policies, processes and procedures to tackle repeat breaches by firms of the financial promotion rules.

This new protocol introduces clear and robust descriptions of the point at which firms should be designated as a repeat breacher, along with well-defined immediate actions we take and appropriate escalation routes, across both Supervision and Enforcement.

Our experience in applying the protocol is that firms generally respond quickly and positively to our early interventions requiring them to make changes to, or to withdraw, financial promotions which may not meet our core requirement that they be clear, fair and not misleading.

Repeated breaches are a sign that a firm lacks integrity or is otherwise unsuitable to carry out particular business. Our processes include, for such cases, referral for supervisory interventions such as the imposition of business restrictions and referral for enforcement action.

Our new guide covers both repeat breacher and individual serious infringement policies to bring together these new approaches in one place. This ensures a consistent approach is adopted, with fast-tracking escalation of breaches to firm supervisors and our enforcement teams for action as appropriate.

Supporting our teams

We have provided support to frontline Supervision staff to improve their understanding of the role they have to play when they identify a financial promotion of concern, including when circumstances indicate that a more in-depth review of a firm's business model, finances, strategy, products, services or culture may be appropriate. This practical approach, consistent across all sectors, will enable all Supervision staff to take increasingly confident, consistent decisions about when and how to intervene.

Setting the standard

We have also been taking steps to make our financial promotions regime as accessible and understandable to firms as possible. One example of this is the case studies web page which we published on 9 July looking at car finance firms in the consumer credit sector and claims management companies focusing on social media and website adverts. Whilst these case studies are focused on sectors where historic compliance with our requirements has not been high, we are planning on using this approach in other sectors to educate firms as to what good and poor practice looks like.

New Financial Promotions and Investment Scams Department

We established our Joint Supervision and Enforcement Team to develop and deliver the supervisory strategy for non-standard investments such as minibonds. The team has taken forward or referred for further assessment over 800 non-standard investment financial promotions cases since early 2020.

We have previously reported how we used our powers to bring in and make permanent a ban on the marketing of speculative illiquid securities, including speculative mini-bonds, to consumers and we also banned the marketing of crypto-derivatives to retail consumers. We have now published a Discussion Paper on strengthening financial promotions rules for high-risk investments. This paper builds on our permanent ban and the feedback on our Call for Input regarding the consumer investment market. The Call for Input closed in December 2020. The feedback we received will inform the consultation proposals we intend to publish later in 2021.

We are currently developing and implementing a new strategy for financial promotions that has a more interventionist, data-led and proactive approach, which will seek to identify scams more quickly and stop misleading promotions at the earliest opportunity using the full suite of our powers. This new strategy will be delivered by a new Financial Promotions and Investment Scams Department.

LCF Recommendation 6: The FCA should ensure that its training and culture reflect the importance of the FCA's role in combatting fraud by authorised firms.

Our robust approach to Authorisations, Supervision and Enforcement, as well as the changes we are making to address training and culture, are described in the preceding paragraphs. In addition, we have published our Business Plan 2021/22 which sets out our broader programme of transformation of the FCA to ensure that we are more effective in preventing bad actors from entering the regulated financial sector and in ensuring that firms and individuals which fall seriously short of the required standard exit the sector. Our new Executive Director, Markets, Sarah Pritchard joined us in June, having most recently served as the Director of the National Economic Crime Centre, bolstering our leadership capability and expertise on financial crime.

We have updated the criteria and thresholds for use of our Warning List to alert consumers to potential fraud. We have now updated our organisation-wide Financial Crime training to include a specific chapter about the FCA's role and interest in combatting fraud. All staff have now completed this training. This is an important first step towards achieving our longer-term strategic objective of increasing our role in combatting fraud.

Consumer alerts published by the FCA rose from 573 in 2019 to 1,184 in 2020 and have already reached 808 this year. The Warning List is updated on a daily basis with new warnings we have issued and is available for anyone to search. We have implemented a new fast-track process which enables quicker additions to the FCA's Warning List and where appropriate, now act on a single piece of information where there appears to be a breach. Our target is that 90-95% of warnings will now be issued within 24-48 hours.

The law applying to online financial promotions changed at the end of the Brexit transition period. A broad exemption from the UK's financial promotion regime for ecommerce financial promotions (those constituting the provision of an information society service) made from an EEA State other than the UK was removed. As a result, online platforms now need to have clear regard to the UK's financial promotion regime when they are disseminating adverts for financial services and products to ensure that consumers are not exposed to unlawful promotions.

We have directly engaged with and are taking part in ongoing discussions on the issue with Google, Microsoft and Facebook/Instagram at a senior and working level. This engagement has encouraged all firms to think directly about how they can become compliant with their legal obligations. As a direct result of this work, Google has made a public commitment that it is putting in place tighter restrictions around the placement of financial promotions on its platform.

We have worked directly with Google and Microsoft to enable both firms to subscribe to the Warning List RSS feed. The feed includes a sortable table of unauthorised firms and the ScamSmart tool and updates both firms daily on any new additions to the Warning List to help in their detection of unauthorised and scam firms. We have provided guidance about other sources of information, including how they can best access the Financial Services Register to support the development of firm infrastructure to tackle online harms.

With Facebook/Instagram and TikTok we can now directly request that user accounts which are creating content in breach of our legislation and their policies be suspended.

Further engagement is scheduled over the next month with other key online firms, including Twitter and Yahoo.

We have stated publicly that inclusion of investment fraud in the Online Safety Bill would be a critical tool to prevent consumers being scammed online. This is, of course, a decision for the Government and Parliament.

LCF Recommendation 7: The FCA should take steps to ensure that, to the fullest extent possible: (i) all information and data relevant to the supervision of a firm is available in a single electronic system such that any red flags or other key risk indicators can be easily accessed and cross-referenced; and (ii) that system uses automated methods (e.g. artificial intelligence/machine learning) to generate alerts for staff within the Supervision Division when there are red flags or other key risk indicators.

We are investing more than £120 million over 3 years to support our data strategy, which aims to ensure that we collect the right data and that all data across the FCA are available to drive our actions.

Data dashboards

We have often relied on multiple and different data sources to assess risks at portfolio and firm level. We now have a single dashboard that brings these together in a user-friendly interface that helps our frontline staff make more rapid and holistic firm assessments. We will continue to add risk indicator data to this 'single view' so that they accurately detect the biggest risks to consumers.

We are rolling out this dashboard to our highest risk portfolios in Consumer Investment Supervision and will expand the capability to other FCA functions and portfolios from September.

LCF Recommendation 8: The FCA should take urgent steps to ensure that all key aspects of the DES Programme that relate to the supervision of flexible firms are now fully embedded and operating effectively.

Delivering Effective Supervision

Following an implementation review of our Delivering Effective Supervision (DES) Programme, we developed a comprehensive plan to ensure the remaining deliverables are rolled out and implemented. We have made the following progress to date:

- We introduced the Portfolio Assessment Model for portfolios to provide a consistent framework for the proactive supervision of flexible firms.
- We ensured that portfolios had completed their phase 1 analyses and strategy setting in line with the DES approach and are in the process of embedding our Single View of Portfolio dashboards.
- We have also completed the initial roll out of our Single View of Firm dashboards and are making good progress to implement it in the remaining areas across the organisation.
- We established a capability framework to ensure that staff have the necessary skills and training to complete their role effectively following these changes.

LCF Recommendation 9: The FCA should consider whether it can improve its use of regulated firms as a source of market intelligence.

More user-friendly digital content

We have revised our 'Contact us' web page to make it clearer and more user friendly. The web page is clear in encouraging reports from industry professionals, distinguishing the reports from whistleblowers and specifying how the FCA should be contacted. Our team in the Supervision Hub are trained to receive and consider information provided by industry professionals and have received additional training to cover fraud and firms' business models.

We are identifying all other entry points for these reports across the FCA and how they are used. We will use this knowledge to develop a single channel to ensure consistent handling and so the information can be fed into our supervision of the firm as well as wider data strategies. We will continue to develop an interconnected operating model where this information is escalated when necessary as well as being fed into the Single View of Firm dashboards to further support the holistic view of firms we supervise.

Connaught Lesson 1: Issues were caused by a lack of clarity about the role of operators and other market participants and the nature and extent of the regulatory perimeter.

In addition to the frontline training already mentioned, we launched the next phase of our ScamSmart Investment campaign. The campaign is aimed at warning consumers of the increased threat of clone investment fraud and alerting them to the key warning signs. Consumers are encouraged to visit the FCA's Warning List of firms to avoid and the Financial Services Register of authorised firms.

The FCA and HMRC have also established an ISA Intelligence Working Group to support improved information sharing between the organisations in relation to ISAs and ISA managers. This includes sharing intelligence that we can use to pursue FCA-regulated firms which are flagging as a concern.

Connaught Lesson 2: The Regulator should continue to improve information sharing between departments and its related IT systems and processes.

We have recently appointed a new Chief Operating Officer and, to reflect the importance of maximising our use of data and intelligence to drive better outcomes, the FCA's first Chief Data, Information and Intelligence Officer. These changes are aimed at ensuring the data and intelligence we possess is processed and analysed more efficiently to ensure effective and timely interventions. The focus of this investment is to enable us to be fit for a more digital future, with efficient systems and processes which allow us to maximise the use of our available data.

We have made a significant investment in our technology. In our Business Plan 2020/21, we set out how we would make a further capital investment of £40 million on our technology, in addition to the £60 million we invested in it during the previous year. As a result of this, we will be moving fully into a cloud environment. We are bringing all our data together in a 'data lake' and have invested significantly in bringing in data science expertise. This will help us deliver more effective supervision across the range of firms we authorise.

Connaught Lesson 3: The importance of effective coordination and oversight across different teams.

Our Policy, Supervision and Competition functions have been brought together under two new Executive Directors to build a strong, coordinated regulatory framework. We appointed a new Executive Director of Authorisations who is now overseeing the FCA's Authorisations Division, the gateway for firms and individuals applying to undertake regulated financial services.

The improvements in systems and data are enabling us to move faster to identify firms and individuals who are most likely to cause harm. We continue to strengthen our capabilities in this area through our Single View of Portfolio and Firm dashboards.

We are establishing a stronger surveillance capability to improve how we identify issues, firms and individuals of concern. We know that this approach works well as demonstrated by how we tackle market abuse. We now need to expand and adapt this approach so it can be applied effectively to the bulk of the activity we regulate. This will work in concert with our tougher approach at the gateway so that we ensure we stop firms who do not meet the required standards from entering the market.

Connaught Lesson 4: Continue to invest in and update systems regarding whistleblowers.

We have launched our first whistleblowing external communications campaign 'in confidence, with confidence'. We published materials for firms to share with employees and we will use future events to highlight the campaign and encourage individuals to have confidence to step forward, if they need to. We have also improved the information on our website about our whistleblowing service and the approach we take to whistleblowing, including providing more regular updates for whistleblowers.

We are increasing our engagement with Government, researching the reports published by other regulators and further developing our use of intelligence about firms, including the publication of data and outcomes. We will also be publishing more on whistleblowing in our annual reports.

Connaught Lesson 5: The culture of the regulator.

All actions set out in this update are helping us evolve our culture – how we work with one another, the wider regulatory family and how we work with those we serve. The actions from these reviews are just the start – through our transformation journey, we are making more fundamental changes to our organisation to make the FCA as efficient and effective as possible. These are longer-term objectives, which are at the heart of our vision and transformation agenda.