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FCA Business Plan 2018/19

Our full analysis

OUR FULL ANALYSIS

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Introduction

The FCA's Business Plan and accompanying Sector Views provide invaluable insight into the regulator's forthcoming activities and priorities. TCC's regulatory experts bring you a full analysis of these key publications, along with guidance on how firms should react to the regulator's areas of focus.

In light of Brexit, a prevalent message from the FCA this year concerns its allocation of resources to EU withdrawal, which has required it to make "difficult" decisions about its priorities for the coming year. The FCA is stretched, reinforcing its steer towards thematic and proportionate supervision and explaining the delay in previously planned studies and publications.

Many of the FCA's cross-sector priorities should come as no surprise, with key issues such as culture and governance, transparency and value featuring throughout the plan. However, increased focus on High Cost Credit and Data Security is notable. Furthermore, the FCA's keen interest in the relationships between firms, both in terms of outsourcing and the chain of distribution must be taken into account by all financial services firms.

The financial services industry continues to develop rapidly, with the use of technology within and between firms growing at pace. The FCA is keen to support these developments and the opportunities they bring to customers and to the market. However, its hesitations about the risks associated with technology are emphasised throughout the plan.

While customer vulnerability isn't explicitly included as a priority, as it has been in previous years, the regulator's consideration of how more vulnerable consumers may be negatively affected by firms' activities is at play throughout and is specifically highlighted in the consumer credit space.

The FCA has once again demonstrated its ongoing commitment to transparency, both internally by clearly stating the outcome indicators to measure its own performance, and throughout the industry with a specific focus on consumers' information needs. Relevant wholesale firms in particular should eagerly anticipate the regulator's Approach to Market Integrity document (Q4 2018), which will sit alongside its Mission and other Approach documents.

EU Withdrawal

Preparations for the UK's exit from the EU form a significant proportion of the regulator's activity, with the FCA anticipating that this focus, unsurprisingly, will continue beyond 2019.

Its work will include:

- Providing technical assistance to the government on negotiations with other countries where appropriate;
- Providing technical assistance to the government on any new legislation introduced. The new EU (Withdrawal) Bill will convert existing EU law into UK law and preserve existing UK law which implements EU initiatives to ensure the system remains robust;
- Reviewing the Handbook in light of any legislative changes;
- Advising relevant areas of government on how the future relationship with the EU may impact the financial services industry and its users;
- Assessing the impact of any transitional arrangements on the industry and its users, and taking any appropriate action to mitigate the emerging risks; and
- Working closely with the Bank of England on areas of joint responsibility and the oversight of dual-regulated firms.

The FCA's Cross-Sector Priorities

The FCA has outlined seven cross-sector priorities, which will form its main areas of focus over the coming months. Whilst most of these will be familiar from last year's plan, the addition of High Cost Credit and Pensions should be noted:

- Firms' culture and governance;
- Financial crime and anti-money laundering;
- Data security, resilience and outsourcing;
- Innovation, Big Data and competition;
- The treatment of existing customers;
- Long-term savings, pensions and generational differences; and
- High cost credit.

Culture and Governance

The FCA is continuing its focus on ensuring firms have an appropriate, customer-centric culture and that their business model, governance and strategies are aligned to support this.

The regulator's core focus in this area will be the implementation of the Senior Managers and Certification Regime (SM&CR) for all FSMA firms, which will ensure that key individuals are suitable for their role and held accountable for their conduct and decisions. For insurance firms the regime will be effective from 10th December 2018, with the commencement date for solo-regulated yet to be confirmed. Final rules and policy on how SM&CR will be extended to all FSMA firms will be published in Summer 2018.

The FCA's core activities in this area will include:

- Finalising the SM&CR rules for all firms;
- Establishing a public register in response to industry feedback; and
- Undertaking a review of the remuneration arrangements of firms not subject to the FCA's remuneration code, to identify any harm they may pose to consumers.

The FCA has previously said it will not dictate what a firm's culture should be, but it will examine whether the behaviours it observes are driving appropriate outcomes for customers. For an in-depth view on FCA expectations of culture and how to assess and improve your culture, read TCC's white paper.

Financial Crime and AML

The risk of UK financial services institutions being used to further financial crime and launder money is high and has been a consistent priority for the FCA since its inception. The regulator has a continuous programme of work in train to ensure firms have appropriate controls in place to minimise the risk of being used to further financial crime.

Furthermore, in February of this year, we saw the establishment of the Office for Professional Body Anti-Money Laundering Supervision (OPBAS). This organisation is government established, housed within the FCA and oversees 22 professional body supervisors for AML. Its aim is to ensure a robust and consistent standard of AML supervision across the legal and accountancy sectors and to improve information sharing between regulatory bodies and law enforcement agencies. Across all sectors, the FCA is highlighting the following Financial Crime priorities:

- Build a picture of how capital markets are being used to launder money;
- Review the risks of money laundering and terrorist financing in the e-money sector;
- Undertake work to embed the new Office for Professional Body Anti-Money Laundering Supervision (OBPAS) and improve information sharing and collaboration between professional body AML supervisors;
- Refine its AML supervisory approach to take into account the Financial Action Task Force (FATF) recommendations;
- Raise greater awareness of fraud and scams; and
- Improve its collaboration and intelligence sharing with other relevant agencies.

Data Security, Resilience and Outsourcing

The FCA is keen to assist in the growth and progress of technology in financial services, acknowledging the benefits they can bring to the market and consumers. However, emerging technologies also present significant risks and potential harm if not managed appropriately.

Cyber-attacks are becoming increasingly prevalent, largely due to the use of complex and ageing IT systems, outsourcing of operations and the growing transfer of data between firms. Considering the significant impact this could have on market integrity and consumers, the FCA is focusing on data security within firms and resilience to cyber-attacks. This includes specific focus on the controls around sharing data when outsourcing, as firms are increasingly outsourcing critical services to unregulated providers without implementing appropriate oversight and controls.

The main thrust of the FCA's work is in ensuring firms have the right infrastructure in place to provide resilience against cyber-attacks and service outages. This includes reviewing how culture, governance, risk management and systems architecture contribute to data security, as well as reviewing the risks posed by outsourcing arrangements. From August 2018, the FCA will monitor the roll out of technology as part of Open Banking and PSD2. For outsourced providers, the FCA will specifically be looking at where one provider supports multiple firms, holding increased potential impact.

Innovation, Big Data and Competition

With its work in supporting innovation, the FCA is working towards a regulatory environment which enables consumers and firms to access the benefits and opportunities presented by competition, big data and innovation, while also tackling the potential harm.

This work includes:

- Maintaining the Innovate program and Regulatory Sandbox to enable firms to develop and test new solutions for the benefit of consumers;
- Testing and applying RegTech to its own processes, including the collection and analysis of regulatory returns;
- Reviewing retail banks' business models to identify the core differences between them and emerging banks' business models;
- Reviewing firms use of data to assess the opportunities and threats this may present;
- Introducing new crowdfunding rules to address areas of concern, including for loan-based crowdfunding; and
- Undertaking a joint review of cryptocurrencies with the Treasury and BoE.

Treatment of Existing Customers

The plan refers to the importance of competition for consumers of all sectors, especially those where customer engagement is low (e.g. overdrafts). The FCA is keen for firms to do more for their existing customers to ensure that competition does not put them at a severe disadvantage to new customers.

Its planned activity in this area includes:

— A review of general insurance pricing practices and the impact on consumers. The FCA's first phase will provide it with a better understanding of Retail GI and intermediaries' pricing practices, including how these affect household insurance customers, by reviewing the data and systems used to decide the final price to consumers and the governance and oversight in these firms. Drawing on this work and the Call for Input on Big Data, the FCA is scoping work to assess whether it needs to act to ensure future insurance pricing practices support a market that works well for customers (details to be published in due course);

— The FCA acknowledges that *"Whilst claims management companies can provide access to justice, some firms may not always operate in the consumers best interests".* The regulator is keen to communicate its expectations to claims management companies in advance of it taking over regulation of the sector from the Ministry of Justice in spring 2019. The FCA will also be assessing claims inflation within the GI sector;

— Measures to improve competition in both the cash savings market and current accounts. Retail banks are now required to publish standardised, comparable information on personal and small business current account services; and

— Publishing final rules to enable more SMEs to access FOS.

Long Term Savings, Pensions and Intergenerational Differences

The increased risks introduced through the Pension Freedoms have created a greater demand for customers to be well informed of their options in both accumulation and decumulation. It also calls for transparency and healthy competition between these options. Unsuitable transfers and under-saving for retirement have caused significant detriment to customers and the FCA is keen to address these issues by:

— Delivering those remedies outlined in the Retirement Outcomes Review;

— Collecting and acting upon data on pension transfer practices;

— Understanding the underlying drivers of retirement under-saving; and

— Publishing a feedback statement on competition in non-workplace pensions.

High-Cost Credit

This year's plan places the spotlight firmly on consumer credit, specifically on high cost products. In last year's business plan, consumer credit was grouped in with "retail lending". This year, the FCA has made it clear that whilst mortgages carry the most capital in this sector, consumer credit firms touch many more consumers with a much higher proportion of vulnerable consumers in their remit.

> "The harms caused by high-cost credit products tend to disproportionately affect vulnerable customers who may turn to them in financial difficulty. We have a responsibility to ensure there is a framework of rules that allows consumers access to products and services that are suitable, affordable and right for their circumstances."

The FCA is keen to look at solutions to increase the choice and availability of alternatives to high-cost credit for those who have struggled to find any other option previously. Furthermore, concerns about the quality of debt advice and the long-term sustainability of some consumer credit business models remain high on its agenda.

In Annex 1 of its Business Plan, the FCA provides a useful timeline of the publications expected in the coming year. Two documents which are particularly noteworthy for consumer credit firms are the Policy Statement on Creditworthiness in which the regulator will set its expectations for firms when carrying out creditworthiness assessments, and the Market Study into Credit Information in Q4 2018. This study is based on outcomes of the FCA's consultation on assessing creditworthiness and the quality of CRA information, which showed it to be unavailable and unreliable at times, preventing customers from obtaining products.

The regulator is finalising its review of high-cost products including:

— **Rent to own –** Reviewing charges for add-ons such as insurance which can substantially increase overall costs for customers. The FCA is keen to understand whether customers weigh up the price and value of these products before opting to buy them.

— **Home collected credit –** The regulator recognises that some customers value access to home-collected credit and that weekly repayments on separate loans may not be affordable. However, they are examining whether repeat borrowing could work better for customers.

— **Catalogue credit –** The FCA has concerns about the high levels of arrears for catalogue credit customers, the fees and charges incurred and any related risk of financial distress for customers.

— **Arranged and unarranged overdrafts,** including the monthly maximum charge (MMC). The FCA has concerns about the long-term use of arranged overdrafts at unsustainable levels and the high charges of unarranged overdrafts. Low customer engagement and lack of competition in this space is also a focus.

Sector Priorities

Wholesale:

The impact of MiFID II in tackling conflicts of interest, strengthening transaction reporting and Initial Public Offering (IPO) regimes will be monitored closely by the FCA to assess their effectiveness in upholding a clean and well-functioning market. The regulator signposts the industry to a document to be published in Q4 of this year, outlining the FCA's approach to market integrity.

The FCA's focus for the coming year will include:

- Defining its approach to market integrity;
- Reviewing AML in capital markets;
- Monitoring compliance with its conflicts of interest rules;
- Addressing operational resilience;
- Monitoring compliance with IPO rules; and
- Publishing final rules and approach to industry codes of conduct for unregulated markets.

Investment management

The low interest rate environment drives a "hunt for yield" mentality so it is important investment management firms act as good agents to their investors and as effective participants in the market.

The FCA's focus for the coming year will include:

- Finalising rule changes following the asset management market study;
- Implementing the PRIIPs;
- Consulting on new rules / guidance on liquidity management;
- Considering the extension of governance remedies to with-profits and unit-linked funds;
- Assisting in the development of a new prudential regime for MiFID II authorised investment firms; and
- Researching the increase in passive investment.

Retail Lending

The FCA acknowledges that credit is largely beneficial for many customers but is focused on the harm caused by poor conduct, particularly when more vulnerable customers are affected. The consumer credit sector affects many more consumers than mortgages in the UK (although the value of loans are smaller) and includes a large number of vulnerable customers. Whilst interest rates are expected to remain low for the foreseeable future, a gradual increase in interest rates could see detrimental effects on customers who carry high levels of debt, making the sector particularly high risk.

The FCA's focus for the coming year will include:

- Reviewing the consumer credit market's approach to assessing creditworthiness;
- Conducting a market study on credit information;
- Publishing the interim mortgage market study report;
- Reviewing commission arrangements between credit brokers and other firms;
- Ensuring the debt management industry works well for consumers. The FCA notes that 3% of UK adults used a debt management or debt advice service in the last 12 months and that 19% of these paid for the service. A review is being undertaken to assess whether providers are meeting their customers' needs;
- Reviewing the motor finance market, including its commission structures and creditworthiness assessments; and
- Reviewing the consumer credit act provisions.

Pensions and Retirement Income

Consumers are enabled to make suitable decisions to fund their retirement when they have access to *"good quality, value-for-money retirement products"* and are well informed through appropriate advice or guidance. The FCA is keen for the industry to understand its role in the pension sector and will achieve this by:

— Creating a joint pensions strategy with The Pensions Regulator (TPR);

— Potentially extending the remit of Independent Governance Committees (IGCs) for workplace pension schemes; and

— Helping consumers avoid scams by, for example, working with the Treasury and Department for Work and Pensions on legislative measures such as a ban on pension cold calling.

Retail Investments

The FCA states that investment advisers must be *"appropriately incentivised when recommending products to their customers and the distribution chain should be free from conflicts".* With this in mind, its focus for the coming year will include:

— Assessing FAMR and RDR impact;

— Reviewing high-risk and complex investments;

— Evaluating ongoing interventions on contracts for difference;

— Publishing an investment platform market study report; and

— Raising consumer awareness of scams and fraud.

Retail banking

Along with the impending implementation date of ring fencing in January 2019, the implementation of PSD2 has brought new challenges and new service providers under the FCA's remit. With this in mind, the regulator will be focusing on:

— Helping firms prepare for ring-fencing requirements;

— Developing a payments sector strategy;

— Delivering PSD2; and

— Ongoing PPI claims deadline awareness campaign.

GI and Protection

With priorities centred on fairness, access and value for retail customers and an effectively functioning wholesale market, the FCA's focus for the coming year will include:

— Implementing IDD;

— Publishing the interim wholesale insurance brokers market study report;

— Initial diagnostic work on GI distribution chains. The FCA is reviewing how the charges that customers pay divides up between the various parties in the chain and can affect the value of insurance product customer services;

— Publishing findings from Call for Inputs on access to travel insurance; and

— Evaluating the effectiveness of the 2015 GAR rules.

Other key themes

Relationships in the distribution chain and their implications

Throughout the plan, the FCA has shown a keen interest in distribution chains and their implications for customer outcomes in terms of value and conflicts between customer interests and commission.

Conflicts

The FCA is reviewing the commission between credit brokers and other firms to see whether the inter-firm payments influence the credit products which are offered and how they are sold (to be published towards end of 2018).

Cost vs Value:

- The FCA is keen to assess the costs associated with different elements of distribution chains and how this accumulates to the total cost for the customer.
- The FCA has published a CP which seeks views on whether it should intervene in charging structures for pension transfer advice.
- The FCA is reviewing pricing practices in GI, focusing on retail GI and intermediaries' pricing practices.
- The FCA is reviewing the value for money of investing through a platform and whether customers understand what these portfolios offer.

In order to respond appropriately, firms must ensure they have clear agreements with all third parties they interact with and outsource to. This includes data protection agreements taking into account GDPR, customer care / conduct standard agreements and clearly documented responsibilities for each party. These agreements must then be monitored though effective oversight.

Furthermore, firms must review their distribution chains, clearly mapping the customer journey and seek to eliminate any conflicts, e.g. unnecessary charges for the customer incurred through the chain for the profitability of parties involved.

Again, the focus on remuneration and commission, their influence on employee behaviour and their implications for fair customer outcomes remains dominant in the FCA's agenda. Firms must be confident that how they generate profit and how their employees are incentivised does not jeopardise the integrity of the market and the interests of their customers.

SM&CR

Although we cannot confirm an implementation date, or assess the final guidance until later this year, all firms are able to begin preparations for the regime. The mapping exercise of key roles and responsibilities within a firm is by far the most onerous exercise of the process and we recommend that firms begin this as soon as possible. This will allow firms to identify any gaps or overlaps in responsibilities, expertise or resource and will allow firms to remedy these prior to implementation.

General Data Protection Regulation

The FCA's focus on Data Protection and resilience is not surprising considering the impending GDPR implementation date of May 25th 2018. Whilst the regulation will fundamentally be the responsibility of the Information Commissioner's Office, its importance (pre and post EU withdrawal) should not be taken lightly. Again, the exercise of mapping the data firms hold and documenting the reasons for holding that data is the first step in achieving compliance.

How should firms respond to the business plan?

Firms can no longer afford to look at their sector in isolation. Issues which were once thought to be sector specific (e.g. remuneration in consumer credit, value in advice etc.) are now being applied across the board. For example, after the lessons learned looking at remuneration in consumer credit, the FCA will be reviewing the remuneration practices of firms across the industry to assess any potential harm they could cause to customers. Nor can firms just look at the regulated part of their business.

> "We have powers to act outside the perimeter in certain circumstances. We will be more likely to do this when the unregulated activity could potentially undermine confidence in the UK financial system or have an impact on a regulated activity. Where we decided we cannot or will not act, we will publicly explain why and for example, raise the matter with other bodies or regulators who are better placed to deal with it or the government".

This is particularly relevant for consumer credit firms whose regulated business only makes up a small proportion of their business.

How can we help you?

To discuss the FCA's forthcoming plans and the implications for your firm in more detail with one of our experts, get in contact now.

Find out how we can help

For help or information on any of our services please call us on 0800 970 9754 follow

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