'A PRACTICAL GUIDE FOR THE C-SUITE'

Outcomes Focused Regulation Unwrapped

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> We need to focus even more on defining the right outcomes, we need to measure them even more and we need to act on the results even faster. That way we will be able to prioritise where we focus our resources even more effectively against the sources of harm that need the greatest attention.

Charles Randell Chair FCA and PSR

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INTRODUCTION

The Financial Conduct Authority (FCA) Outcomes Based Regulatory Strategy

If you have read any guidance, discussion or consultation paper the FCA have published in recent years, you may will have noticed a change in direction and tone. The City watchdog seems to have woken up and realised that products and advice suitability assessments are still not fully delivering the good outcomes that is so craved by the regulator.

You only have to look at Treating Customers Fairly (TCF) principle to see that stipulating what you want is very different to regulating and gaining the results you expect. The TCF Principal came into force in 2001 and requires that ' a firm must pay due regard to the interests of its customers and treat them fairly'. By 2007, the then Financial Services Authority (FSA) felt it had to introduce six consumer outcomes to provide more controls to influence better results. Indeed we now have the forthcoming Consumer Duty which is far more comprehensive than TCF ever was.

In his **May 2021 speech Charles Randell FCA and PSA Chair** stipulated given the above, it is clear rather than produce a piece of outcomes focused regulation, the regulator reverted back to measuring and assessing inputs rather than customer outcomes. Indeed Randell stipulates that after 15 years, 'we are still trying to measure suitability of advice and still finding that, despite the Retail Distribution Review and the increased professionalism that it required of the industry, some advisers are still falling short of our expectations, particularly on pension transfers, with the risk all too often falling back on the Financial Services Compensation Scheme (FSCS).'

This showcases that the regulator now needs to gain focus and define exactly what outcomes it wants to see, measure them and act on the results. This could be why **the FCA 2021/22 business plan** heavily focuses on data led regulation. In a drive to be more innovative the FCA has seen a 200% rise in the volume of data received and observes that financial services are increasingly becoming more data-led. In particular the FCA will focus on:

- **Becoming a data Regulator** – over the next 5 years, the FCA intends to focus its resources on improving its data and technological capabilities (earmarking £120 million to spend over the next 3 years).
- **Intelligence and information** – changing how the FCA identifies and acts upon information received to improve anticipation of potential issues, and remove harm more quickly once identified.
- **Sandbox applications** – the FCA will be opening its Sandbox to applications year-round and making the Digital Sandbox permanent.
- **Digital marketing campaign** – the market has seen a high rise of young people's interest in cryptocurrency, which has highlighted a need to have the right controls in place. The FCA will be creating an £11m digital marketing campaign to warn investors of the risks.

So, this means we have a new era for a more assertive, adaptive and agile regulator in its quest to enforce outcomes-based regulatory framework. This will only be effective if firms understand and adopt an outcomes approach themselves, something this paper explores.

WHAT IS OUTCOMES-BASED REGULATION?

At **Model Office-MO®** we are constantly championing the role RegTech takes in moving firms away from ‘checklist and tick-box’ compliance towards a more holistic approach which measures a firm’s governance, risk and compliance (GRC) practice against desired outcomes across all regulatory requirements. In other words our technology assesses where firms believe they are against where they actually are!

The FCA are now wanting firms to take a close look at their business practices, processes and outcomes. This involves a heavy focus on evidence-based practice, i.e. a move from ‘do we think this is true’ to ‘do we know this is true’. This involves firms measuring the soft facts along with hard facts, so competence and conduct come into the equation and building on the good work they have completed for **The Senior Managers and Certification Regime (SM&CR)** for instance. This means a cultural review across a firms activities in relation to the on-going management of their clients ongoing needs and preferences.

Figure 1 The Regulatory Principles

Adaptive	Shift from regulation and forget to Iterative, responsive approach.
Outcomes based	Results and performance based rather than defining a way thus freedom to choose strategy.
Risk Weighted	Shift from one size fits all to data driven segmented approach i.e. risk evaluation.
Collaborative	Align regulation nationally and internationally by engaging broader set of players.

Figure 1 illustrates how the Future Regulatory Framework – FRF will delegate considerable authority to the FCA (and PRA) with the UK government setting out the framework.

The aim is to enhance transparency and accountability to parliament, HMT and other stakeholders along with providing a framework to move from narrow focus on rules to a more comprehensive outcomes and collaborative focus.

This potentially means firms will have more flexibility on designing services and products, with the end consumer needs central to the proposition.

The stated aim of the FRF is to adopt a comprehensive Financial Services and Markets Act (FSMA) 2000 model replacing EU law on shored post **BREXIT.**

Indeed the SM&CR three tier structure is a great example for outcomes-based regulation in action:

1

The Senior Managers Regime: the most high-profile part of the regime and its aim is to cover only those individuals who have real responsibility, so it is much more focused than the Approved Persons Regime (APER) that it replaced.

a. The Senior Management Functions (SMFs) provide a controlled function that holds Senior Managers to account against their roles and responsibilities
b. Statements of Responsibilities (SoR) make clear what a Senior Manager is responsible and accountable for. The FCA's desire[1] is to have succinct, clear and accurate SoRs, which reflect individuals' accountability and responsibilities, and it feels that a 'guiding principle' would be beneficial to the introductory text to be used when designing SoR
c. The Duty of Responsibility means that, in the event of a breach, the Senior Manager is held personally accountable if they did not take reasonable steps to prevent or stop the breach
d. Prescribed Responsibilities are specific performance-based responsibilities defined in **SYSC 24** that a Senior Manager must be given

2

The Certification Regime: Requires firms to identify employees who might cause 'significant harm' to customers and markets and assess them as fit and proper. This means that it is the firms themselves who are accountable and obligated to self-regulate and ensure that they have the right policies and procedures in place to assess this and prevent any harm occurring.

3

The Conduct rules: Provide a two-tiered outcomes focused approach to manage individual and Senior Manager conduct

[1] FCA (2018) Senior Managers and Certification Regime: Proposed guidance on statements of responsibilities and responsibilities maps for FCA Firms. GC18/4.

CULTURE AND REGULATORY INTERVENTION

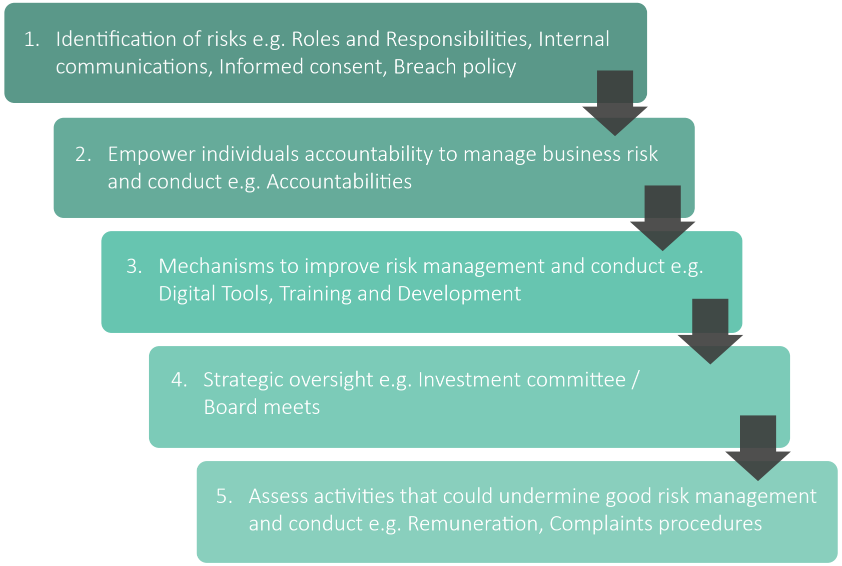
Regulators have placed what we call **Constructive culture** front and centre of their agenda since the 2008/9 financial crises. **The SM&CR, Vulnerable Customers,** **Operational Resilience** and **Consumer Duty** are clear examples of encouraging a culture of accountability, alignment and affiliation.

The pandemic has also shown that the FCA want firms to move away from checklist compliance to embedding the principles behind regulations in figure 1. Figure 2 showcases the core components for culture drivers and the FCA view good cultural attributes as openness, learning from mistakes and challenge.

With the latest **Environmental Social and Governance (ESG)** rules we also see a need for firms to embed corporate social responsibility at the heart of their cultural development.

Figure 2 FCA 4 Drivers of culture

Figure 3: The FCA 5 conduct risk questions



Firms have several levers to create effective cultural change and good conduct (behaviour). **The FCA's excellent 5 conduct risk questions** is the best framework we have seen for firm's to assess their firm's risk management culture.

Behavioural change is at the centre of this and outcomes focus regulation brings an evidence-based approach where firms must prove they are walking their talk. By employing RegTech firms can prove they are complying by;

- Using behavioural science to guide incentives and cultural change
- Applying strategic focus to the continuous process for adapting culture
- Fostering environments of trust to encourage openness and learning
- Applying a systems perspective in assessing both internal culture and external influencers
- Gaining data and an audit trail across the firm's conduct and competence to provide evidence for strengths and areas to improve

The FCA whistleblowing allegations statistics are very telling when it comes to culture, conduct, competence and outcomes. Figure 4 shows us that it is behaviours, skills, TCF and culture that are driving allegations.

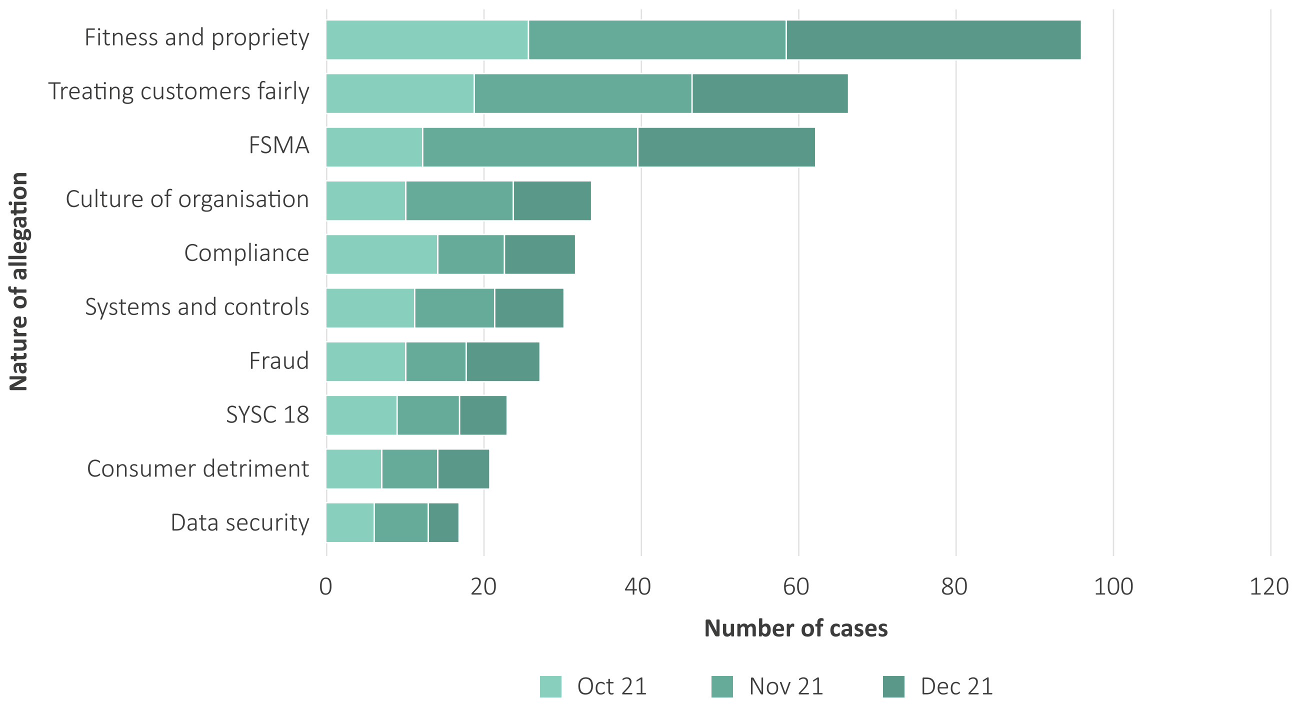
Diversity and inclusion (D&I) and ethics are essential for strong governance and ensuring firms deliver on their outcomes purpose and culture.

This plays to the SM&CR where the Senior and middle managers need to succeed as constructive culture carriers and leaders. So an outcomes focus, the performance of the business against the regulations and client needs is central to culture.

RegTech can facilitate the measurement of these outcomes and cultural growth within the business.

This can move the industry from the limits of law and enforcement and corresponding regulations where a collection of strategies is aimed to deter misconduct, to a data driven framework focused on good outcomes to influence behaviours (conduct) and skill sets (competence) positively through evidence-based practice.

Figure 4 FCA Whistleblowing quarterly data 2021 Q4



Source: FCA whistleblowing data

DEFINE HOW YOU ARE MEETING OUTCOMES

A good question to ask across your regulated services and products is; 'why are we doing this?' Your firm needs to be clear about what outcome your advice processes are trying to and are achieving in meeting your client needs and preferences.

A good place to start is assessing client preferences, across short medium and long-term incorporating risk assessment and capacity for loss. This can then drive your **product governance requirements (PROD)** which in turn influences client segmentation service and product strategy. You can see from the below table, our version of a service segmented strategy that will aid good client outcomes and meet regulatory requirements.

By segmenting by the individual client journey and incorporating client behaviours, preferences and sensitivities, firms can ensure they have a good chance of defining good outcomes with the right services, products and costs meeting client ongoing needs.

Table 1: Client service and product segmentation

Segment	Sub-Segment	Investment Solution	Platform Selection	Advisory Service	Cost £	
					Initial	PA
Young Accumulators	Job starters	Savings acc, LISA	Simple low cost	Light Touch, Tech, Sustainability		
	Young Execs	ISA	DFM	Standard, Tech, Sustainability		
Runway to Retirement	Employed	DC, Auto Enrolment	CIP/Model Portfolio	Standard, Advanced. Sustainability		
	Self-Employed	PPP	Discretionary	Light/Standard Sustainability		
Retirement Income	Low/No Income	CRP	CIP	Standard, Sustainability		
	High Income	Growth	Invest/Annuity	Cashflow/Bespoke, Sustainability		
Vulnerable	Mental Physical	Protected	Invest/Withdrawal	Tailored Sustainability		

HOW TO ADOPT A FOCUSED BASED APPROACH

Adopting an outcomes-focused approach means orienting your organisation to achieve outcomes – the results of your activities. A focus on outcomes helps organisations prove to stakeholders (including their regulator) that what they are doing is working. More importantly, it also helps organisations improve what they are doing, by being armed with better information about what is working and what is not.

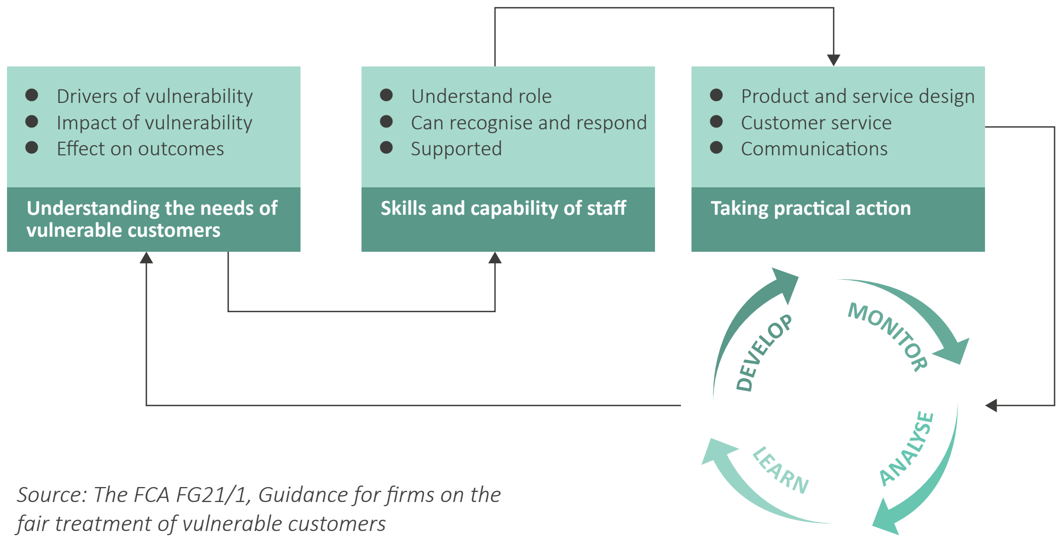
So rather than shift through the regulations at outset, a logic model could be adopted which can support evidence-based decision-making about the best way to address an issue. This model uses a statement of intended consequence (if we do X, we can achieve Y) for example offering regular client reviews will mean you are gaining their engagement and also meeting MiFID II suitability requirements.

A logic model can define and visually represent the outcomes that will happen as a consequence of a firm's activities. The model identifies the intended causal links between the activities and the short, medium and long-term outcomes. The various elements, and the causal links shown between them, articulate your theory of how change will happen. Once you have developed a logic model, you should gather evidence by measuring and analysing data to test that your theory works in practice, and what, if anything, needs to change to achieve the desired impact.

A logic model can support evidence-based decision-making about the best way to address an issue. It can be used to describe the theory of how change will happen for one programme, a group of programmes, or an entire agency or non-government organisation. Logic models can also be used to represent your theory of how to respond to a particular issue, or how to support a particular cohort. The right diagram shows activities firms need to take to achieve good outcomes for **vulnerable customers**, incorporating; **their needs, staff skills and capability, responding to needs and continuously monitoring and assessing**.

This mapping of client needs to service activities, can also be benchmarked back to the above client segmentation strategy, so firms can use a logic model and segmentation strategy to ensure the PROD requirements are met and test whether clients are receiving suitable advice and appropriate products and services. There is no 'one way' to represent a logic model – the test is whether it is a logical representation of the programme's causal links. Below is an example logic model for providing suitable investment advice.

Figure 5: Vulnerable customers logic action approach



Source: The FCA FG21/1, Guidance for firms on the fair treatment of vulnerable customers

Table 2: Advice suitability outcomes focused logic model

	What	Example Outcomes	Regulations
Issue	**Advice Suitability**	**Investment in client best interests**	**COBS 2.1.1R**
Evidence	Client File	Audit programme, Record keeping meets systems and controls	SYSC 9
Activities	Advice process	Fact find, ATR, CFL, Research, Suitability report, Client Agreement, follow regulatory good practice	COBS 9.2.1/2R PROD 3.3.1R
Outputs	**Delivery**	**Informed consent attained and evidenced**	**COBS 4.2.1R**
Outcomes	Immediate	Client is happy with their portfolio risk, cost	COBS 2.2.1R
Outcomes	Intermediate	Client is confident and engages in on-going reviews	COBS 9A.3.3UK
Outcomes	Long-term	Client becomes an advocate and refers on	COBS 9A.3.3UK
Impact	**Needs/objectives**	**Achieve lifestyle and planning goals**	**COBS 2.1.1R**

Define the issue: Clearly allocating a regulatory directive is important as this will focus compliance strategy on the regulatory challenge, stakeholders effected and benchmarked against the individual rule(s).

Evidence: Resources that provide evidence for compliance need to be included and will sign post any shortfalls or good performance against the regulation(s).

Activities: Describing and logging the actions that effect the outcomes is imperative as they have a direct impact on the quality of outcomes delivered

Outputs: Identifying the direct deliverables of activities will breakdown the items (documents/products/services/revenues/profits) that contribute to achieving outcome(s)

Outcomes: Are the measurable results of the outputs and create meanings, relationships and differences i.e. the Why.

Impact: This is the effect your actions, activities have on your stakeholders (clients, regulators) It could be wise to start with the impact first and work the logic model back from there.

Four principles for identifying outcomes

A firm will need to ensure they are identifying their client outcomes and that they meet ongoing regulations. A good strategy would be:

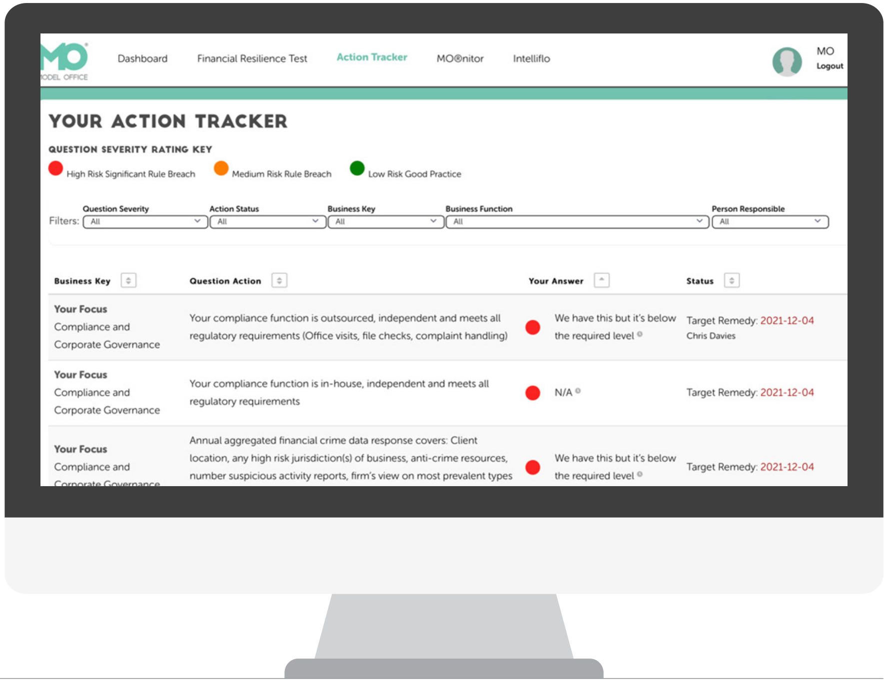
1. Come together as a team: Engage the compliance team and senior management in identification of outcomes
2. Consequences do not all happen at once: Therefore we have outputs and outcomes in the logic model. Immediate results may be termed as direct deliverables or outputs. Short, medium and long terms consequences are the outcomes
3. Consequences can be positive or negative or both: Being open to identifying positive and negative consequences is crucial to ensuring integrity of the resulting outcomes
4. Be exhaustive: It is important to identify as many consequences as possible that may arise from the logic model, including those that are indirect or tangential. So taking a comprehensive approach is likely to yield a sound and holistic logic model benchmarked to the regulations. An exhaustive list of outcomes will contemplate outcomes across all client needs and preferences.

Action tracking your outcomes

One of the most effective ways to track performance against the FCA outcomes strategy is to build a dynamic action planning system that can track activity, behaviours and decision making against the preferred results, outcomes and performance for business services and products.

Model Office-MO®'s automated action tracker software builds an automated and integrated action planning system based on an outcomes focus. This means firms can assess where MO®s algorithms score them against the regulations and evidence actions to ensure outcomes and good practice results are met. Action tracking aligns with the above logic model in assessing firm activities against regulations and their outcomes. Calendar alerts, Management Information and Data is then provided to showcase firms and their staff are making the right decisions based on the FCA consumer protection and good outcomes regulatory framework.

Figure 6 Model Office Action Tracker



SUMMARY

Benchmarking your outcomes

At the heart of **Model Office's RegTech** is the algorithm that assesses a firm's compliance teams subjective belief on where they stand against the regulations and benchmarks this against the outcomes the regulators rules demand.

This means compliance teams receive heat mapped dashboards and data analytics proving evidence on trends and themes that the compliance team need to improve, areas they are performing well and signposting for strengthening GRC activities and strategies.

This is important, as behavioural science tells us, bias and noise can get in the way of decision making (e.g. regulation, interpretation and application) and this can provide a negative effect in a principles based, and outcomes focused regulatory framework. So the ability to benchmark means compliance professionals can sense check the decision making via algorithms and gain a four eyes approach to compliance risk management.

Using audit benchmarking RegTech applies the logic model in evaluating the compliance officers understanding of each regulatory issue across the regulatory outcomes and map each rule as it applies.

The algorithm will then assess if the officer's answers are at the right standard to meet regulatory rules and their outcomes. This provides outputs for MO's Action Tracker system that bring the outcomes to life and delivers valuable data for compliance professionals and their team to improve their outcome performance where necessary.

It will also apply the four principles for identifying the outcomes the firm's clients are experiencing across its services and products and if they match the FCA gold standard for good practice, constructive culture and firms are taking 'reasonable steps' to ensure good outcomes are attained.

By employing RegTech, firms will gain the data, audit trails and evidence they need to illustrate they are embedding outcomes focused regulation into their GRC and move away from tick box, checklist driven practices.

To learn more on how Model Office-MO® can help, contact us on info@model-office.co.uk

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