GUIDANCE NOTE

AN INTRODUCTION TO Developing a Risk-Based Approach to Financial Consumer Protection Supervision

DECEMBER 2022

WORLD BANK GROUP

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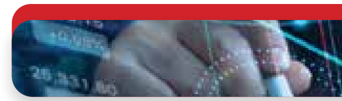
Contents

FIGURES

TABLES



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Abbreviations and Acronyms

FCP	financial consumer protection
FSP	financial service provider
RBS	risk-based supervision

How to Use this Note

This Guidance Note is intended to serve as an introductory guide on key elements to be considered by financial sector authorities (Authorities) when implementing a financial consumer protection (FCP) risk-based supervision (RBS) framework or adapting an existing supervisory framework to include RBS. These key elements are discussed by exploring questions that Authorities will typically need to address when initiating FCP RBS development. Such questions will also be pertinent for RBS implementation on an ongoing basis, as the answers to those questions are expected to evolve and change with time as FCP RBS frameworks continue to be enhanced.

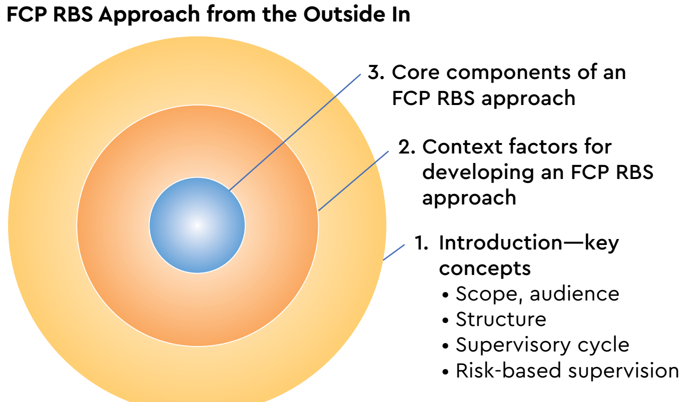
This Note is not intended as a comprehensive one-size-fits-all guide on FCP RBS. Developing such a guide would not be realistic considering the adaptations and customizations required for each Authority and country. Rather, this Note seeks to provide a higher level, practical, guided tour of the key issues, constraints, and decisions that Authorities will usually find themselves dealing with, particularly during the initial stages of developing an FCP RBS framework. The Note aims to facilitate the awareness and management of key issues without dictating predefined solutions, so that readers will better understand the issues and potential approaches to choose from.

The Note is written with particular consideration for the potential needs and context of Authorities implementing FCP RBS in emerging markets and developing economies. Different authors may of course choose different ways of elaborating on the issues it explores, since ultimately there is no single and standardized methodology to guide or describe FCP supervision or RBS.

A key insight that informed the structure of this Note is that the many choices to be made while implementing an FCP RBS framework are interconnected and should therefore be considered holistically. This holds especially true for the core components of an FCP RBS approach. The Note therefore presents discussion of relevant elements for developing an FCP RBS approach "from the outside in."—i.e. starting with an introduction of key concepts, moving on to a consideration of the context in which RBS is being implemented, to ultimately a discussion of its core components. (See figure 1.)

- **Introduction:** The Note first discusses some key concepts, including introducing the supervisory cycle that underlies any FCP RBS approach and the concept of RBS.
- **Context factors:** These are the factors that are not embedded into RBS itself but have a strong impact on how the RBS approach will be formed and developed from a practical and operational perspective, thus requiring an Authority's awareness and assessment.
- **Core components:** These are the supervisory processes and tools that make up the fabric of an FCP RBS approach. They are presented in a way intended to facilitate an Authority's understanding of them and to highlight the advantages and limitations of the processes and tools.
- **For ease of comprehension, readers are encouraged to read through the Note sequentially to first gain awareness of relevant context factors before moving to the core components**

FIGURE 1 Considering the Key Elements of Developing an FCP RBS Approach from the Outside In



of an FCP RBS approach. Each step is linked to the previous one. The core components of an FCP RBS approach are also presented in a suggested logical order of implementation.

In practice, the context factors and core components will often be considered in parallel and will always be subject to further development as supervisory activities naturally evolve. Developing an FCP RBS approach is not a static exercise, but an ever-evolving activity. For example, the legal and regulatory foundation for FCP supervision could alter over time as a result of a successful FCP RBS approach. Also, the data position of supervisors will need to be reevaluated periodically, even continually.

Considering the wide array of possible RBS methodologies and supervisory tools, this Note addresses select issues deemed of more immediate relevance with greater detail and examples. Where possible, the Note provides additional references for further elaboration on various issues. Although crucially important for an effective FCP RBS approach, additional elements such as risk-mitigation efforts are not discussed in detail in order to maintain focus on those issues of greater relevance during the early stages of FCP RBS implementation.

1 Introduction

Financial products and services play a significant role in enabling consumers to build their resilience, seize opportunities, and meet essential needs but consumers also face risks when engaging with such products and services. This is due to a range of factors, including information and power asymmetries and abusive or overly aggressive market practices.

Although an ongoing effort, over the past decade significant progress has been made around the world to strengthen FCP regulatory frameworks. Policy makers have been incorporating a broader range of regulatory approaches to protect consumers from inappropriate market practices, assist consumers to make better-informed decisions regarding the use of financial products and services and ultimately achieve better outcomes for consumers.

However, such regulatory frameworks must be operationalized, including through supervision, to be effective. Authorities are increasingly turning to the task of developing appropriate supervisory processes and frameworks to monitor and implement FCP regulation effectively and foster compliance across the financial market as well as good conduct and consumer outcomes more generally. Undertaking FCP supervision can be a daunting task given the wide range of financial products, providers, and issues to be considered, combined with limited supervisory capacity and resources.

Many Authorities are seeking to develop an RBS approach specifically for FCP. RBS is an approach developed previously by prudential supervisors as a way to make more effective decisions in supervisory planning and promote the more efficient use of limited supervisory resources. In summary, RBS generally refers to a forward-looking, structured process aimed at identifying the most critical risks on which to focus supervisory efforts, including by understanding and assessing the adequacy of relevant risk management systems in place at the level of supervised financial service providers (FSPs). While RBS in a prudential context generally focuses on an assessment of risks from an FSP perspective, RBS in an FCP context assesses risks not to FSPs, but to financial consumers, a very different focus, requiring an appropriately adapted form of RBS.

Unfortunately, very limited international literature has been developed on this topic to date. Authorities, particularly those in emerging markets and developing economies, are therefore left with little public guidance on how best to develop and implement FCP RBS processes that are appropriately tailored to their legal, regulatory, and institutional contexts.

This Note seeks to assist in addressing this critical knowledge gap by providing introductory guidance on key issues, constraints, and decisions that Authorities should consider when establishing RBS for FCP. Given the need to customize RBS models to the characteristics of each country and its existing supervisory infrastructure, this Note does not specify predefined solutions but provides Authorities interested in implementing an RBS model with an overview of various matters to be considered when designing a tailored RBS approach, with the aim of assisting the planning and development of a context-appropriate approach. A range of practical examples are provided as illustrations.

1.1 SCOPE AND INTENDED AUDIENCE OF THIS NOTE

Although this Note may be useful for any reader interested in FCP and RBS, its content is targeted at supervisors who have the task of *developing* an FCP RBS framework or *adjusting* an existing FCP supervisory framework accordingly. It is not intended as a comprehensive guide to conducting FCP RBS. The Note provides both a holistic and a practical view of situations and alternatives that supervisors need to consider when making their first design decisions with regard to FCP RBS. The Note is relevant both for Authorities responsible only for FCP supervision as well as Authorities undertaking prudential and FCP supervision in parallel.

The most successful RBS strategies observed by the authors tend to entail the initial development of relatively simple but conceptually well-defined risk-based supervisory processes, which over time pave the way for the implementation of more sophisticated structures. For this reason, the Note focuses on basic and preliminary elements that may not otherwise receive sufficient attention and does not seek to cover more complex issues to be considered down the line in an RBS context, nor does it seek to cover more specific financial product or provider angles. For example, although new technologies are continually altering supervised products and supervisory tools, a discussion of risks specific to digital financial services and fintech products is beyond the scope of this Note. However, it is noted that this risk dimension would be a strategic consideration for any type of FCP RBS (or in fact any FCP supervision regime).[1]

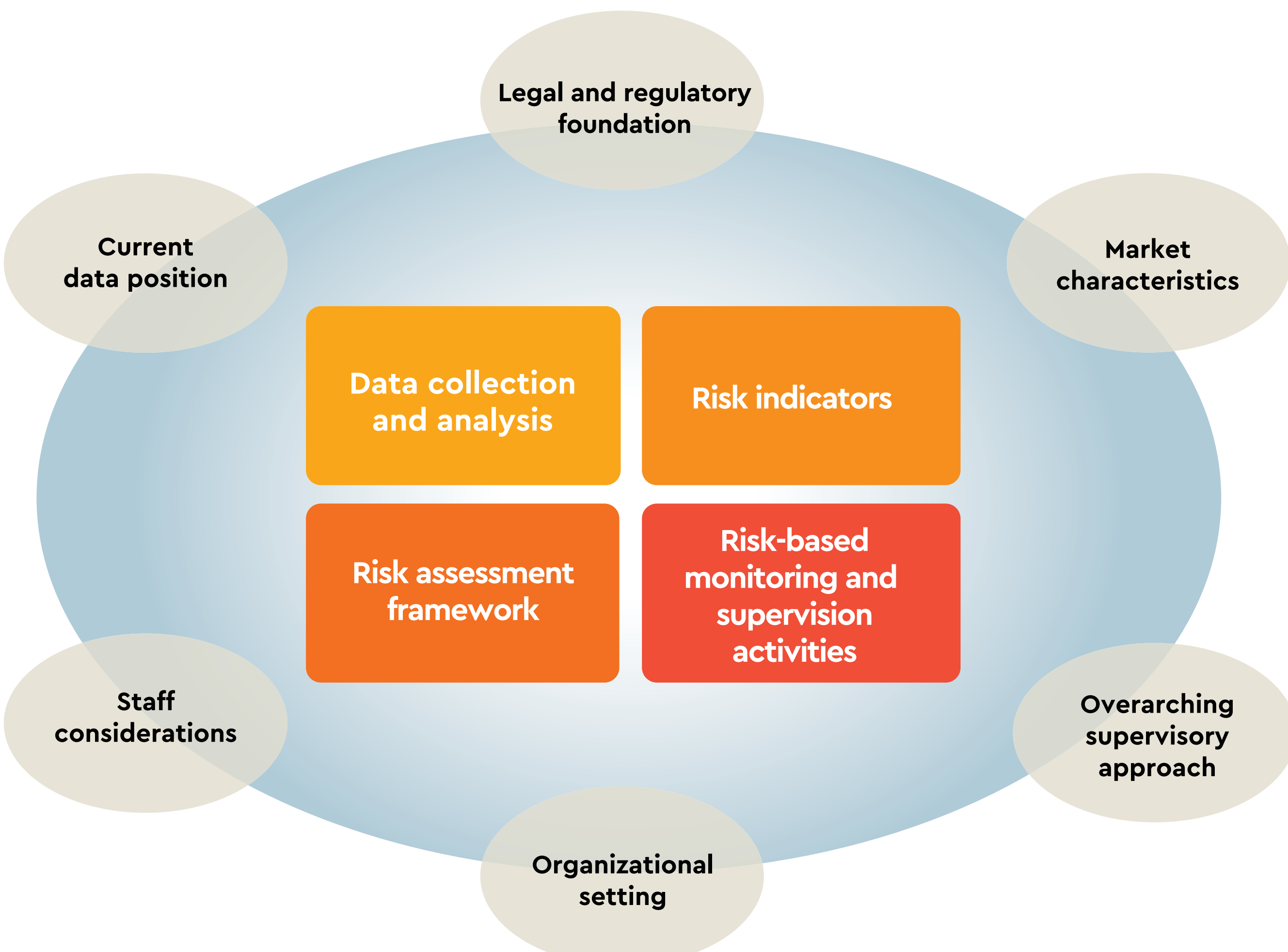
The Note discusses implementation of RBS in the context of FCP supervision (whether risk based or otherwise) but is not intended as a guide to establishing FCP supervision arrangements and processes more broadly, which is a much wider area of consideration. For example, this Note discusses considerations relevant to ensuring that an Authority has appropriate powers and suitable staff specifically for a risk-based approach to FCP supervision, but, obviously, the topics of supervisory mandate and powers, and the selection of staff, are themselves broader areas.

1.2 STRUCTURE OF THIS NOTE

Authorities preparing to develop an effective FCP RBS approach customized for their circumstances typically need to consider a range of key practical elements. Some elements relate to the setting within which FCP RBS is being implemented, such as the legal mandate and supervisory powers or available capacity and resources. Other elements are more strategic or conceptual, such as those regarding preferences in the supervisory approach to be taken. Carefully considering these elements from the first stage of developing an FCP RBS approach is critical.

This Note presents 10 key considerations that Authorities should consider when undertaking the process of designing a customized approach to FCP RBS. These are divided into what have been termed "context factors" and "core components"—the outer (circular) items and inner (rectangular) items in figure 2, respectively. In addition, general background information on supervisory cycles and the concept of RBS is provided in section 1.3 and section 1.4, respectively.

FIGURE 2 **Ten Key Elements to Consider in Developing an FCP RBS Approach**



- **Six context factors for FCP RBS (section 2):** When designing an RBS approach, Authorities should consider these six practical factors relating to the context in which they will be undertaking FCP RBS. The discussion is intended to help Authorities identify the main variables, opportunities, and limitations they have to work with (such as their supervisory powers, staff, current data position, and market characteristics) in order to arrive at an RBS setup that is suitable to their particular circumstances. Section 2 includes hypothetical examples that illustrate how different answers to the stated questions may shape the design of Authorities' RBS approaches.
- **Four core components of an FCP RBS approach (section 3):** Section 3 discusses the four suggested core components of an RBS process (collection and analysis of data, risk indicators, a risk assessment framework, and risk-based monitoring and supervision activities) to be implemented as appropriate for an Authority, having regard to the context factors discussed in section 2. This section presents various strategies, frameworks, and tools that may be adopted to establish these elements and discusses practical issues, such as benefits or limitations, that can influence their adoption.

For each factor and component, key questions are provided to help Authorities analyze that particular item. Simplified examples are provided of how different answers to these questions may shape the design choices an Authority may make in its FCP RBS approach. It is suggested that Authorities explore all 10 elements using the associated questions, to make initial choices in terms of the design of their RBS approach based on their answers to these questions. They should begin to implement the choices while keeping in mind that relevant items will require revisiting and further consideration, including in parallel, as an Authority's customized RBS approach progresses and develops.

The appendices provide additional materials and illustrations to assist an Authority's consideration and analysis. Appendix A provides a range of examples of possible risk indicators from an FCP perspective (emphasizing that indicators should be selected carefully and designed to ensure that they are useful and appropriate in an Authority's supervisory context). Appendix B includes two fictional scenarios intended to illustrate (in simplified form) how initial choices regarding the development and implementation of an RBS approach may be made in practice, having regard to the practical context in which different Authorities are operating.

While a discussion of the use of technological tools to support FCP supervision—that is, supervisory technology (suptech)—is outside the scope of this Note, it will also be a key consideration for RBS implementation, as with any form of FCP supervision. A proper consideration and understanding of the RBS elements discussed should take into account, and also contribute to, any intended adoption of suptech, such as for data collection and analysis.[2]

1.3 KEEPING THE FCP RISK-BASED SUPERVISORY CYCLE IN MIND

When an Authority is starting to consider how it will develop its FCP RBS process, or adjust its existing FCP process to be more risk based, it is important first to have sufficient familiarity with the overall concept and aims of a risk-based supervisory cycle. Although there is no single internationally accepted standard definition, the "supervisory cycle" is a common concept familiar in both prudential and FCP supervision regimes. Its purpose is to plan for a recurrent period of time that will comprise a full range of supervisory activities, from planning to enforcement and reevaluation, in order to start a new subsequent supervisory cycle beginning at a new planning step. A risk-based supervisory cycle in an FCP context is intended to enable an Authority to direct its finite resources, as systematically and effectively as is feasible, to the most important conduct risks facing financial consumers. Conceptually, all supervisory activities must fit within the cycle, which is usually designed to align with a calendar or fiscal year (but some Authorities may opt for different timeframes).

A typical FCP supervisory cycle can be described as follows and is represented in figure 3. It starts with market monitoring (itself comprising a range of monitoring activities), intended to give supervisors a sense of the most significant FCP-related concerns and risks in their market. This will influence how FSPs will be supervised in a risk-based manner. For example, which issues should be assessed specifically at individual FSPs and why? Which FSPs might require closer attention given the identified risks and

FIGURE 3 **FCP Supervisory Cycle—Main Components**

trends? FCP-specific monitoring and off-site/on-site inspections and reviews are undertaken to gain a more in-depth and specific understanding of FCP-related concerns. If such findings identify noncompliance with current regulatory requirements, enforcement action may follow, ranging from informal or formal warnings to penalties or referral for prosecution, for example. Enforcement actions should involve follow-up to ensure that the intended results are achieved. All supervisory activities should then feed into continuous reevaluation of FCP components: policy, regulation, supervision, and so on. Future supervisory planning should specifically take into account and benefit from the information and conclusions arrived at in prior cycles. All steps are interconnected, feeding into one another. Sometimes they overlap or run in parallel, and not all have the same weight or relevance at all times. Also, the supervisory cycle does not function in isolation. For example, the licensing and authorization processes of an Authority should anticipate the risk-based approach (such as by identifying red flags to be monitored), and the findings that substantiate formal/informal enforcement may also give rise to guidance provided to industry on a particular issue.

Regardless of how a supervisory cycle is ultimately defined within an Authority, it is key to have one that is structured according to available resources, a particular Authority's context and characteristics, and the size and nature of the supervised market. (This can be referred to as an Authority's "supervisory universe.") If an Authority develops FCP RBS while establishing its overall FCP supervisory function and cycle for the first time, then consideration of these elements will include a broader range of issues going beyond RBS-specific aspects. For example, the Authority should consider not only whether its existing legal mandate and powers appropriately support RBS but also whether the Authority has a sufficiently clear legal mandate to undertake FCP supervision more broadly.[3]

1.4 REGARDING RISK-BASED SUPERVISION

Before moving to the main content of this Note, it is useful to provide a brief introduction to RBS. As previously stated, this Note does not intend to establish a universal definition of RBS. Considering the uniqueness of each Authority's context, setting specific definitions and standards might limit the flexibility that every Authority needs to develop a customized RBS approach, as opposed to a "standard one." However, to provide context for the following main sections of this Note, common RBS objectives and concepts are summarized below.

At its core, RBS intends to focus supervisory time and resources to engage systematically with the most important issues within the supervisory scope in a forward-looking manner. In this context the concept of "risk" is often understood formally as the probability that harm will occur to the relevant supervisory objectives, multiplied by the impact on those objectives if the harm indeed occurs. In the more specific context of risk-based *market-conduct* supervision, those supervisory objectives typically revolve around appropriate conduct of regulated entities and/or the intended results of such appropriate conduct (for example, market integrity, consumer protection). In the context of risk-based *financial consumer protection* supervision, the supervisory objective might be compliance with FCP regulation and/or to ultimately achieve adequate consumer protection or appropriate consumer outcomes. The concept of risk in the context of FCP supervision thus tends to revolve around the perspective and interests of consumers, rather than those of the regulated entity.[4]

There is no single or standard definition of RBS concepts and methodologies being applied by financial sector Authorities internationally.[5] For a discussion on risk-based supervision concepts generally, suggested reading includes publications on risk-based supervision from the Toronto Centre[6] and from the Financial Action Task Force.[7] These publications discuss in more depth the various concepts involved in risk-based supervision and as applicable across various prudential and market conduct contexts.

NOTES

1. For a discussion of new or enhanced risks to consumers arising from fintech or digital financial services, see WBG (2021a). See also Chalwe-Mulenga, Duflos, and Coetzee (2022). For a discussion of supervisory challenges and implications arising from digital transactions, see FinCoNet (2022).
2. For a discussion of suptech in the context of FCP supervision, see WBG (2021b). See also FinCoNet (2020).
3. This mandate would normally be derived from FCP regulation. However, in some instances, other types of regulation, such as general consumer protection regulation and/or prudential regulation, might also provide a mandate for FCP RBS at least until FCP regulation can be put into effect. For further information, see G20/OECD Taskforce (2014).
4. Although this Note refers to FCP RBS, the insights offered are also largely applicable to developing market-conduct supervisory approaches (even if the market conduct that is within the supervisory scope extends beyond conduct that affects consumers).
5. General risk management methodologies are standardized by ISO 31000:2018 and Guide 73 "Risk Management—Vocabulary." However, regarding supervision of financial services specifically, guidelines and papers have not yet been consolidated or standardized as a result of the complexity and singularity of the context factors faced by prudential and conduct supervisors around the world.
6. See Toronto Centre (2018). See also Toronto Centre (2019).
7. FATF (2021).

2 Context Factors when Developing an FCP RBS Approach

This section describes several practical factors, relating to the context in which an Authority is developing and implementing its FCP RBS, that the Authority should take into consideration when designing its RBS approach. They comprise the legal and regulatory underpinning for FCP RBS supervision (discussed in 2.1);[8] the characteristics of the market to be supervised using RBS (discussed in 2.2); the Authority's overarching approach and positioning for FCP supervision (discussed in 2.3); the organizational setting within which RBS is being implemented (discussed in 2.4); staff-resource considerations (discussed in 2.5); and the Authority's current data position (discussed in 2.6).

2.1 LEGAL AND REGULATORY FOUNDATION

Authorities should consider whether they have an appropriate legal and regulatory underpinning to support RBS, having regard to their legal mandate and powers and any regulatory parameters within which they are undertaking FCP supervision. Such an analysis should be performed during preparations to introduce an FCP RBS regime. How these questions are analyzed and addressed will be affected in part by whether an Authority is establishing FCP supervision generally for the first time or embedding RBS in an already existing FCP supervisory function, in which case decisions on some aspects may have already been made (but this may cause them to be revisited). For current purposes, it is assumed that the Authority has confirmed that it has a mandate to conduct FCP supervision and, more generally, that its scope and mandate are sufficiently clear and unambiguous.

Key questions include the following:

a. Does the Authority have appropriate discretion to (de)prioritize its supervisory activities based on its risk assessments?
b. Does the Authority have legal powers to implement and apply any monitoring and supervisory methods and tools necessary for RBS?
c. Does the Authority have legal powers to require FSPs to cooperate with RBS activities, such as submitting or giving access to relevant information and materials needed for these purposes?
d. In case of FSPs' noncompliance with cooperation requirements and/or substantive FCP regulations, does the Authority have legal powers to take appropriate redress and/or enforcement actions, such as corrective measures, compulsion, or the imposition of sanctions, based on an RBS approach?

The answers to these initial high-level questions may determine whether an Authority should even proceed yet with developing an FCP RBS approach. In such a scenario, the Authority may first need to undertake regulatory reforms before proceeding with the development of an FCP RBS approach.

If proceeding with FCP RBS development, the answers to the above questions may affect what choices will be made in terms of supervisory approaches. For example, an Authority may determine that its powers to compel the provision of necessary information are sufficiently comprehensive, but there may be limitations to more direct supervisory activities (for example, on-site inspections). In such a scenario, the Authority could proceed with developing an FCP RBS approach while addressing some remaining weaknesses in its legal and regulatory foundation.

2.2 MARKET CHARACTERISTICS

An FCP RBS approach by definition is focused on addressing the most important FCP risks in a particular market. This implies that the regime is customized to the characteristics of the regulated market(s), including the size and characteristics of FSPs, the customers they have, and the consumer segments they serve.

Authorities should consider the following key questions when assessing market characteristics to help inform the appropriate design of their FCP RBS approach:

a. How many consumers are there in the supervised market?
b. What are common profiles of consumers in the supervised market?

c. How many FSPs (currently supervised or not) are active in the market?
d. What are common profiles of these FSPs?
e. Which retail products are most relevant to the market and consumers?
f. What are the main medium and long term market trends?
    - Market growth
    - Industry entry/exit
    - Consumer profile changes
    - Technological developments
    - Societal changes that affect market dynamics
g. Are there key stakeholders to engage with who might contribute to the supervisory objectives (such as consumer associations, dispute resolution bodies, and other Authorities)?
h. Are there other jurisdictions with existing FCP supervision regimes and somewhat similar market characteristics, and what lessons could be learned from supervision in those jurisdictions?

The outcome of such an analysis may shape the way FCP RBS is organized by the Authority, the supervisory staff profiles most appropriate to understanding and addressing relevant risks, the data sources leveraged, the supervisory approach and supporting methods and tools adopted, and the approach to risk analysis. For example, large numbers of financial consumers with low levels of financial literacy, low levels of technology at FSPs, and growth trends in digital financial services are all market characteristics that introduce certain FCP risks or limitations that an FCP RBS approach will need to accommodate. Naturally, these variables may change with time, which will lead to the need for ongoing evolution of an FCP RBS regime.

2.3 OVERARCHING SUPERVISORY APPROACH

The FCP RBS methodology that an Authority develops will depend in part on its overall strategic direction for FCP supervision. Conversely, this methodology may also have implications for (and may result in changes to) that approach going forward. When an Authority considers the possible implementation of RBS for FCP, it should first consider what is its current, and intended, overall strategic approach to FCP supervision. This overall strategic approach affects not only how the Authority ultimately embeds and executes RBS within its processes but also factors such as staffing and organizational arrangements, which, as discussed below, have their own implications for RBS development and implementation.

One way to conceptualize an Authority's possible overall strategic approach to FCP supervision is by reference to the five dominant supervisory approaches indicated below.[9] Note that these approaches are not mutually exclusive. In fact, real-life supervisory approaches often combine aspects of two or more of these approaches to varying degrees.

- **Compliance-based supervision:** This is arguably the simplest form of FCP supervision. An Authority taking a compliance-based approach to supervision focuses on promoting that FSPs comply with regulations. The main perspective (although others are relevant) is legal. The Authority takes regulations as the starting point for its actions. Generally, the core activity is to systematically monitor and investigate whether regulated entities have transgressed applicable rules and regulations and, if transgression is established, to take legal measures (impose fines, issue injunctions, and so forth). In addition to these activities, primarily intended to counteract noncompliance, the Authority may also actively promote compliance—for example, by issuing guidance on the interpretation and implementation of regulations.
- **Risk framework–centered supervision:** An Authority taking this approach focuses on analyzing and mitigating the risks that an FSP's activities pose to the interests of consumers, using a risk framework as the primary focal point to structure and guide its actions. The supervisory objectives may be compliance objectives, or they may include a broader objective to promote the spirit of the law or to achieve adequate outcomes for consumers. (The risk framework may or may not be geared toward such outcomes.)[10] The main perspective is risk management. For this Authority, the starting point of analysis and intervention activities is usually the risk profile of an FSP. Typically, significant effort is devoted to developing, implementing, and employing instruments and methods to assess how much risk an FSP poses to the supervisory objectives (including assessing the quality of the FSP´s measures to mitigate these risks). These risks are ranked and prioritized, and based on such assessments, the Authority will adjust its interventions.
- **Industry-centric supervision:** An Authority taking an industry-centric approach to supervision places greater focus on promoting that FSPs adhere to appropriate business standards. The sectoral point of view provides the main perspective. In terms of activity, the Authority would obviously monitor, conduct investigations, and impose legal measures. However, the Authority also attaches greater importance on maintaining a cooperative relationship with FSPs. It expends significant effort on account/relationship management. Regular conversations with FSP representatives are a crucial instrument and component of its supervisory approach (as well as with other approaches), both to maintain this relationship and to gather information and steer FSPs in the right direction. This approach may also include efforts to promote self-regulation (for example, codes of conduct) and work with third parties (for example, to grant certifications).
- **Responsive (motivational) supervision:** An Authority taking a

responsive/motivational approach focuses on influencing FSPs' behavior. The main perspective is motivational—namely, motivating FSPs to comply with regulations and possibly good conduct principles and other relevant standards or, more broadly, to serve consumers' interests adequately. Responsive supervision makes use of aspects of both a compliance and an industry-centric approach. It starts from an assumption that FSPs will want to comply with regulations and serve consumers' interests. Therefore, the Authority may initially use light-touch supervision (for example, provide guidance, perform less intrusive investigations). However, in its interactions with FSPs the Authority makes it clear that, in response to noncompliance, it will apply escalating pressure, up to a heavy-handed enforcement approach. If, in response to such escalation, FSPs return to compliance, the enforcement effort can be scaled back. To implement this approach, the Authority would expend much effort in conveying its approach to FSPs (letting them know what to expect in case of compliance or noncompliance, making them see how compliance is in their best interest), as well as gathering accurate information about FSPs and industry segments to assess to what extent FSPs comply and what their compliance motivations are (to be able to tap into those motivations).

- **Problem-focused supervision:** An Authority taking a problem-focused approach concentrates on identifying and fixing issues in the supervised markets that threaten its supervisory objectives (for example, preventing or mitigating harm to consumers). The main perspective is pragmatic: the Authority is focused on finding solutions that work. This includes using a broad range of supervisory techniques and may go beyond applying regulations (for example, averting through informal interventions FSP conduct that may be legal but nevertheless is harmful to consumers), if that is deemed effective to deal with an identified problem. The Authority is likely to expend significant effort on analyzing potential problems in the financial sector and identifying their underlying drivers or root causes. Each substantial problem has its unique features that need to be considered to devise a custom-made—and, if necessary, even untested—solution. The Authority would not necessarily limit itself to a fixed set of instruments.

Pros and cons of each supervisory approach are summarized in table 1. Appendix C describes in more detail the key characteristics of each approach and its pros and cons.

Except for a purely compliance-based approach, all the supervisory approaches described above are "risk based" in the sense that they are set up to focus an Authority's attention on the issues that it deems pose the biggest risks to its supervisory objectives. However, the perspective and methodologies used in delivering on these objectives vary considerably. As mentioned, the five approaches are not mutually exclusive, and an Authority may very well adopt an overall strategy that combines multiple approaches. For example, the overall approach of an Authority might be more problem focused, but its licensing department may function in a compliance-based manner—focusing on whether regulatory requirements to attain a license have been met.

Importantly, implementation of RBS for FCP does not mean that an Authority should adopt one approach permanently, to the exclusion of the others. For example, an Authority that is only starting its FCP supervision journey may decide to begin with a simpler compliance-based approach while it gains confidence with RBS in parallel. Or an Authority that is already more confident with FCP RBS may, for example, have a strategy that focuses primarily on a risk framework–centered approach but with increasing use of problem-focused supervision. Similarly, combining traits of responsive supervision with a risk-based approach is equally feasible.

TABLE 1 Characteristics of Five Common Overall Supervisory Approaches

Approaches	1) Compliance-Based	2) Risk Framework–Centered	3) Industry-Centric	4) Responsive (Motivational)	5) Problem-Focused
Perspective	Legal	Risk management	Industry-centric	Motivational	Pragmatic
Core activity	Enforcement	Risk analysis and mitigation	Account management	Assess and steer FSP motivations	Problem-solving
Typical tool	Legal checklist	Risk analysis tools and methodology	Regular conversations	Responsive conversations	Custom-made intervention
Method and organizational model	Enforcement process	Risk management cycle	Account structure (network)	Escalation pyramid	Project-based
Preferred measure of results	Enforcement tally	Risk mitigation statistics	Market and industry development	"Carrot and stick" examples	Reporting of problems solved
Potential upside	Simple legal reference point	Priorities fine-tuned to risk level	High industry issue awareness	Sophistication and flexibility	Customized interventions
Potential downside	Legal myopia and inefficiency	Overemphasis on tools and methods	Regulator may be too lenient on FSPs	Complexity and unpredictability	Limited standardization and learning

When an Authority is developing its RBS approach, consideration of the following key questions is suggested to assess what the Authority's current overall approach to FCP supervision is, what it will be in future, and what changes may be necessary to accommodate RBS and respond to market conditions.

a. What is the predominant perspective of the Authority's future FCP supervision? Does this perspective "match" with its current approach(es), and, if not, what might need to change?

b. What aspects of other supervisory approaches may be adopted as part of the intended approach of the Authority?

c. In considering the first two questions, what approach seems most likely to be effective and legitimate in the context of the Authority, considering
   - The resources and capabilities available to the Authority presently and in the foreseeable future;
   - The nature of (i) the regulated sector, (ii) the FSPs active in this market, and (iii) the predominant FCP issues presented by these FSPs' activities; and
   - The expectations of the various external stakeholders (public, political, administrative, and so on)?

4. Which choices regarding the supervisory approach have already been made (implicitly or explicitly)? Which additional choices can be made in the foreseeable future, to enable the implementation of a focused, coherent, and well-customized FCP RBS approach?

The answers to these questions may guide the Authority in adjusting its approach. They will also inform other practical questions discussed below, such as decisions regarding internal organizational arrangements and resourcing.

2.4 ORGANIZATIONAL SETTING

The internal organizational setting for undertaking FCP RBS is crucial for its efficacy. The department primarily responsible for executing FCP RBS requires sufficient resources, institutional support, and autonomy to conduct adequate risk analyses and engage FSPs effectively based on the outcome of these analyses. In addition, the trajectory of implementing an RBS regime—which typically spans several years and the development of multiple iterations or developments while continuing to discharge FCP supervision responsibilities—can put substantial demands on the Authority's organization.

The following key questions should be considered when constructing and maintaining an appropriate organizational setting for FCP RBS. The questions identified here are focused on organizational support for RBS implementation. The Authority also needs to ensure adequate support for FCP supervision more generally, which would be even more front of mind if such a function did not exist yet and RBS implementation was only one aspect of the overall initial setup.

a. Has the Authority ensured leadership's long term credible commitment to the development and implementation of FCP RBS at all hierarchical levels, including its executive and supervisory board(s)?

b. Do the current and/or future organizational structure and reporting lines ensure that the Authority's FCP function has adequate operational mandate and practical autonomy from other functions (for example, from prudential functions, which may have already previously developed and implemented prudential RBS, as well as from handling consumer complaints) to develop and implement RBS effectively for FCP purposes?

c. How can effective and efficient cooperation with all other relevant functions within the Authority (for example, licensing, prudential supervision, complaint handling, financial inclusion, financial education, legal, research, IT/data management) be secured to support RBS appropriately?

d. Do the Authority's organizational culture and the attitudes of its key officials sufficiently support FCP RBS implementation?

e. Does the Authority possess sufficient change management capabilities? These capabilities may include the following:
   - Executive time and focus dedicated to implementing an FCP RBS regime
   - Sufficient dedicated staff, with ample formal and informal standing within the Authority, to coordinate and push forward a range of parallel and interconnected change and implementation work streams
   - IT and data management change capabilities

The outcome of such an analysis may lead to changes in internal responsibilities, the organizational structure (organigram) for FCP, and the budget available for FCP. An analysis of the organizational setting for implementation of RBS should also guide subsequent decisions on topics such as staff composition for a risk-based FCP supervisory function, data sources, supervisory methods and tools adopted, and the risk framework to be developed. For example, if the initial analysis identifies insufficient organizational willingness to support change, it may be unfeasible to proceed with FCP RBS implementation at the current time. Efforts should be focused first on generating high-level and broad support for change management.

2.5 STAFF CONSIDERATIONS

An RBS regime is likely to place considerable demands on the staff primarily responsible for its execution. These demands relate both to staff hours and to skill sets and experience. Regardless of approach, the qualities frequently required of staff engaged in FCP supervision (formal background, knowledge, skills, experience) already differ significantly from those required of staff responsible for functions such as consumer complaint handling, as well as those sought for prudential supervision.[11] However, in an RBS context these qualities can also differ substantially from those required of staff engaged in a simpler and more mechanical compliance-based supervisory approach to FCP supervision. (See appendix C for further elaboration.) For instance, effective FCP RBS requires substantial knowledge of the workings of financial products and services and underlying FSP processes, associated FCP regulation, and consumer behavior. It also requires strong interpersonal skills and thorough quantitative and qualitative analytical abilities (for example, root-cause analysis).

When developing a customized FCP RBS approach, it is important to consider the following key questions regarding staff:

a. How many staff members dedicated to FCP RBS are currently available, and how many can be made available in the foreseeable future?

b. Which technical backgrounds are available; which others may be needed? For example:
   - Law/regulatory
   - Economy/business administration/sociology
   - Auditing/analysis
   - IT/data management and analysis
   - Administration/support

c. Which relevant practical knowledge, skills, and experience fields are available; which others may be needed to contribute specifically to effective RBS? For example:
   - Legal/regulatory
   - Industry segments
   - Financial products/services
   - Monitoring/supervisory/enforcement methodology
   - Analytical and data management

d. Do relevant staff have the necessary mindset and perspective needed to deliver on the Authority's FCP RBS aims? Key traits include being proactive (this is crucial because it can take considerable initiative to identify FCP risks that are not apparent and to take strategic action to deal with them) as well as flexible (for example, to adapt to new methods and a changing context, even when the FCP RBS regime is fully developed). These are obviously not to the exclusion of other traits relevant to FCP supervision more generally, such as a consumer-protection focus, thoroughness, tenacity, and integrity.

The outcome of such an analysis should guide an Authority's practices and decisions with regard to hiring, training, and retaining staff in order to provide the necessary capacity to operate a new FCP RBS approach. This applies to the staffing of both the department primarily responsible for executing the FCP RBS regime and ancillary and supporting departments. For example, the initial analysis may determine that current staff lack data analytics skills, but there is sufficient scope to expand capacity (such as by hiring supervisory officers and a quantitative researcher, or by bringing in officers from prudential supervision or other specialized risk units whose skill sets can be adapted) or to upskill existing staff.

2.6 CURRENT DATA POSITION

RBS tends to be a data-intensive form of supervision. An Authority's access to data—which can also be referred to as its "data position"—is a crucial factor in constructing an effective FCP RBS approach. As discussed later in this Note, for the risk-based framework at the center of an Authority's RBS approach to be useful, the Authority will need to be able to obtain the data required to conduct the analyses required by the framework *to a reasonable degree* (as data is never complete). A risk-based framework that does not match available data can be 'worse than useless,' potentially taking up supervisors' attention with ineffective information, or taking them in inappropriate directions, rather than allowing them to make better—even if more limited—decisions based on whatever accurate information they actually have.

To start conducting RBS analyses for FCP purposes, a wide range of data types may be relevant. Examples of such data types are listed in table 2, which sets out a high-level overview intended to assist in an exploratory analysis of an Authority's current data position. (A more detailed stocktaking will likely be required at later stages of the implementation of the FCP RBS approach.) More detailed discussions about useful data, associated risk indicators, and their relevance to FCP are included in sections 3.1 and 3.2 and appendix A.

The following are key analytical questions to assess an Authority's current data position for its FCP RBS purposes:

a. Which data sources, relevant for FCP RBS, are currently available *within the Authority* (including data from functions other than FCP supervision within the Authority, such as prudential or other supervision/oversight, financial inclusion, complaint handling, any credit registry, and research functions)?

b. Which data sources, relevant for FCP RBS, are currently available *from FSPs*
   - In a standardized format/frequency; or
   - In an ad hoc manner (for example, via one-off information requests)?

c. Which data sources, relevant for FCP RBS, are currently available *from other entities* (other regulators, external dispute resolution mechanisms/financial ombudsman schemes, consumer associations, social media, and so forth)
   - In a standardized format/frequency; or

TABLE 2 Examples of Data Types Relevant to Help Implement an FCP RBS Approach

	Data Type Relevant for FCP	Further Specifications
1	**FSP organizational profile**	
1.1	License type	
1.2	Governance	Organizational structure, governance and ownership, outsourcing arrangements
1.3	FSP leadership	Executive and nonexecutive board members; other key executives
1.4	FSP risk profile	
1.5	FSP conduct track record	Regulatory compliance; fair treatment of customers (also questionable conduct besides regulatory noncompliance)
1.6	FSP regulatory relations	Interactions with the Authority
2	**FSP customer profile**	
2.1	Number of customers	
2.2	Customer characteristics	Age, wealth, customer segments
2.3	Regional customer distribution	
3	**Product and service characteristics**	
3.1	Types of sales and service channels	
3.2	Categories of products/services	
3.3	Product/service characteristics	Reported by FSPs or available via, for example, corporate websites
3.4	Marketing materials	Digital/analog
3.5	Terms and conditions	
3.6	Realized service data	For example, customer interactions recorded by FSP or other entities; mystery shopping data
4	**Incentives that drive market conduct**	
4.1	Executive remuneration	Including bonuses and other potential incentives such as share options, expense accounts, discounts, vouchers
4.2	Sales staff remuneration	Including bonuses and other potential incentives such as share options, expense accounts, discounts, vouchers
4.3	Organizational incentives	For example, intermediation commissions
5	**Business and commercial indicators that drive market conduct (prudential data)**	
5.1	Macroeconomic and monetary analyses	
5.2	Business model analyses	
5.3	Solvency indicators	
5.4	Liquidity indicators	
5.5	Commercial indicators	For example, product margins, profitability, marketing expenses
5.6	Client-related money movements	Payments, collections, and other client-related money movements (for example, refunds, benefits)
6	**Complaints data**	
6.1	Formal complaints data	Complaints submitted to FSPs, the Authority, an external dispute resolution mechanism (for example, financial ombudsman scheme)
6.2	Informal complaints data	For example, grievances expressed via social media
7	**Operational supervisory data (if transitioning from compliance-based to RBS approach)**	
7.1	Information reporting data	
7.2	Inspection data	
7.3	Enforcement data	

- In an ad hoc manner (for example, via a one-off information request)?

d. Which data sources, referred to in the questions above, might be made available *in the foreseeable future*?

The answers to such analytical questions will directly affect what FCP RBS activities can be undertaken in the near term and will guide the Authority's actions to improve its current and future data position to build up its FCP RBS model. For example, an initial assessment may determine that the licensing and prudential supervisory departments administer several databases that systematically track several data types listed in table 2, while banks report limited amounts of such data, but additional data on complaints may be available from several relevant ombudsman schemes. In such a scenario, the Authority should seek to establish operational data sharing linkages with relevant internal and external data sources while also planning to rely on ad hoc information requests in the short term for its FCP RBS activities.

Alternatively, an initial assessment may determine that existing systems collect very limited data that can be utilized for FCP RBS activities. In this scenario, it may be necessary to rely on more qualitative and ad hoc assessments during the initial stages of FCP RBS activities while making it a critical priority to dedicate time and resources to exploring and improving the Authority's overall data position for FCP to enable expanded FCP RBS activities over the longer term.[12]

To assist with an initial data stocktaking and, importantly, to continue to build on this as its RBS approach is further developed, it is useful for an Authority to capture various details about data items. The details captured may vary, but they need to help in identifying not only the data and its source but also its reliability and feasibility of collection, since these segmentations will help to prioritize, in a next step, which set of data will actually be collected, at least in a first supervisory cycle. This exercise is meant only for supervisory purposes and should not be confused with formal "Data Classification Policy" methodologies used by organizations to manage data sensitivity. The following list suggests a possible (non-exhaustive) set of categories:

- **Data type**
  A brief description that allows the reported data to be segregated by its purpose. This can be standardized (for example, complaints, regulatory reporting, commercial data, social media). There is no single way of defining this categorization, so it is important to create categories according to the kinds of data available. For example, if available data regarding complaints is limited to a basic set of general data, then just one category of "complaints" may be enough. However, if available data is more granular and diverse, then it is likely that "complaints" would be better framed by having subdivisions (that is, "internal complaints," "external complaints," "ombudsman complaints," and so on). If there are more specific subdivisions, such as categories related to products or the nature of complaints, these could provide even more accurate data sources to be prioritized.
- **Data source**
  This category is intended to record the origin of the data—more specifically, the organization (if external) or department/area (if internal) responsible for the data. Some data may originate from external entities or persons but is processed and delivered by an internal data owner (such as complaints or prudential data from FSPs). Most of the data already available will likely be internal, but some relevant external data may also already be available.
- **Data description**
  Name of the data, including the original source (if it comes originally from FSPs, for example), even though it has an internal data owner.
- **Other data characteristics**
  Qualitative/quantitative data, frequency of collection, segment/product relation.

It is useful to undertake such a stocktaking through active and broad engagement (for example, workshops) and not only via passive means. After finalizing the list, it should be easier to assess whether there may be important data types, segments, or products that are not sufficiently available. If that is the case, two solutions are possible: (1) to seek existing additional data currently unavailable, or (2) to look directly for indicators (instead of identifying the data and then creating the indicators). Unavailable data may be costly to collect, so the first option should be considered cautiously. Indicators generated by other departments or organizations will limit the Authority's capacity to influence its governance and updates, so it is more viable as an alternative when the owner of the indicator is closer—for example, inside the same organization. External indicators could be considered depending on how critical the gap is that they would be able to close. A final output would be a list of all relevant data available to start data collection and analysis, the first of the core elements of an FCP RBS approach, as discussed in the next section.

NOTES

8. For more information on the legal and regulatory context see WBG (2017).
9. For example, see Kasdorp (2018).
10. A substantive supervisory strategy geared toward achieving specified outcomes for financial consumers is sometimes referred to as a "customer-centric strategy." Such a strategy may feature a risk framework that is geared toward measuring and analyzing the degree to which such specified outcomes for financial consumers are achieved.
11. For further information on the different skill sets required for FCP supervision, see WBG (2014).
12. For additional information on tools to assess the quality of regulatory reporting data, see Izaguirre et al. (2022).

3 Core Components of an FCP RBS Approach

This section discusses four components that typically make up the core of an Authority's FCP RBS approach. Authorities will want to consider these components holistically, together with the context factors outlined in section 2. A first core component is the data collection and analysis strategy that underpins the Authority's RBS approach (discussed in 3.1). Another core component is a set of risk indicators, which in an FCP context will normally include both qualitative and quantitative indicators (discussed in 3.2). Authorities adopting an RBS approach will frequently (though not always) use a formalized risk assessment framework to structure and guide risk analyses that inform prioritization and other decisions regarding monitoring, supervision, and enforcement (discussed in 3.3). The final core element of an RBS approach comprises the ongoing monitoring, supervisory, and enforcement tools and activities that will be deployed on a risk basis and used in turn at least in part to support the ongoing identification and assessment of risks (discussed in 3.4). In effect, these activities constitute a risk-informed version of the continuous supervisory cycle described in section 1.3.

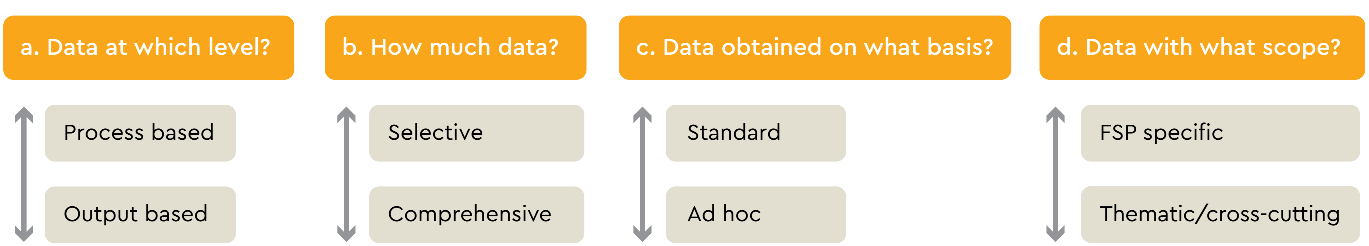
3.1 DATA COLLECTION AND ANALYSIS

How an Authority collects and analyzes data lies at the heart of its RBS approach. From a conceptual viewpoint, Authorities tend to balance how they collect data for RBS purposes along several dimensions, as illustrated in figure 4.[13] Note that the two "opposite" types of data collection and analysis highlighted for each of the four dimensions presented can be considered as opposite ends of a continuum. They do not necessarily exclude each other and indeed are often complementary.

a. **A first consideration for data collection and analysis is to what extent an Authority's FCP RBS approach will rely on supervised FSPs' risk identification and control processes versus directly verifying whether the providers' resulting conduct affecting consumers (the output of these processes) is appropriate.** In this context, an FSP's control processes may refer to the full set of explicit and tacit measures (procedures, forms, IT systems, governance arrangements, leadership, aspects of corporate culture, and so forth) that an FSP uses to steer the market conduct of the organization and its staff. The extent to which an Authority relies on a process-based approach has a profound impact on the type of data it collects and analyses to ensure an appropriate degree of FCP, as well as on the type of risk indicators, risk assessment framework, and risk-based monitoring and supervision activities that may be suitable to deliver on its RBS approach.

   For example, using a primarily process-based approach to data collection and analysis, the Authority might audit the procedures that an FSP employs to control how its staff han-

FIGURE 4 **Data Collection and Analysis Approaches Relevant to Developing an RBS Approach**



dles consumer complaints. This may require obtaining copies of relevant policies and procedural manuals, doing a walk-through of relevant IT systems and procedures, reviewing the staff training setup, interviewing relevant officials, and so on. In contrast, in a primarily output-based approach, the Authority would audit how individual complaints are handled in practice. This would require other types of data and analysis. This Authority might obtain and analyze a sample of complaint files, recordings of complaint-handling calls, and consumer feedback—for example, via social media channels.

An advantage of a primarily process-based approach is that it can be more efficient and less time-consuming than an output-based approach, such as when analyzing large-scale operations, where representative direct verification requires large samples. In certain circumstances, such an approach may be more effective in identifying the cause of shortcomings (for example, a flaw in the training of complaint handling staff), rather than just the symptoms (incidents of inappropriate complaint handling). This approach might more effectively stimulate investigated FSPs to improve their practices and mitigate the risks they present to consumers.

However, a process-based approach alone can also prove to be ineffective or inappropriate. It can easily be reduced to a paper exercise (supervisory officials scrutinizing policy documents) that does not accurately identify actual daily practices (for example, how well consumers are treated). It may thereby also stimulate FSPs themselves to focus on the paperwork, rather than on the purpose of that paperwork and on what happens in practice.

Therefore, it is generally advisable to combine elements of process-based and output-based approaches. Practical implementation factors, such as staff capabilities (for example, data analysis skills) and the technology that it adopted to support data capture and analysis, should account for how and to what extent an Authority relies on process-based or output-based approaches.

b. **A second data-related consideration in developing an Authority's FCP RBS approach is the extent to which it will be focused on selective data collection and analysis, in contrast to undertaking more comprehensive data collection.** Statistical analysis of a more comprehensive dump of transaction data may, for example, reveal patterns not evident from a limited sample. However, selective data collection—such as scrutinizing a selective sample of transactions, followed by a targeted series of interviews with an FSP's relevant staff—may better enable an Authority to understand such patterns and identify their underlying drivers.

   An optimal approach is likely to include a balance of both comprehensive and selective data collection and analysis. An approach that focuses only on the former is less likely to be effective, given that at some point the Authority will need to drill down to pinpoint the precise nature of market conduct issues. On the other hand, a selective approach is likely to be more powerful—for example, if backed up by the collection and analysis of more comprehensive preparatory information. How an Authority strikes the balance between comprehensive and selective data collection and analysis is typically closely connected to the other core components of its RBS approach, such as its selected risk indicators and toolkit of risk-based monitoring and supervision activities, discussed in the sections below.

c. **There is also a balance to be struck between a focus on standard (regular/periodic) and ad hoc data collection and analysis.** Standard data collection and analysis (for example, regular/periodic FSP reports and data transfers) can be efficient in the sense that both the Authority and relevant FSPs can adjust their systems and practices to this information flow. However, standard data collection and resulting analysis alone is unlikely to produce a sufficient indication of significant supervisory issues. An Authority can, in addition, customize ad hoc data collection and analysis to increase the effectiveness and relevance of data capture, providing in-depth insights into potential conduct issues that cause risks to consumers. In addition, addressing newly identified issues effectively often requires ad hoc data. The potential for ad hoc requests for data can also assist to keep FSPs themselves vigilant for new issues.

   The balance an Authority strikes between standard and ad hoc data collection and analysis will have significant implications for how its RBS approach works in practice. For example, an Authority that emphasizes standard data collection and analysis will typically devote more resources to setting up an ongoing monitoring data flow (from FSPs and other sources) that feeds into its risk indicators, which in turn feed into FSP-specific risk ratings. A greater part of its engagements with FSPs may also be devoted to improving this data flow. In contrast, an Authority that emphasizes ad hoc data collection and analysis may devote its FSP engagements mostly to discussing the substantive FCP risks that result from the FSP's market conduct.

d. **A fourth crucial data-related balancing choice for an Authority is the extent to which its data collection and analysis focus on FSP-specific issues or on thematic issues relevant to part or all of the financial sector it supervises.** Risk framework–centered and problem-focused supervisory approaches (discussed in section 2.3 above and in more detail in appendix C) lend themselves well to addressing risks and issues that transcend an FSP-specific context (also referred to as "thematic/cross-cutting issues"), either because many FSPs are affected by the same issue (for example, a widespread failure to comply with certain new regulations) or because it is a collective issue (for example, intense competition pressures triggering patterns of misconduct among a range of FSPs). For thematic analyses, the Authority will need to build up a data set and conduct in-depth analyses that cut across a range of FSPs. In contrast, a primarily FSP-specific approach to risk-based data collection may be focused more on issues that are unique to a particular FSP (typically the most impactful FSPs in the local market). The balance that an Authority strikes between focusing on FSP-specific or thematic issues will affect its choice of risk indicators, the type and elements of its risk assessment framework, and the risk-based supervisory activities in which it engages.

In addition to the four balancing choices discussed above, an Authority's ability to analyze and address the root causes of the FCP issues identified will likely have a dominant impact on its long term efficacy. A pitfall to avoid is that interventions may have only short-lived effects. Once supervisory attention is focused elsewhere, if the root cause of an issue has not been addressed, the issue may reemerge (in the same or a similar way). Performing root cause analyses of FCP issues requires experience, a sound understanding of business issues, and strong critical analysis skills. Subsequently addressing these root causes by engaging the relevant FSP(s) also requires strong communication skills and perseverance.

Capacity limitations are a crucial factor to bear in mind when developing an initial data collection and analysis approach, especially for Authorities with limited resources. For instance, process-based data may at times be easier to come by (through reporting and/or information requests) than output-based data but may require more expertise to assess appropriately. Also, setting up a standard (regular/periodic) data flow tends to require a greater up-front investment of time and resources, as well as expertise, than obtaining samples of data by issuing ad hoc information requests.

In light of the above, a key focus for an Authority will be what choices it makes with regard to data collection and analysis for its FCP RBS function. The choices made on the questions listed below will affect the types of data an Authority collects and analyzes to support its FCP supervision generally, as well as the type of risk indicators, risk assessment framework, and risk-based monitoring and supervision activities that may be suitable to deliver on its RBS approach.

a. How will the Authority balance and combine process-based and output-based approaches to data collection and risk analysis?
b. How will the Authority balance and combine selective and comprehensive approaches to data collection and risk analysis?
c. How will the Authority balance and combine standardized and ad hoc approaches to data collection and risk analysis?
d. How will the Authority balance and combine FSP-specific and thematic approaches to data collection and risk analysis?
e. To what extent will the authority engage in root cause analyses?

3.2 RISK INDICATORS

Once an Authority has made initial choices about its data collection and has a sufficiently clear perspective regarding the context factors discussed above, the natural next step is developing an initial set of risk indicators. As with other core components of its RBS approach, choosing and designing risk indicators will require an Authority to select not only what is relevant to its approach but also what is feasible. Context factors of particular relevance here include having a sufficient understanding of the characteristics of the market it supervises and of its data position, as these will have a direct impact on what are likely to be the most useful and feasible indicators.

a. What Are Risk Indicators?

Risk indicators provide much of the basis for undertaking the risk analyses that ultimately support risk-based supervisory decisions in the context of RBS. They are intended to provide a measure, or other relevant indication (whether direct or indirect), of risks that that an Authority's FCP supervision is concerned with addressing. An Authority that has accurately defined its supervisory approach having regard to its context will be able to determine more easily which indicators will provide a useful perspective of the market. With time, changes within the market and context factors, especially the legal and regulatory foundation, will likely require new or enhanced indicators.

When selecting an appropriate set of initial risk indicators, an Authority will need to focus on the indicators' intended purpose and ultimate relevance to apparent FCP issues. It will also be necessary to consider whether and how an indicator will be able to show *changes* relevant to supervisory action. A good practical test, if possible, is to evaluate what prior outputs of potential indicators would have been. If a particular indicator would have shown little relevant change over, say, the last two to three years, such an indicator may not be as useful to prioritize in an initial indicator set (unless there are other compelling supervisory reasons for including it, such as if the lack of change is due to persistent ongoing issues).[14]

b. Setting the Parameters for Individual Indicators

Developing well-defined indicators requires identifying sufficient parameters for each indicator, which should be captured in some standardized form. It is important to describe each indicator with sufficient detail and clarity to ensure consistency in how staff (and any systems) capture, administer, and report on these. Table 3 provides a sample initial template, with suggestions for parameters. This is only one possible way of defining indicators; an Authority should choose both the parameters and a format appropriate for its context.

TABLE 3 Sample Template for Risk Indicator Parameters

Indicator	Name of indicator to be tracked
Description	Brief description of what is being tracked/measured (and how this is calculated, if necessary)
Format	Whether the indicator reports qualitative or quantitative data (and any other relevant details)
Periodicity	Indicator may be reported monthly, quarterly, or yearly, or periodicity may be not applicable (for example, if frequency is irregular or it is based on qualitative data)
Purpose	How the indicator is relevant in terms of FCP-focused risks and corresponding risk assessment
Risk correlation	For quantitative indicators only, state if the indicator output is positively correlated to risk (the higher the figure, the higher the risk) or not
Data source	Specific data (available to the Authority) that will be used to generate the indicator

There is likely to be a variety of ways to determine individual indicators and interpret results for the purposes of a risk assessment, as well as to establish thresholds or triggers for supervisory actions. It is important to ensure that the set of selected indicators includes appropriate complementary indicators to support better supervision decision-making. Reaching sound conclusions based on indicators will of course also always require sound supervisory judgment.

Indicators may assist in identifying FCP-related risks through, for example, the following:

a. **Nominal numbers** (over a reporting period, in total, and so forth): What is the current figure? How does this figure compare to prior periods/performance? Is it above or below average? Changes between reporting periods or to averages could indicate a relevant change in FCP risk concerns.

   Example: If there is a sudden/material increase in an FSP's total complaints indicator, or in complaints about a particular product, this may warrant further analysis or action.

b. **Growth rate:** This figure is calculated by dividing the difference between the start and end values for the period(s) being analyzed by the starting value. It can be useful to understand and compare the pace of growth of different indicators.

   Example: The total complaints indicator for an FSP shows a growth rate of 10 percent in the last two quarters, but the number of the FSP's active consumers increased by more than 15 percent within the same period. The figures in combination may therefore indicate that the increase in complaints is not as potentially concerning as may be suggested by the first indicator alone. This example shows the importance of selecting a sufficiently complementary set of indicators and not treating the selection of each indicator as a separate and stand-alone exercise.

c. **Weighted measure** (for example, by total market figures, total accounts, total consumers, total assets, and so on): Absolute numbers may need parameters that allow verification of the real weight of an indicator. This may require the calculation of an index that allows the comparison of indicators from FSPs of different sizes, types, and complexities. An example of a common and useful measure is "complaints per 1,000" (or a similar measure), which consists basically of weighting the number of complaints by some metric of the volume of business (for example, per 1,000 accounts, per 1,000 sales, or per 1,000 insurance policies).

   Example: Three or four FSPs have almost the same number of complaints reported for the last quarter. However, since the FSPs have considerably different numbers of active consumers, the absolute figures are not comparable. The Authority therefore creates an index: total complaints divided by number of customers for each FSP, or calculating the number of complaints per 1,000 accounts, then dividing by the number of active accounts. In both cases, an FSP with a higher index will indicate a worse ratio of complaints.

d. **Data aggregation** (combination of all FSPs' results, when available): Many FCP risk indicators will also allow consolidation of individual FSPs' figures to reach a total market number. This can be key not only to monitor the market but also to provide a basis for weighting each FSP against the market figure.

   Example: An Authority is monitoring a market composed of five major FSPs in terms of total complaints. However, two are responsible for 70 percent of all market complaints. This may draw greater attention to them than to the three other FSPs. The level of supervisory attention will also be influenced by other FCP risk indicators.

e. **Market average:** Calculating an average for a market by using individual FSP figures will allow an Authority to compare FSPs above and below that average (and the extent to which this is the case for each FSP), which can provide a relatively straightforward perspective of possible priorities to address in supervisory activities. Market averages will provide more meaningful results when used to compare FSPs of the same peer group, usually grouped by factors such as by provider type, product, or size. However, an FSP's performance may be affected by several endogenous and exogenous factors that must be accounted for carefully to produce a more accurate comparison.

Example: In a supervised market comprising 10 major FSPs in terms of total complaints, four FSPs are close to the average complaints index, two are below the average, and four are significantly above it.

f. Market benchmarks and performance ranges: Highest/er and lowest/er historical figures for indicators and individual FSPs can be key in understanding FSP performance and potential risk implications. It is important to consider such historical performance ranges and the implications of indicators that show significant change in either direction.

Example: If an FSP reaches the highest complaints figure ever recorded, that could merit further attention. However, an FSP showing a very low relative number of complaints, depending on context, may raise concerns regarding the quality of the data being reported, also potentially meriting further supervisory attention.

c. "Start Small but Start Right" Approach

RBS is an evolving process for any Authority. At first, it is recommended that an Authority develop a relatively small number of indicators, using the best possible data and prioritizing essential risks within the jurisdiction. As the Authority progresses and staff members gain confidence and experience, the indicator set can be expanded. For example, FCP supervisors may initially have access only to some complaint-related data and other basic data regarding FSPs, such as number of customers, number of transactions, loan volumes, and so forth. A small set of risk indicators built around the monitoring of complaints received, transactions processed, loans approved, and similar indicators can be more than sufficient to support an initial RBS-based supervisory cycle. Starting with a large number of indicators, or with more complex indicators, may be tempting, given the potential information it generates. However, particularly at the start, it can raise the risk of relying on or attempting to reconcile bad information (as the number of indicators grows, so grows the risk of "garbage in, garbage out"), and it may overwhelm the risk-based prioritization process, affecting the effectiveness of resource allocation.

An initial set of indicators could include the following, for example:[15]

- Number of retail (consumer) clients
- Number of accounts (for example, loans, deposits, credit cards)
- Volume of consumer complaints relative to a measure of size, such as total depositors, borrowers, turnover, or assets
- The nature of consumer complaints (for example, complaints related to fraud and abusive behavior may be deemed more important than those related to errors)
- Main product line(s) (for example, complexity) and market share
- Distribution channels (for example, third party agents or brokers)
- Profile of target segment(s)
- Evaluation of FSPs' internal control and quality of management to mitigate risks
- Geographic coverage

After defining all individual risk indicators, some Authorities prefer to separate the indicators into impact indicators[16] and probability indicators.[17] Other Authorities compile them together. There are different possibilities for combining indicators and the best option for each Authority will depend on considerations relevant to the framework in which they will be used. These are discussed in section 3.3 on the risk assessment element of FCP RBS.

Appendix A provides a range of examples of qualitative and quantitative risk indicators from an FCP perspective. The indicators used by any Authority should be selected carefully and designed to ensure that they are useful and appropriate in that Authority's supervisory context. The G20/Organisation for Economic Co-operation and Development's Task Force on Financial Consumer Protection has also published guidance on FCP risk drivers relevant to the selection and development of risk indicators.[18]

3.3 RISK ASSESSMENT FRAMEWORK

An Authority developing an FCP RBS approach will frequently adopt some form of formalized risk assessment framework to structure and guide the risk analyses that ultimately inform its prioritization of supervisory efforts and resources. The extent of formalization, detail, and specificity of such a framework will vary significantly depending on each Authority's context and needs. The characteristics of the framework that an Authority ultimately settles on will depend on factors such as its current legal and regulatory foundation, organizational setting, and overarching supervisory approach. It is also important to ensure that the way any risk assessment framework is ultimately applied, and relied on, is not excessively rigid. Room should always be left in supervisory decision-making for adjustments based on supervisors' professional judgment.

A risk assessment will be the result of the analysis of selected risk indicators and other relevant and available data, with the purpose of obtaining a risk view of the market and of at least the most relevant FSPs. This risk view will be key to determining which FSPs merit more intensive supervisory attention and resource deployment and for which FSPs a less intensive, more reactive approach is justifiable on a risk basis, or which consumer segments are being exposed to the most harm by market risks being monitored. The same approach will also apply, one level down, with regard to which activities, internal processes, and business lines within relevant FSPs may merit more supervisory attention and resources. For example, a risk assessment can inform supervisors about which areas and products should be prioritized during an FSP's examination and which ones may not be examined at all in a particular instance. A risk assessment methodology therefore helps indicate not only what to focus on and how intensively but also what should *not* be prioritized, ensuring that the Authority has a reasonable and coherent process for validating supervisory decisions, including placing more attention on only some FSPs. This is crucial also because the success of any RBS approach depends on having sufficient capacity and in-depth engagement to address the most important issues.

A risk assessment for FCP supervision purposes has a different focus compared to a prudential supervision risk assessment. Prudential supervisors focus on an assessment of an FSP's soundness. This is typically achieved by considering relevant key risk factors, such as considered in the 'Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity' (CAMELS) system,[19] as well as inherent risks that could harm the financial, operational, and liquidity capacity of the FSP (credit, market, operational, IT, and so on). On the other hand, FCP supervision must assess the risks not to the FSP, but to financial consumers (typically individuals, rather than all customers, given that not all financial customers, such as government and most corporations, are equally vulnerable). Risks to be managed come from FSPs' conduct or from the broader consumer relationship and use of financial products and services. This is quite a different focus, focusing on interactions between consumers and FSPs (and a range of related parties relevant in this context), the areas and processes affecting those interactions (consumer-facing, governance, product development, and so forth), as well as consumers' use of relevant products and services. FCP supervisors must also weigh market factors, including financial sector developments, given that risks being assessed generally relate to mass markets, standardized products, and common distribution channels. More recently, some Authorities have evolved their FCP risk assessment focus to include the outcomes to consumers or the effects that FSP actions may have on them, in the pursuit of a more customer-centric supervisory approach.

If an Authority undertakes prudential supervision as well as FCP supervision, this can affect some of the choices made in developing and implementing a risk assessment methodology for FCP purposes. An Authority may have responsibility only for FCP supervision (for example, being part of a "twin peaks" model, where prudential supervision is the responsibility of another Authority), or it may be responsible for both. If it is responsible for both, tasks may then be undertaken by separate units or departments ("internal twin peaks") but are sometimes executed by the same unit or department that undertakes all supervisory functions (although this is generally not recommended from an FCP supervision perspective, given the risk of conflicts of interest between the two functions and the risk that FCP supervision may not receive adequate resourcing or emphasis). In such circumstances, Authorities may choose to begin with FCP RBS as part of their existing prudential assessment framework and thus to undertake an FCP risk assessment as an element within the prudential risk assessment. This strategy is not entirely consistent with the reasons why an internal twin peaks approach is advisable, nor with the differences in risk focus between prudential and FCP supervision noted above. Nevertheless, in practical terms, it may at least allow an Authority to be able to start FCP RBS more quickly and, with time, to then move to a separate RBS framework dedicated to FCP. Other Authorities may be able to adopt a separate FCP RBS framework from the start.

Particularly within an Authority that covers both prudential and FCP supervision, there may also be expectations that FCP RBS will reflect some prudential approaches and elements, including those allowing for some comparability between both risk views. If that is the case, it is important to reinforce that any FCP-related risk definition adopted for this purpose, for consideration with prudential risks, is connected to the probability of harm to financial consumers (or similar), rather than risks for the FSP, even if there can be overlap in terms of risk implications for consumers and FSPs from some of the same sources.[20]

Once an Authority is working on an FCP-specific RBS framework, it will have a range of alternatives to consider and choices to make. The framework may be divided into two elements: (1) a market-wide risk assessment and (2) an FSP risk assessment, both feeding into and complementing each other. Some examples of approaches to risk assessment frameworks are outlined below. The examples do not represent all types of approaches adopted internationally but represent some of the more common approaches. What they all have in common is that they seek to identify FSP-specific risks and specific aspects (products, controls, and so forth) that may warrant greater focus during a supervisory cycle.

a. Market-Wide Risk Assessment

Implementing a market-wide risk assessment as part of an RBS risk assessment framework is not strictly mandatory but highly recommended, because it can provide an Authority with a more comprehensive view of the main FCP concerns in the market, important trends, and emerging risks for financial consumers. This can be extremely valuable for FCP RBS, since international experience has demonstrated that the most pressing FCP issues often tend to be cross-cutting/market-wide, rather than isolated to individual FSPs. Having a more complete view of risks across the market can assist an Authority to anticipate issues that may not be as readily identifiable at the FSP level (or are affecting many FSPs even if a more limited set are subject to more extensive supervision). A market-wide risk assessment also supports thematic supervisory interventions (for example, thematic inspections across a range of FSPs), which can be an effective method to generate substantial improvements in the level of consumer protection in the market.

There are two main approaches to undertaking a market-wide risk assessment: (1) an approach based on combining individual FSP risk views to produce a consolidated risk view (supply-side perspective), and (2) an approach focusing on how consumers are being affected and are behaving in the market (demand-side perspective). In the first approach, the process of undertaking a market-wide risk assessment will comprise two elements: the collection of results for selected risk indicators for all monitored FSPs for a specific timeframe, and then compilation of these results so they can be analyzed together for a market risk view. The data for this risk assessment will be obtained from both market- and FSP-level monitoring (discussed in the next section). The second approach will require collecting risk indicators that measure consumer behaviors and circumstances irrespective of their existing relationship with specific FSPs (for example, indicators of indebtedness, vulnerability, financial literacy, demographics, and experiences with and results of using financial services or engaging with FSPs in general). Authorities may choose to use both approaches combined into their risk assessment methodology, depending on the context factors.

The resulting risk assessment may be documented in formal reporting, updated periodically. The assessment could be presented as a report of all identified risks (for example, new developments, historical trends, possible upcoming concerns) along with a risk-level score (for example, high, medium high, medium low, or low), taking into account the significance of each issue for consumers and the estimated likelihood that a particular pattern of misconduct or mistreatment will materialize. Outputs may include a periodic list of key FCP risks, assessed for significance and the likelihood of consumer mistreatment, similar to the process and output for FSP-level specific risks; inputs for necessary thematic reviews; and any kind of additional responses to new and emerging risks, which could include additional examination procedures, the publication of guidelines, recommendations and warnings, and even regulatory changes. Table 4 provides a simple example.

While it is desirable for a market-wide risk assessment relying on FSP-related data to combine data from all FSPs, this is not essential, as it may be difficult to collect all necessary data from all FSPs. It may be sufficient, at least for initial assessments, to undertake an assessment comprising a smaller set of the most relevant FSPs, depending upon the context factors of the legal and regulatory framework and overarching supervisory approach. An Authority may decide which FSPs are essential to include based on such impact measures as number of consumers or total assets, as discussed under "FSP-Level Risk Assessment" below.

b. FSP-Level Risk Assessment

In addition to market-wide risk assessments, an Authority's risk assessment framework will typically (but not always) include undertaking risk assessments of individual FSPs that the Authority supervises. There are various ways to undertake such risk assessments, ranging from using a single type of measure (for example, grading FSPs based on impact indicators) to using a combination of risk and impact indicators. Regardless of the indicators used to compare FSPs, qualitative and quantitative assessments must be balanced and combined, since quantitative indicators alone may hinder the supervisors' capacity to account for environmental contexts and other underlying "drivers of risk" that may affect such metrics.

TABLE 4 Market-Wide Risk Assessment Example

Issue	Source of Risk	Risk and Impact Indicators	Risk
Rising consumer losses due to fraud and scams	- Increasing use of digital channels - Low digital financial literacy levels - New technologies	- Total consumer losses - Total fraud events - Complaints about fraud and scams - Total digital payments transactions	***High*** Losses may be significant at FSPs with lowest control quality ratings
Increased sale of personal loans through agents/third party distributors	- New entrants in the lending sector marketing aggressively to gain market share - Sales-based incentives - Agents/third party distributors targeting low-income segments of consumers	- Total new loans originated via agent/third party channels - Complaints about mis-selling of loans by agents/third party distributors	***Medium High*** There is still a limited number of FSPs using agents/third party distributors as a sales channel for personal loans, though next year may register a sharp increase
Rapid growth of investment products through digital channels / apps	Consumers may have difficulty understanding options and risks of offers	- Total digital channel investment sales - Complaints about investment mis-selling through such channels	***Medium Low*** Limited sales yet, though it could deliver increased risks in the foreseeable future
. . .	. . .	. . .	. . .

Prioritizing FSPs for Further Risk Assessment

An Authority may undertake an individual risk assessment for all or only some FSPs, based on impact indicators and other considerations. To support such prioritization, the risk assessment should include multiple tiers into which FSPs will be categorized for impact indicators. The FSPs assessed (graded) to be in a higher-impact tier would then be prioritized, for example, for the more in-depth individual risk assessments.

Tiers should be well defined and appropriate to allow meaningful segmentation of all FSPs based on selected indicators. Often four tiers are adopted for this purpose—although an Authority may prefer to work with more or fewer tiers—where tier 1 is the lowest-level peer group for the relevant indicator(s) and tier 4 is the top-level peer group. Statistical methodologies and/or supervisory judgment may be applied to select the most appropriate range for each tier, including possible weights for each indicator.

Examples of impact indicators that can be used for the purposes of ranking FSPs include the following:

- Number of retail customers at the reporting date
- Number of active accounts per product type
- Volume of product sold by type and by distribution channel over the reporting period
- Market share of each segment
- Financial value of products[21]

Each FSP would be allocated a specific impact grade, allowing all supervised FSPs in the market to be ranked as shown in table 5.

After selecting FSPs that warrant a deeper risk assessment (or if an Authority decides to undertake a risk assessment for all FSPs), an Authority should apply an appropriate risk assessment tool for this purpose. Regardless of the result, an Authority may determine that some FSPs below the defined threshold require a deeper risk assessment in light of other factors (for example, exponential growth or new products released in the market). Supervisory judgment will play a significant role in such decisions. Examples of risk assessment tools that an Authority can consider are discussed next.

FCP Risk Matrix

An FCP risk rating model based on a matrix such as the one shown in figure 5 is aligned with typical prudential methodology for risk assessments and can be the most appropriate alternative when an Authority is contemplating some kind of integration of both types of supervisory assessments. The framework requires identifying an inherent risk view[22] and an evaluation of the quality of controls at the FSP applicable for relevant risks. The analysis of these two items in combination produces a final net risk rating (that is, "residual risk"). The matrix allows risk assessment of different business lines within the same FSP, as well as cross-cutting elements such as governance and culture, producing a final net risk rating for each business line and a final overall risk rating for the FSP when all of these aspects are combined. Risk grades, whether for individual inherent, final net risks, or the overall risk rating, are typically graded as high (H), medium high (MH), medium low (ML), low (L), or a variation of these.

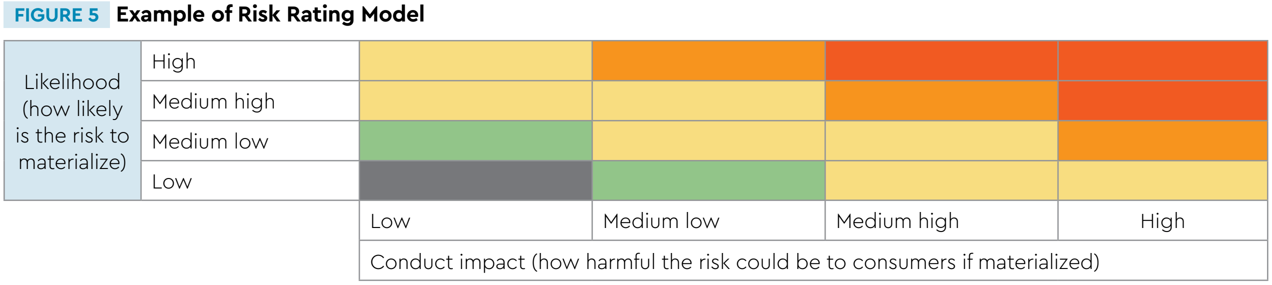
An Authority will often be able to assign an inherent risk assessment rating only for the most intensely supervised FSPs. This is because also evaluating internal controls is a more complex exercise, usually requiring more in-depth individual engagement with an FSP and more extensive supervisory resources, and tends to be feasible only for the highest inherent risk (and highest impact) FSPs.

Numerical ratings or grades are not the only important aspect of applying a risk assessment methodology. Qualitative descriptions and justifications supporting any assessment will also be crucial when indicating the most relevant concerns and assisting to prioritize supervisory attention based on the risk assessment.

TABLE 5 Example of Impact Grading

Impact Indicator	Tier 4	Tier 3	Tier 2	Tier 1
Total [accounts] [retail customers]	Over five million	Four to five million	Two to four million	Fewer than two million
Total transactions	Over 2,000/day	1,000–2,000/day	500–1,000/day	Fewer than 500/day
Market share	Over 55%	45%–55%	15%–44%	Less than 15%

FIGURE 5 Example of Risk Rating Model



A detailed and wide-ranging exploration of the different risk matrices that may be in use internationally is outside the scope of this Note, but the following are two examples of such matrices for illustrative purposes. The generic example shown in table 6 illustrates an approach sometimes adopted by Authorities that focus on undertaking separate risk assessments for each business line of an FSP. Of course, the specific elements making up the approach will also depend on the context factors and other core components discussed in this Note.

The Central Bank of Ireland, publisher of the detailed *A Guide to Consumer Protection Risk Assessment*,[23] is one of a limited number of Authorities that have made their risk framework and matrix public. Figure 6 shows how the Central Bank represents its approach in diagram form. The figure reflects a complex and highly sophisticated methodology that was developed over time to reflect the Central Bank's particular context and necessities, and like other examples, it should not be viewed as a predefined framework that another Authority can adopt automatically and easily. The Alliance for Financial Inclusion has also published a Guideline Note on market conduct RBS that can be a further useful reference point. The Note includes a range of detailed definitions and descriptions of impact and probability indicators, as well as inherent risk, internal controls, net risk, and overall risk.[24]

Outcomes Based

An alternative, simpler framework that can be used to assess risks for an FSP from a consumer perspective is to refer to key topics or desirable outcomes to consumers that may be defined by the Authority. Possible topics or outcomes may be developed according to risks supervised by the Authority and could include, for example, topics such as: confidence, transparency, disclosure, equitable treatment, advice, recourse, product performance, and sales. Such a framework requires the development of a list of indicators and questions for each topic to guide an assessment and possibly to determine a final composite score based on risk scoring for all of these topics. Questions may be divided into "risk" and "controls" types, in order to evaluate the FSP's current risk profile and mitigating measures. This assessment will deliver a final grade for each topic—for example, high, medium high, medium low, or low. The overall risk will be a final composite of all topics. Such a framework can aid an Authority in focusing on key FCP elements, but it also comes with challenges in assessing different business lines within the same FSP.

Product Life Cycle

The U.S. Consumer Financial Protection Bureau uses a product life cycle–based approach that reflects a relatively intensive risk assessment methodology. It has also made its risk assessment framework publicly available.[25] This approach is designed to assess each business line separately; supervisory judgments are used to determine how to combine multiple products from the same FSP to achieve this view. When assessing inherent risks, the approach requires evaluating products, consumers, market methods and sales, customer-relationship management, and compliance-management challenges and scoring them as low, moderate, or high.[26] As part of assessing "Quality of Consumer Compliance Risk Controls and Mitigations," the bureau's methodology requires risk analyses of the FSP's board and management, authority and accountability for compliance, compliance risk management and oversight, product and system development and modification, training, and complaint management, all to be scored as strong, adequate, or weak.[27] Impact is then considered based on the size of the FSP and the number of customers. A final overall risk classification is then produced, again scored as low, moderate, or high.

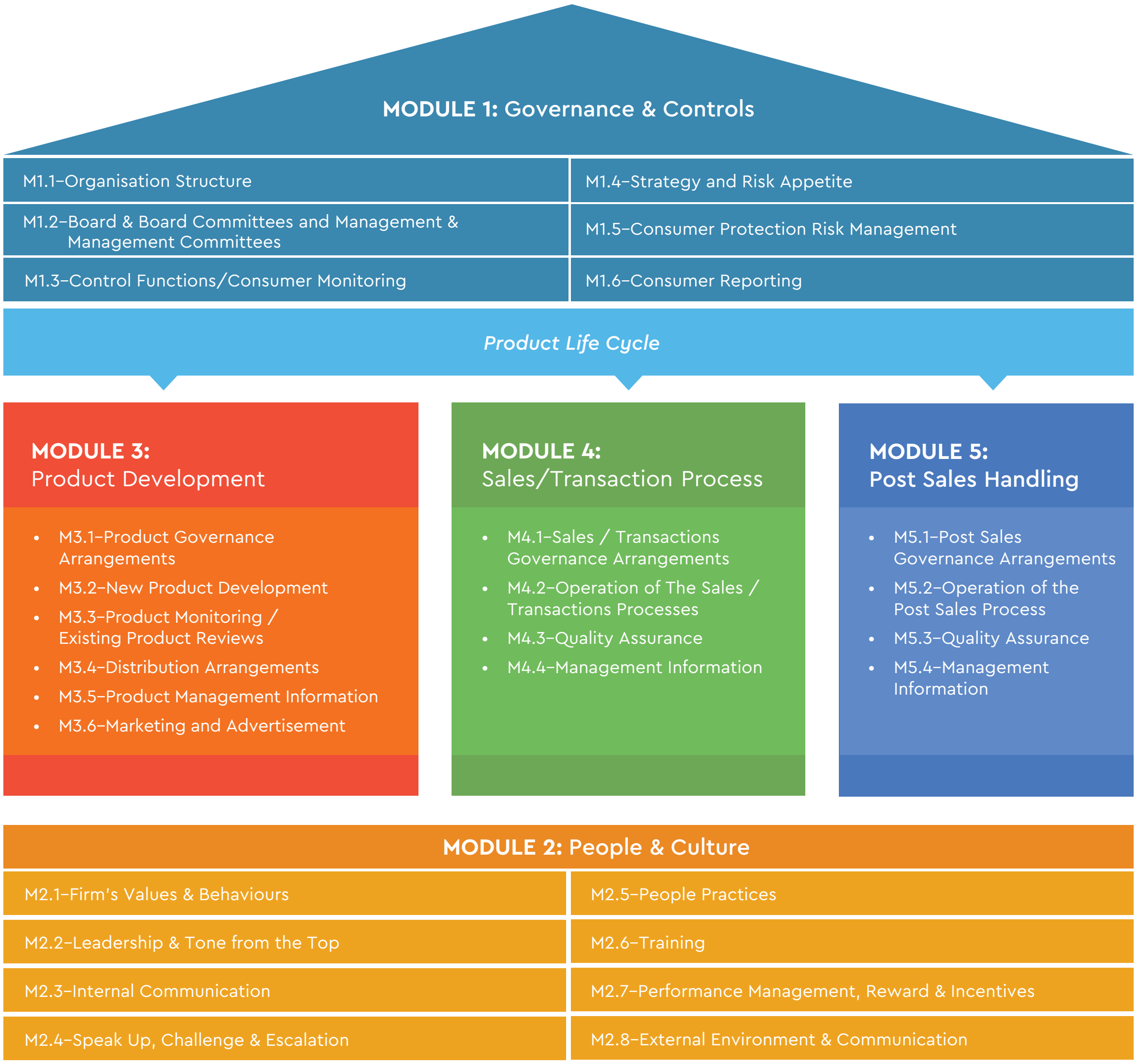
c. Which Framework Will Be the Most Appropriate?

The examples presented above exhibit various differences, including a range of choices made by Authorities across multiple dimensions. They differ in how they categorize risk and controls, score risk assessments, combine net risks, and so on. Differences in approach between Authorities' risk assessment frameworks and RBS approaches more generally are common and should not be a point of concern, provided that the methodology adopted by an Authority is suitable and feasible for its purposes at a particular time. These differences again demonstrate the fact that Authorities can choose from a range of different approaches when building the FCP RBS approach best suited to their own needs and circumstances.

TABLE 6 Risk Matrix Example

Business Line	Inherent Risks	Processes	Controls	Net Risk
For example, personal loans, insurance, etc.	H, MH, ML, or L	H, MH, ML, or L	H, MH, ML, or L	H, MH, ML, or L
. . . .				
. . . .				
Firm/group	H, MH, ML, or L	H, MH, ML, or L	H, MH, ML, or L	H, MH, ML, or L
Governance and culture (assessed for the whole firm/group)				H, MH, ML, or L
Overall risk				H, MH, ML, or L

FIGURE 6 **Central Bank of Ireland's Consumer Protection Risk Assessment**



Source: CBI (2017)

The following are key questions that an Authority may consider, having regard to the framework examples discussed in this section and the context factors discussed in section 2. The best framework for an Authority will be the one that makes more sense for and best fits its current organizational setting, level of comfort with RBS, experience and overall supervisory approach to FCP, and data position. Authorities taking the first steps to building an FCP RBS framework may find themselves more comfortable with simpler methodologies, while Authorities that have been undertaking FCP supervision for some time and are currently supervising larger and more complex sectors may feel the need to develop a more complex methodology. The answers to these questions should be revisited periodically, as relevant answers are likely to evolve over time.

a. Will the Authority develop a formalized FCP risk framework at this time?

For example, an Authority that also undertakes prudential supervision may already have a formal risk framework for its prudential function. That risk framework may cover market conduct/FCP risks only at a high abstract level and/or only to the extent that market conduct may harm the interests (for example, reputation or due to litigation) of the FSP itself, rather than focusing on the interests of consumers. The Authority may therefore decide that its FCP function would benefit from a more specific and tailored risk framework for FCP RBS purposes.

b. Is there a need to define formally what constitutes risks from an FCP RBS perspective, or is this already well understood? (And related to the above, what is the risk definition? What are the associated risk scope and consumer perspective? What are the long term FCP supervisory objectives?)

For example, an explicit FCP risk definition may be useful within an Authority that also undertakes prudential supervision, at least to clarify the contrast with the concept of prudential risks for both staff members and FSPs. However, even if an Authority does not have a "competing" prudential function, adopting a formal FCP risk definition, risk scope, and perspective may be useful for both development and implementation purposes (for example, when deciding whether risk indicators are in fact relevant to an FCP risk), or if the Authority is also required to address other objectives (for example, financial inclusion, consumer education, competition), to assist in distinguishing between these different objectives.

c. Will the FCP risk framework be used only to guide risk analyses in a qualitative manner (that is, without specific risk ratings), or will it also be used to generate risk ratings?

For example, an Authority whose initial data position is very limited—limiting its ability to generate individual ratings for FSPs—may decide to start with a basic risk framework consisting of mostly qualitative profiles of key FSPs. FSP profiles will then be based on the collective professional judgment of the supervisory officers involved, rather than attempting to set up a rating mechanism without access to the required data.

d. How central will the role of the FCP risk framework be in the Authority's supervisory cycle?

i. Will the FCP risk framework (and any ratings based on this framework) support, or determine more strictly, how the Authority sets its supervisory priorities?

ii. Will the FCP risk framework (and any ratings based on this framework) support, or determine more strictly, how the Authority decides on supervisory and/or enforcement interventions?

For example, an Authority whose market means that FCP-focused RBS attention is initially likely to be limited mostly to a small number of key FSPs (with other FSPs meriting thematic attention) may decide that there is less value in developing a framework—at least initially—that generates more sophisticated quantitative risk ratings as the basis for its priority setting. The Authority may opt to use its risk framework simply as a way to structure analyses and internal discussions more generally. On the other hand, an Authority with a more disparate and numerous cohort of supervised FSPs may decide that, even in the initial stages of FCP RBS, a more fully fleshed-out risk rating function is needed. For example, it may decide to rank FSPs from a risk perspective using three or four risk categories to inform and direct decisions on monitoring and supervisory efforts, such as how often it will conduct supervisory meetings with a particular FSP.

e. What will be the relationship between the FCP risk framework and any prudential risk framework employed by the same Authority or a separate prudential regulator?

i. How will these frameworks relate to each other conceptually?

ii. How will these frameworks relate to each other formally?

iii. How will any risk ratings based on these two frameworks relate to each other?

iv. How will the data underlying such risk ratings be shared and reconciled?

For example, an Authority that also undertakes prudential supervision with its own dedicated formal risk framework may decide that its FCP RBS risk framework will be structured conceptually as an elaboration of the FCP risk rating category used in prudential supervision but that both risk frameworks will be applied separately.[28] Assessments of FCP-related risks by prudential and FCP supervisory officers may be reconciled periodically where the nature of the risk suggests this is appropriate. An Authority that is separate from its prudential counterpart may decide it is unnecessary to undertake such harmonization in terms of risk assessment, although it may nevertheless be useful also to have an appropriate level of information sharing with an external prudential supervisory function.

e. Given the answers to these questions, what would be an appropriate approach to (further) develop an Authority's FCP risk framework?

For example, an Authority may choose to begin with limited, purely qualitative risk assessments. Only after it has sufficient critical mass in terms of its quantitative knowledge and capabilities might the Authority start to lay the groundwork for a quantitative risk framework and decide that some quantitative FCP risk ratings are necessary. This will also depend on the availability of supervisory resources and the number of FSPs that may require some level of one-on-one supervision, now and in the foreseeable future—any such decision should always follow actual needs. This may involve experimenting with different methods of arriving at FCP risk assessments for individual FSPs, appropriate testing of these (for example, through peer review or "devil's advocate" testing), and evidence-based documentation of relevant methodology.

3.4 RISK-BASED MONITORING AND SUPERVISION ACTIVITIES

Risk-based monitoring and supervision for FCP purposes can be executed through a range of possible activities and tools. It is crucial first to establish all the core components of an FCP RBS approach previously discussed. Once these components are in place, determining which are the most suitable types of supervisory activities to utilize to achieve a risk-based approach becomes more straightforward, though of course it is never entirely so and adjustments will continue to be necessary.[29] Sound data collection and analysis (discussed in 3.1) feeds into appropriate risk indicators (discussed in 3.2), which in turn deliver relevant key information to conduct an accurate risk assessment (discussed in 3.3), which is ultimately used by an Authority to decide when and how to engage in supervisory action to mitigate the most crucial risks to consumers. The ultimate aim always being to enable effective and efficient deployment of finite supervisory resources for optimal impact. Crucial to achieving this aim is ensuring that, as far as feasible, the Authority selects the most appropriate tools to mitigate particular risks. Such tools will, in turn, also support the ongoing identification and assessment of risks, creating an ongoing supervisory cycle.

For the purposes of this discussion, a conceptual distinction is made between risk-based monitoring, supervisory and enforcement activities, even if there is typically overlap between these activities and some tools may relate to multiple activities.

- **Monitoring activities** enable an Authority to gain insight into FCP risks and FSP conduct in its regulated domain, without directly affecting the conduct of specific FSPs.
- **Supervisory activities** enable an Authority to engage with FSPs directly to gain insights about FSP conduct and, potentially, to affect and improve FSP conduct directly.
- **Enforcement activities** typically involve the use of formal legal powers to coerce FSPs to change their market conduct (for example, fines, injunctions, formal warnings, license suspensions/revocations).

Risk-based monitoring and supervisory and enforcement activities are all essential for an FCP RBS regime and complement each other. Without adequate monitoring, supervisory activities cannot reliably focus on the key FCP risks. Without focused supervisory efforts, monitoring insights cannot lead to in-depth understanding of FCP conduct in the regulated domain. In addition, both monitoring and supervisory activities are typically required for subsequent formal enforcement actions, as they allow the Authority to collect the data and take the procedural steps necessary for legitimate enforcement actions. Conversely, without a credible enforcement regime, it is very hard to maintain an effective supervisory function.

Given that risk-based monitoring, supervision, and enforcement are inherently interconnected and rely on each other to be effective, an Authority will need to choose and develop its methods and tools in a way that ensures that each of these activities is sufficiently robust and mutually reinforcing. For example, a mistake to avoid is setting up a new FCP RBS regime that focuses mostly on monitoring methods and tools without systematically engaging FSPs to improve their performance in a way that benefits financial consumers (such as via direct supervision and enforcement).

a. Market and FSP-Level Monitoring

As previously mentioned, monitoring activities enable Authorities to gain insight into FCP risks and FSP conduct in their regulated domain, without directly affecting the conduct of specific FSPs. This activity is important both to feed into the FCP RBS framework (as a reminder, see figure 3, which shows the FCP supervisory cycle) and also to provide a continuous assessment of FCP compliance, identifying current and emerging risks across the industry at any time. Monitoring includes not only monitoring previously established impact and probability indicators (discussed in 3.2) but also any additional monitored situations and issues that could identify problems or trigger the need for further investigations.

As defined for the purposes of the discussion in this Note, monitoring involves not only reporting risk indicators but also reviewing them and extracting insights into what has happened and what could happen, requiring a type of intelligence analysis. Market and FSP-level monitoring should be reported in conjunction, since they are mutually dependent. Authorities will be able to analyze an FSP's trends effectively only if they are able to compare their indicators' performance with those of the market overall.

During its initial supervisory cycles, it is important for an Authority to focus monitoring activities on the main risks to consumers as articulated in the FCP RBS framework, choosing indicators and situations that really need to be monitored. Monitoring activities take up valuable supervisory resources. Therefore, selected monitoring activities must always result in valuable outputs, such as tracking key risk indicators, triggering alerts of new noncompliance situations, providing internal reports that offer a historical view of the market and FSPs, or generating key inputs for supervisory interventions and strategic planning. Although much interesting and valuable data could be monitored, such data may need to be disregarded in order to have fewer monitored situations and issues but more time to interpret and analyze the results for a select set of issues, to provide more detailed and thoughtful suggestions on potential courses of action for supervisory planning and ongoing activities, and to generate inputs to improve the FCP legal and regulatory framework and the supervisory approach. With time, monitoring processes will evolve and gain maturity and scale, covering more issues and situations without losing quality analysis. Regardless of the monitoring activities to be prioritized, their connection to the FCP legal and regulatory framework and to the overarching supervisory approach will hopefully increase the efficiency and effectiveness of the FCP RBS approach as a whole.

b. Common Risk-Based Supervisory Methods and Tools

Planning for a supervisory cycle should consider the use of all available supervisory tools in a holistic manner. When starting a first RBS cycle, it is expected that not all supervisory tools will be available, and some tools may never be, due to legal restrictions. Furthermore, activities that will call for more supervisory resources should be reserved for the highest priority risks and the riskiest FSPs, and simpler and less resource intensive tools should be used for all remaining situations. By following such an approach, RBS ultimately provides more comprehensive coverage of all risks and FSPs and, hence, greater protection for consumers overall. The greater the number of tool options, the more results may be obtained, provided such tools are well applied. A few common supervisory tools are described below, along with discussions of their potential benefits for an RBS approach and potential limitations and considerations. Although there are several possible ways to organize and categorize the following tools, they are discussed here in a way that highlights their potential contributions to a successful RBS approach, as well as the limitations to take into account before applying them (see also figure 7).

Thematic Inspections

Thematic inspections (also known as thematic reviews) involve assessing a specific issue based upon the assessment of a sample of relevant FSPs, usually within the same timeframe and using the same examination procedure. This method tends to fit particularly well with an FCP RBS approach, since international experience consistently indicates that most of highest-priority FCP risks are strongly related to sector-wide themes and issues.

Contribution to RBS Approach

Thematic inspections provide a market-wide and comparative view of any topic within the most relevant FSPs. Thematic inspections may aim to

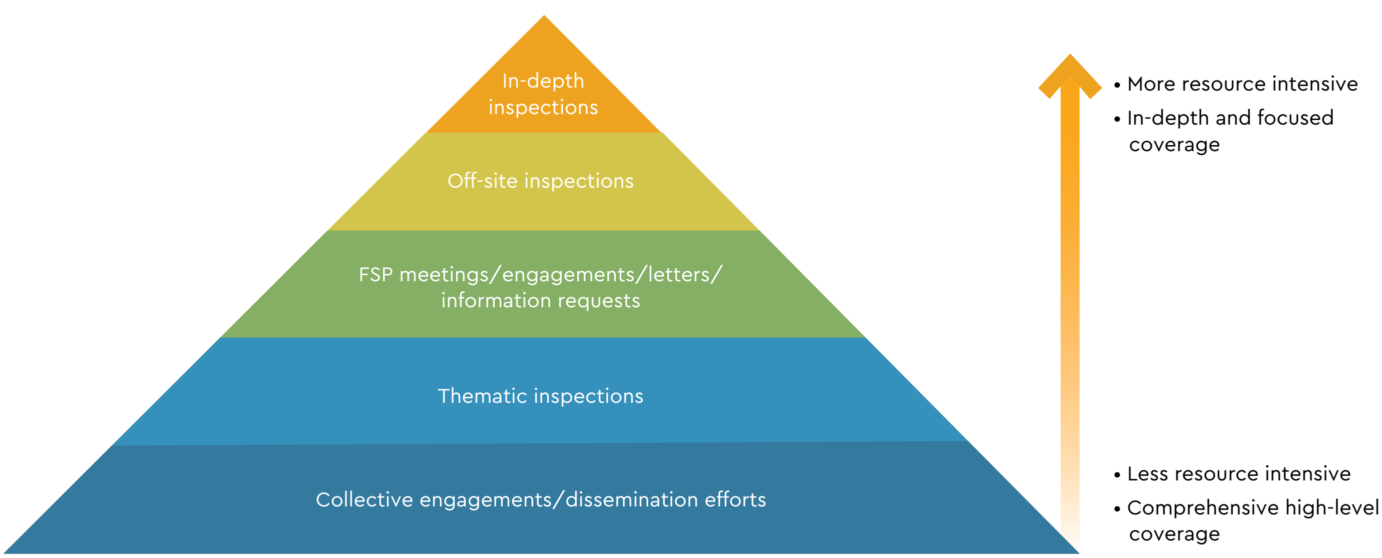
- Identify new FCP problems and find solutions for them;
- Push for market-wide improvement in already familiar FCP issues;
- Assess the potential impact of and level of compliance with new FCP rules; or
- Identify good practices and publicize them in order to be used to communicate supervisory expectations to FSPs and other stakeholders.

Guidance based on thematic inspections provides an effective way to disseminate supervisory concerns and expectations to the entire market at once. Because this kind of examination focuses on a defined objective and examines the same issue across a group of FSPs, it is a practical way to initiate an RBS FCP supervisory regime. For example, thematic inspections could be utilized to examine the top risks that emerge from conducting a market-wide risk assessment. It is expected that most initial RBS supervisory cycles will rely on thematic inspections as one of the main supervisory activities. The inspection results are typically disseminated through a series of follow-up actions (for example, new guidelines development, self-assessment exercises by FSPs) that may also substantially affect the assessed FCP risks and concerns.

Limitations and Other Considerations

While thematic inspections can be very effective and relatively efficient, they also tend to require substantial workforce capacity, so the objective of any such review should be chosen wisely. For example, unexpected noncompliance situations will often be observed at one or a few FSPs. Utilizing thematic inspections to pursue such situations could potentially drain precious supervisory resources without providing sufficient results, given that the noncompliance situation is not more broadly present in the market. Such situations will call for supervisory judgment to determine if such breaches should be prioritized and, if so, which supervisory tools should be used. Useful criteria to consider include the esti-

FIGURE 7 **Illustration of a Possible Combination of Supervisory Tools**



mated extent of harm to consumers, the level-playing-field principle,[30] the number of FSPs involved, and the possible side effects of the issue. Taking all these criteria into account will help to determine if thematic inspections are the appropriate tool to employ, if the scope of a thematic inspection should be redesigned, or if these new items should be considered for future FSP examinations.

Off-Site Inspections

Off-site inspections are one of the most common risk-based supervisory tools. They involve conducting any of a range of interactions with an FSP without necessarily having to delve too deeply into an FSP's internal systems and procedures or visit the FSP's facilities. This kind of inspection allows for a wide array of activities, ranging from a simple inquiry resulting in a noncompliance finding to a more comprehensive inspection that could involve several different FCP policies and procedures and identify/mitigate an array of FCP risks.

Contribution to RBS Approach

Off-site inspections can provide a fast and relatively straightforward way to address issues of consumer risk that need some level of analysis that can be executed without in-depth examinations.

Limitations and Other Considerations

Off-site inspections are commonly the best alternative for a supervisor to find out the status of an FSP risk or concern, provided it is subject matter that has a low likelihood of being concealed or disguised by an FSP. Supervisors should always be appropriately skeptical of an FSP's responses and be ready to initiate further inspections depending on the findings, such as for findings related to sales staff management and IT situations (both of which are usually some of the hardest to inspect effectively solely on a remote basis).

In-Depth Inspections (Remote or In-Person)

While off-site inspections are less costly and highly valuable in terms of supervisory findings, in-depth inspections provide a unique and thorough view of specific FCP concerns, regardless of whether the physical presence of supervisors at the FSP´s premises are necessary. Some relevant findings are obtainable only by specific inspection procedures or on-site visits. Walkthroughs conducted by an FSP's operational staff (whether conducted in person or via remote channels) are frequently a useful way to find out how procedures are being executed, as opposed to reviewing written policies. But this is even more likely to be the case when it comes to FCP RBS, since the weight and impact of the organizational culture in driving an FSP staff's conduct can be perceived much more easily when observed directly by supervisors, whether in person or through remote inspections.

Contribution to RBS Approach

In-depth inspections enable a thorough assessment of an FSP's performance on a specific FSP risk or concern in a manner that cannot be obtained from off-site examinations. Therefore, their use will be more valuable whenever risk assessment results and additional supervisory activities indicate the need for more accurate, in-depth supervisory investigations.

Limitations and Other Considerations

In-depth inspections usually demand a high amount of supervisory resources, which means their use should be rationed carefully. For example, it is always advisable to assign at least two inspectors/supervisors for any on-site activity, since perceptions can be complemented and compared for a fuller picture and there will be double testimony of what has been said in interviews. Depending on the Authority's organizational culture, different hierarchical levels may be involved, so the assigned supervisory team can avoid potential team conflicts during on-site procedures.[31]

Considering resource limitations, in-depth inspections should have a well-determined focus, prioritizing any issue that would be too troublesome to be evaluated through off-site inspections. Ideally, an in-depth inspection should originate from previous off-site supervisory activity that was unable to assess a particular issue fully due to information gaps that can now be addressed only by in-depth activities.

In-depth inspection aspects should include interviews with managers and operational employees and agents and normally also involve accessing management systems and conducting walkthroughs of procedures, either on site or via remote channels. Typical in-depth inspection activities also include observation of staff at branches and agents conducting their daily activities (in particular, the interaction between consumers and sales staff), checking disclosure materials in the main sales channels, and interviewing sales and agent staff, board and management members, auditors and compliance officers, and any other staff that could help examiners understand the current situation.

Letters to FSPs

Once an FCP issue has been identified, properly analyzed, and documented (for example, via a thematic inspection or FSP-specific inspections), it may be necessary to set down this finding in a formal communication to the FSP's board/senior management. Such communications are conveyed via a warning letter, order, or other equivalent document depending on the terminology applied by each Authority regarding formal communication procedures to FSPs. Regardless of the term used, these documents can be key to addressing FCP risks in a timely manner, with an appropriately calibrated level of intrusion, where appropriate.[32]

Contribution to RBS Approach

The objective of such formal communication is to indicate clearly to FSPs an Authority's awareness of the situation and also to formalize the FSP's acknowledgment of it. Such communications are a frequently applied tool used to assure that the risk situation has at least been formally addressed while also providing evidence to track the mitigating actions put in place.

Limitations and Other Considerations

Delivering any kind of formal communication of an identified non-compliance situation is always a sensitive undertaking. As a formal communication from an Authority to an FSP, its content should be standardized or carefully customized depending on need. Having standard form content to communicate the necessity to present a corrective measure tends to facilitate its acceptance. However, there may be situations when a customized letter would be more appropriate. Supervisory judgment should be used to determine which option will provide the best results.

FSP Meetings and Engagements

Holding meetings or equivalent engagements (for example, video calls, email exchanges) with different management levels of higher-risk FSPs potentially can provide strong benefits for RBS while requiring relatively limited resources. It may be used at any time and in multiple ways, allowing great flexibility. It is one of the most frequently used supervisory tools for FCP RBS, contributing to keeping a good grip on higher-risk FSPs' activities and even replacing costly inspection procedures for medium or low risk FSPs. Meetings and engagements can be used ad hoc or as part of a more comprehensive supervisory activity (for example, off-site or in-depth inspection meetings).

Contribution to RBS Approach

The objective of FSP meetings is to have direct interaction with an FSP's representatives, to do things such as obtain information or clarification from them or to inform them of a concern or of a rule or guideline the Authority expects should affect the FSP's conduct or policies. Each meeting/engagement should have clear, specific objectives and be based on appropriate pre-planning. Considering RBS is all about prioritizing and saving scarce supervisory resources, the proper use of meetings is essential in pursuing such a goal.

Limitations and Other Considerations

There are many potential strategies for approaching RBS meetings. It is helpful to consider a list of elements that will guide the best options for each scenario.

- **Purpose:** What is the expected outcome of the meeting? Generally, it is possible to divide supervisory meetings/engagements into three categories: (i) informational, when it is only expected that an FSP receives or delivers some position on a risk or issue; (ii) enforcement, when an informal or formal enforcement measure is to be applied, such as a warning letter, corrective measures order, or another type of noncompliance reporting; and (iii) deliberative, when there is not a firm position from either side and where the meeting allows for an exchange of ideas and perceptions regarding a relevant FCP issue or risk. A strong standpoint from the Authority during an informal enforcement engagement/meeting, requesting a change of position by the FSP, often achieves its objective and thus avoids the necessity of formalizing warning letters or even the execution of a specific in-depth inspections.
- **Formality/recurrence:** Again depending on the purpose, some meetings may require more formal procedures. Examinations usually have opening and closing meetings that are described in supervision manuals and demand that predefined conditions be met. Outside of examinations, ordinary meetings can be used whose only purpose is to check some information or concern. Recurring meetings/engagements are also a valuable means of maintaining an up-to-date view of an FSP's performance and intentions on any given FCP risk or issue, so they are one of the best strategies to use to enrich an FSP's risk profile in an efficient manner (such as using meetings instead on-site/off-site examinations for lower-risk FSPs). For example, for each supervisory cycle, an Authority may proactively require quarterly or semiannual meetings/engagements with an FSP's relevant business lines and internal controls, internal dispute resolution and internal audit functions. The recurrence of these meetings could be defined according to the FSP risk level assessed for the current supervisory cycle. Another relevant recurring meeting strategy is often referred to as a "moral suasion" meeting. This is a more formal meeting (for example, held once or twice a year) with an FSP's board. It is an occasion for the supervisor to report its assessment of the FSP's performance and risk profile. It is intended to make sure that the board is made aware of all or key identified issues and concerns with the FSPs' activities and then is persuaded to commit to improvements that will be followed up on during the next period. It is a powerful tool if well executed on a recurring basis (for example, every supervisory cycle), thus triggering all FSP functions/departments to anticipate the Authority's concerns and to seek to address those issues prior to the next scheduled meeting.
- **Attendance:** Defining the purpose of a meeting or engagement will facilitate the decision about who should attend the event on both sides. For example, operational staff attendance may be sufficient for technical meetings/engagements. However, enforcement meetings or engagements will call for the attendance of at least one or more FSP directors (or similar senior management) who are directly responsible for the issue of concern. It is advisable to hold meetings with at least two Authority representatives to strengthen the supervisory position and to try to balance the rankings of each side (top-level FSP management meeting representatives of equivalent seniority from the Authority's side), to avoid the risk of underrepresentation on either side, which could jeopardize the desired outcome of the meeting.
- **Location:** The location should always be chosen by the Authority's representatives. Though location is not crucial to achieve a meeting's purpose, there are two issues to be considered: the location's relevance to local culture (for some countries this may play a role, while for others it may not be that important), and the impact of the subject on the FSP. Operational meetings are usually held at the FSP's premises. More delicate and higher-level subjects may call for a meet-

ing at the Authority's premises. Also, when starting an initial supervisory cycle, choosing the Authority's facilities for meetings is a way to demonstrate a "soft power" presence for the newly established FCP unit.

Dissemination Efforts

Publicizing supervisory activity findings and results, and guidance, can be an efficient way to disseminate an Authorities' views regarding an emerging or newly trending risk arising from market-wide risk assessments. All FSPs can then receive relevant guidance at the same time.

Contribution to RBS Approach

Public dissemination efforts can be a powerful way to address a risk concern without the cost of conducting some kind of inspection. They provide a fast and agile means of addressing an Authority's concern and providing guidance regarding an FCP risk identified across a significant part of the market, giving all FSPs opportunity to address the potential situation at the same time. This method may also serve to disseminate supervisory expectations regarding new FCP rules or standards. Since it is a public communication, it is also the case that other FSPs may "whistle-blow" a competitor, which may assist to indicate where supervisory intervention may be necessary.

Limitations and Other Considerations

The main potential shortcoming regarding publicizing guidance is related to the capacity and propensity of the Authority to then take action whenever an FSP is found to not be heeding such public guidance. An Authority will need to be sufficiently ready to follow up to ensure such guidance is taken seriously by the market, while not taking up excessive resources for this purpose. Such communications should therefore be reserved for situations with a substantial negative impact on the entire market or where the content of communications is suitable to be disseminated in an open-ended manner (more informative and less directive), in order to avoid excessive pressure on supervisory resources to respond to the particular issue at hand.

Collective Engagements

Collective or industry engagement is a direct interaction between an Authority and FSPs, as well as industry and consumer associations. Distinct from public dissemination efforts, this tool is designed to collect intelligence on market risks and responses and to understand business conduct and FCP risks based on information gathered from other stakeholders' perspectives.

Contribution to RBS Approach

Collective engagement is a feasible alternative to address cross-sector risks in a flexible way, usually when feedback from stakeholders is necessary to improve the Authorities' risk perception. It is usually well-accepted by industry and consumer bodies, since it can provide an open forum of discussion.

Limitations and Other Considerations

Collective engagements can have the benefit of being able to reach the whole market at once, but organizing such events is usually time consuming and may require complex content and logistics management to achieve their objectives. Also, Authorities should not underestimate the risk of fostering the image of a "soft" Authority (inclined to bend to the industry's wishes) or of an Authority that does not meet the expectations of stakeholders not included in the engagement (for example, consumers).

Information Requests

Formal information requests include asking an FSP to answer questions or provide a set of data, usually assuming that the FSP is legally bound to respond truthfully. Such requests may form part of a broader supervisory activity (such as a thematic inspection or an in-depth examination), but they can also be considered as a stand-alone RBS tool, since they can be used on an ad hoc basis as a single supervisory activity.

Contribution to RBS Approach

Used as a stand-alone supervisory tool, RBS information requests are designed to obtain information considered key to assessing an FCP risk or compliance issue. Information requests are also sometimes used to send a message that an issue is being monitored by the Authority (for example, requesting information on how FSPs are dealing with new issues or developments, or the schedule for achieving compliance with a new rule in the context of upcoming deadlines). In both situations, information requests are especially advantageous when it becomes necessary to address a new and unanticipated risk (for example, a sudden increase in complaints regarding a product offered by an FSP categorized as medium to lower risk, or a concern regarding a new product in the market) that needs some sort of response but not enough to require a formal inspection (at least not yet). The difference with information requests during thematic inspections is that the answers to an ad hoc information request will not *necessarily* be thoroughly analyzed, and immediate additional supervisory interventions are not necessarily expected. It is common for issues to be identified by monitoring processes that may be further explored and contextualized via an information request, thereby avoiding additional and unnecessary supervisory activities.

Limitations and Other Considerations

As with public supervisory communications, stand-alone information requests are intended to address market-wide or FSP-specific FCP issues without undertaking more formal, intrusive, and costly reviews or examination procedures, though this may not always be the case. Depending on the answer obtained, it may or may not be necessary to dig deeper into some FSPs' processes. It is also important to consider the weight of an information request, since this can vary depending on the country background (for example, depending on cultural perceptions and expectations) and legal mandate of the Authority. This tool is more effective when the very sending of the request is regarded as an impactful supervisory intervention; this may not be the case for all countries and for all Authorities, especially when the FCP regime is still in its early stages.

Mystery Shopping

Mystery shopping is a technique that uses individuals (supervisors or not) trained to experience and measure customer interactions by acting as potential consumers and analyzing as well as reporting back on their experiences in a detailed and objective way. It is often also used as a market-monitoring tool**.** It is can be a unique and sometimes quite accurate way to obtain evidence of how consumers are being exposed to FCP risks, providing a better understanding of their overall experience when interacting with FSPs.

Contribution to RBS Approach

Mystery shopping can provide a relatively vivid practical perspective of situations faced by consumers during their interactions with FSPs, focused on preidentified FCP risks. It can also work as a conduct deterrent for FSP staff or agents, given the risk of interacting with a mystery shopper.

Limitations and Other Considerations

It is important to analyze in advance whether the procedure is legally possible in a given jurisdiction, and also whether it would actually be able to provide a useful viewpoint depending on the issue that is of concern. As it is a simulation, legal systems in some countries may consider that mystery shopping is not an adequate practice for inspection purposes. Costs are also a constraint, since it is a highly specialized tool that is not easy to conduct frequently.[33] In addition, not all issues affecting consumer interactions with FSPs can necessarily be tested effectively through mystery shopping so the appropriateness of this method needs to be carefully considered in advance.

c. Selecting and Deploying Risk-Based Supervisory Methods and Tools

As can be seen from above, Authorities can draw from a range of monitoring and supervisory methods and tools as part of their FCP RBS approach.[34] The following are key questions that Authorities should ask to help determine which methods and tools should be selected and deployed for their circumstances. The answers to these questions will be affected by various key context factors discussed in section 2, including, for example, any legal limitations on supervisory activities, the structure and size of the financial sector being supervised that may warrant certain prioritization choices, and the overarching supervisory approach of the Authority.

a. **Which risk-based monitoring methods and tools are available for FCP RBS or can be made available in the foreseeable future?**

b. **Which risk-based supervisory methods are available for FCP RBS or can be made available in the foreseeable future?**
For example, an Authority that is just beginning its operations and is faced with limited capabilities may initially adopt monitoring and supervision methods and tools that are primarily qualitative. Thus, its supervisory interventions—even if risk based—may be much more ad hoc and limited, and its RBS methodology and toolkit will expand over time.

c. **How can the Authority achieve an appropriate balance between risk-based monitoring and supervisory activities?**
For example, an Authority that has been undertaking supervisory activities—such as a central bank already undertaking prudential supervision (and possibly also FCP supervision, even if not yet on a risk basis)—may be able to commence the monitoring component of its RBS supervisory cycle immediately, using a mixture of methods such as analysis of prudential reports, analysis of complaints data, media monitoring, and industry engagements. The supervisory methods and tools that it could already engage with a risk-based focus may include supervisory engagements with market incumbents backed up by FSP-specific inspections where needed and some thematic inspections aimed at particular parts of the market. It may also choose to adopt an initial position regarding allocation of resources to have a more immediate impact on the industry's FCP performance despite limited capacity, such as initially dedicating, for example, 60 percent of its annual operational capacity to supervision and 25 percent to monitoring (and the remainder to other activities).

d. **Of the additional risk-based monitoring and supervisory methods and tools that are not yet available, which might realistically be developed in-house?**

e. **Of the additional risk-based monitoring and supervisory methods and tools that are not yet available, which might realistically be acquired? From which outside providers (either for-profit or not-for-profit)?**

f. **Of the additional risk-based monitoring and supervisory methods and tools that are not yet available, which would add the most value to the Authority's FCP RBS regime, given the context in which it finds itself?**
For example, the increasingly digital nature of financial services delivery and business models in an Authority's market may make expansion of tools that focus on supervising digital distribution and communication channels (online apps, social media, and so forth) one of the selected priorities.

Once an Authority has established its initial RBS approach, including development of its initial set of monitoring and supervisory tools to be employed, it would aim to combine these to cover all FSPs under supervision (the supervisory universe referred to earlier) as far as feasible using its market and FSP risk assessment results as drivers. The total supervisory activities to be undertaken will be determined by the availability of supervisory resources (human and technology), and the subject matter of each activity will be determined by the completed risk assessments. Table 7 provides an illustrative example of what an initial preplanned com-

TABLE 7 Illustrative Example of a Combination of Supervisory Activities for FCP RBS

Supervisory Tool	Planned Coverage of the Supervisory Universe
Information requests	Market-wide
Thematic inspections	Three inspections per year for tier-4-risk FSPs; two inspections per year for tier-3-risk FSPs; one inspection per year for tier-2-risk FSPs
In-depth inspections	Two inspections per year for tier-4-risk FSPs; one inspection per year for tier-3-risk FSPs
FSP meetings	Recurring biannual meetings for tier-4-risk FSPs; recurring annual meetings for tier-3-risk FSPs; ad hoc meetings for tier-2-risk and tier-1-risk FSPs
Mystery shopping	Scheduled for tier-4-risk FSPs for specific issues
(Other relevant activities—for example, public supervisory communications)	

bination of risk-based supervisory activities may look like. Naturally, it is expected that throughout the periodic supervisory cycle, there will be new risks or issues that will necessitate review and adjustment of this plan.

d. Enforcement

While a detailed discussion on enforcement activities is beyond the scope of this Note, it is important to emphasize that, after an Authority has properly established its monitoring and supervisory activities and risks have been identified and assessed, the ultimate success of its approach will rely heavily on the effectiveness of its risk mitigation/enforcement regime, including formal and informal enforcement efforts. Monitoring and supervisory efforts will lack real world impact without taking proper enforcement measures where needed. The enforcement regime should be able to deter FSP misconduct, granting credibility to the Authority's reputation for seriousness and follow up, and strengthening a culture of compliance and respect for FCP in the jurisdiction.

Enforcement may be divided into soft-power measures, which are the informal tools available to shape an FSP's conduct, such as those mentioned above (for example, meetings, information requests, warnings), and hard-power tools (for example, sanctioning, fines, penalties, compensation orders). However, hard-power tools and strategies are less often an immediate part of RBS regimes, as their use is more rigid and based upon the legal framework and context of each country (as opposed to the discretionary judgment employed within an RBS regime). Precisely for this reason (and also to preserve a "screen" or "firewall" between both duties), when it becomes necessary to employ hard enforcement measures, some Authorities choose to assign formal enforcement activities to nonsupervisory teams in different departments, assuring that this matter will be carried out strictly under a compliance-based approach, as opposed to a risk-based approach.

NOTES

13. Note that these four dimensions are not exhaustive. For example, one might also distinguish data collection and analysis approaches on a continuum of aggregated versus granular. Section 3.2 considers this dimension.
14. For example, if a sector has a history of significant complaints regarding fraud events in general, or of a wide incidence of fraudulent credit card transactions not being resolved, there would be a compelling reason to include indicators relevant to these issues (whether in terms of complaints, market metrics, consumer losses, numbers of customers affected, and so forth) despite—or, arguably, even because—such indicators did not show significant change.
15. For further details, see Dias (2013).
16. Impact may be defined as the potential impact of an FSP's conduct-related harm to consumers and/or to the confidence and trust in a financial market. It is typically assessed by reference to factors including the size of the business and number of consumers. An Authority will need to develop a context-specific definition depending upon its RBS framework characteristics.
17. Probability may be defined as the likelihood of the event (in this case, FSP conduct harming consumers and/or confidence and trust in a financial market). It is usually assessed by reference to the nature of the financial products. (For example, for a consumer, acquiring a credit card can result in a greater likelihood of harm than just having a prepaid card.) An Authority will need to develop a context-specific definition depending upon its RBS framework characteristics.
18. G20/OECD Task Force on Financial Consumer Protection (2018).
19. See, for example, Sahajwala and Van den Bergh (2000), 7.
20. For instance, an increased probability of harm to consumers (FCP perspective) may coincide with an increased probability of reputational harm to the FSP (prudential perspective), as the FSP's reputation may be damaged through rising complaints and adverse media coverage.
21. In contrast with other impact indicators more related to scale, the financial value of products focuses on the potential financial detriment to which consumers are exposed as a result of the products (although there are considerable challenges in measuring a variable that does not affect all consumers equally).
22. Inherent risk could be defined as the level of risk present in (presented by) an FSP before controls are applied. In the model presented in figure 5, it is the result of impact versus likelihood.
23. CBI (2017).
24. AFI (2016).
25. https://www.consumerfinance.gov/compliance/supervision-examinations/
26. To underscore to what extent risk assessment frameworks can differ, some elements, such as customer-relationship management and compliance, are considered internal controls in other methodologies.
27. Again, some of these elements are regarded as inherent risks in other methodologies.
28. Prudential supervisors without an FCP-specialized unit often incorporate FCP risk assessments into their prudential methodology as a specific element or embedded into other prudential elements, such as reputation and strategy risks. However, once such an Authority has developed any level of an internal-twin-peaks model, the prudential risk assessment framework will require revision in order to ensure that prudential and FCP risk assessments are consistent and complementary and not competing processes.
29. For further elaboration on some relevant risk-based monitoring and supervisory tools and activities, see Izaguirre et al. (2022) and FinCoNet (2018).
30. The level-playing-field principle or concept, meaning that all competitors should compete under the same set of rules, is even more relevant for FCP supervision, since corrective measures in this area usually result in direct impact on an FSP's operational results and commercial strategies. Hence, any situation found in a particular FSP whose correction may substantially affect its profitability should also be assessed as soon as possible at other FSPs of a similar type.
31. In-depth inspections are also a crucial method of on-the-job training for less experienced inspectors/supervisors, due to their intensity and in-depth nature. It can be useful to have seasoned and new staff to work together as a team for training purposes.
32. Although part of the description here may suggest enforcement measures, and not risk-based supervision activities per se, the use of letters to FSPs is also a valuable tool for addressing FCP risks efficiently and in a timely manner, thus its relevance to the present section on supervisory methods.
33. For further information about mystery shopping, see Izaguirre et al. (2022).
34. As noted above, for further information on some of these tools, also see Izaguirre et al. (2022) and FinCoNet (2018).

APPENDIX A

Examples of Risk Indicators

An Authority can theoretically develop a wide range and large number of combinations of indicators for FCP RBS purposes. The following are examples of possible indicators for use from an FCP perspective. Some examples may result in a subset of multiple indicators (rather than necessarily a single indicator), depending on how they are organized by the Authority and the level of granularity in terms of different issues. Importantly, as discussed earlier in the Note, RBS is an evolving process for any Authority, and it is recommended that an Authority develop a relatively small number of indicators at first, reflecting the best possible quality data the Authority has available and prioritizing essential risks within the jurisdiction. Examples of indicators that would require a set of more complex data have not been included below. As an Authority progresses, and as staff gain confidence and experience, the indicator set size and complexity can be expanded, but always ensuring that each indicator serves a clear and useful purpose.

The examples suggest briefly how individual indicators (or limited combinations) may be interpreted and used to trigger additional risk-based activities. However, more accurate conclusions will always rely upon the combined interpretation of all available indicators, the background behind those indicators, and sound supervisory judgment.

In addition, an Authority will need to define relevant segments (such as product segments) for specific indicators. For example, loan-specific indicators may be derived having regard to all loans and also specific results/data for mortgages, auto loans, credit cards, payday loans, and so on.

Indicator	Consumer perspective(s)
Description	Assessment of the current situation for financial consumers (or certain types of consumers) combining/including information on financial literacy, vulnerability profiles, and demographics
Format	Qualitative
Periodicity	Usually quarterly, semiannually, or annually
Purpose	To be used to assess relevant risks at a market level regardless of consumer dealings with specific FSPs. It relates to consumers' profiles/life circumstances, rather than FSP performance. It gives an important perspective by providing a risk view that may not necessarily be assessed only through FSP data, and it can offer a more comprehensive view of some consumer risks
Risk correlation	N/A
Data source	Authority's databases or research or other government, industry, or consumer association databases, or research/FSP data and social media regarding vulnerability circumstances of consumers, such as financial health or digital maturity
Potential additional indicators	The data may allow assessment of historical trends. Data relating to/from FSPs regarding vulnerability factors for consumers may also be used for a qualitative FSP-related indicator, although the data quality (or availability) may be limited

Indicator	**Total consumer accounts/products**
Description	Total number of active/open deposit accounts, credit card accounts, and payments accounts. Depending on the circumstances, it may be replaced with total number of active consumers, instead of accounts
Format	Quantitative
Periodicity	Usually quarterly, semiannually, or annually
Purpose	This can be one of the most important indicators of potential impact for FSPs, whether combining all/multiple products or reporting on each business line/product type separately. For some segments, it can also be an important market-share indicator
Risk correlation	Positive (the higher the number, the higher the risk)
Data source	FSPs
Potential additional indicators	This data can also allow assessment of historical trends regarding total accounts/products (for example, increases in number of accounts, growth rate, gender disaggregation, and level of relevance of each product/type/business line for the market and the individual FSP)

Indicator	**Total assets**
Description	Total assets per segment (total active loans, total deposit accounts balance, and so forth)
Format	Quantitative
Periodicity	Usually quarterly, semiannually, or annually
Purpose	This can be one of the most important indicators of potential impact for FSPs, whether combining all/multiple products or reporting on each business line/product type separately
Risk correlation	Positive (the higher the number, the higher the risk)
Data source	FSPs
Potential additional indicators	This data can also allow assessment of historical trends regarding total assets (increase in assets/balances during the reported period, total asset/account balance growth rate, and so on)

Indicator	**Total revenue**
Description	Total revenue per segment (credit, insurance, accounts, payments, and so forth)
Format	Quantitative
Periodicity	Usually quarterly, semiannually, or annually
Purpose	Although typically more prudentially focused, this can also be a useful indicator regarding share of market activity
Risk correlation	Positive (the higher the number, the higher the risk)
Data source	FSPs
Potential additional indicators	This data can also allow assessment of historical trends, such as those relating to revenue growth rate, including weighted by total number of consumers and/or complaints

Indicator	**Segment profile**
Description	Profile classification for each FSP's business line(s)
Format	Qualitative
Periodicity	Annually
Purpose	This is to identify which FSPs may have higher inherent risks due to a greater focus/more extensive dealings with more vulnerable consumer segments, especially considering possible gender disaggregation. FSPs targeting lower-income segments are expected to present higher FCP risks. The classification for the purpose of the indicator is developed using the four tiers used for risk levels (that is, each possible market segment is classified as high, medium high, medium low, or low risk)
Risk correlation	N/A
Data source	Data from FSPs with application of risk classification methodology
Potential additional indicators	N/A

Indicator	**Distribution channels**
Description	Use of third party/outsourced distribution channels
Format	Qualitative
Periodicity	Annually
Purpose	Heavier dependence on agents/other third parties to market and sell products can present higher inherent risk for consumers, as controls and oversight tends to be inherently more limited than those of an FSP's own branches (or directly administered digital channels). The risk indicator classification for the purposes of different levels of reliance on third party distribution is developed using the four tiers used for risk levels (that is, levels are classified as high, medium high, medium low, or low risk)
Risk correlation	N/A
Data source	Data from FSPs with application of risk-classification methodology
Potential additional indicators	N/A

Indicator	**Product profile**
Description	To assess relevance for FSPs of product types with higher inherent risks
Format	Qualitative
Periodicity	Annually
Purpose	Products must be categorized in terms of inherent risks for consumers. (For example, credit cards present higher inherent risks than prepaid card accounts, which present higher inherent risk than some other types of accounts, and so on.) The riskier the products an FSP offers, the higher the inherent risk. The risk indicator classification for the purposes of different products is developed using the four tiers used for risk levels for each possible financial product (that is, levels are classified as high, medium high, medium low, or low risk)
Risk correlation	N/A
Data source	Data from FSPs with application of risk classification methodology
Potential additional indicators	This indicator could additionally take into account (or analysis could be combined with) the relevance of each product/business line to an FSP while also considering "Total consumer account/product" and "Total assets" indicators

Indicator	**Consumer complaint drivers**
Description	To assess the most significant types of/reasons for complaints at each FSP (including resulting in complaint increases)
Format	Quantitative
Periodicity	Usually quarterly, semiannually, or annually
Purpose	Each FSP reports a list of the statistically most relevant complaint types/reasons (for example, the top 10 or top 20) and corresponding complaint numbers, assisting to provide a view of which issues may need to be prioritized during the next supervisory cycle
Risk correlation	N/A
Data source	FSPs
Potential additional indicators	This indicator may additionally be considered together with indicators relating to account/product numbers, market share, and so forth, providing a weighed perspective, given that the nature of complaints is usually at least in part connected to product features. (Other considerations, such as distribution channels and gender disaggregation are, of course, also relevant.)

Indicator	**Volume of consumer complaints**
Description	Total number of consumer complaints relative to a measure of size, usually per number of consumers/accounts
Format	Quantitative
Periodicity	Usually quarterly, semiannually, and annually
Purpose	Providing a relative view regarding an FSP's complaint levels
Risk correlation	Positive (the higher the number, the higher the risk)
Data source	FSPs
Potential additional indicators	The data additionally allows assessment of historical complaint trends, spikes (or improvements) for a reporting period, and so on

Indicator	**Complaint resolution**
Description	Total number of (fully) resolved consumer complaints
Format	Quantitative
Periodicity	Usually quarterly, semiannually, and annually
Purpose	To identify possible issues with complaint resolution (and, if feasible, segmented by available classification methods—for example, complaints relating to different products).
Risk correlation	Negative (the higher the number, the lower the risk)
Data source	FSPs
Potential additional indicators	There are typically various standard indicators used by FSPs to assess the quality of their internal dispute resolution processes, such as FCR (First Call Resolution), dropped-call rates, and so forth, that could also be requested from FSPs, including for peer comparison

Indicator	**Number and volume of transactions**
Description	Total number and volume of transactions by any type of financial product/service. More relevant for payment services.
Format	Quantitative
Periodicity	Usually quarterly, semiannually, and annually
Purpose	This can be an important indicator of potential consumer impact of an FSP, whether based on a combined figure or reporting by service/product separately
Risk correlation	Positive (the higher the number, the higher the risk)
Data source	FSPs
Potential additional indicators	The data can also allow identification of historical transaction trends, transaction increases, growth rates, and significance of each business line for the FSP and for the market, as well as weighting by total number of consumers/complaints

Indicator	**Media and social media monitoring**
Description	Analysis of mentions of FSPs on social media platforms, blogs, online forums, and mainstream media. The latter may be measured through a separate indicator, apart from social media
Format	Qualitative
Periodicity	Usually semiannually and annually (but it may be monitored even daily, if resources allow)
Purpose	It can provide additional perspectives regarding potentially significant or problematic concerns in relation to an FSP as reported by their own customers, consumer associations, or others
Risk correlation	N/A
Data source	Internal specialized monitoring team or outsourced. It requires media monitoring expertise and technology
Potential additional indicators	The data may be compared with complaints and total accounts/total assets indicators to improve relevant risk perspectives (for example, a rapid growth in sales by a specific product followed by an increase in consumer dissatisfaction expressed via social media)

Indicator	Dispute resolution and compliance reports
Description	Analysis of mandatory reports to the Authority from FSPs regarding their internal dispute resolution processes and their FCP compliance (including internal audit) and management of FCP issues
Format	Qualitative
Periodicity	Usually semiannually and annually
Purpose	Although such reports may have the most relevance to the quality of an FSP's controls, they may also provide a good perspective for possible inherent risks or issues to be prioritized during future supervisory activities
Risk correlation	N/A
Data source	FSPs
Potential additional indicators	The data may be compared with complaints and total accounts/total assets performance indicators to provide a more accurate risk perspective

The following is a more extensive list of possible indicators (including those listed above) that may be used for different purposes in an RBS context. All indicators may be disaggregated by relevant FCP variables, such as sociodemographic segments, gender, consumer vulnerability, ethnic groups, financial literacy, and digital maturity, all depending upon the quality of available data, market characteristics, and overarching supervisory approach.

Indicator	Category
Total consumer indebtedness	Market conditions
Financial literacy	Market conditions
Technological literacy	Market conditions
Country's banking access rate	Market conditions
Total active retail accounts/consumers	General profile
New retail accounts/consumers acquired during reporting period	General profile
Number of retail accounts/consumer relationships ended during reporting period	General profile
Number of vulnerable consumers/percentage of vulnerable consumers	General profile
Market share per relevant segment (as defined by the Authority)	General profile
FSP's relevance of higher inherent risk products (as defined by the Authority)	General profile
Total inactive/dormant accounts	General profile
New inactive/dormant accounts	General profile
Total assets by segment/total accounts balance	General profile
Net interest income earned by FSP	General profile
Net non-interest income earned by FSP (fees, charges, and commissions of any type)	General profile
Total penalties and losses to consumers	General profile
Penalties and losses during the reporting period	General profile
Total complaints (filed with FSPs, the Authority, or, for example, ombudsman schemes)	Complaints
Total complaints by critical subject (filed with FSPs, the Authority, or, for example, ombudsman schemes)	Complaints
Complaints by resolution time	Complaints
Complaints by status	Complaints
Complaints by product	Complaints
Total branches and agents	Distribution channels
Total agents by service delivered	Distribution channels
Share of new accounts/new consumers originated from digital channels	Distribution channels
Total fraud events	Assets misuse

continued

Indicator	Category
Total value of fraud loss	Assets misuse
Total new loans	Loans
Nonperforming rate	Loans
Average interest rate	Loans
Value of new loans	Loans
Events of early payments	Loans
Value of loans transferred from the FSP to another provider	Loans
Total events of loans transferred from the FSP to another provider	Loans
Total unsuccessful events of loans transferred from the FSP to another provider	Loans
Total payment events	Payment services
Total volume of payments	Payment services
Average payment ticket	Payment services
Total unsuccessful transaction events	Payment services
Total insurance claims	Insurance
Loss ratio	Insurance
Renewal events	Insurance
Sanctioning history (by all legally mandated Authorities)	Supervision
Timely solution of noncompliance findings	Supervision
FSP's quality of regulatory reporting	Supervision

APPENDIX B

Illustrative Scenarios of RBS Approach Development

The following are two fictional scenarios illustrating how initial choices regarding the development and implementation of an RBS approach may be made in practice, based on the practical context that different Authorities may be dealing with. The scenarios describe how an analysis and decision-making process based on the context factors and core components discussed in this Note may progress for hypothetical Authorities, including context-specific answers they may give to key questions mentioned in various sections of the Note. These scenarios illustrate how context factors and core components discussed in the Note are crucial to adopting a sound FCP RBS implementation approach; how such analyses will and should vary in light of the situation in which an Authority finds itself; how these context factors and core components interact with each other; and how this can yield a decision-making process for implementing a pragmatic FCP RBS. Potential conclusions and action items for these fictional examples are provided in footnotes.

Note that these examples are brief and highly stylized—a real-world example would likely be more elaborate and complex. Although aspects of these scenarios may appear to be more or less similar to an actual Authority's specific situation, the Authority's mix of practical and strategic considerations will vary and ultimately be unique, and it may make different but equally valid decisions. Nevertheless, it is hoped that the examples will provide readers with a more tangible feel for how these context factors and core components can guide their own, customized analyses and subsequent conclusions and actions.

EXAMPLE A

Authority A is a central bank that has recently decided to implement an FCP supervisory function that will take an RBS approach. There has been a considerable FCP regulatory reform effort, and some staff members have been earmarked to help set up and execute the FCP supervision, but other than that, not much has been decided or implemented yet.

Context Factor 1: Legal and Regulatory Foundation

Due to recent regulatory reforms, Authority A has a clear mandate to conduct FCP supervision with regard to banks, but not yet with regard to non-banks and financial intermediaries, which are subject to limited and largely ineffective self-regulatory regimes. The internal mandate of the Authority's FCP department to undertake supervisory actions, including on-site inspections, is not yet explicit (in contrast with the prudential supervisory departments, which do have an explicit mandate). Until an explicit mandate is arranged, the FCP department may have to rely on prudential supervisory departments for on-site inspections and enforcement actions.[35]

Context Factor 2: Market Characteristics

The supervised market features a large number of consumers (50 million), of whom a large portion are unbanked and/or have very low financial literacy. There are two major local banks (incumbents) and a range of international bank branches. The local banks are relatively "low-tech" general banks that are slow to change and use mostly manual processes. The international banks are relatively "high tech" and feature elaborate control systems; these banks are mostly active in specific niche markets focused on specialized target groups such as high net worth individuals or corporate customers. Market growth is positive but limited, and industry entry/exit of significant FSPs is rare.[36]

Context Factor 3: Overarching Supervisory Approach

Crucial approach-determining factors in the context of Authority A are the limited staff resources available to the FCP department, the greater supervisory expertise available within Authority A's prudential supervision departments, and the particular structure and nature of the industry—that is, two incumbents and a range of international bank branches. Authority A considers that a basic risk framework–centered approach seems the most sensible supervisory approach for the foreseeable future.[37] Once the FCP department has gained sufficient experience, reputation, and track record, from an RBS perspective it may consider further developing its risk framework and, from a broader strategic perspective, adopting elements of a responsive or problem-focused approach—for example, customized supervisory projects.[38]

Context Factor 4: Organizational Setting

There are currently no board members at Authority A who have affinity with FCP. The FCP department currently reports to the board member responsible for prudential supervision. Awareness of the upcoming implementation of the FCP RBS regime among relevant departments within Authority A, other than within the FCP department, is limited. The prevailing mindset/attitude toward FCP within Authority A (outside of the FCP department) is neutral to negative, as only a few officials at the Authority as yet are cognizant of its importance.[39]

Context Factor 5: Staff Considerations

There are currently six staff members in the FCP department and one FCP regulatory specialist within the policy department. There is some budget available to expand this capacity. Prudential supervision officers may also be interested in switching to an FCP supervisory role. The FCP department consists only of lawyers, all of whom have substantial knowledge of FCP theory and regulations and some knowledge of financial products and services but no supervisory experience. There is, however, a lot of enthusiasm to protect financial consumers better and a willingness to pursue this goal vigorously and overcome the associated organizational and practical challenges.[40]

Context Factor 6: Data Position

The licensing and prudential supervisory departments administer several databases featuring a range of data types that may be combined to substantiate risk indicators for FCP RBS. The two major incumbent banks for the moment are not expected to be able to report much additional and relevant detailed data on a recurring basis (other than perhaps on complaints); the other (international) banks are expected to have this ability, but given the variation in data systems between them, establishing standardized reporting lines may nevertheless be problematic. There is a separate ombudsman scheme that should be able to provide formal complaints data.[41]

Core Component 1: Data Collection and Analysis

Given the analyses above, Authority A's FCP department will primarily apply a system-based risk analysis approach to the two incumbents (leveraging their own control systems), supplemented by direct verification if confidence in the outcome of system-based analyses is lacking. The approach toward the international bank branches will be determined on a case-by-case basis. Given the limited capacity available, all analyses will be selective (risk based) except for monitoring analyses that can be (mostly) automated. The expected limited ability of FSPs in the market to deliver reliable periodic monitoring data suggests that the FCP department will rely heavily on ad hoc information requests and analyses. The approach toward the international bank branches will be thematic unless an incident forces the FCP department to adopt an FSP-specific intervention.[42]

Core Component 2: Risk Indicators

Considering the limited capacity in data collection, Authority A's FCP department will incorporate a basic set of indicators that are already managed and monitored by prudential supervision: number of accounts, total assets, and total loans will be monitored with data from the entire market and will be combined with complaints indicators restricted to the data reported by just the two incumbents and the data reported by the ombudsman scheme once a technical cooperation agreement has been formalized. Since Authority A already has an outsourced media monitoring, the FCP department will request a monitoring specific for consumer protection issues, at a market-wide perspective and at FSP level.

Core Component 3: Risk Assessment Framework

The risk framework applied by Authority A's prudential supervision departments covers market conduct and consumer protection risks only at a high abstraction level, and only to the extent that market conduct may harm the interests (for example, reputation) of the FSP itself, rather than focusing primarily on the interests of customers. The FCP RBS function will benefit from a more specified and tailored risk framework. This framework should feature an explicit risk definition, if only to clarify the contrast with a prudential risk definition for the benefit of all staff members as well as FSPs.

Given that the FCP-focused RBS attention to specific FSPs will mostly be limited to two incumbents (the other FSPs will receive mostly thematic attention), the development of a sophisticated risk rating system seems counterproductive. Rather, a high-level risk framework guiding just risk analyses and internal discussions covering basic market concerns will be more than sufficient. The FCP RBS risk framework will conceptually be structured as an elaboration of the market conduct risk rating categories used in Authority A's prudential supervision, but both risk frameworks will be applied separately, once a year.[43]

Core Component 4: Risk-Based Monitoring and Supervision Activities

The FCP department will likely be able to commence the monitoring component of its supervisory cycle using a mixture of methods: analysis of prudential reports, analysis of complaints data (if data exchange with the ombudsman scheme can be established, as well as from direct FSP reporting), media monitoring, and industry engagements. Its initial supervisory methods and tools will include supervisory engagements with the incumbents backed up by FSP-specific inspections where needed (in cooperation with the prudential supervision departments) and thematic inspections aimed primarily at the international bank branches. Once the department has amassed sufficient experience, a reputation, and a track record, this arsenal might be enriched with collective engagements and public supervisory communication. To enable sufficient supervisory capacity to have an impact on the industry's FCP performance despite the limited capacity, the FCP department will initially dedicate 60 percent of its annual operational capacity to supervision and 25 percent to monitoring, the focus of each of these being informed by its risk insights.[44]

EXAMPLE B

Authority B is a new government authority dedicated to FCP. In addition to its mandate to supervise and enforce FCP regulation, it is tasked with monitoring and promoting financial consumer education and competition. Staff and management have been recruited primarily from other supervisory agencies.

Context Factor 1: Legal and Regulatory Foundation

Authority B has a clear legal mandate to supervise FCP, although the legal basis for compelling FSP assistance during an on-site inspection is disputed, and industry lobbying has meant that the imposition of fines or other legal measures cannot be publicized. Regulatory context therefore does not seem to present an obstacle to implementing FCP RBS, but Authority B will need to consider how to address limitations on its supervisory and enforcement tools.[45]

Context Factor 2: Market Characteristics

The supervised market features 10 million financial consumers. A large portion of these consumers is young, relatively tech savvy (mainly with mobile phones), but solid financial literacy is scarce. Besides a few international banks and insurance companies, the market is dominated by nontraditional players: financial start-ups as well as some major Big Tech companies that seem to consider this a suitable jurisdiction to test new financial propositions. Due to these consumer and FSP profiles, the market is extremely dynamic; FSPs frequently introduce new and aggressively marketed propositions.[46]

Context Factor 3: Overarching Supervisory Approach

Given Authority B's limited data position and quantitative analytical capabilities, an elaborate risk framework–centered approach seems unrealistic for the short term. However, it may be realistic to develop a responsive approach, given the staff's expertise with such approaches in conducting various supervisory functions in other authorities and jurisdictions. This approach may also be appropriate for developing a customized engagement style for the various Big Tech companies and the range of start-ups. Once Authority B's data and analytical capabilities have developed sufficiently, this approach can be complemented with a formalized risk framework.[47]

Context Factor 4: Organizational Setting

Authority B's leadership is recruited mostly from financial regulators—both prudential and consumer protection oriented—including from other jurisdictions. The organization is still developing; currently there is no clear distinction of responsibilities, as everyone is involved in setting up all functions. There is a strong collective drive and enthusiasm to set up an FCP RBS regime and "get on with it," which is certainly needed at this stage (also given the dynamic and constantly evolving market conditions), although some prudence may be necessary as well. Understanding of the local context is also an important concern, given several executives and many staff members are from other jurisdictions as well as on term contracts. The change capabilities of the organization are very strong, although the capabilities to set up stable monitoring and supervisory processes remain to be seen.[48]

Context Factor 5: Staff Considerations

Authority B currently has 25 staff members, including four executives and two board members, but the total is set to expand to 45 staff members and three board members. There are ample staff members with legal and auditing backgrounds, but basic IT and data expertise is lacking and therefore needs to be outsourced entirely, which is creating multiple issues and prevents substantial development of supervisory functions. Quantitative analytical capabilities are also scarce. The collective mindset and attitude (proactive, flexible, consumer protection focus) are excellent for the present "start-up" phase of the FCP RBS function.[49]

Context Factor 6: Data Position

The only market data currently available at Authority B is staff's qualitative knowledge of the local industry and consumer markets. It is as yet unknown which data may be readily available from FSPs. Presumably, the Big Tech companies have large amounts of data, but how this data is structured is unknown, and these companies' attitude toward sharing the data with Authority B remains to be seen. The start-ups are unlikely to have much quantitative data available. There is a new financial ombudsman, which seems to be overwhelmed by the flow of complaints. There is also a central bank that may have relevant data. Currently, Authority B does not have the expertise (until further successful recruitment occurs, as noted above) systematically to explore and improve its data position for RBS.[50]

Core Component 1: Data Collection and Analysis

In light of the short-term constraints on data availability, the analytical approach for the short term will partially rely on engaging FSPs through supervisory meetings, questioning how they set up their systems and controls to ensure that they comply with consumer protection regulations and realize appropriate "customer fair treatment/fair customer outcomes" objectives. Once more data sources become available (prioritizing the implementation of FSP reporting and data exchanges with the central bank and the new ombudsman), this approach will be supplemented and verified through direct verification of FSPs performance in this regard. The analysis approach will be highly selective/risk based, building on an incrementally improved understanding of key FSPs' business models. Analysis will be mostly ad hoc, but Authority B can gradually work toward a standardized method of conducting analysis on compliance motivation/capabilities and aspects of corporate culture. Given the variation in profiles and business models, analyses will be mostly FSP-specific, rather than thematic, except for thematic efforts to assess and correct social media engagements (once the required data gathering and analysis methods are operational).[51]

Core Component 2: Risk Indicators

Considering the market characteristics, overarching supervisory approach, and the data collection possibilities, in the immediate term Authority B has decided to prioritize qualitative indicators, since quantitative indicators will require additional time to develop agreements for exchange of information with the central bank and the other authorities, as well as the new ombudsman. Some qualitative indicators will be developed from the start leveraging data made publicly available by the central bank and other government agencies (the latter more related to financial consumers' behavior and sociodemographic factors).[52]

Core Component 3: Risk Assessment Framework

Given its current data position, Authority B will start with a basic risk framework consisting of mostly qualitative profiles of key FSPs. Even though Authority B does not have a "competing" prudential task, it may still be worth adopting a formal FCP risk definition, risk scope, and perspective, given that the Authority and its supervisory officers will also serve other objectives (consumer education and inclusion, competition, data privacy). Both for analysis and for priority setting purposes, it is important to distinguish these objectives clearly.

FSP profiles will be based on the collective professional judgment of the supervisory officers involved, rather than attempt to set up a rating mechanism without access to the data required for such a mechanism. These FSP profiles will be ranked from a risk perspective and on that basis grouped into three or four risk categories, to inform and direct decisions on monitoring and supervisory efforts, such as how often Authority B will conduct supervisory meetings with a particular FSP. With time, Authority B expects to increase its knowledge and capability to develop a more quantitative risk rating framework and possibly even harmonizing the future risk framework with that of the central bank, whose data will be key to improving Authority B's data position.[53]

Core Component 4: Risk-Based Monitoring and Supervision Activities

Given Authority B's current capabilities, in the immediate period the initial monitoring and supervision methods and tools will be primarily qualitative. Considering the data-heavy business models of the main players—especially the Big Tech companies—this is unfortunate but unavoidable (and, as noted above, in the meantime the aim is to scale up qualitative data gathering). Besides developing solid off-site and in-depth inspection capabilities (a cornerstone of any supervisory regime), a range of other methods and tools should be considered in light of the market characteristics. For example, the marketing and operations of the Big Tech companies as well as many of the current start-ups rely heavily on social media engagements with their customers—from this, it is already evident that Authority B will need strong social media mining and analysis capabilities.[54]

NOTES

35. Potential outstanding work for the Authority that goes beyond RBS implementation includes, for example, the following:
    - Initiating further regulatory reform
    - Implementing a clearer and stronger internal supervisory mandate for the FCP department
    - Implementing internal coordination/cooperation arrangements
36. Potential conclusions and action items from an RBS perspective include anticipating the need for a supervisory regime that is able to perform both system-based and direct-verification risk monitoring and inspections (to adequately analyze and correct the operations of both the incumbent and international banks).
37. Within this overall approach, the FCP department will grow and leverage a strong account-management relationship with the two incumbent local banks, incorporating elements of an industry-centric approach. With regard to the range of international bank branches, the supervisory approach will be mostly thematic (rather than FSP-specific).
38. Potential conclusions and action items:
    - From an RBS implementation perspective: Work toward a basic FCP risk framework. Learn the expectations of senior leadership/board members in this regard, and manage those expectations where needed.
    - In addition, ensure that at least one or two experienced supervisors from existing supervisory departments, potentially supervisors who already have familiarity and engagement with the two incumbents, join the FCP department.
39. Potential conclusions and action items:
    - The current organizational setting potentially precludes the implementation of an effective RBS FCP regime. An empowered FCP "champion" at the board level is required to effectuate the required organizational changes.
    - Identify and appoint a qualified executive for this purpose.
40. Potential conclusions and action items:
    - Prudential supervision officers may well complement the current staffing of the FCP department, both in terms of capacity and background/capabilities, including with regard to existing familiarity with RBS, albeit from a prudential perspective. Explore to what extent prudential supervision officers are interested in switching to an FCP RBS role.
    - Hire a quantitative researcher and a data management/analysis specialist to support FCP RBS.
41. Potential conclusions and action items:
    - Establish operational data sharing linkages with A's licensing and prudential supervision departments and the ombudsman scheme.
    - Anticipate that, at least for the foreseeable future, much of the data required for FCP RBS will be obtained on the basis of ad hoc information requests, rather than via standardized monitoring efforts.
42. Potential conclusions and action items:
    - Set up a preliminary analysis of the controls and governance of the two incumbents from an FCP perspective (leveraging available data, knowledge, and insights from the prudential supervision departments) to facilitate future system-based analyses and risk ratings.
    - Develop basic procedures and formats to be applied in thematic reviews and inspections (leveraging available formats from the prudential supervision departments).
    - Draw up a preliminary list of known cross-cutting FCP risks/issues in the current market.
43. Potential conclusions and action items:
    - Begin drafting a customized FCP-specific risk framework, bearing in mind the analysis above.
    - Discuss the intended course of action and proposed framework with relevant board members and prudential supervision executives to ensure that they are comfortable with it.
44. Potential conclusions and action items:
    - Train staff for all of the selected monitoring and supervisory tools and methods and how to engage with them on an RBS basis. Develop the customized formats and procedures required to work with these tools and methods.
    - Work on creating a data analysis environment that enables the FCP department to combine RBS-relevant insights from all of its monitoring and supervision activities.
45. Potential conclusions and action items:
    - Pursue further regulatory reform to strengthen supervisory and enforcement powers.
    - In the meantime, when deciding on appropriate supervisory action given identified risks, the authority may need to consider alternative ways of encouraging and alerting FSPs to address those risks.
46. Potential conclusions and action items:
    - Recruit at least some staff members that have worked at—or are at least thoroughly familiar with the workings of—Big-Tech companies and/or financial start-ups—to assist in understanding potential risk dimensions and circumstances for RBS purposes.
    - Consider how any existing engagements with industry, including on innovation, can be leveraged on an ongoing basis to improve understanding of market developments from an RBS perspective.
47. Potential conclusions and action items:
    - Adopt a responsive supervisory approach, focused on analyzing and leveraging compliance and noncompliance motivations.
    - In the meantime, begin developing a profile of all major players active in the market, including their compliance motivations and capabilities, to inform risk identification and assessments.

- Set up a structured engagement agenda with all these players to support this analysis, and start applying the analytical findings on their individual compliance motivations through risk-based one-on-one engagements (and through the incubator, once established).
- In these engagements, make data a recurring discussion item in order to systematically increase Authority B's knowledge of the data types and sources available to key players in the market (laying the groundwork for the future risk framework).

48. Potential conclusions and action items:
    - Study organizational models for FCP RBS in other jurisdictions, including internal responsibilities and reporting lines; consider what the organizational model should be in both the short and the long term, as well as the consequences of these choices—for example, IT and data management choices.
    - Consider how staff members recruited from other jurisdictions may be assisted in developing greater understanding of the local context and market, which will be crucial for understanding risks for RBS purposes.
49. Potential conclusions and action items:
    - Top human resources priority is to recruit IT and data management staff with experience working for supervisory organizations.
    - Recruit a Chief Analyst, then set up an extensive training program, overseen by the Chief Analyst, to nurture staff members' analytical capabilities to support RBS.
50. Potential conclusions and action items:
    - Acknowledge that B's data position is currently its biggest challenge and vulnerability in setting up an effective FCP RBS function.
    - For the upcoming one to two years, emphasize qualitative observations from one-on-one engagements with FSPs as the initial basis for the RBS regime.
    - Prioritize recruiting staff members who have the expertise to explore and improve B's data position systematically. For to-be-recruited staff members with a Big Tech background, emphasize hands-on data and analytical capabilities.
    - Seek cooperation with the central bank, emphasizing the synergy between prudential and market-conduct/consumer protection supervision.
    - Safeguard budget for investments in B's data position and analytical capabilities.
51. Potential conclusions and action items:
    - Develop formats and a knowledge base to set up and execute a risk-based cycle of supervisory meetings with FSPs.
    - Approach Authorities in jurisdictions with a substantial Big Tech presence in the financial industry to learn how they approach supervising these entities, which risk factors they prioritize in this regard, and what cooperation may be realized.
52. Potential conclusions and action items:
    - As soon as practical, implement exchange of data with other authorities and the new ombudsman to allow the development of some basic quantitative risk indicators.
    - As soon as practical, also develop at least basic FSP reporting requirements.
53. Potential conclusions and action items:
    - Draft a standardized FSP profile format.
    - Experiment with methods to ensure quality and consistency of qualitative risk analyses of FSPs (peer review, "devil's advocate" methods, evidence-based documentation requirements).
    - Estimate how many FSPs might "fit" into the three or four risk categories, given the capacity required to deliver on the monitoring/supervisory intensity associated with each risk category.
    - Hold off on further risk framework development until Authority B's data and analysis capabilities are sufficiently advanced for in-depth data mapping and developing a customized road map for risk framework development.
54. Potential conclusions and action items:
    - Proactively manage political and media stakeholder expectations, conveying why it may realistically take one or more years for Authority B's monitoring, supervision, and enforcement functions to become fully effective.
    - Prepare for an investment in social media mining and analysis capabilities, but hold off on any impactful decisions on this work stream until sufficient in-house knowledge and capabilities are available to make sensible choices in this regard.
    - Until that time, invest in other monitoring of traditional and social media and one-on-one engagements with key individuals who represent the most impactful FSPs.

APPENDIX C

Five Common Types of Overarching Supervisory Approaches

This appendix provides further elaboration of the five common types of overarching supervisory approaches discussed in section 2.3.[55]

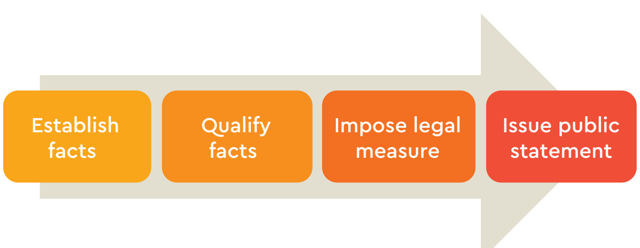
1. Compliance-Based

A compliance-based Authority focuses on promoting that FSPs comply with regulations. The main perspective (although others are relevant) is legal. This Authority takes regulations as the starting point for its actions.

Generally, the organization´s core activity is to monitor systematically and investigate whether regulated entities have transgressed applicable rules and regulations and, if it establishes a transgression, take legal measures (impose fines, issue stop orders, and so on). In addition to these activities, primarily intended to counteract noncompliance, some Authorities also positively promote compliance—for example, by issuing guidance on the interpretation and implementation of regulations.

Typically, the standard legal process that underlies this activity also provides the core for the way this Authority works and how it is organized. One department´s main function—in terms of activity and employees´ collective self-perception of their role—is to establish the legally relevant facts through investigations. A second department´s function is to qualify these facts in legal terms (the Legal Department). A third department´s function may be to impose fines and other punitive measures. A fourth department´s function (Communications) may be to issue press releases announcing such legal measures.

Illustration of a Compliance-Based Approach



Although this Authority obviously employs a range of instruments, its quintessential instrument—the one that best represents how the organization supervises—is the legal checklist that is used to determine systematically whether an FSP has complied with relevant regulations. Its employees tend to take pride in being thorough, spotting the infringements, winning court cases, and being strict and heavy enforcers. The preferred way to report supervision results are enforcement tallies. ("Last year, X fines were imposed.") The main potential upside of a primarily compliance-based approach is that it conforms to the expectations of many of the Authority´s stakeholders and has a clear and relatively unambiguous reference point: law and regulations. A potential downside is that an exclusively compliance-based approach can easily lead to a myopic focus on the law and subsequent systematic investigations and enforcement (regardless of market impact), which tends to be an inefficient use of resources, may not effectively stimulate good conduct, and might even undermine spontaneous compliance.

2. Risk Framework-Centered

A risk framework–centered Authority focuses on mitigating the risks that an FSP´s activities pose to its supervisory objectives. The supervisory objectives may be compliance objectives, or they may include broader objectives such as to promote the spirit of the law or to achieve adequate outcomes for consumers. (The risk framework may or may not be geared toward such outcomes.)[56] The main perspective is risk management.

For this Authority, the starting point of analysis and intervention activities is usually the risk profile of an FSP. Typically, significant effort is devoted to developing, implementing, and employing sophisticated instruments and methods to assess how much risk an FSP poses to the supervisory objectives (including assessing the quality of the FSP´s measures to mitigate these risks). These risks are ranked and prioritized, and based on such assessments, the Authority will adjust its interventions.

The Authority´s organization and way of working will likely reflect risk management functions, and departments will be linked to each other according to the steps of a risk management cycle. Thus, a Policy department may formulate risk objectives, and a Monitoring/Analysis department frequently identifies and measures corresponding risk levels, Management evaluates and prioritizes these levels, and inspectors from Supervision mitigate and control the prioritized risks through proportionate interventions (ranging from informal communication to full-fledged enforcement). Employees tend to take pride in their financial risk management knowledge and skills. The Authority´s result reporting will stress risk mitigation statistics.

This approach evolves around risks posed by individual FSPs. As a variation, a segment-oriented risk-based approach assumes that supervisory risks are usually not limited to single FSPs and can therefore be analyzed and mitigated on the aggregate level of a local industry segment. It will typically result in thematic investigations or other projects, focusing on groups of FSPs, rather than singling out individual cases. For example, rather than scrutinizing the derivative sales portfolios of each major FSP in an industry segment to pinpoint which of their products pose the greatest risks to retail investors, this approach may identify as particularly risky a specific type of derivative that is increasingly being sold in this industry segment (for example, binary options). The Authority may then push every FSP selling these products to mitigate these risks (regardless of this product's contribution to the FSP´s portfolio).

A clear advantage of a risk framework–centered approach is that is allows for a fine-tuned adjustment of supervisory activity to the perceived risk level. A disadvantage is that it can easily lead to an overemphasis on standardized risk management information, tools, and methodology, rather than staying open-minded and focused on market realities.

3. Industry-Centric

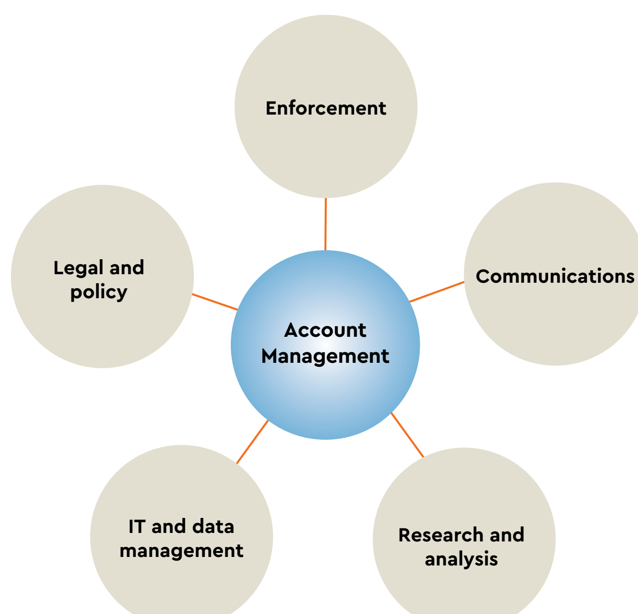
An industry-centric Authority focuses on promoting that FSPs adhere to appropriate business standards. The sectoral point of view provides the main perspective. The Authority identifies itself primarily as a government organization within the local financial sector.

In terms of activity, this Authority obviously monitors, conducts investigations, and imposes legal measures. However, this Authority attaches great importance to maintaining cooperative relationships with FSPs. It expends significant effort on account management. Regular conversations with FSP representatives are a crucial instrument and component of the supervisory approach, both to maintain this relationship and to gather information and steer FSPs in the right direction. This approach may also include efforts to promote self-regulation (for example, codes of conduct) and work with third parties (for example, to grant certifications).

The Authority´s organization and way of working reflect this network perspective. Departments mirror industry segments (large banks, small banks, brokers, multilateral trading facilities). The organization emphasizes account management, both in the way staff members work and wield influence within the Authority and in how they self-identify. Employees typically take pride in being account managers for a major FSP, being considered a respected counterpart in their industry network, and understanding an FSP´s

Illustration of a Risk Framework–Centered Approach

Illustration of an Industry-Centric Approach



issues. As a relay point within the Authority, they consider an FSP's legitimate interest—for example, by managing the administrative load imposed on an FSP through supervisory activities. In reporting on results, the Authority may prefer to include such indicators as the depth, liquidity, and efficiency of its markets, as well as industry growth.

A clear advantage of an industry-centric approach is that the Authority is well aware of the issues in the market from an industry perspective. A disadvantage of a predominantly industry-centric approach is that it can easily lead to "regulatory capture" tendencies—that is, the regulator effectively protects or spares the interests of FSPs. For this reason, this overall approach seldom occurs in its pure form; rather, an industry-centric Authority´s working methods will typically contain some elements of a compliance-based or risk framework–centered approach.

4. Responsive

A responsive Authority focuses on influencing FSPs´ compliance behavior. The main perspective is motivational. The Authority´s approach is aimed at stimulating FSPs to comply with regulations and possibly good conduct principles and other relevant standards (or, more broadly, to serve consumers' interests adequately). Responsive supervision makes use of aspects of both a compliance and an industry-centric approach.

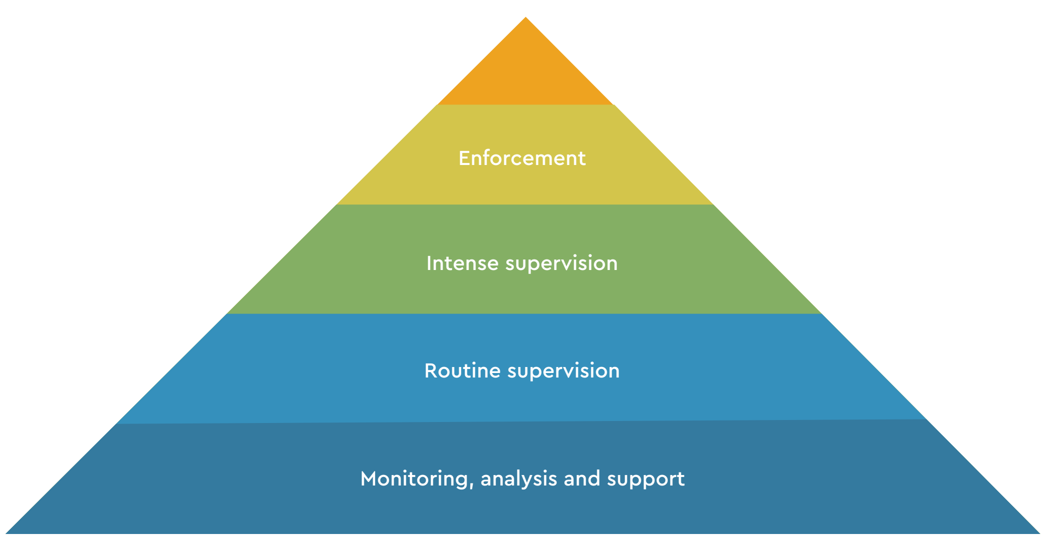
Responsive supervisory activity starts from the assumption that FSPs will want to comply with regulations, and therefore the Authority initially uses a light-touch supervisory approach (for example, providing guidance, performing less-intrusive investigations). However, the Authority makes it clear that, in response to noncompliance, it will escalate to applying more pressure, up to a heavy-handed enforcement approach. If, in response to such escalation, FSPs return to compliance, the enforcement effort can be toned back as well. The typical motto is "Talk softly, and carry a big stick."

To play this responsive game effectively, this Authority expends much effort in conveying its approach to FSPs (letting them know what to expect in case of compliance or noncompliance, making them see how compliance is in their best interest), as well as gathering information about FSPs and industry segments to assess to what extent FSPs comply and what their compliance motivations are (to be able to tap into those motivations). Therefore, as with an industry-centered approach, conversations with FSPs are a crucial instrument in this approach, but with a different conversation content.

This Authority´s organization and way of working combine aspects of the compliance and industry-centric approaches; process and network are therefore both crucial organizational considerations. The organization may reflect the escalation/de-escalation pyramid, illustrated below: teams dedicated to industry compliance and motivational analysis, as well as a well-developed public communication function; one or more departments dedicated to maintaining the Authority´s network and routine supervision; and other departments or teams specialized in heavy-handed styles of supervision and/or enforcement. Its employees typically take pride in their skill in managing the escalation/de-escalation dynamics that responsive supervision demands and in effectively harnessing an FSP's motivations to influence its compliance behavior. The Authority´s result reporting may stress both carrot and stick efforts: how it is successfully eliciting voluntary compliance while making a deterrent example of unscrupulously noncompliant FSPs.

A core advantage of a responsive supervisory approach is that it allows the Authority to be flexible in leveraging compliance moti-

Illustration of a Responsive Supervisory Approach



vations. However, a disadvantage is that this apparent sophistication can prove complex and may be hard to predict by its stakeholders.

5. Problem-Focused

A problem-focused Authority focuses on identifying and fixing issues in the supervised markets that threaten its supervisory objectives (for example, preventing or mitigating harm to consumers). The main perspective is pragmatic: the Authority is focused on finding problem solutions that work. This includes using a broad range of supervisory techniques and may go beyond applying regulations (for example, averting FSP conduct that may be legal but is nevertheless harmful to consumers, through informal interventions), if that is deemed effective to deal with an identified problem.

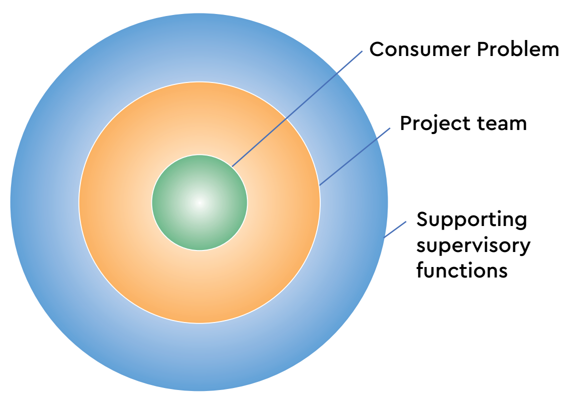
In terms of activity, this Authority expends significant effort on analyzing potential problems in its financial markets and identifying their underlying drivers or root causes. Indeed, such analyses and subsequent interventions may go through several iterations before arriving at the natural shape and size of the problem. Each substantial problem has its unique features that need to be considered to devise a custom-made—and, if necessary, untested—solution. This Authority therefore does not limit itself to a fixed set of instruments. For example, the Authority may find that small intermediaries pay insufficient attention to regulations and corresponding official guidance documents, as they find them too lengthy and formal to digest. Parallel to possible enforcement actions, the Authority might then distribute an easily digestible summary of its core messages and determine if this is more effective in delivering these messages in this industry segment.

Employees tend to take pride in their problem analysis skills, as well as in their capability to craft creative solutions. The Authority´s preferred result reporting will include accounts of problems diminished or solved.

The Authority´s organization and way of working reflect the need for flexibility, as each new problem that is identified requires a custom-made supervisory team that is organized around (tailored to) this specific problem, with the right mix of knowledge and skills needed for this job. It is typically a project-based organization. The organization creates project teams to deal with a prioritized problem and dissolves them when a problem is solved, reduced satisfactorily, or proves unsolvable at reasonable costs. If a problem is particularly large or complex, it may merit a portfolio of projects, each aimed at dealing with a composite part of the problem.

A clear advantage of a problem-focused approach is that it encourages open-minded analysis and customized—and, therefore, more likely effective—interventions in response to market issues. However, as a disadvantage, this analysis and customization tends to be challenging, it might lack continuity, and it also implies that the solutions are hard to replicate effectively and therefore allow for only limited standardization and learning from previous interventions.

Illustration of a Problem-Focused Approach



NOTES

55. See, for example, Kasdorp (2018).
56. A substantive supervisory strategy geared toward achieving specified outcomes for financial consumers is sometimes referred to as a "customer-centric strategy." Such a strategy may feature a risk framework that is geared toward measuring and analyzing the degree to which such specified outcomes for financial consumers are achieved.

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