TC NOTES

PRACTICAL **LEADERSHIP**
AND **GUIDANCE** FROM
TORONTO CENTRE

SUPERVISORY INTERVENTION BY RETAIL CONDUCT SUPERVISORS

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SUPERVISORY INTERVENTION BY RETAIL CONDUCT SUPERVISORS

TABLE OF CONTENTS

SUPERVISORY INVERVENTION BY RETAIL CONDUCT SUPERVISORS

Introduction[1]

This Toronto Centre Note builds on concepts introduced in Toronto Centre (2019b), with a specific focus on intervention practices for retail conduct supervisors. While many of the foundation pieces for intervention are similar to those for prudential supervisors, the nature of retail conduct supervision, which can often be more prescriptive and rules based, can result in different approaches to intervention. For example, some conduct supervisors have traditionally relied on the use of formal powers and post-event sanctioning to deal with misconduct matters.

This Note suggests that supervisors should take a more proactive risk-based approach to dealing with potential areas of misconduct and should apply the key principles of risk-based supervision to facilitate an earlier identification and remediation of issues.[2]

For supervisors, conduct and prudential alike, risk assessment is not an end in itself. Supervisory assessments often result in the requirement for some sort of action or remediation on the part of the supervised firm. In their simplest form, supervisory assessments can be a catalyst for discussion with the firm about the supervisors' observations, with a way forward agreed upon in a cooperative matter. Where this does not happen, supervisors may need to increase the intensity of their actions (interventions) to achieve the desired outcomes.

Why Intervention?

Intervention is a normal part of supervisory work. Under a risk-based supervisory approach, supervisors assess the inherent risks of the activities undertaken by the firm; how well these risks are being governed, managed, and controlled; and the adequacy of the firm's financial resources. This is not the end of the process and in many cases the output of supervisory work comes in the form of recommendations for action by the firm. As illustrated in Figure 1 below, intervention involves some part of the net risk equation:

[1] This Toronto Centre Note was prepared by Karen Badgerow. Please address any questions about this Note to publications@torontocentre.org

[2] See Toronto Centre (2018), page 2.

Figure 1: Supervisory intervention within risk-based supervision

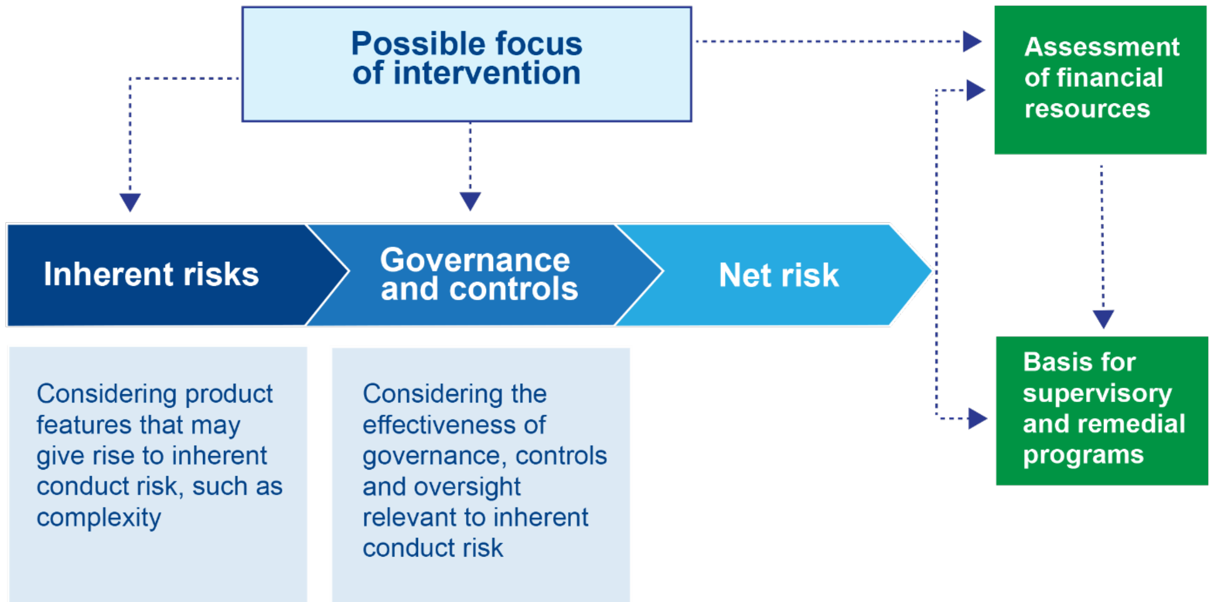
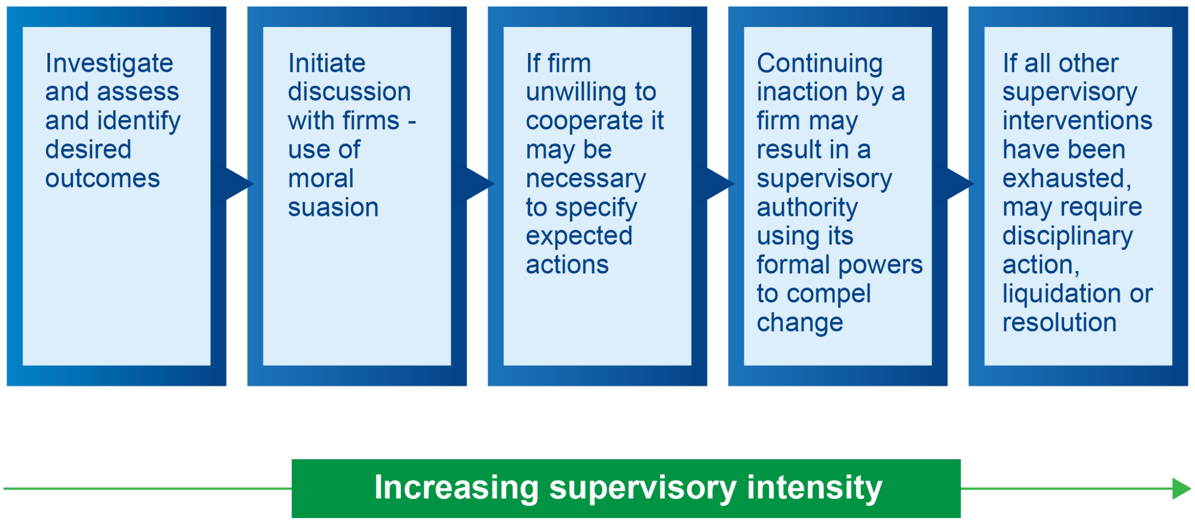


Figure 2 below sets out a range of actions often deployed by supervisors to achieve the remediation of observed deficiencies. In an ideal world, supervisors will achieve the desired outcomes through moral suasion accompanied by the presentation of persuasive evidence on areas requiring remediation. However, this assumes that supervisors can rely on management and boards to proactively fix identified problems.[3] Supervisors in some jurisdictions may have to revert to more intensive intervention at an earlier stage to achieve the desired outcomes. Notwithstanding the form of intervention, clear communication with the affected firm is critical so that there is no ambiguity about the views of the supervisor and the expected course of action.

Supervisory intervention can sometimes be viewed as punitive in nature, particularly where supervisors rely on the use of formal powers to compel changes.

[3] See Toronto Centre (2019b), page 14.

Figure 2: Intensity of supervisory intervention



As discussed in Toronto Centre (2018), the level of intervention is often influenced by two factors: the seriousness of the issue identified by the supervisor and the response of the supervised entity - in other words how open the firm is to the observations of the supervisor. This does not mean that the firm should be expected automatically to accept the recommendations of the supervisor. Firms should be willing to have a dialogue with the supervisor to understand their views and provide any additional insight or information on the issue. Supervisors should be open to this. The key requirement is that the dialogue is effective in identifying ways to address the observed shortcomings.[4]

Supervisors should not however be caught up in a cycle of the endless pursuit of more information and continuing discussions. They must be willing and able at some point to conclude their assessment and decide on their supervisory intervention.[5] Where firms are unwilling to accept supervisory recommendations then supervisors must be willing and able to pursue more intensive action to secure the appropriate outcomes.

Intervention in Retail Conduct Supervision

As discussed in Toronto Centre (2022), the core concepts of risk-based supervision (RBS) are equally relevant for retail conduct supervisors. While undertaking RBS, retail conduct supervisors will face similar challenges of deploying resources efficiently and focusing on the highest priority risks. The similarities extend to risk-based intervention activities, where

[4] Toronto Centre (2018), page 4.
[5] International Monetary Fund (2010).

supervisors will have to make difficult choices about what remediation to pursue, and the form and intensity of their approaches to intervention.

At the heart of conduct supervision in retail markets is the concept of "treating customers fairly". Supervisory authorities may use different ways to express this concept, but key concepts considered by retail conduct supervisors include the importance of supervised firms having due regard to the interests and needs of customers and ensuring fairness in interactions between firms and their customers or clients.

The concept of harm or potential consumer detriment is a key feature of retail conduct supervision, and the level of perceived harm will weigh significantly on the choice and approach to intervention. Retail conduct supervisors will need to consider the impact (harm) together with the likelihood of the risk emerging (possible consumer detriment or loss).

A number of factors may influence a conduct supervisor's view on harm:

- The nature and severity of the misconduct.
- The duration of the conduct violations.
- Whether the misconduct has targeted or impacted a vulnerable set of consumers.
- The level of intent or negligence involved.

The supervisor's approach to intervention may also be influenced by their experience with the firm in terms of:

- When issues arise, remediation extends over lengthy periods with no notable improvements.
- The firm's supervisory history of violations.

Supervisory history may result in otherwise similar firms being treated differently at the point of intervention, because supervisors will have to make judgements as to "what works best" for a particular firm – the type of intervention which is most likely to elicit the response that supervisors are seeking from the firm. Supervisory authorities often include supervisory history as a filter for determining the form of intervention, and ultimately for taking enforcement actions. The choice of intervention tools may also be driven by a supervisory authority's risk tolerance and the perceived need to be more punitive for certain types of conduct matters, for example in response to detriment in vulnerable classes of consumer.

All supervisory authorities will have a suite of powers included in their legislation, and some supervisors, because of their culture, or their experience of which intervention strategies are most effective for the firms they supervise, may prefer to rely more on persuasive tools to achieve the desired outcome. Supervisory authorities are best positioned to decide the approach to intervention that is most suitable for dealing with their supervised firms.

Experience of a significant misconduct event may influence both the focus of a supervisory authority's work (the selection of firms and areas of risk for assessment) and the intensity of actions for those firms where similar weaknesses are observed. A history of repeated events of misconduct can erode confidence in a firm and can be an influencing factor in its failure.[6]

Misconduct can occur at any point in the lifecycle of a product, from product design through to post sales performance. The process of risk assessment and ultimately the taking of supervisory action (or intervention) requires that the supervisor understands the areas or activities that may give rise to the highest conduct risk and assesses whether these activities are subject to appropriate controls and oversight.

Figure 3: Product lifecycle

Some of the goals of intervention are set out in the table below, then discussed in more detail in the following sub-sections of this Note.

Table 1: Goals of intervention

General principles of intervention	**From a retail conduct perspective**
Making sure supervisory objectives can be met	Consumer protection mandate
Undertaking action early enough to avoid future problems or problems growing bigger	Having proactive supervision aimed at preventing customer detriment before it occurs or worsens
Dealing with underlying issues and not just the symptoms of problems	Going beyond simple compliance with the rules and employing a more comprehensive approach to addressing broader conduct risks

[6] A loss of market and client confidence due to a series of scandals was cited as one of the factors leading to the failure of Credit Suisse in March 2023. See FINMA (2023).

General principles of intervention	From a retail conduct perspective
Encourage a change in behaviours or attitudes within firms	A supervisory approach which places emphasis on the behaviour and actions by firms or individuals within firms
Requiring boards and senior management to undertake their roles and responsibilities more effectively	Seeking cultural change within firms so that the provision of products and services is consumer centric and considers the needs and interests of the consumer
Instilling public confidence	Making firms aware of the consequences of misconduct Sending a message to those who may be tempted to commit misconduct Publicly demonstrating a willingness to act against misconduct

Meeting supervisory objectives

One of the goals of risk-based supervision is to contribute towards meeting supervisory objectives.[7] Where a supervisor observes a practice (or absence thereof) that could significantly jeopardize the achievement of their objective they will have to weigh up a number of factors to determine the appropriate course of action.

The following hypothetical example is intended to illustrate that rules cannot solely be relied upon to remediate misconduct and that supervisors should consider their broader conduct objectives when determining the form and intensity of intervention.

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[7] Toronto Centre (2019a), page 3.

Box 1: Illustrative example of broader conduct objectives

- Supervisors in jurisdiction A have a comprehensive framework around consumer disclosure for the sale of life insurance products and securities.
- The disclosure requirements prescribe the form of key information a consumer must receive, including the commission that will be paid to the agent at the point of sale.
- Supervisors have been alerted to the fact that a recent marketing campaign by one of the supervised entities has been highlighting unusually high rates of return for a life insurance product.
- In reviewing their own disclosure standards, the supervisors cannot find a specific rule that prohibits this form of advertisement.
- The supervisor is aware that the returns being highlight in the advertisement are generally unachievable in the current market environment.
- The supervisor cannot rely on a rule to prohibit this practice and should consider its broader objective of the fair treatment of customer, the potential harm the continuation of this practice may have on consumers, and whether the supervisory authority has any higher-level Principles that could be relevant to this case.
- As a first step, the supervisor engages with the firm to understand the basis on which the advertised returns could ever be achieved. If the supervisor remains unpersuaded, they may request the firm to amend its campaign literature to reflect a more realistic range of outcomes and should then make a risk-based judgement as to whether more work is necessary to understand the disclosure provided to consumers at the point of sale.
- The supervisor may also wish to recommend that the insurer's management pay particular attention to post sales product performance data.

Identifying problems early to mitigate the risk of consumer detriment

Supervisory authorities will often talk about having an "early intervention mandate". This assumes that supervisors follow a practice of risk assessment that facilitates the early identification of risks and that firms are required to take prompt actions to adequately address these risks. Not all risks should be pursued. Under a risk-based approach, prudential and retail conduct supervisors alike will need to decide what areas need to be followed up, reflecting their views on impact (harm) and the likelihood of the risks emerging. An early intervention mandate must also be backed up by sound processes and an efficient and effective allocation of resources to the highest areas of risk.

In the hypothetical example that follows, the supervisor's intervention, if early enough, may curtail the future mis-selling of an unsuitable product.

Box 2: Illustrative example of early intervention

- Supervisory authority B is responsible for retail conduct supervision. Its supervisory objective is that “consumers are treated fairly in their dealings with financial institutions”.
- Insurance company A, which is supervised by supervisory authority B, is providing a unit linked product targeted at middle-income professionals.
- The product will be sold through independent agents (who are under contract with several insurance companies).
- The marketing materials have been geared at a level of understanding typical of middle-income professionals.
- During a supervisory review of the marketing strategy that will be used by the firm it was discovered that the sales campaign involves marketing this product to a cohort of consumers who are viewed as less financially literate than the originally intended target group (middle-income professionals).
- The risk of this strategy is that the less financially literate consumers may not fully understand the risks associated with this product and may be sold a product that is not suited to their needs - a mis-selling event.
- Consistent with the conduct supervisors’ responsibility to protect consumers, the supervisor’s early intervention includes a recommendation to the firm to review both the marketing strategy and the suitability assessment process undertaken by the sales agents, to ensure that the product is marketed and sold to the original target consumer group.

Supervisors should also continue to take stock of the external environment and reassess the risks to ensure that their intervention is timely. A fundamental part of understanding the evolution of risks within firms is to consider the impact of both macro-economic and macro-prudential issues on the operations of a firm.[8] Remediation can be lengthy and there needs to be a continuous process of reassessing the external environment to understand how any changes might have an impact on the intensity of the intervention. Supervisors often make the mistake of focusing on the intervention itself, without paying much heed to how risks are evolving.

Box 3: Illustrative example of evolving risks

- Bank A is a significant residential lender in a small community.
- Like many local economies, small businesses and families are starting to feel the effects of continuing high interest rates and increasing rates of inflation.
- 40% of Bank A’s residential lending portfolio is renewing in the next two years and bank management has expressed concern that some borrowers may not be able to afford increased payments.

[8] See Toronto Centre (2019a), page 8.

- At the last supervisory review some 18 months ago, a recommendation was made to bank management that they should undertake a review of their problem loan management system as some of the underlying data supporting the system (including property security documents and property valuation reports) appeared to be outdated. The supervisors also observed that the current problem loan management processes provided little optionality for borrowers who are more than 90 days in arrears, other than foreclosure.
- At the time, management committed to address these issues as part of a major systems overhaul which was scheduled to run over the next three years.
- Given the current economic environment (increasing interest rates and inflation) the supervisor has increased the supervisory intensity and has recommended that management take more immediate steps to address the identified issues.

Internal processes

Supervisory authorities should have internal decision-making processes which support an early intervention mandate**.** A key principle for effective intervention is having due process to support supervisory action.[9] Intervention processes should be well documented and transparent, with supervisory recommendations for action backed by solid evidence. The types of judgements that supervisors will need to make will be different, as some recommendations for action will be more focused on outcomes (for example improving board oversight of compensation regimes) while others may be more prescriptive (for example improving consumer disclosure in some key areas). Each will drive a different level of supporting information and discussion.

Inevitably supervisors are left with the task of determining how much information is sufficient to intensify intervention. Supervisors can fall prey to the desire to have perfect information before acting - which can be an impossible task to accomplish, particularly in a changing economic environment. A wait and see approach may delay important early intervention.

Supervisors will always be challenged by the level of evidence required to invoke intervention, particularly where the intervention is more intensive and involves the use of formal powers. As they build out their intervention and supporting decision-making processes, supervisory authorities should be clear on how authority for decision making is delegated and build in some ability to "fast track" decision making in the face of imminent risks. As discussed later in this Note, some form of panel or review process can facilitate consistent decision making on supervisory interventions. Equally, the use of panels to continually assess the status of "watch listed" firms may help to overcome information paralysis and support earlier intervention.

Addressing underlying issues, not just the symptoms

For intervention to be effective it should deal with the root causes of problems. The nature of risk-based supervision requires supervisors to consider a broader range of risks and to look at risks and mitigation more holistically.

[9] See Toronto Centre (2019b), page 10.

Retail conduct supervisors' minimum supervisory requirements, such as disclosure regimes and suitability assessments, can influence the nature of intervention. Clear rules and requirements have the benefit of providing supervisors with a clear roadmap of what must be done by firms. However, without a more root cause analysis of issues, supervisors may miss the opportunity to address more fundamental problems that exist within firms that can lead to misconduct.

In the hypothetical example provided below the more significant risk goes beyond the non-compliance with a rule, and the supervisor may need to do further work to better understand the potential vulnerabilities to misconduct and thus to better focus their intervention activities.

Box 4: Illustrative example of root causes

- The supervisory rule book in country C requires that firms maintain a Register of Complaints.
- Supervisory reviews tend to focus on the existence of the Register of Complaints and whether the prescribed information is captured in the prescribed format.
- Where any of these requirements are not met, supervisory actions are directed at requiring the firm to make changes to the Register to meet the requirements.
- However, a closer review of one firm's procedures showed that the management information package provided to the board did not include the results of a recent consumer survey on a major product offered by the firm, which indicated a high level of customer dissatisfaction.
- Management decided not to report this information to the board, citing that it was not part of the prescribed data requirements for the complaints register.
- In this case, the narrow compliance requirements (existence of a register) were met, but the deeper issue of reporting to the board warranted some form of intervention by the supervisor.
- One possible approach would be to require the firm to undertake a more comprehensive assessment of the risks associated with this product, and to review the types of data that are provided to the board. The results of this work should further inform the board as to the appropriate level of its oversight of the complaints management process.

Supervisors need to avoid knee-jerk reactions or interventions focused solely on an identified compliance issue. While firms need to comply with prescribed requirements (a minimum standard), more detailed analysis could reveal more significant matters that can have an adverse impact on consumers. In the above example, intervention should extend beyond the obvious deficiencies in the Complaints Register and focus on how the information available to the firm is being used by management and the board. This approach may yield some useful additional information to the supervisor on the attitude of the firm to treating its customers fairly, and result in more targeted and effective intervention.

Additional areas of focus could include:

- The accessibility of the complaint making process to customers of the firm.

- The analysis being undertaken by the firm on the customer complaint data and any other available data to identify trends and issues, and to identify and address any root causes of complaints.
- How complaints are normally remedied.
- The reports provided to senior management and the board on the complaints data.
- How the Complaints Register is being used by the firm's senior management and board to understand customer satisfaction and to identify emerging problems.

Instilling public confidence – demonstrating your willingness to act

Much of the intervention work of supervisors sits out of the public eye and remains a matter between the supervisory authority and the supervised firm. This is typically the case for lower-level problems and where the supervisory authority can achieve the desired outcome without reverting to the use of its powers.

Supervisory authorities should ensure that their expectations and their level of risk tolerance is clear to the firms they supervise, for example through the publication of frameworks and guidelines. Where matters escalate and the authority is compelled to use its powers, supervisors may also wish (or may be required by law) to publish their interventions, resulting in a more public demonstration of how they will respond when these expectations are not met.

Supervisory authorities may wish to establish thresholds or parameters to determine when an intervention action should be publicized. For example, the exercise of some form of disciplinary action using formal powers may warrant public disclosure. Equally, where an action by a firm causes considerable consumer harm, there may be a benefit in publishing the supervisory intervention – not only to demonstrate that the supervisor is willing to act, but also to signal to other firms the kinds of behaviour that will not be tolerated.

In the absence of publicized intervention actions, supervisory authorities may contribute to the goal of public confidence through enhanced transparency around their processes for intervention and enforcement, for example through their website or social media. The development and publication of frameworks such as the authority's risk appetite statement, general supervisory expectations, and processes for intervention, can be useful in demonstrating the willingness of the supervisory authority to act (what they will and will not tolerate) and their ability to act (the types of tools they have available). Some supervisors may also choose to publish anonymized data around the types of supervisory interventions undertaken during the year. A possible approach to developing a guide to intervention for conduct supervisors is discussed below.

Encouraging change in behaviours and requiring boards to undertake their roles and responsibilities more effectively

Supervisory intervention is often rooted in trying to change the behaviours of firms. For retail conduct supervisors, their work is focused on achieving better outcomes for consumers, and requiring firms to address deficiencies that may have an adverse impact on consumers. While some elements of retail conduct supervision will rely on compliance with rules, a risk-based perspective shifts the focus beyond compliance towards actions that should be taken by firms to ensure better consumer outcomes. Boards and management must possess the mindset to support more consumer centric behaviour and to ensure that there are processes in place to cascade their expectations regarding conduct to their staff. Where these (mindset and/or processes) are absent or deficient, retail conduct supervisors should intervene to have these matters addressed by the firm in a timely fashion.

Related to the earlier concept of behaviour and attitudes, supervisory intervention usually begins by drawing issues to the attention of management and having an open dialogue on how these might be remedied. Supervisors should not lose sight of the fact that the ultimate responsibility for the management of the firm (and its risks) rests with the board. Where board oversight is weak and/or customer centric culture is lacking, more intensive intervention may be required to ensure that the seriousness of conduct risks is recognized by the board and acted upon promptly.

In the following hypothetical example, while the firm has declared a consumer centric approach to its business, the actions of the board do not necessarily reinforce the importance of this concept. Supervisory intervention in this case should recommend that the board strengthens its oversight processes to reinforce the importance of a customer-centric business environment, including the introduction of some performance boundaries that set out the kinds of behaviours that are expected of the firm's sales agents.

Box 5: Illustrative example of board oversight

- Supervisory authority D is undertaking a governance review to better understand how a firm meets its obligations towards consumers.
- In reviewing the board approval process for new products, the supervisor notes that there is very little discussion around how the product would serve the needs and interests of the target consumer group beyond the promised financial returns. No metrics are provided to the board on post sales product performance.
- The supervisor recommends that the board articulates more clearly its expectations to management for promoting good consumer outcomes and considers how it might monitor management's performance against these expectations.
- The supervisor also recommends that the board should review the compensation arrangements provided to agents to guard against any financial rewards that might lead to mis-selling, and to better reward behaviours that promote the fair treatment of customers.

Tools for Effective Intervention

Supervisory authorities should expect that their actions will be subject to increased scrutiny, particularly as they intensify. Supervised firms and other stakeholders should reasonably expect that supervisory expectations are clear, and that the range of potential supervisory actions is known at any stage of intervention. Supervisory authorities should consider how their internal processes around intervention can be structured to support enhanced accountability and transparency.

As a starting point, supervisors need to have the necessary powers to act. Where it is a matter of strict compliance with rules, the pathway to enhanced intervention may be clearer and more direct. Where rules are not met, the supervisor has the latitude to take action to ensure compliance. Where the focus is more outcomes driven, and based more on high-level rules such as Principles, decisions around supervisory intervention require the exercise of more judgement.

For supervisors, a focus on outcomes versus rules can be more daunting when facing resistance from firms to undertake necessary remediation. The use of examples in supporting guidance can be helpful to supervisors and firms alike to explain the range of acceptable and unacceptable practices. Supervisors may also wish to use thematic reviews to highlight acceptable (and unacceptable) industry practices.

A Guide to Intervention

Supervisory authorities that are introducing risk-based supervision should consider how intervention practices can be tailored to address the highest areas of conduct risk, namely those that can pose the greatest harm to consumers.

As discussed in Toronto Centre (2019b), supervisory authorities have found value in setting out the relationship between the riskiness of a firm (level of supervisory concern) and the type of supervisory response that may be expected. Often referred to as a guide or ladder of intervention, the guide can be adapted to reflect the risks and responses of conduct supervisors in relation to their judgements on firm-wide conduct risk (the inherent risk and how well the risk is managed and controlled by a firm). Considerations of harm and potential consumer detriment should be a feature of the ladder of intervention and influence the progression of a firm through the levels of intervention.

Supervisory authorities should consider the need to increase coordination with other authorities as the level of concern with a firm increases. Where retail conduct supervision sits in a separate authority from that of prudential supervision, publicly setting out coordinating arrangements between the authorities can serve to underscore the level of concern to firms and set the groundwork for joint work and enhanced sharing of information. The need for increased coordination can also extend to overseas authorities (foreign home/host supervisors) and compensation regimes. Supervisory authorities may wish to add an additional column in their guide to intervention (as is done in the table below) setting out the proposed form of engagement and coordination arrangement with other authorities.

Table 2: Ladder of intervention for conduct risk

Risk Rating	Meaning	Typical action	Engagement with other authorities
Low	No significant conduct issues Effective controls and management oversight of conduct/consumer issues Management and board can demonstrate a customer centric view in undertaking its business	Regular review and assessment	Providing regular updates as part of inter-authority or supervisory colleges
Medium low	Some (relatively minor) conduct issues Some weaknesses in controls or board and management oversight	Requirement on firm to address deficiencies Enhanced interaction with senior management regarding their approach to treating customers fairly Increased use of reviews by specialist teams or "thematic reviews" to identify whether problems are more widespread Additional reporting requirements (for example more detailed analysis of consumer complaints or requirement for additional post-sales consumer surveys)	Relevant authorities are advised of the change in intervention rating and may wish to meet to exchange information on risk assessment and on remediation activities Regular meetings are held to discuss the risk profile of the firm

Risk Rating	Meaning	Typical action	Engagement with other authorities
		Enhanced follow-up by supervisors Review of consumer complaint processes and compensation arrangements	
Medium high	Significant conduct issues Significant weaknesses in controls or board and management oversight Evidence or likelihood of consumer detriment or harm	Required to review or modify business plan Direct product intervention (moderate or stop sales) or the imposition of other restrictions and conditions Requirement to strengthen controls over conduct and demonstrate management and board's oversight More frequent reviews Possible engagement of third parties to undertake a more comprehensive review of the specific issue and potentially assess culture around the treatment of consumers Review of consumer complaint processes and compensation arrangements	More serious matter for consideration and possible joint work (pre-planning for increased intervention) Contingency planning is commenced
High	Serious conduct problems (significant consumer detriment may have already happened)	Use of formal powers to issue direction Shortened time frame for strengthened controls or further limitations on business activities	Coordinated efforts with other authorities on the formal use of powers and the status of

Risk Rating	Meaning	Typical action	Engagement with other authorities
	Serious weaknesses in controls or board or senior management oversight	Possible change in senior personnel and board Disciplinary action	contingency arrangements

Supporting internal infrastructure

Consistent decision making is a key principle of risk-based supervision. Retail conduct supervisory authorities should consider how internal processes can be developed to support consistent decision making as intervention intensifies. Supervisory authorities may already have existing infrastructure to support the risk assessment processes and they may wish to extend these to support their intervention practices. Whatever the approach chosen by the authority, public disclosure of the processes may improve effectiveness as they demonstrate that the supervisory authority is prepared to act.

Some processes to support consistent decision making are discussed below.

Watchlist committee

As part of an early intervention mandate, supervisory authorities should have processes that allow them to monitor and track firms that are considered “higher risk” (in terms of potential harm to consumers and the likelihood of this harm occurring). Supervisory authorities may wish to constitute some form of committee to undertake this task.

The committee should not be purely reactive, but should proactively reassess, at regular intervals, the intervention stage rating of each “higher risk” firm, as well as the effectiveness of the strategy being used by the supervisors to achieve effective remediation. The ladder of intervention set out above can be a useful tool to help guide the actions that the supervisors should undertake as the risks in a firm increase.

This type of committee can provide a useful mechanism for the escalation of issues through the decision-making processes and should be structured to complement (and not replace) a rigorous risk assessment process.

Case review panels

As intervention intensity increases, supervisory authorities may wish to use some form of internal case review panel to promote consistency of judgements around proposed supervisory interventions. Such a panel can be used to compare proposed actions against other similar historical cases, assess whether the evidence base compiled by the supervisors sufficiently supports the proposed intervention level, and provide a forum for knowledge sharing around intervention activities. Depending upon the delegation framework at the supervisory authority, the panel may serve as either an advisory authority on a proposed course of action, or a decision-making forum.

While consistency of approach is important, conduct supervisors need to be mindful that similar misconduct matters in different firms can reasonably give rise to different intervention actions. In choosing the approach to intervention, the supervisor will want to consider – among other things - a firm's supervisory history (the extent to which misconduct and other issues have arisen in the past) and how cooperative the firm has been in responding to concerns raised by the supervisor.[10]

Where the panel takes decisions, the decision-making process should be documented and there may be merit in publicly disclosing how these processes will be used, including the processes to be followed if firms wish to appeal a decision.

The following hypothetical example sets out an approach to using a ladder of intervention rating guide and provides some considerations that might influence a supervisor's choice of rating.

Box 6: Illustrative example of using a ladder of intervention

- Supervisory authority E has recently developed a framework for intervention which sets out a range of expected supervisory action based on an assessed level of risk, with 1 being the lowest level of risk and 4 being the highest. The supervisory authority has started the process of categorizing firms into these buckets to facilitate supervisory planning and resource allocation.
- Every year the supervisory authority undertakes at least one thematic review in its largest sector, banking. Given concerns with slowing economic growth, the authority conducted a thematic review of five banks to understand better the affordability assessment analysis used by the banks to approve secured loans for first time home purchasers.
- The thematic review identified a range of good practices, including providing clients with various on-line tools to self-assess the full cost of home ownership, and rigorous income verification measures. However, in one bank (Bank B) the review revealed that it employed a very liberal interpretation of qualifying income, which resulted in a significant overstatement of income and affordability. The supervisors were concerned that these mortgage loans would prove to be a financial struggle for the borrowers.
- Under the framework for intervention, Bank B had previously been rated at level 2. The findings of the thematic review caused the supervisors to reconsider the level of conduct risk that Bank B posed and whether level 2 remained appropriate. Some factors that were considered by the supervisors to determine the appropriate rating included:
  - The extent of the harm - how many new home buyers were subject to the faulty income verification measures. In the case of Bank B, approximately 30% of its

[10] See Toronto Centre 2019(b).

residential loans had been granted in the past two years, half of which had been to new home buyers.

- The firm's supervisory history - Bank B had a reputation of operating a bit in the grey area in terms of the application of its lending policy. The bank had been very public about its desire to be the residential lender of choice and was known to aggressively pursue potential borrowers.
- Bank B currently has a 20% market share in mortgage lending in the jurisdiction.
- Bank B enjoyed a cordial relationship with the supervisory authority but was quick to bring in its lawyers whenever it felt that a supervisory requirement was unfair. The supervisors had heard that lawyers for Bank B were going to challenge the most recent findings in relation to its income verification methodology.
- On consideration and having taken this case to an internal review panel, the supervisors judged that the risk of continuing misconduct was significant and given their past dealings with Bank B they needed to underscore the importance of this concern to the bank. The supervisors determined that Bank B should be moved to level 3, and that supervisory intervention should become more intensive as a result.

The supervisory planning process

Supervisory authorities should ensure there are adequate resources to undertake the risk assessment of matters that may cause significant consumer detriment, and to undertake supervisory interventions in response to these assessments. As retail conduct supervision moves towards more risk-based supervision some of the supervisory practices may still reflect compliance-based approaches. For example, some authorities may continue to use a rigid coverage-based model that focuses on-site work over a pre-determined cycle (for example undertaking an on-site review of all firms over a 3-year period), rather than a risk-based planning process that is driven by impact (harm) and likelihood.

A supervisory planning process, if not risk-based, may not be sufficiently flexible to allow the supervisors to take early and appropriate intervention action. The following hypothetical example illustrates this point.

Box 7: Illustrative example of risk-based planning

- Supervisory authority F has developed a rigorous supervisory plan to look at its entire mid-size general insurance sector over a 24-month period.
- Supervisors covering one of the mid-sized insurance companies discover an issue with its claim handling procedures that require claimants to provide an unreasonably large amount of documentation to support their claims. There is a concern that this practice may be more widespread across the sector, as supervisors have found that other insurers are also taking a tougher approach to accepting claims from policy holders.

- The supervisors of this general insurer need to issue their report within the prescribed time frame and make a note in their supervisory files that this is an area for future follow-up.
- The ability of supervisors to delve further into this issue is hampered by the tight supervisory program for this cohort of insurance companies.
- Under a risk-based approach the supervisory authority should be able to adjust its supervisory program to allow the supervisor to do more immediate work to understand the full extent of the issue (both in the firm being reviewed and across the sector as a whole) and to assess the risk that it might pose to consumers.

Some practical challenges to effective intervention

There are many reasons why supervisors may be unwilling or unable to act when they observe failings in firms. Often without realizing it, supervisors may unwittingly allow issues to worsen in firms without any form of intervention. This is often referred to as supervisory forbearance. The following is a list of possible causes of supervisory forbearance and some suggested approaches to help address these.

Table 3: Causes of supervisory forbearance and suggested approaches

Possible causes of supervisory forbearance	**Possible approaches to address the issue**
Failure to follow-up on risk assessments Supervisors' good efforts to identify risks may be of little value if they do not lead to supervisory interventions (where appropriate) This could be considered a form of "passive forbearance"	• Internal guidance around required follow-up procedures for supervisory risk assessments that identify higher levels of harm and likelihood • Internal processes (ideally automated) to track open supervisory issues
Failure to follow up on supervisory intervention Supervisory interventions may not be carried through to a conclusion	• Specifying required timelines for firms to close actions required by supervisors • More rigorous follow-up standards for firms rated medium/high and above • Regular review of outstanding supervisory recommendations (with priority given to higher risk firms)

Possible causes of supervisory forbearance	**Possible approaches to address the issue**
	• Having graduated processes to increase intervention when significant issues are not addressed, or in some cases where firms have a history of misconduct. The supervisor may need to escalate the form of intervention more quickly beyond the use of "moral suasion"
Non-supportive management within supervisory authorities This may be reflected in an "unwillingness to act" Supervisors may be constrained from achieving a successful intervention if they are not supported by management to make the tough calls[11]	• This is a more difficult one for supervisors to overcome • Having agreed processes to track open supervisory recommendations • Providing information to senior management to highlight where remediation work is lagging or ineffective • There may be cases where there is a legitimate reason why senior management do not accept a supervisor's recommendations. In such cases these reasons should be documented and, where appropriate, escalated for further consideration[12] • For conduct supervisors, where there has been a reliance on more compliance-based approaches to supervision, the shift to a risk-based approach requires a significant leadership commitment and a focus on outcomes
Lack of resources Supervisory authorities may lack appropriate resources (number and	• Supervisors should have a planning program which considers the allocation of resources and is sufficiently flexible to respond to new emerging issues

[11] See International Monetary Fund (2010).

[12] For example, management within a supervisory authority may wish to escalate some matters for decision to higher levels due to their unique nature, or because they set an important precedent.

Possible causes of supervisory forbearance	Possible approaches to address the issue
quality) to fully pursue issues to a conclusion This can be exacerbated where supervisory authorities have an overly prescriptive supervisory plan which impedes the supervisor from further exploring risk issues or dedicating time to follow up outstanding higher risk supervisory matters Supervisory authorities may not possess the necessary expertise to pursue certain risk matters Intentional or not, the inability or unwillingness to deploy the necessary resources can impede successful intervention	• For conduct supervisors, the ability to identify the extent of harm should influence the timing and intensity of intervention • Supervisory authorities should avoid the temptation to schedule back-to-back reviews to achieve "supervisory coverage" and should consider the use of other tools, such as thematic reviews to achieve their supervisory goals • Where supervisory authorities lack resources or do not possess the necessary expertise, they should consider engaging third-party resources to undertake follow-up work and should have the ability to require firms to bear the cost of these reviews
Risk appetite Where prudential and conduct supervision are housed in one authority, conduct supervision may take on a secondary importance	• Supervisory authorities should develop risk-based processes to assess the relative importance of conduct and prudential matters (in terms of the risks posed to supervisory objectives) within a single risk tolerance framework and be prepared to dedicate the necessary resources accordingly

Moving from Routine Intervention to Enforcement

Enforcement typically occurs where a firm has committed a major breach of a rule or a form of legal requirement, or where there is some form of serious misconduct. It may also occur where a supervisor has exhausted all other reasonable means to achieve the desired outcome and must exercise its formal enforcement powers to achieve effective remediation.

Enforcement powers can be criminal, civil or regulatory. They could include withdrawing a firm's authorization or permissions to undertake specific activities; prohibiting firms and individuals from carrying on regulated activities; issuing fines against firms and individuals who have breached rules; applying to the courts for injunctions, restitution orders, winding-up and other insolvency orders; and bringing criminal prosecutions to tackle financial crime, such as insider dealing or money laundering.[13]

Post-event enforcement or sanctioning has been relied on by some conduct authorities to address misconduct and has been a visible supervisory tool in many high-profile cases. It can serve a dual purpose of targeting known misconduct and acting as a deterrent to others who may be engaged in similar practices.

The appropriate use of enforcement tools can also be helpful in setting out the supervisory risk appetite for misconduct, in other words what a supervisory authority will or will not be tolerate. However, enforcement should not be the sole means for supervisors to address misconduct and should generally be reserved for the highest risk and where all other remediation efforts have failed. Sometimes the mere threat of enforcement will incentivize a supervised firm to get ahead of the problem and address the matters before any official enforcement action is undertaken.[14]

There will however be cases where the use of formal enforcement powers, rather than less formal supervisory interventions, is appropriate. For example, where a director of a supervised firm has been engaged in an activity that brings into question their integrity (for example being convicted of a criminal offence), supervisors may revert to the use of their formal powers to disqualify that individual. In other cases, enforcement powers may be used to stop firms from undertaking an activity that may cause (current or future) consumer detriment until identified control or oversight issues are remedied.

Enforcement can be a difficult path to follow because decisions and action need to be supported by rigorous processes; specialized resources (legal and investigative) may be required; and enforcement actions usually require significant senior management attention within supervisory authorities. However, where matters are more serious and consumer harm potentially imminent, supervisors may need to invoke immediate enforcement action to avoid serious detriment to consumers and should consider how their processes can be designed to support this kind of decision making.

[13] See Financial Conduct Authority. https://www.fca.org.uk/about/how-we-regulate/enforcement

[14] Government of Australia (2019).

Box 8: Illustrative example of enforcement

• During a supervisory review of an investment firm, supervisors observe that the firm is marketing a pension product for which it does not have the necessary professional expertise to provide advice. • The supervisor is aware that recently there have been several high-profile misconduct cases where advice related to pension transfers has resulted in significant consumer losses. • To mitigate the potential harm related to this product, supervisors direct the firm to immediately halt the distribution of this product until it can demonstrate that it has developed the necessary competency to provide professional advice on pension transfers.

As supervisors move closer to undertaking enforcement, they should revisit the broader goals of intervention, and consider how the increased intensity of their intervention will help achieve this objective.

There are many reasons why supervisors may hesitate to move to more intensive intervention (enforcement). Some of these reasons are set out below, and approaches are proposed to help overcome them.

Table 4: Impediments to intensive intervention and suggested approaches

Common impediments to proceeding with enforcement action	**Possible approaches**
Supervisory reluctance to hand-over the file to an enforcement team Supervisors who have been actively managing remediation with a firm may be reluctant to concede that remediation is not working. They may view this as a failure of supervision	• Developing a process for supervisors and the enforcement team to have regular discussions on firms that are on the watchlist, including the development of agreed criteria on what would cause a firm to move from remediation to more intensive intervention (including enforcement)
Culture within the supervisory authority A supervisory authority may place over-reliance on "moral suasion", and pride itself on having "good relationships" with industry	• Setting the right culture within the supervisory authority to demonstrate that the use of enforcement powers can be a natural progression • Having transparent enforcement processes and intervention criteria so that supervisory expectations are better

Common impediments to proceeding with enforcement action	Possible approaches
The authority may then be reluctant to engage in a more contentious relationship, as is often associated with enforcement	understood, and firms understand the circumstances under which supervisory intervention will be intensified • Internal peer review/case review processes to ensure consistent escalation of firms through the stages of intervention • Regular rotation of supervisors' portfolio responsibilities, to ensure that supervisors are not caught up in a cycle of perpetual remediation • Normalizing enforcement as a natural part of risk-based supervision • Avoiding "surprises" - where supervisors have pursued an active remediation program and have not been successful in achieving the desired outcomes, enforcement should be viewed as an appropriate continuation of the supervisory process
Enforcement can be resource intensive Supervisory authorities may be reluctant to deploy (or redeploy resources) to enforcement activities	• Authorities should consider having dedicated supervisory resources for enforcement activities (budget, staffing) • Where internal resources may not be available, supervisors may wish to revert to the use of third parties (such as a legal firm) to provide advice on possible approaches to enforcement
There may be mis-aligned risk appetites and tolerances within a supervisory authority A supervisory authority may not have a preconceived or documented framework for judging what are acceptable and not	• Establishing internal agreement on the authority's risk tolerance for non-compliance with supervisory recommendations, and where this might escalate to the use of formal enforcement powers

Common impediments to proceeding with enforcement action	Possible approaches
acceptable practices within the industry, or the point at which these might warrant the use of formal enforcement powers Where responsibilities are shared across supervisory authorities (for example separate authorities for prudential, conduct or anti-money laundering) there may be no formalized mechanisms to support joint enforcement action	• Where responsibilities are shared across authorities, setting out possible coordinated actions as firms move through the stages of intervention • Having processes to address areas of disagreement within or across authorities

Enforcement tools

Various types of enforcement tools are used by supervisory authorities. Several factors will influence the supervisor's selection of these tools. Ultimately, consumers need to have confidence in the system and participants expect markets to be fair, open and competitive. Public notifications (as discussed above) and fines are a means of demonstrating that rules are being enforced.

The selection of the form of enforcement may sometimes be the result of a negotiated settlement with the affected firm. Where supervisory authorities choose (or are required) to disclose the outcomes of enforcement action, they may wish to reflect the level of cooperation received from the firm in arriving at the selected form and severity of enforcement. Supervisors should guard against being worn down through the negotiations and have a clear view going into enforcement action of what they intend to achieve.[15]

[15] Government of Australia (2019).

Table 5: Enforcement tools and best usage

Enforcement tool	To whom	When best used
Issuance of private warnings setting out concerns	Typically to individuals	The avoidance of reputational damage can be a significant incentive for behavioral change There may be cases that are less egregious; or where the costs of other actions outweigh the benefits; or where the matter is a first incident for the firm or individual involved
Public warnings	Firm or individual	Some supervisory authorities may have requirements to issue public warnings for certain acts of misconduct Public warnings may also be beneficial when there is a concern that similar practices exist in similar firms Serves as a warning to the public to be cautious
Directions to a firm or the placing of conditions on a license	Firm	When it is a more localized issue, and the directions will remedy the harm
Civil/administrative penalties	Firm or individual	Significant harm has occurred Supervisory intention to send strong messages around specific types of misconduct

Enforcement tool	To whom	When best used
Voluntary compliance agreement	Firm or individual	Where there has been a history of supervisory cooperation and where there are reasonable assurances that a firm will introduce the necessary remedies This is often combined with an independent process to verify compliance[16]
Criminal prosecution	Firm or individual May be in concert with other authorities	Evidence of criminal activity - may require a referral to other authorities for consideration of criminal action
Disqualification	Individual	Evidence of lack of fitness and propriety, or other criminal conviction (theft, fraud)

Box 9: Illustrative example of use of enforcement tools

- Supervisory authority G has recently identified that an advisory firm is aggressively marketing one of its core investment products which has certain features that are "tax friendly".
- The literature provided to consumers is vague on what these "tax friendly" features are, but prominently claims higher than average returns as a result of these features.
- While originally intended for high-net-worth individuals, third party agents have also been targeting consumers in lower income brackets (vulnerable consumers) who have no ability to benefit from some of the tax friendly features of the product.
- Upon review of the terms of engagement of these third-party agents it was discovered that the compensation levels have significant front-end fees as well as trailer fees[17] for this product. The third-party agents work for several advisory firms

[16] See Toronto Centre (2019b), page 14.

[17] Trailer fees refers to the practice of charging an ongoing fee for as long as the investor holds the product (with no other benefit accruing to the investor (no further service).

in the jurisdiction. and as a result, the supervisor is concerned that the targeting of vulnerable consumers is more widespread.

- The firm in question was asked to demonstrate that its marketing and remuneration practices were not to the detriment of consumers, and it was also asked to stop the distribution of this product until this matter was resolved.
- The firm was not able to provide any data to support the published returns, nor did it have sufficient supporting evidence to support its view that this product was sold with the best interests of the consumer in mind.
- In the meantime, the firm continued to market and sell this product.
- Industry data indicate that sales of this product have increased in volume in the months running up to the end of the tax year and would seem to support the supervisor's concerns that this practice may extend beyond the firm under investigation.
- Following a more comprehensive review of industry practices, a few firms are identified as having mis-sold this product. The identified firms were also not able to support the advertised rates of return and in some of firms there were growing consumer inquiries around the performance of the product.
- In looking at its enforcement options, the supervisor considers what outcome it is trying to achieve:
    - Providing a warning to the public as to the specific actions of the firm under investigation (current harm) and of the general industry practice (future potential harm)
    - Serve as a deterrent to other firms from undertaking an aggressive sales approach.
- The supervisor decides to issue a fine to the identified infracting firms along with a public warning, naming the firms that have been involved in this mis-selling and describing the general practice.

The FINMA (2023) report on the Credit Suisse collapse noted that supervisors exhausted all reasonable supervisory and intervention actions, including the use of enforcement powers, and ultimately had to revert to the use of resolution powers that led to the takeover of Credit Suisse by UBS.

Conclusion

Supervisory intervention is a natural outcome of supervisory risk assessment work. In the course of their work supervisors will make judgements around levels of risks and, where they are unacceptable, determine the appropriate approach to remediation.

Retail conduct supervisors face the same challenges in judging the most important areas to pursue for intervention and the form of that intervention. The concept of harm to consumers is a key consideration for retail conduct supervisors and will influence the timing and intensity of intervention. They will also have to judge the appropriate balance between a prescriptive, compliance-based approach, and taking a more outcomes-focused approach in their interventions to protect consumer interests.

This Note has focused on some of the important objectives of intervention and proposes a range of possible tools that can be used by retail conduct supervisors to better focus their intervention activities. For prudential and retail conduct supervisors alike, enforcement is often viewed as a measure of last resort. However, the nature of a jurisdiction's industry may lend itself more to the use of "hard" enforcement tools, because a more accommodative moral suasion approach may simply not be effective.

As with all aspects of risk-based supervision, jurisdictions are best positioned to judge the approach to intervention that will work best for them.

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