

THE FINANCIAL SERVICES  
PRACTITIONER PANEL  
ANNUAL REPORT

2006/7

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# PRACTITIONER PANEL

## ANNUAL REPORT 2006/7

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## 1. CHAIRMAN'S INTRODUCTION



I am pleased to share with you the Annual Report of the Financial Services Practitioner Panel (the Panel) for 2006/7. Its primary purpose is to create a document of record – as part of our responsibility to our stakeholders and our accountability role within the framework of the Financial Services and Markets Act 2000 (FiSMA) – that outlines our main activities over the past year and our likely areas of priority going forward.

### General

2007 will be a very important year for the FSA. Many good initiatives are scheduled to be implemented and if their objectives are achieved this should substantially enhance practitioners' views of their regulator.

The market in which regulated firms operate changes much more rapidly than a few years ago and the FSA must operate at the same pace as required of practitioners to achieve good regulatory outcomes.

In addition, we operate in an electronic and globalised market and business is easily moved internationally. Practitioners recognise that good regulation is a key ingredient of a successful international centre which will be attractive to existing and new members.

In this environment there is fierce competition amongst practitioners and all help that the FSA is able to bring to them is greatly appreciated and is in the best interests of all the cities in the UK, whether in relation to consumers or - in many cases - as employees of the industry.

*“ 2007 will be a very important year for the FSA. Many good initiatives are scheduled to be implemented and if their objectives are achieved this should substantially enhance practitioners' views of their regulator. ”*

### The role of the Panel

As always, the past year has been a busy one for the Panel and its members. It is worth noting at this point that the work of the Panel generally and the nature of its engagement with the Financial Services Authority (FSA) has changed considerably over the past couple of years, as the regulator moves away from rules-based regulation towards a more principles-based regime. Whereas previously the bulk of the Panel's agenda would be spent commenting in detail on specific FSA proposals relatively late in the process, the Panel is often now involved at an earlier stage and provides feedback to the FSA on its various initiatives from a more strategic, high-level perspective.

We are always careful to take due account of the views and interests of not only the major and larger regulated firms but also of smaller firms which, in numerical terms, make up over 90% of the marketplace. In that context we are especially grateful for the input we receive from the Smaller Businesses Practitioner Panel and, in particular, its Chairman Mark Rothery, who is an ex officio member of this Panel.

#### 4th Panel survey of regulated firms

The Panel's most significant and time-intensive piece of work over the past year was its biennial Survey of Regulated Firms, to which over 4,000 firms responded from across all sectors of financial services activity. The views of the newly-regulated mortgage and general insurance (M&GI) population of firms were also captured, for the first time.

*The survey identified a number of specific areas where the FSA had shown some signs of improvement*

The survey identified a number of specific areas where the FSA had shown some signs of improvement – these included; relationship management, the provision of guidance, the navigability of the Handbook and the day-to-day treatment of smaller firms. However, it also found – perhaps disappointingly – that other than on the wholesale and major groups side, overall satisfaction ratings of the FSA by the firms it regulates had not much improved since 2004, especially amongst smaller firms.

The survey's qualitative and quantitative findings suggested that the main concerns, shared by both large and smaller retail firms, centred on the FSA's policy approach to the retail market; uncertainty about the move towards principles-based regulation; a lack of clarity about FSA initiatives like Treating Customers Fairly (TCF); and continuing discontent over the costs and burden of compliance. Further information on the survey and next steps is discussed in greater detail in the body of this report.

At this point, I would like to thank Matthew Bullock for his considerable contribution and commitment in chairing the last two Panel survey sub-groups.

#### A good idea in principle...

A major FSA initiative which has taken up a large amount of the Panel's time over the past year has been the regulator's move towards a more principle-based regime; and related issues such as Treating Customers Fairly, provider/distributor and firm/consumer responsibilities, and industry codes. The Panel has been supportive of this important strategic change of emphasis but has warned FSA that it may face a number of potential obstacles and challenges if the transition is to be successful.

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One of the major challenges for both regulator and industry over the coming years will be to establish exactly how principles-based regulation will work in practice. Our survey found that a great many firms failed to understand what principles-based regulation meant and how it would work – even through the majority supported the idea in principle. On TCF specifically – which is the FSA’s first major principles-based iteration – the survey showed that over half of all firms still did not feel that the FSA had been clear enough about what specifically it expected of them.

“Principles-based regulation will test firms’ ability to operate outside the safety, certainty and rigidity of a rules-based environment – with the potential benefit being greater flexibility and room for innovation.”

Principles-based regulation will test firms’ ability to operate outside the safety, certainty and rigidity of a rules-based environment – with the potential benefit being greater flexibility and room for innovation. For the FSA, on the other hand, the greatest challenge will be to ensure that its supervisory (and other) staff are sufficiently capable, confident and supported to make the judgements – and have the type of conversation with individual firms – that will be required of them in a principles-based world.

The FSA’s recent conference on principles-based regulation and the launch of its “Principles-based Regulation - Focusing on the Outcomes that Matter” paper, which the Panel was able to review prior to its publication, was an important milestone in this process, and was welcomed by the Panel. It should begin to help firms understand better what will be expected of them – and what they could expect of the FSA – under the new approach.

The Panel recognises that much effort is underway within the FSA to effect enhancements along the above lines. This includes a large-scale internal training programme to prepare FSA supervisory (and other) staff for the challenges of principles-based regulation; and a focused effort to hire and retain suitably skilled staff. If successful, these efforts should result in a sleeker, leaner FSA operation that would be able to respond more swiftly, effectively and proportionately to changes in the increasingly complex financial services markets.

## Going forward

I will not list here all of the other workstreams in which the Panel has been involved over the past year, as many are discussed elsewhere in this report. I will, however, take a brief look ahead and identify some of the issues that are likely to occupy our agenda over the next 12 months.

Principles-based regulation and TCF will inevitably continue to feature in our discussions. A related item that will take further shape over the coming year is the FSA’s “Making a Real Difference” agenda. This entails many aspects – both internal and external facing – that should enable the FSA to position itself in a more principles-based regulatory environment. The Panel is involved in ongoing discussions on this subject and will monitor developments closely.



The FSA's approach to its retail strategy is another major theme going forward, and one on which the Panel has already made strong representations. Specifically, the Panel has warned the FSA to carefully consider the cumulative impact on retail firms of its numerous reviews, projects and thematic initiatives, especially at a time when firms are grappling with principles-based regulation and the implementation of some major pieces of EU legislation. This burden affects all retail firms to varying degrees, and is of particular concern to smaller firms.

Specific matters that will merit closer scrutiny in 2007/8 include the Retail Distribution Review, the Quality of Advice project, MiFID and CRD implementation, and the FSA's action in respect of previous State Second Pension transactions. By all indications, 2007/8 is therefore likely to be another busy year for the Panel.

I would like to take this opportunity to thank those members who have left the Panel over the past year – Alan Ainsworth, David Hardy, Jonathan Bloomer and Matthew Bullock – for their time, effort and expertise. I would also like to thank my fellow serving Panel members for the considerable energy they invest in our work, and our small Secretariat team for their enthusiastic and dedicated support.

Last but not least my thanks go to FSA staff and senior management for their willingness to engage in open and frank dialogue with the Panel – we hope that they take our views in the constructive spirit in which they are given. While exchanges between the FSA and Panel members can be spirited at times, our genuine aim and motivation is to help foster a fairer, more effective regulatory regime for all stakeholders.

I hope that you will find this Annual Report helpful, informative and interesting.

Roy Leighton  
Chairman  
May 2007





## 2. THE PANEL'S YEAR IN REVIEW

*Please note that even though the following items appear in our Year in Review as they took up a large proportion of the Panel's time during 2006/7, most of them are ongoing and will continue to occupy the Panel's agenda during 2007/8. This is particularly true for section 2.c. – the FSA's move towards more principles-based regulation.*

### 2.a. Survey of Regulated Firms – Results and Next Steps

In November 2006 the Panel published the results of its fourth biennial survey of regulated firms. The survey is an authoritative, in-depth piece of research, providing robust feedback from the financial services industry on the FSA's performance over time. It also gives the Panel a solid basis on which to recommend improvements to the FSA.

The survey has been run every two years since the Panel's inception in 1999, during which time it has prompted a useful series of actions for both the Panel and the FSA. The Panel plans to run a further survey in 2008, in advance of which it will review and refine the survey's objectives and questionnaire to ensure their relevance and value.

Over 4,000 firms from across the whole financial services industry responded to the 2006 survey, which for the first time captured the views of the newly-regulated mortgage and general insurance (M&GI) firms. More detailed information on the findings of the survey can be found on the Panel's website – [www.fs-pp.org.uk](http://www.fs-pp.org.uk).

The survey's key findings included:

- **Overall unchanged satisfaction masks sectoral and size differences:** Although firms continued to support effective regulation and recognise its benefits, their overall satisfaction with the work of the FSA showed little or no sign of improvement, and varied sharply between sectors. Major groups – wholesale and retail – had become more contented, but smaller wholesale and relationship-managed retail firms showed little change from 2004. Smaller retail firms' overall views of the FSA deteriorated, despite steps taken by the FSA to make itself more approachable. These firms now make up over 80% of the population of firms regulated by the FSA.

- **Uncertainty about principles-based regulation and TCF:** Most firms welcomed the concept of principles-based regulation. Similarly, most firms – two thirds – supported the Treating Customers Fairly (TCF) initiative. However, the main concerns, shared by both large and smaller retail firms, centred on uncertainty about the move towards more principles-based regulation and how the FSA and its supervisory staff would implement and enforce the new strategic approach in the retail marketplace.
- **Burden of regulation remains high:** As had been the case in previous Panel surveys, the overall burden of regulation was still considered high across the spectrum of firms, particularly in the retail sector. Recent FSA initiatives like TCF, combined with a flurry of EU regulation, had left the majority of firms with the impression that the level and costs of regulation would continue to increase. This reflected general anxiety among practitioners over the coherence of the FSA's retail strategy, which is discussed in greater detail in Section 3.b.
- **Improvements:** Firms recognised that the FSA had delivered improvements in several of its day-to-day interactions with them – some of which were highlighted as problem areas in previous surveys. These included FSA handling of consultation procedures, satisfaction with relationship managers, the willingness to provide guidance, the navigability of the Handbook, and the FSA's general treatment of smaller firms (including the creation of the Small Firms Division). Improvements had also been made to the FSA website. Unfortunately, progress in these areas was overshadowed by concerns about the FSA's high-level approach to the retail market.

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*The Panel has long argued that the quality of FSA staff was key to a successful shift towards a more principles-based regime...*

### Next Steps

The FSA accepted the survey in the constructive spirit in which it was intended and has already embarked on a number of measures that can, at least in part, be linked to the survey's findings. These include:

- **FSA Business Plan 2007/8:** In its 2007/8 Business Plan, published on 6 February 2007, the FSA allocated a budget of up to £50 million over the next three years to improve the effectiveness of FSA staff and support the move to principles-based regulation. The Panel has long argued that the quality of FSA staff was key to a successful shift towards a more principles-based regime – and this view was supported by the findings of the latest Panel survey. We therefore welcomed the FSA financing announcement, providing that this expenditure achieves a measurable and tangible improvement in performance.
- **Retail Savings Regulatory Strategy Group:** In January 2007 the FSA set up the Retail Savings Regulatory Strategy Group. This stakeholder group would provide input to help the FSA enhance the coherence of its industry-facing regulatory initiatives in the retail area; and deliver a more principles-based approach to meeting its statutory objectives, in a way that also facilitates the contribution from market-led solutions. The group is chaired by Clive Briault, FSA Managing Director for Retail Markets.

- **FSA staff changes:** The FSA announced that it would reduce its overall headcount and focus at the same time on bringing on board higher-calibre, expert staff to meet specific needs across the organisation. Again, the Panel was supportive of those developments, if they indeed lead to a more streamlined, skilled and effective organisation.
- **Communication with firms:** The survey showed that a high degree of uncertainty persisted among both larger and smaller firms on how principles-based regulation, and the Treating Customers Fairly initiative, would be applied in practice. The FSA has already begun working on targeted communication strategies, in particular for smaller firms. Further work was undertaken with the Panel and the Smaller Businesses Practitioner Panel on developing specific communication tools for various markets and sectors – for example, on TCF and MiFID. Such material and assistance has been helpful to the industry, but we would suggest that there remains scope for further improvement and to enhance accessibility/awareness – the FSA must not become complacent here.
- **Reducing the cost and burden of regulation:** The FSA's Better Regulation Action Plan set out what the regulator was doing to reduce costs where possible. The FSA claimed that by the end of 2008 it would have reviewed activities which account for 80% of the administrative costs incurred by firms as a result of its rules, and it has already taken significant actions in this direction – for example, by moving the anti-money laundering requirements to a more principles-based approach, with consequent savings of over £250 million per year. The FSA has also proposed a more risk-sensitive approach towards the capital requirements of life companies, resulting in reduced aggregate capital requirements of UK life insurers of some £4 billion.

The Panel welcomes these and any further steps taken by the FSA in response to the survey. It will closely monitor all of these developments and looks forward to contributing to further discussions arising from those findings during 2007/8.

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## 2.b. Costs of Regulation Survey – Follow-up and Next Steps

In June last year the FSA and the Panel released the results of its jointly-commissioned Costs of Regulation study, undertaken by Deloitte. Designed as a gritty and in-depth accounting study into regulatory costs, it was launched in direct response to the Panel's 2004 survey of regulated firms, which had found the costs and burdens of regulation to be possibly the single biggest issue of concern to practitioners. Its conclusions were discussed in last year's Panel Annual Report, which can be accessed via the Panel's website on [www.fs-pp.org.uk](http://www.fs-pp.org.uk).

Unsurprisingly, of the three sectors examined as part of the study, the retail-oriented investment and pensions advice sector showed the highest incremental regulatory costs; including activities such as training & competence and compliance with elements of the Conduct of Business rules. At the time, Chairman Roy Leighton said that, “The highly prescriptive nature of [certain] requirements as currently framed in the FSA Handbook is what generates the significant incremental costs in the retail sector.”

## Regulatory Fee Reviews

Regulatory fees – including FSA fees, Financial Services Compensation Scheme (FSCS) contributions and Financial Services Ombudsman (FOS) fees – were identified as one of the main drivers behind the regulatory costs burden. While the Panel accepts that these are an inevitable and necessary component of the UK regulatory regime, it welcomes the regular reviews of these fees; in particular the ongoing review of the FSCS funding requirements, which aims to establish a fairer, more representative compensation scheme that better reflects the current make-up of the UK financial services markets (*for more detail on the FSCS Funding Review, see section 2.f.*).

The Panel also recognises that FSA fees are bound to increase for 2007/8, due to the FSA's move towards a more principles-based approach to regulation and related expenditure on IT system upgrades, knowledge management and staff improvements (training, retention, recruitment).

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## Handbook Reviews

Over the past year, and continuing forward, the FSA has been embarking on a major review of its Handbook, which aims at a substantial reduction of the overall volume and unnecessarily prescriptive content. It has also launched tailored handbooks, available online, which contain only rules relevant to certain types of firm; and the ability to build personal handbooks. While reduced prescription is welcome this does not in itself improve the clarity, navigability and usability of the Handbook, and there remains a concern that the FSA may seek to supplement this with the increasing use of soft communications and explanatory information that sits outside the Handbook.

As part of the FSA's commitment to better regulation and its move towards a more principles-based regime, in 2007/8 it is planning to review a number of its sourcebooks, including the **Client Assets Sourcebook**; its **Approved Persons regime**; and the **Training and Competence Sourcebook**.

The Panel will stay closely involved with these reviews.

## Benefits of Regulation

To counterbalance the work on the costs of regulation, the FSA has undertaken a study, conducted by Oxera Consulting, to set out a framework for identifying and measuring the benefits of regulation. One main focus of this study will be the requirement on firms to use suitability letters – an area that was highlighted by the Deloitte project as a major source of incremental costs. Conclusions should be known shortly and will be followed closely by the Panel.

## 2.c. Principles-Based Regulation

The Panel is generally supportive of the FSA's move towards a more principles-based regime, which it believes is the appropriate approach towards a modern, proportionate and effective risk-based regulatory framework in the UK. It recognises the opportunities this could create for regulated firms through

greater flexibility and a reduction in their regulatory burden. However, the Panel has consistently warned the FSA that it would need to navigate carefully some potential obstacles towards principles-based regulation to ensure the success of this transition.

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- **Consistency of implementation:** Broad consistency of implementation across the FSA would be crucial to ensure the success of principles-based regulation.
- **Communication with the industry:** As experience evolves, the FSA should continuously articulate what it means in today's market by principles-based regulation. A lack of clarity persists, as highlighted by the Panel's 2006 survey of regulated firms, fanning fears that an arbitrary framework might be applied in practice. Some progress has now been made in this regard, and we would encourage the FSA to pursue those efforts.
- **Role of enforcement:** There were anxieties over the role of enforcement and fears that it might be used by the FSA to set precedents; help interpret untested principles; and unfairly single out firms to establish industry markers. In that context, the Panel would also like to see the introduction of the concept of a “reasonably conscientious firm” to help govern the basis on which the FSA might consider pursuing such formal action.
- **Role of the FOS:** Concerns also persisted over the Financial Ombudsman Service (FOS) and its role in interpreting principles rather than rules, especially as FOS decisions are widely seen as benchmarks of good practice. This also resulted in some practitioners being anxious over their inability to appeal individual FOS decisions. The Panel maintains a continuous and constructive dialogue with the FOS and has been reassured that it is acutely aware of the importance of its decisions where they may have a wider impact on the industry. A formal arrangement with the FSA exists for dealing with such instances.
- **Regulation through the back door:** There is a perceived danger of creating a second tier of “regulation through the back door”, via senior FSA executives' speeches, press releases, Dear CEO letters, “good practice” guides and enforcement precedents. Such developments would not be subject to the statutory consultation processes. Additionally, easily accessing and cross-referencing such “soft” material is an issue that firms would have to cope with.

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Industry guidance, high-quality FSA staff and targeted, clear communication programmes, like the TCF Aide Memoire, will go some way to addressing a number of the concerns held by practitioners over principles-based regulation.

The Panel welcomes the recent publication of the FSA's positioning document: Principles-based Regulation – Focusing on the Outcomes that Matter; and hopes that this will help address some of those issues set out above and provide the greater clarity that regulated firms are looking for. The Panel will use that document as a basis for further dialogue with the FSA on the development and application of principles-based regulation in practice.

### Treating Customers Fairly

The Panel has engaged with the FSA on this subject at great length, and set out the overall thrust of those discussions in its 2005/6 Annual Report. Even though Treating Customers Fairly (TCF) predates the formal articulation of the FSA's move towards a principles-based regime, it represented the first major iteration of that evolving approach to regulation. The way in which the FSA has been monitoring and enforcing TCF as it beds down has therefore been watched closely by the industry.

As with principles-based regulation more generally, the Panel's survey of regulated firms highlighted that many firms remained confused over what exactly was expected of them by the regulator under TCF – with the majority arguing that they already treated their customers fairly. In the first instance, this is an issue of good communication and, over the last year, the FSA has endeavoured to provide the type of TCF-related material and facilities – for example, case studies and industry roadshows – that it hopes will give firms the necessary information and understanding to get to grips with this crucial and high-profile initiative.

Firms feared that their greatest costs and challenges would arise in relation to evidencing and management information – being able to demonstrate to the FSA through paper and other records that they had, in fact, treated their customers fairly and engaged with the TCF process. This was in spite of FSA's reassurances that its evaluation of a firm's

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compliance with TCF would be outcome-focused. Consequently, many practitioners approached (and continue to approach) TCF as a rather more expensive and onerous project than the FSA might have expected and recommended. Any more support and clarification that the FSA can provide in this specific regard would be welcomed.

In this context, the Panel has also pointed out consistently that in the absence of an appropriate recognition and application of consumer responsibility – or caveat emptor – firms would be inclined to be overly conscientious and cautious in their implementation of TCF across their organisations, to safeguard against legal action and unfavourable FOS decisions. The Panel is very supportive of the FSA's apparent intention to revisit the consumer responsibility debate in the context of its move towards more principles-based regulation.

Conclusions drawn and lessons learnt from the FSA's investigation into the March 2007 TCF implementation deadline represent a significant marker by which to measure its success in delivering TCF messages to firms and its progress towards a more principles-based regime. Those findings are expected shortly, and the Panel will be taking a keen interest in what they say and the way that the FSA chooses to position them – a suitably balanced communication strategy is essential to avoid unfair and disproportionate interpretations being drawn.

### **Provider/Distributor and Firm/Consumer Responsibilities**

*While the Panel was supportive of the FSA's desire to clarify the respective responsibilities of providers and distributors in the context of TCF, it urged the FSA to ensure that any guidelines on the subject sat comfortably with the FSA's intention to reduce prescriptive rules in its shift to a more principles-based approach to regulation. The Panel generally felt that it was not necessary to bolt detailed provisions on top of a principles-based framework. It also feared that an unintended consequence of the FSA's actions might be a market wide review of the contractual obligations between providers and distributors that could be unnecessarily cumbersome and problematic for firms – we would encourage the FSA to clarify this aspect when it pronounces on the issue shortly.*

*The Panel welcomed the FSA's decision to publish its thinking as a Discussion Paper rather than as a Consultation Paper (as had initially been mooted). This high-level positioning, without further prescriptive rules or guidance, is consistent with the FSA's move towards a more principles-based regime and greater reliance on market-driven solutions, and should ensure that a one-size-fits-all approach is avoided.*

*The Panel also continues to press the FSA to articulate more authoritatively its views on consumer responsibility, or caveat emptor, under TCF and in the context of more principles-based regulation. The Panel has long maintained that the absence of a clearer definition and application of the consumer responsibility principle – i.e. that consumers should take due responsibility for the investment decisions that they make - was one of the key drivers of regulatory cost in the retail markets, as firms go above and beyond what was required by law and regulation to protect themselves against complaints and possible Financial Ombudsman Service action or litigation. The Panel welcomes the fact that the FSA acknowledges this issue in its "Principles-based Regulation – Focusing on the Outcomes that Matter" paper and that it will evidently now be returning to the discussion table – we shall seek to influence that thinking as it develops.*

### **Quality of FSA Staff**

The Panel has continued to stress that the quality of FSA supervisory and other staff was crucial in ensuring that principles-based regulation works, and would be implemented pragmatically and consistently. In a principles-based world, in which both firms and regulator can no longer rely on the certainty of detailed rules, supervisors would have to make difficult judgement calls on a regular basis. In order to do so, thorough training and detailed industry knowledge would be required.

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The Panel therefore welcomed the FSA’s considerable efforts in this area, including the Regulatory Curriculum, ARROW 2 review and residential ARROW course for supervisors. In the Panel’s view, the FSA is taking strides in the right direction by investing heavily in staff training, retaining its good people and recruiting specific industry expertise – while at the same time reducing headcount overall – as part of its “Making a Real Difference” agenda.

The Panel is also supportive of the FSA’s decision in its 2007/8 budget to allocate up to £50 million over the next three years to improving the effectiveness of FSA staff and supporting the move to more principles-based regulation. The fact that the cost would be amortised in terms of firms’ fees over a period of 10 years is also welcome. Nonetheless, it stressed that this was a considerable amount of money and that the FSA would, in due course, be expected to demonstrate that it was being well-targeted and produce tangible evidence of its influence and benefit to the industry.

### Industry Guidance

The Panel felt that industry guidance should help to plug gaps created by a move to a more principles-based regime and allay some practitioners’ concerns who preferred the

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certainly of a rules-based framework – provided that the FSA was prepared to review and endorse such initiatives where appropriate. While the Panel accepted that the FSA would stop short of giving such material “safe harbour” status, the industry would welcome a “sturdy breakwater” assurance that industry guidance could provide. It encouraged the FSA to be prepared to work collaboratively with the trade associations on this but

emphasised that its approach must be proportionate and focus on the areas of real need.

The Panel also recognised that a number of concerns persisted over the use of industry guidance, and communicated these to the FSA. They included:

- Industry guidance must add real value and not create a second tier of regulation.
- Trade associations should not – and have no desire to – turn into “quasi regulators”.
- Some trade associations were thinly resourced and might find it difficult to accommodate a move towards the production of and greater reliance on industry guidance.
- Adherence to guidance should be voluntary and the Enforcement position in this respect would need to be clarified, along with how industry guidance would sit within the EU regulatory framework.
- Industry guidance would not be workable unless it received an adequate degree of endorsement and authority from the FSA.
- The position of the FOS on industry guidance needed to be understood.



- The FSA should not look exclusively to trade associations to provide guidance, but should also consider other sources of expertise, such as industry fora.
- The FSA's expectation of trade associations to make their guidance widely available to non-members as well as members might compromise some associations' willingness and ability to produce guidance.

### Thematic Work and Mystery Shopping

During 2006/7, the FSA relied more heavily on thematic work and mystery shopping exercises to identify problems in certain sectors. While the Panel was sympathetic to this approach in principle, it pointed out to the FSA some anxieties that persisted over general conclusions being drawn from often small sample sizes that had little statistical relevance; over the lack of feedback to firms and industry representatives; over the objectiveness of the methodology; and over potential enforcement action on the basis of such work.

There have also been concerns by practitioners, large and small, about the extent to which they are becoming overloaded by the number of thematic reviews. The Panel has therefore repeatedly taken up with the FSA the need for

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the regulator to consider the cumulative impact on firms of these various initiatives, and to have robust internal processes to safeguard against those initiatives that might not be truly justified and/or an immediate priority.

The Panel has urged the FSA to raise the results of contentious exercises with the relevant trade association prior to publication to fact-check the broad findings. Also, the FSA should seek to help firms by providing them with specific feedback through supervisors and relationship managers. Efforts are underway within the FSA to address some of these issues.

The Panel also noted that with regard to both Dear CEO letters and thematic results, the FSA's approach to their publication was key; the FSA should consider carefully how it publicly communicates the results of thematic work; what it seeks to achieve with publication; and what impact publication might have on consumer confidence. Similarly, given the absence of a consultation process, the FSA must be mindful of concerns over “regulation through press release”, as well as through Dear CEO letters and senior executives' speeches.

Finally, the Panel continued to remind the FSA to ensure that regulatory intervention arising from its thematic work and mystery shopping exercises were “must dos” rather than “nice to dos” – except where such action might serve to lower the regulatory burden. At a time when regulated firms have to cope with the implementation of two major pieces of EU legislation – MiFID and the CRD – the FSA should be mindful not to add unnecessarily to the cumulative impact of regulation on businesses.

Going forward, the Panel will stay close to the FSA's thematic work and mystery shopping exercises to ensure that its actions are proportionate, fair and justified. The publication of the FSA's six-monthly forward programme of thematic work is seen as very useful and was welcomed by the Panel.

## 2.d. Financial Capability and Generic Advice

The Panel has remained closely involved with the development of the FSA's Financial Capability strategy and developments on Generic Advice.

### Financial Capability

The Panel was generally supportive of the FSA-led National Strategy for Financial Capability but noted the limitations of the current funding strategy and intention to increase funding to £20m per annum from 2007 to 2010. It remained uncertain that the increase in Financial Capability expenditure – whilst laudable – would have the wider overall effect that was hoped for. The Panel has always felt that the most effective way to make significant progress on financial capability would be through appropriate amendments to the National Curriculum – a point it put strongly to the Economic Secretary to the Treasury Ed Balls MP when it met with him in early 2007.

If the industry was being asked to pay more for financial education, then it would naturally expect to see how its money was being spent, the value it would get and the benchmarks for determining whether the objectives had been delivered by the FSA. The Panel urged the FSA to produce a detailed prospectus in order to encourage a positive response from the regulated community.

The Panel was also aware that hundreds of millions of pounds in unclaimed and dormant assets were held in bank accounts. It suggested that the FSA should use its influence to lobby the Treasury and Ministers to allocate some of this money towards financial education in the UK. It wrote to The Commission on Unclaimed Assets in November 2006 in support of such an approach. Further, the Panel encouraged the FSA to lobby the Treasury to include National Savings as a contributor to the Financial Capability work.

### Generic Advice

The Panel supported the recent re-launch of the FSA's consumer website, [www.moneymadeclear.fsa.gov.uk](http://www.moneymadeclear.fsa.gov.uk). It had always felt that a clear, user-friendly internet-based hub for generic financial information – ideally provided by the FSA – was the best way to offer far-reaching and truly independent material to a large part of the population. The new website was therefore seen by Panel members as a suitable generic advice solution for a majority of the market. Of course, the key would be whether consumers accessed and used this material, and how the FSA would in turn measure its impact on their behaviour.

*“A clear, user-friendly internet-based hub for generic financial information – ideally provided by the FSA – is the best way to offer far-reaching and truly independent material to a large part of the population”*

The Panel also welcomed the formation in early 2007 of a new taskforce, led by Otto Thoresen, Chief Executive of AEGON UK, to research and design a national generic financial advice service; ensuring that every person, including those on the lowest incomes, can get quick, easy and simple access to good-quality financial advice. However, it remains to be seen whether a viable commercial case can be made for the universal provision of face-to-face generic advice. Otto Thoresen is expected to report to Ministers by the end of the year, and the Panel looks forward to engaging in those important discussions.

## 2.e. MiFID and CRD Implementation

The Panel has been monitoring closely how the FSA was approaching the implementation of the Markets in Financial Instruments Directive (MiFID) and the Capital Requirements Directive (CRD), both of which come into effect in 2007. This will be a significant challenge for both regulator and regulated, as firms will need to have the systems in place to meet the new or revised prudential, organisational and Conduct of Business requirements.

As part of its work in this area, the Panel has met regularly with FSA staff responsible for the transposition of these crucial directives into UK law, as well as industry representatives, such as the MiFID Connect group, which combines trade associations wishing to simplify the UK implementation of the directive.

The Panel's key concern has been to ensure that UK firms do not suffer a commercial and competitive disadvantage vis-à-vis their EU counterparts due to super-equivalence, passporting, home/host issues, and delays in firms' ability to complete necessary system development because of late implementation and other factors outside their control. It also continuously urged the FSA to curtail other discretionary "nice to do" initiatives at a time when a vast majority of firms have to grapple with the implementation of these substantial legislative and regulatory changes.

*“The Panel urged the FSA to curtail other discretionary “nice to do” initiatives at a time when a vast majority of firms have to grapple with the implementation of these substantial legislative and regulatory changes.”*

The Panel shared the industry's concerns regarding gold-plating and the FSA's proposals on client categorisation and best execution during the earlier stages of the consultation process, but is now satisfied that discussions between the FSA and the industry on these subjects are progressing well. It welcomes the fact that an agreement on best execution had been reached between buy-side and sell-side trade associations and that the European Commission had supported that consolidated view. The Panel hopes that the FSA and industry representatives can iron out any outstanding disagreements on this important issue.

The Panel was also initially concerned to ensure that the FSA effectively co-ordinated its work internally on the two directives, as well the related communication programmes. It urged the FSA to send out clear messages to retail markets, in particular smaller retail firms and non-scope MiFID firms, and to continue to engage in constructive discussions with industry expert groups, like MiFID Connect.



The Panel supported the FSA's intention to concentrate on three main areas going forward:

- The FSA would engage in robust discussions with industry bodies such as MiFID Connect and with individual firms;
- The FSA would not just rely on the formal consultation process but would tailor its communications to firms – for example, through industry events and by raising awareness via articles in the press; and
- The FSA would launch a refreshed website initiative with clearer signposting for firms of all sizes and types.

Some of these measures are already in effect and the Panel will continue to monitor progress in this area.

## 2.f. FSCS Funding Review

The Panel has been involved on a regular basis in the consultation on the new Financial Services Compensation Scheme funding structure. It recognises that the FSA faced a considerable challenge in reforming the regime to make it more sustainable and better reflect the current structure of the UK financial services markets. The Panel also acknowledged the challenge of constructing an FSCS funding framework in a way that satisfied all the sectors and stakeholders. The following two issues were raised specifically by Panel members:

*“The Panel was somewhat surprised by the addition of a wholesale pool, which it deemed neither fair nor reasonable when all circumstances were taken into account – including the likely further narrowing of the UK's competitive edge compared with overseas regimes.”*

### Wholesale Pool

The Panel was somewhat surprised by the addition of a wholesale pool, which it deemed neither fair nor reasonable when all circumstances were taken into account – including

the likely further narrowing of the UK's competitive edge compared with overseas regimes. It urged the FSA to keep in mind that the wholesale sector contributed considerably to the UK economy, but was a highly mobile business that could very easily and quickly move abroad.

Moreover, it was unclear how a metric could be developed that would measure wholesale firms' rather intangible benefits from a retail compensation scheme in order to assess contribution levels fairly and accurately.

### General Insurance Thresholds

The Panel encouraged the FSA to revisit the basis for calculating general insurers' potential liabilities, along with any associated impact on firms' credit ratings and the capital adequacy provisions. It had not felt that the latter two points had been sufficiently considered by the FSA in its initial deliberations. Even though the FSA's eventual proposals, published in March 2007, reduced general insurers' liability thresholds, they were still set very high and represented a significant increase on the previous level.

The Panel will continue to engage with the ongoing FSA consultation; and will also seek to take an active involvement in the separate consultation process on the wholesale pool, which is expected sometime later in the year.

## 2.g. National Audit Office Value for Money Review of the FSA

Practitioners are keen to ensure that the FSA operates with economy and efficiency, and that the fees paid by regulated firms are put to good and proportionate use.

The Panel therefore contributed to the National Audit Office's (NAO) Value for Money Review of the FSA through several meetings with NAO officials and received progress reports through the duration of the project.

The Panel awaits the formal publication of the NAO's findings and recommendations; along with the FSA response thereto. These are expected shortly. It will keep a watching brief on how any issues emerging from this study are to be taken forward by the FSA

## 2.h. Other Key Issues

The Panel gets involved in a wide range of issues over the course of a year, reflecting the far-reaching spectrum of the FSA's activities. The following items were also on the Panel's agenda during 2006/7. While this by no means constitutes an exhaustive account of the Panel's workload, it does nonetheless provide a flavour of the diversity of the Panel's activities.

- International competitiveness:** The Panel has been continuously emphasising this point by urging the FSA to include the competitiveness of UK financial services firms, vis-à-vis their international counterparts, in its policy considerations. We rightly encourage the FSA to be involved in international discussions at an early stage and at a suitably senior level. This is of particular importance in the implementation of EU directives, where super-equivalent interpretations and the transposition of directive texts could put UK firms at a serious competitive disadvantage. The Panel feels that it is crucial that the FSA gets involved at the earliest stages of the EU policy-making process to help shape EU directives so that they do not adversely impact the UK financial services markets and strongly supports FSA involvement and visibility at the most senior level in key negotiations. The way that the FSA engages with US and Transatlantic authorities, and those regulatory regimes prevailing in other key markets such as Asia and the Middle-East, is also hugely important.

*“The Panel feels that it is crucial that the FSA gets involved at the earliest stages of the EU policy-making process to help shape EU directives so that they do not adversely impact the UK financial services markets and strongly supports FSA involvement and visibility at the most senior level in key negotiations.”*

- **Private equity and hedge funds:** Through sub-groups and full Panel discussions with relevant FSA staff, the Panel has contributed to the FSA's examination of the private equity and hedge fund markets. The Panel is supportive of the FSA's measured and thoughtful approach to these difficult topics and its desire to take a leading role in international regulatory initiatives that might impact on these markets. Panel members look forward to further engagement with FSA staff in these areas.
- **Retail Financial Services Group:** The Panel Chairman, Roy Leighton, has been a member of the Retail Financial Services Group since its inception and continues his involvement. Important topics of discussion over the past year have included equity release and financial capability. The RFSG remains an important forum that brings together not only industry and practitioner views, but also those of consumer interest groups, around one table.
- **Firm Contact Centre and Regulatory Transactions departments:** Following the outcome of the Panel survey, which was in part critical of the performance of the FSA's Firm Contact Centre (FCC), the Panel Chairman visited the FCC and also the FSA's Regulatory Transactions unit. He was impressed with the ongoing efforts to improve effectiveness and the level of professionalism in both divisions. The Panel has offered its assistance in the development of measures that might further boost the performance of these important functions (which are also trailed in the FSA's "Focusing on the Outcomes that Matter" document, published in April 2007).
- **Meetings with senior FSA executives and other stakeholders:** Aside from its engagement with FSA staff on specific issues at its monthly meetings, the Panel also regularly invites FSA senior executives and other stakeholders for discussions. The former include FSA Chairman, Sir Callum McCarthy; CEO, John Tiner; Head of Enforcement, Margaret Cole; Head of HR, Kathleen Reeves; as well as the FSA's managing directors and sector leaders. The latter include Economic Secretary to the Treasury, Ed Balls MP; FOS Chairman, Sir Christopher Kelly and Chief Ombudsman, Walter Merricks; and FSCS Chairman, David Hall and Chief Executive, Loretta Minghella. Panel members also attended annual dinners with the FSA Board and with the Consumer Panel.
- **Relationship with Trade Associations:** The Panel fosters a close relationship with trade associations to ensure that it is fully briefed on their issues and concerns. These links are maintained through regular meetings between Panel Secretariat staff and key trade association representatives; via correspondence; and by virtue of individual Panel members' ties with their respective trade bodies. The Panel also gives a biannual briefing to senior executives of trade associations, hosted jointly by the Panel Chairman and the Chairman of the Smaller Businesses Practitioner Panel.

## 3. THE PANEL'S PRIORITIES FOR 2007/8

*Many of these issues emerged and were discussed by the Panel during 2006/7, but feature among the Panel's Priorities for the coming year as they are expected to take up an increasing amount of time in 2007/8.*

### 3.a. FSA's "Making a Real Difference" Agenda and 2007/8 Priorities

#### FSA's "Making a Real Difference" Agenda

The FSA's "Making a Real Difference" agenda is the cornerstone of its organisational strategy going forward. As Clive Briault said in his speech at the BBA's Annual Retail Banking Conference on 15 November 2006, "[The FSA's] main focus for 2007 will be on 'making a real difference' – to consumers; to our own effectiveness; and to regulation internationally."

As discussed in section 2.c. on Quality of FSA Staff, in terms of the inward-facing elements of "Making a Real Difference" – in particular, the FSA's intention to operate with a somewhat smaller but higher calibre workforce – the Panel is warmly supportive

*"...in terms of the inward-facing elements of "Making a Real Difference" – in particular, the FSA's intention to operate with a somewhat smaller but higher calibre workforce – the Panel is warmly supportive of the strategy."*

of the strategy. If delivered as hoped the industry could see many of the issues of concern arising from the Panel's 2006 survey tackled head-on, especially those impacted directly by the quality and approach of FSA staff in policy, supervisory and Firm Contact Centre roles. However, the Panel also notes that it is necessary to develop suitable and objective measures to monitor progress and improvements in this regard.

Panel members welcome the inclusion of an international dimension in the FSA's "Making a Real Difference" work, as it has always felt that the FSA's open and collaborative approach to financial services regulation should be actively encouraged and promoted abroad. The Panel looks forward to engaging with the FSA on this and other elements of its agenda over the coming year.

#### FSA 2007/8 Priorities

With regard to FSA priorities for 2007/8 generally, the Panel stressed that it was imperative for the FSA to stand back and put itself in the position of regulated firms – commercial businesses – to better understand why they felt burdened by regulation and repeatedly pleaded for a period of greater stability.

The Panel continues to urge the FSA to review continuously its list of planned initiatives for the coming year in a robust, objective and critical fashion to determine those discretionary issues that might not be of immediate urgency or meet the essential criteria of market failure, cost/benefit analysis and maintaining confidence in the financial system. It feels strongly that a solid internal vetting process must be in place to ensure that only those regulatory initiatives that are absolutely necessary get the green light to go ahead.

“*It feels strongly that a solid internal vetting process must be in place to ensure that only those regulatory initiatives that are absolutely necessary get the green light to go ahead.*”

### 3.b. FSA Retail Strategy

The Panel’s survey was quite clear that there is a perception among firms – rightly or wrongly – that the FSA’s retail strategy lacked clarity, focus and coherence; the cumulative burden of which was seen as perhaps the major factor leading to firms’ current levels of frustration and dissatisfaction with the regulator.

Following the survey’s findings, the FSA announced in early 2007 the formation of the Retail Savings Regulatory Strategy Group. It held its first meeting in January 2007, at which it confirmed that it would focus on helping the FSA to deliver as effectively as possible the coherence of industry-facing regulatory initiatives in the retail area; and in a way that facilitated the contribution from market-led solutions.

The Panel welcomes the formation of this group and will continue to scrutinise the coherence and objectives of the FSA’s retail strategy. In addition, it has met Clive Briault – FSA MD of Retail Markets – to discuss practitioners’ concerns in greater detail. Following that meeting, he undertook to reflect further on the Panel’s views and provide a substantive and considered response – this is expected shortly.

#### **A Retail Success: NEWCOB**

*The Panel is supportive of the FSA’s efforts to develop a more principles-based and simplified Conduct of Business (COB) regime. The reform of the existing COB rules is a flagship project for the FSA in the move towards more principles-based regulation and away from detailed prescriptive rules, with the aim being to remove around half the content of the old Handbook text. NEWCOB – as it is known – will therefore be substantially shorter, and is being carried forward by the FSA at the same time as implementing the relevant provisions of MiFID.*

*The Panel has said on previous occasions that the current COB and disclosure framework is burdensome and inflexible for firms; and contains a volume and depth of information that makes it difficult for consumers to understand and engage with. This initiative should give firms’ senior management the ability to focus on outcomes – rather than procedure – in a way that suits their particular business models, but without relaxing the standards of behaviour and service expected of them.*



### 3.c. Retail Distribution Review

In June 2006 the FSA launched its Retail Distribution Review, with the aim of identifying and addressing the root causes of problems it perceived in the retail investment markets. It called on the industry to play a lead role in delivering market solutions to provide better outcomes for consumers, producers and distributors; and identified five themes to be addressed by the review:

- The sustainability of the sector
- The impact of incentives
- Professionalism and reputation
- Consumer access to financial products and services; and
- Regulatory barriers and enablers.

To progress the Review the FSA set up five working groups – one for each theme – consisting of industry, consumer representatives and FSA staff. It plans to publish a Discussion Paper in mid-2007, setting out the analysis, initial conclusions and next steps.

The Panel broadly agree with the FSA's suggestion that there might be certain flaws within the current distribution system for some retail financial services products. However, in their representations to FSA staff, Panel members expressed concern over the momentum that appeared to be building behind this Review and warned the FSA not to disrupt the current distribution system without first being able to propose a viable alternative. The Panel also echoed practitioners' concerns over some of the initial comments that had been made by the FSA on the subject (which were not in every case backed up by hard facts) – such comments could unnecessarily undermine market confidence and prejudice the outcome of the Review.

*“The Panel broadly agree with the FSA's suggestion that there might be certain flaws within the current distribution system for some retail financial services products. However, in their representations to FSA staff, Panel members expressed concern over the momentum that appeared to be building behind this Review and warned the FSA not to disrupt the current distribution system without first being able to propose a viable alternative.”*

This will undoubtedly be a significant and time-consuming project in the coming year, which could have far-reaching consequences for the retail sector. The Panel has been heavily involved in the Review to date, through a dedicated sub-group as well as through participation in the working groups.

The Panel's endeavours on this issue will continue during the year ahead.



### 3.d. Quality of Advice Project

In the second half of 2006 the FSA launched its Quality of Advice project, which would examine the quality of the outcome of advice during the sales process of investment products. The FSA set up an industry expert group, on which the Panel is represented, to help it establish the scope and methodology of this challenging piece of research.

When first presented with the project, the Panel raised serious concerns about the justification, feasibility and value of such an exercise; and also questioned whether it was sufficiently joined up with the FSA's other retail initiatives. There was some apprehension that the different timetables of other FSA's workstreams – e.g the Retail Distribution Review, TCF, the M&GI and Depolarisation reviews, etc. – could lead to an overall fragmented approach, and that findings in one area could unhelpfully prejudice ongoing work in another.

The Panel will stay closely involved with this project and has an open mind as to its practicability and methodology. It will also monitor carefully how any eventual findings of this research will be used and communicated, and what further work may arise from it.

### 3.e. Mortgage, General Insurance and Depolarisation Reviews

FSA reviews into the effectiveness of its Depolarisation, Mortgage and General Insurance regimes have been ongoing throughout the year and are likely to start yielding preliminary as well as some final conclusions during 2007. The Panel will keep a close watching brief on these studies and will be regularly updated by FSA staff on progress.

Most importantly, the Panel will engage in substantive discussions with the regulator once preliminary findings and proposals are available to ensure that they are accurate, proportionate, communicated responsibly and do not lead to hasty regulatory reactions. That said, it is important that the FSA objectively considers any enhancements or change that might serve to make these regimes operate better and – in a principles-based environment – appropriate to the nature of the business and risks at hand.

*“When first presented with this initiative, the Panel stressed that the costs and implications for the industry of such a proposed course of action could not be understated; and could raise serious questions about proportionality and fundamental fairness to firms due to the passage of time, accepted industry practice and the Government’s position at the time, and issues surrounding burden of proof.”*

### 3.f. S2P Review

In late 2006 the FSA mooted plans for a Review into the sale of State Second Pensions (S2P). When first presented with this initiative, the

Panel stressed that the costs and implications for the industry of such a proposed course of action could not be understated; and could raise serious questions about proportionality and fundamental fairness to firms due to the passage of time, accepted industry practice and the Government's position at the time, and issues surrounding burden of proof. The Panel welcomed FSA discussions with the relevant trade associations and considered an industry-led initiative to be the best way forward.

This issue remains under active discussion within the FSA and the Panel is being regularly updated/engaged by FSA staff. But it is fair to say that the Panel's concerns have not yet subsided, although we are hopeful that a pragmatic solution will emerge. The outcome of these considerations is expected shortly, and the industry is awaiting that development keenly.

### 3.g. EU and International Developments

EU and international developments will continue to feature prominently on the Panel's agenda. With a wide range of issues under discussion in the international arena at any given point in time, the section below focuses on a number of items we expect to be of particular importance and impact over the coming year.

#### Implementation of EU legislation

As mentioned in Section 2.e. of this report, the implementation of EU legislation, such as MiFID and the CRD, will be a key priority for firms and regulator alike in the coming year. The Panel considers that a pragmatic and evolutionary approach to implementation of such measures is essential and that this would be an excellent export from the FSA to its fellow regulators internationally, within the EU and beyond. In its 2007 Financial Risk Outlook, published on 31 January 2007, the FSA highlighted the substantial volume of international regulatory reform for financial institutions, which would challenge the industry until at least 2008 – and the need to contain the regulatory burden on firms - as one of its priority risks.

The Panel agrees with the FSA on the urgent need to prioritise this issue, but also stresses continuously that domestic, FSA-driven initiatives constitute a considerable source of regulatory burden and costs for UK firms. As mentioned previously in this report, a robust vetting mechanism for new projects within the FSA is therefore crucial to ensure that only those initiatives move ahead that are absolutely necessary and justified by solid cost benefit and market failure analyses.

Even though the European Commission has now moved into what is called a 'consolidation phase', there still are several evolving regulatory initiatives that will command the Panel's attention; such as Solvency 2, which aims to create a system of risk-based prudential regulation in the insurance sector. The adoption of the CRD has also renewed interest in measures concerning the composition of capital, the large exposures regime and liquidity-risk management.

#### EU Mortgage Directive

In the first half of 2007 the European Commission is expected to issue a draft mortgage directive, which could have a significant impact on the UK mortgage market. The Panel had supported and commended the FSA on its successful efforts to remove mortgages from the Directive on Consumer Credit in 2005 and will follow closely the consultation process on this impending – and potentially damaging – piece of EU legislation.



## Developments on Clearing and Settlement

The Panel has kept a watching brief on EU discussions on clearing and settlement and welcomed Commissioner Charlie McCreevy's announcement in 2006 that no directive was planned for the time being, although other avenues would be explored to increase the efficiency of cross-border settlement processes within the EU.

The Panel is also following developments on the European Central Bank's proposals for Target 2 Securities (T2S) – the creation of a single settlement platform for Eurozone central securities depositories. We share UK stakeholders' concerns on a variety of issues, including competition, legal basis, conflicts of interest and concentration. Even though the UK's involvement in these talks is limited, as they focus on Eurozone members, the Panel recognises that the T2S discussions may well impact on the wider EU debate surrounding clearing and settlement, and therefore appreciates their importance.

## Improvement of International Regulatory Standards

The Panel is confident that the FSA's brand enjoys good standing internationally and should be used proactively by FSA staff to push for improvements in international regulatory standards. The inclusion of an international dimension in the FSA's new "Making a Real Difference" agenda is a welcome development that should pave the way for a more deliberate explanation abroad of FSA principles and practices, such as its move away from a heavily rules-based regime; its risk-based approach to supervision; and the open, collaborative engagement with its various stakeholders.

*“The inclusion of an international dimension in the FSA's new “Making a Real Difference” agenda is a welcome development that should pave the way for a more deliberate explanation abroad of FSA principles and practices, such as its move away from a heavily rules-based regime; its risk-based approach to supervision; and the open, collaborative engagement with its various stakeholders.”*

## 4 . A N N E X

### 4.a. Background to the Panel

#### Background to the Panel

The Practitioner Panel was established in November 1998, comprising senior figures from a cross-section of the financial services industry, to provide a high-level body available for consultation on policy by the FSA and which is able to communicate to the FSA views and concerns of the regulated industries. It has a statutory basis under Section 9 of FiSMA.



#### Objectives

*“The Panel sees its main role as being that of a ‘constructive critic’ of the Financial Services Authority”*

The Panel considers that it has six core objectives:

1. Monitor the overall effect of the FSA’s activities on the industry
2. Assess the FSA’s effectiveness, as seen by practitioners, against its statutory objectives and the principles of good regulation
3. Communicate industry concerns to the FSA
4. Help maintain market confidence, by promoting a suitably risk-based and proportionate regulatory regime
5. Provide practitioner views to the FSA on specific regulations
6. Promote international competitiveness of the UK marketplace

These objectives should be viewed in the context of the FSA’s four statutory objectives and the principles of good regulation (as set out in FiSMA), and its three strategic priorities – promoting efficient, orderly and fair markets; helping retail consumers achieve a fair deal; and improving FSA business capability and effectiveness.

The Panel believes that these are the characteristics of a properly functioning financial services sector and of effective regulation. We also recognise that practitioners’ interests are best served by ensuring clients’ prosperity and financial awareness/capability. We believe that a suitable distinction must be drawn between wholesale and retail issues – and the various types and size of firm operating within those markets.

Further information on the role and work of the Panel can be found on its website: [www.fs-pp.org.uk](http://www.fs-pp.org.uk).

## Membership

The current members of the Panel are:

**Roy Leighton** – Chairman, Nymex Europe (*Panel Chairman*)

**Nick Prettejohn** – Chief Executive, UK Insurance, Prudential (*Panel Deputy Chairman*)

**Russell Collins** – Head of Deloitte UK Financial Services Practice

**Iain Cornish** – Chief Executive, Yorkshire Building Society

**Clara Furse** – Chief Executive, London Stock Exchange

**Douglas Gardner** – Former Chief Executive, AWD

**Mark Rothery** – Chief Executive, Ancient Order of Foresters Friendly Society  
(*Chairman, Smaller Businesses Practitioner Panel*)

**Roger Liddell** – Group Chief Executive, LCH Clearnet

**Colin Keogh** – Group Chief Executive, Close Brothers Group

**Helena Morrissey** – Chief Executive, Newton Investment Management

**Gordon Pell** – Executive Chairman, Retail Markets, Royal Bank of Scotland

**Patrick Snowball** – Group Executive Director, Aviva UK

**Andrew Ross** – Chief Executive, Cazenove Fund Management

**Alan Yarrow** – Vice Chairman, Dresdner Kleinwort Wasserstein

Members of the Panel are appointed by the FSA, normally based on a recommendation by the Panel Chairman following canvassing of the relevant trade associations. The appointment of the Panel Chairman also requires the approval of HM Treasury.

## 4.b. FSA response to 2005/6 Panel Annual Report

(taken from the FSA's 2005/6 Annual Report –

[http://www.fsa.gov.uk/pages/Library/corporate/Annual/ar05\\_06.shtml](http://www.fsa.gov.uk/pages/Library/corporate/Annual/ar05_06.shtml))

### Cost of regulation survey

*The Deloitte study on the costs of regulation, jointly commissioned by the FSA and the Practitioner Panel, represents important progress in providing, for the first time, detailed data on the incremental costs of complying with particular FSA requirements. We are grateful to the Panel for their support for the project and for the strong practical contribution they have made, including in persuading firms to take part. In his Foreword to the Report, John Tiner sets out the ways in which the FSA will use this new data as it pursues its better regulation agenda. We will delete or amend rules over which we have discretion where the costs are not justified by the benefits. We are conscious that the Cost of Regulation study surveyed firms from three sectors rather than the whole financial services industry, but believe the results offer information that can be used more broadly. We are already making progress towards our targets; in June 2006, we published an update on our Better Regulation Action Plan (BRAP), setting out steps we have taken to improve regulation in a number of areas. Looking ahead, we will focus on costs imposed by rules on training and competence, complaints, retail conduct of business and record-keeping requirements, all of which are of particular interest to many smaller firms. Alongside the Cost of Regulation Study and progress report on the BRAP, we also published a framework for assessing the benefits of regulation, prepared for us by Oxera.*

### Consumer responsibility

*As Callum McCarthy made clear in his speech on 9 February 2006, we are keen to promote a shared understanding with industry and consumer representatives of what can reasonably be expected of consumers, and we will continue to discuss these issues with the Panels over the coming period. Through our financial capability strategy we are working hard with a range of partners to improve consumer understanding of financial matters, so that they are better placed to take well-informed financial decisions.*

### Principles-based regulation

*We welcome the Panel's support for our move to a more principles-based approach to regulation. As John Tiner says in our Annual Report for 2005/06, we fully recognise the challenge which this poses, to the FSA and the industry. We will work closely with the Panel and other industry representatives as we articulate further what a more principles-based approach means in practice. Some public consultation will also be involved; for example, we plan to issue a Discussion Paper later this year on possible use of industry guidance. We have generally used mystery shopping to gather qualitative information to gain a broad understanding of industry practice in particular areas, not to assess the performance of individual firms. Therefore, it is unlikely that these results would in their own right form a case for further investigation by Enforcement because the number of assessments of any one*

*firm's practice is limited. However, there can be circumstances where we identify such significant bad practice in a firm, through qualitative or quantitative research, that in its own right or, more likely, in conjunction with other evidence, we may use it to justify further investigation. We will shortly issue revised guidance to our staff on the use of mystery shopping. In response to industry concerns we will issue a statement clarifying the uses to which we will (and will not) put the results from future mystery shopping exercises.*

### **Treating customers fairly (TCF)**

*We regard TCF as a good example of our move towards a more principles-based approach to regulation. We remain of the view that a high profile initiative in this area is appropriate given the incidence of poor treatment of customers (non-compliance with Principle 6 in our Handbook) that we continue to find in firms of all sizes and sectors. The initiative is outcome-focused – it is about achieving improvements in the fair treatment of customers through firms making changes where necessary to ensure that the customer is placed at the heart of their business. We have now published six more specific outcomes against which we will measure the success of the initiative going forward. We continue to facilitate firms' work through experimenting with a variety of more principles-based means of communication, including case studies illustrating particular issues and relevant questions to ask, as well as 'cluster reports' that provide examples of good and poor practice that we have seen. One area where the industry has consistently asked for further clarity from us during the year is the respective responsibilities of product providers and distributors. We have done work in this area and are currently considering the best format for sharing it more widely in the autumn. We also recognised that our staff needed further training. During the year, a significant proportion of supervisory staff has attended TCF-specific training, in addition to the compulsory training on the updated version of our regulatory model, Arrow II.*

### **Disclosure**

*We had originally intended to issue a Consultation Paper in March 2006 setting out our proposals to reform the disclosure regime for investment products. These proposals were to include: (i) replacing the current Key Features Document (KFD) with a two-sided Key Facts-branded 'Quick Guide'; and (ii) replacing the current Key Features Illustration (KFI) with separate projections and charges sheets. The current three-rate projection model would have been replaced with a single-rate model and strengthened risk warnings. However, as we announced on 24 March 2006, we concluded that it would be inappropriate to consult on these changes while uncertainties remained in relation to our cost benefit analysis (CBA) on our proposals for reform and delays in the negotiations on the Market in Financial Instruments Directive (MiFID). Our detailed CBA had shown that there would be significant costs in implementing our proposals, particularly the changes to the projections and charges documentation. Our consumer testing indicated that the benefits of change would be limited. Due to delays in the MiFID negotiations, the full impact of MiFID on our existing disclosure requirements remained uncertain. Given these uncertainties, we announced our intention to link any changes to the disclosure regime to the implementation of MiFID and the related*



*simplification of our Conduct of Business rules. We expect to issue a CP in the last quarter of this year setting out our proposals, including whether to introduce the Quick Guide. We agree with the Panel on the desirability of reducing and simplifying disclosure documentation. Our policy work to date has focused on achieving that aim while ensuring that the appropriate level of consumer protection is maintained. In all policy work we seek to engage with industry and consumer bodies to develop proposals that achieve our aims without imposing disproportionate costs on industry.*

### **Enforcement review**

*We welcome the Panel's support for the improvements we made to our processes in the light of the recommendations of the Enforcement Process Review. We are committed to effective use of enforcement action in areas which pose the greatest risk to our statutory objectives. The work of the Enforcement Division is driven by the requirements and priorities of the rest of the FSA. This does not mean that enforcement action will only happen in our priority strategic areas. Such action will also be necessary in particularly serious cases; cases where consumer protection is a key issue; or where a case is necessary in the interests of achieving effective deterrence. From a legal perspective, our 11 Principles for Businesses have the status of rules and we can take enforcement action on the basis of a breach of them. We intend increasingly to take enforcement action on the basis of those Principles alone, where this is appropriate. We recognise that there is a legitimate concern that in order for consequences to be attached to the breach of a Principle it must be possible to predict, at the time of the action concerned, whether or not it would be in breach of a Principle. But as long as the action or actions in respect of which discipline is being brought could reasonably be predicted to be in breach of the Principle, we do not consider that there is anything unfair about taking enforcement action for breach of Principles alone. In other words, where the requirement of predictability is met it is legitimate for consequences to follow even though the Principle is expressed in general terms. This does not mean the individual must have known at the time of the conduct that they were in breach but rather that, had they applied their mind to the question, they would have realised the risks they faced.*

### **International issues**

*We welcome the Panel's support for the very significant effort which we put into international issues at all levels, and across the business. We acknowledge the Panel's concern that this may not be fully appreciated by the industry at large, even though we highlight it in our major corporate documents (Business Plan, International Regulatory Outlook, Annual Report) and in speeches by the senior team. We would welcome the Panel's suggestions on how we could explain the scale and nature of our international work to the industry more effectively. As Callum McCarthy has explained, he and the FSA senior management devote significant amounts of their time to international work. Given this, and the breadth of the international agenda, we do not think it would be appropriate or would add value to nominate one senior executive with overall responsibility for international issues. We are committed to implementing EU Directives in a pragmatic way and to taking the opportunities offered by*

*implementation to pursue our better regulation agenda. We agree with the Panel that non-EU international developments are very important for the UK financial services agenda; we devote significant time at senior level to discussions on those, including through our membership of, and active contribution to, a number of global committees such as the International Organisation of Securities Commissions, the International Association of Insurance Supervisors, the Basel Committee on Banking Supervision and the Financial Stability Forum. As our resources are aligned to our statutory objectives using a risk-based approach, it is to be expected that the larger part of our international work, including policy work, is directed to EU, North American and Japanese firms and issues. We also devote considerable resource to maintaining longstanding bilateral contacts with the regulators from those areas. At the same time, given the international character of the UK market and the operations of UK firms overseas, we have markedly stepped up our engagement with regulators and policymakers in a range of other jurisdictions, including emerging markets such as China and India.*

### **Hedge funds**

*We welcome the Panel's support for our work on hedge funds, including our decision to establish a dedicated supervision unit in this area. We announced in our Feedback Statement to Discussion Paper 05/3 ('Wider Range of Retail Investment Products: Consumer Protection in a Rapidly Changing World') that we will consult in Q1 2007 on widening the range of funds that can be marketed to retail investors to include new authorised funds of hedge funds. This would enable retail investors, who are already gaining access to products with hedge-fund investment characteristics through a variety of means, to invest in products that would be subject to our regime for authorised collective investment schemes. Retail investors can currently gain access to products with hedge-fund investment characteristics through a variety of means, including listed funds of hedge funds, funds offered on the internet from European jurisdictions, structured products linked to hedge fund indices and funds under the UCITS III (Undertakings for Collective Investments in Transferable Securities) Directive. Given the reality of the contemporary retail market, we believe it is sensible to permit the marketing of funds of hedge funds through an authorised, onshore vehicle. These onshore funds of funds would benefit from the protections already in place for authorised funds. We recognise the need to consider how we can help consumers to understand the features and risks associated with these products. Our consultation will also address this.*





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