

THE FINANCIAL SERVICES  
PRACTITIONER PANEL  
ANNUAL REPORT

2007/8

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## 1. CHAIRMAN'S INTRODUCTION



I am very pleased to introduce the Annual Report of the Financial Services Practitioner Panel (the Panel) for 2007/8. 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 (FSMA) – that outlines our main activities over the past year and our likely areas of priority over the coming year.

I was delighted to take the chair in December 2007 following Roy Leighton's excellent stewardship. One of my priorities for 2008 was to be more active in setting for the Panel our agenda. Consistent with this approach the Panel has undertaken its own assessment of whether more principles-based regulation (MPBR) is being applied in day to day supervision in the suitably proportionate, consistent and risk based way that the FSA has promised. Secondly, the Panel has also looked carefully and critically at the FSA's Business Plan workload for 2008/9. Specifically, we have looked at the focus and resource being directed at retail and prudential requirements with a view to highlighting a number of activities which could legitimately be dropped or given lower priority. This has been an important exercise in the light of the results of the FSA's internal review of the supervision of Northern Rock. It is also consistent with the Panel's general view that the balance between conduct of business and prudential regulation has been too heavily weighted towards conduct of business.

In all of our work, the Panel uses the yardstick of what should be expected of the "reasonably conscientious firm". We have found this a useful concept in calibrating our view of the FSA's supervisory policy and its risk based application. We will continue to refer to this yardstick and we commend it to the FSA.

Throughout our work, we will also continue to question the cost benefit analyses undertaken by the FSA to support its regulatory initiatives. We are taking a close interest in the process to generate this analysis and the use of that output.

The Panel continues to support the FSA's move to MPBR. Regulation that focuses on outcomes rather than prescription is more likely to respond and adapt to the pace of change in markets and so allow them to continue to develop and innovate for the benefit of their users. However, practitioners continue to feel strongly that the FSA must do more to help translate MPBR into supervisory practice. Firms that can demonstrate that they have taken reasonable steps to achieve the right outcomes should in due course expect to receive real benefits in the form of "regulatory dividend". Regular evidence of this has yet to be seen. Further, detailed and prescriptive day to day regulation still appears to be the norm in a number of areas where the Panel believe it to be unnecessary.

Practitioners are wholly supportive of the objectives of the Treating Customers Fairly (TCF) initiative. We believe that the target outcomes set out by the FSA provide a useful framework, and are thoroughly desirable. However, we have become increasingly concerned that the TCF programme is disproportionate. The programme has been over detailed and insufficiently risk based in its application. As a result, the Panel believes that it is absorbing too much regulatory resource at the FSA, and is placing a disproportionate burden on many firms.

The Panel has had consistent concerns about the cumulative burden of regulation imposed by the FSA's retail strategy. There appears to be much duplication in supervisory processes such as Arrow, Close and Continuous supervision and thematic work with a lack of co-ordination and prioritisation between these often myriad initiatives. The Panel has therefore welcomed the FSA Executive's decision to review and re-articulate its overall retail strategy and looks forward to discussing those outputs with the FSA Executive.

The Panel remains to be at all convinced that "Regulatory Transparency" as discussed in the recent Discussion Paper will add value to what can and should be achieved by existing supervisory practice. We will watch the development of the FSA's policy and practice in this area with a sceptical eye.

The Supervisory Enhancement Programme emerging from the internal Review of Northern Rock will be a flagship work priority for the FSA over the course of the next twelve months and beyond. In that context, instrumental to the FSA's success will be improving the commercial understanding of its staff as well as reducing supervisory turnover to allow staff to gain the experience and understanding necessary for them to achieve a pragmatic and consistent approach to regulation.

This year sees the Panel's 5th Survey of regulated firms and the main postal questionnaire was issued to firms in June 2008. The outputs of the Survey provide the Panel and the FSA with genuinely objective input. The Panel is therefore very keen to see a high response rate to its 2008 Survey, and I would like to urge all firms that receive the questionnaire to respond to it.

I would like to take this opportunity to thank Roy Leighton for his enthusiasm, diligence and hard work in leading the activities of the Panel over the last two years. I would like to thank my fellow serving Panel members for the considerable energy they invest in our work, and for all their collegiate spirit, comradeship and individual expertise. Our small Secretariat team give us enthusiastic and dedicated support, for which we are very grateful.

I would also like to thank Sir Callum McCarthy (FSA, Chairman) for his constructive engagement with the Panel over the last five years, and to wish him the very best for the future when he leaves the FSA in September. The Panel looks forward to working with his successor, Lord Turner.



The Panel welcomed the appointment of Hector Sants (FSA, Chief Executive) in July 2007. Hector was previously a member of the Panel and therefore knows what it feels like to “sit on the other side of the table”. The Panel has engaged in frank and constructive discussions with him and he has been generous in his willingness to attend Panel meetings. The Panel wishes him well in his task of leading the work of the FSA.

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

**Nick Prettejohn**  
Chairman, Practitioner Panel  
June 2008

## 2 . E X E C U T I V E S U M M A R Y

The Financial Services Practitioner Panel (the Panel) was established in November 1998 and it monitors the overall effectiveness of the Financial Services Authority (FSA) and ensures that the views, concerns and interests of practitioners are properly represented in UK financial services regulation. It aims to speak across all sectors in offering input at a strategic level on important policy issues. The Panel consists of high-level financial services executives covering all aspects of our industry. The Chairman of the Smaller Businesses Practitioner Panel is an “ex-officio” member of the Panel and represents the interests of smaller firm practitioners.

The Panel sees its main role as being that of a ‘constructive critic’ of the FSA and its key objectives are to monitor the overall effectiveness and performance of the FSA, to communicate specific industry concerns to the FSA and represent their interests generally, and promote the international competitiveness and innovative nature of the UK financial services markets. At the same time, the Panel recognises that practitioners’ interests are best served by ensuring wholesale and retail clients’ prosperity and financial awareness.

Together with the Consumer Panel and the Smaller Businesses Practitioner Panel, the Panel plays an important role in the accountability and regulatory framework of UK financial services regulation. We aim to take a high-level strategic view, and to complement the excellent work of the trade associations (without undue duplication) with whom we maintain close links.

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

### Key Issues

This Executive Summary focuses on those key issues that exercised the Panel most over 2007/08 and where it proportionately spent more time in evaluating and assessing those issues.



The Panel is supportive of the FSA's move towards **more principles-based regulation (MPBR)**. With the help of the trade associations the Panel has documented its high-level observations as the basis for the further development and application of MPBR, and is in discussions with the FSA. The Panel believes that there have already been good examples of both the move towards MPBR and areas where MPBR is clearly not being translated into supervisory practice. Further, the Panel believes that Enforcement must support the move to MPBR and that predictability of action is essential, and favours the concept of a “**reasonably conscientious firm**” to help govern the basis on which the FSA might consider pursuing formal action, along with how any ‘**regulatory dividend**’ would be applied to such a firm.

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The Panel is very supportive of the **Treating Customers Fairly (TCF)** target outcomes. However, the Panel feels strongly that the TCF programme has become excessively preoccupied with granular detail turning TCF into a series of process oriented tasks rather than focusing on outcomes, which is at odds with the spirit of more principles-based regulation.

The Panel has called for a **fundamental overhaul and review of TCF** and has welcomed the FSA's recent decision in April 2008 to conduct some detailed work on assessing the costs, burdens and impact of TCF and MPBR.

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The Panel has consistently voiced its concerns about the overall direction of the FSA's **retail strategy** and the volume, intensity and cumulative burden of numerous initiatives imposed on firms in retail markets. The Panel has not been convinced that the FSA's overall retail strategy is suitably joined up, prioritised and where appropriate scaled back with business-as-usual supervisory activities. The Panel has welcomed the FSA's decision to review its overall retail strategy in conjunction with the Retail Distribution Review through a separate workstream – **Retail Markets Structures**.

The Panel looks forward to discussing the outputs of this work with the FSA Executive during the remainder of 2008.

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Given the potentially rising cost of other regulatory fees, the Panel was disappointed by the cost increases in the **2008/9 FSA Budget**. The Panel feels that the apparently increasing number of priorities for the FSA requires a zero based budget approach, and has advised that the industry does not believe that it should be expected to absorb regular fee increases of this nature as a matter of routine. The Panel has also presented the FSA Executive with a list of specific items taken from the **2008/9 Business Plan**, which might in the Panels opinion be ripe for reprioritisation, deferral or simply be discontinued. In its submission to the FSA Executive, the Panel emphasised that the supervisory balance between the regulation of Conduct of Business (COB) and prudential requirements needed urgent, critical and tangible realignment.

The Panel will continue to discuss these matters with the FSA.

The Panel recognises the need for the **Retail Distribution Review (RDR)**, but is, at this stage, disappointed with the FSA's progress towards reaching any firm conclusions. The translation of ideas into practical proposals will be a major challenge and the consequences of any changes will need to be thought through carefully. Further clarity is required on the manner in which 'Money Guidance' will interface with the conclusions of the RDR. Most importantly, it would be damaging in the Panel's view, for any proposals from the RDR to result in a disruptive transition period which resulted in less advice being available to consumers.

The Panel will continue to monitor industry feedback and will have further discussions with the FSA prior to publication of the RDR Feedback Statement later in 2008.

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The Panel welcomes the decision to reduce the retention period on **Taping (CP07/9)** from 3 years to 6 months. This concession was only possible as a result of significant industry efforts in terms of time, commitment and expense. The Panel felt strongly that the FSA should have arrived at its decision on the retention period much earlier on in the process, the root cause being a contentious Cost Benefit Analysis which had significantly underestimated industry costs. The Panel remains concerned about the prominence, quality, transparency and robustness of **Cost Benefit Analysis (CBA)** within the policy making process and beyond.

The Panel is planning to spend more time understanding the level of interaction, oversight and challenge provided between the FSA's Economics of Financial Regulation (EFR) area and the policy teams within the FSA.

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The Panel is concerned about the level of **non-compliance in the mortgage intermediary market** as highlighted by the results of thematic reviews at the end of 2007. This was a major area of risk from a consumer point of view and while noting various other mortgage related workstreams, the Panel saw limited value in undertaking yet more reviews that would highlight levels of non-compliance in this sector. Far more targeted and decisive action was needed now to ratchet up standards of compliance.

The Panel will continue to monitor the FSA's progress in respect of its Enhanced Smaller Firm Strategy and the embedding of TCF within smaller firms, and will engage with the FSA on the findings of its other mortgage related thematic workstreams over the course of 2008.

The Panel welcomed the FSA's report on its **internal Review of Northern Rock** as a thorough and critical appraisal of its supervisory failings in that case. The Panel is very supportive of the FSA's intention to ensure that all high impact firms have an irreducible minimum level of supervisory staff to enable effective relationship management at all times. The Panel welcomes the FSA's explicit commitment to ensuring that the balance of resource committed to Conduct of Business Regulation (COB) relative to prudential supervision will be reassessed - an important strategic concern that the Panel has regularly raised with the FSA throughout the course of the year.

The Panel has been briefed on the FSA's **Supervisory Enhancement Programme**, and will continue to monitor developments and assess the FSA's progress with the implementation of the programme.

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The Panel has been regularly updated on developments in relation to **Banking and Compensation Reform**. The Panel sees no objective or material justification to increase the FSCS limits for deposits from 100% of £35,000 to 100% of £50,000. The Panel remains unconvinced by the proposals contained in the Tripartite Consultation Paper particularly in relation to the Special Resolution Regime, and has cautioned against rushing through proposals to what are complex issues. In practice, should a similar situation arise in the future, the Panel would expect the appropriate authorities to intervene as a matter of urgency.

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While being supportive of the FSA's '**Making a Real Difference**' (MARD) agenda, the Panel considers that a cultural shift in the approach from supervisors will be instrumental to effective relationship management. To facilitate this it is essential that the FSA reduces supervisory turnover to allow staff to gain the experience and understanding necessary for them to achieve a pragmatic and consistent approach to regulation.

The Panel will monitor the FSA's progress on the MARD initiative.

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The Panel was disappointed with the FSA's decision to publish its Discussion Paper on **Regulatory Transparency** and feels that the FSA has adopted a 'gold plated' approach. The Panel felt that the implications of losing its appeal under the Freedom of Information Act (FOIA) needed to be fully thought through and that the most prudent course of action for the FSA was not to pursue these proposals until the law had been clarified. Most importantly, the Panel believes that the FSA already has sufficient and credible regulatory tools to achieve its objectives – the most important being the Arrow supervisory process, followed up by appropriate enforcement action if ultimately necessary.

The Panel has pointed out that the FSA is in danger of **fundamentally changing the nature of its supervisory relationship with firms** and that firms are likely to become less co-operative, adversarial and litigious. The Panel is very concerned that the FSA may be able to ‘cherry pick’ the information that it decides to disclose without context of the fuller picture. There could be unintended consequences and reputational damage to the industry if the media, consumers and those who advise them misinterpreted the nature of any information being made public.

The Panel will monitor industry feedback to the DP and in the spirit of being constructive will offer its further input to the development of the ‘Code of Practice’.

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This year sees the Panel’s **2008 Survey of Regulated Firms**, which is an extensive study incorporating views from a cross-section of firms and sectors in order to provide valuable feedback to the FSA. The Panel is keen to produce an end product which not only is credible and meaningful, but which gives the Panel and the FSA a genuinely objective and actionable basis on which to move forward in certain areas.

The Panel’s postal questionnaire was issued to firms in June 2008 and the results of the Survey will be published in Q4 2008. The Panel is very keen to see a high response rate and urges all firms that receive the questionnaire to respond to it.

## 3. 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 2007/8, most of them are ongoing and will continue to occupy the Panel's agenda during 2008/9. The Year in Review specifically covers the period from April 2007 to April 2008. Please also see our table of priorities for 2008/9.*

### 3.a. More Principles-based Regulation

The Panel is supportive of the FSA's move towards a more principles-based regime (MPBR), which it believes complements a modern, proportionate, effective risk-based and evidence-based regulatory framework in the UK. Regulation that focuses on outcomes rather than prescription is more likely to respond and adapt to the pace of change in markets and so allow them to continue to develop and innovate for the benefit of their users. The Panel welcomed publication of the FSA's MPBR positioning document – *'Focusing on Outcomes that Matter'* (April 2007) – as the basis for further dialogue with the industry on the development and application of principles-based regulation in practice.

*“Enforcement must support the move to MPBR and predictability of action is essential.”*

While the Panel has been supportive of the structural changes arising from the Strachan Review of Enforcement Processes (February 2005), there have been on-going industry anxieties over the role of enforcement in relation to MPBR. Anxieties include fears that enforcement might be used by the FSA to set precedents, help interpret untested principles, and unfairly single out firms to establish industry markers. Enforcement must support the move to MPBR and predictability of action is essential.

In that context, the Panel favours the concept of a “reasonably conscientious firm” to help govern the basis on which the FSA might consider pursuing formal action. Firms that engage positively and openly with the FSA and can demonstrate that they have taken reasonable steps to achieve the right outcomes should expect to receive real benefits in the form of a regulatory dividend. Regulatory dividends may include relatively lower levels of regulatory capital, less frequent risk assessments, greater reliance on firms' senior management or a less intensive risk mitigation programme. The Panel is supportive of this.

In order to address broader industry concerns about the application of MPBR in practice, the Panel held discussions on this topic during Q1 2008. The Panel was supported in its discussions through detailed submissions from Panel members and the trade associations,

which included high-level observations and good and poor practice case studies on MPBR. The Panel has drawn out and documented the key messages and themes arising from the submissions along with suitable good and poor practice examples of MPBR.

The Panel has requested a formal response from the FSA to its submission on MPBR and will discuss the document with the FSA Executive and other FSA staff, as the basis for the further development and application of MPBR.

**While there are good examples of both the move towards MPBR and areas where MPBR is clearly not being translated into supervisory practice, the Panel believes that the FSA can reassure the industry by undertaking the following additional measures.**

- Confirming that MPBR is ‘work in progress’ and dispel any suggestion that MPBR has already been delivered.
- Recognising industry concerns about the absence of FSMA disciplines around MPBR initiatives and committing to regular reviews of progress.
- Clarifying the regulatory status of ‘soft communications’ such as speeches, case studies, ‘Dear CEO’ Letters and guidance, and clearly articulating that failure to mirror the approach set out within these publications does not indicate a rule breach.
- Stressing that the minimum requirement for MPBR is compliance with the rules to avoid a continuous ratcheting up of the requirements.
- Emphasising that industry guidance is not binding, and that it need not be followed to achieve compliance or that departing from guidance is not indicative of a rule breach.
- Providing user-friendly pathways to all relevant material on a particular topic to help practitioners remain abreast of key communications and cut through any ‘regulatory clutter’.
- Championing MPBR as the ‘direction of travel’ across all UK regulators as well as the EU and other international regulators.
- Demonstrating more flexibility in respect of Financial Promotions, supporting firms who choose innovative approaches and avoiding unnecessarily prescriptive requirements.
- Driving forward the cultural shift within the FSA in relation to ‘fewer, better staff’ as part of its ‘Making a Real Difference Agenda’, so that the competency of supervisory staff is improved to allow them to demonstrate a pragmatic and consistent approach to regulation.
- Creating more industry confidence by working closely with the FOS on use of the ‘wider implications process’ to ensure that any FOS decisions that have broader application to other cases are subject to proactive cooperation between the FSA and the FOS.
- Providing the industry with practical examples which they believe demonstrate success in replacing prescription with a more principles-based approach.

## Treating Customers Fairly (TCF)

The Panel has engaged with the FSA on this subject at great length over the course of 2007/8 and remains disappointed (with the FSA's inability to deliver a more principles-based approach) in its articulation and implementation of Treating Customers Fairly (TCF). The target outcomes of TCF are ones which the Panel and the industry support wholeheartedly. But the TCF programme has lost sight of these outcomes and has become an exercise with a life of its own. The Panel believes that the FSA is too preoccupied with the detail of 'how' a firm meets TCF, rather than focussing on outcomes and has therefore adopted a very granular approach which has turned TCF into a series of process oriented tasks. This approach to TCF is at odds with the spirit of more principles-based regulation (MPBR).

The Chairman has stressed to FSA TCF leaders the importance of informing firms of the need to keep their TCF processes simple and without over elaboration. The Panel will monitor carefully the FSA's communications in respect of firms' compliance with the March 2008

deadline on Management Information for balance and proportionality, along with the criteria that would constitute a satisfactory assessment in relation to the December 2008 compliance deadline on embedding TCF.

The Panel remains concerned about the balance between prudential supervision and conduct of business supervision, given that FSA has neither quantified nor estimated the significant cost to industry caused by this particular Conduct of Business (COB) initiative. Given that the TCF initiative is in its third year, the Panel considers it appropriate to press the FSA to conduct a review of TCF with a comprehensive Cost Benefit Analysis. In that context, the Panel welcomes the FSA's recent decision in April 2008, to conduct some detailed work on assessing the costs, burdens and impact of TCF and MPBR, which the Panel looks forward to contributing to and awaits the outputs with interest.

## Caveat Emptor

The Panel 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 been, and remains very disappointed that progress on this issue has been slow. The Panel notes that a Discussion Paper will be issued by the FSA in late 2008 setting out the common law position, its views on the balance of responsibility between firms and consumers, and those actions a sensible consumer might take. Whilst there appears to be a consensus as to the nature of firm responsibilities and agreement about what might be sensible for consumers to do to protect their own best interests, there is currently no consensus as to consumers' responsibilities.

*“The Panel believes that the FSA are too preoccupied with the detail of 'how' a firm meets TCF, rather than focussing on outcomes and have therefore adopted a very granular approach which has turned TCF into a series of process oriented tasks. This approach to TCF is at odds with the spirit of more principles-based regulation (MPBR).”*

The Panel believes that a consumer’s legal responsibilities should be those underpinned by contract law, which includes a duty to act lawfully and in good faith, not to make misrepresentations or withhold material information, to abide by the terms of the contract, and to take responsibility for his or her own decision. There may also be other responsibilities not underpinned by law (that could include an expectation that consumers will read the information provided to them and ask any relevant questions about any aspects that may be unclear). The Panel will engage further with the FSA on this issue.

### Industry Guidance (IG)

Wholesale members of the Panel were generally supportive about the take up of Industry Guidance (IG) for their sectors and felt that this had provided wholesale firms with reassurance or ‘sturdy breakwaters’ in areas such as softing and unbundling, MiFID suitability requirements and contract certainty. Retail members of the Panel were sceptical about the demand for IG, the lack of appetite among trade associations to make it freely available and felt that it would put retail firms in a defensive position – on the backfoot having to justify why they had chosen not to use a particular piece of IG – as opposed to demonstrating how they had achieved appropriate outcomes in a principles-based manner.

The Panel emphasised that the FSA needed to stress to the industry that guidance was not binding, and that it need not be followed to achieve compliance or that departing from guidance was not indicative of a rule breach, particularly in respect of the Enforcement process. There was also a danger that the elaboration of principles through guidance could reintroduce prescription. Therefore, if poorly used, IG could threaten the objective of MPBR by becoming ‘pseudo rules’, which were neither formally consulted on nor subject to CBA. Industry Guidance must not perform the role of rules and thereby threaten the ‘level playing field’ between sectors.

### 3.b. Burden of Regulation

#### FSA Retail Strategy

The Panel has consistently voiced its concerns about the overall volume, intensity and cumulative burden of the FSA’s numerous initiatives on firms in

retail markets – a view endorsed by the trade associations during the Panel’s twice yearly briefing of senior trade association representatives. The Panel has not been convinced that the various retail policy and thematic initiatives were suitably joined up, prioritised and where appropriate scaled back with business-as-usual supervisory activities, with the resulting cumulative burden on all retail firms. The FSA needed to clearly articulate how individual initiatives fitted into its overall retail strategy. It remains the Panel’s view that the FSA does not do enough to put itself in the shoes of practitioners and recognise the cumulative burden – in terms of time, expense and transposition – that FSA regulation creates on market participants.

“The Panel has not been convinced that the various retail policy and thematic initiatives were suitably joined up, prioritised and where appropriate scaled back with business as usual supervisory activities, with the resulting cumulative burden on all retail firms. The FSA needed to clearly articulate how individual initiatives fitted into its overall retail strategy.”



## FSA Business Plan & Budget 2008/9

The annual funding requirement in the FSA's Budget for 2008/9 will increase by £22m in relation to the overall budget of £323m, and the Panel was disappointed to see a continuous year on year increase in the overall cost of regulation as a result of FSA, FOS and FSCS fee increases, proposed changes to the FSA's scope, Banking and Compensation reform, and the forthcoming industry contribution as a result of the Thoresen Review. The Panel reiterated to the FSA Executive its preference for a nil increase in the budget with a zero based budget approach to priorities, and has advised that the industry does not believe that it should be expected to absorb regular fee increases of this nature as a matter of routine.

“*In its submission to the FSA Executive during Q1 2008, the Panel emphasised that the supervisory balance between the regulation of Conduct of Business (COB) and prudential requirements needed urgent, critical and tangible realignment.*”

The Panel felt that the practical delivery of all aspects of the Business Plan would remain a significant challenge given current market conditions and its on-going concerns about the FSA's overall retail strategy. The Panel was set a challenge by the FSA Executive to identify those specific items appearing in the FSA's 2008/9 Business Plan which might – in its opinion be reprioritised, deferred or discontinued. That analysis could then be a starting point for further discussion between the FSA and the Panel. In its submission to the FSA Executive during Q1 2008, the Panel emphasised that the supervisory balance between the regulation of Conduct of Business (COB) and prudential requirements needed urgent, critical and tangible realignment.

The Panel recognised that the FSA's internal review and Report on Northern Rock might itself be a trigger for the FSA to review and revise the (by its own admission) challenging agenda for the year ahead, and establish a need to rebalance its workload and resources accordingly. The Panel pointed out that the FSA must withdraw resource from certain retail initiatives and, in particular, the majority of initiatives relating to Treating Customers Fairly (TCF), and devote proportionately more time and attention to those issues falling under the theme of *'Financial soundness and well managed firms'*.

### Further observations made by the Panel included the following:

- lack of a commercial focus when allocating business priorities, and current approach to prioritisation appears to involve more the adding of priorities than the reassessment of what is reasonable and feasible in a given period;
- no explicit weighting and information provided within the Business Plan to individual items about the level of resource allocation, cost and time being dedicated by the FSA to such issues – consequently there is no clear evaluation of which items are more or less important from a regulatory standpoint;
- lack of information about the FSA's own risk appetite and internal decision making processes has meant that the industry is typically unsighted about how priorities are established, why certain initiatives are commenced and those which end up on the cutting room floor;

- larger firms often report that there is an unhelpful overlap and duplication between the application of Arrow, Close and Continuous and thematic work – often putting them to multiple, piecemeal and costly effort; and in the Panel’s view there is an outstanding question around the interaction and coordination between these respective supervisory elements;
- there appears to be a propensity for one review to lead to another. Where the FSA cannot clearly identify additional concerns which justifies further work, then the default position should be to move on to other priorities rather than adopt a process of continual review.

The Panel will continue to discuss these matters with the FSA.

### Retail Distribution Review

The Panel has received regular updates on the FSA’s progress with the Retail Distribution Review (RDR) including a briefing on the ‘direction of travel’ in relation to the Interim

*“While recognising the need for an overall review, the Panel is at this stage, disappointed with the FSA’s progress towards reaching any firm conclusions.”*

Report that was published at the end of April 2008. Following Callum McCarthy’s (Chairman, FSA) speech at Gleneagles in September 2006 about commission bias, inadequate business models and the shortcomings of the retail distribution market, the objective of the RDR was to identify and address the root causes of problems in retail investment markets. While recognising the need for an overall review, the Panel is at this

stage, disappointed with the FSA’s progress towards reaching any firm conclusions. The translation of ideas into practical proposals will be a major challenge, and the Panel is particularly concerned that the consequences of any changes will need to be thought through carefully. It would be damaging, in the Panel’s view, for any proposals to result in a disruptive transition period which resulted in less advice being available to the consumer.

The Interim Report envisages three distinct services to consumers; ‘Advice,’ ‘Sales’ and ‘Money Guidance.’ Moving the intermediary market to an ‘Advice’ model that requires the provision of independent advice from the whole market, higher capital requirements, higher professional standards and a shift to fee based or Customer Agreed Remuneration may take many intermediary business models to a point where they are no longer sustainable. This could potentially have an adverse impact on consumer choice when there is a need for ‘real advice’ given the low levels of financial capability in the UK. The Panel is also not convinced that higher capitalisation requirements will prevent misselling.

*“It would be damaging, in the Panel’s view, for any proposals to result in a disruptive transition period which resulted in less advice being available to the consumer.”*

Sales will include non-advised sales (execution only business) and ‘guided sales’ with an element of ‘persuasion’ for a range of simpler products. Most consumers are unlikely to fully understand and appreciate the subtle distinctions between ‘advice’ and a ‘guided sale’ with persuasion, and clearly more thought is required around the expressions used.

‘Money Guidance’ is a recommendation arising out of the Thoresen Review and the FSA is to lead a two year ‘pathfinder’ pilot project. The manner in which any handover or referral of a consumers requirements from ‘Money Guidance’ to ‘Sales’ or ‘Advice’ (or vice versa) will need proper clarification.

Given (technological) developments in the intermediary sector and the knock on impact on business models, there is a real danger that any eventual changes may come too late to make a real difference and/or could actually have the opposite impact for consumers than that intended. The Panel will continue to monitor industry feedback and will have further discussions with the FSA prior to publication of the RDR Feedback Statement later in 2008.

### Retail Market Structures

Following consistent Panel concerns, the Panel was pleased to learn that the FSA had decided to examine more broadly its overall retail strategy in conjunction with the RDR. The FSA will rearticulate its strategic vision for retail markets through a separate workstream – Retail Market Structures which commenced in Q1 2008. This workstream will ‘dovetail’ and be aligned with the conclusions of the RDR and the Panel looks forward to discussing the outputs of this work with the FSA Executive during the remainder of 2008.

### Quality of Advice (Outcomes) Project

The Quality of Advice (Outcomes) Project is designed to create a baseline measure of the suitability of recommendations in the mortgage, savings and investment markets. The Panel has questioned whether this project was sufficiently aligned and joined up with the FSA’s numerous other retail initiatives including the RDR and TCF (although we note that the results of this work will not directly feed into the RDR but may be taken into account where relevant). The Panel is concerned that the project is hugely complex with a number of operational and reputational risks, and doubts its ability to provide credible outputs and value for money.

“*The Panel is concerned that the project is hugely complex with a number of operational and reputational risks, and doubts its ability to provide credible outputs and value for money.*”

The Panel has also questioned the need to conduct further research on the suitability of recommendations when there are already examples of poor practice in various sectors, and that the FSA should be making more effective use of its resources by focusing on improving standards through further targeted supervisory and enforcement activity.

The FSA has undertaken a pilot survey to test the methodology that has been developed before deciding whether to proceed with the main stage of the research. The Panel expects to be briefed on the results of the pilot in June 2008.

### Taping (CP07/9)

The Panel raised the issue of the recording of voice conversations and electronic communications in relation to the FSA's proposals on market abuse (CP07/9). The Panel felt that the principle of taping was a good idea but that the FSA had failed to make a convincing case to the industry about its proposals. While welcoming the decision to reduce the retention period to 6 months from 3 years, the Panel noted that the issue would still remain a challenge for those firms that currently did not tape as they would have to put in place appropriate measures within the transition period. The Panel felt that this concession was only possible as a result of significant industry efforts in terms of time, commitment and expense.

*“While a ‘protocol’ for information requests from firms has been developed, the Panel pointed out that any request to retain records for more than 6 months would need to be thoroughly justified by the FSA.”*

The costs and benefits had been uncertain all along and the FSA's Cost Benefit Analysis (CBA) had underestimated the costs of its proposals by a magnitude of between 4 and 5 times, and the FSA was still not in a position to put a monetary value on the benefits of taping. The Panel felt that the FSA senior management could have provided more challenge in conducting a ‘reality check’ on the proposals much earlier in the process.

The Panel remains concerned about the impact of the European Commission's review on this issue with some firms potentially being forced into a UK solution and then a European solution within a short period of time. While a ‘protocol’ for information requests from firms has been developed, the Panel pointed out that any request to retain records for more than 6 months would need to be thoroughly justified by the FSA.

### Cost Benefit Analysis (CBA)

The Panel remains concerned about the prominence, quality, transparency and robustness of Cost Benefit Analysis (CBA's) within the policy making process and beyond. The Economics of Financial Regulation (EFR) team are responsible for the methodology of the Market Failure Analysis (MFA) and CBA process, while individual policy areas produce MFA's/CBA's with oversight from EFR and the Regulatory Policy Committee (RPC). The Panel is planning to spend more time understanding the level of interaction, oversight and challenge provided between the EFR team and the policy areas.

*“The Panel remains concerned about the prominence, quality, transparency and robustness of Cost Benefit Analysis (CBA's) within the policy making process and beyond.”*

Undertaking CBA's in a principles-based world where there is more guidance than prescriptive rules will be a challenge as will be bringing

CBA to bear on EU policy making. The Panel believes that there are some weaknesses in the FSA CBA processes – for instance, in the ex-post CBA of policy, the analysis of the costs of system changes (as can be seen by the taping issue) and in securing samples that are representative of the relevant population. The Panel has engaged the FSA in further discussions on these matters.

## Financial Capability & Money Guidance

While the Panel has been generally supportive of the FSA-led strategy for financial capability it is concerned that the overall strategy and direction may have become fragmented with the Thoresen Review's recommendation that the FSA undertake a two year pathfinder pilot on the provision of 'Money Guidance'. The Panel engaged in a lively debate with Otto Thoresen (CEO, Aegon UK) in September 2007 and January 2008 prior to publication of the interim and final reports on the Thoresen Review. The Panel is concerned that the outputs of 'Money Guidance' may potentially impose a further burden on regulated firms, as they will be required to make a substantial financial contribution. In this context, the industry would need to see a robust and precise Cost Benefit Analysis. Further clarity was also required on the manner in which 'Money Guidance' would interface with the conclusions of the RDR.

The Panel also felt that the web should constitute the anchor for a 'Money Guidance' service as the most cost effective and independent manner in which to deliver generic financial information via a user-friendly internet based hub that could reach a large number of consumers. The Panel therefore supported and welcomed the re-launch of the FSA's consumer website in early 2007, [www.moneymadeclear.fsa.gov.uk](http://www.moneymadeclear.fsa.gov.uk) as a major step in the right direction. Of course, the key measure of success will be whether consumers access and use this material, and how the FSA will in turn gauge its impact on their behaviour.

*“...the industry would need to see a robust and precise Cost Benefit Analysis. Further clarity was also required on the manner in which 'Money Guidance' would interface with the conclusions of the RDR.”*

## Mortgage Intermediary Sector Concerns

The Panel is concerned about the level of non-compliance in the mortgage intermediary market as highlighted by the results of thematic reviews at the end of 2007. This was a major area of risk from a consumer point of view and the Panel considered that the Mortgage Conduct of Business (MCOB) rules were not achieving the objectives that were intended by them – in fact, to some degree, they had served to compound the issue. The Panel remains concerned that the FSA's supervisory and enforcement activities in this area continue to move too slowly to significantly improve standards in this sector. The FSA intends to assess 3,000 small firms this year (with full visits to around a quarter of those) as part of its 3 year timetable for the Enhanced Smaller Firm Strategy. However, the Panel is far from convinced that the process for selecting firms for attention is suitably rigorous and risk-based to address the very real and present problem that exists in the mortgage intermediary sector.

*“Far more targeted and decisive action on mortgage intermediaries is needed now to ratchet up standards of compliance...”*

While noting the other mortgage related workstreams such as responsible lending and Mortgage Quality of Advice Processes that would report in Q2 2008, the Panel saw limited value in undertaking yet more reviews that would highlight levels of non-compliance in this sector. Far more targeted and decisive action on mortgage intermediaries is needed now to ratchet up standards of compliance – to the extent that it may already be too late meaningfully to do so. The Panel will continue to monitor the FSA’s progress in respect of its Enhanced Smaller Firm Strategy and the embedding of TCF within smaller firms, and will engage with the FSA on the findings of its other mortgage related thematic workstreams over the course of 2008.

### **Commercial Insurance Commission Disclosure**

The Panel noted that the FSA had found no evidence of actual customer detriment but only scope for potential detriment in the Commercial General Insurance market. The CBA had clearly indicated that the costs outweighed the benefits of mandating commission disclosure, and therefore the Panel felt that the FSA should not proceed with its second phase of work. This had been a long running issue, and notwithstanding potential differing points of view around its substance, the Panel considered that a recommendation of yet further work could not be justified – to do so would be superequivalent and not a proportionate approach to regulation – a view shared by the Smaller Businesses Practitioner Panel. Against this background, the Panel was disappointed that the FSA decided to issue a Discussion Paper (DP08/2) in March 2008 and the Panel will monitor industry responses to it.

*“the Panel considered that a recommendation of yet further work could not be justified – to do so would be superequivalent and not a proportionate approach to regulation – a view shared by the Smaller Businesses Practitioner Panel.”*

## **3.c. Financially sound and well managed firms**

### **Northern Rock Review**

The FSA published a summary of its Review into the supervision of Northern Rock carried out by its Internal Audit Division at the end of March 2008. The Review identifies a number of areas for improvement in the execution of supervision, which will be advanced urgently by the FSA’s management, via a dedicated Supervisory Enhancement Programme (SEP).

In engaging the FSA on this issue, the Panel had pointed out that the FSA needed to clearly articulate that it intended to undertake a fundamental and robust internal review of its supervisory approach and strategy in respect of Northern Rock (and a sample of firms in its peer group), as this would be essential to the credibility of the Review. The Panel also felt particularly strongly that the balance between conduct of business and

prudential supervision needed to be explicitly addressed, both in analysing the recent supervisory history for Northern Rock and in planning the future strategy of the FSA. In the event, the Panel was satisfied that the FSA's Review contained a thorough critical appraisal of its supervisory failings, which included a robust remediation programme.

“*The Panel also felt particularly strongly that the balance between conduct of business and prudential supervision needed to be explicitly addressed, both in analysing the recent supervisory history for Northern Rock and in planning the future strategy of the FSA.*”

While the FSA's scope of the Review was restricted to its supervisory policy and engagement, the Panel observed that broader issues needing critical evaluation include the loss of confidence in the UK banking system, effective communication by the Tripartite Authorities and effective responsibility for financial stability. It should be noted that only one of the Tripartite Authorities – the FSA – has published a specific report on the lessons to be learnt on Northern Rock (and the Panel accepts that even if supervision had been carried out at a level acceptable to the FSA, it was by no means the case that in itself would have changed the outcome). The FSA is not a ‘no failure’ regime and while its supervisory framework seeks to mitigate risk in a risk based and proportionate manner, it must continue to be mindful of fostering innovation and competition in markets.

Following from the recommendations of its internal Review, the Panel is supportive of the FSA's intention to ensure that all high-impact firms will have an irreducible minimum level of staff to enable effective relationship management at all times. There will also be a clearer structure and framework for the exchange of information and expertise between the FSA's wholesale and retail business units – best practice from the FSA's wholesale division will be exported across all supervisory areas – and the Panel believes that this will be of particular benefit to those responsible for the supervision of major retail groups. The FSA have also committed to ensuring that the balance of resource committed to conduct of business regulation relative to prudential supervision will be reassessed – a decision that the Panel is very supportive of and a concern that it has regularly raised with the FSA throughout the course of the year. The Panel will continue to engage with the FSA on its Supervisory Enhancement Programme.

### **Banking and Compensation Reform**

The Panel had formally responded to the earlier Tripartite Discussion Paper: ‘*Banking reform – protecting depositors: a discussion paper*’ and has been actively discussing the current Tripartite Consultation Paper with the FSA – ‘*Financial stability and depositor protection: strengthening the framework.*’ The Panel sees no objective or material justification to increase the FSCS limits for deposits from 100% of £35,000 to 100% of £50,000. The Panel has supported the view expressed in many quarters that such a move could in fact serve to undermine consumer/market confidence. Full consideration must be given to the uncompetitive effects that such actions would have on the financial services industry and any unintended consequences.

The Panel remains unconvinced by the proposals contained in the recent Tripartite Consultation Paper: *‘Financial stability and depositor protection – strengthening the framework,’* particularly in relation to the Special Resolution Regime and payment systems, and has cautioned against rushing through proposals to what are complex issues. While recognising the political imperatives, it seems to the Panel that this is a flavour of ‘fighting the last war’ and shifts the consequences of earlier regulatory and commercial failings on to the industry as a whole. In practice, should a similar situation

“*In practice, should a similar situation arise in future, we would expect the appropriate authority(s) to intervene as a matter of urgency – and so the measures arising from this Consultation are in practical real terms, never likely to be called upon.*”

arise in future, we would expect the appropriate authorities to intervene as a matter of urgency – and so the measures arising from this Consultation are in practical real terms, never likely to be called upon.

The Panel has been kept abreast on developments in respect of the FSA’s review of liquidity requirements, which included feedback to DP07/7 (*Review of the liquidity requirements for banks and building societies*). The Panel is supportive of a liquidity framework that continues to emphasise the FSA’s high-level standards and principles-based approach, and the FSA will need to continue to co-ordinate its work on liquidity both at a national level (with the other Tripartite Authorities) and on an international level. The Panel has requested that the FSA provide further clarity on its liquidity timetable and is aware that the FSA intends to publish a CP in the autumn. The Panel looks forward to further engaging with the FSA on the development of its liquidity regime.

### **FSCS Funding Review tariff changes**

During the course of 2007 the Panel engaged the FSA in respect of its Funding Review of the FSCS (CP07/5) and the FSA confirmed its intentions for the new model in November 2007 (PS07/19). The Panel felt that the FSCS funding arrangements should have not been examined in isolation to the broader Banking and Compensation reform arrangements and that these strands of work needed to be properly joined up.

The Panel welcomed the decision not to create a general wholesale pool given that the wholesale sector would never make a claim on the FSCS. Moreover, given the mobile nature of capital, safeguarding London’s position as an international capital market was of great importance. The Panel also welcomed the reduction in the final threshold for the general insurance provision and fund management sub-classes. However, the Panel was disappointed that the FSA was not minded to proceed with the establishment of separate sub-classes on the basis of the prudential regime that firms in those sub-classes were subject to. The Panel felt that the key to proportionality and fairness within the broad investment class was the creation of a separate and distinct sub-group for those firms subject to MiFID and the CRD and for those that are not.



The Panel considered that a review of the compensation scheme could not be undertaken in isolation of a fundamental root cause analysis of why firms fail, why certain sectors have higher failure rates, what could be done to address this and the impact this might have on reducing the levy. Prevention is always better than cure. The Panel is also mindful of the fact that the UK's compensation scheme is superequivalent to those of some EU member states in terms of breadth of coverage, types of compensatable claims and amounts payable. It was therefore crucial that any reforms to the compensation scheme as a whole did not put UK financial services firms at a significant competitive disadvantage in relation to their EU counterparts. The Panel will monitor industry feedback and offer its views to the FSA in respect of its current consultation on tariff measures (CP08/8).

### 3.d. European and International Developments

EU and international developments have featured 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 that have been of particular importance and impact over the course of the last year.

#### MiFID and CRD Implementation

The Panel has received updates on how the FSA was approaching the implementation of the Markets in Financial Instruments Directive (MiFID) and the Capital Requirements Directive (CRD), both of which came into effect in 2007, and has been a key priority for firms and the regulator alike. The Panel has stressed that a pragmatic and evolutionary approach to the implementation of such measures was essential. The Panel has been broadly satisfied that discussions between the FSA and the industry (and in particular, MiFID Connect) on various issues has progressed well. The Panel has communicated industry concerns to the FSA of the need to consider deferring any significant initiatives or keeping changes in 2008/09 to a minimum in order to give firms the necessary breathing space needed to implement MiFID.

The Panel has also encouraged the FSA both to work with the Basel Committee to develop appropriate international liquidity standards as soon as is practicably possible and also to ensure as far as possible that the UK liquidity requirements do not conflict with emerging international ones.

### Commissioner Charlie McCreevy

The Panel met with Commissioner McCreevy (Internal Markets & Services) in April 2008, and enjoyed an open and lively debate on a range of topical EU and international issues.

*“The Panel felt that the Commissioner had provided the financial services industry with a very good service throughout his term of office, and that his key achievement of promoting better regulation and the use of impact assessments had already been adopted by a number of member states.”*

The Panel was particularly pleased to hear Commissioner McCreevy’s thoughts about the challenges ahead to any single EU prudential regulator, and how he hoped his own ethos and commitment to Better Regulation would permeate through to his eventual successor – an aspiration which the Panel itself shared. The Panel felt that the Commissioner had provided the financial services industry with a very good service

throughout his term of office, and that his key achievement of promoting better regulation and the use of impact assessments had already been adopted by a number of member states.

### Lead supervision and supervisory structure

The Panel is supportive of the FSA’s position that the Lamfalussy arrangements, while in need of some improvement, represent a solid basis on which to build further. The Panel agrees with HMT/FSA that a single prudential supervisory framework for the EU would be counterproductive to a risk based and principles-based regime as we understand it in the UK, that was disposed to market solutions, or which placed the same reliance on senior management systems and controls.

*“The Panel agrees with HMT/FSA that a single prudential supervisory framework for the EU would be counterproductive to a risk based and principles-based regime as we understand it in the UK, that was disposed to market solutions, or which placed the same reliance on senior management systems and controls.”*

While continuing to oppose the concept of a single prudential regulator, the UK authorities have promoted regulatory convergence on the basis of enhanced cooperation among regulators through crisis management and prudential colleges of supervision, and other multilateral arrangements to allow supervisors to get a better perspective on group-wide issues, to share information, co-ordinate their plans and undertake joint work in respect of the sharing of supervisory tasks. While being supportive of this, the Panel feels that greater ministerial visibility and engagement on European financial services discussions is needed, which would help the UK’s negotiating position and thereby benefit both HMT and FSA.

### Prudential colleges and crisis management colleges

The FSA see colleges as an important tool in streamlining communication between national regulators and internationally active firms, in improving regulatory understanding of group wide activities and in facilitating the sensible delegation of tasks. Precise college arrangements need to be determined on a case by case basis with different requirements applying to prudential colleges as opposed to crisis management colleges.

While being supportive of prudential and crisis management colleges covering banking, insurance and securities supervision, the Panel felt that these also needed to cover the derivatives arena given the potential cross border risks posed by this sector. Commissioner McCreevy had pointed out that there was still much to be done in developing the EU mechanisms for dealing with a cross border banking crisis. 48 banks operated on a cross border basis in Europe that had numerous reporting requirements in various jurisdictions and formats, and the EU mechanisms had to be robust enough to deal with the potential implications of a banking failure in any of these institutions. The Panel noted that there may be lessons from the Solvency II model in respect of insurers that could be applied to the banking sector, and also pointed out that there needed to be a global basis for prudential and crisis management colleges to enhance supervisory cooperation across markets (for example, in respect of NYSE/Euronext).

### EU/US ‘Mutual Recognition’

The EU/US dialogue had delivered significant benefits and it could scarcely have been predicted five years ago that the Securities and Exchange Commission (SEC) would agree to recognise the International Financial Reporting Standards (IFRS).

The merger of NYSE and Euronext had also created significant commercial pressure to extend ‘mutual recognition’ (or substituted compliance in SEC speak) to exchanges and possibly broker dealers. The SEC had envisaged that it would publish a position paper on this next stage of ‘mutual recognition’ by the end of 2007. The paper has yet to appear, and there must be a possibility that it will not do so before the Presidential election. The Panel felt that the SEC had crossed the bridge about not ‘cherry picking’ EU regulation, however, its key concern remained the application of enforcement intensity among EU member states.

The Panel felt that Henry Paulson (US, Treasury Secretary) and Christopher Cox (SEC, Chairman) had initiated a ‘sea change’ in US attitudes. The SEC had permitted ‘deregistration’ and Chairman Cox had recognised the value and importance ‘of trusting each others systems, rather than policing it all in the US’. Henry Paulson had put forward proposals for dealing with crisis management. The Panel were uncertain whether a change in the US administration could potentially undermine progress on ‘mutual recognition’. The fragmented nature of the US regulatory system and the various vested interests, along with the power of the political and regulatory lobby could not be underestimated. The Panel will continue to monitor developments on ‘mutual recognition’.

“*The Panel felt that the SEC had crossed the bridge about not ‘cherry picking’ EU regulation, however, its key concern remained the application of enforcement intensity among EU member states.*”

### 3.e. FSA Operational Effectiveness and Performance

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

The Panel has long argued that the quality of FSA staff was key to a successful shift towards a more principles-based regime, and are therefore supportive of the FSA's decision under its 'Making a Real Difference Agenda' (MARD) to allocate a budget of up to £50m over three years to improve the effectiveness, skill and attitude of FSA staff and support the shift to MPBR. Better commercial understanding and the ability to exercise suitable, consistent judgement will be key here – especially for Relationship

*“...a cultural shift in the approach from supervisors would be instrumental to effective relationship management. To facilitate this it was essential that the FSA reduce supervisory turnover to allow staff to gain the experience and understanding necessary for them to achieve a pragmatic and consistent approach to regulation.”*

Managers and Firm Contact Centre staff. Upgrading the FSA's IT and knowledge management infrastructure is also an important element.

The Panel's 2006 Survey of regulated firms illustrated that most practitioners felt that FSA staff had insufficient commercial understanding of their businesses. While

noting that the focus of MARD was on improved performance management, the Panel pointed out that the framework would also need to focus on behavioural changes – as a cultural shift in the approach from supervisors would be instrumental to effective relationship management. To facilitate this it was essential that the FSA reduce supervisory turnover to allow staff to gain the experience and understanding necessary for them to achieve a pragmatic and consistent approach to regulation.

The Panel has also questioned the FSA's on-going commitment to headcount reduction in relation to retaining 'fewer, better staff'. While noting that by March 2010 the FSA intends to reduce its headcount by a net 209, the Panel felt that this level of headcount reduction may not in the event make a material difference. The Panel has therefore urged the FSA to ensure that through the use of rigorous performance management that the FSA workforce comprises only those staff with the ability to meet the standards of competency envisaged under the MARD initiative. The Panel will monitor the FSA's progress on the MARD initiative.

#### Regulatory Transparency

The Panel remains disappointed that the FSA has decided to press ahead with the publication of its Discussion Paper on Regulatory Transparency in May 2008, given that the Panel had articulated its on-going concerns on this matter. While the FSA's decision to develop a coherent policy on disclosure at this stage was in some ways understandable, the Panel felt that the implications of losing its appeal under the Freedom of Information Act (FOIA) needed to be fully thought through and that the most prudent course of action for the FSA was not to pursue these proposals until the law had been clarified.

The Panel felt strongly that the FSA already had sufficient and credible regulatory tools to achieve its objectives without this transparency option, and emphasised that it had not seen any evidence of market failure that warranted the use of this further regulatory tool to change firm behaviour. The Panel emphasised that concerns about individual firms should properly be dealt with under ‘business as usual’ supervisory processes – as part of a firm Arrow visit and Risk Mitigation Plan with appropriate enforcement action if ultimately necessary. Otherwise, this transparency initiative could be viewed as an explicit example of ‘goldplating’ or superequivalence (with no EU directive driving this initiative), and an implicit admission that the Arrow process and relationship management were failing.

“ *The Panel emphasised that concerns about individual firms should properly be dealt with under ‘business as usual’ supervisory processes – as part of a firm’s Arrow visit and Risk Mitigation Plan with appropriate enforcement action if ultimately necessary. Otherwise, this transparency initiative could be viewed as an explicit example of ‘goldplating’ or superequivalence (with no EU directive driving this initiative), and an implicit admission that the Arrow process and relationship management was failing.* ”

The Panel pointed out that the FSA was in danger of fundamentally changing the nature of its supervisory relationship with firms. It was very likely that the FSA would be challenged by firms to justify its actions and that firms as a result may become less co-operative, adversarial and litigious. The Panel felt that the success of more principles-based regulation (MPBR) would essentially consist in the level of trust the regulator had with the regulated to make predictable, pragmatic, proportionate and outcome-focused decisions without fear of retrospective regulatory action – this form of regulatory creep could potentially undermine progress towards MPBR.

The Panel remains concerned that the FSA may be able to ‘cherry pick’ the information it decides to disclose (for example, firm specific data on complaints or individual capital ratios) and that this may provide an isolated snapshot without context of the fuller picture. The Panel felt that there could be unintended consequences and reputational damage to the industry if the media, consumers and those who advised them misinterpreted the nature of any information being disclosed. The Panel also pointed out that the FSA should not underestimate its responsibility to properly inform/educate those who chose to utilise its information on regulatory transparency, as this initiative could potentially have a detrimental impact on the relationship that retail financial services firms have with their customers – given that the retail financial services industry is already grappling with the Treating Customers Fairly initiative and the potential outcomes of the Retail Distribution Review.

While accepting the FSA’s decision to press ahead with its proposals and in the spirit of being constructive, the Panel will monitor industry feedback to the DP and offer its further input to the development of the ‘Code of Practice’.

## 2008 Survey of Regulated Firms

This year sees the Panel's fifth survey of regulated firms, which is an extensive study incorporating views from a cross-section of firms and sectors in order to provide valuable feedback to the FSA. The research agency BMRB has been appointed to carry out the survey on behalf of the Panel after a robust tender process, and the main postal questionnaire was issued to firms in June 2008.

While the Panel will steadfastly preserve the independence, authority and confidentiality of its Survey, it is also committed to a methodology and process which is informed, transparent and includes regular engagement with the FSA along the way – including the development work leading up to the qualitative (March/April) and quantitative (June/July) fieldwork stages. The purpose of that is to produce an end product which not only is credible and meaningful, but which gives the Panel and the FSA a genuinely objective and actionable basis on which to move forward in certain areas.

*“The purpose of that is to produce an end product which not only is credible and meaningful, but which gives the Panel and the FSA a genuinely objective and actionable basis on which to move forward in certain areas.”*

The Panel is very keen to see a high response rate to its 2008 Survey and urges all firms that receive the questionnaire to respond to it. The Panel is fully appreciative of the time and commitment provided by firms – whose support is critical to the success of the 2008 Survey – in agreeing to participate in the qualitative fieldwork and in completion of the quantitative questionnaire. The Panel will publish the results of the 2008 Survey in Q4 2008.

## Financial Ombudsman Service & Hunt Review

While noting that the FOS was well run and is managing its case loads efficiently, the Panel was concerned that industry costs were being driven higher as a result of regular annual increases in FOS, FSCS and FSA levies. The Panel noted the increase in the FOS case fee from £400 to £450, and felt that the increase in the number of 'free' cases from two to three would particularly benefit smaller firms.

The Panel was pleased to contribute to Lord Hunt's Review of the FOS on 'accessibility and transparency' when it met with him in January 2008. The Panel was interested to learn whether there was a potential conflict between the FOS and the FSA in their definitions of 'fairness' in respect of Treating Customers Fairly (TCF), as FOS conclusions on individual complaints had the potential to be inconsistent with FSA supervisory judgements on a firm's compliance with TCF. The Panel observed that the FOS had the benefit of hindsight and could review issues through a 'different lens' thereby creating precedent without necessarily taking account of FSA rules in its case decisions.

The Panel discussed the concept of an alternative appeals process where a firm believed it had just grounds to contest an Ombudsman's decision, but felt on balance that if the appeals process was made easier, firms may not be sufficiently incentivised to resolve the complaint prior to it reaching the FOS. There was the likelihood that the FOS may become more legalistic and the cost to firms could significantly increase on appeal. The FOS had also prevented US style class action lawsuits from developing in the UK and the Panel were not in favour of publishing details about individual FOS cases because of its potential to create class action law suits. The Panel were sympathetic to Lord Hunt's views on the facilities required to make the FOS more accessible to consumers with low levels of financial capability.

### **Hampton Implementation Review**

The Panel contributed to the National Audit Office's and Better Regulation Executive's high-level review of the FSA's compliance with the Hampton principles, which was undertaken over a two week period in November 2007. Among other suggestions, the Panel emphasised the importance of a directed review that drilled down to specifics and an appropriate level of detail on a few key issues given the limitations on evidence gathering over a two week period.

### **Financial Crime**

The Panel received an update from Bob Ferguson (Financial Crime & Intelligence Department, FSA) and Oliver Shaw (Detective Superintendent, City of London Police) on financial crime issues, and how the FSA and the police work together. The Panel was supportive of the good work undertaken by both the FSA and the police in tackling financial crime.

## 4. OTHER ISSUES & TABLE OF PRIORITIES FOR 2008/9

### **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 external stakeholders for discussions. The former include FSA Chairman, Sir Callum McCarthy; CEO, Hector Sants; Head of Enforcement, Margaret Cole; Head of HR, Kathleen Reeves; as well as the FSA's managing directors and sector leaders. The latter include European Commissioner for Internal Markets & Services, Charlie McCreevy; FOS Chairman, Sir Christopher Kelly; Centre for Regulatory Excellence, Lord David Currie; Hunt Review of FOS, Lord David Hunt; Detective Superintendent, City of London Police, Oliver Shaw. Panel members also attended lunches with the FSA Board and a dinner with the Consumer Panel where topical issues were discussed.

### **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, correspondence, individual Panel members' ties with their respective trade bodies and a biannual briefing of senior executives of trade associations, held jointly by the Panel Chairman and the Chairman of the Smaller Businesses Practitioner Panel.



## Table of Priorities for 2008/9

*Many of these issues emerged on the Panel's radar screen in 2007/8, but feature among the Panel's Priorities for the coming year as they are expected to take up an increasing portion of the Panel's time in 2008/9.*

<i>FSA Retail Strategy – overall volume, intensity and cumulative burden (see pg 14)</i>
<i>Balance between Prudential &amp; Conduct of Business Supervision (see pg 13, 15 &amp; 20)</i>
<i>Business Plan initiatives – reprioritise, defer or discontinue (see pg 15)</i>
<i>Supervisory enhancement programme arising out of Northern Rock Review (see pg 20)</i>
<i>MARD – commercial understanding, cultural shift, pragmatic/consistent supervisory approach to regulation (see pg 26)</i>
<i>RDR output/Retail Market Structures work – proportionate outcomes that do not diminish availability of advice (see pg 16 &amp; 17)</i>
<i>More principles based-regulation – development and application (see pg 11 &amp; 12)</i>
<i>Treating Customers Fairly – Review with CBA &amp; monitoring of March and December 2008 deadlines (see pg 13)</i>
<i>Cost Benefit Analysis – Prominence, quality and robustness (see pg 18)</i>
<i>Banking &amp; Compensation Reform (see pg 21)</i>
<i>MiFID/CRD implementation, EU and international developments (see pg 23, 24 &amp; 25)</i>
<i>Financial Capability &amp; Money Guidance – (see pg 19)</i>
<i>2008 Survey of Regulated Firms – (see pg 28)</i>
<i>Regulatory Transparency – monitoring industry views (see pg 26 &amp; 27)</i>
<i>Mortgage Intermediary Sector concerns – (see pg 19)</i>
<i>Commercial Insurance Commission Disclosure – (see pg 20)</i>



## ANNEX A

### List of Panel Members (as at 1 April 2008)

**Nick Prettejohn – (Chairman)**, Chief Executive, Prudential UK & Europe

**Roy Leighton – (Deputy Chairman)**, Former Chairman, Nymex Europe

**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

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

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

**Gordon Pell** – Chairman, Regional Markets, Royal Bank of Scotland

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

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

**Patrick Snowball** – Deputy Chairman, Towergate Partnership

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

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

Further information on the role and work of the Panel, including its terms of reference and details of its membership, are available on its website: [www.fs-pp.org.uk](http://www.fs-pp.org.uk)

The Panel can be contacted via its Secretariat at the FSA.

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