

THE FINANCIAL SERVICES PRACTITIONER PANEL



Annual Report
2009/2010

Chairman's Foreword

This year the Panel believes that we have seen the FSA respond effectively to challenging times as the fallout from the global financial crisis continues. The FSA has worked to improve its capabilities: it has made significant progress in developing and implementing the changes in policy and approach to regulation which are the inevitable and necessary responses to the crisis. The FSA's work has been made more difficult, as it has taken place against a background of uncertainty about its future, with proposals from the Conservative Party for a fundamental restructuring of financial services regulation in the UK.

The remit of the Practitioner Panel is to give an industry viewpoint into the policy making of the FSA. We have been supportive of many of the individual developments put forward by the FSA. We come from the perspective that it is clearly in the interests of consumers, practitioners and the wider economy that we have an effective regulator. However, there have also been areas of sometimes significant disagreement. Our greatest concerns have been what we perceive on several occasions to have been a tendency towards a "one size fits all" approach to regulation, driven by a focus on the issues which arose primarily in the banking sector. There have also been times where actions may have been taken with, in our view, insufficient consideration of the full potential cost of them leading to a risk of "regulatory overshoot".

We have been particularly keen that in the development of its policies and overall approach to supervision, the FSA should be

very clear about its objectives. The actions taken by the FSA should link directly to the achievement of objectives, and it should measure its performance relative to the outcomes against those objectives. We accept that the cost of regulation will increase, but have continued to press for increased focus on high quality cost-benefit analysis, general cost effectiveness and improvements in the approach to performance measurement.

I would like to thank my predecessor Nick Prettejohn, who handed over the Chairmanship to me in November 2009, and Alan Yarrow, who stepped in as Deputy Chairman until the end of his term in March 2010. Nick's leadership and effective Chairmanship ensured the Panel maintained a productive dialogue with the FSA during a time of unprecedented financial turmoil. I would also like to thank Adair Turner and the Board of the FSA, and all the staff at the FSA who have been helpful, constructive and consistent in their engagement with us over the past year. We would particularly like to thank Hector Sants for his significant contribution to the structure of financial services regulation during his three years as Chief Executive of the FSA.

Iain Cornish
Panel Chairman



Iain Cornish
Practitioner Panel Chairman

Introduction

The Practitioner Panel is a statutory Panel, set up under the Financial Services and Markets Act 2000, to advise the Financial Services Authority on its policies and practices from the point of view of the practitioners who are regulated by the FSA. We have an opportunity to discuss the FSA's plans for new regulatory policies, before the ideas have been made public. We therefore provide an important sounding board for the FSA from the industry point of view, and at a different level to the detailed debate which then takes place with trade associations on the impact of changes at the sectoral level.

We look at the impact of regulatory changes for practitioners as a whole. Our work is complemented by the work of the Smaller Businesses Practitioner Panel, whose Chairman sits on our Panel, both to represent that side of the industry in our debates, and to ensure coordination between the work of the two Panels.

We aim to ensure that membership of the Panel represents the main sectors of the financial services industry as regulated by the FSA. We currently have senior practitioners from the retail and investment banks, building societies, insurance companies, investment managers, financial services markets, custodians and administrators.

During the course of the financial year, we have seen some changes in membership of the Panel. We are grateful to those members who have stood down over the course of the year – to Nick Prettejohn, particularly for his Chairmanship until November 2009, and to Gordon Pell. We have welcomed Helen Weir on to the Panel from January 2010. A full list of members of the Panel is shown in Appendix 1.

Our approach

This past year has been one where the changes in regulatory priorities have continued in response both to the financial crisis, and to the development of the FSA's wider regulatory commitments.

We aim to work with the FSA rather than against it, to help deliver effective regulation for all in the financial services industry. We have the advantage of seeing much of the FSA's policy proposals at a formative stage, and we try to use this to engage in debate on key industry issues and concerns and to provide a cross sectoral sounding board for the FSA.

Key themes

Throughout the year's engagement with the FSA, we have pursued a number of key themes. On many occasions we have been supportive of the overall direction of travel of the FSA, and we appreciate the need for strong and effective regulation. However, we are keen to see that the cost of regulation is kept under control. We were not surprised that concern about the cost and burden of regulation was a key theme from our last survey of regulated firms which we undertook in 2008/9. As part of our follow up to that, we have focused particularly on the FSA's use of cost benefit and pressed for this to play a more central role in decision making.



We have supported the FSA's move to outcome focused regulation which we believe should be the ultimate test of a regulator. However, our support is tempered with a concern that the FSA should not adopt a 'one size fits all' approach to supervision. It must avoid the temptation of treating all financial services companies in the same way.

Relationship with the FSA

We have been pleased with the positive and constructive relationship we have had with the FSA this year. From the Chairman down through the organisation, we have had constructive discussions about FSA policy in our meetings, and have enjoyed broader opportunities to promote the role of the Panel this year with FSA Board members and the senior leadership team of the FSA.

Wider industry views

We have not only worked with the FSA. We have also worked to strengthen links to trade associations and other stakeholders to ensure a coordinated voice in making representations to the FSA. As part of this, we have also developed greater co-operation across the independent panels of the FSA and have, for the first time this year, produced a coordinated response to the FSA on aspects of the Retail Distribution Review.

The future of the FSA

During this year there has been an additional uncertainty about the future form of financial regulation: in the run up to the 2010 General Election the Conservative Party proposed a whole new structure of financial services regulation involving the abolition of the FSA. We have engaged in dialogue with the key decision makers on Conservative Treasury Policy to provide a perspective from representatives of industry who have direct experience of the current system with all its strengths and weaknesses.

Views on how the FSA operates

Restructuring of FSA to supervision and risk

We welcomed this year's FSA restructuring to divide its regulatory activities into Supervision and Risk directorates. We had previously expressed our reservations about the efficiency for the FSA of operating with a Wholesale and Retail divide, and so we believe the new structure should lead to better regulation.

We have given feedback on the strategies of the different directorates as detailed below. We plan to continue dialogue with the FSA in this area, as it is at the heart of the effectiveness of the FSA.

Effective supervision

We have been generally supportive of the FSA's Supervisory Enhancement Programme. We accept that this will increase the cost of regulation, but our greater concern is to make sure that the programme really delivers more efficient and effective regulation. We have pressed the FSA to ensure that it measures the quality of supervision: it needs to ensure that the increased investment in supervision is effective and indeed, that the desired regulatory outcomes are achieved. Although we accept that this form of measurement is not straightforward, it is vital to get it right, and we have contributed a number of suggestions on how this might be done. We were pleased that the FSA discussed its development of management information on supervisory effectiveness with the Panel during the year and we welcomed the FSA's inclusion of performance measurement metrics in its Annual Report.

In all its supervisory activity we have urged strongly that the FSA recognises the concept of the 'reasonably conscientious firm'. It must draw a clear distinction in its approach between those firms with a strong compliance culture who do their best to adhere to relevant rules and principles, and those who do not demonstrate a similar commitment.

Core Prudential Programme

We reviewed the core prudential programme for the FSA, and were concerned that the level of resource needed for implementation would be a significant challenge for the FSA. We questioned the FSA on the high-level cost-benefit analysis (CBA) of raising prudential standards undertaken by the National Institute of Economic and Social Research (NIESR) during 2009.

Conduct Strategy

Towards the end of this financial year, the Panel was briefed on the FSA's new conduct strategy. We have asked for continued dialogue on the implementation of this strategy, as we believe that this work will have a significant impact on firms over time.

The success of the approach will very much depend on the quality and effectiveness of the FSA's interaction with firms. This new strategy will involve the FSA making judgements with which firms could, on occasions, fundamentally disagree. We have suggested that the FSA will need to develop a clear means of addressing any disagreements on judgement with firms.

Rules and Principles

We have been pleased with the FSA's recognition that, although principles clearly have a place, rules are often easier to deal with. However, we have expressed some concern that the industry may end up with the worst of all worlds in the FSA's combined use of rules and principles.

We have seen examples in the FSA's PPI work where a prescriptive stance is being taken in some areas but in addition the FSA is relying on principles for everything not covered by specific rules. In other areas the risk of potential conflict between rules and principles is apparent. For example, the FSA's plans for mortgage arrears handling (CP10/2) propose rules which might be interpreted as requiring firms to offer customers options which may not be appropriate to them under the Treating Customers Fairly principles.

We appreciate the demands of Europe will mean that new rules may have to be introduced. However we have suggested that FSA will need to work for a sensitive application of the rules and some discretionary supervision to ensure balance is maintained.

We have also reiterated our view that the FSA guard against 'regulation by speech' where concerns about firm activities or new ideas for regulation are announced in speeches by senior FSA figures. We have said that conventional channels such as Dear CEO letters should be used to convey regulatory messages to firms.

Cost Benefit Analysis (CBA)

The Panel has highlighted to the FSA that there is industry concern about the FSA's use of CBAs. The FSA is required by legislation to take costs and benefits into account when introducing new regulation, although not all decisions have to be driven by CBAs.

We have seen that the FSA has introduced some changes when the CBA has not supported the case for implementation – such as with the publication of complaints data. There have also been initiatives such as Treating Customers Fairly where a CBA was not carried out, even when significant changes were required of firms. We will continue to focus on the FSA's use of CBAs during the coming year.



Fees

We were pleased that the FSA carried out a strategic review of the cost allocation and fees regime this year. The review resulted in a welcome increase in the transparency of the process to achieve the annual funding requirement and proposed fee rates for 2010/11.

It is vital that the FSA is seen to be providing value for money, and we had suggested that the FSA should explore how fees could differentiate between firms, including those in the same sector, on the basis of risk and time spent by the FSA. This would enable well-run firms to benefit financially from a regulatory dividend. We also pointed out that the ability to plan with some certainty is important, particularly for smaller firms, so the standard minimum fee level is important.

FSA Business Plan

We had a number of helpful meetings with Hector Sants from an early stage in the development of the FSA's 2010/11 Business Plan. We pursued a number of key themes for the FSA to consider.

We encouraged the FSA to focus on only a minimal number of discretionary new initiatives, and the deprioritisation of a number of less critical issues in this time of financial and resource pressure on both the industry and the FSA.



We suggested that the FSA needed to gather tangible evidence that the FSA's recent Supervisory Enhancement Programme (SEP) is working in order to ensure the programme is designed effectively and to justify the increased fee levels. We are wholeheartedly supportive of the FSA's actions to improve the quality of supervision. However, we would like to see evidence of value for money and measurable outcomes to demonstrate that SEP is succeeding. We would also expect to see clear evidence of improved efficiency and effectiveness reflected in fee levels in future years.



With recruitment and retention potentially becoming possibly difficult for the FSA at more senior levels in a time of potential change by a new Government, we suggested the FSA should review priorities regularly, and in particular the risk based emphasis of supervision.

In relation to regulation developed in one sector which may have applications in others, we asked that the FSA should give a clear and early indication where read-across is not planned for a particular initiative. We explained that firms expend considerable effort and resources in planning for possible read-across from sector specific FSA initiatives and that such announcements from the FSA would minimise unnecessary effort.

We also urged the FSA to ensure that the long-term international agenda should be given the highest priority. The recent financial crisis has shown how international coordination of regulation will become increasingly important.

We supported the work of the FSA on a consumer engagement strategy. However, we believe that the FSA needs to have a clear view of what it is seeking to achieve, and a strong appreciation of consumer behaviours, particularly at the point of interaction between consumers and firms. We remain of the view that it will be important to give consideration to the boundaries between firms' and consumers' responsibilities.

Financial Risk Outlook (FRO)

We were pleased that the FSA introduced greater linkage between the Financial Risk Outlook and its Business Plan this year. We believe that the FRO should be an important driver of FSA activity. We also urged the FSA to ensure that the tone and content of the FRO is clear and useful to the Boards and management of regulated firms, and that it should avoid over-simplistic generalisations which might be misinterpreted and which could raise unwarranted concern about the future of a particular firm or sector.

Enforcement Fines System and Regulatory Decisions Committee (RDC)

We welcomed the FSA's announcement of increased transparency around fines (PS10/4) in March 2010. We look forward to more consistent levels of financial penalty being developed over time. We also welcomed efforts from the RDC to be clearer on what it would be reasonable to expect senior staff to do in respect of systems and controls. We believe that the concept of the 'reasonably conscientious firm' referred to earlier (in the section on Effective Supervision) is particularly relevant in relation to the approach to Enforcement.

Views on new and developing policies

Transparency – FSA publication of complaints

We supported the Financial Ombudsman Service's initiative this year to publish its complaints data as, having been through an appropriate judgement process, it will be fair and informative for consumers.

However, we have been critical of the FSA's decision to publish its data on numbers of complaints made to individual firms. We do not believe that this is indicative of whether the firm is working in the interests of consumers. The complaints often have causes beyond a firm's control, such as the actions of government bodies like HMRC, or the requirements of money laundering rules. There is the potential for the publication of raw data in this way to be misleading and counter-productive.

We had significant concerns about the FSA's Cost Benefit Analysis and the potential reputational costs and international comparisons. We therefore commissioned our own work which bore out our concerns. We were disappointed that the FSA went ahead with its plans to publish the complaints data in spite of an inconclusive Cost Benefit Analysis.

Corporate governance and remuneration

We recognise that it is important for the regulator to consider remuneration and corporate governance and the role that they have played in the recent financial crisis. We have been keen to engage in debate with the FSA on the most appropriate ways of dealing with this.

We have wanted to ensure that any new regulation is proportionate to the risks, and flexible to reflect the range of sectors and size and type of firms involved in financial services. In addition, we believe it is vital to consider any new proposals in the context of European and wider international regulatory action. We have highlighted our significant concerns about the competitiveness of the UK as a financial services centre if the UK does not move broadly in step with regulators globally.

Retail Distribution Review (RDR)

The FSA work on the Retail Distribution Review has been of significant interest to our Panel, along with all the FSA's independent Panels. We were pleased to combine with the Smaller Businesses and Consumer Panel members to make a joint approach to the FSA on a policy issue for the first time in February/March 2010.

We have been supportive of the general aims of the RDR and its ambitions to raise standards in the investment advice sector. We believe that overall, the changes to product fees/charges and product distribution in the medium to longer term are all deliverable. However, we believe the impact of the RDR may leave the mass market with more limited access to financial advice, together with the likely increase of costs in producing products.



We have registered considerable concerns about the transitional arrangements and delivery of the training required by 2012. We believe this will result in a significant reduction in the availability of advice, particularly for those in the middle market. Many experienced advisers are choosing to leave the industry rather than undertake new exams and a new training and competency programme. Our concern is that there will not be time to recruit and train new advisers to fill this gap in the interim period.

We believe that the UK must also have a distribution model which is sustainable within a European context. The FSA must be cognisant of developments in European regulation, to ensure that major elements of the RDR will not require subsequent expensive industry changes to fit with the European direction of travel, and that passporting arrangements from Partner states to the UK do not create in the UK an uneven or anti-competitive UK advice and regulatory system.



Payment Protection Insurance (PPI)

We criticised the FSA's PPI proposals which, we consider, amount to retrospective legislation. The scale of the challenge for firms is significant, and the proposals are significantly biased in favour of consumers. Although it is accepted that there has previously been wrongdoing by some firms, the proposals impose an unreasonably high burden of proof on all firms.

We were pleased that the FSA agreed to think again and published a further consultation in March 2010, as the original timeframe and proposals had caused considerable concern. We remain concerned about the costs of the proposals and see a fundamental difference between the industry's estimates and those of the FSA. The industry remains convinced that the FSA's proposals could have a systemic impact. We have also highlighted the risk that a disproportionate response may contribute to the fundamental erosion of consumer confidence in PPI at a time when it may be of most benefit.

Consumer Financial Education Body

We are supportive of the ambition to improve the level of financial education in the UK, and the work that the FSA has undertaken to develop financial capability. However, we asked the FSA to be conscious of cost to the industry in its negotiations with the government in splitting off the FSA's financial capability into the new Consumer Financial Education Body (CFEB).

Care should be taken to minimise wasting resource already spent, and we noted that the MoneyMadeClear branding was transferred from the FSA to CFEB. We said that industry's contribution should not be regarded as open-ended, and should be restricted to an agreed maximum, after which the proposals would have to be scaled back if public funds were not available. We also expressed the view that it would be difficult to justify statutory immunity in respect of advice given by the new body. This would need to be looked into further as the role and remit of CFEB is developed.



Financial Services Compensation Scheme (FSCS)

We welcomed the review of the FSCS funding which the FSA initiated at the end of 2009. This has been needed for some time, and we welcome particularly the FSA's commitment to look at the system of funding cross-subsidisation.

Views on the development of European and global regulation

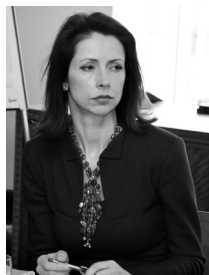
The Panel has encouraged the FSA to take a leading role in the development of European and international regulation. Financial services firms and the UK economy as a whole will benefit from UK representatives taking an active and positive part in international policy developments, particularly in the wake of the recent global financial crisis. We have previously been concerned at the level of influence which can be exerted both by the FSA and also by the UK as a whole in this vital area. We are pleased that the FSA has increased its focus and resources in European and international policy development over the past year.

The Panel expressed its support for the stance taken by the FSA on a number of European regulatory developments, particularly Solvency 2 and hedge fund regulation.

Solvency II

We have supported the thorough way in which the FSA has engaged with the Solvency II debate and its implementation in the UK. We have been reassured that there will be consistent implementation across Europe and we will not be disadvantaged by the UK being more diligent than possibly some of the other European countries.

We accepted that a special levy on insurance companies to cover the FSA's implementation costs for Solvency II was appropriate. Moving staff across from other projects to Solvency II was not without risk for the FSA. So as well as diverting some staff internally, we recognised that the FSA will also have to recruit extra staff to cover its new responsibilities. It is vital that the FSA has the quality of staff to ensure that Solvency II is implemented effectively, and that lessons learnt in the application of Basel II are applied to Solvency II.*



Future priorities

Future of the FSA

We are pleased that the FSA has continued with planning for business as usual in the next few years. This has been despite the Conservative Party announcing plans to undertake a fundamental re-structuring of financial regulation should they win the General Election in May 2010.

After the election, we have said that we will work to assist the regulator to work effectively with the industry and government to promote financial regulation which:

- Works effectively to regulate the industry and protect consumers;
- Is able to promote a strong UK voice in Europe and internationally;
- Works to underpin the UK and London's position as a leading financial centre;
- Understands the need for regulatory clarity, particularly for larger financial services firms, whose operations spread across wholesale and retail activities.

Our main aim will be to work for an overall stability and continuity of regulation in the future. It is crucial that a clear direction for regulation is maintained in such a significant industry for the UK economy as a whole.

Panel effectiveness

At the turn of the financial year, we began a review of the Panel's effectiveness. This is likely to lead to a number of changes to the way in which the Panel operates in 2010 in order to increase further the value which the Panel is able to add to the FSA's work.

Panel Survey

Work has started on the Panel's sixth biennial survey of regulated firms in 2010, which continues to provide a vital overview of the opinion of firms. The results of this survey provide a useful indicator of the opinions of the regulated community and to give more strength to our voice in representing industry views in the development of FSA policy.

Key issues

In the next year, we will continue our focus on working with the FSA to help it to be a cost effective and strong regulator. We will particularly look at how the FSA ensures:

- High quality and cost effective supervision;
- Development of an effective conduct strategy;
- Appropriate use of Cost Benefit Analysis;
- A strong engagement with the debate and reasonable application of European and international regulatory developments.



Members of the Practitioner Panel

April 2009 – March 2010

Panel Member	Position
Iain Cornish (Chairman)	Chief Executive, Yorkshire Building Society
Richard Berliand	Head of Global Cash Equities & Prime Services, JP Morgan Securities Ltd
Simon Bolam	Principal, EH Ranson and Company
Russell Collins	Partner, Head of UK Financial Services, Deloitte LLP
Mark Hodges	Chief Executive, Aviva UK
Roger Liddell	Chief Executive, LCH.Clearnet Group Limited
Helena Morrissey	Chief Executive Officer, Newton Investment Management
Gordon Pell <i>(Panel member to December 2009)</i>	Deputy Chief Executive, Royal Bank of Scotland Group
Nick Prettejohn <i>(Panel member to November 2009)</i>	Chief Executive, UK & Europe, Prudential plc
Xavier Rolet <i>(Panel member from July 2009)</i>	CEO, London Stock Exchange Group
Andrew Ross	Chief Executive, Cazenove Capital Management Limited
Malcolm Streatfield	Chief Executive, Lighthouse Group plc
Helen Weir	Group Executive Director Retail, Lloyds Banking Group plc
Alan Yarrow	Chairman, Chartered Institute for Securities and Investment

Practitioner Panel objectives 2009-10

1. Monitor overall effect of FSA activities on the industry.
2. Assess FSA effectiveness, as seen by practitioners, against its objectives.
3. Actively communicate industry concerns to FSA.
4. Actively promote broad industry views and interests.
5. Provide practitioner view to FSA on specific regulation.
6. Promote international competitiveness of the UK markets.



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