Annual Report
2013/14

FCA
Practitioner Panel

Chairman’s foreword

This is the FCA Practitioner Panel's first report on the FCA's first year in operation. There is no doubt that the twin peaks approach to regulation and the FCA's role has raised the profile and importance of conduct regulation and, in particular, consumer outcomes within the financial services industry and more broadly in political circles and with industry commentators. This is good and coincides with a desire and intent by the industry to rebuild trust and confidence following the aftermath of the financial crisis and the mis-selling scandals of the last few years.

The FCA has made good progress against the delivery of its statutory objectives. The latest annual survey of industry views and perceptions shows a year on year improvement across most metrics and an increased confidence that the FCA can fulfil its objectives. The findings of the survey are available in a separate report on the Panel's website – www.fs-pp.org.uk.

It is also the first year following the implementation of a major piece of regulatory change affecting the sale of investment products; namely the Retail Distribution Review (RDR). The implementation also gave rise to a revision of the rewards and remuneration structure for the distribution of investment products. The impact of RDR is still playing out and a post implementation review is scheduled for the end of 2014. Immediate observations are that whilst there has been an improvement in transparency of charges, and in some cases a simplification of process, we have seen more complexity and fragmentation of charges and a reduction in capacity and services across some sectors of the market, which could ultimately lead to an advice gap.

There remains an industry concern about the type of advice available for consumers. Most practitioners have opted to offer either full advice or no advice leaving no middle ground for guidance or simplified advice because of concerns about exposure to compliance driven liabilities. Equally, the boundaries of where responsibility resides, between firms and consumers is unclear, particularly where it plays out in consumer regulation. The FCA work in this area; the Expectation Gap, will provide important clarification and add insight and may help to close the 'advice gap' mentioned above.

The FCA has had to deal with some major increases in workload and remains exposed to a bandwidth challenge. It has assumed responsibility for regulation of the Consumer Credit Act from the OFT, is dealing with actions from the Parliamentary Commission on Banking Standards and is establishing a Payment Systems Regulator in addition to the agenda it started with. Having the right capacity, experience and expertise will be critical to its success and development

The communications strategy of the FCA has been called into question following publicity attaching to elements of the Business Plan in March 2014 and the consequent impact on the share price of some insurance companies. This is now subject to an independent review. The Panel has questioned the need for and nature of the proactive engagement with the media and whether this is conducive to the effective operation of the FCA and also, whether the tone of communication is balanced and does not overly emphasise enforcement action and activity.

In conclusion, a positive year dealing with some complicated issues but not without challenges. It is important for the FCA and the financial services sector that the good work is not over shadowed by the communication failing in March 2014 but equally, lessons need to be learned.

Graham Beale
Chairman, FCA Practitioner Panel

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Introduction

The FCA Practitioner Panel is a statutory Panel for the Financial Conduct Authority (FCA). It is one of a number of Panels which the FCA is required to establish and maintain under the Financial Services and Markets Act. The FCA Practitioner Panel must represent the interests of practitioners to the FCA on the extent to which its general policies and practices are consistent with its general duties.

The Panel meets on a monthly basis to provide senior level industry input into the FCA, with membership selected to reflect the major sectors of the UK financial services industry. We focus predominantly on issues with a strategic cross-sectoral impact, and provide advice and feedback directly to the FCA Board and Executive.

We have contributed our opinions to the FCA on a range of topics, and have added to the debate by commissioning independent research and conducting an annual survey of industry practitioners about their view of the regulator.

For the first year of operation of the FCA, the Panel has adopted the following priorities for its work, which provide the structure for this report:

The FCA as an effective regulator;

The strategic impact of regulation;

The balance of firm and consumer responsibility; and

The FCA's engagement with and implementation of EU rules.

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The FCA as an effective regulator

The FCA was established on 1 April 2013, with an overall strategic objective to ensure that financial markets function well and operational objectives to secure an appropriate degree of protection for consumers; protect and enhance the integrity of the UK financial system; and promote effective competition in the interests of consumers.

FCA constructive and judgement based approach

The FCA has committed to being a forward-looking and judgement based regulator.

The Panel encouraged the FCA to set out a clear long-term vision for regulation which would foster a well-functioning competitive market place for consumers and a successful, thriving industry for firms.

There have been positive examples of FCA judgement and constructive approach: dealing with potential problems with interest-only mortgages; a new FCA data strategy to reduce duplication of requests from firms and the number overall; and a reduction in the reporting burden for investment advisers.

We highlighted the wider implications from the FCA's increasing use of attestations without a formal structure. We welcome the FCA's response with a plan to centralise oversight of attestations, and to provide greater clarity on their intended use.

We expressed some concern about consistency of approach and knowledge of the industry between senior management and more junior staff on the ground. Our annual industry survey also highlights firms' concerns over the level of experience and knowledge among supervisors. To help with industry experience amongst supervisors we have supported the development of a firm-FCA secondment programme.

Value for money

The FCA is funded through levies on the industry and is required to use its resources in the most efficient and economical way. The National Audit Office (NAO) took over responsibility for auditing the financial regulators from 1 April 2014, and HM Treasury can commission Value for Money reports on the FCA and PRA. The NAO undertook its first report into the FCA and PRA this year.

We welcomed the commitment to a freeze on spending for existing work and maximum 3% increase in fees and budget to address some of the FCA's new responsibilities in the proposed budget for 2014-15. This is an encouraging moderation following a longer term growth trend, which we have highlighted previously, of double-digit percentage increases in spending by the regulator.

One of our key messages to the NAO as it carried out its first Value for Money Review of the FCA and PRA was that it must look at the costs of regulation beyond just the annual budget and industry annual funding requirement which makes up the levy. We were pleased that the NAO recorded the expense of Skilled Person Reports (s166). Although the overall number of reports has gone down, the widening of scopes has led to increases in costs, particularly for staff time and resources within firms in servicing such investigations. It is not only the formal s166 reports that add to compliance costs. There will also be times when firms feel pressure to commission additional – informal skilled person – reports, to ensure that their viewpoint has external validation or endorsement.

We have urged the FCA to consider the total cost of regulation and ensure robust cost benefit analysis is undertaken before actions are taken or new policy developed. Compliance costs are ultimately borne by consumers and can lead to a reduction in innovation and service levels, as well as a drag on the growth of the UK economy.

Success measures

In the Business Plan for 2013-14, the FCA stated that it was considering eight key success measures to represent the milestones it should achieve in the next two to three years, as driven by its statutory objectives.

The Panel has questioned the FCA on how it will measure its success, particularly as the three operational objectives can create some tension. The results of the Practitioner Panel survey of industry views showed that practitioners thought the FCA would focus the majority of its time and resources on its consumer protection objective rather than competition.

When we reviewed the FCA's proposed success measures, we encouraged the FCA to commit to positive measures indicating good consumer outcomes, rather than negative measures indicating the FCA's success: we suggested customer experiences and the building of trust as indicators of good performance, rather than the number of issues identified or the size of redress achieved. We also had some concern about the FCA using any measurement of pricing, given that it is not a pricing regulator.

Consumer credit regulation

During the 2013-14 financial year, the FCA has been preparing to take on consumer credit regulation from the OFT as directed by Government. This has required the pre-authorisation of 50,000+ new firms by 1 April 2014, and planning for a significant extension of the regulatory remit.

The Panel's main focus in the build up to 1 April 2014, has been whether the FCA would have the capacity to cope with the large number of players in this market falling within the regulatory net. It seems that the FCA has chosen a proportionate approach to regulation and has had clear management priorities for the process. However, it will also continue to be a concern that this new area, with its high public and political profile will take up significant amounts of the senior management and Board's time.

The Panel has sought to highlight any potential for unintended consequences as the FCA introduces the new regime. One specific example of this is the application of the Consumer Credit Act (CCA) to general insurance premiums paid in instalments. We urged the FCA to adopt a pragmatic approach by using the same approach as previously applied by the OFT and utilising guidance rather than rules.

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Strategic Impact of Regulation

The Panel is established under the Financial Services and Markets Act to represent the interests of practitioners on the extent to which the FCA's policies and practices are consistent with its duties. The FCA has an overarching strategic objective to ensure that relevant markets function well.

Our second priority has been the strategic impact of regulation; we believe it is important for the Panel to encourage the FCA to view their policy and supervisory decisions within their wider context. We are interested in the impact of both significant one off items of regulation, such as Mortgage Market Review, and also the cumulative impact of all regulation on individual firms and the industry as a whole. The role of Europe in fuelling the cumulative burden of regulation on UK firms is a topic we have discussed with both the FCA and HM Treasury, stressing the need for congruent regulation where possible and active engagement at the European level on behalf of the UK.

Constructive tone from FCA

The FCA has promised a more open and transparent approach to firms "where we listen to what you tell us, communicate clearly to you, and work together to identify and solve problems before they can cause damage"[1]. The FCA Business Plan for 2014-15 commits to work to determine if there is an 'expectations gap' in terms of the relationship between the FCA Handbook and firms' perceptions of it to ensure the FCA is working in the interests of consumers.

Throughout the year, we have emphasised the importance of the FCA's overall tone of voice in setting a constructive regulatory agenda. Greater awareness and transparency around expectations and developments is welcome, but communications from the regulator need to be balanced and constructive, especially when delivered directly to the press or consumers. Although we note that the FCA needs to demonstrate it is taking action and creating strong deterrence messages by highlighting bad practice, the FCA can damage public trust if it persistently talks down the industry and creates sensational headlines, albeit unintentionally. At this time, when firms are aware of the need for reform and rebuilding trust, some poorly worded messages may prove counterproductive.

[1]FCA Approach to Supervision March 2014

The pitfalls inherent in delivering messages via the media were exposed in the FCA's handling of publicity around its Business Plan on 28 March 2014. The lead up to the events and the market disruption are now subject to an independent review led by Simon Davis. The Panel has offered to assist in considering lessons learned from that review. Separately, we have expressed concern to the Board about the specific events and the broader use of proactive media engagement.

The FCA's communication directly to firms has also been an important topic of interest to us this year. We support the FCA's commitment to further development of the FCA website and electronic means of communication, and have facilitated input to the review of the FCA website. Our annual industry survey also highlights strong support for the FCA's more collaborative and constructive approach and general improvement in the quality of communication.

The Panel provided examples and urged greater clarity and consistency in rulemaking, and their interpretation by the FCA. The FCA has initiated work to address the 'expectations gap' – ie, the gap between what the FCA expects in terms of compliance and what firms think the FCA expects of firms.

Enforcement as credible deterrence

The FCA states that credible deterrence is central to its enforcement approach, in order to show there are meaningful consequences for firms and individuals who do not play by the rules. In the Financial Services Act 2012, the Government gave the FCA new powers to publish warning notices, and so make enforcement action public at an earlier stage than previously. The FCA consulted on its approach to the new powers during 2013, and published its plans in October 2013.

The Panel agrees that regulated firms should be expected to comply with the regulatory requirements, and those who clearly do not meet the standards required should be subject to enforcement action. We have welcomed renewed evaluation by the FCA of how enforcement can be most effective, including promotion of the credible deterrence message. Our view that major firms watch and learn from enforcement action in their sectors was reinforced in the results of the 2014 industry survey. This showed that all very large (C1) institutions and 77% of large (C1 and C2) institutions were fully aware of relevant enforcement action and took appropriate action.

We expressed our concern about the wider impact of the FCA's new power to publicise enforcement warning notices. We emphasised that there is a delicate balance between the need to be transparent and the undermining of trust in individual firms and the industry more generally.

Competition and market studies

The FCA has an operational objective to promote effective competition in the interests of consumers, which contributes to its strategic aim of making markets work well. The FCA expects to use market studies as the main tool for examining competition issues in the markets it regulates. In the first year, the FCA commenced market studies into cash savings, retirement income, and general insurance add-ons.

We were disappointed that we were not given the opportunity to provide context and understanding on the selection of areas for investigation before commencement of the market studies. Particularly, we felt that it was the wrong time to look at the cash savings market, as currently the market is affected by a host of unique and potentially distorting influences including 300-year low interest rates, the funding for lending scheme, Quantitative Easing and a structural recalibration of liquidity following the financial crisis.

Nevertheless, we provided some input into the scope of the market studies once they were announced. We warned the FCA against too much focus on price. For instance in the cash-savings study the quality and reputation of an institution can be equally influential.

We have also encouraged the FCA to take a broad perspective on its approach to competition, including considering the impact of regulation and the FCA's own actions on competition.

UK Banking Standards

The Parliamentary Commission on Banking Standards (PCBS) was established to review standards in banking and published its report 'Changing Banking for Good' in June 2013. The report made a large number of recommendations, many of which were to be carried out by the FCA. The FCA published its initial response to the PCBS report in October 2013, which set out next steps for its implementation of the recommendations. As a result of other PCBS recommendations, Sir Richard Lambert led the Banking Standards Review in early 2014 which aims to create a new organisation to help raise standards of competence and behaviour among bankers doing business in the UK.

We emphasised to the FCA that there must be proportionality in the approach and consideration of the individual and cumulative effects of the many PCBS recommendations. The measures could be damaging to the industry if a 'blame culture' and potential criminal liability put off the 'best and brightest' from joining the industry. We advocated a constructive and yet proportionate approach and suggested that senior managers' responsibilities might be fairer if applied broadly across all industry sectors, not just banking.

We support the work of Sir Richard Lambert on the new Banking Standards body. We believe it is a positive step towards improving trust and confidence in the financial services industry and that there is an opportunity to align with the FCA's objectives.

Impact of regulation on the financial advice market

The FSA initiated the Retail Distribution Review, which introduced major changes to financial advice in the retail investment market and came into effect at the beginning of 2013. The FCA has committed to undertake a post-implementation review of the RDR by the end of 2014.

The Panel has registered concern about the implications of the fall in the number of advisers at large high-street banking institutions, and financial advisers overall as the RDR came into effect. This is a risk of an 'advice gap' with some customers unable or disinclined to receive appropriate advice.

We have taken a particular interest in the FCA's review into simplified advice and the non-advised market in retail investments. Our research into consumer responsibility indicated that there is demand for guidance or 'nudges' to show consumers what sorts of products they should be investing in. The FCA has been receptive to this concern and has initiated a review of the role of simplified advice.

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Balance of Firm and Consumer Responsibility

In addition to its statutory objectives, the FCA is subject to eight Regulatory Principles which are also set out in the Financial Services and Markets Act. One of these is 'the general principle that consumers should take responsibility for their decisions'. The FCA has not as yet defined clearly how it will apply this principle in its overall approach.

The Panel believes that consumer protection should not translate to mean firms taking responsibility for all implications of any consumer decision. However, it recognises the difficulties in defining where the boundaries lie between what a firm is responsible for and what a consumer is responsible for.

Consumer responsibility report

The FCA has not as yet published any formal position on consumer responsibility, although as a result of conversations with the Practitioner Panel, the concept of the balance of firm and consumer responsibility was encompassed in the FCA's plans to consider whether there is an expectations gap between firms and the regulator. Further work is expected on this during 2014.

To assist our understanding of firms' and consumers' positions with regard to consumer responsibility and ways in which thinking can develop, we commissioned independent research between March and July 2013. This looked at current perceptions of consumer responsibility amongst consumers and firms, and probed the reasons for these views. Our assumption had been that there were gaps between the responsibilities that firms on one side, and consumers on the other, would be prepared to accept. However, the research showed common ground, with consumers and firms agreeing what both parties' respective responsibilities should be.

However, the research also identified a number of reasons why many firms and consumers feel it is difficult to engage fully with their respective responsibilities. Examples from consumers include the complexity of disclosure documents, oversupply of information (including terms and conditions), the use of technology services preventing some consumers engaging effectively and a lack of effective help, guidance and advice.

We have published the results of the research and discussed them with the FCA. We look forward to seeing the research contribute to the FCA's expectations gap work, and for further clarification on the FCA's position on consumer responsibility in the coming year.

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FCA Engagement with and Implementation of EU Rules

An increasingly large amount of the UK rulebook and policy is now initiated at EU level, and the FCA must implement European requirements. With less direct accountability of the EU institutions to UK firms and consumers, it is down to the FCA to ensure it engages effectively to reach the right outcomes which will work in the UK market and its specificities, as well as across the EU.

The Panel has been keen to review how the FCA engages in the European process and implements EU requirements domestically, to create an environment in which UK financial services companies can thrive.

FCA engagement with the EU and international standard setters

The FCA is required to implement, supervise and enforce EU and international standards and regulations in the UK. It is also committed to contributing to international debates and policy making processes to help to embed its key aims of protecting consumers and maintaining market integrity, into international regulation.

Our concern continues to be that creation of financial services legislation is becoming ever more political in nature and some proposals achieve populist aims at the expense of getting a sensible regime which provides the best overall outcomes for UK consumers. In some specific dossiers, we have discussed the successes that the UK has been able to achieve, as well as the less desirable outcomes. For instance, we were pleased to hear that the EU Directive on Mortgages aligned with many of the proposals the UK had already put in place via its mortgage market review (MMR). However, the Mortgages Directive will require firms to make disclosures to consumers in a form which is less clear and helpful than is currently required under the FCA's own rules. Although the FCA will be unable to win every debate, we hope to see continuing efforts to reach the best results in all European-level discussions.

We have also urged the FCA to ensure that it has a clear strategy and commitment to proactive engagement in the European theatre given the increasing influence of Europe on the financial conduct agenda. It is important that the FCA recognises its role as a leader in this area and looks to shape the debate to ensure European regulation is not unduly onerous on UK firms, but also that it does not contradict existing UK regulation.

HMT Balance of competences on financial services

HM Treasury published a Call for Evidence in October 2013 on the balance of competences between the UK and the EU on financial services and the free movement of capital in the Single Market. The consultation closed in January 2014 and the review is due to provide an analysis of what the UK's membership of the EU means for the UK national interest.

The Panel submitted evidence to the Treasury review, in which we recognised the benefits of EU membership for the UK economy, but gave our views on some of the potential issues that arise from rules being created at EU-level.

In general, we were supportive of high-quality regulation whether created at EU level or domestically, provided it is effective, proportionate, and designed to balance the competing objectives of financial stability, growth, consumer protection and a competitive market. We commented that there is a place for both EU and domestic rules, and particularly highlighted our concern that retail consumers are not homogeneous across the EU, and some rules should be left to national level to achieve the best outcome. We also reported a certain amount of 'change fatigue' within financial services firms because of the vast amount of reform emanating from Brussels in a relatively short space of time.

Members of FCA Practitioner Panel
1 April 2013 – 31 March 2014

Graham Beale
(Chairman)
Chief Executive, Nationwide Building Society

John Pollock
Deputy Chairman (from 1.2.14)
Chief Executive, Legal & General Assurance Society

David Bellamy
CEO, St. James's Place PLC
Member from 1.5.13

Alison Brittain
Group Director of Retail, Lloyds Banking Group

Peter Crook
Chief Executive, Provident Financial plc
Member from 1.1.14

Michael Dobson
Chief Executive, Schroders

Paul Geddes
Chief Executive Officer, Direct Line Group

Mark Harding
Group General Counsel, Barclays Group
Member until 31.12.13

John Hitchins
Global Chief Accountant and Financial Services Partner, PwC

Mark Ibbotson
Group Chief Executive Officer, G.H. Financials
Member until 31.10.13

Stephen Jones
Chief Financial Officer,
Executive Director, Santander UK plc
Member from 1.8.13

Alexander Justham
Chief Executive Officer,
London Stock Exchange plc
Member until 31.12.13

Helena Morrissey CBE
Chief Executive Officer,
Newton Investment Management
Member until 31.10.13

Anne Richards
Chief Investment Officer,
Head of EMEA and Executive Director,
Aberdeen Asset Management Plc
Member from 1.11.13

Antonio Simoes
Chief Executive UK, HSBC Bank plc
Member from 1.7.13

Malcolm Streatfield
Chief Executive, Lighthouse Group plc

Paul Swann
President and Managing Director,
ICE Clear Europe
[Markets Practitioner Panel Chairman]

Andrew Turberville Smith
Finance Director and Chief Operating Officer Weatherbys
[Smaller Business Practitioner Panel Chairman]

Practitioner Panel
The FCA Practitioner Panel
25 The North Colonnade
Canary Wharf
London E14 5HS
Tel: +44 (0)20 7066 1000
Email: fs-pp@fca.org.uk
Website: www.fs-pp.org.uk

FCA
Practitioner Panel