

THE FINANCIAL SERVICES
PRACTITIONER FORUM
ANNUAL REPORT

1999

This document contains the first Annual Report
of the Practitioner Forum.

It describes a busy and productive year.

At the end of a year with more activity than any
of us expected at the outset I would like to take
this opportunity to thank the members of the
Forum for their willing support to me in getting
this initiative off to a good start.

David Challen
CHAIRMAN

JANUARY 2000

PART I: THE FORUM'S FIRST YEAR

INTRODUCTION

This is the first Annual Report of the Practitioner Forum.

The Practitioner Forum was set up just over a year ago by the FSA. In deciding to establish the Forum, the FSA aimed to create a high-level body to which it could turn for opinions on key issues having an impact on regulated firms. The idea that such a body had an important place in the regulatory framework and could play a part in ensuring the accountability of the FSA to the industry was taken up by the Government. In the Financial Services and Markets Bill it is given statutory force and described as the Practitioner Panel – a name to which we shall move when the Bill is enacted.

MEMBERSHIP

The membership of the Forum (shown in the Appendix) is drawn from nominations made by various trade associations representing financial services businesses. This ensures that different angles are considered in the formation of our collective view.

THE ROLE OF THE PRACTITIONER FORUM

The terms of reference of the Practitioner Forum are to help the FSA carry out its objectives and to ensure that it takes proper account of considerations set out in legislation. These are broadly designed to ensure that regulation is efficient, is not needlessly burdensome, allows the financial services industry to be innovative and competitive and allows it to maintain the position of the United Kingdom in the international market for financial services.

The members of the Practitioner Forum expect it to have four principal functions:

- to monitor the FSA's effectiveness as seen by the industry
- to communicate to the FSA issues of general concern to regulated businesses about regulation in practice
- to respond when requested to by the FSA with a practitioner view on key regulatory issues and
- to contribute a broad financial industry view on the formulation of FSA policy and on the response the FSA proposes to make to representations it has received during any formal consultation process.

The role of the Practitioner Forum should not be confused with the extremely important role played by the various trade associations in representing the interests of their members. These interests need to be advanced and vigorously promoted by such associations, which are generally staffed to do so. To play a constructive role on behalf of the regulated industries, the Practitioner Forum must act as an interpreter between the industries and the FSA, able to offer a dispassionate but forceful industry view on issues of particular importance to regulated firms, while recognising that the FSA's duties also require it to take account of other points of view. We will achieve most through a low profile exercise of influence at a senior level, designed to steer the FSA towards regulation which is effective but not intrusive and which gains the willing assent of those regulated.

The Practitioner Forum has no staff and has requested no budget from the FSA. Ad hoc expenditure (such as the cost of the survey of firms conducted this year) is agreed with and paid for by the FSA. Since the costs of the FSA are ultimately paid by the regulated businesses we believe this is the right approach for the time being. As we gain practical experience we shall keep under review whether we can continue to operate in this way and be fully effective. To do so requires the generous support of the employers of the members of the Forum, which we should like to take this opportunity to acknowledge. In addition we should like to acknowledge the administrative assistance we have had throughout the year from the FSA Secretariat.

ACCESS TO THE FSA

We have access to the Chairman of the FSA and, through him, to the Board whenever we need it. The Chairmen of the FSA and the Forum meet regularly about six times a year to review issues of current importance. These meetings provide the opportunity to raise for the attention of the Chairman of the FSA matters which the Forum members consider to be significant. In addition, of course, there is frequent ad hoc contact. We aim to meet the Board regularly once a year to present our views on selected topics.

We regularly receive presentations from senior FSA executives about their areas of responsibility, particularly in relation to policy developments on which they are seeking our initial views before going to wider consultation.

The relationship now established between the Forum and the FSA is open and responsive and we feel that this bodes well for the kind of positive contribution we aim to make to the development of financial regulation in the United Kingdom.

ACTIVITIES OF THE FORUM DURING THE YEAR

We have met monthly and been engaged in addition in regular consultation together on issues arising which require prompt attention. Some of our work has been led by sub-groups working up our ideas for subsequent consideration by the full Forum.

Our activities can best be described under the following headings:

(a) The Financial Services and Markets Bill

We have kept a close watch on the progress of the Bill in Parliament. We gave evidence to the Joint Committee before it completed its report on the Bill particularly in relation to the issue of the accountability of the FSA. We felt that the Joint Committee's report achieved a great deal in proposing a reshaping of the Bill to take account of the real objections which were raised against it in its earlier form.

We have been unsuccessful to date in persuading the Treasury to adopt two recommendations which appeared in the Joint Committee's report but which it rejected. The first relates to the statutory immunity to be granted to the FSA. We feel that if this is to be accepted the FSA should be liable to have compensation awarded against it if, through the negligent use of its powers, it causes damage to an individual or firm which it regulates. So far the Treasury has refused to concede this point and has argued that the FSA is free to adopt a policy of making *ex gratia* payments in such cases, which seems to us a very weak form of reassurance.

The second issue on which we have been unsuccessful relates to the formal accountability of the FSA to the Practitioner Panel – a point we have raised not because of any fear that under the present management of the FSA this is likely to be a difficulty but because the arrangements made in the Act must work in different times and with different people. We have argued that the FSA should be required to give its reasons to the Practitioner Panel if it decides to ignore formal guidance offered by the Panel. In the absence of this requirement we feel it would be possible for a future administration to side-line the Panel and make it difficult for the Panel to assert its viewpoint.

We are disappointed that the Treasury, which endorsed the formation of the Forum to be a vehicle for the expression of industry views, has not yet accepted what seem to us to be two relatively straight-forward points.

(b) Consultation

As everyone in the industry is only too well aware, the FSA has an enormous task to formulate policy in key areas, with due consultation, before it takes on its full responsibilities following the enactment of the Bill. This process imposes also a heavy burden on the regulated businesses and the trade associations which represent them if proper consideration is to be given to matters which could have a profound influence on the way the businesses operate in future.

We felt it was necessary to be quite clear about what could be expected of the Forum in this process, since we are neither qualified nor equipped to proffer comprehensive views on all the issues under consideration. We have established, therefore, the following procedure with the FSA. First, we expect to be informed and consulted as the FSA develops its broad policy approach towards matters which will become subject to detailed public consultation. Second, we aim to review the key features of draft consultation papers before their publication to help the FSA avoid suggestions which would be unworkable and which would be dismissed by the industry. We then intend to provide no formal detailed comments during the consultation period, believing that the right people to provide this input are the trade associations and individual

firms. Finally, however, we expect to be given by the FSA at the end of the consultation period a synthesis of the key issues which have arisen and to be told how it proposes to address these issues. This should give us an opportunity to comment if we feel the FSA is giving insufficient weight to points raised by the industry during consultation.

This is the process which we now apply to consultation, although when the Forum first came into existence it had to address issues for the first time on which consultation was already in progress or had even been completed.

Issues on which we feel our input has had a material influence on the direction of the FSA's policy include

- the regulation of approved persons
- the approach to consumer education
- principles for businesses
- senior management responsibilities
- comparative information
- the price of retail investing in the UK.

(c) Survey of industry views

When the Forum was established it was envisaged by the FSA that independent surveys of industry opinion would be an important source of information to the Forum and thus to the FSA. While the regulatory regime is in transition there is inevitably a good deal of uncertainty about how it will eventually settle down. This is particularly the case while the SROs retain responsibility for regulation even though much of their work is outsourced to the FSA.

The fact that we are in this transitional state could have led to a decision to defer research but we felt that it was desirable to begin the process of benchmarking industry opinion as early as possible even if it was necessary to interpret the results of opinion research conducted at this stage with care, particularly as it relates to individual regulators. Consequently we undertook a survey with the assistance of BMRB International whom we appointed after a competition amongst leading independent research firms.

While the results of a single survey are of considerable interest we feel the real value of this exercise has been to establish a benchmark from which future change can be measured in subsequent comparable surveys. We are cautious about drawing conclusions from absolute measures of opinion since there is clearly a maximum score practically achievable in surveys of this type well below the theoretical maximum. In our view, comparisons between measures and between regulators on the same measure provide better quality information (subject to the caveat about confusion existing amongst respondents during this transitional phase, as discussed in the report). In the future the trends observable in a series of such surveys will be the most valuable information of all.

The results of the survey are summarised in Part II of this report and the full report by BMRB can be accessed on the FSA's website (www.fsa.gov.uk/practitioner.htm).

It is our intention to repeat this type of survey periodically to measure the extent to which regulation is moving in a direction desired by the regulated businesses and to give early warning of unwelcome trends.

The response level we achieved from the industry was very high, demonstrating firms' eagerness to have their views heard. We would like to take this opportunity to thank all those who participated in the survey.

We would also like to acknowledge the support of the FSA in conducting this study. We feel it is very much to the credit of the FSA that we should have been encouraged by them to undertake work which was never likely to elicit a wholly favourable reaction. It suggests an openness to industry opinion and a willingness to be judged over time, at least in part, by trends in industry attitudes to regulation in practice which is most encouraging. In addition to their moral support for the survey we received a great deal of practical help from the FSA team in bringing it to a conclusion.

(d) Contact with Consumer Panel

It is in the interest of regulated businesses that the system of regulation commands confidence among the industry's customers. We have therefore established informal contacts with the Consumer Panel to identify areas where we have a common point of view and to ensure that if issues arise in future which have the potential to divide us they can be freely discussed.

(e) Other

A number of other matters received our attention during the year.

We maintained a watching brief on the way in which Phase 2 of the pension mis-selling programme has worked in practice, especially through our insurance company representatives.

We have established a sub-group comprising Martin Ritchley and Amelia Fawcett to assist the FSA to determine a practical approach to secondment from the industry to the FSA. We feel it would be strongly in the interests of the industry to provide secondees from time to time provided appropriate safeguards can be established.

We have commented on work being undertaken within the FSA to establish ways of measuring the costs of retail investment products.

We contributed views on how the issue of competition raised in the Cruickshank Interim Report would best be handled.

We alerted the FSA to the risk that its early approach to publishing its views of the industry's preparedness to deal with the millennium bug could lead to an unnecessary loss of confidence. The FSA has willingly taken our comments into account in its subsequent pronouncements which have described a reassuring picture of compliance.

We received a presentation from the FSA's finance director of the budget for the year ending 31 March, 2000. Now that the Practitioner Forum is established we expect to receive information about the proposed budget each year before it is finalised so that we can begin to assess the efficiency with which the FSA is undertaking its responsibilities.

CONCLUSION

This has been a busy year for the Forum. We feel we have made good progress in establishing a working relationship with the FSA executive team which is constructive and responsive.

This is a difficult period for the FSA. It does not yet have the full responsibility and authority which the Bill will give it when it is enacted. Furthermore, the management are trying to bring together a team of people drawn from regulators with different traditions. They have a mammoth task in establishing a coherent framework of regulations which will deliver the integrated, consistent and fair regulatory environment which, if it can be achieved, could be a real advantage for the United Kingdom as a financial centre. The industry has shown itself willing to do its part – despite the large calls on the time of key people in regulated businesses. An important role for the Forum is to encourage the FSA to establish a strong and consistent tradition for approaching different regulatory challenges in a manner which is effective, but is also measured and in proportion to the real regulatory need.

To be fully effective on behalf of the industry we need to be made aware of key issues of concern to regulated businesses. Some of these will be best pursued through other channels, but wherever we feel there is a significant matter on which our involvement could be productive, we shall be happy to take it up with the FSA. The addresses and contact numbers of the members of the Forum appear in the Appendix.

PART II: SUMMARY OF RESULTS FROM SURVEY OF INDUSTRY VIEWS

INTRODUCTION

The survey was conducted to establish a benchmark of industry opinion of regulation. All types of businesses which are directly regulated were surveyed and, as this is a time of transition, when the FSA has not yet taken over full responsibility for regulation, opinions were obtained based on experience of regulation by the FSA, the Personal Investment Authority (PIA), the Investment Management Regulatory Organisation (IMRO), the Securities and Futures Authority (SFA), the Building Societies Commission (BSC), the Friendly Societies Commission (FSC) and the Treasury.

HOW THE SURVEY WAS CONDUCTED

The appointed research agency, BMRB International, initially conducted a series of in-depth interviews to identify the issues of particular importance to those interviewed. A postal questionnaire was designed in the light of the information thus gained and also reflecting the objectives of the FSA as defined in the Financial Services and Markets Bill and the principles which the Bill proposes the FSA should observe. The full questionnaire was sent to Heads of Compliance while a shorter version was sent to Chief Executives.

All directly regulated firms were included in the survey except in the case of IFA firms with less than ten employees where a random sample of one in three firms was selected. Most firms were sent both versions of the questionnaire, for separate completion by the chief executive and the senior person responsible for compliance. Friendly Societies, firms previously regulated by the Insurance Brokers Registration Council (IBRC) and small IFAs were only sent the compliance version of the questionnaire. Only one contact was listed for these firms on the FSA databases, and it was felt that in these smaller organisations there was unlikely to be a separate person responsible for compliance. The results for these small organisations – four fifths of which were small IFA firms – have been analysed separately.

The survey results are based on an achieved sample of 1,440 Chief Executives (CEOs), 1,565 Heads of Compliance (HOCs) and 990 Small Organisations (SOs). Because the databases currently available to the FSA do not permit the elimination of duplication the exact percentage response cannot be calculated but it lies in the 58-69 per cent range. This represents a very high response rate for surveys of this kind, reflecting the importance regulated businesses attach to making their views known.

The survey was conducted in August 1999 and results relating to legislative proposals reflect the state of the Financial Services and Markets Bill at that time. It has since been significantly amended.

At the time that the survey was carried out, the FSA had taken over full responsibility for supervising firms from the Bank of England. It also had interim responsibility for some firms previously regulated by the IBRC, while they were waiting for authorisation by the PIA. The other regulators meanwhile retained their separate responsibilities, and will continue to do so until the Financial Services & Markets Bill comes into force. At the time of the survey, therefore, all firms except banks and a small number of ex-IBRC firms were still being regulated under the existing arrangements.

However, by early in 1999, staff formerly employed by the Bank of England, the SROs (IMRO, PIA and SFA), the SIB, the RFS and HM Treasury's Insurance Directorate had already transferred to new contracts of employment with the FSA, operating under a single management structure. Under contracts agreed with the FSA, these FSA staff have been providing services to the other regulators to enable them to continue to carry out their responsibilities during the transitional period.

This situation is likely to have led to some understandable confusion among regulated firms, with some firms believing that they were already regulated by the FSA, when formally they were still regulated by one of the existing regulators.

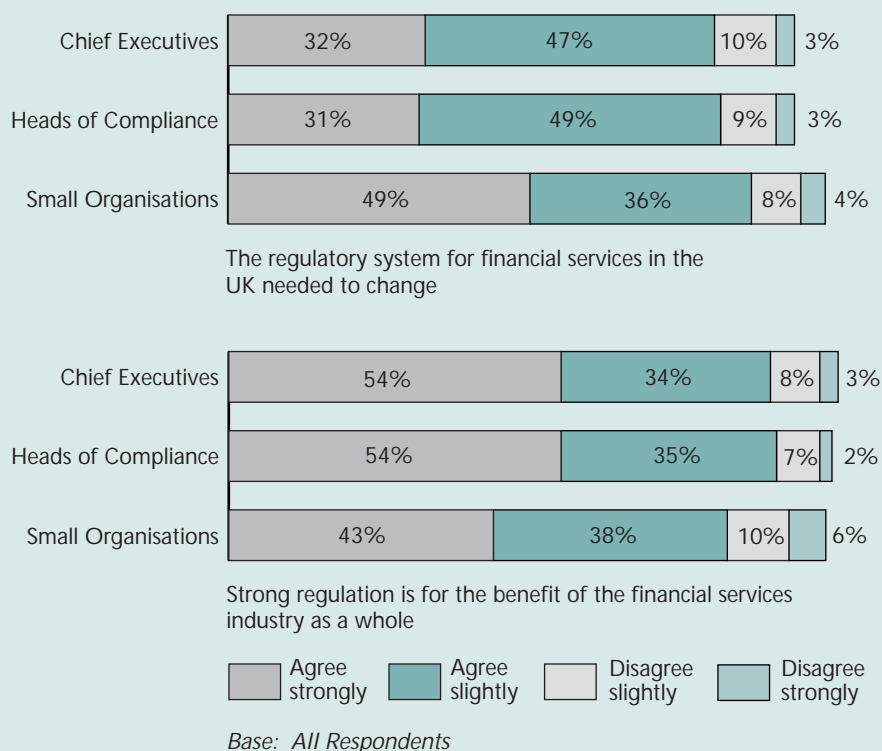
What follows is the Summary and Conclusions section of BMRB's report. Those who wish to read the full report can access it through the FSA's website (www.fsa.gov.uk/practitioner.htm).

SUMMARY AND CONCLUSIONS

I GENERAL ATTITUDES TO REGULATION

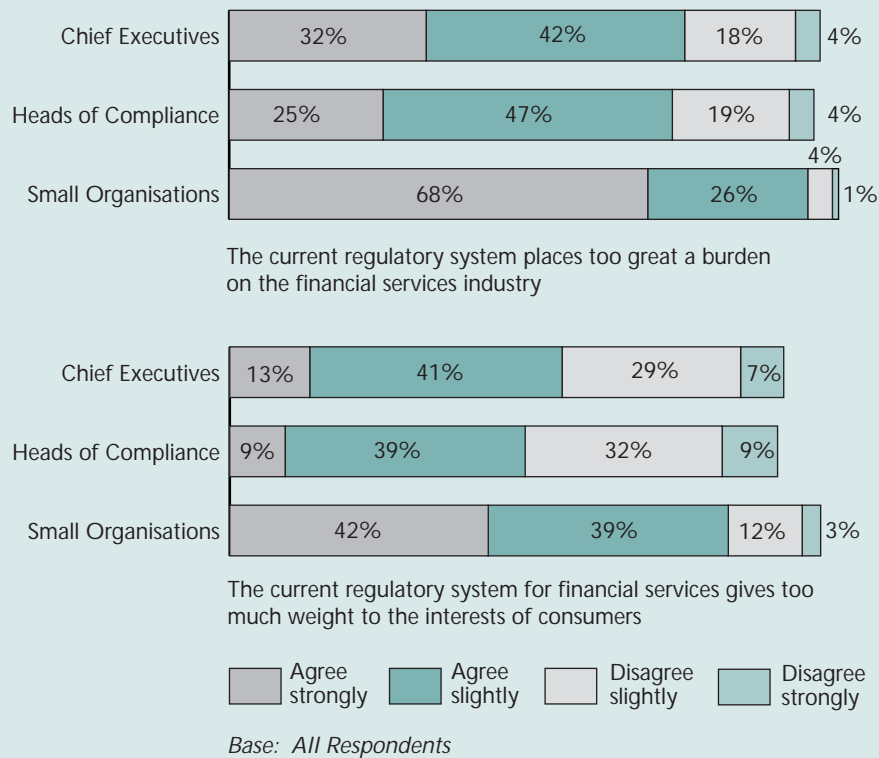
There was strong support among all sectors of the financial services industry for the principle of strong regulation. More than eight in ten practitioners thought this was for the benefit of the industry as a whole, and a similar number agreed that the regulatory system in the UK needed to change. The need for change was advocated most strongly by small IFAs, life/pensions firms and complex groups providing a range of different products, and received least support from building societies.

Chart 1: General attitudes towards regulation 1



Three out of four practitioners – over nine in ten in small organisations – believed that the current system places too great a burden on the industry, and more agreed than disagreed that it gives too much weight to the interests of consumers. Strong views about the burden of regulation, and about the undue weight given to consumer interests, were most prevalent among IFAs and compliance heads in firms providing life assurance and pensions.

Chart 2: General attitudes towards regulation 2



2 REQUIREMENTS FROM A REGULATOR

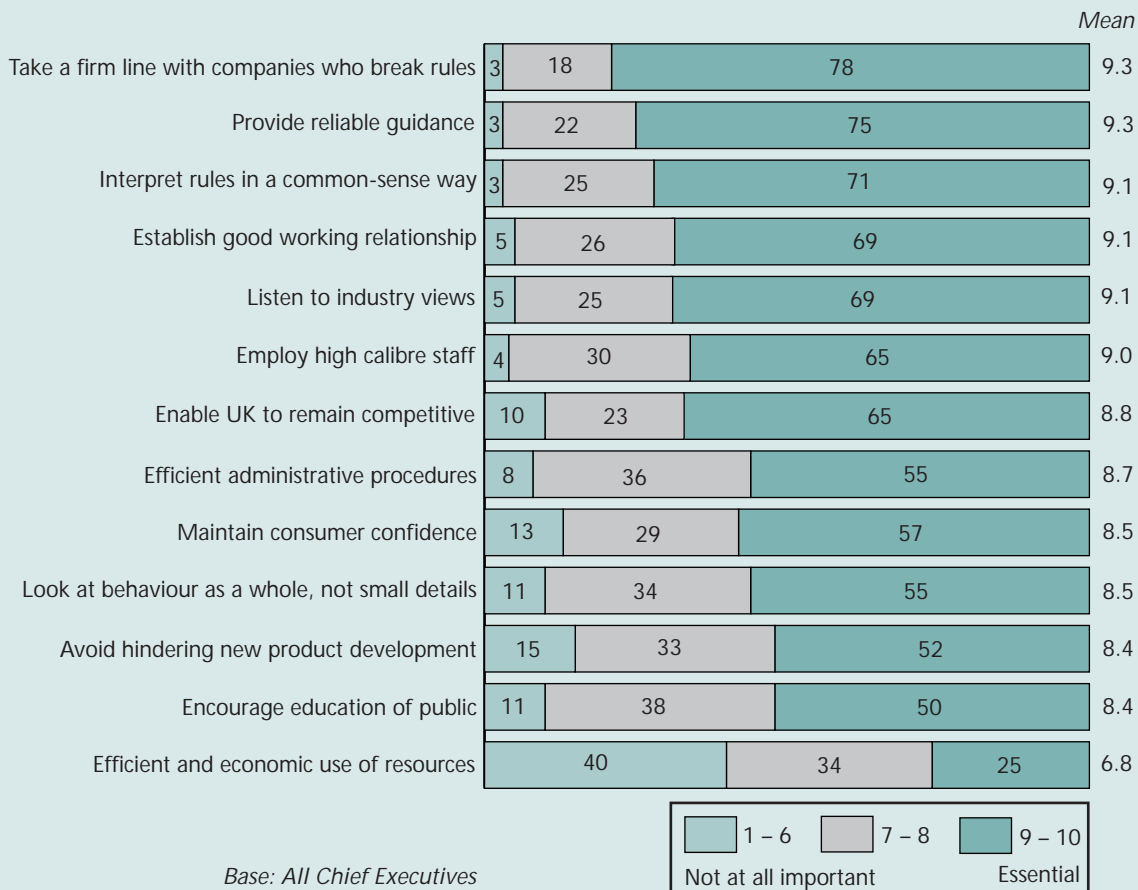
Twelve out of thirteen different criteria were all seen as very important by practitioners, for evaluating the effectiveness of a regulator. Two aspects of the regulatory role stood out as particularly important – taking a firm line with businesses which persistently broke the rules, and providing reliable guidance when needed. Also near the top of the list were: interpreting rules in a flexible, common-sense way; establishing a good working relationship with regulated firms; listening to industry views when deciding policies and procedures; and employing high calibre, well-trained staff.

Slightly lower in overall ranking but still all very important to practitioners were: enabling the UK to remain competitive as an international financial centre; having efficient administrative procedures; maintaining consumer confidence in financial products and services; looking at the behaviour of the business as a whole rather than focusing on small details; not hindering the development of new financial products and services; and being efficient and economic in use of its own resources.

Encouraging the education of the public about financial products and services was seen as the least important of the different criteria which practitioners were asked to consider.

There was a high level of consistency between chief executives and compliance heads, and across different industry sectors, in the importance that practitioners attached to different criteria. Among small organisations, greater emphasis was placed on interpreting rules in a flexible, common-sense way and on being economic with resources.

Chart 3: Most important criteria for evaluating regulator – Chief Executives



3 EFFECTIVENESS OF CURRENT REGULATOR

Practitioners were also asked to rate the effectiveness of their current regulator, on each of the same criteria, by allocating a score from 1 to 10 with high numbers indicating a high level of performance. Average scores for most criteria ranged between 5 and 7 (4 and 7 in the case of small organisations), suggesting that most practitioners judged their regulator’s performance as average rather than good. Building societies and firms whose main area of operation was banking or general insurance tended to give the highest ratings, and IFAs and life/pensions firms almost invariably gave the lowest. The ratings given by chief executives and compliance heads were very similar (average of mean scores across all 13 criteria 6.1 and 6.2), but those given by small organisations – predominantly small IFAs – were much lower (average of mean scores 4.8). Small organisations gave particularly low scores to their regulators for interpreting rules in a common-sense way and looking at the behaviour of the business as a whole.

For both chief executives and compliance heads, the attribute which was judged to be most important for a regulator – taking a firm line with persistent offenders – achieved the highest performance rating, while consumer education, which was seen as the least important, achieved the lowest. The largest gaps between importance and performance scores – and therefore the biggest shortfall between expectation and

delivery – were for interpreting rules in a flexible, common-sense way, providing reliable guidance, listening to industry views and enabling the UK to remain competitive.

Chart 4: Importance vs performance – Chief Executives

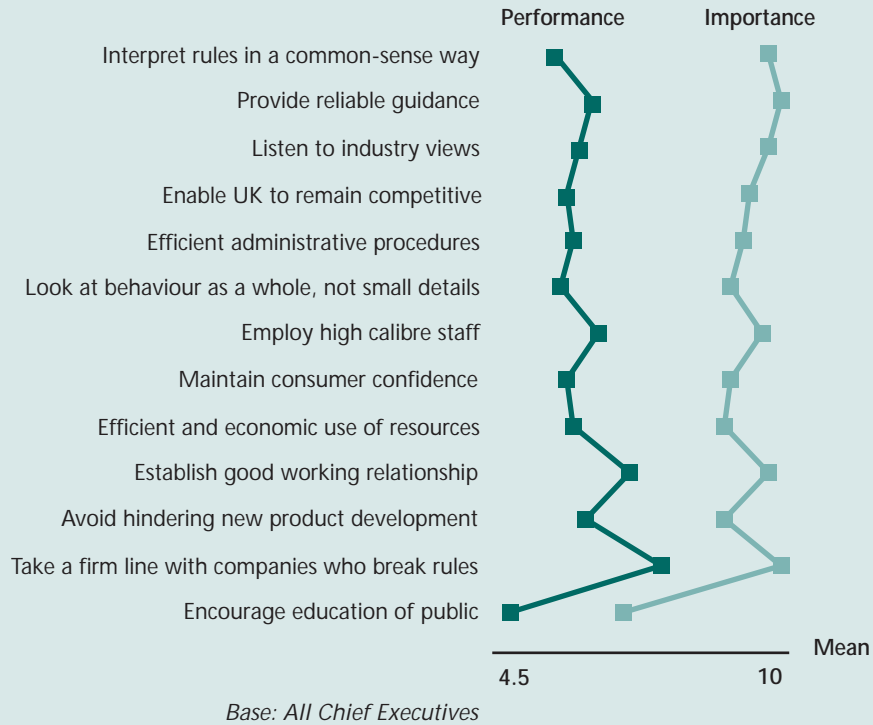
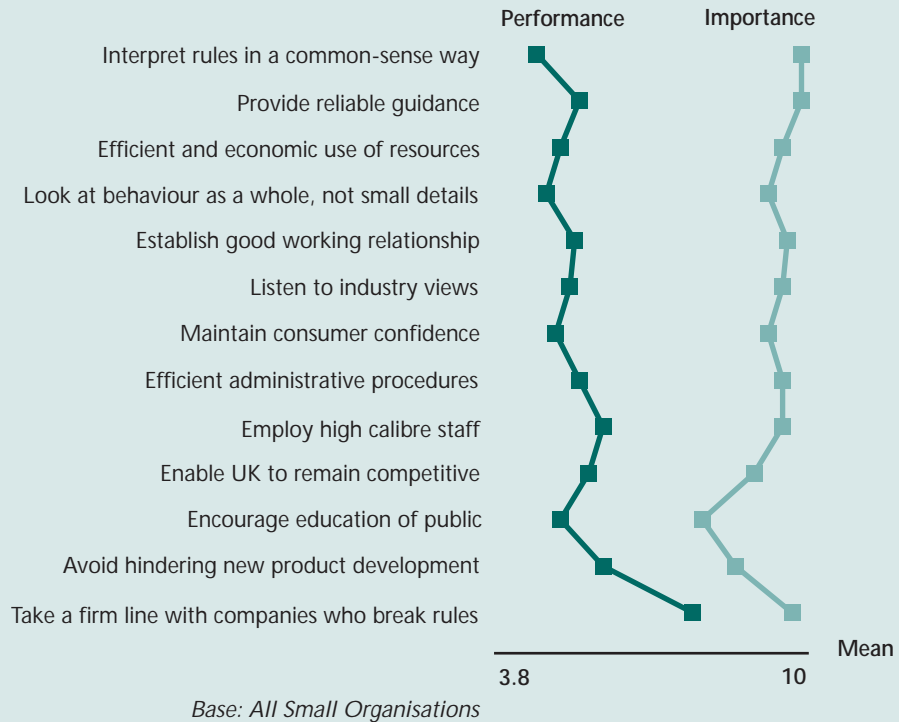


Chart 5: Importance vs performance – Small Organisations



There are some interesting differences between the ratings given to individual regulators:

The PIA stands out as having received consistently lower performance ratings than other regulators from all three groups. The firms which regarded the PIA as their main regulator were primarily IFAs and life/pensions firms.

IMRO and the SFA were given broadly similar performance ratings by both chief executives and compliance heads, with IMRO scores lagging slightly behind on some dimensions. In most cases scores were lower than for all other regulators except the PIA. Those rating IMRO nearly all stated their main area of business as investment management; most firms who saw their main regulator as the SFA were in the securities and derivatives business, but there were also some whose main business was investment banking or investment management.

With few exceptions the BSC consistently received the highest performance ratings. The FSC's ratings were better than those for the PIA, IMRO and SFA, but lower than those given to the BSC.

The Treasury was rated highly on some criteria – establishing a good relationship, providing reliable guidance – but badly on others, especially taking a firm line with businesses which break the rules, maintaining consumer confidence and encouraging consumer education. The majority of firms which regarded the Treasury as their main regulator were offering general insurance products, the remainder were in the life/pensions business.

Both chief executives and compliance heads rated the FSA as equal or superior in performance to all regulators except the BSC for listening to industry views and employing high calibre staff. Among chief executives, it received higher ratings than any other regulator for enabling the UK to remain competitive internationally and encouraging consumer education. For nearly all criteria, ratings were higher than for IMRO and the SFA. These ratings came primarily from firms whose business was banking or general insurance.

Among the small organisations which regarded the FSA as their main regulator – mainly IFAs and those offering insurance or life/pensions products – ratings were uniformly poor, on a par with those given to the PIA. Ratings were particularly poor for interpreting rules in a common-sense way, looking at the behaviour of the business as a whole, and maintaining consumer confidence. The latter may refer to the FSA's role in publicising the pensions mis-selling review.

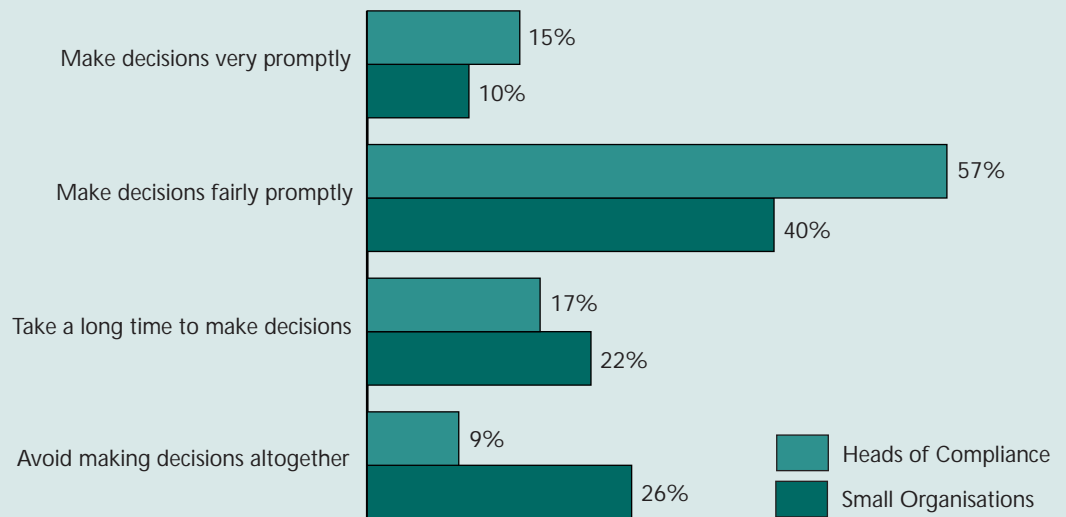
As already noted, during the transitional period there is clearly some confusion about the responsibilities of the FSA for regulation, because FSA staff are working under contract to the existing regulators.

5 PROVISION OF GUIDANCE

Three quarters of compliance heads and half of small organisations which had sought guidance felt that their current regulator made decisions promptly, although

most described this as ‘fairly promptly’ rather than ‘very promptly’. One in five indicated that their regulator took a long time to make decisions. A quarter of small organisations but only one in ten compliance heads claimed that they avoided making decisions altogether.

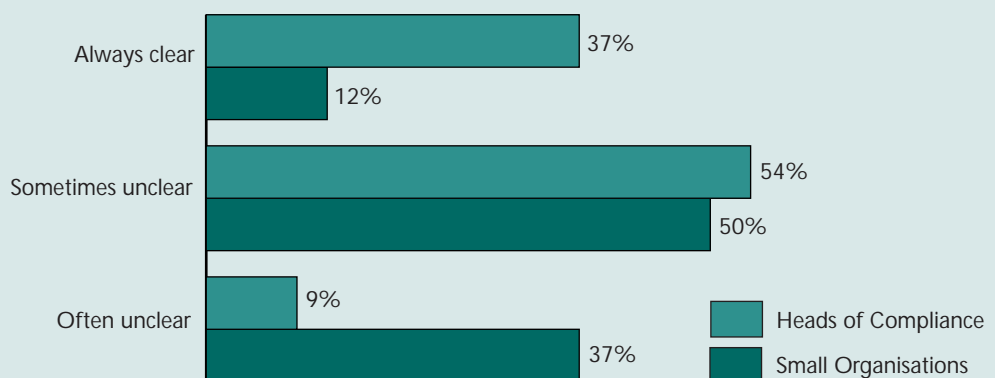
Chart 6: Promptness of decision-making by current regulator



Base: All HOCs/SOs who had experience of seeking guidance on rules or regulatory policy from their current regulator (HOC: 1330/SO: 714)

Only a third of compliance heads thought that the guidance received from their regulator was always clear, although this rose to half of those who regarded the FSA, the BSC or the FSC as their main regulator, and nearly two-thirds for those regulated by the Treasury. Less than one in ten compliance heads thought guidance was often unclear. Practitioners in small organisations were much less likely than compliance heads to say that guidance was always clear, and more likely to say it was often unclear.

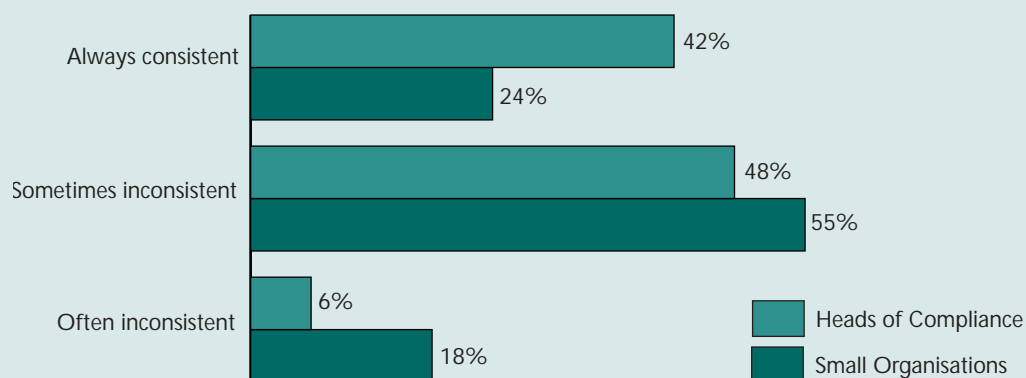
Chart 7: Clarity of guidance provided by current regulator



Base: All HOCs/SOs who had experience of seeking guidance on rules or regulatory policy from their current regulator (HOC: 1330/SO: 714)

A similar pattern emerged with regard to the consistency of guidance over time. About two fifths of compliance heads felt that guidance from their regulator had always been consistent, and this rose to three fifths for the Treasury and four fifths for the BSC. The FSA was below these two and the FSC, but above the other regulators. The PIA again had the most negative responses, with only a fifth saying guidance had always been consistent. Among small organisations, the PIA and the FSA were seen as equally poor.

Chart 8: Consistency of guidance provided by current regulator



Base: All HOCs/SOs who had experience of seeking guidance on rules or regulatory policy from their current regulator (HOC: 1330/SO: 714)

The highest priorities identified for improvement in the FSA's new regime were the provision of clear, concise and unambiguous guidance, and for guidance to be based on broad principles rather than narrow rules.

6 SUPERVISION AND INVESTIGATION

A substantial majority of practitioners – around eight in ten – thought that their current regulator applied a reasonable level of supervision for a business of their type and size, and that the regulator was willing to hold a dialogue with them about compliance issues. Those able to give an opinion also expressed quite positive views about the regulatory approach during an investigation.

There were however other aspects where opinions about the regulator's approach were more mixed. Almost two thirds of chief executives thought their regulator tended to look at processes rather than outcomes, and about half felt they were asked for too much detailed information about their business. Only a third agreed that their regulator gave praise as well as criticism, and the same proportion felt that they were adversarial in approach. Compliance heads held very similar views to chief executives.

Looking in more detail at the views of chief executives and compliance heads on individual regulators, a clear pattern emerges in which the PIA was again regarded least favourably, especially for looking at processes rather than outcomes, giving praise as well as criticism and being adversarial. The FSA did better than average on all three of these dimensions, and was in line with the average on the rest.

The views of practitioners in small organisations, as for previous questions, were much more negative than others on all dimensions, with particularly strong differences – in a negative direction – on the regulator being adversarial, being willing to hold a dialogue about compliance issues, looking at processes rather than outcomes, and giving praise as well as criticism. The views expressed by small organisations were equally critical of both the PIA and the FSA, which again probably stems from firms misunderstanding the respective transitional responsibilities of the two regulators.

7 SUPERVISORY STAFF

On the positive side, around eight in ten compliance heads felt that their regulator's supervisory staff had a fairly good understanding of the nature of their business, had quite good interpersonal skills, took the trouble to read information sent out to them, and treated the firm's staff as trustworthy. Only a small minority felt that site visits were too frequent.

However, there were also a number of less favourable impressions. About half felt that staff stuck rigidly to the rule book rather than interpreting rules pragmatically, that they just followed a checklist rather than focusing on broad issues of principle, and that, rather than being consistent, the regulatory approach varied according to the individual. One in three thought that staff did not really take into account the level of risk arising from their business.

Compliance heads in firms where the PIA was the main regulator consistently expressed more negative views than others, especially on following a checklist, sticking rigidly to the rule book, and treating the firm's staff with suspicion. BSC staff received most approval on all dimensions. Responses from compliance heads in firms regulated by the FSA were always among the two or three most positive, overtaken only by the BSC and, in some cases, the Treasury or the FSC.

The views of small organisations about their regulator's staff were again much more unfavourable, driven by the high proportion of these firms which had the PIA as their regulator. Views of both the PIA and the FSA among this group were equally negative, the latter in sharp contrast to the positive views about the FSA expressed by compliance heads in the larger organisations.

Among compliance heads whose firm had more than one regulator, the balance of opinion was that co-ordination between different regulators was fairly or very ineffective. Those working for complex groups, or in the areas of investment management or life/pensions were the most likely to feel that co-ordination was ineffective. Among small organisations, those who could express an opinion were fairly equally divided on the effectiveness of co-ordination.

8 ENFORCEMENT

About thirteen percent of practitioners had been subject to enforcement procedures in the last three years. The figure was lower for building societies and friendly

societies and higher for complex groups and life/pensions firms. Over half of chief executives and compliance heads in these firms, but only a quarter of practitioners in small organisations, felt that their regulator had been justified in starting these procedures.

This pattern was repeated in responses to other questions about the enforcement process. For chief executives and compliance heads, there was a fairly equal split between those who agreed and those who disagreed that their firm had been treated fairly during enforcement, and a majority view that the timescale for the investigation and enforcement process had been reasonable, and that the rationale for the penalty had been made clear. However, the balance of opinion was that the penalty imposed was not reasonable. Small organisations also supported the view that the timescale for the process was reasonable, and that the rationale for the penalty had been made clear. However, there was strong disagreement that their business had been treated fairly by the regulator and that a reasonable penalty had been imposed.

There was an overwhelming preference for the FSA to lay down broad principles of conduct, as a basis for enforcement, rather than to draw up a very detailed rule-book, with about eight in ten practitioners voting for the first option. This response was consistent across all three practitioner groups and all sectors of the industry.

The same preference was reiterated by compliance heads when asked to suggest what the FSA's main priority should be in their approach to supervision and enforcement in the future. One in four made a plea for the application of broad principles rather than narrow rules. The next most common answers were for the new regulator to recognise diversity and make regulation appropriate to the organisation, and to understand and work together with firms, rather than against them.

In spite of the importance ascribed to punishing persistent offenders in an earlier question, only one in ten compliance heads suggested that this should be the FSA's main priority. This suggests that in their answers to this question, practitioners were thinking more about the ways in which their own relationship with the regulator could be improved, rather than the FSA's consumer protection role. In any case, as we have seen, this is one area where practitioners felt that most regulators were already performing reasonably well.

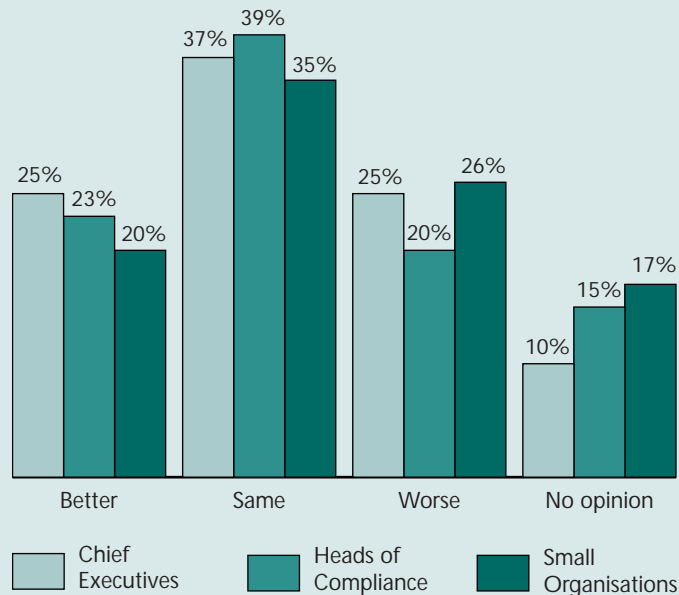
9 TRANSITIONAL PERIOD

Around half of practitioners had noticed some recent changes in regulation which they attributed to the creation of the FSA. For most the changes were only slight and between two fifths and a half had not noticed any changes at all. The majority of changes described in answer to a subsequent question were negative rather than positive. They included more bureaucracy, a more prescriptive approach and more suspicion and aggression. The main positive change was an improvement in communication and dialogue.

Around three-quarters of practitioners were expecting to see further change, and one in three thought there would be a lot of change. However, when asked whether the

new regulatory regime would be better, worse or the same for their business, about two fifths of practitioners did not think there would be any difference. One in four expected the new regime to be better, a similar proportion expected things to be worse, and the remainder were unsure. The practitioners most likely to anticipate an adverse effect from the new regime were those in firms currently regulated by the BSC, the FSC and the Treasury.

Chart 9: Whether expect new regime to be better, worse or same for own business



Base: All respondents

Compliance heads who thought their business would be worse off expected increased bureaucracy and regulation, inappropriate regulation, a more dictatorial approach, an increase in costs and poorer understanding by staff. Those who were more optimistic about the change hoped for more consistency and cohesion, a more pragmatic approach, better understanding by staff, less administration and complication, and increased efficiency, communication and consultation.

10 KNOWLEDGE AND VIEWS OF THE FSA

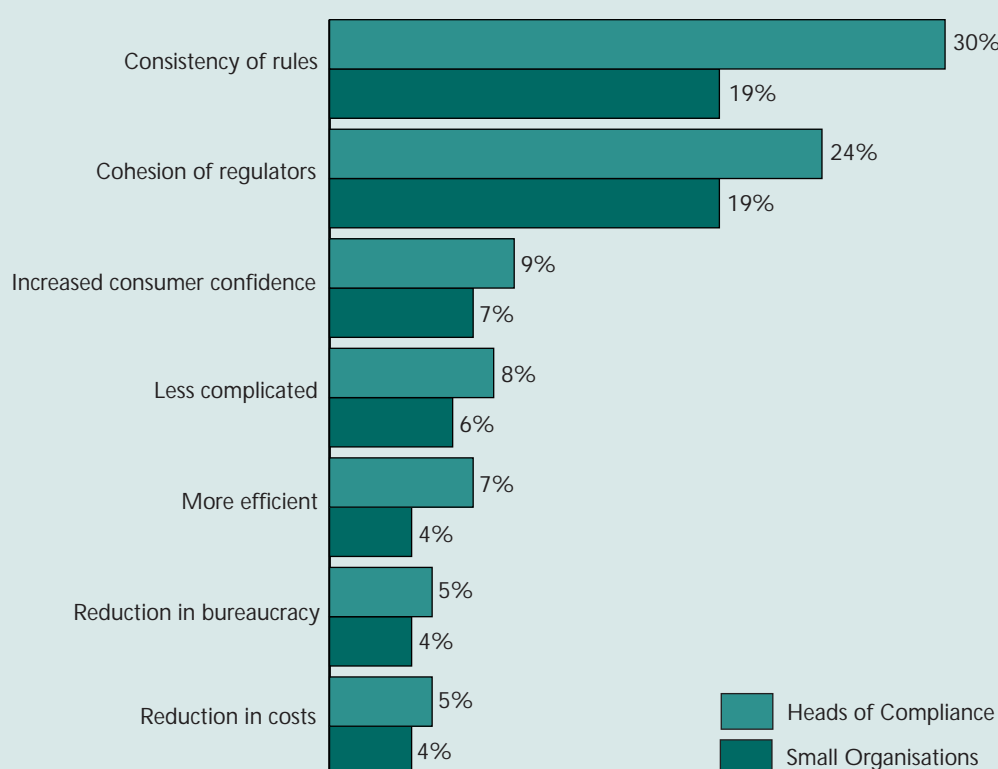
For all sectors of the industry, the main sources of information about the FSA were its own booklets and consultation papers. Other important sources included the trade press (especially for small organisations), direct contact with FSA staff (especially for compliance heads), the national press, trade associations and other representative bodies. Nine in ten chief executives and compliance heads (two thirds of small organisations) had had some face-to-face or telephone contact with FSA frontline staff, but only a third (one in ten small organisations) had had any contact with FSA policy-makers.

There were mixed views on how the switch to the new regulator would affect the way in which rules and regulations were applied. Two fifths of chief executives and a third

of the other two groups thought that the FSA would not be any different from other regulators in this respect; two fifths of each group expected the FSA to apply the rules more rigidly, and only around one in ten chief executives and compliance heads – one in seven small organisations – thought the new regulator would take a more flexible approach.

Around half of practitioners thought that the advent of the FSA would be beneficial to the industry, compared with only one in six who thought it would be harmful. About a third either did not know or thought it would make no difference. Practitioners in small organisations were less likely than others to think the changes would be beneficial and more likely to think it would make no difference. The reasons given for the change being good or bad for the industry were very similar to those previously mentioned by practitioners, as to why it would be good or bad for their own business. However, when taking an industry-wide view, rather than focusing just on their own firm, the positive outcomes expected outweighed the negative.

Chart 10: How the change will be beneficial



Base: All HOCs and SOs who expected the change to the FSA as a single regulator to be beneficial for the financial services industry as a whole (HOC: 860/SO: 360)

In answer to a further question about specific aspects of the FSA's role, six out of ten practitioners gave the regulator credit for being as open and responsive as possible in the way in which it was operating. A similar proportion thought it was taking too long to get the FSA up and running. In both cases, only one in five disagreed, with

the remainder not expressing an opinion. There was slightly less agreement among small organisations.

There still appear to be a number of concerns about the way in which the FSA will operate, fuelled perhaps by comment in the trade and national press in the period leading up to the survey. Six in ten chief executives and compliance heads, and two thirds of small organisations, felt that the FSA's proposed powers were too extensive, with only one in five dissenting. Conversely, well over half disagreed that there were sufficient safeguards in place to ensure the FSA would be accountable for its activities, against only one in four – one in five small organisations – who believed this to be the case.

There was also evidence of much suspicion about the relationship between the FSA and the government. Less than a fifth of small organisations believed that, in setting up the FSA, the government had listened to industry views, and only a quarter believed the regulator would operate independently of government, compared with at least three fifths who disagreed with these propositions. The perceptions of chief executives and compliance heads were less negative, but there was still a balance of opinion towards the view that the government had not listened to the industry, and an equal split between those who agreed and disagreed that the FSA would operate independently. The pattern of these responses was repeated with only slight variation across all sectors of the financial services industry.

II CONSULTATION PROCEDURES

Seven in ten compliance heads recognised that the FSA was making a lot of effort to consult the industry, compared with one in five who felt that this was not so. However, there were clearly doubts about the effectiveness of the consultation process. Nearly three-quarters of compliance heads felt that consultation papers should be more concise, and six in ten asserted that their business did not have time to respond to FSA consultation papers, with stronger levels of agreement from smaller firms. Opinion was divided on whether there had been sufficient feedback from the results of consultation exercises, and on the question of whether or not the FSA actually took account of industry views, with a small majority giving a positive answer to both questions.

Small organisations expressed more negative views about the consultation process on all dimensions.

Among chief executives, over half thought the FSA's consultation process had been ineffective in collecting the views of their business, compared with a third who took the opposite view. For compliance heads, opinion was more evenly split. Nearly two thirds of small organisations thought the process had been ineffective.

For both chief executives and compliance heads, the most popular method of consultation was to communicate their views directly to the FSA, although a substantial proportion preferred to put forward their views via their trade body. Slightly fewer preferred to communicate via surveys such as the Practitioner Forum had undertaken. For small organisations, however, surveys were a clear first choice, followed by

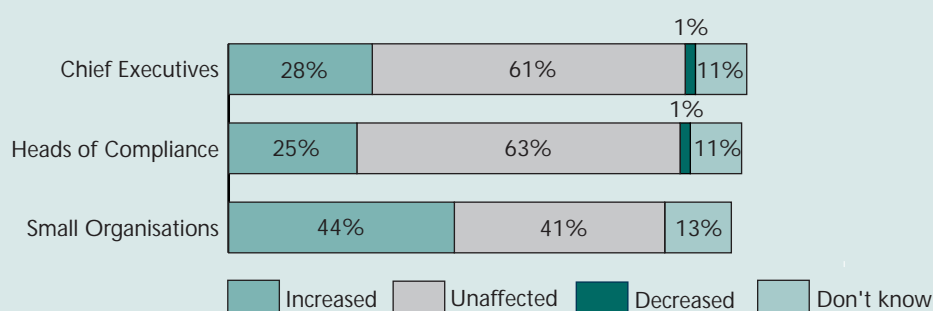
contact via a trade association or representative body, and only then direct contact with the FSA. Industry meetings or conferences were the least popular alternative for all three groups.

When compliance heads and small organisations were asked to suggest improvements to the way the FSA conducts future consultation exercises, around two thirds did not have any suggestions to make. The positive ideas which were put forward were very fragmented and were mainly a reiteration of points that had already been made. They included face-to-face discussions, shorter and simpler consultation documents with up-front summaries, targeting documents at relevant firms, forums and seminars, and increased use of new technologies.

12 COSTS AND EFFICIENCY

Less than a quarter of chief executives and compliance heads thought their business's total compliance costs (both fees and internal costs) were reasonable, with over two fifths of each group thinking costs were high but not excessive. Just over a third of chief executives and a quarter of compliance heads felt the costs were excessive. The responses from small organisations present a different picture; only one in 20 thought the costs were reasonable, and nearly two thirds saw them as excessive.

Chart 11: How costs have been affected by creation of the FSA



Base: All Respondents

Only a quarter of chief executives and compliance heads, but over two fifths of small organisations, felt that the internal costs of compliance had been affected by the creation of the FSA. The proportion was higher among firms whose current regulator was either the FSA or the BSC, and especially among chief executives of complex groups, banks and building societies, and among small organisations offering insurance products.

A large proportion of practitioners – two thirds of chief executives and compliance heads, and just under half of small organisations – could not say how efficient the FSA had been in controlling its own costs and making prudent use of its resources. Of

those who gave an answer, the majority of chief executives and compliance heads believed that the FSA had been at least fairly efficient in this respect. However, small organisations took the opposite view.

13 PRACTITIONER FORUM

Only a quarter of small organisations, around one in three chief executives, and a slightly higher proportion of compliance heads had heard of the Practitioner Forum before they received the letter informing them of the survey. Large firms were much more likely to have done so than small firms. Consequently, many were unable to express an opinion in answer to subsequent questions about the Forum's role.

Among those who did give an answer, the balance of opinion was extremely positive. Around two thirds agreed, and only a very small proportion disagreed, that the Forum had an important role to play on behalf of the industry with the FSA. By a large majority, practitioners also felt that the Forum was helping the FSA to understand industry views, and was independent of the FSA.

There were more mixed views about the Forum's ability to represent the industry as a whole, and to influence FSA policies and decisions, with about one in three of those who expressed an opinion feeling that this was not the case. There was also more disagreement that it was easy for firms to express their views to Forum members.

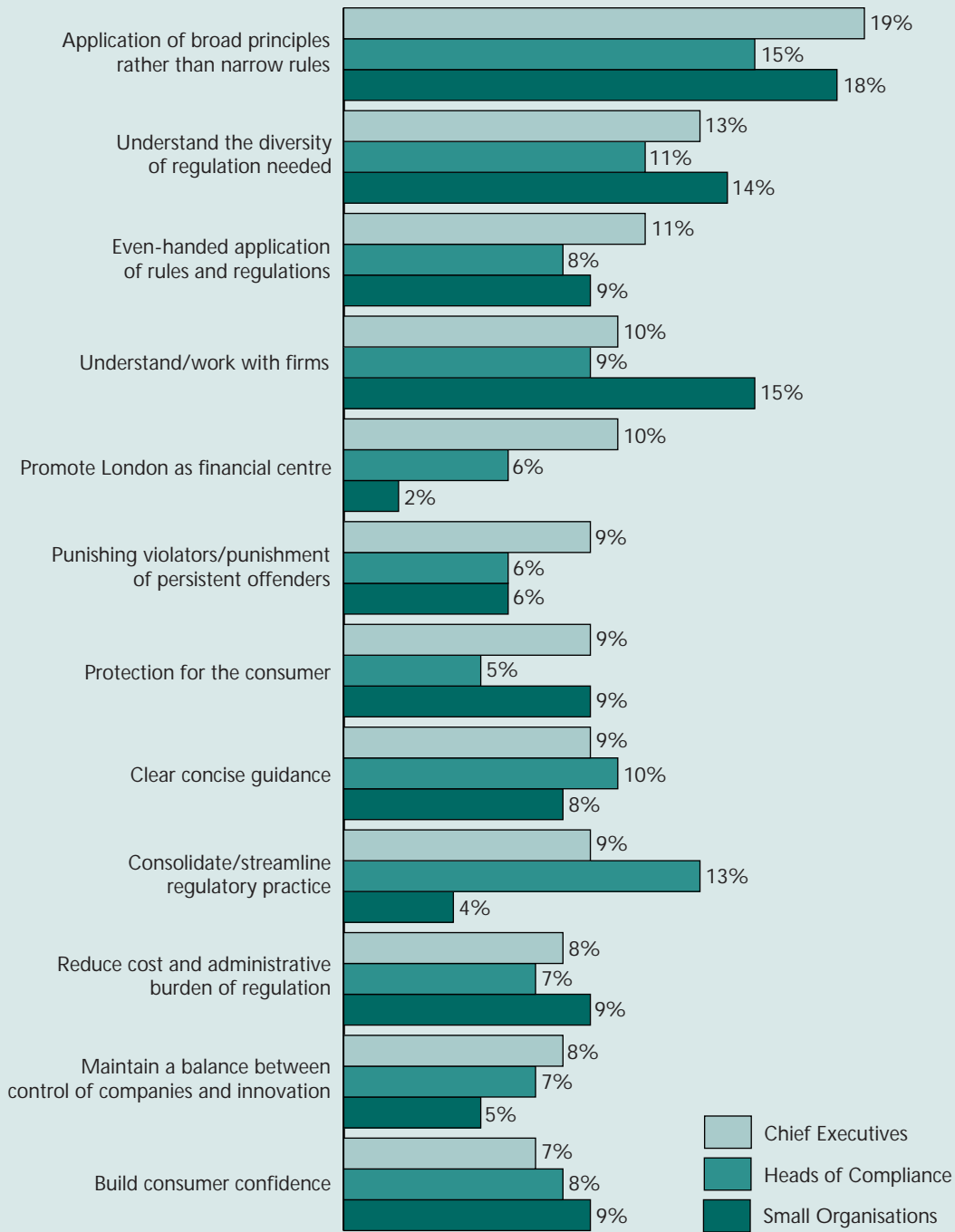
14 OVERALL PRIORITIES FOR THE FSA

All practitioners were asked to describe what they saw as the most important priorities for the FSA, when it takes over the role of the single regulator. Most of the issues mentioned in response to this question had been identified in the qualitative interviews, and covered elsewhere in the questionnaire, but this provided an opportunity for practitioners to sum up their priorities overall.

From an industry viewpoint, the most important priority for the FSA is to establish a style of regulation that involves the application of broad principles rather than narrow rules. About one in five practitioners mentioned this, more than any other issue. The next most important priority is to recognise the diversity of regulation needed and make it appropriate to the type and size of organisation.

Several other issues were each a priority for around one in ten practitioners. These included: the even-handed application of rules and regulations; understanding and working together with firms; clear, concise guidance; protection for consumers; and (particularly for compliance heads) consolidating and streamlining regulatory practice. Chief executives felt it was equally important for the new regulator to promote the UK as an international financial centre, and to punish persistent offenders, while small organisations were more likely to see reducing the cost and administrative burden of regulation and building consumer confidence as priorities.

Chart 12: Important priorities for the FSA to address



Base: All respondents

CONCLUSIONS

The survey results provide a valuable benchmark against which the FSA's performance as a single regulator can be assessed in future years. During this transitional period, many regulated firms have had little direct experience of the FSA, and many of the measures collected therefore relate to the current regulators.

Nevertheless, most firms do have strong views about aspects of the FSA's role and performance, no doubt heavily influenced by the FSA's own publications, and by press and industry comment. Firms also have strong views about the regulatory approach which they would – and would not – like to see in the future. Linked with this, they have hopes and fears about the FSA as their future regulator.

Current performance of the FSA

Chief executives and compliance heads in financial services firms which already regard the FSA as their main regulator – the majority are banks and general insurance firms – are, on the whole, fairly positive in their assessment of the regulator's performance. They give the FSA particular credit for listening to industry views, employing high calibre staff, enabling the UK to remain competitive internationally and encouraging consumer education.

The FSA, as we have seen, is not viewed so favourably by small organisations, and this appears to be the result of some confusion between the respective roles and responsibilities of the FSA and the PIA during the transitional period. These practitioners' evaluation of the FSA's performance is similar to their assessment of the PIA, which consistently received lower performance ratings than any other regulator. They see the FSA as particularly poor at interpreting rules in a common-sense way, looking at the behaviour of the business as a whole, and maintaining consumer confidence.

In its approach to supervision, the FSA tends to be seen by small organisations as adversarial, unwilling to hold a dialogue and process-oriented. FSA supervisory staff are felt by many small organisations to be over-suspicious, to ask for too much detail and then to just follow a checklist rather than concentrating on broader issues. Many also feel they do not take into account the level of risk that a business poses.

There is clearly much room for the FSA to improve industry perceptions of its performance in the future, when it assumes complete control over the regulatory process for all firms.

The FSA's consultation procedures also leave room for improvement, according to practitioners, and this is something which clearly merits attention in the short term.

Hopes and fears

A substantial proportion of practitioners believe that the new regulatory regime will bring changes, both for their own business and for the industry as a whole, and the majority expect the changes to be beneficial. They hope the single regulator will ensure greater consistency and cohesion of regulation across all sectors of the industry, and that this will lead to less administration and more efficiency. They also hope for better communication and consultation, and a more pragmatic approach.

The greatest fear is that the new regime will turn out to be more bureaucratic and dictatorial, with no account taken of the level of risk from different types of businesses and inappropriate regulation for some. This might lead to higher costs. Many practitioners fear that the FSA will apply the rules more rigidly than has happened in the past.

There are also more general concerns about the role and powers of the FSA. The perceptions of a majority of practitioners are that the FSA's proposed powers are too extensive, and that insufficient safeguards are in place to ensure accountability. Many also are doubtful about the FSA's independence from government. Regulated firms need more reassurance on these issues, if the FSA is to command their respect and trust.

Overall priorities for the FSA

From the industry viewpoint, the most important priority for the FSA is to establish a style of regulation which involves the application of broad principles rather than narrow rules. There is overwhelming support for this approach from all sectors. In addition, practitioners want the FSA to recognise the diversity of regulation needed, and to ensure that it is appropriate to the type and size of the organisation and the level of risk.

Beyond this, there is an extensive wish list, much of which is concerned with the working relationship with the regulator and the style of supervision. The regulator's role, as practitioners see it, should be to understand and work with firms rather than against them, and that encompasses a range of behaviours which were explored in the survey.

Establishing a good working relationship means listening to firms' views, and being willing to hold a dialogue with them on compliance issues. Of course, practitioners acknowledge the importance of punishing those who persistently break the rules, but most firms do not fall into this category and are trying to do a good job. In supervising their businesses, they would like the regulator to recognise and praise positive results, not just criticise failings. Above all, firms are adamant that the new regulator should not adopt a rigid rule-book approach, but be pragmatic and interpret the rules in a flexible, common-sense way. To do all this, the FSA will need to employ high calibre staff, preferably with experience of the businesses they regulate.

Of similar urgency is the need to consolidate and streamline regulatory practice; to provide clear, accurate and consistent guidance to regulated firms when the need arises; to apply regulation in an impartial and even-handed way; and to protect consumers. For chief executives, it is equally important for the FSA to promote the UK as an international financial centre, while for small organisations reducing cost and administrative burden and building consumer confidence are higher priorities.

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BMRB Social Research

APPENDIX

Members of the Practitioner Forum in 1999

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