THE FINANCIAL SERVICES PRACTITIONER PANEL ANNUAL REPORT 2005/6

www.fs-pp.org.uk

PRACTITIONER PANEL ANNUAL REPORT 2005/6

Contents

CHAIRMAN'S FOREWORD

I am pleased to introduce this Annual Report on behalf of the Financial Services Practitioner Panel (the Panel) for the period 2005/6. Its primary purpose is to create a document of record – as a part of our responsibility to the industry and our role in the wider Financial Services and Markets Act 2000 (FSMA) accountability framework – that summarises the work we have done in the past year.

2005/6 has been a busy and demanding year for the Panel where our workload has evolved from the period of many consultative documents to dealing with the live experience of implementation post N2.

This Report begins by commentating on the progress made on some of the Panel's most important areas of activity and key priorities over the past year and goes on to identify what we see as our main priorities for 2006/7 and how we intend to tackle them.

A major piece of work for the Panel in partnership with the FSA has been the Cost of Regulation study which focused on regulatory costs across three chosen sectors – corporate finance; institutional fund management; and investment and pension advice. The objective was to identify specific rules from the FSA Handbook in these sectors where incremental costs may not be justified by the benefits they aim to secure. The Panel will use the results of this exercise to engage in a constructive dialogue with the FSA about the burdens of regulation – in particular, on the retail side - and how these might best be relieved.

We also commenced our biennial survey of regulated firms, the results of which will be published in November 2006. Following a series of qualitative interviews, over 10,000 regulated firms – of all sizes and types – have recently been invited to complete a postal questionnaire and provide the Panel with their views on a wide range of issues relating to the FSA's effectiveness and performance. The results will provide us with an informed, authoritative and enlightening portfolio of data which will help inform subsequent discussions with the FSA and drive much of our focus in the year ahead.

The Panel dedicated considerable time over the past year seeking to develop a practical articulation of "consumer responsibility"; often referred to as Caveat Emptor. Callum McCarthy's (Chairman of the FSA) speech to the Financial Services Forum in February 2006 was helpful in highlighting the principle of consumer responsibility and stimulating further debate. The Panel will continue its efforts to achieve a sensible balance between the responsibilities of firms and those of their clients.

The Panel is supportive of the FSA's move from a prescriptive rules-based regime to a more principles-based regime. This issue has been regularly debated at Panel meetings and a key challenge for the FSA is to ensure that what their senior management says gets effectively translated further down the line, in particular to FSA supervisors, to enable them to achieve consistent and proportionate judgements based on the circumstances of particular firms. Fears regarding the prescriptive application of the Treating Customers Fairly initiative continue to abound.

FSA is investing heavily in staff training as part of its 2010 vision which incorporates a move towards a more principles based approach to regulation that the Panel welcomes. Principles-based regulation leaves the opportunity for the use of and reliance on industry codes as part of the market developing its own solutions. The Panel has clearly articulated its views to the FSA that the successful implementation of industry codes will depend on their use only where there are specific gaps in particular sectors, and they must be seen to add value and not create a second tier of regulation. Moreover, their effectiveness will depend on the FSA providing adequate endorsement and authority.

On international issues the Panel is keen to ensure that UK interests are properly represented in the various international fora, that UK plc is seen as an attractive place to do business in and we continue to encourage the FSA to adopt a proactive and suitably high-profile global outlook and approach.

2006/7 is likely to be another busy year for the Panel. As well as those issues mentioned above and in section 2 of the Report, the key priorities on our agenda include Markets in Financial Instruments Directive (MiFID) and Capital Requirements Directive (CRD) implementation, the FSA's approach to disclosure, the HM Treasury Value for Money Review, FSCS funding issues, and generic advice and financial capability. Fuller details can be found in section 3 of this Report.

Most of the Panel's input to and discussions with the FSA are undertaken in private – this is the best way to stimulate constructive debate between the industry and the FSA senior management. That means, however, that much of our work and effect often goes unseen. We have actively reviewed how well we are operating, and will make improvements where necessary. This includes a more proactive and risk-based approach to setting our agenda and identifying issues of industry concern, the greater use of specific sub-groups to look in more detail at sectoral and technical issues and – where appropriate – taking the opportunity to make stakeholders better aware of the Panel's activities and views. This includes bi-annual briefings of the trade associations to provide them with an update on the Panel's work.

We are conscious of the burden of regulation on smaller firms and have always taken time to consider their needs through the representation on the Panel by Ruthven Gemmell, who has recently been succeeded as Chairman of the Smaller Businesses Practitioner Panel – and on this Panel – by Mark Rothery. Mark will continue to ensure that smaller firms' concerns are communicated to and discussed by us at our meetings.

One member of the Panel stepped down this year – Luqman Arnold; and I would like to thank him for his time and commitment to the Panel. I took over as Chairman of the Panel in November 2005 from Jonathan Bloomer, who is now

my Deputy Chairman. Jonathan has served the Panel well through his Chairmanship and I would like to convey my gratitude and thanks to him.

Finally, I would like to thank my fellow Panel members, and our small Secretariat support staff, for their expertise, commitment and enthusiasm during the preceding 12 months. In my view the workload of the Panel has become significantly more onerous as we now experience the full implementation of the FSMA. It is a tribute to our industry that very senior people give their time freely for the good of all our practitioners and their clients. Our thanks also go to the FSA staff with whom we have engaged in regular, open and frank dialogue. The year ahead will be an extremely important one for the FSA, the Panel and the industry in defining the future shape and nature of financial services regulation in the UK. The Panel looks forward to helping meet this challenge.

I hope that you will read this Annual Report, and that you find its content informative, interesting and relevant.

Roy Leighton

Chairman

2005/6 – THE PANEL'S YEAR IN REVIEW

This section examines in greater detail some of the Panel's most important areas of activity and key priorities over the past year. This list is by no means a complete representation of the Panel's workload, but instead focuses on those issues that have demanded a significant amount of the Panel's time and attention.

2.a. Cost of Regulation Survey

Responding directly to findings in the 2004 Panel survey of regulated firms, the FSA decided to undertake, in partnership with the Panel, an in-depth study into regulatory costs, the scope of which was announced in March 2005. The Panel's survey, published in December 2004, had found that the costs and burdens of compliance were the single biggest issue of industry concern, in particular to smaller firms, which now account by number for over 90% of the regulated industry.

The Cost of Regulation Survey focused on three sectors – corporate finance, institutional fund management, and investment and pension advice – and paid particular attention to the impact of costs on smaller firms and on wholesale firms operating in internationally competitive markets. Deloitte was commissioned to undertake this work. Its purpose was to provide robust estimates of the costs of regulation that stemmed from the Financial Services and Markets Act 2000 (FSMA) to firms in those three sectors. It was hoped that this would help to identify where there might be discretionary elements of regulation that were costly to firms but which were not matched by corresponding benefits.

The impact of FSMA regulation on firms' operating costs in the three chosen sectors was analysed using a methodology that reflected discussions with relevant outside experts and could allow future replication for comparative purposes. The key aim of the study was to identify which individual rules were most costly for participating firms in both the wholesale and retail sectors, thereby quantifying those costs incurred by firms in undertaking regulated activities which would not be incurred in the absence of FSMA regulation. These costs were defined as incremental regulatory costs.

What the study does is provide a solid and indicative basis on which to pin-point a number of specific areas of the FSA Handbook that attract and drive the highest incremental costs – i.e. those that firms would not otherwise incur in the course of good business practice. It should be noted, however, that this work covered the financial year 2004/5 and the findings therefore pre-date several new instances of regulation, the most obvious ones being Treating Customers Fairly (TCF), the incoming Markets in Financial Instruments Directive (MiFID), Depolarisation and the recent introduction of electronic reporting.

Overall, the relative incremental costs of regulation in the Corporate Finance and Institutional Fund Management sectors are comparatively low and, in the Panel's view, are not unreasonable or troubling. This reflects largely on the wholesale nature of the activities involved, and the typical lack of private customers. That is, however, not to say that there are some aspects that the FSA should not take careful note of, and which the Panel will seek to engage in dialogue with the FSA over time.

By far the most pointed findings from this study relate to the retail-oriented Investment and Pensions Advice sector with the highest incremental regulatory costs being human resource related activities such as Training and Competence and compliance with Conduct of Business rules such as advising and selling, complaints handling and post sale client servicing. Regulatory fees and levies are also – inevitably – major drivers of incremental costs. Linked to this is the wider issue of record-keeping and evidence. To be clear, no firm disputes the need to develop and assess the capability of its staff, to have in place arrangements for handling dissatisfied consumers, and to treat their customers fairly at the point-of-sale (and thereafter). But it is the highly prescriptive nature of these requirements as currently framed in the FSA Handbook that generates the significant incremental costs.

These are the areas where the Panel would expect to see the FSA take quick and decisive action in order to mitigate these costs (where that can be justified on objective cost/benefit grounds). We acknowledge that there are a number of strategic initiatives already in train that are likely to encompass some of the elements in question – for example, as part of the FSA's wider Better Regulation agenda and the Conduct of Business simplification project. However, the findings and messages emanating from the Deloitte research deserve discrete, dedicated and close attention from the FSA; with a clearly defined action plan.

If the efforts to reduce costs are to be truly successful, it will not only require a review and revision of the Handbook but will also require a step-change in the culture of both regulator and regulated. The FSA's ongoing shift toward a more principles-based approach should have consequential cost advantages for firms. It should provide a flexible and pragmatic backdrop for them to comply with their regulatory obligations in a way that best suits firms' individual type, size and model of business. At the same time, it is necessary for the industry to embrace the FSA's deregulatory work, and not position itself against it. If the FSA is seen to be delivering on its part of the bargain, then so must we.

The Panel welcomes the commitments set out by John Tiner in his Foreword to the Cost of Regulation report. We shall work together with the FSA to ensure that these are indeed delivered, but shall be rigorous in our representations where we feel that the FSA is failing to do so.

The industry rightly has an expectation that this piece of work will contribute to seeing real and meaningful improvements in the way that it is regulated and, specifically, on the issue of costs.

The Panel was represented on the project's Steering Group by its Chairman Roy Leighton, Deputy Chairman Jonathan Bloomer and the (now previous) Chairman of the Smaller Businesses Practitioner Panel Ruthven Gemmell, who was also an ex officio member of the Panel.

2.b. Consumer Responsibility

The Panel dedicated considerable time over the past year to developing a practical articulation of "consumer responsibility" (or Caveat Emptor) and engaged in a series of discussions with members of the Financial Services Consumer Panel and the FSA. The original aim of those discussions was to define what exactly was meant by "the general principle that consumers should take responsibility for their decisions," as outlined in section 5(2)(d) of the Financial Services and Markets Act 2000.

It was further felt that as a balance to the principle of Treating Customers Fairly (TCF) it was important not only to focus on the obligations of firms during the retail sales process – which already are prescribed in great detail in the FSA's regulatory regime – but also on what could reasonably be expected from the consumer; "fairness," after all, is a concept that usually is not applied in a unilateral manner (see p.12 for further information).

On 9 February 2006 the FSA's Chairman Callum McCarthy publicly commented on the subject, saying that:

"(…) Were the FSA to aim to relieve consumers of all adverse consequences, an environment would be created in which they no longer needed to weigh up the reasonableness of their financial decisions. No market can work effectively without involved consumers. To relieve consumers of retail financial services of the consequences of their actions would destroy this as an effective market. (…)"

"(…) [T]he absence of reasonable care on the part of the customer is not irrelevant. The courts have often accepted various arguments from firms that customers have displayed "contributory negligence" because, for example: they withheld important or provided inaccurate information; omitted to read product particulars and/or implement fully a package of interrelated investment proposals; or failed to take into account relevant advice simultaneously being received from other professional advisers, such as accountants or lawyers. (…) They are things to which consumers should also have regard. Put simply, they can act in ways which reduce or eliminate the protection they can otherwise expect from the FSA, FOS or courts."

The statement was welcomed as encouraging progress by the Panel, and as an opportunity to further engage in a public debate on this important and difficult subject. An open, common-sense discussion on what may reasonably be expected from firms and consumers when they enter into financial contracts should benefit both sides – by giving firms that have met their regulatory requirements and the principles of TCF a greater degree of certainty, and by helping consumers to know what they have to do to achieve the best deal for themselves.

The Panel has long maintained that the lack of a clear definition of the principle of consumer responsibility was one of the main drivers of high regulatory costs in the retail sector, as firms in search of legal certainty often incur additional costs in being extra careful in complying with existing rules and regulations; these costs eventually get passed down to the consumer.

For the coming year, the Panel will explore further how it can contribute to a frank, balanced and constructive debate with interested stakeholders on this complex issue, for example, as part of the Retail Financial Services Group (see p.22 for further information) and through trade associations. It hopes that agreeing a reasonable consensus of where firms' responsibilities end and consumers' responsibilities begin could be of considerable benefit to all parties.

The Panel is clear that it will not be feasible to set out an exhaustive or legally binding series of consumer obligations in this regard. We also recognise that not all consumers are capable of understanding and taking responsibility for the financial decisions that they take. However, we do not feel it should be impossible, in counterbalance to the introduction of the principle of TCF, also to agree a generally accepted set of "ground-rules" or "guiding principles" that would help both buyer and seller to understand what they can expect from the other.

While this may not have force or status in law, it could nevertheless provide an indicative basis to help both parties maximise the value of their relationship and assist in the consideration of future complaints. Regardless of where the line on consumer responsibility might be drawn, consumers will, of course, continue to benefit from the protection of Conduct of Business rules and other safeguards that are currently in place.

2.c. Principles-based Regulation and Thematic Work/TCF

The Panel is supportive of principles-based regulation, which it considers the appropriate approach towards a modern, proportionate and effective risk-based regulatory framework in the UK. However, if this is to succeed, the FSA will need to properly consider the implications of this new approach to its work in a number of areas, including supervision and enforcement. The Panel recognises that principles-based regulation is a new and largely untested concept, and that a clear-cut, definitive approach might be an unrealistic expectation at this point. Nonetheless, in a recent letter to John Tiner, we conveyed some commonly held concerns by practitioners to senior FSA management. Smaller firms, in particular, appear to struggle with some aspects of principles-based regulation.

- **Consistent implementation**: Broad consistency of implementation across the FSA will be crucial to ensure the success of principles-based regulation. Supervisors must be able to apply risk-based concepts with appropriate understanding, flexibility and pragmatism and accept that no two firms are the same. At the same time, the FSA needs to continuously articulate what it means by principles-based regulation, to address the concerns of firms over a perceived lack of clarity and the possibility of arbitrary application of the framework in practice, and have a strategy in place to address any systematic failures.
- **Quality of FSA staff**: For the aforementioned reason, it is vital that FSA supervisory staff are of the requisite calibre – only supervisors with an in-depth understanding of the markets and firms they monitor will be able to form the sort of risk-based judgements that are required under a principles-

based regime. We have therefore been very supportive of FSA initiatives to provide both technical and attitudinal training to its staff, including the Regulatory Core Curriculum and a residential ARROW course for supervisors, and consider the FSA's notable progress in this area among the Panel's key successes of the past year.

- **Role of enforcement and FOS:** There are some industry anxieties over the role of enforcement in the context of principles-based regulation, with fears that disciplinary cases will be used to set precedents and help interpret untested principles. Similarly, concerns exist over how the Financial Ombudsman Service (FOS) will interpret principles rather than rules, and the wider impact that this might have. While most FOS cases may hinge on case-specific factual elements rather than direct consideration of FSA rules, it is important to accept that FOS decisions are widely seen to set precedents for good practice. It will also be important that the FSA/FOS "wider implications" process is sufficiently robust to identify and address such instances.

  The concern of firms about the application of hindsight might also be alleviated if it was clear that the determination of wrongdoing depended on whether the firm's compliance arrangements were in line with those of reasonably conscientious firms undertaking the same kind of business at the time of the alleged breach of requirements. Finally, there is a feeling that the onus of evidential requirements in FOS cases rests solely with the firm, thus driving up compliance costs considerably. The Panel continues to engage regularly with the FOS on this and on other matters.

- **Second tier of regulation:** While principles-based regulation is welcome, the industry is concerned that there is a danger of creating a second tier of regulation through the back door, via press releases, Dear CEO letters, speeches, "good practice" guides and enforcement precedents, without being subject to the normal, statutory consultation processes. Thus, a mechanism should be in place to ensure that some final input can be provided by stakeholders prior to the distribution of Dear CEO letters and, likewise, the release of thematic work and mystery shopping results.

  Regarding the latter, there are anxieties over general conclusions being drawn from often small sample sizes that have little statistical relevance; the lack of feed-back to firms and industry representatives; and potential enforcement action on the basis of mystery shopping. More generally, the Panel has urged the FSA to consider carefully how it publicly communicates the conclusions drawn from such initiatives, to avoid causing unwarranted damage to consumer confidence and the reputation of the market.

The Panel acknowledges that efforts are underway within the FSA to address some of these issues and welcomes these developments. They include staff training (see above); proposed greater reliance on industry codes to help bridge the gaps between some practitioners' preference for rules, and principles-based regulation; publications like the Treating Customers Fairly Self Assessment Tool; and other online aids and material on the FSA website.

With regard to industry codes, the Panel recognises that these will be unlikely to provide the industry with "safe harbours"; but at the very least should offer "sturdy breakwaters", reassuring firms that by adhering to industry codes that have been developed in close co-operation with the FSA, they are less likely to fall foul of the regulator. The Panel welcomes current efforts that are ongoing within the FSA to clearly outline its approach to industry codes. Generally, the Panel supports this move, but also appreciates that it will put further strain on the resources of trade associations – hence, the industry will have to be prepared to support such initiatives as necessary.

Now that the FSA is placing greater emphasis on thematic work as part of its shift towards principles and away from rules and new policy, the Panel is keen to be better engaged in the regulator's work in this regard at the strategic level and, where appropriate, in respect of particular themes. **This will be one of our priorities for the year ahead**. In the meantime, we welcome the FSA's public commitment to make its forward thematic work programme more transparent and to better communicate the outcomes of such initiatives.

Treating Customers Fairly:

One of the major initiatives that the FSA has introduced as part of its evolving principles-based framework is Treating Customers Fairly (TCF). While the Panel has been supportive of the TCF concept generally, it shares many of the industry's concerns regarding its implementation, supervision and enforcement. As mentioned in the previous section, consistency of approach will be crucial to ensure that TCF is applied fairly across the industry. At present, confusion persists, especially among smaller firms, over the regulator's expectations regarding firms' embedding of TCF, and evidencing thereof.

Anecdotal evidence has reinforced the fear that FSA supervisors' application of TCF in practice might sometimes be highly detail-oriented and meticulous, signalling a disconcerting departure from the FSA's commitment to high-level principles. Moreover, it also appears to hint at a possible disconnect between senior FSA managers' public stance on principles-based regulation and the day-to-day application of this concept throughout the organisation. The Panel appreciates that this will be one of the regulator's major challenges going forward, and will continue to observe developments in this area closely, offering its input as required.

Finally, question marks also remain over the extent to which TCF applies to the responsibilities of product providers versus distributors, with some industry representatives fearing that a blurring of the lines of responsibilities between the two could have a considerable long-term impact on the structure of the financial services retail marketplace. We know that the FSA is actively considering this issue and has discussed it with the relevant trade associations. The Panel awaits the outcome of FSA's considerations and looks forward to engaging with it further on this important issue. That said, we would not support any FSA proposal to intervene in circumstances where ongoing industry solutions should be allowed to prevail. On a related note, the Panel also feels strongly that the introduction of TCF should be accompanied by a clearer definition of consumers' responsibilities,

to provide firms with some degree of certainty as to where their responsibilities start and end (see p.9 for further information).

Progress has been made on some of these items, and the Panel will keep on pushing the aforementioned points that have not yet been satisfactorily addressed.

2.d. Disclosure

Over the past year the Panel as a whole and as part of a sub-group raised various fundamental concerns about the FSA's disclosure regime[1]. This is a complex issue, given the difficult balance between the need to provide consumers with the depth of information they require to make well-informed purchasing decisions on the one hand and the desirability of clear, user-friendly product documentation on the other.

The Panel maintains that the FSA's disclosure policy at present does not provide consumers with the readily digestible information they need to help themselves properly understand what they are buying and results in documentation that is too complex, voluminous and thus confusing. Practitioners welcome better disclosure but have doubts over the soundness of the FSA's current approach, which sees retail investors receiving far too many documents – a problem that could be aggravated further as Treating Customers Fairly beds down. That said, we appreciate that certain disclosure obligations imposed by the FSA are EU driven.

Whilst some individual documents, including the Key Facts Quick Guide, may be transparent and concise, the full array of documents, and the FSA's approach to introducing new disclosure material piece by piece, adds to the overall complexity of the regime. The sheer volume of paperwork is unlikely to help consumers and the Panel feels there is a need to stand back and look again at the goals of disclosure and the best way of achieving them.

Ideally, the Panel would like to see a fundamental change in the FSA's disclosure regime, which should be based around a limited number of short, concise documents. These documents should clearly state a product's downside risk, provide links to additional information that is available to the consumer and emphasise that if the consumer does not understand what they are buying they should seek further advice. While it is perhaps unrealistic to expect that the FSA will revise its disclosure requirements from scratch, it should at the very least aim for an overall reduction and simplification of the documentation currently required.

The Panel is keen to approach this issue constructively with the FSA and made it one of its main priorities, underlining the huge significance of disclosure to all market participants. We will continue to monitor progress – and engage in further collaborative discussions with the FSA - over the coming year. This will include the interplay between incoming MiFID provisions, the FSA Conduct of Business rules (with reference to the ongoing COB simplification initiative) and the desire to maintain effective levels of consumer protection. In the meantime, we have been

1 The sub group members are Alan Ainsworth, Luqman Arnold, Matthew Bullock, Gill Cardy (member of the Smaller Businesses Practitioner Panel) and Douglas Gardner.

pleased to note that the FSA is reviewing its earlier thinking with regard to proposed new point-of-sale disclosure requirements, in light of unsupportive cost benefit analyses.

2.e. Enforcement Review

The Panel was engaged in and contributed views throughout the FSA's review of its Enforcement processes[2]. At the conclusion of the review, we were pleased to note that the majority of the Panel's and industry's substantive concerns had been taken on board. These included a clearer separation between investigation and decision-making processes, and measures to improve fairness and transparency more generally. For example, FSA Enforcement staff will no longer be afforded privileged access to the Regulatory Decisions Committee (RDC), which will also now have its own independent legal advisers, and greater controls within the Enforcement Division set up to monitor the progress of cases and assess their merit.

With regard to settlement, the Panel supported the development of a "discount" scheme for early settlement, subject to the need for firms and their senior management to understand the broad nature of the case against them. The desirability of the RDC to be involved at the conclusion of mutually-agreed actions can be argued either way – but the Panel is content to watch how the chosen model operates in practice.

On a separate but related point, there are continuing market anxieties about how the FSA determines the type of cases that should be taken to discipline, and how individual firms are selected. We accept that the FSA needs to be risk-based in this regard, and that not all firms can be taken through such a formal route. However, there does need to be greater clarity for the industry, or else fears that the enforcement tool will be used arbitrarily, disproportionately and to satisfy FSA policy objectives will continue to abound (see p.11 for further information). This concern is compounded by the move towards a more principles-based regime, and the likely difficulties that enforcing against such a framework will present.

2.f. International Issues

The Panel has considerably increased its focus on international issues over the past year, both from a strategic perspective and with regard to specific topics and themes, including the Capital Requirements Directive (CRD) and the Markets in Financial Instruments Directive (MiFID). Strategically, the Panel is keen to ensure that UK interests are properly represented in the various international fora, especially in European Union negotiations.

By the FSA's own estimates, a significant amount of regulation is currently driven by EU directives, and it is therefore vital that the competitiveness of UK firms is championed in Brussels. Too often in the past the UK – in spite of being home to the single largest proportion of Europe's financial services industry – appears to be on the back foot in European negotiations.

2 The members of the sub group were Roy Leighton, Russell Collins, Douglas Gardner and Ruthven Gemmell (Chairman of the Smaller Businesses Practitioner Panel).

In a conscious strategic move, FSA senior management decided as part of its restructuring in 2004 that responsibility for EU and international representation on specific issues should lie with the line managers responsible for the respective domestic policies. In its latest International Regulatory Outlook (IRO) the FSA states that:

"It is essential that those individuals in the FSA with relevant sector-specific expertise play a major role in international discussions affecting their portfolios. New EU legislation and proposals are, accordingly, allocated to a policy 'lead' in the policy unit responsible for the topic being addressed. The intention is that 'international' work is largely integrated into our day-to-day activities, rather than separated from them."

At the time the reorganisation caused some concern among industry representatives who feared the perception that a less visible and less centrally positioned international strategy group would undermine the FSA's ability to influence EU and international policy agendas proactively, and put in question the FSA's overall commitment to EU and international issues. Callum McCarthy has always vehemently rejected these suggestions, pointing to his and his senior colleagues' heavy involvement in a wide range of international fora (e.g. CESR, CEBS, IOSCO, etc.). He has also stated publicly that international issues occupy more of his time than any other single matter.

Some of these original concerns appear to have abated. The Panel feels that the FSA's work in the EU and international arenas is of high technical quality and might merit being promoted more effectively to the industry at large.

However, in its talks with the FSA, the Panel has stressed the desirablilty for a suitable externally visible senior executive within the FSA to take overall responsibility for international issues. This would help the FSA to drive EU and international regulatory agendas even more proactively and to set clear strategic priorities. Clear goals are necessary to enlist practitioners' support and push back in Europe with a united, strong message.

At home, the Panel strongly supports the trade associations' view that EU and international regulatory measures must be implemented in a pragmatic manner that avoids super-equivalence, unless there is a compelling case for it – and FSA senior executives, including John Tiner, have publicly embraced such an approach. The implementation of MiFID will prove to be an interesting test case for the FSA's commitment in this regard, and the Panel will closely follow developments in this area (see p.20 for further information).

Finally, the Panel is keen to ensure that the heavy workload generated by EU regulation does not distract the FSA's and the industry's attention away from the wider international picture. Developments across the Atlantic can potentially have a serious impact on the UK financial services industry, and must therefore be watched closely. Moreover, emerging markets in the East, including China and India, are gaining rapidly in influence and thus must be properly considered on the UK's global financial services agenda.

2.G. Hedge Funds

The Panel has shared the FSA's interest in hedge funds over the past year, both from a supervisory and market monitoring perspective, as well as from a retail product angle and was also involved through a sub group in this work[3]. On the supervisory side, the Panel has been keen to establish how the FSA would ensure that it gathered a comprehensive understanding of this market in its entirety, and the associated risks; it was felt that an over-reliance on the prime brokerage side to collect information on hedge funds would only capture a part of the market and ultimately deliver an incomplete picture of risk exposures and leverage. Many hedge funds still use multiple market counterparties and clearing houses. In any event, we welcome the FSA's decision to establish a hedge fund centre of expertise to increase the supervisory oversight of hedge fund managers in the UK.

On the retail side, the Panel would like to see greater accessibility to hedge funds and similar alternative investment products for retail consumers to widen their investment choices and allow them to benefit from any potential growth in this area.

Generally speaking, the Panel supports the FSA's measured approach and its various international and domestic initiatives to tackle this issue in a proportionate, risk-based manner. However, it is mindful that the current fiscal requirements in the UK, which are beyond the FSA's immediate control, make a concerted push to move the regulation of hedge funds onshore difficult at present. It will continue to support FSA efforts to make progress in the retail products arena and welcomes proposals, such as those outlined in the Feedback Statement to DP05/4, that would increase the range of retail collective investment schemes in the UK by allowing funds of unregulated schemes. Alternative investment products more generally are expected to continue featuring heavily on the Panel's agenda in 2006/7 (see p.22 for further information).

3 The sub group members were Alan Ainsworth, Roy Leighton and Alan Yarrow.

3. THE PANEL'S PRIORITIES FOR 2006/7

This section takes a look ahead and outlines some of the areas where the Panel expects to be heavily engaged over the coming year. Again, this is not a complete agenda for 2006/7, which will also include ad hoc issues that will undoubtedly appear on the Panel's radar, as well as many items that are carried over from the previous year.

3.A. 2006 Survey of Regulated Firms

A key priority for the Panel over the coming year will be its next Survey of Regulated Firms, designed to obtain an authoritative industry assessment of the performance of the FSA. This survey, which is carried out every two years, is aimed at gathering industry views on the FSA and establishing a track record of the regulator's effectiveness. Previous surveys have achieved a high response rate, providing robust feedback from the financial services industry[4].

The Panel is particularly pleased to note that in the past the survey's results have been taken on board in a positive manner by the FSA and have had a considerable impact on front-line policy decision-making and regulatory operation generally. A number of the major issues that emerged from the 2004 survey – the excessive and ever-increasing cost of regulation, the treatment of smaller firms and the quality of FSA staff – were prioritised more appropriately on the regulatory agenda and progress has been made. One outcome in particular is the regulatory costs survey, which was launched by the FSA in partnership with the Panel to quantify regulatory costs and identify areas where those costs might not be justified by the benefits they aim to secure (see p.7 for further information).

As before, the 2006 Survey, to be conducted by GFK NOP, is divided into qualitative and quantitative stages. The qualitative phase, involving a series of interviews with a representative sample of senior staff from a cross-section of regulated firms, commenced in early 2006. This provides valuable feedback and context in itself, but is also used to help identify issues for inclusion in the quantitative questionnaire that has recently been sent to firms of all sizes and types.

The substantive quantitative fieldwork – in the form of a postal questionnaire – is taking place during June and July. Subject to input from the qualitative work, our aim was to retain a significant amount of the questions that were asked in 2004 – this will enable reliable benchmarking of the core issues over time. However, we also supplemented this with the addition of more topical matters (e.g. TCF and principles-based regulation) and the removal of those which are no longer relevant.

4 The survey sub group is chaired by Matthew Bullock and also includes Russell Collins, Ruthven Gemmell (Chairman of the Smaller Businesses Practitioner Panel) and Nick Prettejohn.

The inclusion of the newly regulated Mortgage and General Insurance (M&GI) firms will present something of a challenge for this year's survey. While M&GI firms will be included in the study, this will likely be done in such a way as to reflect their "newness" to FSA regulation and to facilitate like-for-like tracking and analysis of the pre-existing population. We will have to balance the need to provide a level of continuity and consistency of the data we collect, to allow for comparisons to previous surveys, with the need to capture the opinions of a new population of more than 14,000 primarily smaller firms. The contribution of the Smaller Businesses Practitioner Panel, which is represented on the survey sub-group, will therefore be invaluable to the successful conclusion of this year's survey.

The questionnaire has been issued to all relationship-managed firms and to a representative sample of smaller firms. We would greatly encourage firms to provide us with their views. The Panel plans to publish the final report findings later in 2006 and will then use the information to inform subsequent discussions with the FSA.

3.b. Generic Advice and Financial Capability

Financial Capability and the related issue of Generic Advice have featured prominently on the Panel's agenda, and in various public appearances of the Panel Chairman. The Panel has been very supportive of the FSA's various efforts to boost consumers' financial capability and progress on Generic Advice. At the same time, it recognises the considerable challenges that are associated with these matters, not the least of which is securing adequate funding for consumer education purposes.

The FSA's seven-point plan on its Financial Capability Strategy, as well as FSA initiatives like the Financial Healthcheck and Debt Test – interactive, web-based tools available through the FSA's consumer website and the BBC website – and the Money Laid Bare campaign are encouraging steps in the right direction to boost consumers' financial capability. The Panel has been actively involved in this area through participation on the Financial Capability Steering Group and the Financial Services Skills Council.

On Generic Advice, the Panel is neither convinced that there is a viable commercial case for regulated firms to provide this, or else they would likely already do so in large numbers, nor that the majority of consumers would be willing or able to pay a fee for such a service. The Panel has therefore stressed the need to pull together the FSA's various financial capability initiatives in one user-friendly and easily accessible place. Its proposal of a central, independent, national internet-based hub for Generic Advice and consumer education appears to be moving forward, and the Panel looks forward to engaging further with the FSA on this matter.

3.c. Better Regulation Agenda

The Panel is very supportive of the findings put forward in the Hampton Report and the Government's Better Regulation Agenda and is actively engaged in a variety of workstreams that have emerged from this initiative. For example, the Panel has contributed its views to HM Treasury on their proposed Value for Money Review of the FSA.

The Panel was also engaged in and welcomes the long-awaited Regulatory Reform Order, which intends to make amendments to the Financial Services and Markets Act (FSMA) to remove unnecessary process restrictions on the FSA, for example, by introducing greater flexibility to the FSA's requirement to consult on rules, guidance and certain other matters. It will be important, however, to ensure that procedures are in place allowing firms to raise concerns about proposals for rule changes that are to be made under the fast track procedure in cases where unexpected difficulties are identified.

The recently announced review of how the UK puts EU legislation into practice, which runs parallel to other work by the Cabinet Office's Better Regulation Executive to reduce regulatory burden, is a further encouraging development and one to which the Panel hopes it can contribute going forward. Over the coming year the Panel will be happy to engage further on the aforementioned and other initiatives that will contribute to enhancing the regulatory environment in the UK.

We will also liaise closely with the FSA in its continuing efforts to reduce the regulatory burden on firms and remove those rules that are costly but provide few tangible benefits. In this context, it is important that the industry is receptive to the notion of such deregulation, both in terms of helping to identify potential requirements for removal and otherwise supporting the spirit in which the FSA is seeking to act in this regard.

3.d. HM Treasury Value for Money Review

The Panel is supportive of HM Treasury's Value for Money Review of the FSA and has shared its informal views with HMT on specific areas which should be explored further as part of the review. Some of the areas where the Panel considers FSA resources might currently be over-allocated include the duplication of requirements (e.g. the overlap between detailed client money protections and capital adequacy rules); and the overall number and frequency of thematic reviews.

On the other hand, the Panel felt that an increase in FSA resources could be valuable to address possible shortages in the number of staff with the necessary technical skills to implement Basel II capital adequacy requirements; in accountancy skills; and in specialist technical skills relating to investment banking supervision, to provide dependable and practical guidance on rule interpretations in areas as diverse as fee calculation and insider dealing.

Other areas the Panel recommended for further investigation included the FSA's approach to conforming to the principles of good regulation in FSMA; the

visibility and effectiveness of the FSA's international work and its impact on the international competitiveness of the UK financial services industry; the speed and effectiveness of FSA work on enhancing Financial Capability and delivering Generic Advice; the proportionality of the enforcement regime; and the effectiveness of outsourcing solutions.

The Panel has offered HMT its assistance in taking this project further and looks forward to discussing this with the parties involved in due course.

3.e. Consumer Credit

There have been discussions to possibly extend the scope of the the FSA's regulatory remit to include consumer credit and certain personal pension schemes (SIPPs), following the release of the Hampton Report in March 2005. The Government was consulting on this issue in early 2006.

The FSA's position regarding the potential transfer of consumer credit functions from the Office of Fair Trading (OFT) is clear. In the Chairman's Foreword to the FSA's 2004/5 Annual Report, Callum McCarthy wrote:

"No argument has been advanced that such a move would help the consumers and firms whose interests are at stake; it would mix local enforcement done by trading standards officers with a very different approach adopted by the FSA; and it would add some 100,000 licensees to those currently regulated by the FSA. I have grave reservations about the wholesale transfer of these responsibilities to the FSA (which I recognise is at present no more than a possible option) and will wish to explore with Government other arrangements which hold out the prospect of better achieving the protection of consumer interests."

There are significant potential implications for the FSA, which might not be in the best interests of consumers and firms. Moreover, some practitioners have expressed grave concerns that, if full responsibility for the regulation of consumer credit were to be transferred to the FSA, the whole operational shape and nature of the organisation, and the way in which existing firms are currently regulated, may have to change substantially.

Latest proposals suggest that rather than pushing for a full transfer of consumer credit responsibility to the FSA, a compromise solution is more likely. This would be based on increased co-operation between the FSA and the OFT, information sharing and avoidance of duplication of regulation. The Panel welcomes this development and will stay closely involved in this matter over the coming year.

3.f. MiFID and CRD Implementation

The implementation of the Markets in Financial Instruments Directive (MiFID) and the Capital Requirements Directive (CRD) will have a significant impact on the regulation and operation of the UK's financial services industry. The Panel will remain vigilant over the coming year and closely monitor developments in

this area. To maintain the competitiveness of UK firms, it will be vital to ensure the following:

- **Timetable:** Firms must be given adequate time (and clarity) to implement the directives' provisions prior to the implementation deadline.
- **Pragmatism:** The FSA should, where possible, adopt a flexible, risk-based and proportionate approach to the transposition of the directives into UK regulation and to monitoring firms' compliance.
- **Avoidance of goldplating:** Unless there is a compelling reason for it, the FSA should avoid goldplating and over-zealous interpretations of the directive text, where they leave room for such discretion.
- **Co-operation with the industry:** The FSA should work closely with industry representatives – in particular, trade associations – during the implementation phase and should update stakeholders regularly.

MiFID continues to be a moving target, and its eventual implications for UK firms are not yet fully apparent. Regardless of the final outcome, the Panel alongside other industry representatives has been encouraging the FSA to continue to work as closely as possible with the industry on the directive's implementation. The Panel has welcomed the FSA's co-operative approach to date, which includes regular industry briefings and the issuance of information documents such as "Planning for MiFID", and also supports the trade associations' initiative to form the MiFID Connect Group. The Panel would encourage the FSA to delegate much of the highly detailed and resource-intensive interpretative work to the Group and collaborate with it to produce guidance for firms.

The slippage of the implementation timetable remains a major concern for the industry. Another challenge for the FSA is the management of the interplay between MiFID and CRD, and their respective timelines.

Flexible, pragmatic and proportionate implementation remains a key objective for stakeholders. The Panel will continue to urge the FSA to take a suitable approach and will remain vigilant to ensure that the concessions won in Brussels are not lost either by goldplating, or by taking an overly cautious approach to interpreting EU text which has been quite deliberately drafted with 'constructive ambiguity'. Where the directives have swept away existing regulatory tools, the FSA should not be tempted to re-introduce them.

Aside from its focus on specific EU-related issues, the Panel will continue to closely monitor the FSA's engagement and visibility in the international arena outside the EU. It will be crucial to ensure that the UK financial services industry's interests are properly represented in the global arena to protect the competitiveness of UK based firms vis-à-vis their international counterparts.

3.G. Other Issues on the 2006/7 Agenda

The following items are also expected to take up a considerable amount of the Panel's time and attention. The list focuses on some key issues and is not a complete representation of the Panel's work plan for the coming year.

- **Quality of FSA Staff:** The need to improve the overall quality of FSA staff, especially on the supervisory side, is one of the most frequently discussed topics at Panel meetings, especially in the context of principles-based regulation and Treating Customers Fairly. The Panel will therefore continue to raise this issue with senior FSA executives and will stay closely engaged with the relevant staff on the human resources and training side. As mentioned earlier in this report, several well thought out initiatives are currently under-way within the FSA to address this issue, and the Panel will closely monitor their progress and impact on the regulator's day-to-day operations and performance (see p.10 for further information).

- **Alternative Investment Management:** While hedge funds were an important item on the Panel's agenda last year (see p.16 for further information), the general area of alternative investment management products will continue to be a dominant topic over the coming year. Specifically, the FSA has recently announced an inquiry into private equity products, along the lines of its review of the hedge funds sector, and the Panel looks forward to engaging with the FSA on this important issue.

- **Financial Services Compensation Scheme (FSCS):** The Panel has been involved in the FSCS Review Advisory Group through one of its members over the past year and will continue to be involved in these important discussions going forward. The debate touches on the complex issue of product provider versus distributor responsibility, which was mentioned earlier in this report. At this stage the Panel supports a degree of pre-funding for problem–prone sectors where many firms are lowly capitalised, but is not yet convinced of the benefits of significant cross-subsidisation, especially from the wholesale to the retail sector. It will be interesting to see how the debate unfolds over the coming year, and the Panel will actively contribute to it.

- **Retail Financial Services Group (RFSG):** The Panel's Chairman is a member of the RFSG, which was set up in 2005 in response to the House of Commons Treasury Select Committee report on long-term savings and consumer confidence. The report discussed a wide variety of issues, including mortgage endowments and consumer financial capability, and recommended the establishment of a broad ranging forum that should include representatives from all parts of the industry, consumer groups, the FSA and Government.

The RFSG, chaired until recently by Richard Lambert, an external member of the Bank of England Monetary Policy Committee, had its first official meeting in June 2005 and aims to encourage a savings culture and competitive retail financial services environment in the UK by building consumer confidence. The Group is an appropriate forum to discuss certain complex, high-level issues, such as consumer responsibility, equity release and financial capability. The Panel looks forward to engaging further with the Group over the coming year.

ANNEX I
Background to the Panel

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

Objectives

"The Panel sees its main role as being that of a 'constructive critic' of the Financial Services Authority"

The Panel considers that it has six core objectives:

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

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

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

Membership

The current members of the Panel as at 1 April 2006 are:

Roy Leighton, Chairman, Nymex Europe (Chairman)

Jonathan Bloomer, Managing Director, Operations Europe, Cerberus UK Advisers LLP (Deputy Chairman)

Alan Ainsworth, Former Deputy Chairman, Threadneedle Asset Management

Matthew Bullock, Chief Executive, Norwich & Peterborough Building Society

Russell Collins, Head of Financial Services Practice, Deloitte UK

Clara Furse, Chief Executive, London Stock Exchange

Douglas Gardner, Distribution Director, Positive Solutions

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

David Hardy, Chief Executive, London Clearing House

Colin Keogh, Group Chief Executive, Close Brothers Group

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

Nick Prettejohn, Chief Executive, UK Insurance, Prudential

Patrick Snowball, Group Executive Director, Aviva UK

Andrew Ross, Chief Executive, Cazenove Capital Management

Alan Yarrow, Vice Chairman, Dresdner Kleinwort Wasserstein

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

Further information on the role and work of the Financial Services Practitioner Panel can be found on its website: **www.fs-pp.org.uk**

Further information on the role and work of the Smaller Businesses Practitioner Panel can be found on its website: **www.sbpp.org.uk**

ANNEX II

FSA Annual Report 2004/5 – extract

http://www.fsa.gov.uk/pubs/annual/ar04_05/Appendix%206.pdf

We welcome the positive comments in the Panel's Report, in particular its acknowledgement of the work we have already carried out, or are planning, to address the issues which are of concern to the industry and to the Panel. We look forward to continuing our discussion of these subjects with the Panel in the open and constructive way which has characterised our relationship over the last year.

The costs of regulation

As we have said in our Business Plan, we are aware of the burden of regulation on the firms we regulate, especially small firms. In our view increases in compliance costs over recent years have to some extent been necessary to bring standards of risk management and behaviour in firms up to what is now required. However, we agree that we need to continue to work hard to test whether the benefits of new rules we propose justify the costs. Market failure and cost-benefit analysis will continue to drive our policy thinking. When developing policy proposals we will consider the likely effects of those policies on small firms. As the Panel is aware, we have embarked on a project to identify areas where our requirements can be cut back without damaging our ability to achieve our regulatory objectives.

A majority of our policy work is driven by EU legislation. We wish to see full regulatory impact assessments as part of an evidence-based approach to EU policy-making and for the full range of non-legislative solutions to be explored before proposals for further EU legislation are brought forward. In implementing EU legislation, our policy is that our rules will be superequivalent (that is, going beyond the strict requirements of a Directive) only where this is necessary to maintain standards in UK markets and to help us achieve our statutory objectives. We apply this policy pragmatically, taking into account the need to implement Directives on time and cost-effectively.

To date there has been no agreement between regulator and regulated on the proper definition of 'costs of regulation' nor on the nature and extent of total regulatory costs and incremental costs (i.e. those costs which well-managed firms would not incur in the absence of regulation). We believe that the research that we have now jointly commissioned with the Panel will provide an agreed basis for a better informed discussion of this important issue, and we look forward to discussing the results with the Panel and, in due course, with the industry.

The FSA's risk-based approach ('Arrow')

We welcome the Panel's constructive response to our review of 'Arrow' and to our continuing work to embed a truly risk-based approach in our day-today work. We recognise that an important part of this is continuing to build and develop the knowledge and skills of our staff. We describe in some detail in our Annual Report the work we have done to recruit, retain and manage effectively the staff we need.

We agree that a proportionate and risk-based approach is needed just as much from the FSA and law enforcement, as it is from firms. Improvements to Arrow must include improving the identification and assessment of Financial Crime risk by our supervisors.

Endorsing trade association guidance

We welcome industry initiatives to improve its own practices. Examples include the Banking Code, the work of the Joint Money Laundering Steering Group and the recent work by the brokerage and fund management industries, in active dialogue with the FSA, on a framework for improved practice in relation to the execution and research elements of commission. If problems are dealt in this way, then market failures may be corrected without the need for further detailed FSA rules.

We would distinguish this situation from the provision of guidance by trade associations to supplement rules that the FSA has made. In such a situation we have decided that rulemaking to address the market failure is appropriate. Where the relevant rule would otherwise be unclear, we stand ready to issue guidance.

Our commitment to open and transparent regulation (including public consultation involving all those with an interest in the rules in question) and our duty to pursue our statutory objectives mean that, where provision of guidance is needed, then it will normally be most appropriate for that material to be FSA guidance. That guidance would be made following public consultation in accordance with the statutory requirements and our public commitments including regarding cost benefit analysis. Of course, the FSA would take account of industry views and, if appropriate, may draw from industry material.

As an alternative to producing FSA guidance, the FSA is willing to consider endorsing industry guidance in appropriate circumstances. For example, in January 2004 the FSA endorsed the statement of recommended practice for financial statements of authorised funds issued by the Investment Management Association. In these situations the normal processes for public consultation would still apply.

Where an industry body elects to produce its own guidance, and if that guidance is warranted and it is appropriate for it to be given by an industry body rather than by the FSA, then the FSA is willing to review it and offer views including, where it is the case, stating that the guidance is consistent with the intended effect of our rules. Any such statement would need to include an explanation of the effect of the statement. An example of where we have done this is the industry

guidance on conflicts issued by the British Bankers Association and other organisations in February 2004.

As the Panel says, we are moving to more principles-based rules, where compatible with our objectives and EU requirements. We consider that this is likely to lead to the need for more guidance rather than less, particularly for smaller firms. We know that there has been some concern in the industry that an unwelcome by-product of trying to simplify the Handbook will be to drop guidance of real value. We can confirm that this is not our intention. But, as has always been the case, firms should not look to guidance from the regulator as a comfort blanket to reassure them that they do not need to take responsibility themselves for complying with the rules, or that the rule does not mean what it says.

Treating customers fairly

We welcome the Panel's involvement in our Treating Customers Fairly (TCF) initiative. We continue to work with the Panel and other industry representatives to ensure that as we develop our work we take account of the views of our stakeholders, including industry, through our consultative group (of which trade bodies, the Financial Ombudsman Service and consumer representatives are also members). We also have regular discussions with trade bodies and meetings with individual firms to gain a better understanding of the implications of TCF for particular types of firm. The TCF principle is not a new requirement – it has existed since N2 – and our supervisors have always considered the extent to which firms treat their customers fairly. Our TCF work aims to reinforce the requirements of the principle and to help firms understand what they must do to comply with it. A key element of our communication with industry is the finding out what material will help firms and their senior management to do this. We have already published reports of supervisory work and a case study for firms. We intend to publish further material for firms in June 2005.

Our primary objective is to raise standards for the future. To do this, we will use the regulatory tools that best achieve our aims, and in many cases these will be supervisory rather than enforcement. But we do not rule out the possibility of enforcement action for a breach of the TCF principle where that is an appropriate and proportionate response. In reaching a view on that, we will take into account the standards of conduct that were considered acceptable at the time of the breach and the extent to which the senior management of the firm had sought to ensure compliance with the principle.

Enforcement

Our review of our enforcement process is under way and its recommendations are due to be published in July. As the Practitioner Panel Report notes, the review team has had discussions with the Panel, as well as with a range of other stakeholders. We welcome the Panel's input.

Arrangements for settlement between the FSA and firms subject to enforcement action is a topic on which we sought views in our published Issues Paper, and will be given careful consideration. We also recognise that the industry's understanding of current enforcement and decision-making processes is variable. The FSA and the new chair of the Regulatory Decisions Committee (RDC) agree that we will need to promote greater awareness of the procedures that emerge from this review.

ANNEX III

Panel Chairman, Jonathan Bloomer's speech to the FSA Annual Public Meeting – July 2005

Good morning,

It is my pleasure to address you again as Chairman of the Financial Services Practitioner Panel after another year in office. As always, it has been an eventful year for the Panel and for the Financial Services Authority itself – no rest for the wicked!

Since I last spoke before this audience, over 14,000 new firms have come under the aegis of the FSA's regulatory regime, with the inclusion of mortgage advisors and general insurance intermediaries, while the FSA is also busy working on the transposition of major EU directives into UK law. On the Panel's side we completed our third biennial Survey of regulated firms and, in addition to our regular activities, were and still are engaged in numerous sub groups, forums and advisory committees. More about that later.

On a general note, it is reassuring how the Panel's relationship with the FSA has evolved over the past 12 months. Two of our main complaints since the establishment of the Panel in 1998 – the deluge of consultation papers and its involvement at such a late stage in the consultation process that could hardly make a difference – are moving in a positive direction.

The overall number of consultation papers that come before the Panel and the industry at large has reduced significantly, in line with John Tiner's commitment in 2004 to halving the overall numbers of FSA CPs. This allows us to spend more time on each issue and feed back to the regulator more effectively. Moreover, it gives us greater flexibility to be proactive in organising our time and agendas to focus on the issues that we consider to be most important.

At the same time FSA staff are beginning to approach the Panel at a much earlier stage in the policy-making process. This allows us to make our contribution at a strategic and conceptual level, as we had always wanted, rather than getting too involved in the detailed technical discussions of the later consultative stages – something for which we have neither the inclination nor the resources, and which really is more within the realm of the industry bodies and individual firms.

The cost of compliance is still seen as the single largest issue by the more than 3,000 firms surveyed by us. The majority of all firms categorised their current total cost of compliance as high or excessive – and nine out of 10 practitioners believe that costs would continue to rise for the foreseeable future! 29% of all practitioners and 36% of those from smaller retail businesses stated that compliance costs were 15% OR MORE of total cost. Unsurprisingly, this burden is even more keenly felt by smaller firms – Ruthven Gemmell, Chairman of the Smaller Businesses Practitioner Panel will elaborate on this point later.

Disconcertingly, many felt that this would have an adverse impact on consumer choice, as firms would reduce the range of services they offered or curb new product development, and would be detrimental to innovation and to the international competitiveness of the UK financial services industry.

While we realise that not all of these costs are generated by FSA regulation, the regulator could still play a major role in reducing the industry's cost burden. The Panel thus welcome current efforts by the FSA to identify areas in which it could roll back regulation without sacrificing any necessary investor protection, for example, as part of its ongoing Handbook Review. An actual reduction in regulatory requirements where possible would be seen as a great step in the right direction by practitioners.

Moreover, we also strongly support the survey into compliance costs, which the FSA is conducting in partnership with the Panel. This is an important piece of work. The Panel was keen to be co-joined in its governance and the FSA's agreement to this demonstrates the willingness on both sides to produce a piece of research that has the necessary degree of practitioner input and credibility. The work will quite rightly pay particular attention to the way that costs bear most heavily on smaller firms, and will also endeavour to look at how costs in the UK compare with other relevant international marketplaces. We would expect results to become available late this year or early next year and hope that they will help the regulator identify areas in which the compliance cost burden could be reduced.

Another area of continuous concern is the amount of regulation, in particular those initiatives that are driven by European Union legislation. For example, the huge mortgage and general insurance framework was in the first instance driven by European legislation. MIFID and the Transparency Directive are two other pieces of legislation that have been prompting large-scale regulatory action in the UK.

While we accept that this is not the FSA's doing, we cannot help but wonder whether the FSA is as effective as it could be in the formative stages of EU legislation and whether it does enough to represent the interests of all UK financial services markets participants – practitioners and consumers. Furthermore, the Panel continues to monitor whether the FSA transposes EU directives in the most effective and pragmatic manner.

As I said earlier, the Panel is pleased that many of its comments and suggestions have been taken on board by FSA staff. I would like to briefly discuss some of areas where we believe our influence has resulted in an improvement, but I must stress beforehand that, obviously, the Panel does not work in isolation, and its achievements are often a joint effort with the trade bodies and individual firms that lobby tirelessly for a best-of-breed, competitive and proportionate regulatory framework in the UK.

One area of great Panel involvement was Treating Customers Fairly. The Panel never objected to this initiative per se. In fact, it would argue that practitioners in this country would see fair treatment of their customers as an integral part of a successful business strategy. However, we did express our grave concerns about the prejudicial, negative language in early versions of the TCF paper, which we felt

could have a detrimental effect on consumer confidence, and the lack of recognition of the sound work that had already been conducted by the industry to raise standards.

Since then, things have moved on considerably. The TCF paper published earlier this month included many of our suggestions and is a vast improvement on the earlier versions. Now it will be crucial to ensure that TCF will be applied in a suitably proportionate, risk-based and pragmatic way. The proof will be in the pudding, so to speak. Ruthven again will elaborate on this subject from the smaller firms' perspective. The Panel will continue to monitor further developments in this matter and take an active role in any future work streams.

Another related area in which we believe we have made some progress over the past year is caveat emptor, or buyer beware. We always maintained that TCF could not be considered in isolation from the recognition that consumers themselves must take some responsibility for their investment decisions – an obligation that is enshrined in FSMA legislation.

We have been part of a working group with the Consumer Panel and senior FSA representatives to articulate some reasonable expectations of consumers' as well as firms' responsibilities. Later this year the FSA will publish a paper on the subject; at the very least we have managed to launch a discussion on this important subject and get FSA staff to include it in their policy considerations.

Finally, Panel members have always felt that the quality of FSA staff is crucial in ensuring an effective regulator – particularly on the supervisory side. We believe that it is reasonable to expect FSA staff to be similarly qualified as the people they supervise. We therefore warmly welcome the FSA's training curriculum for its staff, which they shared with us at a recent meeting. This effort should reap great rewards both for the FSA as well as for regulated firms.

The coming 12 months look like another busy period for the Panel. We are involved in a number of working groups, dealing among other matters with the aforementioned cost survey, monitoring the impact of depolarisation and the M&GI regimes, the Financial Capability Steering Group and the Retail Financial Services Forum (now called the Retail Financial Services Group). Moreover we continue to be involved with the ARROW review, the Handbook review, and many other ongoing work streams. Finally, we are already launching preliminary preparations for our 2006 Survey of Regulated Firms, to build on our important work of creating a track record of the regulator's performance.

This will be my last appearance before you as Chairman of this Panel. Roy Leighton will assume the chair in November. I would like to take this opportunity to thank my fellow Panel members for their invaluable contributions and the Panel secretariat for their support. I would also like to thank the FSA for its continued constructive dialogue with the Panel. We may not always agree but I believe both sides realise that an open, collaborative and challenging debate in the end leads to a more effective regulatory regime. It is no accident that other regulatory bodies, including CESR in Europe, have started to imitate this model.

PUB REF: 2587