Annual Report
2012/13

Chairman's Foreword

I am pleased to have taken the Chair of the FCA Practitioner Panel from 1 April 2013, and to be leading such a group of experienced and committed colleagues from across the financial services industry at such a significant time in the development of financial services regulation in the UK. I am grateful to my predecessor Joe Garner, who led the Panel so ably for the past year.

While this annual report focuses on the work undertaken by the previous Financial Services Practitioner Panel with the FSA, I also want to take this opportunity to look ahead to the FCA Practitioner Panel's work with the Financial Conduct Authority (FCA) from 1 April 2013.

At a time of significant regulatory change, it is all the more important for the FCA to have the ability to consult its statutory Panels on the most effective way to achieve its objectives.

The role of the Practitioner Panel is to represent the views of regulated firms in debates with the regulator. To assist us in this role, the Practitioner Panel commissioned the independent research company, GfK, to undertake a Survey which we published in May 2013. We are extremely grateful to the 1,470 firms who contributed to the survey.

From the Survey we identified three key findings for action from the FCA:

- More work is needed to support the FCA's competition objective;
- Communication with firms needs to improve; and
- Firms want clearer and more predictable regulation.

We plan to monitor FCA progress on each of these issues over the coming year.

Our priorities will be focused on the need to ensure that the FCA is able to achieve its new statutory objectives in an effective manner. It is to the benefit of consumers and the industry alike to have a regulator which achieves the overall objective of ensuring markets work well. I look forward to active engagement with the FCA on the development of its new approach to regulation during 2013-14.

Graham Beale

Chairman, FCA Practitioner Panel

1. INTRODUCTION

This annual report is for the Financial Services Practitioner Panel, which was a statutory Panel for the Financial Services Authority (FSA). The majority of the members of this Panel were transferred over to the FCA Practitioner Panel when the FSA was replaced by the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) on 1 April 2013.

The Financial Services Practitioner Panel provides senior level industry input into the FSA, with membership selected to reflect the major sectors of the UK financial services industry. The Panel continues in the same manner now. It focuses mainly on issues with a cross-sectoral impact, and does not seek to duplicate the work of trade associations. The Panel has regular liaison with the main trade associations to help ensure a coordinated view from the industry to the regulator.

The year ending 1 April 2013 was, for the Panel, understandably dominated by the discussions on developing the new regulatory system. However, the Panel also developed a themed approach for considering the relevant issues. The themes are the:

- Potential unintended consequences of regulatory actions;
- Balance between consumer protection and consumer responsibility;
- Appropriate approaches for wholesale and retail;
- Potential inconsistencies between EU/international and UK approaches.

This report therefore follows activities according to these themes.

2. PREPARING FOR THE NEW REGULATORY SYSTEM

2.1 FCA culture and transparency

When the FSA was setting out the proposed approach for the FCA, the Panel emphasised the importance of the regulator working in a constructive manner with the industry. We suggested that the FCA should consider adopting a success measure related to an increase in the level of mutual trust and confidence in financial services, not just between consumers, firms and the regulator – but also politicians, consumer groups and the media.

We suggested that a key area of FCA culture should be not only one that is more judgemental, proactive and determined, but also one that is 'balanced and thoughtful'. We suggested that the FCA should build on positive engagement with firms, and be clear on the ways of working for the new regulator. We have looked to highlight opportunities where the FCA can show where firms are doing things well, and not just focus on the firms who are performing worst through complaints and enforcement procedures.

We were pleased to engage in debate on how the FCA would use the greater emphasis on transparency in its remit. We emphasised, as previously, that the contextualisation of data published about firms would be critical. We registered concern about the way that newly published areas of information, such as that relating to insurance premium payouts and enforcement warning notices, would be interpreted.

We were also concerned to ensure that transparency requirements did not lead to a restriction of internal debate and consideration of the FCA's activities. One example was in the interpretation of the financial promotion banning powers, which seemed to require the FCA to publish its use of a banning power, whether it was upheld on appeal or not. We felt that it would be unhelpful for the regulator and firm, if the FCA was found to have been wrong about its decision, and yet still the details would need to be made public.

2.2 FCA risk articulation

We encouraged the FSA to articulate the risk levels planned for the FCA in the same way that the PRA had done, so it could set out a yardstick against which its work could be measured. We acknowledged that it was more difficult to set tolerance levels of potential consumer detriment, but said this should not be a reason to avoid doing so. Indeed, it was all the more important to be clear about what could be achieved, as we warned that the FCA must not come

under political pressure to offer an undeliverable guarantee for all consumers, which would not be healthy for the economy, firms or ultimately, consumers.

We were pleased to provide input into the development of the FCA's Risk Outlook, which was published at the end of March 2013. We emphasised our previous position, and warned of unintended consequences of the FCA setting out with an extremely low risk tolerance for detriment. We saw a danger of the FCA 'overshooting' in its demands, which would lead to firms withdrawing from markets and products (eg investment advice and interest-only mortgages) rather than leaving themselves potentially vulnerable to uncertain regulatory action.

2.3 FCA Business Plan, outcomes and success measures

As the FCA's first Business Plan was being developed by the FSA, the Panel emphasised the importance of rigorous cost control going forward. We pointed out that there had been continual fee increases over the past few years, and asked the FCA to take into account the other regulatory costs faced by firms, as well as the general economic environment, and the impact of many firms having to pay for dual regulation.

We asked the FCA to take a radical look at its costs and to scrutinise any areas where it could cut back expenditure, before asking for any further fee increases. Although the overall fee levy was again increased for 2013-14, we believe that the FCA is conscious of the need to control costs. We are hopeful that the new remit for the National Audit Office in undertaking Value for Money studies of the FCA will enable there to be some external independent scrutiny of the FCA's costs in the future.

We suggested that the wording of the outcomes and success measures specified in the Business Plan would become critical in channelling the focus and energy of the FCA in its first few years. We therefore highlighted some key elements of the FCA's objectives which should have an impact on the development of its priorities. For example, the FCA's objective is to secure an appropriate degree of protection for consumers, rather than the maximum degree of protection.

The FCA must also apply the general principle that consumers should take responsibility for their decisions. Therefore, the FCA should consider when its consumer protection measures might go too far and end up restricting the provision of higher risk products and services to those consumers who were willing and able to take responsibility for their actions.

Under its competition objective, we were somewhat reassured by the team that the FCA will not be a price regulator after we registered some concern about plans to scrutinise prices as part of the outcomes measures. While we accept that price can be a useful indicator, it should not be seen as a measure to be used by itself. We also suggested that the FCA should consider to what extent competition is encouraging innovation. Under the objective of protecting and enhancing the integrity of the UK financial system, we suggested that the FCA should not just be aiming for 'stable' markets, but should aim for 'growing' financial markets.

2.4 FCA supervision structure

We have been supportive of the plans to change the structure of supervision work to reflect the changes in focus for the FCA. The more sector-based supervision structure will enable supervisors to specialise in one sector, and apply a thematic approach which should lead to more effective supervision.

The biggest risk in this area continues to be in ensuring that the FCA has the right calibre and experience of people to undertake supervision. We were pleased to see that this was recognised, as the FCA's restructuring of the Supervision division included more senior-level Directors. We urged the FCA to prioritise the recruitment of these Directors, given their seniority and importance in the new structure.

We suggested that the FCA should look at setting up a formal system of regular secondment from industry. This could lead to a more planned approach from firms, who could regard secondments to the FCA as part of career development opportunities for their best staff.

2.5 Regulator's role in changing firms' culture

In our response to the Parliamentary Commission on Banking, we used the opportunity to emphasise how important it is to create a culture where the people running banks deeply and thoughtfully consider the outcome of their actions on their customers and the broader community, while still delivering an attractive return for shareholders.

We suggested that regulators and policymakers should seek to incentivise positive cultural change, and that the culture in firms can be measured, regulated and steered in a certain direction. It is important for the FCA to recognise the broader impact of its requirements and rules when setting out its future agenda.

We also used this approach in considering the FSA's work on the risks to customers from financial incentives. We asked the FSA to emphasise that they did not regard incentive payments to sales staff to be inherently bad. The emphasis should be on control over incentives, and that the surrounding culture at the firm using those incentives needs to be right. Examples of good practice as well as bad should be used by the FSA (and FCA going forward) in connection with this work.

Also during the year we asked the FSA to ensure it carries out effective monitoring of the impact of the RDR (Retail Distribution Review) in changing the culture and practices of the advice sector. This programme has led to a radical revision of incentive payments and the way that advice is given to customers. We look forward to engaging with the FCA in discussing their RDR post-implementation review at the appropriate time.

2.6 Prudential and conduct coordination

We have continually emphasised how important it is for firms who are dual regulated (ie regulated by both the PRA and FCA), to have some coordination of activities. Although we understand that the new regulators will necessarily look at different aspects of a firm's business, there will be much that overlaps in terms of information required and engagement with senior level executives.

We argued that the PRA, as well as the FCA, should have some regular and statutory input from practitioners. We were pleased that the House of Lords inserted a parallel requirement for the PRA to have a Practitioner Panel into the new legislation. We very much hope that the FCA and PRA Practitioner Panels will have some opportunities to liaise in the future.

3. POTENTIAL UNINTENDED CONSEQUENCES OF REGULATORY ACTIONS

3.1 FCA positioning and tone of voice

During this year, we engaged in an ongoing debate with the FSA about the positioning of the FCA in the public domain. We were concerned that, if the FCA became too aggressive towards the industry in its public statements, it would have consequences that could be the opposite of what was intended. Such messages could further undermine trust in the industry, and over-promise on the FCA's powers to act and prevent all wrong-doing.

We also suggested that the regulator should provide positive examples of the industry making improvements, as well as highlighting significant faults when they occur. An example of where this could have been done better was in the FSA's publication of thematic work on the management of conflicts on interest in asset management in November 2012. The work was based on a small sample of the industry, and contained some examples of good practice as well as bad. Yet the messaging – and so ultimate publicity for this work – was overwhelmingly negative.

We were pleased that the launch of the Journey to the FCA document in October 2012 emphasised the need for partnership with the industry in achieving the FCA's objectives. We have encouraged the FCA to continue in this vein. Although there will always be a 'healthy tension' in the relationship between regulator and firm, we suggested that the FCA considers making a formal commitment to the level of trust it wants to engender with the industry. If the trust is increased from current levels, the FCA should be able to obtain better intelligence and therefore regulate better in future.

3.2 Setting the threshold for use of Section 404 powers

One particular example of how important it will be for the FCA to set clear boundaries for its activities was in the FSA's decision on the use of new Section 404 powers in relation to Arch cru mis-selling. The Panel focused more on the precedent and proportionality of the use of such a powerful regulatory tool in this case than on the rights and wrongs of the case itself.

We pointed out that the use of full Section 404 powers would set quite a low hurdle rate for the future, bearing in mind some of the concerns expressed at the time this power was granted. It could be argued that 18,000 consumers and fewer than 400 firms are not a 'widespread problem', given that there are an estimated 27,000 financial services firms in the UK. There was additional

concern that possibly up to a third of advisory firms were said to be likely to fail if a full Section 404 was used, and this would put further pressure on the funding of the Financial Services Compensation Scheme (FSCS), as it would have to pick up the historical commitments of the firm on any other issue as well.

We were pleased that the Board of the FSA took additional time to consider action in this area. The ultimate position taken by the FSA, which offered a consumer opt-in, was an improvement over the original plans, and a more proportionate approach to the regulator's consumer protection objective.

3.3 Temporary product intervention rules

We acknowledged the need for the regulator to be able to create temporary product rules where there is a risk of significant consumer detriment which requires urgent action, in line with the FCA's expected more pro-active and interventionist approach. However, we supported the view that this power should only be used as a last resort, where a lack of intervention would lead to unacceptable levels of detriment. We were concerned that the FSA did not give a definition of 'significant' levels of detriment, and that the FCA would need to guard against any unintended consequences of its actions in this area.

We suggested that whenever possible when taking action, the FCA should consider a full market impact and Cost-Benefit Analysis and ensure it consults with industry as a whole. We also highlighted the need for greater clarity about what redress is or should be available to firms and consumers, should the FCA find it has used a power inappropriately and inadvertently caused detriment.

We also raised concern about indications that the FCA might use these rules when it perceived a product as being 'poor value for money'. Given that the Government had been clear that the FCA should not be seen as a price regulator, we were concerned as to where such action might lead. Even statements from the FCA to say that it is considering such action could have a detrimental impact on the industry. Any such public statements must be carefully considered by the FCA as they are likely to deter firms from investing in new products and product lines out of fear that the FCA will 'regulate away' any potential profits on innovative products.

3.4 Interest-only mortgages

We were encouraged by the way that the FCA's new approach was being interpreted by the team considering whether regulatory action needed to be taken over consumer understanding of the liabilities involved with interest-only mortgages. We believe that the approach adopted should avoid the potential unintended consequences of raising more concern in the marketplace than is necessary.

We were pleased that the FCA listened to the Panel's input when we suggested that the FCA should aim to get the industry on board with preparing how to respond to customer queries, before publicising the issue to consumers themselves. We suggested that this was likely to result in better outcomes for consumers. We were pleased that the FCA also recognised that this is a long-term issue that need not become a major problem if it is dealt with cooperatively.

3.5 Prudential issues

During the year, we continued to engage in debate on prudential issues with the team who were to transfer to the PRA, as well as those at the FCA for those firms who would not be dual regulated.

For instance, we raised concerns about the cumulative impact of rising capital requirements from a variety of regulatory initiatives. We were also particularly interested in the EU negotiations for capital requirements relating to loss absorbency capital ('bail-in') for banks. We suggested that calculations of bail-in capital based on a percentage of a non-risk weighted balance sheet could have a distorting effect, with potential unintended consequences on consumers and the economy in general. Such an approach could result, for example, in certain building society mutuals and other lower risk business model firms having less usable capital to make available to the market and wider economy.

3.6 Costs and use of section 166

We asked for more information from the FSA on the use of section 166, or skilled person reviews, as we were concerned about the increasing cost and invisible burden on firms when these tools are used. A section 166 report is conducted when the regulator

instructs firms to commission an outside expert to review an aspect of their activities. These can be costly, and the industry is concerned that the FCA has committed to make greater use of section 166 in future.

We also asked the FSA to look into the use of informal or shadow 166s. This is where a firm is asked to provide proof that their systems or processes are robust. Often, the only way that a firm believes it is able to do this is to commission a skilled person to undertake a review. We are concerned that this has an unrecognised burden on firms, and could be a way of regulatory staff passing back their responsibilities for scrutiny of a firm's activities to the firm and outside agencies.

3.7 FSCS funding model review

The Panel has this year continued to reflect the strong industry feeling regarding the fairness and predictability of the funding of the current Financial Services Compensation Scheme (FSCS). Many firms have faced very substantial and unanticipated bills as a result of failures of companies with whom they feel they have little in common. Therefore we were pleased to contribute to the review initiated by the FSA this year.

However, the Panel felt that the FSA's proposals did not go far enough in addressing the key weaknesses of the existing Scheme, and in assuaging industry concerns around fairness and moral hazard.

We welcomed the elimination of cross-subsidy between the PRA and the FCA, but believed the FSA could have gone further in also reducing cross-industry payments within the FCA. While recognising that the FCA classes cannot be self-sustaining as in the PRA, we suggested that consideration should always be given to whether the FSCS could take out a loan, to be paid back by the relevant class over time, rather than paying out through the retail pool.

We argued in favour of the FSA introducing some form of risk-weighting into the firm tariff calculations. We felt that the FCA should have considered some of the existing international alternatives available in this area. We also suggested that the FSA should consider introducing a 'right of access' to information for industry in cases such as Bradford & Bingley.

4. BALANCE BETWEEN CONSUMER PROTECTION AND CONSUMER RESPONSIBILITY

4.1 'Appropriate' rather than maximum protection due from FCA

The FCA's decisions on the appropriate level of consumer protection will have a significant impact on firms and the competitiveness of the financial services industry. We have therefore taken a particular interest in the development of the consumer proposition and culture for the FCA, as set out in Section 2 of this report as a key element of the Panel's work this year.

4.2 Consumer responsibility research initiated

The Panel has agreed with those developing the approach for the FCA, that it could play a role in helping the debate about how the FCA could approach consumer responsibility in the context of its regulation of the financial services industry.

We believe there is a 'gap' in views on consumer responsibility between firms and customers which needs to be addressed. We are keen to close this gap and to help to agree a boundary which means that firms have a degree of certainty on the extent of their responsibilities. We continue to believe that there could be a seriously adverse impact on the provision of financial services to some customer segments as firms decide to withdraw from certain products rather than risk unmanageable responsibility for consumer decisions.

We have therefore commissioned some qualitative research work with consumers and firms, to look more at perceptions of consumer responsibility. We look forward to reviewing the results of this work with the FCA later in 2013.

4.3 Money Advice Service role

The Panel has always taken the view that financially literate consumers are better consumers, and that working to improve the financial capability of the public at large is a laudable aim. We have therefore been supportive of the Money Advice Service's (MAS) statutory objectives to enhance the knowledge of the public on financial matters, and improve their ability to manage their own financial affairs.

However, we expressed concern about the lack of detail in the business plans provided by MAS for 2012-13 to justify the amount of investment asked for. We emphasised the importance of strong oversight and accountability of this body. We were felt there was some improvement in the level of detail for MAS's Business Plan and Budget for 2013-14. We supported the adoption of key measurable outcomes by the MAS, as well as better strategic use of interlinkages with other organisations such as Citizens Advice.

4.4 Financial Ombudsman Service

We have supported the measured and constructive way that the Financial Ombudsman Service has responded to the increased demand on the service with the Business Plan for 2013-14. Nevertheless we remain frustrated about the pressure on the Ombudsman due to the activities of Claims Management Companies.

In addition, although we welcome the Ombudsman's attempts to make registering a complaint as easy as possible, we expressed some reservation about activities which might tip into the territory of actually generating complaints by engaging in online social media forums.

4.5 Claims Management Companies

The Panel has become increasingly concerned about how some Claims Management Companies (CMCs) are misleading consumers. The lack of effective regulation by the Ministry of Justice in this area is damaging. The opaque nature of their work, and pressure selling of their services mean that consumers are not being well served, and there is not an open competitive marketplace where consumers can choose a CMC in full knowledge of the costs involved.

We made representations to the Ministry of Justice and to the Legal Ombudsman to suggest that, even if the regulation of CMCs remains at the Ministry of Justice, people should at least be able to complain to the Legal Ombudsman about the actions of CMCs. We were pleased that the Ministry of Justice has now said that it will make this change, although the exact timing for this remains unclear.

5. APPROPRIATE APPROACHES FOR WHOLESALE AND RETAIL

5.1 The need for a balanced approach for wholesale

During the development of the legislation for the FCA, we registered concern about the single definition of 'consumer' for the Financial Conduct Authority. We were worried that this means the industry has to rely on the regulator being clear on a proportionately different approach towards wholesale and retail consumers, without there being any formal differential which can be used as a point of reference.

Such a focus on retail consumers was evidenced in the Journey to the FCA document, published in October 2012. We pointed out that there was not much detail on the way that the FCA would approach the regulation of wholesale markets. It only relied on general comments such as there being a 'more systematic focus on wholesale conduct' and an 'opportunity to do things differently', without any detail about how this would be achieved. The majority of the rationale for taking action in wholesale markets was on the basis of the ultimate impact on retail consumers, rather than on the need to have clean markets for wholesale players. And yet, the perceived efficiency and effectiveness of the wholesale market is important in itself, as it has a significant effect on the competitiveness of the UK's financial markets.

5.2 Markets Practitioner Panel plans

We were pleased that in the legislation for the Financial Conduct Authority, the Government recognised that there was a need to encourage debate on the regulation of markets through the creation of a separate Markets Practitioner Panel.

We were keen to assist in ensuring that the Markets Practitioner Panel would be able to start immediately after the creation of the FCA on 1 April 2013. We therefore established a Sub Group of Practitioner Panel members who were involved in wholesale markets, to meet and develop an outline approach for the Markets Practitioner Panel.

5.3 FCA implementation of market powers

The Markets Sub Group provided the information for the Panel to respond to a consultation (CP12/37) on the new market powers, decision making procedures and penalty policies. We supported many of the proposals, although noted some concerns, such as that the proposed powers for PIPs

might push the FCA into the role of price regulator in that area. We also suggested that the powers for Recognised Investment Exchanges (RIEs) should be used sparingly, considering the potential impact on market confidence and stability and the overall desirability of RIEs working alongside the FCA in markets regulation.

5.4 Markets Division outcomes

In our discussions in the Markets Sub Group, we have concentrated much of our discussions on overall markets strategy with the Director of the Markets Division. For instance, we have provided input on selecting outcomes against which the FCA's work in markets could be measured, and how the FCA might use new powers over unregulated holding companies.

6. POTENTIAL INCONSISTENCIES BETWEEN EU/INTERNATIONAL AND UK APPROACHES

6.1 EU research

The Panel has been keen to highlight an ongoing concern within the industry that many of the EU laws and proposals applicable to UK financial institutions may run counter to some of the domestic changes being implemented by HM Treasury and the FSA. We felt that such inconsistencies were only considered by the regulator on an individual basis. We therefore wanted to show the cumulative effect and impact on industry of all of the separate initiatives.

We undertook some research which identified a number of areas where we believed that significant inconsistencies were in danger of occurring between EU and UK rules in financial services. From that, we made some initial proposals for future monitoring, to assess and minimise the types of inconsistencies we had discovered. We then asked the FSA to commit to clearly communicating a coordinated policy towards European transposition, and seek to understand the broader cumulative effect of these inconsistencies on the industry.

We were pleased to receive a constructive response from the FSA to our work. The FCA is committed to base future decisions on achievement of their statutory objectives, and to conduct cost-benefit analysis and consultation on any changes. This is an area which we will continue to monitor in the future.

6.2 Coordination of RDR with MiFID

The Panel has throughout the year continued to monitor the EU negotiations around the MiFID 2 (Markets in Financial Instruments Directive) proposal. While the Panel has recognised the benefits of some of the investor protection measures proposed in this legislation, we were concerned about the possibility of the European level text undoing some of the FSA's own initiatives.

We have continued to highlight that the RDR is in danger of front-running and diverging in approach from EU initiatives in the same area. The Panel questioned how the FSA would maintain the RDR's ban on payment of commission to advisers if at the conclusion of negotiations on the MiFID 2 text does not provide for this. It was recognised that if the provisions were at odds they could undermine the FSA's policy goals, create burden for industry and confuse consumers.

Members of the Financial Services Practitioner Panel

1 April 2012 – 31 March 2013

Panel Member	Position
Joe Garner *Chairman (to 31.3.13)*	Deputy Chief Executive & Head of UK Bank, HSBC Bank plc
Paul Swann *(Deputy Chairman from 31.7.12)*	President and Managing Director, ICE Clear Europe
Graham Beale	Chief Executive Officer, Nationwide Building Society
Alison Brittain *(Member from 1.3.13)*	Director of Retail Banking, Lloyds TSB Group
Russell Collins *(Member until 31.5.12)*	Partner and Vice Chairman, Deloitte LLP
Michael Dobson *(Member from 1.1.13)*	Chief Executive Officer, Schroder plc
Paul Geddes	Chief Executive, Direct Line Insurance Group
Mark Harding	Group General Counsel, Barclays Group
John Hitchins *(Member from 1.9.12)*	Global Chief Accountant and Financial Services Partner, PwC
Simon Hogan	Chief Operating Officer for Sales and Trading EMEA Morgan Stanley
Mark Ibbotson *(Member from 1.10.12)*	Chief Executive Officer, NYSE – Liffe
Garry Jones *(Member until 6.6.12)*	Group Executive Vice President & Head of Global Derivatives, NYSE Euronext
Alexander Justham (Member from 1.9.12)	Chief Executive Officer London Stock Exchange plc

Panel Member	Position
Guy Matthews	Chief Operating Officer and Partner, Sarasin & Partners [SBPP Chairman]
Helena Morrissey	Chief Executive Officer, Newton Investment Management Ltd
John Pollock	Group Executive Director, Legal & General Group plc
Malcolm Streatfield	Joint Chief Executive, Lighthouse Group plc
Doug Webb *(Member until 30.6.12)*	Chief Financial Officer, London Stock Exchange Group

The Financial Services Practitioner Panel
25 The North Colonnade
Canary Wharf
London E14 5HS

Tel: +44 (0)20 7066 1000
Email: fs-pp@fca.org.uk
Website: www.fs-pp.org.uk