



Financial Services Authority

*Smaller Businesses
Practitioner Panel*

Annual Report 2006/7

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The FSA Smaller Businesses Practitioner Panel

1. CHAIRMAN'S INTRODUCTION



It gives me great pleasure to introduce the FSA Smaller Businesses Practitioner Panel's Annual Report for the year 2006/07.

This report provides a summary of the Panel's work over 2006/07, the issues that have occupied our time and efforts during that period, and those that are likely to do so in the immediate future.

The challenge for both the FSA and the industry is about communication. My first message to the FSA is that smaller firms require communications that are clear, simple, targeted and minimum in quantity as they lack the resources to sift through for what is relevant from the volume of information that the FSA produces. The Panel has worked hard with the Small Firms Division to ensure that this is the case – and I commend their efforts to date. My second message to the FSA is that it must ensure on an on-going basis that its communications on industry issues to a wider audience contain the appropriate balance, tone and proportionality so that reputational confidence in the industry is not undermined. My message to all smaller firms is that this is your industry – it is up to you to take responsibility to engage with the FSA and create a well managed and operated sector.

I would characterise my year as Chairman as interesting, challenging but one of further steady progress. In particular, the Panel has contributed towards ensuring that the FSA gives greater focus to the concerns, needs and interests of smaller firms. It is the case that the Panel's engagement with the FSA now typically takes place at an earlier stage of the regulatory thought process, thereby giving it the best possible opportunity to apply Panel member's expertise to maximum advantage and exert influence where necessary.

We cautiously welcome the FSA's transition to a more principles-based regime and the articulation of those ideas in its recent publication – *'Principles-based regulation: Focusing on the outcomes that matter'*. However, I would assert that the perception that smaller firms should find it easy to implement principles-based regulation because they are closer to the 'coal face' is one typically made by the FSA and larger firms, rather than smaller firms themselves. If principles-based regulation means that smaller firms are required to stop and re-design any part, or their whole method, of operation – this will be no easy feat for any smaller firm to achieve. The FSA needs to do more to explain to those running smaller firms exactly what it is they need to do to embrace principles-based regulation as part of their daily working routine.



Treating Customers Fairly (TCF) is the first iteration by the FSA of a principles-based initiative. The Panel has focused its efforts throughout the course of the year on ensuring that the status, positioning and language used in TCF communications to smaller firms was clear, balanced and proportionate. We are disappointed that only 41% of smaller firms met the March 31 TCF implementation deadline. While the Panel has never acted as an apologist for smaller firms who fail to comply with FSA requirements, we have pointed out to the FSA that the reason why smaller firms have not moved at the same speed on TCF as Small Firms Division, and the Panel, would have liked – is because they do not enjoy relationship management by the FSA – the issue is not simply a larger/smaller firm issue. At the same time, our message is to urge all those smaller firms who have not already done so – to raise their game, take prompt action and genuinely engage with this important initiative.

Given the challenge faced by smaller firms in keeping pace with regulatory developments we firmly believe that a risk-based regulatory framework requires that more resources should be dedicated to smaller firm supervision or engagement. This would help provide greater qualitative support for and collaboration with smaller firms, and would also have a significant impact on their overall view of the FSA.

Whilst recognising the challenge of regulating 18,000 small retail firms, the Panel would like to see increased resources used to facilitate greater personal contact with smaller firms. The greater use of the telephone for this contact is one method, particularly more proactive contact, by the FSA to engage actively with smaller firms. In that context, we welcome the FSA's planned upskilling of its Firm Contact Centre staff – the point of contact for all non-relationship managed firms – which should provide an improved service to smaller firms. Greater visibility on the part of the FSA would also ensure that smaller firms do not mistakenly perceive themselves to be 'under the FSA's radar.'

I would like to take this opportunity to thank those members who have left the Panel over the past year – Ruthven Gemmell (Deputy Chairman), Chris Brennan, Neville Thompson and Fraser Gillespie – for their enthusiasm, time, effort and expertise. In particular, I would like to thank my Deputy Chairman, Ruthven Gemmell whose tenure ended recently, for his significant contribution to the Panel over a number of years. I am pleased that the FSA accepted my recommendation to appoint Simon Bolam as my new Deputy Chairman – a role I know he will perform with the enthusiasm and commitment that it deserves.

Finally, I would like to express thanks to my fellow Panel members for their comradeship, diligence and significant contributions; our small team of conscientious support staff for their guidance and loyalty; and to the FSA staff, at all levels, for their willingness to listen and respond to our views.

I hope that you will find this Annual Report helpful, informative and interesting. I commend its content to you – please do take the trouble to read it.



Mark Rothery
Chairman, Smaller Businesses Practitioner Panel



2 . B A C K G R O U N D T O T H E P A N E L

The Smaller Businesses Practitioner Panel (the Panel) was set up by the Financial Services Authority (the FSA) in 1999 to represent the views and interests of smaller regulated firms. It is composed of independent industry practitioners from a variety of smaller firms and covering the major sectors of financial services activity. The Panel's main purpose is to ensure that the FSA fully considers the impact of its activities and policies on smaller firms, thereby helping them to continue to compete and prosper in a stable, competitive and suitably proportionate environment; and provide consumers with choice, service and flexibility. The Panel also monitors the FSA's *overall* performance and effectiveness in the context of its treatment of smaller firms.

The Panel's membership is made up of individuals with a balance of experience and expertise from smaller firms and operating across the major sectors of regulated businesses – IFAs, insurance companies, friendly societies, stockbrokers, professional firms, banks, building societies, general insurance, mortgage intermediaries, credit unions, derivative trading and fund/investment management. There are currently 15 members.

In the context of the Panel, the terms 'smaller' and 'small' are often misunderstood. Its composition is a function of its Terms of Reference – set by the FSA – that provide for the Panel's members to be drawn from the *full spectrum* of regulated activities and not simply from what might conventionally be regarded as the very smallest firms (such as retail intermediaries). This necessarily encompasses firms at the smaller end of their own particular sector of business – for example, banks and insurance companies.

So, the Panel's membership is made up from firms that are not only supervised by the FSA's Small Firms Division but also from some of those that have a dedicated relationship manager. This ensures that the Panel is able to act as a necessary and valuable complement to the Financial Services Practitioner Panel, which is made up almost entirely of very senior individuals from the very largest firms.

The Panel Chairman is an *ex officio* member of the Financial Services Practitioner Panel, which has statutory independence from the FSA. This helps to ensure that smaller firms are properly represented at the highest level within the Financial Services and Markets Act 2000 (FSMA) framework.

The Panel meets on a monthly basis, when it discusses current (and future) issues of relevance to smaller firms – some of which are driven by the FSA's priorities and some of which are raised proactively by the Panel itself. In addition, small sector-specific groups of Panel members convene to discuss certain matters with the FSA at greater length – the use of such groups is increasing, providing more focused and detailed deliberation.





3 . T H E P A N E L ' S Y E A R I N R E V I E W

This section of our Annual Report focuses on those issues that have taken up much of our time during 2006/07 and that, inevitably, will continue to occupy us over the coming 12 months. These are areas that the Panel believes are fundamental in terms of determining the nature and style of FSA regulation and which, ultimately, will be most important in shaping the strategic and economic environment in which smaller firms do business.

3.a. Practitioner Panel Survey of Regulated Firms – Smaller Firm Issues

In November 2006 the Practitioner Panel published the results of its fourth biennial survey of regulated firms. The Panel's survey is an authoritative, in-depth study, providing robust feedback from the financial services industry on the FSA's performance over time, and includes the views of smaller firms. The survey establishes a track record of the regulator's effectiveness and performance, and gives our Panel (the Smaller Businesses Practitioner Panel) a solid basis on which to recommend improvements to the FSA in respect of smaller firms.

Over 4,000 firms from across all sectors of financial services activity and size of business responded to the 2006 survey, which for the first time also captured the views of the mortgage and general insurance (M&GI) population of firms.

The survey's key findings included:

- **Smaller retail firms continue to remain dissatisfied:** In the survey overall satisfaction was higher for all types of firms except for smaller retail firms. Mainstream M&GI firms had similar scores to smaller investment firms.
- **Burden of regulation is excessive:** Sixty four percent of smaller retail firms (and 63% of all retail firms) felt that the costs of compliance were excessive. Smaller firms continue to struggle with the volume of regulation and the resulting cost of compliance with some smaller retail firms stating that this had resulted in them thinking about leaving the industry.
- **Uncertainty about principles-based regulation and TCF:** A significant majority of smaller firms disagreed when asked if the FSA had properly explained what principles-based regulation and TCF meant and how they would work in practice.

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- **Improvements:** Smaller firms did welcome changes to the FSA's structure and many noted an improvement in overall approach. Seventy two percent of smaller retail firms agreed that the Small Firms Division had been a positive development and 54% of smaller firms agreed that FSA had improved its treatment of smaller firms since 2004 (including – Handbook accessibility, communication and provision of guidance).

Smaller retail firms – while recognising some improvement in the overall attitude of the FSA to small firms – felt that they had seen no improvement in their day to day dealings with the regulator. For example, 59% of smaller retail firms felt that the Retail Mediation Activities Return (RMAR) had produced a substantial extra burden on firms.

In summary, smaller firms typically feel that the volume and pace of regulatory change is too much and too fast for them to cope with given their limited resources.

Next Steps

The Panel has had constructive discussions with both the Small Firms Division and the FSA Executive on the findings of the survey and the actions needed in respect of smaller firms. The FSA already has in train a number of initiatives. In its 2007/08 Business Plan the FSA has allocated a budget of up to £50m to improve the effectiveness of FSA staff and support the move to more principles-based regulation – under its 'Making a Real Difference' Agenda.

“*The Panel has recommended to the FSA that simpler, clearer and more targeted communications be issued to smaller firms, which should also include examples of action required by them in respect of TCF and more-principles based regulation.*”

- **Clear and simple communication:** The Panel has recommended to the FSA that simpler, clearer and more targeted communications be issued to smaller firms, which should also include examples of action required by them in respect of TCF and more-principles based regulation. The Panel continues to work with the FSA in improving the clarity of its communications to smaller firms. While things have improved with the creation of the SFD, there is more that the FSA can and should do.
- **Volume and intensity of FSA retail initiatives:** The FSA's retail strategy, in the Panel's view, continues to lack coherence and focus – there is simply too much being done, at the same time, without due prioritisation (much of which is largely discretionary). A key theme emerging from the Practitioner Panel Survey was that the cumulative burden of this regulation was simply too much for small firms to cope with – due to their limited resources and access to expert advice.
- **FSA resources too focused on larger firms:** The Panel continues to feel that the FSA's resources are directed disproportionately towards larger firms – who, on the whole, are more content with their regulatory lot. A shifting or refocusing of that balance, in order to facilitate greater qualitative support for and collaboration with smaller firms – especially in the supervisory context – would help them tremendously, and might well have a significant impact on their overall view of the FSA.



- **Smaller firm expertise on the FSA Board:** The Panel has been concerned that the impact of regulatory developments on smaller firms still has the potential to be overlooked at policy-making, strategic and governance levels within the FSA. The Panel feels that specific smaller firm input and/or expertise needs to be more prominently addressed higher up the decision-making machinery, so that their interests are properly and critically taken on board. We have therefore suggested to both the FSA and HM Treasury the desire for additional expertise from the smaller firm sector on the FSA Board.
- **Smaller firms leaving the industry:** The Panel has been concerned about a key finding emerging from the survey – the significant number of smaller firms who had felt that regulation was harmful to their business, resulting in them contemplating leaving the industry and, also, the barriers for new entrants to financial services. The Panel has urged the FSA to do more to understand this feedback.

3.b. More principles-based regulation (MPBR)

The Panel is cautiously supportive of the general notion and purpose of principles-based regulation.

The move to MPBR is perhaps the most ambitious project undertaken by a financial services regulator and there needs to be a recognition that some market sectors will find it very difficult to make the transition, and that this transition could take a number of years – in particular, for smaller firms within retail markets.

- **Cultural change:** The emphasis of MPBR will be on outcomes. It is essential for smaller firms that the FSA clearly explains exactly what it means by this and how those who run smaller firms (along with their staff) need to change their behaviour, the cultural shift that is required and the incentives for doing so. Those who run smaller firms must have the confidence to sanction and use the flexibility that MPBR provides them, and believe that the FSA will apply a suitably pragmatic, proportionate and consistent approach when it comes to smaller firms.
- **Smaller firms who prefer rules based prescription:** MPBR does not specify the minimum standards of regulatory compliance expected of firms. Some smaller firms will no doubt wish to take full advantage of the flexibility and opportunities that MPBR provides but, at the other end of the spectrum – others may well simply wish to provide a good service to their clients by continuing to meet their FSA obligations as they are currently framed (even after some specific rules may be taken away). If smaller firms choose to rely on certain prescriptive rules that may no longer exist as a result of the move to MPBR then it is important that subsequent material on MPBR addresses in clear terms the FSA's position in that respect.
- **Communication:** The Panel will continue to engage with the Small Firms Division to

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help ensure that the FSA produces clear, accessible and helpful communications specifically for smaller firms. In the meantime, the FSA's strategic positioning document on principles-based regulation, 'Focusing on the outcomes that matter' (published in April 2007) is a helpful starting point and sets the high-level scene about the status, purpose and application of MPBR.

- **Firm Contact Centre (FCC):** As part of MPBR and its own 'Making a Real Difference' initiative, the FSA is committed to upgrading the structure and quality of its Firm Contact Centre – which, for most smaller firms, is their main point of contact with the FSA. We are very supportive of those efforts. While there is a balance to be struck, the Panel feels that the FSA's ability and willingness to provide – through the FCC – qualitative and valuable guidance (albeit not as a first resort) to smaller firms will be crucial to the success of MPBR in the eyes of such firms.

3.c. Treating Customers Fairly (TCF)

The Panel has continued to be nervous about what TCF means for smaller firms and how it will be applied by the FSA in practice. The Practitioner Panel Survey showed that practitioners from smaller firms did not consider that the FSA had provided a clear explanation of exactly what TCF meant for them and what they needed to do to comply (and demonstrate compliance) with this principle.

In measuring the success of the TCF strategy, the Panel believes that the FSA also needs to recognise that the cultural change required of some smaller firms will not happen overnight and that TCF should be regarded as a longer term strategy.

“However, given the findings of the Practitioner Panel Survey, the Panel continues to remain uncertain about what records and management information the FSA would expect to see retained by smaller firms in order to demonstrate compliance with and their commitment to TCF.”

- **Evidence of TCF:** The Panel has focused its efforts throughout the course of the year on helping the FSA to ensure that the status, positioning and language used in its TCF communications to smaller firms were clear, balanced and proportionate. The self assessment tool was a helpful resource in that regard. However, given the findings of the Practitioner Panel Survey, the Panel continues to remain uncertain about what records and management information the FSA would expect to see

retained by smaller firms in order to demonstrate compliance with and their commitment to TCF.

- **Policing the March 2007 deadline:** In April 2007, the FSA published details of the extent to which firms had met the March 31 deadline for making progress in implementing TCF in their businesses. While we are pleased and encouraged to note the FSA's view that smaller firms are showing an increased awareness and planning in respect of TCF, the Panel is of course disappointed that progress remains slower than the FSA had hoped for. That said, there must be an acceptance that there could be various reasons for this including – as the Practitioner Panel Survey suggested – the lack (until more recently) of suitably clear messages and support for smaller firms on this issue.



- **Enforcement:** The Panel has urged the FSA to be extremely careful and clear about how and in what circumstances the use (or threat) of enforcement action would be considered – for example, only where there is categorical evidence (or demonstrable risk) of systemic consumer detriment. Otherwise, such messages could be seen by smaller firms as aggressive and disproportionate, and have an adverse impact on market confidence and reputation.

For our part, the Panel will do its best to be proactive and urge the smaller firm sector – and especially those firms that may not have done so to date – to raise their game and to take prompt action to engage with the TCF process. While we welcome the FSA’s assurances that TCF will be operated in a proportionate and risk-based way for smaller firms, the Panel will be robust in its representations to the FSA should that commitment fail to be delivered in reality.

3.d. Small Firms Division (SFD)

The Panel are supportive of the work undertaken by the SFD and recognises the challenges in supervising 18,000 small retail firms (*see Annex 5.d for further information*). The Panel has discussed with SFD the apparent disconnect between the results of the satisfaction based Practitioner Panel Survey, and FSA’s own surveys such as those conducted on behalf of the Regulatory Transactions Unit. While we do not consider that there are any obvious specific activities SFD should not be undertaking, we consider that there is room for improvement in the allocation of resources within the FSA.

The Panel believes that the reason why smaller firms have not moved at the same speed on TCF as SFD, and the Panel, would have liked – is because they do not enjoy relationship management by the FSA – and the issue is not simply a larger/smaller firm issue. The Panel fully understands that relationship management for all these firms is unachievable because of the scale involved, but at the same time it does strongly believe that a risk-based regulatory framework requires that more resources should be dedicated to smaller firm supervision given the challenge faced by smaller firms in keeping pace with regulatory developments. This would help smaller firms and would also have a significant impact on their overall view of the FSA.

“*The Panel fully understands that relationship management for all these firms is unachievable because of the scale involved, but at the same time it does strongly believe that a risk-based regulatory framework requires that more resources should be dedicated to smaller firm supervision given the challenge faced by smaller firms in keeping pace with regulatory developments. This would help smaller firms and would also have a significant impact on their overall view of the FSA.*”



3.e. Thematic work and Mystery Shopping

The Panel is concerned about the specifics of FSA's thematic work plan and its use of mystery shopping – in particular, over general conclusions being drawn from sample sizes that were not statistically robust, over the lack of feedback to firms, the arbitrary selection of firms, the covert recording of advice conversations, the time wasted by advisers operating on a fee basis, the overall objectiveness of the methodology employed, and indeed whether the findings would be an automatic precursor to enforcement action.

The Panel has provided the FSA with feedback on various aspects of its thematic work including the publication of its Mystery Shopping Guide (November 2006) and Major Thematic Work Plan (April 2007). Provision has also now been made for better and timely circulation to the Panel with information about the forward thematic plan and individual pieces of thematic work. The Panel's key concern has been to ensure that the communication of findings to smaller firms in respect of – the press release, emerging findings/actions and publication strategy (i.e. CEO letters) – is both balanced and proportionate.

The Panel will continue to urge the FSA to consider carefully how it acts upon and publicly communicates the results of its thematic exercises to ensure that negative messages do not do serious, unanticipated and undesirable damage to the industry's reputation and to consumer confidence.

3.f. DPO6/4: The responsibilities of providers and distributors for the fair treatment of customers

The Panel broadly welcomed the discussion paper that had set out the responsibilities of providers and distributors in a clear, balanced and comprehensive manner.

- **Status of such guidance:** The Panel welcomed the fact that the paper had clarified that providers were not responsible for the regulatory responsibilities of distributors within the distribution chain (or for that matter, vice versa). The Panel's key concern was the status of such guidance within the regulatory framework given the shift to a more principles-based regulatory approach. Such guidance had to be consistent with principles-based regulation and not become a form of prescription or second tier regulation by the backdoor.

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- **TCF between providers and distributors:** The Panel pointed out that a professional customer relationship exists between providers and distributors (including within distribution chains), and that each link in such chains should be treating each other fairly – as failure to do so would mean that the end retail customer would not be treated fairly. The Panel were concerned that consumer detriment could arise as a result of the breakdown in such professional customer relationships, which may have an adverse impact on the FSA’s consumer protection objective. However, apart from the rather obvious point made in the DP about redress via the legal system, the Panel felt that the FSA needed to further articulate how accountability would be determined in such instances, when clearly one or more parties may be innocent and not at fault.

We await the Feedback Statement which the FSA is due to publish during Q2 2007.

3.g. Markets in Financial Instruments Directive (MiFID) and CP06/19: Reforming Conduct of Business (NEWCOB)

MiFID Issues: The Panel has been monitoring closely how the FSA is approaching the implementation of MiFID and in particular how it communicated key messages to smaller firms in a suitably organised and focused way. The Panel is concerned that smaller firms within the scope of MiFID may be unable to meet the MiFID implementation deadline of 1 November 2007, as they have not been given sufficient time and support to understand and prepare in order to discharge their obligations properly. The Panel also remains especially anxious about smaller, non-scope firms that may be continuing to labour under the mistaken belief that this was not something that was going to affect them to any significant degree – the Panel felt that the FSA needed to do more to alert such firms to the impending and wide-ranging implications of MiFID and its associated workstreams (e.g NEWCOB).

“The Panel is concerned that smaller firms within the scope of MiFID may be unable to meet the MiFID implementation deadline of 1 November 2007, as they have not been given sufficient time and support to understand and prepare in order to discharge their obligations properly.”

The Panel saw the following elements as key to the FSA’s ongoing MiFID work.

The FSA’s communications strategy needs to be proactive, urgent and where necessary creative – especially in respect of non-scope firms who would be impacted by the changes. As a result of prompting from the Panel, a traffic light system was designed with appropriate signposting on the Small Firms website to assist firms in gauging the impact of and urgency with which they should be treating the matter. The Panel also suggested that a direct ‘Dear CEO’-style of communication might have a better impact than other more-generic communications.

It remains essential for the FSA to approach the policy aspects of, and arising out of MiFID, in a suitably organised and holistic way across the FSA. Wherever possible, the Panel urged the FSA to take appropriate, full and early advantage of industry expertise that stands ready to help its thought processes and decision making – in particular, the MiFID Industry Connect group, individual trade associations and the Panels.



CP06/19: Reforming Conduct of Business (NEWCOB): The Panel was supportive of the FSA's overall approach to applying 'intelligent copyout' and was generally opposed to any 'gold-plating' or 'superequivalence' affecting smaller firms, but noted that direct competition between MiFID scope and non-scope products has necessitated some levelling up of MiFID requirements to non-MiFID business.

The NEWCOB sourcebook was essentially the FSA's primary building block or flagship for developing a more-principles based regime. Principles-based regulation would provide firms with increased flexibility of action so that they could find ways to meet the outcomes that would fit more closely with their business objectives. The Panel emphasised that some smaller firms particularly non-scope firms may wish to continue to comply with the prescriptive requirements of the COB sourcebook simply because they do not have an understanding about what (if anything) was changing or who may simply prefer the reassurance of prescriptive rules and their provision of 'safe harbours.'

Moreover smaller firms do not generally have a dedicated compliance function and face a significant challenge in interpreting the proposals and identifying changes that would need to be made to their business practice by 1 November 2007. Providing smaller firms – scope and non-scope – with clear targeted communications through the small firms section of the FSA website, 'Dear CEO' letters, seminars/roadshows and other media will be key to help ensure their compliance.

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3.h. Financial Services Compensation Scheme Funding (FSCS)

The Panel has been involved on a regular basis in discussions about the FSCS funding structure and recognises the challenge of constructing a future funding framework for the FSCS in a way that satisfies all sectors and stakeholders.

- **DP06/1: FSCS Funding Review:** While there was considerable divergence of views from Panel members across the different industry sectors represented on the Panel, the Panel endeavoured to focus its input on the impact of the FSCS on smaller firms as a group, rather than what might benefit one industry sector over another. In its response to DP06/1, the Panel was inclined to support Option D: Three-tier ('widening net') – with very high thresholds for classes, and diverse thresholds for sub-classes. The Panel considered that this option aimed to strike the right balance between the advantages of pooling that provides catastrophe cover across all financial sectors and the economic virtues of segregated contribution groups.
- **Ongoing concerns:** The proposed maximum contribution for general insurance (GI) intermediaries and insurers and the lack of clarity on how this might affect their capital requirements caused significant disquiet. The Panel has urged the FSA and FSCS to carefully consider the fairness of the thresholds for GI firms and their wider impact.



On 20 March, the FSA published CP07/5: Financial Services Compensation Scheme Funding Review – including feedback on DP06/1. The Panel will respond to this CP in due course but while the proposals may go some way to mitigating the possible exposure for GI intermediaries and insurers, the thresholds still represent a significant increase from the previous framework.

3.i. Financial Ombudsman Service (FOS) & Funding Review

The Panel has had an open and constructive relationship with the FOS and Walter Merricks, its Chief Ombudsman. Regular meetings take place between him and the Panel (or a sub-group of members).

- **Right to appeal FOS decisions:** Under FSMA there is no external right of appeal to a FOS ruling about which a firm disagrees. While there is an internal review process, the Panel considers this to be insufficient particularly when there may be very good reasons and/or matters of principle for wanting to take a matter forward. This has led the Panel to question the fairness and transparency of the Ombudsman scheme. A firm can seek a judicial review in the courts which would cover (among other criteria) whether the Ombudsman had followed due process. However, smaller firms (unlike larger firms) do not have the resources to engage in a potentially protracted and expensive legal process.
- The Panel believes that by its case decisions, the FOS is effectively setting precedents on policy and that such decisions are not tested through consultation and analysis. Although the FOS may apply the same principles as a court of law, there is no opportunity to test the evidence, and failure to comply with the terms of a contract appears to be of greater importance than failure to comply with specific rules. The FOS have pointed out that any fears that it will fill gaps created by the FSA's shift to more principles-based regulation are unfounded as less than five percent of its decisions turn on the interpretation of FSA rules. The majority turn on disputes of fact or on issues of legal liability to which all businesses are subject. However, given the FSA's move to a more principles-based regime – with fewer rules – the Panel remains concerned that this will allow the FOS a greater opportunity to create precedents – an issue the Panel will monitor going forward.
- **FOS Database:** The Panel is, however, supportive of the FOS's decision to create in due course a database of 'precedent' decisions – this will be useful to firms in understanding how the FOS had reached its decisions/judgements, and to the FOS itself in terms of ensuring consistency across its determinations.

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3.j. Summary of responses to FSA consultation papers

The following table summarises all the formal consultation responses made by the Panel since the last Annual Report. The Panel also considers and comments on many items from the FSA at the pre-publication and feedback stages. However, we do not routinely set out publicly the detail of these discussions and the views that we provide, in order to preserve confidentiality and the open (and constructive) relationship with FSA staff that the Panel enjoys.

DP06/01: FSCS Funding Review

The Panel was regularly involved as the FSA's work on this issue progressed and felt that the regulator had entered into this consultation process in an open, objective and collaborative manner and had done well to meet the not inconsiderable challenges that a review of this nature presented. While it was unlikely that any of the proposed solutions would be wholly supported by all market participants, in its endeavour to focus on the impact of FSCS on smaller firms as a group the Panel was inclined towards **Option D: Three-tier ('widening net')**. This was a combination of options A, B and C – with very high thresholds for classes, and diverse thresholds for sub-classes.

DP06/02: FOS Compulsory Jurisdiction: Funding Review

The Panel was unable to reach a consensus on the most suitable Option, due to a major change illustrated in a number of scenarios where there had been a significant shift from charging some sectors on an approved persons basis to all sectors being charged on a per permissions or a per firm basis. What suited one sector, might not suit another. While the Panel sought to put the interests of smaller firms in general above the interests of particular individual sectors, this was not easy in circumstances where there were competing imperatives and arguments. The Panel summarised the options that had the most appeal to smaller firms that included:

- *Option H: (10 free cases per firm, £480 case fee and £230 flat rate annual fee per firm),*
- *Option A: (2 free cases per firm, £360 case fee and annual fees based on fee blocks and tariff rates),*
- *and a hybrid of Option D&H: (5 or 10 free cases per firm, £xx case fee and no annual fees).*

The Panel notes that the FSA will need to resolve the FSCS funding issue prior to determining regulatory levies in respect of FOS funding requirements. A feedback statement is expected from the FOS in April and the Panel will continue to engage in the funding discussions, and will also respond to any forthcoming CP on the matter.



**DP06/03:
Implementing
MiFID's Best
Execution
Requirements**

The Panel's key concern had been the disproportionate impact of the costs involved for smaller firms, specifically in relation to chapter 3 proposals on benchmarking, and supported the joint paper from the BMA, ICMA and ISDA on the subject. Firms should be allowed some flexibility provided they could demonstrate an appropriate execution policy and reasonable approach within it to achieve the best result.

**DP06/04: The
responsibilities of
providers and
distributors for the
fair treatment of
customers**

The Panel was pleased that the paper properly acknowledged trade association initiatives and the role they might play in developing market-driven solutions. It also welcomed the fact that it clearly articulated that providers were not responsible for policing distributors. It felt the feedback statement could better articulate the following issues:

- Clarify the status of guidance in a principles-based framework.
- Clear TCF guidance on where firms stood when there was a failure in the relationship between providers and distributors and multiple distributors.
- Examples of how producers should monitor their end results (without intruding on distributors' relationship with their retail customers).
- Consider the role of mortgage packagers and mortgage clubs in the distribution process and the potential need for regulation.
- Ensure that guidance takes account of European cross-border distribution realities.



DP06/05: FSA confirmation of Industry Guidance

The Panel noted that larger firms were likely to benefit more from these proposals as they were more likely to be members of trade bodies. It also felt the feedback statement could better articulate the following issues:

- Where there was a clear market failure within a particular sector, industry guidance would facilitate a market driven solution without the need for regulatory intervention.
- How would the FSA help smaller firms (many of whom are not members of trade bodies and have no access to industry guidance) achieve the transition to principles-based regulation.
- Industry guidance must be prepared by a body with a sufficiently mixed population of firms and not just drafted by the main players in any given sector, and guidance must not cause conflict between sectors.
- The FSA should not effectively delegate responsibility (and costs) to the industry in circumstances where the regulator itself should rightly provide the necessary information, guidance and support for smaller firms – industry codes should be a complement to, but not a substitute for, the FSA’s regulatory function and Handbook.

CP06/19: Reforming Conduct of Business Regulation

The Panel was supportive of the FSA’s overall approach to applying ‘intelligent copyout’ to the proposed implementation of the conduct of business (COB) requirements of MiFID. The Panel was also cautiously supportive of principles-based regulation. It was also generally supportive of the FSA’s proposals to use Article 4 to retain sections of the current COB regime that took account of the more complex UK retail market peculiarities and offered better consumer protection than the Directive. However, the Panel was not convinced that this was necessarily the case in respect of ‘suitability letters’ or the ‘suitability report’ under NEWCOB. The Panel suggested that the FSA produced a short and clear communication outlining the changes for both scope and non-scope firms in the impacted sectors.



4. OTHER PANEL PRIORITIES FOR 2007/08

In addition to those issues referred to above which will continue to feature on the Panel's agenda going forward, the following section summarises a number of additional items of business that we shall expect to be engaged in during 2007/08.

4.a. FSA's 'Making a Real Difference' Agenda and 2007/08 Priorities

FSA's 'Making a Real Difference' Agenda: The Panel is supportive of the FSA's 'Making a Real Difference' Agenda, which is essentially the regulators charismatic vision of how it sees itself operating both now and in the future. The theme has three fundamental elements to it that covers improving the performance of the FSA as an organisation, delivering quality outcomes for consumers and markets, and the effective development of global regulation. The Panel has welcomed the FSA's shift in focus away from policy making and towards supervision, as well as its drive to improve the overall quality of its staff, including in the Firm Contact Centre (FCC) but makes the following points on the role and treatment of smaller firms in FSA's overall strategy:

- FSA resources appear to be directed disproportionately towards large firms, even though smaller firms make up 93% of FSA regulated firms. While this may be understandable to a degree in a risk-based regime, the Panel urged the FSA to reconsider its allocation of resources, to reflect more accurately the composition of the regulated community. A shift in the balance of resource – away from largely satisfied wholesale/major groups, towards smaller firms – could help address many of the concerns expressed in the Practitioner Panel Survey and result in higher levels of contentment among such firms.
- The Panel is concerned that the experiences and views of smaller firms appear to have little influence on final policy/strategic outcomes – as illustrated by the Practitioner Panel Survey results. As a result, smaller firms remain disillusioned and frustrated with the regulatory regime. Better face-to-face communication by FSA staff – for example, through periodic visits and an upgrading of the FCC – with smaller firms will be crucial to understanding their concerns and commercial realities.

“Better face-to-face communication by FSA staff – for example, through periodic visits and an upgrading of the FCC – with smaller firms will be crucial to understanding their concerns and commercial realities.”



- Among the potential obstacles to implementing its ‘Making a Real Difference’ initiative, FSA should include smaller firms’ ability to cope with regulatory change and the burden and time commitment it imposes on them. Communication is another possible point of failure – FSA must ensure that communications with smaller firms are clear, targeted, helpful and relevant. Direct hard communication to smaller firms – e.g. Dear CEO letters on TCF – can be effective.



FSA 2007/08 Priorities: The Panel has encouraged a reduction in the many activities listed under the FSA’s strategic aims in the Business Plan 2007/08, to ease the overall burden on smaller firms and the FSA. The FSA does not appear to appreciate that this extensive shopping list would impose further significant, disproportionate burdens on smaller firms – there must be a more objective internal process to distinguish between the must-dos and the nice-to-dos. Again, this was a prominent theme arising from the survey.

“*The Panel has encouraged a reduction in the many activities listed under the FSA’s strategic aims in the Business Plan 2007/08, to ease the overall burden on smaller firms and the FSA.*”

The Panel communicated to the FSA that the most important expectations that smaller firms would have of the FSA in respect of its longer-term strategy was the following.

- An understanding of the effects of EU legislation on the domestic UK market;
- A positive attitude towards market innovation;
- Regulatory stability (i.e. less change) – although the Panel recognises that deregulation itself involves change;
- A sense that in pursuing its objectives (notably the market confidence one) the FSA is working ‘in partnership’ with firms;
- Recognition that small firms have fewer resources to participate in the consultation process;
- Consistent interpretation of high level principles by both senior staff and supervisory staff visiting firms;
- Clarity as to the status of any guidance issued by the FSA.

4.b. National Audit Office (NAO) Value for Money Review

The terms of reference for the National Audit Office’s (NAO) Value for Money Review of the FSA consisted of examining the following issues: internal performance management, external joint-working within the UK, influencing and representation internationally, financial crime, and financial capability. The Panel contributed to the



Review through meetings with NAO officials, providing feedback through completion of a detailed questionnaire and also provided copies of the Panel's Annual Reports.

Panel members urged the NAO to make the report as forward-looking as possible, or else the FSA could easily dismiss it. Smaller firm representation in the FSA's performance management system was a key point, alongside the FSA's role in keeping smaller firms – as opposed to large ones – satisfied. The quality and accuracy of Cost Benefit Analysis (CBA) needed to be considered along with an analysis of the benefits of regulation (not just the costs of regulation). Proportionality of regulation was essential as excessive and disproportionate regulation would drive a larger number of smaller firms to exit from the market, and consequently reduce consumer choice and create significant barriers to entry. The Panel awaits publication of the NAO report at the end of April.

4.c. Retail Distribution Review

The FSA launched its review of retail distribution in June 2006 with the participation of industry stakeholders – the aim being to identify and address the root causes of problems it perceived to emerge in retail investment markets. The FSA identified five themes for the review and set up five industry working groups covering the following strands: the sustainability of the sector, the impact of incentives, professionalism and reputation, consumer access to financial products and services and regulatory barriers and enablers.

The Panel has been engaged in discussions with the FSA via a Panel sub-group and also two representatives sitting in a personal capacity as experts in two strands of the review. The FSA will publish a Discussion Paper in June 2007, setting out the analysis and initial conclusions. The Panel stressed the importance of the FSA adopting a collaborative approach to engaging with the industry and working together to achieve the desired outcomes. Predicating this work from a negative standpoint would not be helpful and would generate concern about the FSA's motives. It was also key for the FSA to be clear about specific objectives, with appropriate disentanglement and prioritisation of the different sectors of activity.

The Panel has emphasised the fact that it does not consider that the current distribution system based on commission is fundamentally flawed or that it needs sweeping changes,

“The Panel has emphasised the fact that it does not consider that the current distribution system based on commission is fundamentally flawed or that it needs sweeping changes, nor has it seen any evidence so far of an alternative distribution system to commission.”

nor has it seen any evidence so far of an alternative distribution system to commission. There is nothing wrong with the current distribution structure that would prevent providers and distributors from treating their customers fairly, provided it is operated properly, which we believe is indeed the case with most small firms. The FSA need



to test what consumers are and are not prepared to do first, before deciding whether and how to change the current distribution structure. This involves developing an in-depth understanding of how fees and commissions really work in practice – this is not always obvious or logical.

4.d. Quality of Advice Project

In the second half of 2006 the FSA embarked on a major piece of thematic work focusing on the suitability of investment advice outcomes by financial advisers – in the product areas of protection, savings and retirement options. The FSA set up an industry group, on which the Panel is represented, to help it identify the scope and methodology of the research. The Panel remains concerned about the purpose and practicalities of this exercise.

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While the Panel accepts the FSA’s assurance that this research is not designed to be retrospective, the Panel remains sceptical about how the quality of advice delivered at point of purchase, can be assessed objectively without examining the product recommended or the quality of the process that led to a particular outcome, or for that matter whether the advice continues to remain suitable after the point of purchase. Indeed, advice outcomes that might appear positive at the time of purchase could turn negative further down the line or vice versa and the inevitable subjectivity of these type of judgements was a cause for concern. We also remain concerned about the mechanics of ‘shadow shopping’ and whether a robust sample size of advisory cases would be considered. In particular, whether the shadow shopper as a result of the process employed would be led to ask the adviser questions in a particular manner.

The results of the review may well have wide reaching implications, particularly in respect of consumer confidence. It was therefore important for the FSA to understand the review and communicate any messages in a careful and balanced manner. Clearly the credibility of the methodology employed was fundamental, and if this could not be satisfactorily demonstrated – the Panel considered that taking no further regulatory action may well be the most appropriate and proportionate conclusion. Otherwise, once again, such thematic work could impose significant and unreasonable burdens for smaller firms.

4.e. State Second Pension Review (S2P)

During the latter part of 2006 the Panel was consulted about a review into the sale of State Second Pensions (S2P) to consumers who contracted out between 1988 and 1993, and who were over the pivotal age at the time of advice. Options discussed included a



S404 FSMA review, a targeted supervisory approach, a proactive complaints led approach and taking no proactive regulatory action. The Panel voiced grave concerns over the fundamental fairness of a review of this nature, which required firms to go back up to 18 years and puts the burden of proof firmly on the firms – most of which are unlikely to have kept hold of records going back that far.

Doubts were also raised about the FSA’s ability to factor in accepted industry practice at the time (including the use of LAUTRO or ‘own-charges’ projections) and, consequently, its ability to form objective judgements on whether mis-selling had occurred. The role of the regulator and government at the time and the impact of this work on professional indemnity insurance (PII) were also unclear. While we accept that any compensation would be paid into the pension fund – and therefore reduce the potential advantage for complaints handling firms – our primary concern remains the considerable costs and burdens for smaller firms.

Due to the many unresolved concerns, the Panel urged the FSA to consider carefully whether it should progress with this thematic work at all, and weigh its substantial costs for firms against the magnitude of the loss. The Panel considered that this might be a good example of where taking no further regulatory action might be the most appropriate and proportionate conclusion.

“The Panel considered that this might be a good example of where taking no further regulatory action might be the most appropriate and proportionate conclusion.”

4.f. Industry Guidance

While the Panel was cautiously supportive of the move to more principles-based regulation, it has emphasised the point that industry codes must never become a substitute for FSA rules, and that trade bodies must not turn into quasi regulators. One of the main roles of the trade associations is to challenge the regulator and lobby on behalf of the industry sector they represent, not to produce codes. We recognise that it will be a challenge for the FSA to resolve who or what will plug the gaps left by a principles-based regime; however, alternatives to industry codes should also be considered.

DP06/5: FSA confirmation of industry guidance: In its submission to the Discussion Paper, the Panel said that it was not convinced about the demand for ‘FSA confirmation’ from providers of industry guidance. Ultimately demand for industry guidance would be driven by three factors:

- what is actually deleted from the Handbook following industry consultation which the FSA is obliged to undertake;
- the comfort level of firms in working to principles only, following the deletion of those rules;
- the appetite for trade associations and others to utilise this facility would only become apparent over time as the FSA slims down its Handbook.



Bearing in mind the relatively low number of smaller firms within membership of a trade body, and given the limited resources of such trade bodies to produce industry guidance, there would be a natural reluctance from the membership of such bodies to seek FSA confirmation if the resultant ‘guidance’ was then freely available to the industry as a whole. We also remain concerned that larger firms are likely to benefit more from these proposals as they are more likely to be members of trade bodies with the ability to exercise greater influence than smaller retail firms, a large number of whom do not belong to a trade body.

The Panel also pointed out that unless the FSA produces, in these circumstances, its own guidance then there may be a potential risk that the move to a more principles-based approach to regulation would lead to greater confusion and further non-compliance among smaller firms.

“*Bearing in mind the relatively low number of smaller firms within membership of a trade body, and given the limited resources of such trade bodies to produce industry guidance, there would be a natural reluctance from the membership of such bodies to seek FSA confirmation if the resultant ‘guidance’ was then freely available to the industry as a whole.*”

4.g. Mortgage Effectiveness Review (MCOB)

The Panel has been involved in Stages 1 and 2 of the FSA’s Mortgage Effectiveness Review. The regime seems to have operated smoothly over the last 12 months and relatively few consumer complaints have been generated from this sector. The Panel advised the FSA that the effectiveness measures against which the FSA evaluated the MCOB regime needed to be suitably, balanced, objective and holistic. Certain specific issues needed to be included on the overall review, for example, accountability of third party packagers/client money, the apparent tension between the FSA’s disclosure rules/views of the FOS, the length of mortgage interviews and associated barriers to shopping around.

As far as principles-based regulation was concerned, smaller firms in particular preferred operating in the certainty of a rules-based environment. Record keeping was an area that smaller firms would continue to struggle with in respect of the FSA’s expectations and it was felt that case studies, for example on suitability testing would be useful to smaller firms. The Panel considered that the market was not yet ready for the removal of the ‘most suitable’ requirement in line with COB changes as a lot of firms were new to regulation and that a period of consolidation and education was required.

The Panel pointed out that the rules on financial promotions were too prescriptive and contradictory in respect of loans and mortgages, and urged the FSA to consider reviewing these requirements. The Panel will keep a watching brief on the EU White Paper on mortgages (expected June 2007) as this may have a significant impact on the UK mortgage market. The Panel will continue to involve itself in Stage 2 of the review and awaits publication of the results in Q1 2008.



4.h. Insurance Conduct of Business Review (ICOB)

The Panel has been supportive of the FSA's review of the ICOB rules. This involves the deregulation review of simple GI products (such as motor, household and pet insurance) along with the simplification and limited move to high level rules covering personal protection products (such as PPI, term, critical illness and income protection). The removal of the requirement to issue a Policy Summary was welcomed as this was not a DMD requirement for insurers and a 'copy out' approach of the both the DMD/IMD was preferred. While the FSA was scaling back the impact of the IMD for insurers, the Panel stressed that it was also important for the intermediary sector to perceive the changes impacting it to be, on balance, fairer. For example, tighter controls were required in respect of exaggerated advertising by insurers.

The Panel pointed out that the sale of single premium PPI products had caused more consumer detriment than the sale of monthly premium PPI products and that the FSA should consider a differentiation in the rules covering single and monthly premium PPI sales, along with clarifying what aspect of the advisory process came first – the regulated PPI product or the loan, which was in essence the nub of the market problem. The Panel emphasised that the linking of the PPI product to the loan and eligibility to claim were the two key issues causing consumer detriment but recognised that rules in respect of poor selling practices would not in itself remedy competition problems arising from the lender's point-of-sale advantage, and that the industry would have to await the outcome of the Competition Commission's enquiry into PPI. The Panel was also supportive of the mandatory eligibility check for PPI non-advised sales along with the status disclosure requirement for such sales. The Panel will provide further input to the FSA's proposals once the CP on the ICOB review is published in June.

“The Panel emphasised that the linking of the PPI product to the loan and eligibility to claim were the two key issues causing consumer detriment but recognised that rules in respect of poor selling practices would not in itself remedy competition problems arising from the lender's point-of-sale advantage, and that the industry would have to await the outcome of the Competition Commission's enquiry into PPI.”

Review of commission disclosure in wholesale/commercial general insurance markets: The FSA has committed to undertaking a review of commission disclosure in the wholesale/commercial general insurance markets that would examine issues such as the unlevel playing field, transparency to the customer, and lack of full transparency in the market ('efficiency issues'). It is not known at this stage whether a lack of transparency in respect of commission disclosure has created consumer detriment for commercial customers – and indeed whether such additional information would lead to a change in behaviour from commercial clients. The FSA has said that it would only consider regulatory intervention if both the Market Failure Analysis (MFA) and Cost Benefit Analysis (CBA) tests were met.



The Panel is opposed to the introduction of commission disclosure in commercial general insurance markets, in particular the SME market. This issue had arisen in the wholesale market as a result of Spitzer and competition issues in the London market. There was a fundamental difference between how large and small brokers operated and issues such as contingent commissions (dependent on placing specific volumes with a risk carrier) and profit shares were more relevant to the larger broker market. The SME market was very competitive and commission disclosure had never been a typical demand or requirement from SME clients. The Panel has stressed the importance of the MFA taking into account issues affecting the smaller broker marketplace, and will continue its involvement in this aspect of FSA's work as it further develops.

“The Panel is opposed to the introduction of commission disclosure in commercial general insurance markets, in particular the SME market.”

4.i. RU 64

The Panel were disappointed with the FSA's decision to delay its decision on the future of the RU64 rule on which it had consulted last year. The sale of stakeholder pension plans are considered not to be economically viable without a supporting fee for accompanying advice. There is also a lack of clarity as to the standard of proof of suitability required by the FSA to support a recommendation of a non-stakeholder personal pension plan. The FSA's decision appears to go against the grain of its promised shift towards a more principles-based approach; and contrary to the weight of informed responses to the consultation. Furthermore, the Panel felt that to cite the FSA's continuing 'concerns over the general quality of advice' somewhat prejudged any conclusions to be drawn from the yet-to-be-undertaken Quality of Advice project.



4.j. RMAR and Firm Contact Centre (FCC)

Early in 2007, the Panel visited the FCC to form its own impressions of the operations. While the Panel was impressed with the professionalism of the department, it noted that a potential improvement that could be made would be to break the teams down by sector/product expertise.

The Panel continues to be concerned that at least half the volume of all calls to the FCC are in relation to the Retail Mediation Activities Return (RMAR), which is indeed telling of the complexity of the reporting process. In the recent Practitioner Panel survey, 59% of small retail firms reported a substantial extra burden brought about by this return. It is crucial that the process is simplified as this will relieve the burden for both firms and the FSA. It remains to be seen whether changes to electronic reporting via the Integrated Regulatory Reporting (IRR) would increase or decrease the number of reporting related calls to the FCC.



4.k. Maximising the Panel's Effectiveness

The Panel is supported by an enthusiastic, dedicated but small secretariat team. The secretariat prides itself on its independence and provides the Panel with its operational, policy and research resource. The Panel on a regular basis takes stock of its method of operation and effectiveness. Below are some examples of how the Panel operates.

- *The Panel meets on a monthly basis and utilise a risk-based and controlled approach to agenda planning – so that it focuses and spends time on the issues that really matter to small firms.*
- *Issues that would benefit from in-depth sector expertise are discussed via Panel sub-groups. Sub-groups that have met over the course of the year include Cost of Regulation, GI, Mortgages, FOS, MiFID, and Supervision of smaller wholesale firms.*
- *Proactive and organised tracking and following-up of Panel representations with the FSA Board and staff, and reporting back accordingly on progress in order for the Panel to get a better sense for the influence of their submissions.*
- *Regular liaison with the FSA's Small Firms Division so that they understand and appreciate the concerns of smaller firms in policy, supervision and enforcement issues. The Panel has an open and co-operative relationship with Stephen Bland (Director, Small Firms Division) and is grateful for his regular updates on FSA smaller firm issues at Panel meetings.*
- *The Chairman meets with the FSA Chief Executive on a monthly basis. The FSA Chief Executive and the FSA Chairman visit the Panel during the course of the year. The FSA also hosts lunches for the Panel with the FSA Board and a dinner with the Consumer Panel to encourage and facilitate an exchange of views on topical issues.*
- *The Panel Chairman briefs the trade associations twice each year along with the Chairman of the Practitioner Panel on the work of the Panel.*
- *Raising of the Panel's profile by building stronger links with key national and trade journalists and identifying potential opportunities for interviews, articles and press releases. For example, the interviews with journalists along with the Chairman of the Practitioner Panel on the results of the Practitioner Panel Survey received widespread coverage in the national press.*





5 . A N N E X

Annex 5.a.

Terms of Reference for the FSA Smaller Businesses Practitioner Panel

1. To consider from a smaller business perspective, and to advise the FSA, on the cost and practicability implications for smaller businesses of:
 - the overall impact of regulation and its potentially disproportionate impact on smaller businesses;
 - the implementation and development of the FSA Handbook of rules and guidance, and proposals for changes to rules and guidance;
 - proposals contained in FSA consultation and discussion papers;
 - the FSA's implementation and continuing development of its policy and procedures in the following areas:
 - authorising firms and approving individuals, including grandfathering provisions
 - supervision, and the effect of the implementation of the risk assessment framework and consequent move away from front-line contact with smaller firms
 - enforcement and disciplinary processes
 - the level of FSA fees and their distribution across types of firm and 'fee blocks,' paying particular regard to the impact on smaller firms
 - training and competence requirements
 - cost-benefit analyses, research and performance measurement
 - the policies and procedures for handling consumer complaints (*Financial Ombudsman Service*) and compensation (*Financial Services Compensation Scheme*) and the FSA's input to developing strategy in these areas
 - the FSA's thematic-related work; and
 - any other aspects of the FSA's operations and functions which are of particular significance to smaller businesses.



2. To advise the FSA on emerging regulatory, consumer protection, public awareness and industry structure issues which the Panel considers to be of specific significance to smaller businesses.
3. To consider and make recommendations on any matters referred to the Panel by the FSA, or by the Financial Services Practitioner or Consumer Panels.
4. To report annually to the FSA Board on the work of the Panel, and to publish a copy of that report.

Relationships with other bodies

1. The Chairman of the Panel (or his Deputy, as his alternate) to attend Practitioner Panel meetings as an ex-officio member and to provide the Practitioner Panel with updates on issues specifically affecting smaller firms as appropriate.
2. The Panel to meet informally with the Consumer Panel to discuss issues of mutual interest at least once a year.
3. The Panel to meet with the Complaints Commissioner, the Chairman of the Regulatory Decisions Committee, and representatives from FOS and FSCS as necessary to discuss relevant topics.
4. Members of the Panel to keep in regular contact with their relevant trade bodies.
5. Members to communicate to the Panel relevant issues of concern from their relevant trade or professional bodies and also raise issues of concern to smaller firms with their trade or professional bodies, having regard to the confidentiality of issues raised at Panel meetings.

Membership

1. Representatives to be drawn from smaller businesses and from across the spectrum of activities regulated by the FSA.
2. The FSA will appoint members and seek nominations for membership from any relevant trade and professional bodies.
3. The Chairman and Deputy Chairman of the Panel to be selected from among its membership by the FSA, subject to representations made by the Panel itself. The Chairman, and Deputy Chairman, will normally serve a two-year term, having been an ordinary member of the Panel for at least a year before their appointment.
4. All Panel members to serve for a three-year term (including a formal review after 1 year), which, at the FSA's discretion, can be renewed with the support of the Chairman. Shorter terms may be agreed between the FSA and individual Panel members as appropriate.



5. If Panel members wish to retire during their term, the relevant trade or professional body will be asked to put forward a maximum of two names from whom a replacement may be selected by the Panel. The appointed individual can then serve a full three-year term.
6. An appropriate senior manager (ideally, a director) shall be selected to attend Panel meetings as a matter of course, together with other members of the FSA as appropriate for particular agenda items.
7. The Panel to be supported by a Secretariat, comprising the Secretary, a member of staff providing policy support and an administrator.



**Annex 5.b.
List of Panel Members
(as at 1 April 2007)**



Panel member

Position

Mark Rothery
Chairman (from 1 June 2006)

Chief Executive, Ancient Order of Foresters
Friendly Society

Ruthven Gemmell
Deputy Chairman (until 31 May 2007)

Partner, Murray Beith Murray WS

Rod Ashley

Chief Executive, Scotwest Credit Union

Stephen Atkins

Director, Freedom Finance

Simon Bolam

Principal, EH Ranson and Company

Chris Brennan

Legal and Compliance Director,
Cube Financial

Gill Cardy

Principal, Professional Partnerships

Paul Etheridge

Chairman, The Prestwood Group of Companies

Fraser Gillespie

Group Finance and Insurance Manager,
Marshall Motor Group

Phil Gray

Chief Executive, Beverley Building Society

Chris Gomm

Director, Gomm Insurance

Bella Hopewell

Managing Partner, C Hoare & Company

Philip Ireland

Director, TD Waterhouse Investor Services

Keith Morris

Chief Executive, Sabre Insurance Company

Guy Matthews

Chief Executive, Sarasin Investment Funds



Annex 5.c. Making contact with the panel

The Panel is happy to hear your views which should be directed in the first instance to our Secretariat team (see below), for forwarding on (as appropriate) to the relevant Panel member(s). While the Panel cannot undertake to respond individually to each communication received, feedback from small firms (either on specific issues or more generally) helps inform our discussions with and representations to the FSA. Please note however that firm-specific issues or questions should of course continue to be directed to the appropriate supervisory contact at the FSA, rather than to the Panel.

We would also urge small firms to respond to relevant FSA Consultation Papers. It is not necessary to respond to all the questions posed (or in great detail). Such Consultation Papers are now marked more clearly in terms of to whom they are likely to have greatest relevance and/or significance – this should help small firms more readily determine which documents (or sections thereof) will be of interest.

You can e-mail the Secretariat at sbpp@fsa.gov.uk or contact them individually as below.

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Annex 5.d.

Extract from FSA Business Plan 2007/08 – 'Making it easier for small firms to do business with the FSA'

What is currently available:	What is currently available:	New initiatives for small firms in 2007/08:
<ul style="list-style-type: none"> • A Firm Contact Centre that handles queries from authorised firms about regulation and the Handbook. 	<ul style="list-style-type: none"> • Treating Customers Fairly web pages with a built in self assessment tool and examples of good and poor practice. 	<ul style="list-style-type: none"> • Targeted communication including case studies to explain what more principles-based regulation means for small firms.
<ul style="list-style-type: none"> • Regional visits, with surgeries to enable firms to discuss topical issues with an FSA representative. 	<ul style="list-style-type: none"> • Interactive online tool to help firms build their own Initial Disclosure Document. 	<ul style="list-style-type: none"> • Helping small firms engage in consultations on policy developments, for example by distributing sector specific consultation forms at roadshows to ask for firms' views on the key proposals affecting them.
<ul style="list-style-type: none"> • Roadshows for small retail firms, to feed back on current supervisory issues, including findings from our thematic work. 	<ul style="list-style-type: none"> • Self-assessment tool for financial adviser firms to work out their anti-money laundering responsibilities. 	<ul style="list-style-type: none"> • Improved website navigation to include A-Z index and intuitive headings.
<ul style="list-style-type: none"> • Industry Training sessions designed and delivered by FSA people across the UK. Distance learning materials including audio and computer-based products. 	<ul style="list-style-type: none"> • Guide to how and why we carry out mystery shopping. 	<ul style="list-style-type: none"> • Improvements to the structure of the small firms web pages to enable firms to choose the level of detail in which to view the requirements that apply to them.
<ul style="list-style-type: none"> • Liaison with trade bodies to help them keep up to date with what is happening in specific sectors and to consult early on proposed changes. 	<ul style="list-style-type: none"> • 'Firms Online' service on our website, allowing electronic submission of regulatory returns, along with forms to notify us of changes to, for example, static data (e.g. address). 	<ul style="list-style-type: none"> • Introduction of Key Rules for mortgages, to help firms understand the requirements that apply to them in their day-to-day activities.



What is currently available:	What is currently available:	New initiatives for small firms in 2007/08:
<ul style="list-style-type: none"> • Tailored handbooks containing only the rules relevant to certain types of firms and the ability to build a personal handbook. 	<ul style="list-style-type: none"> • Build your own application packs tailored to individual applicants, so that firms are presented only with the questions that are relevant to them. 	<ul style="list-style-type: none"> • Piloting the use of new audio and visual communication channels.
<ul style="list-style-type: none"> • Handbook Guides (for example, for IFAs, mortgage and general insurance intermediaries), to help firms in those sectors find the rules relevant to them. 	<ul style="list-style-type: none"> • An online Fees Calculator, to help firms budget for the year ahead. 	<ul style="list-style-type: none"> • Running training workshops and roadshows together to reduce cost and improve the accessibility of training for firms.
<ul style="list-style-type: none"> • Key rules for general insurance intermediaries, to help firms understand the requirements that apply to them in their day-to-day activities. 	<ul style="list-style-type: none"> • A fees section on our website including answers to the most common questions. 	<ul style="list-style-type: none"> • Training and roadshows for motor retailers.
<ul style="list-style-type: none"> • A section of our website dedicated to small firms, with specific pages for different types of firm (including a new section for motor retailers). 	<ul style="list-style-type: none"> • The option of paying fees to the FSA, FOS and FSCS by instalments. 	<ul style="list-style-type: none"> • Web-based tool to help small firms calculate FOS compensation awards.
<ul style="list-style-type: none"> • Targeted electronic distribution of FSA material, on request, via our website. 	<ul style="list-style-type: none"> • A single invoice showing all direct regulatory costs in one place. 	<ul style="list-style-type: none"> • Continued review of the Complaints Return and the RMAR to consider whether the data we receive is appropriate and whether the guidance and training we provide could be improved.
	<ul style="list-style-type: none"> • Help for small firms on implementing MiFID and the CRD. 	



Annex 5.e. The FSA's Formal Response to the Panel's Annual Report for 2005/06

In its Annual Report for 2005/06, the Panel comments on a range of our policies, plans and activities. We welcome the Panel's support for particular aspects of our work. In this response we focus on those topics on which the Panel expresses concerns or criticism. Over the year we have continued to discuss a wide range of topics with the Panel, including those on which we comment in more detail below. Many of the issues raised by the Smaller Businesses Practitioner Panel were also raised by the Practitioner Panel in its Annual Report. We do not repeat here the points we have made in our response to the Practitioner Panel.

In the text below, the Panel's comment is in italics, followed by our response.

Principles-based regulation

The Panel is cautiously supportive of the general notion and purpose of principles-based regulation. However, it continues to be uneasy about how this approach will be applied in practice. There is a real fear among smaller firms that the FSA will fail to supervise and enforce against principles in a suitably pragmatic, proportionate and broadly consistent way. Smaller firms not only pose a different risk but also typically lack the legal/compliance resource of their larger counterparts – they are therefore likely to be understandably nervous about, and find it much more difficult (financially and expertise-wise) to adjust to and have confidence in what is a fundamentally new method of FSA regulation.

The FSA has a programme of work underway to develop its vision for the future, which includes the transition to and the implications of the shift towards more principles-based regulation. It is hoped that this will pick up many of the concerns identified by the Panel; such as the skills and training that the FSA's supervisory, enforcement and policy staff will require to make effective and proportionate judgements when developing, using and interpreting principles.

The Panel will seek to engage with the FSA in an open and collaborative way as this vision for a more principles-based regime, and all that that entails for smaller firms, moves forward. We would encourage the FSA to put our industry expertise to best use, and to do so consistently at an early stage, so that we can add real value. This will be a crucial area for smaller firms in years to come, and it is imperative that the FSA has sufficient understanding of practitioners' views before the thinking is too far developed, thereby enabling it to react more positively to them.

The FSA is also looking at the feasibility of encouraging (and cooperating with) the industry to help set standards through the use of industry codes and guidance. The Panel would like to emphasise that such industry codes must never become a substitute for FSA rules, and it would not be desirable for trade bodies to become quasi regulators (nor



might they wish, or have the resource to be so). There are also various status and practical issues that would need to be considered if such a system was to be successful. In any event, the development of such codes would work best where a particular gap has been identified in a specific sector or there is a danger that they will simply become a second-tier layer of best practice requirements, with the real spirit and benefits of principles-based regulation being lost.

In the Chief Executive's report in our Annual Report 2005/06, John Tiner highlights the importance we attach to delivery of our better regulation objectives and the importance of moving towards a more principles-based approach to regulation. We believe that an approach based less on detailed rules and that focuses more on outcomes will allow us to achieve our objectives in a more efficient and effective way. We regard the increased emphasis on principles as a refinement of our current approach, rather than a fundamental change of direction; principles have existed in financial services regulation since 1992 and the 11 high-level principles for firms have been in place since 2001. We are aware of the need to equip our staff with the skills necessary to implement a more principles-based approach and have incorporated relevant training into the Regulatory Curriculum we introduced last year. In addition, we are currently putting all our supervisory staff through a mandatory, residential training course on our updated regulatory model, ARROW II.

We see potential benefits for firms and consumers in a more principles-based approach; we believe that providing firms with the flexibility to decide more often for themselves what business processes and controls should operate so that compliance with the principles is secured, will better align good regulation with good business practice.

We are aware of the need to consider the interests of all our stakeholders in pursuing our better regulation strategy, including in relation to the use of industry codes. We acknowledge the Panel's concerns and will continue to take its views into account in preparing our Discussion Paper on industry codes for publication later this year.

Treating customers fairly

TCF is the FSA's first meaningful iteration in its move to a more principlesbased regime. We commented last year that – at the strategic level – smaller firms already see treating their customers fairly as a fundamental principle of successful business and a basic necessity for survival. Put simply – and given that they do not have the same brand identity as larger, household-name firms – it is not in smaller firms' best interests to engage in poor practices and run the risk of losing their valued customers. That is not to say, of course, that the regulator's expectations (in so far as they are defined) will always be met in full – the FSA itself acknowledges that we operate in a nonzero failure environment. Instances of non-compliance can and inevitably will occur from time-to-time at an individual rule level, in firms of all sizes and for a variety of reasons. But the Panel was never convinced that the high-profile TCF initiative was the appropriate way for the FSA to tackle any such perceived market weakness. However, given that TCF is here to stay, we focus our remarks at this time to the day-to-day aspects of its application.



Despite a strong commitment to the general principle of TCF, the Panel has repeatedly expressed concerns to the FSA about its operation in the smaller firm community. In particular, the Panel continues to feel that there is a significant lack of clarity and an unhelpful ambiguity about exactly what TCF means for smaller firms and how it will be applied by the FSA in practice. At present, it seems to fall awkwardly and unhelpfully between a prescriptive and a principles-based framework, achieving authority and implementation without any formal consultation or quantitative assessment of the inevitable cost implications.

Similarly, we are uncertain what records the FSA would expect to see retained by smaller firms in order to demonstrate compliance with and their commitment to TCF – this is especially pertinent in light of the Costs of Regulation findings (see below) on the burden of certain evidential obligations. In fact, and disappointingly, we have already seen examples of where FSA supervisors have sought detailed and technical information from some smaller firms regarding their approach to TCF.

We welcomed a recent presentation from the Small Firms Division that suggested the FSA was now taking smaller firms' concerns regarding TCF far more seriously, and was proactively exploring the best ways of providing practical assistance and information. The Panel is also pleased that the FSA is taking the various concerns on internal training and development more seriously – in particular, in relation to relationship managers and Contact Centre staff – and that a number of initiatives are already underway (such as the Core Curriculum). We are aware that FSA staff are sometimes seen by industry as overly-bureaucratic, unduly critical and having poor interpersonal skills. It is essential that these 'cultural' aspects or perceptions can indeed be addressed, as well as improving their overall technical abilities and market understanding. We welcome the FSA's assurances that TCF will be operated in a proportionate and risk-based way with regard to the different size, type and nature of regulated firm – including in relation to smaller firms. The Panel was also involved in the development of the Self Assessment Tool designed to help smaller firms help themselves in considering how TCF would apply in their individual circumstances, and how they might best go about meeting the FSA's expectations. We welcome the helpful intentions of this document.

However, it is fair to say that smaller firms remain to be convinced that TCF will prove in practice to be what the FSA expects it to. The Panel will be watching this closely over the year ahead, and will be robust in its representations should these concerns fail to diminish over time.

On the question of record-keeping, we recognise that small firms do not produce management information in the same way as larger firms but they should maintain adequate records appropriate for the size and nature of their business.



Costs and burdens of regulation

The Panel has long held the view that the costs and burdens of regulation are not only too high, but that smaller firms feel the impact of these in a disproportionate way. That belief is repeatedly borne out by the findings of the biennial survey undertaken by the Practitioner Panel.

The joint FSA/Practitioner Panel Costs of Regulation research (undertaken by Deloitte, and published on 28 June), in our view reinforces this, especially in the retail advice sector – and the Panel hopes that this project will be a major driver for the FSA to treat the issue of costs for smaller firms more seriously and take positive steps to remove/reduce these (where justifiable). The Panel was involved and informed throughout the currency of that work – in particular, in helping to secure the necessary response rate from smaller firms, many of whom were understandably somewhat daunted by the complex methodology and lengthy questionnaire. This was the most in-depth study of its kind ever attempted (whether in the UK or elsewhere) and it does provide a solid and reliable basis for tackling the issue of costs in times ahead. Albeit a number of challenges were faced along the way.

The full text of the report – with individual Forewords by Roy Leighton (Chairman of the Practitioner Panel) and John Tiner (FSA Chief Executive) – can be accessed on www.fs-pp.org.uk.

It should also be noted that the Deloitte research only explored the costs of regulation in three distinct sectors. The FSA should ensure that its onward thinking does not exclude those other sectors of business which may include smaller firms.

More generally, the FSA must be rigorous and relentless in its drive for Better Regulation and deregulatory measures. Without that, the prospect of smaller firms being forced out of business is very real indeed.

The Panel also sees a connected issue here regarding the barriers to entry for new entrants to financial services – and there is concern that if the price and effort of regulation is commercially prohibitive for those looking to choose financial services as a prospective career, there will be a reluctance to do so (or they might choose to base themselves offshore). Again, this is an area that the Panel will be watching closely in coming months and we shall be expecting to see the FSA act quickly and decisively.

We remain determined to strike the right balance between discharging our statutory duties and avoiding unjustified costs; we can do this only with a sound understanding of both the benefits and costs of regulatory action. We acknowledge the Panel's helpful contribution to the Cost of Regulation study, a major piece of work which broke new ground by providing a more complete and detailed analysis of costs than any other major study. This work emphasises our strong commitment to better regulation. Alongside the Cost of Regulation Study we also published a framework for assessing the benefits of regulation, prepared for us by Oxera.



The Cost of Regulation study confirmed that much of what regulation requires is good business practice. Overall, the costs of regulation in the wholesale sector, where a lighter regime applies, were lower than those in the retail sector covered. This is understandable given the extent to which our work on retail firms has to take account of our consumer protection objective, particularly in an industry where it is recognised that there is a gap in knowledge between the provider and seller, on the one hand, and the typical buyer on the other.

The findings of the study in the investment and pensions advice market were that incremental compliance costs are not proportionally higher for smaller firms. This appears to reflect the nature of the regulation in this sector, which is mostly transaction-based. In the two wholesale sectors – corporate finance and institutional fund management – incremental costs were proportionally higher for small firms. This can be explained to a significant extent by the differing risk appetites between larger and small firms; often small firms said that, in the absence of individual rules, they would stop compliance activities that larger firms see as part of their business model.

Under FSMA, we must have regard to the desirability of facilitating competition between the firms we regulate. Avoiding unnecessary barriers to entry into a particular sector or market is an important consideration in this context. If the Panel has evidence of particular requirements that act as barriers to new entrants, we will look at them carefully. Our authorisation teams processed record numbers of applications during 2005/06. While some applications arise as a result of exceptional circumstances such as the closure of a network, this suggests that the barriers to entry to the financial services market are not too high. We also see applicant firms proposing innovative new business models in their applications; the overwhelming majority of applicants are small firms.

We are committed to using the data from the Cost of Regulation study to determine whether regulation is proportionate and will use them when prioritising our future work. We will delete or amend rules over which we have discretion where the costs are not justified by the benefits. We are conscious that the Cost of Regulation study surveyed firms from three sectors rather than the whole financial services industry, but believe the results offer information that can be used more broadly.

We are already making progress towards our targets; in June 2006, we published an update on our Better Regulation Action Plan, setting out steps we have taken to improve regulation in a number of areas. Looking ahead, we will focus on costs imposed by rules on training and competence, complaints, retail conduct of business and record-keeping requirements, all of which are of particular interest to many smaller firms.

The FSA's supervision of and engagement with smaller firms

The Panel has been keenly supportive of the FSA's efforts to make itself 'easier to do business with' both generally and in relation to smaller firms. Given that the vast majority of 'small' firms will not have a dedicated relationship manager – although some



Panel members are sufficiently large that they do – it is all the more important that (for example) the guidance available from the Firm Contact Centre is clear, meaningful and reliable; that the Handbook is accessible and easy-to-use; and that the method/means of communication with smaller firms are appropriate and helpful. The Panel believes that the FSA is making good progress in these areas, for which the Small Firms Division deserves much of the credit.

On the communication front, the Panel sees the key being for the FSA to develop and creatively use a range of tools – for example, roadshows, surgeries and good practice guides. We feel that there remains some scope for the FSA to explore other – mainly Internet based – means of maximising accessibility to material and events, and which smaller firms are likely to find easier (and less time consuming) with which to engage. Linked to this is the issue of cost – information and attendance should be competitively priced to ensure that they are not prohibitive for the majority of smaller firms.

In its Business Plan for 2005/06, the FSA undertook to develop and introduce a number of specific measures to help smaller firms. While we do not list those individually here, the Panel is pleased to note that in large part these initiatives have indeed been brought into effect. In its Business Plan for 2006/07 the FSA, once again, set out a number of workstreams designed specifically with smaller firms in mind – we shall be following these over the coming year to ensure that they are delivered.

With regard to the use of supervision tools, the Panel welcomes the FSA's promise of greater clarity and feedback on its thematic work. However, concerns prevail about certain aspects, in particular regarding the role and use of mystery shopping exercises. Mystery shopping may be a helpful tool in the FSA's armoury to learn more about industry practices in the smaller firm sector and, where problems are identified, to encourage/incentivise better conduct – but the findings must be seen in context and should not be used as an automatic precursor to enforcement action. Such exercises also often lack statistical relevance due to small sample sizes and can be predicated on unrealistic scenarios, which throws further doubt on the ability to draw wider conclusions. Given these limitations, the FSA must consider carefully how it acts upon and publicly communicates the results of such exercises to ensure that negative messages do not do serious, unrepresentative and undesirable damage to the industry's reputation and to consumer confidence.

The Panel is keen to get more regularly and collaboratively involved in the FSA's thematic programme – both strategically and in relation to individual initiatives, and plans are underway to ensure that this happens.

One of our key aims is to create an appropriate regulatory regime for smaller firms, both in terms of our supervision of such firms and in making it easier for them to do business with us. We welcome the Panel's support for the initiatives we set out in our Business Plans 2005/06 and 2006/07.



We will continue to develop these initiatives further, taking into account feedback from smaller firms. As a result of the Panel's feedback on training earlier this year, we have started delivering training courses tailored specifically for smaller firms which we have priced to reflect their limited resources. We will continue to look at innovative ways to make our training more accessible to smaller firms.

We have generally used mystery shopping to gather qualitative information to gain a broad understanding of industry practice in particular areas, not to assess the performance of individual firms. Therefore, it is unlikely that these results would in their own right form a case for further investigation by Enforcement because the number of assessments of any one firm's practice is limited. However, there can be circumstances where we identify such significant bad practice in a firm, through qualitative or quantitative research, that in its own right or, more likely in conjunction with other evidence, we may use it to justify further investigation. We will shortly issue revised guidance to our staff on the use of mystery shopping. In response to industry concerns we will issue a statement clarifying the uses to which we will (and will not) put the results from future mystery shopping exercises.

In terms of our general thematic work, in our Business Plan 2006/07 we set out our intention to improve the way in which we communicate the nature, timetable and outcome of such work. Our decision to brief trade and consumer bodies about the major pieces of thematic work planned every six months provides an opportunity to learn about our overall agenda. This material is available on our website where we also provide a summary of which aspects affect smaller firms.

Before each piece of major thematic work begins, we will generally inform the major trade associations of the scope, purpose and timing. However, we may not do this if mystery shopping is involved, particularly if it is to be undertaken in relatively concentrated sections of the market.

The FSA's approach to enforcement

Alongside members of the Financial Services Practitioner Panel, we contributed at a number of sub-group meetings as the FSA's review of its enforcement powers and processes moved forward during 2005. Throughout those discussions, we felt that David Strachan (the FSA Director who lead this review) and his team engaged in an open and collaborative way, genuinely seeking input from the smaller firm perspective.

The vast majority of the steps and measures introduced as a result of the review received the Panel's warm support – and took suitable account of the representations that we made. Once fully embedded, we hope these will indeed help improve and enhance the fairness (and perceived fairness), transparency and overall effectiveness of the FSA's investigatory and decision-making procedures. As well as helping raise general awareness and understanding of the way the FSA's approach to enforcement works in practice. It is vital that smaller firms can be confident in, and trust the way that they would be treated if ever facing potential (or actual) disciplinary or authorisation sanction by the FSA.



One area on which the Panel expressed disappointment following the review related to our feeling that the Regulatory Decisions Committee (RDC) appeared to be under-represented in the context of direct, financial services expertise from the smaller firm sector. While we agreed that having the right overall mix of skills and experience on the RDC was preferable to a specified quota or representatives of particular interests, given that over 90% of regulated firms are now generally classed as 'small,' we felt that it was crucial for credibility and industry confidence that the FSA sought to address this apparent imbalance in the RDC's membership.

Since we made those representations, the Panel has been pleased to note that effort has indeed been made in the most recent round of RDC appointments to increase its smaller firm input. In the meantime, the Panel will be alert to any evidence to suggest that the FSA (and/or RDC) appears not to be taking proper account of smaller firm dynamics or, more worryingly at face value, cites the smallness of a firm as a negative factor in and of itself.

With regard to any increased emphasis on negotiated settlement of enforcement cases, it should also be said that, typically, such discussions (which are often legal, complex and finely-balanced in nature) are likely to have most benefit for larger firms and their lawyers – smaller firms, who may not have access to such advice or the in-house capability to enter such talks with the desired expertise, may therefore be disadvantaged as a result. And it will also be important that the FSA is not (and is not seen to be) exerting unreasonable or unfair pressure on smaller firms to settle cases which they might otherwise be minded to contest. Again, the Panel shall monitor this aspect in operation.

We welcome the Panel's support for the new arrangements introduced as a result of the Enforcement Process Review. We believe that these changes are bedding down well and we have received positive feedback from our stakeholders; we remain willing to listen to suggestions for further improvement. As the Chairman said in our Annual Report 2005/06, we would encourage stakeholders to make intelligent and constructively critical use of our systems for commenting on how we do our job.

Settlements are available to all firms that find themselves the subject of an investigation. We are committed above all to achieving fair settlements, and there is no question of our exerting unreasonable or unfair pressure on any firm or individual. We believe it is important to achieve early settlements, as they facilitate prompt redress in consumer-related cases and enable us to achieve swift and effective outcomes, so that we can use our resource more efficiently and move on to the next important issue. However, we will not compromise the integrity of our decisions and outcomes by rushing to tie up settlements on bases which are inappropriate. This applies equally whether we are dealing with a large or small firm.



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