14th April 2011

RESPONSE FROM THE SMALLER BUSINESSES PRACTITIONER PANEL OF THE FINANCIAL SERVICES AUTHORITY
TO
HM TREASURY CONSULTATION
A NEW APPROACH TO FINANCIAL REGULATION: BUILDING A STRONGER SYSTEM

INTRODUCTION

This response is from the Smaller Businesses Practitioner Panel, which was set up by the Financial Services Authority in recognition of the need to have a specific Panel to represent the interests of smaller firms to work alongside the Practitioner Panel and Consumer Panel. We are pleased that the Government plans to make our Panel into a statutory panel of the FCA in the new structure. More details of our current role and membership are set out in Appendix 1.

In this submission, we concentrate on the impact of the changes on smaller regulated firms. This response aims to complement the submission of the Practitioner Panel, which will be responding on the issues for regulated firms as a whole, and those of trade associations who will be responding from the perspective of different sectors. We have therefore only responded to questions where we have a point of view to offer from smaller firms.

Fairness and balance

We welcome the steps that have been taken in this consultation paper to establish regulators which will be balanced and fair in their approach to firms and consumers – and the change of name to the Financial Conduct Authority (FCA) is a key indicator of that.

Proportionality and diversity

We also particularly welcome the Government's emphasis on proportionality in this consultation paper. It is crucial for smaller firms that the regulator takes a proportionate approach in its dealings with smaller firms. We would urge that the Government also takes the size of firm into account in its wish to ensure diversity in the financial services industry. Both the Government and the regulators must

guard against a situation where the drive towards security puts so great a burden on firms that only the largest firms are able to survive, as the smaller, sometimes more nimble and more attuned to specific consumers needs firms are unable to compete and survive.

Access and coordination

There will be a large number of small firms which will also need to be dual regulated by both the PRA and FCA. The decision to take on whole sectors means that small banks, insurance companies, credit unions and mutuals will all be caught in the net. It is therefore vital that dual regulated smaller firms have as simple system as possible for access and information from the regulators. There needs to be coordination between the regulators at the level of detail so that small firms are not burdened with duplicate requests for information and visits, or requests for similar information but presented in slightly different formats, by the two new regulators.

Engagement with practitioners throughout the regulatory system

We also support the Practitioner Panel's call for there to be some formal structure for engagement with practitioners at the PRA. We believe that a smaller firm representative could usefully be incorporated within such a Panel, and it could play a useful role in providing a forum for debate in making prudential regulation by the PRA as effective as possible for larger and smaller firms alike.

We believe the best approach will be to have a specialist Panel for the PRA, together with a joint advisory body made up of representatives of all the Practitioner Panels, to look across the regulatory structure, and particularly focus on coordination requirements. If it is not possible to have both of these, there should at least be a joint advisory body of the FCA Panels which has the power and responsibility to advise on issues at the PRA as well as the FCA.

CONSULTATION QUESTIONS

BANK OF ENGLAND AND FPC

1. What are your views on the likely effectiveness and impact of these [FPC] instruments as macro-prudential tools?

The Government is proposing effective macro prudential tools which should assist the FPC in meeting its objectives, although we have some concern about the ability of any organisation to be able to predict future developments and be able to react in a way which is reasonable and yet makes an impact on avoiding disorderly failures. At the same time, we would urge a flexibility of approach at FPC level: many of the tools seem largely designed with banking regulation in mind, and yet some could have a wider impact across different sectors. Macro-prudential tools which have a potentially wider impact, such as stress testing, must specifically consider the business model in question.

3. Do you have any general comments on the proposed role, governance and accountability mechanisms of the FPC?

We remain concerned about the accountability of the FPC. Although we recognise that the FPC will not have the activities of small firms as its focus, nevertheless, it must not make decisions which will unnecessarily penalise them. Many of the FPC's proposed governance mechanisms are quite rigid and backward looking, and so damage could already have been done to the interests of smaller firms.

One way of ensuring that the impact of FPC actions on all types of firms are considered is by giving members of the FPC have a clear responsibility to devote significant amounts of time to their role (similar to that of the MPC). Part of their role should involve travelling around the UK and engaging with a variety of different types and size of firm, as well as consumers and academic and research organisations. This will help to ensure the FPC's discussions are grounded in the practical realities of life and business in the UK.

We also believe that the FPC's objective should be phrased in a way that is more positive in terms of working to provide an environment to enable growth in the UK economy. We appreciate that the FPC should not have a remit to go out and actively promote competition per se, but at the same time, it has to be more of an impetus than simply not restricting growth.

We note that "the Treasury will be able to 'switch off' or modify the requirements for the regulators to consult or undertake cost benefit analysis when implementing these tools" (2.97). If this is necessary, the use of such powers should be strictly controlled in the legislation.

5. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the PRA?

We welcome the idea of both regulators sharing the same regulatory principles as set out in Box 3.B. From the point of view of smaller firms, the most important aspect of the objectives and principles for the PRA is to ensure that they are applied in a proportionate manner. The PRA's will need to make its overall risk appetite clear and ensure this fits with its overall objectives.

We therefore particularly welcome the second regulatory principle which requires both the regulators to abide by the principle that a burden or restriction imposed should be proportionate to the benefits. For smaller firms who will be swept into the PRA as well as the FCA, this is particularly important. Small firms in the PRA will represent a minimal risk to financial stability and, as such, should not have to bear a disproportionate level of regulation or costs. However, equally FCA firms need to be assured that there will be the proper measurement of costs and benefits of new regulatory policies for firms going forward. We will be keen to ensure that the FCA's focus on consumers is not allowed to be used as a justification for measures from the FCA which unfairly burden firms and provide little or no benefits to consumers. This has been an area of vigorous dialogue between the Panels and the FSA in the past, and continues to be so with the FSA's current development of the Mortgage Market Review

We also welcome the clear regulatory principle that consumers should take responsibility for their decisions, and with that, the recognition that the regulator and firms cannot take all the burden of responsibility away from the individual consumer.

We are disappointed that the PRA as well as the FCA is not to be given a role in having regard to competition and diversity. The only concession towards diversity is in the Government's proposals with regard to mutuals. However, there are other aspects of diversity in the financial services marketplace which are worthy of consideration – not least being diversity in size of firm. No one would want a situation where the drive towards security puts so great a burden on firms that only the largest firms are able to survive, and the smaller, sometimes more nimble and more attuned to specific consumers needs firms are unable to compete and survive.

It would be useful also to enshrine the principle that the PRA should promote the soundness of firms but in a way that does not rule out the possibility of firm failure whilst maintaining adherence to the strategic objective.

We also believe that the duty to coordinate should be incorporated into the regulatory principles, to ensure that coordination does not just happen at the strategic level, but is embedded into the day to day processes of the regulators.

6. What are your views on the scope proposed for the PRA, including Lloyd's, and the allocation mechanism and procedural safeguards for firms conducting the 'dealing in investments as principal' regulated activity?

We remain concerned about the burden which may be placed on smaller firms which are being swept into dual regulation by the PRA and FCA. A particular example of this is with credit unions. Credit unions are considered to be high risk but low impact, and so hardly likely to cause a ripple on the financial stability playing field. They are at the simplest and lowest end of the small business ladder, although both the numbers covered and the role played by credit unions are developing. This is recognised by Government which has just granted £73 million to assist credit unions to grow their capital base and stability in the more challenged areas of our society. Over 50% of CUs have no staff and are entirely volunteer run, often with community minded directors with little or no business experience. This has to impact on how regulation and authorisation are viewed.

We welcome the recognition that banks and insurers have different business models and levels of risk, and that insurers have less exposure to causing systemic problems. However, it is of some concern that after a number of years of regulatory activity there is a comment that 'The Government, the Bank of England, and the FSA will continue to consider how the characteristics of insurance firms should be recognised appropriately within the regulatory framework' (3.22).

Within the insurance sector, there needs to be a level playing field for regulation. It is essential that Lloyd's activities are subject to the same degree of regulation as other insurers.

7. What are your views on the mechanisms proposed to make the regulator judgement-led, particularly regarding: rule-making; authorisation; approved persons; and enforcement (including hearing appeals against some decisions on a more limited grounds for appeal)?

We continue to support the idea of regulators applying their judgement in assessing firms, but only on the basis of clear and agreed principles. We recognise that the mechanisms proposed in this consultation go some way to setting out those principles. However, we remain concerned about the regulator not being clear enough in its requirements leading to possible misinterpretation – particularly for smaller firms who would not have such a close relationship with supervisors at the PRA.

1. **Rule-making** – A criticism of the FSA has been that principles and rules are developed, but when clarification and assistance is sought the response has been that it is up to the firm to interpret and work within the principle/rule. The statements of purpose must communicate the reasoning behind the rules and should not be so brief that firms have difficulty understanding the desired outcome
2. **Authorisation** – It looks sensible to allow the PRA to consider the overall picture of a firm, and we would hope that this would be taken in consultation with the FCA. We believe there should be an opportunity for full and open

discussion with the firm over any PRA concerns, so the firm is given the opportunity to modify the model with limitations being imposed only after completion of a formal dialogue between firm and PRA. We continue to advocate a single portal for engagement with the PRA and FCA, at least for smaller firms who are dual regulated.

3. **Approved persons** – Many small firms find it hard to engage first time around with the authorised person regime in the FSA and this may become even more complicated when such approval is spread across the PRA and FCA – so for instance, CEO approved by PRA and MLRO approved by FCA. We would again advocate a single point of entry, at least for smaller firms. In addition, the PRA may need to recognise that firms such as smaller mutuals include individuals on their Boards who do not have qualifications or experience in financial services. They do bring customer focus and give confidence to customers and other stakeholders. We would urge the PRA's judgement to allow these persons to be approved as Board members, while also being expected to participate in training designed to enhance their skills so that they can challenge the executive directors effectively.
4. **Enforcement** – The process surrounding judgment based decisions needs to be strengthened by being able to be subjected to the rigours of a full merits review to consider the decision made. The more restrictive judicial review, simply looking at process, is probably not suitable for a judgements based decision system.

8. What are your views on the proposed governance framework for the PRA and its relationship with the Bank of England?

The overall governance framework proposed appears sound. However, we would like to be assured that the interests of the broadest range of firms being regulated by the PRA would be able to be taken into account, and this would include smaller firms.

We are also concerned that the accountability of the PRA for its budget and value for money is only to the Court of the Bank of England, when it is the firms that are providing the funding. With the current absence of any formal structure for PRA engagement with the industry, there would be no route for any wider challenge function beyond the non-executive members of the PRA Board. We would like to see a role for any Practitioner Panel engagement with the PRA (see answer to question 10). The new regime should not be significantly more expensive than the FSA for small firms (which did not cause the recent problems). This is particularly the case with small mutual firms which are not posing a significant risk that merits more regulation, and where the burden of regulatory costs is borne directly by the consumer in the absence of shareholders.

9. What are your views on the accountability mechanisms proposed for the PRA?

The proposed accountability to Parliament and Ministers seems reasonable. It should provide some external accountability for the efficiency and effectiveness of the PRA.

However, we still maintain that, as the costs of the PRA are being met by financial services companies, the PRA should have some responsibility to engage in dialogue with representatives of those firms on the way that it spends their money to ensure that there is cost effective regulation. This is particularly relevant as PRA firms will be required to pay a double set of regulatory fees, and yet there seem only to be proposals for dialogue and consultation on the FCA's fees. For smaller firms, any increase in regulatory costs can be significant, and we believe there should be some means for dialogue on those funding to be able to discuss value for money aspects of the PRA budget.

We support the proposals for external scrutiny of complaints.

We note that the proposal is for the PRA to have flexibility to establish appropriate decision-making structures for significant regulatory decisions on specific firms. We believe that the FSA's Regulatory Decisions Committee has provided an important arms length decision making mechanism for the FSA's enforcement decisions. We therefore advocate an RDC style body being required to be set up for PRA significant decisions.

10. What are your views on the Government's proposed mechanisms for the PRA's engagement with industry and the wider public?

We believe that these proposals weaken the existing structure by not recommending the continuance of practitioner panels to consider how the PRA meets its statutory objective and to help it to adhere to the regulatory principles. The introduction of a more judgement based focus should increase the need for practitioner panel engagement to assist the PRA in their role. The Government requires the PRA to establish transparent and public mechanisms for engagement: this could be readily answered by the continuance of at least one statutory panel for the PRA as well as the FCA.

An annual consultation is simply inadequate for purpose. Timely consultation on changes to rules is vital. They have proved most useful through the FSA, as smaller firms can inadvertently get caught up in new regulations that are designed to tackle issues that have no real bearing on smaller firms. The class of small firms in itself is not homogeneous, and more regular dialogue with practitioner representatives would allow debate, and sectors to be forewarned of changes which will affect it in the future. The Panels provide a useful first step of gauging the reaction of the industry to proposed changes, without going out to full consultation. They can also be used to discuss developments in Europe and internationally, and how best to represent UK interests in negotiations. The Panels can often be used as a quick and efficient means of obtaining the views of industry representatives who are aware of the overall regulatory picture.

We believe the best approach will be to have a specialist Panel for the PRA, together with a joint advisory body made up of representatives of all the Practitioner Panels, to look across the regulatory structure, and particularly focus on coordination requirements. If it is not possible to have both of these, there should at least be a joint advisory body of the FCA Panels which has the power and responsibility to advise on issues at the PRA as well as the FCA.

11. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?

We support the proposed objectives and regulatory principles for the FCA. We are particularly pleased with the clarification (in 4.9) of the role of the FCA in securing appropriate consumer outcomes. It is vital that it is made clear in the legislation that the FCA should be an entirely impartial regulator, from whom consumers and firms can expect fair treatment. We also welcome the focus on proportionality and consumer responsibility as key aspects in developing future regulatory policies for the FCA.

As we have said in the answer to Q5, we also believe that the duty to coordinate should be incorporated into the regulatory principles, to ensure that coordination does not just happen at the strategic level, but is embedded into the day to day processes of the regulators.

We fully support the operational objective of facilitating efficiency and choice in the market for financial services, and welcome the Government's commitment to elaborate on the FCA's objectives to encourage the FCA to exercise its general functions in a manner intended to promote competition. This is particularly important, so that the regulator does not put so many burdens on firms, which would risk creating a situation where only the largest firms can operate profitably.

As the majority of smaller firms will have their prudential regulation undertaken by the FCA, it is also important that there is a clear and explicit recognition of the FCA's role in this area. The FCA must guard against prudential regulation being seen as a minor role at the FCA, with the inherent ramifications for recruitment and retention of qualified staff and management time devoted to this area.

12. What are your views on the Government's proposed arrangements for governance and accountability of the FCA?

We welcome the proposal to have a structure for the governance and accountability of the FCA which is similar to the current structure for the FSA. This is a system which seems to have worked well.

We are pleased that there has been general support for the Smaller Businesses Practitioner Panel being made into a statutory panel. We see this as important recognition of the particular needs of smaller firms in dealing with regulatory requirements.

We also appreciate the motivation for the creation of a separate Markets Panel for the FCA. However, we also believe that the SBPP benefits in having its Chairman as a member and taking part in the broader debates of the Practitioner Panel. In the future structure, we believe there will need to be a system to bring together the interests of practitioners across the Panels in debates with the FCA. We also believe that there should be a means for the Panels to engage in debate with the PRA as well as the FCA: dual regulated firms will have fully integrated business

plans, and the regulation of conduct cannot be entirely separated from the regulation of the prudential side of a business.

The requirement on the FCA to produce a report on regulatory failure could provide useful lessons in the future. It may be useful to consider if the Treasury Select Committee could have a specific power to write to the Treasury to trigger a report, in addition to the power of the Treasury itself.

We would like to highlight how important the FCA's future role will be in the prudential regulation of the vast majority of smaller firms. We are pleased to see some recognition of this role in Box 4.E, although the detail is due to be provided later this year with the FSA's publication of the FCA's operating model. The quality of this prudential supervision at the FCA could have a significant impact on consumers if not carried out to high standards. It will be vital to be able to attract high quality staff to undertake prudential supervision at the FCA, and so we will be looking to see that appropriate recognition is given to this role for the FCA.

13. What are your views on the proposed new FCA product intervention power?

We understand the Government's wish for the FCA to have a more proactive and interventionist approach. However, the key will be to ensure that the safeguards are in place, for firms and the regulator, as well as for consumers.

It is good that the paper confirms the government will not expect a "zero risk" regime and are not looking to "pre-approve" products. However the FCA may face some significant responsibilities in taking on such a product intervention power. If the regulator bans a product which is subsequently agreed is safe, it will need to be protected from liabilities for the costs incurred by firms in withdrawing that product. In the opposite situation, there could be problems for the FCA if a product is not banned which is subsequently found to have been a problem – could consumers hold the regulator responsible for losses incurred?

14. The Government would welcome specific comments on:

- **the proposed approach to the FCA using transparency and disclosure as a regulatory tool;**

We are not against the FCA using transparency and disclosure as a regulatory tool, as long as appropriate safeguards are in place. The individual reputation of a small firm can be critical to its success or failure. Therefore it is vital that the regulator does not release incorrect details or unsubstantiated claims about firms without having a firm basis on which to do so. The regulator also must not rely on disclosure as the first choice of regulatory tool, as it often will be expensive for firms, and may not provide the sort of information which will help consumers to make informed decisions.

- **the proposed new power in relation to financial promotions; and**

We have no objections to this and support this proposal. Indeed, we believe that more information about financial promotion decisions could help other firms to

improve their compliance with financial promotion requirements. Therefore, we would ask that there is a requirement on the FCA to publish the details of these decisions, to build up a library of 'case law' to help other firms to adhere to the regulatory requirements.

- **the proposed new power in relation to warning notices.**

Whilst we understand why the Government is proposing this mechanism, we believe that further work should be done in terms of timing. We believe it is generally inappropriate to publish details of an alleged wrongdoing, although there may be some circumstances where it is appropriate if the investigation into allegations is likely to take a long period of time.

A smaller firm's reputation is a key part of its ability to do business and consideration should be given to safeguards and formalised "triggers" for earlier publication. Otherwise a firm's reputation could be irreparably damaged, even if subsequently they are found to be entirely innocent, as there is a tendency for people to remember even if someone was only accused of an offence.

PROCESSES AND COORDINATION

17. What are your views on the mechanisms and processes proposed to support effective coordination between the PRA and FCA?

Many of the proposed mechanisms and processes - such as cross membership of boards and MOUs – are essential to have in place. However, there could still be room for operational inflexibility, as statutory duties can often be difficult and cumbersome to apply. Nevertheless, it will be important to put the high level coordination processes in place, with specific statutory recognition of its importance, so that the processes which will fall in beneath can be cross referenced back to the duty to coordinate.

We would suggest that the consultation's proposal of a general duty to coordinate is strengthened. The paper recognises that firms should not receive conflicting views (p82 4th bullet). We would like to see the general duty to coordinate and not give firms conflicting views added to the regulatory principles, as set out in Box 3.B.

The system must be made to work efficiently, particularly for small firms who will be dual regulated. We believe that the regulators should provide a single point of contact or gateway, at least for smaller firms, for as many processes as possible.

We also support the Financial Services Practitioner Panel's proposal to set up a Practitioner Panel Advisory Committee to provide feedback and guidance on coordination between the regulators from the point of view of firms. This would have representatives from all the Practitioner Panels at the FCA – as well as the Practitioner Panel for the PRA if one is set up. Such an Advisory Panel should have the power to look across the regulatory system and comment on all aspects which impact on firms.

18. What are your views on the Government's proposal that the PRA should be able to veto an FCA taking actions that would be likely to lead to the disorderly failure of a firm or wider financial instability?

As there may be times when time critical decisions will be taken, it seems sensible to have the PRA as the lead regulator in this instance. This is unlikely to take place with reference to smaller firms, unless action against a group of smaller firms working in the same sector may cause financial instability. In this case it seems sensible for the PRA to become involved.

19. What are your views on the proposed models for the authorisation process – which do you prefer, and why?

From the smaller firm perspective, this is an example of where we continue to prefer that one authority takes the lead role. We think that this may also be more effective for the supervisors dealing with smaller firms that are dual regulated too. We believe that the FCA appears to be best placed to take on this gateway role. However, small firms may also need to be given detailed guidance on prudential requirements from the PRA, so we would not want to see this provision as then causing a barrier for smaller dual regulated firms to access supervisory advice.

20. What are your views on the proposals on variation and removal of permissions?

It seems logical that the PRA has a veto for dual regulated firms, but again as in our answer to Q19, we would like a single gateway at least for smaller firms.

21. What are your views on the Government's proposals for the approved persons regime under the new regulatory architecture?

We believe that the effective authorising of fit and proper individuals as individuals who have significant influence over an authorised firm is critical to regulation. However, we believe that for dual regulated firms, the proposal that each regulator will share responsibility for controlled functions whilst being in line with their objectives should be reviewed.

In a smaller company where due to scale of the operation, more than one controlled functions may be held by one individual there is an additional complication that means that the individual may have to apply to both regulators for approval for different responsibilities. At present, no specific charges are made for authorising individuals but a change in that policy by either one or both new regulators would lead to additional costs for the firm.

From a smaller business perspective it would be much more satisfactory to make a single application to one regulator and develop a process for each regulator to conduct its checks as necessary and handle the individual's application together. This enables regulators who have differing views on an individual to liaise and come up with a joint decision avoiding the situation where one regulator may accept and the other decline. It should also lead to cost savings for both regulator and firms well as a more co-ordinated approach.

23. What are your views on the Government's proposals on the treatment of mutual organisations in the new regulatory architecture?

We are very supportive of these proposals, as those in the mutual sector have been asking for such treatment for some time.

We believe that the proposal to require the PRA and FCA to conduct an impact assessment in addition to cost benefit analysis when proposing changes to the rules which affect mutually-owned institutions will be a useful discipline. However, we question why such an impact assessment should not be carried out for other firms who will be affected by proposed changes in rules, and this could particularly be applied to the impact on smaller firms.

On the registrar of mutual societies, we believe it is sensible for mutuals in the financial services sector to be registered with the prudential regulator to provide the simplest possible system. It would be yet another hurdle if mutuals were registered elsewhere. For mutuals which do not do financial services business, it seems that registry elsewhere may be sensible.

24. What are your views on the process and powers proposed for making and waiving rules?

Effective coordination between the regulators will be critical to the process of rule-making for dual regulated firms. In the current system with the FSA, the practitioner panels perform a useful role in giving opinions and guidance on the impact of rules prior to public consultation. We believe that such a dialogue with both the PRA and FCA in the future would be even more important, as there may not be full appreciation of the wider potential impact of new rules on a aspects of a business model of a firm within the other regulator's jurisdiction. If the PRA as well as the FCA had access to practitioner panels prior to consultation, some difficult public debates may be avoided.

The wider consultation process which both the PRA and FCA will be obliged to undergo for new rules should provide some opportunity for public debate around overlap of functions. However, the consultation only suggests the FPC taking a role if disagreements relate to the authorities' assessment of the impact of a rule on financial stability. It seems unclear how differences will be resolved if rules impact on other areas of firms' ability to do business.

25. The Government would welcome specific comments on:

- **proposals to support effective group supervision by the new authorities – including the new power of direction; and**

The proposals for effective group supervision seem to be appropriate, but consideration must be taken of the size of the group, and proportionality considered for regulatory purposes. Our assumption is that these proposals relate to larger companies, but an unintended consequence could be that smaller businesses get rolled into a more complex supervisory process which is not warranted by the risks presented by the business.

We would like the legislation to be clear that the new power of direction and group supervision will only be undertaken on a proportionate basis, where group companies are large enough to pose significant risk, or are defined as such by associated legislation.

- **proposals to introduce a new power of direction over unregulated parent entities in certain circumstances?**

It seems sensible for the supervisor to have powers over non regulated parent, within the framework as set out in the consultation.

26. What are your views on proposals for the new authorities' powers and coordination requirements attached to change of control applications and Part VII transfers?

The proposals for the new authorities' coordination requirements in this area seem sensible. Particularly speaking from the point of view of smaller firms, the costs from such transactions can be significant. High fees must be paid to lawyers and actuaries, which in a mutual company context does impact on returns for members. Therefore, we would ask for a recognition in the legislation of the regulators acting in a cost effective way.

For instance, in paragraph 5.85 the power for both regulators to be able to apply for an independent actuary's report should be limited by a requirement to agree to appoint one actuary for the purpose. The necessity for regulators to use the same actuarial advisor is likely to have positive impact of policy proceeds in the not uncommon situation where a small company is involved.

28. What are your views on the Government's proposals for the new authorities' powers in respect of fees and levies?

We welcome the recognition in the consultation document that the allocation of fees will be particularly important for dual regulated smaller firms who will have to pay two sets of fees. However, there is still a lack of clarity on how this will be achieved.

We support the requirement for proportionality in the fee setting. This is another area where we are concerned that it there is no current proposal for the PRA to have a system of pre-consultation with Panels in the way in which the FSA currently does and it is proposed for the FCA. There must be dialogue with both authorities to ensure balance in the procedures for fee setting. This is another argument for the proposal for a PRA Practitioner Panel and an overall Practitioner Advisory Panel as suggested in the answers to Q10 and Q17.

COMPENSATION, DISPUTE RESOLUTION AND FINANCIAL EDUCATION

29. What are your views on the proposed operating model, coordination arrangements and governance for the FSCS?

We support the proposal for the FCA and PRA to have joint oversight and associated functions in relation to the FSCS. However, we believe that the

regulators should take more of a proactive interest in the implications of FSCS funding requirements on regulated firms.

The effects of the recent financial crisis has led to the FSCS requiring far greater funding of defaults than has ever been the case in the past. Small firms in particular find it extremely difficult to plan a virtually unlimited and unquantifiable potential liability to the FSCS with limited financial resources.

It should be noted that the recent request for a huge additional FSCS levy on fund managers to supplement the contributions from intermediaries on the Keydata losses, was unexpected in its size and levied with little notice. Further unexpected requirements of this size could cause instability in hitherto well-run and compliant firms

Neither the FSA nor FSCS are required to take any account of these points or acknowledge that smaller firms are being required unfairly to pay compensation for entirely unrelated matters. It is particularly the case with smaller firms that they are able to build direct relationships with their clients and have less need to pay compensation for other firms to encourage this view. There is also, of course, no appeal against the size of FSCS levies for firms.

We would therefore like a responsibility to consider the impact of FSCS levies on the activities of firms to be added to the PRA and FCA requirements in this area.

30. What are your views on the proposals relating to the FOS, particularly in relation to transparency?

We support the proposal for the FCA to take on the FSA's existing functions in relation to the Financial Ombudsman Service. We also support the provision to allow the Ombudsman Service to publish determinations if it considers it appropriate to do so. It can be useful for firms, as well as consumers to be able to see how the Ombudsman has made decisions in difficult cases.

31. What are your views on the proposed arrangements for strengthened accountability for the FSCS, FOS and CFEB?

We welcome the proposals for strengthened accountability for the FSCS, FOS and CFEB.

We are particularly concerned that CFEB has the potential to cause a significant burden on firms since the Government has withdrawn its funding. We support the proposal for there to be NAO auditing of CFEB. In paragraph 6.27 of the consultation, there is reference to CFEB's requirements to publish its annual plan and report under the Financial Services Act 2010. We ask that CFEB's duty to consult the FSA Panels is extended to all the new statutory panels so that the SBPP is also incorporated. It will be important for the SBPP to have a role in assessing the burden of future funding of CFEB on smaller firms in particular.

EUROPEAN AND INTERNATIONAL ISSUES

32. What are your views on the proposed arrangements for international coordination outlined above?

We welcome the greater recognition of the impact of European and international issues in this consultation paper, compared to the last consultation. It is vital that the UK is able to engage effectively in regulatory debates at European and international levels.

We believe there will be some significant disadvantages in the fact that the EU's structure for financial regulation is organised around activities and does not map exactly onto the UK's regulatory structure. MoUs can be inflexible mechanisms to coordinate the UK position relative to Europe across the regulators and Government. However, we are pleased to see plans for a definite commitment to coordination across the regulators for this vital area of international and EU engagement.

We also believe that there should be practitioner involvement in discussions on both conduct and prudential requirements being developed in the EU and internationally. This is another argument for the setting up of a practitioner panel for the PRA as well as for the FCA, as suggested in our answer to Q10.

APPENDIX – COSTS AND BENEFITS

Do you have any comments on the assumptions made for ongoing compliance costs for regulated firms?

We believe that it is unfortunate that the comparison in the appendix is on the cost difference in breaking the regulator into three parts rather than two parts. There will be significant increased costs for smaller firms which are dual regulated. The costs of regulation are difficult to extract, but we have taken the example of a small bank to indicate that the costs are not insignificant.

In this case the small bank spends circa £150k on regulation activities pa which is around 2% of the cost base. On top of this, there have been additional regulatory requirements in recent times – producing an ICAAP, an ILAA, Reverse stress tests and dealing with Single Company view (FSCS) requirements. This broadly might cost an extra £50k in each of the last 3 years. The bank is assuming that when they become dual regulated the annual costs might increase by 40%-50% pa, so £60k-75kpa.

For smaller non banks but dual regulated firms then cost allocation becomes more important – presently the larger firms pick up a larger proportion of the supervisors' costs. Much will depend on how the regulators manage their reviews of the smaller, dual regulated entities – if they duplicate and do not coordinate in their searches for information, then the burden will be considerably higher for small firms.

APPENDIX 1

ROLE AND REMIT OF THE SMALLER BUSINESSES PRACTITIONER PANEL

1. The Smaller Businesses Practitioner Panel (SBPP) was set up by the Financial Services Authority (FSA) to represent the views and interests of smaller regulated firms and to provide advice to the FSA on its policies and strategic development of financial services regulation.

2. Our members are drawn from smaller firms operating across the main sectors of regulated business.

3. We consider several factors when deciding on the definition of "smaller" businesses and take a flexible approach to the application of criteria. A firm may have – in relative terms – a minor market share or small number of employees in the context of its industry sector. In addition, the firm's financial position and whether the firm is owner-managed may be relevant.

4. We work to ensure that the interests of smaller financial services firms are taken into account and their importance to a healthy, successful and vibrant marketplace are properly reflected in the policies of the FSA.

5. The names of the members of the SBPP as at 14 April 2011 are as follows.

Panel Member	*Position*
Guy Matthews *Chairman*	Chief Executive, Sarasin Investment Funds
Clinton Askew	Director, Citywide Financial Partners
Ian Dickinson	Director, The Brunsdon Group
Paul Etheridge	Chairman, The Prestwood Group
Peter Evans	Chief Executive, Police Credit Union
Sally Laker	Managing Director, Mortgage Intelligence
Fiona McBain	Chief Executive, Scottish Friendly Assurance
Andy Smith	Risk, Governance and Compliance Director TD Wealth International
Ian Templeton	Managing Director, UIA (Insurance) Ltd
Andrew Turberville Smith	Chief Operating Officer and Finance Director, Weatherbys Bank Ltd