Advisors, Wealth and Pensions
Consumer Investments Directorate
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

By email

4 March 2024

Dear Sir/ Madam,

CP23/24: Capital deduction for redress: personal investment firms (PIFs)

The Panel supports the principles behind the proposals. The 'polluter pays' approach is the right one to target poor behaviours, and the outcomes sought are in the interest of both consumers and all firms who pay into the FSCS levy. Our comments concern how the proposals would be implemented in practice and the importance of getting the detail right.

We welcome that the proposals are seeking to take a proportionate approach to reduce the burden on smaller firms, focusing on how much capital firms are required to have and the likelihood of the harm they would cause. We are however concerned that the estimated costs for smaller firms may be above the annual £1,000 per firm estimated. It will be important to collect and monitor data to gain a clearer understanding of cost following implementation.

The proposals to introduce a change to capital requirements based on firms' individual complaints status appear to be heavily reliant on effective self-governance by firms, and our concern is that 'bad actors' will be least likely to comply with the rules. Close monitoring to identify warning signs in data coming through from firms and a robust supervisory approach will be needed to deal with firms who may be trying to hide their potential redress liabilities.

The Panel has previously raised concerns regarding a lack of availability and affordability of PII cover to smaller businesses. Allowing flexibility for firms who are unable to procure this cover to meet regulatory requirements via other means (such as the ability to hold materially higher levels of capital or a 'ring-fenced' amount of core liquid assets) would be helpful. In the longer term we will be interested to see whether access to PII increases if there is recognition by insurers that firms' financial practices and risk management has improved.

There is risk that an unintended consequence of the policy may be that firms identifying they have some liabilities and not holding the amount of capital needed may decide to put themselves into default or sell off/move their client base, with redress liabilities effectively defaulting to the FSCS. In the context of years of difficult economic conditions and growing regulatory requirements smaller firms in particular may be more likely to see consolidation as an easier route than continuing in business. The FCA will need to be alive to this risk, communicate its expectations clearly and consider how best to incentivise firms to stay in business alongside taking a firm supervisory approach.

While the proposals may disincentivise firms from giving bad advice, we are not clear on how they would motivate or inspire firms to work harder to give good advice. We would encourage the FCA to explore how to positively recognise firms which demonstrate good practices, consistently comply with regulation and pro-actively embrace the spirit of the Consumer Duty.

Finally, we are supportive of the proposal in the discussion chapter to move towards a more comprehensive prudential regime for PIFs to include specific liquidity requirements and potentially increase minimal capital requirements. Having higher threshold conditions in place at the gateway should help reduce the incidence of firm failures down the line, and there is rationale for making the requirements for PIFs more consistent with other types of regulated firm.

We would be happy to discuss any of these points further.

Yours sincerely,

[signed]

Andy Mielczarek
Chair, FCA Smaller Business Practitioner Panel