Cosmo Gibson
Redress Policy
Strategy & Competition
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

31st March 2017

Dear Cosmo,

SBPP response to CP 16/42 – reviewing the funding of the Financial Services Compensation Scheme

The Panel welcomes the opportunity to respond to this consultation, as it considers a review of the funding of the Financial Services Compensation Scheme (FSCS) well overdue. Firms, especially smaller firms, are not currently contributing based on the risk they pose to a well-functioning industry. Firms which may have prudently managed their businesses and have not recommended, sold or manufactured high risk products are being made liable when such products fail. In an environment where regulatory costs are substantial, and rising, any increase in FSCS levies can be the final straw for smaller firms, forcing them out of business and decreasing the access to financial services to the market. Due to the mismatch between risk and the size of the levy it is not necessarily firms which pose a threat to the consumer which close their doors, which is not a good outcome for consumers, for the industry, or for the regulator.

In an ideal world, the funding of the FSCS would reflect the risks posed by firms that participate in the industry, and reflect the risk of those firms creating claims on the fund. This is not currently the case. There is a fine balance to be maintained between defining classes broadly enough to accommodate claims, while maintaining fairness of liability amongst firms.

We look forward to hearing the outcome of the review.

Yours sincerely,

Clinton Askew
Chair, Smaller Business Practitioner Panel

Responses to specific questions

Q1: Do you agree with the introduction of risk-based levies? Should we also consider other regulatory responses?

and

Q2: Do you believe that risk-based levies could be appropriate in relation to: a) higher risk investment products; b) insurance brokers that choose to place business with unrated insurers; and c) any other types of specific products or services?

Although we do not disagree in principle with the concept of risk-based levies, targeting intermediary firms that distribute investment products which are already subject to restrictions, such as:

- Non-mainstream pooled investments
- contingent convertible instruments (CoCos) and CoCo funds
- mutual society shares, and
- non-readily realisable securities

we have some concerns about the level of complexity which would be involved in calculating such levies. The process of risk-rating products would have to be transparent – for example, for existing products, is past history used as a risk measure, and if so, how far back would it go? For new products, there is a fine line between risk rating a product and pre-approval of products, which we agree is not the role of the regulator. New products may not fall into any of the proposed new categories, and risk rating them may shut such products down. We do not agree with the concept of banning products, as long as the risks of a product are explained - risk in itself is not a bad thing, but needs to be appropriately positioned and explained to the customer. Therefore we consider that risk rating a company makes more sense than risk rating individual products. There are different approaches to risk rating companies, including levels of capitalisation, which could usefully be used in this approach.

Q3: Do you agree in principle that product providers should contribute towards FSCS funding relating to claims caused by intermediary defaults?

We believe that there are reasonable arguments for and against such an approach. On the one hand, product providers benefit from products being distributed by intermediaries, and arguably should contribute towards intermediary defaults. There is a danger that intermediaries, the least capitalised element of the distribution chain, become the insurer of last resort. Providers should contribute where the product is at fault. There is, however, also an argument that as providers already contribute to the FSCS they are already shouldering some of the risk. We urge the FCA to consider a proportionate response, taking the burden on smaller firms into account.

Q4: Do you have any views about the current effectiveness, or otherwise, of PII cover including in reducing the number and cost of claims on the FSCS, and about the role of PII in providing compensation to consumers who have claims against failed firms?

And

Q5: Do you have any views or suggestions about the possible features of more comprehensive, mandatory PII insurance? Do you have any suggestions about

other possible tools, remedies or approaches which could be used to reduce the scale of funding currently required by the FSCS?

And

Q6: Do you have any views on the impact of a requirement on PIFs to hold more comprehensive PII? For example, what would be its impact on the PII market, the financial advice market and on consumers in general?

We have consistently argued for PII cover to be an integral part of improving the options for compensation. We are strongly supportive of mandatory wording of PII cover and PII cover in the event of firm failure. If prescribed wording is introduced, it would be helpful to develop a protocol for administering claims involving PII Insurers, FSCS and if still in existence, firm representatives.

Currently there is not a clear methodology for firms to help them calculate the amount for which they should insure, and we consider the FCA has a role here to help. We would be interested to know if the FCA is currently comfortable that the minimum amount is adequate, and if not, what it should be, or whether there should be a different approach to calculation.

The main issue with expanding PII cover is whether the market can bear the increased demand. For smaller firms in particular we would welcome further discussions with the FCA about options for providing cover for those which are not able to access appropriate PII immediately following any such expansion.

Q7: Would you support an increase to the FSCS compensation limit in relation to any or each of the investment provision, investment intermediation and life & pensions intermediation classes? If so, do you have any views on what those limits should be?

We consider there is some confusion among consumers about the different levels of protection from the FSCS. There is a relatively clear understanding and awareness of protection for deposits, but much lower awareness of the other categories of protection. We consider that in general, standardisation of protection would be preferable.

The exception to a standardised rate of cover would be for pensions, which have an extra layer of complexity, depending on products used for decumulation and the existence of different wrappers. However, the fact that further work needs to be done on pensions should not prevent work on improving clarity for consumers of other classes of protection.

Q17: Do you have any views on the idea of a fixed levy for smaller firms?

There are a number of issues for debate around the area of a fixed levy for smaller firms. If the requirement for PII cover is to be expanded, there is an argument that smaller firms should be required only to pay a smaller levy as their PII cover will provide a level of protection. As referred to in our answer to questions 5 and 6, however, there may be issues with supply in the PII market which could be a particular problem for smaller firms, especially in the immediate aftermath of any change.
Given the number and diversity of the smaller firms in the market, we consider that a fixed levy would only really be practical if it were to be implemented with the option of a risk premium for those firms dealing in very high risk products.

Q19: Do you agree with our proposals to include protection for client money for debt management activities within the scope of FSCS protection and our proposed funding arrangements?

We agree.

Q22: Do you agree with our proposed approach to provide FSCS protection for claims relating to fund management?

We consider there is a lack of consistency in the treatment of different types of investments, such as ETFs, investment trusts, OEICs, loan stock, loan note, corporate bonds or debentures. Not only is there an inconsistency, it is extremely difficult for a consumer, or even an adviser, to establish exactly what cover is applied to each type of investment. We consider that clarifying the levels of cover should be a priority for future consumer protection.

Q24: Do you agree with our proposal for a new reporting requirement on higher risk products in the RMAR?

We agree this is a proportionate request for data and would be relatively easy for firms to provide.

Q25: Do you agree with our proposal to remove the rule relating to paying FSCS levies by quarterly direct debits or should we consider other options?

We support the option of phased payment on commercial terms.

Q30: Do you have any comments on our proposal to bring the tariff bases for insurers into line with the PRA's approach?

We consider that consistency between the regulators is welcome.

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