FINANCIAL CONDUCT AUTHORITY

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Dear Andy,

I want to thank you for your continued support and engagement since taking on the role as Chair at the start of June 2022 and for all Panel members' insights and contributions throughout the year.

This has been another challenging year for smaller firms, and the Panel has played a vital role in providing insight and advice to help us gain a deeper understanding of these challenges as well as external factors, such as the war on Ukraine and the wider implications on smaller firms.

I want to respond to some of the issues raised in in your 2021/22 Annual report.

<u>Future Regulatory Framework (FRF)</u>

You asked for an update on the Future Regulatory Framework.

We are supportive of the Financial Services and Markets Bill as drafted, including provisions which help ensure proper scrutiny of the FCA's work, but recognise the provisions included in the Bill may change and evolve as it is considered by Parliament. As the Panel is aware, we are waiting for further information on the Government's timetable for transferring files. We will continue to engage with the Panel once we have more information on this and what impact it may have on our other commitments.

The Treasury framed the new proposed 'international competitiveness and growth' objective as secondary. We believe this strikes the right balance by reflecting our important role in supporting long-term international competitiveness and medium-to long term growth, without detracting from our existing operational objectives. Importantly, the objective as drafted helps ensure short-term competitiveness is not prioritised at the cost of long-term growth.

The FCA's statutory Panels are crucial in providing challenge and input to our work. We are committed to ensuring that the role of all the Panels in our policy and rule-making process is transparent, effective, and well-understood. Therefore, we support the FRF measures that enhance public information about our engagement with the Panels.

We will build on existing arrangements and work with the Panels to determine the best approach for publishing further information about how we have engaged with them.

We will also draw on the Panel's support and expertise as we move forward with the transfer of retained EU law to our Handbook, in line with the priorities and timetable set by the new Government.

Environment, Social and Governance (ESG)

Your report suggested that we map out our initiatives within and outside the FCA, which address the areas of ESG and sustainability. You also said that plain language is needed in disclosure requirements.

We published our ESG Strategy in November 2021. This outlines all our ESG-related workstreams and how they inter-relate thematically. It also includes a related milestone timeline. We plan to publish an ESG 'report card' in early 2023. The report card will cover progress made against our ESG Strategy and the milestones we set. Separately, we are also developing metrics to assess progress against the target ESG outcomes we set out alongside our Business Plan 2022/23.

We have now published our sustainability disclosure requirements and investment labels consultation paper. The proposals will address labels to help consumers navigate the complex landscape of investment products. It will also look at consumer-facing disclosures, including product-level disclosures, to provide greater transparency on sustainability-related features of products. We will also address entity-level disclosures on how firms manage sustainability-related risks. Other areas we propose to tackle are the naming and marketing rules to ensure sustainability-related terms are used proportionately, and requirements for distributors to ensure that product-level information is made available to retail consumers. The consultation will be open for 3 months, and we intend to publish a policy statement next year.

FCA Transformation

You asked whether we had sufficient capacity to undertake our transformation programme alongside significant policy initiatives, for example the Consumer Duty.

We are two and a half years into a three-year transformation programme. We are on track to deliver it on time and in line with the original mandate.

Much of the programme involves investment in resources and capabilities the FCA needs, and will need increasingly in the future, for example in data analytics. Coupled with improvements in governance allowing for quicker regulatory decision making, as well as reforms to how we manage and reward performance, these changes could not wait because they are vital in ensuring we can achieve our objectives for the long term.

However, we recognise that the scale of transformation needs careful management. Phasing the programme over three years has helped ensure there has been no significant impact on day-to-day regulation. The ability to deliver has been possible due to the active management of project resources and subject matter experts throughout the organisation. In addition, the £30m hypothecated budget for the programme is ringfenced and is not subject to potential de-prioritisation.

We have also been successful in recruiting talent to the FCA, even as we have transformed with 479 colleagues joining the FCA between 1 January 2022 and 30 June 2022.

This figure includes around 40 in Edinburgh (where we are seeking to double our headcount), and we have opened a new office in Leeds to draw on a wider pool of talent. We are on track to seeing around 1,000 new colleagues joining the FCA over the course of this year.

## Firm Failure

You have encouraged us to work with Professional Indemnity Insurers (PII), so they have the best possible data and understanding of the market, ensuring the supply of cover is appropriate and affordable. You are also concerned about the cost of firm failure.

We have engaged with PII manufacturers to understand the current state of the market. Our view remains, following this, that the answer to lower PII costs is, ultimately, higher standards reducing the total redress bill. To achieve this, we are strengthening our authorisation process, and now the number of firms that we did not authorise in 2021/22 was one-in-five, up from one in fourteen in the previous financial year, as well as supervising more assertively making better use of the data we collect. Additionally, we have continued our work to review the prudential regime for non-MIFID investment advisers. This work aims to ensure that firms that create redress liabilities are better able to pay them.

We published a discussion paper in December 2021 on our compensation framework to get views on how to ensure it remains proportionate and appropriate and plan to publish a Feedback Statement.

We want to ensure that the FSCS is widely seen to represent a true 'fund of last resort'. This means the cost of redress is met by the firms that cause the harm, rather than costs mutualised across FSCS levy payers.

In the short term, we may see FSCS costs increase as our interventions to improve standards take effect. However, as firms' conduct improves in the longer term, we expect to see fewer redress claims, reducing associated FSCS and PII costs.

## Cost of regulation

You asked if the volume of regulatory changes put too much pressure on firms, creating a possible competition issue if firms exit the market.

Firms will always carry a risk of failing. We aim to minimise the fallout if this happens. When consulting on new policies, we undertake a cost-benefit analysis which carefully considers the additional regulatory costs to firms. Our CBA framework sets out how we estimate costs to firms. We consider if our proposals will unreasonably raise barriers to entry or cause firms' profitability to be materially reduced. Where a policy might lead to the exit of some firms, either due to the substantive impact of the policy itself or the costs of complying with the policy, we consider the impact on competition in the market to ensure sufficiently healthy competition remains.

We conduct competition assessments across our supervisory firm portfolios, looking at where competition issues might arise. Where we see evidence of materially increased exit of firms, we would look at the drivers of that exit and whether that is caused by underlying economic factors, changing market dynamics or regulatory factors.

Claims Management Companies (CMCs)

You have urged us to work closely with the Solicitors' Regulation Authority (SRA) to protect consumers from excessive CMC fees. You have also raised serious concerns around phoenixing and CMCs.

We have published rules capping the CMC fees for financial services and financial products claims. Those rules came into force on 1 March 2022. We continue to liaise with the SRA, which published a discussion paper in July 2021, adopting our approach for firms they regulate.

In June 2022, we published a policy statement with rules preventing those connected with failed financial services firms phoenixing and setting up as a claim manager. The rules came into force on 7 July 2022. Within two years of the rules coming into force, we expect the number of FCA-regulated CMCs submitting claims where they have a relevant connection to be zero.

Data Strategy

You have encouraged us to make the best use of our data, repurposing this without requiring further information from the industry.

We agree with the Panel. The 'Transforming Data Collections' joint programme with industry, the FCA and the Bank of England aim to transform how we collect data, ensuring regulators get the information needed to fulfil our regulatory functions at the lowest cost to the industry.

We will continue to evaluate and assess the data we collect to improve collection so that it's both proportionate and effective. As part of the 2022 recommendations, we will create a 'personalised firm view', which will provide a visual to each firm of the information they provide. This aims to increase transparency and drive higher quality.

The FCA Information Governance Board monitors all new firm requests. It states that any new collection should be tested with firms before issuing it and should include a clear explanation of why we are requesting the information. As part of the FCA's data acquisition strategy, our teams must look at the data we hold, can procure, and share with regulatory partners, before requesting data from firms.

Our Data Quality team reviews firm submissions and will publish information on common mistakes to drive good practice. We've published 40 data-led publications to increase the transparency of the information firms provide us.

The Consumer Duty (The Duty)

You have raised concerns that firms will rely on the law rather than regulation if a private right of action is introduced.

As the Panel is aware, our final rules, following consultation, do not include a private right of action. This is principally because we believe the existing redress framework is likely to be a more appropriate route for almost all consumers to seek redress. It is designed to make it straightforward for consumers to pursue complaints at no additional cost to them, and without the need for representation. In our final rules, we made several changes to the Duty that consumer organisations noted would help to replicate the benefits of a private right of action, for example strengthened governance, accountability and redress requirements.

Pensions

You have suggested we align our work in this area in terms of saving for later life, which can be done through a pension, consumer investment or a combination of both.

We welcome the Panel's continued and recent input on policy initiatives helping to shape proposals including delivering value for money in pensions, stocks and shares ISAs and qualifying pensions dashboard services.

Our work on pensions sits alongside our Consumer Investments Strategy, which directly covers the prevention of pension scams, ensuring consumers only invest in higher-risk investments through whatever channels, including via a self-invested pension product (SIPP), where these are appropriate for them and align with their risk profile. And the Duty is aimed at improving consumer outcomes regardless of the product or service being used and how savers invest.

Many consumers do not invest directly into a pension; choices are made for them, typically by employers as part of an auto-enrolled workplace pension. This changes at retirement or when a consumer saves using a SIPP or personal pension. We continue our work to support consumer decision-making in these areas following our Stronger Nudge to Pension Wise Guidance rules and publication of our Pensions Consumer Journey Feedback Statement jointly with The Pensions Regulator in June 2022. In doing so, we will ensure our work is aligned.

Advice gap

In your report you discuss your concern around the advice gap potentially being filled by online and social media sources, shifting participation in financial services and high-risk investments towards a younger age group.

Our consumer investment strategy recognises that advice is not reaching all parts of the market. Only 8% of UK adults have received financial advice. Robo advice is failing to fill this gap, with only 1.3% of adults having used this in 2020. The majority (54%) have received no support in making investment decisions.

In a speech in September, Sarah Pritchard confirmed that once the FCA has greater rule making powers under the future regulatory framework legislation, the FCA intends to carry out a holistic review of the boundary between advice and guidance.

As part of our Consumer Investments Strategy, we have said that we want to establish a simplified advice regime for mainstream stocks and shares ISAs where the risks to consumers are relatively low.

We launched the InvestSmart campaign last year to better inform self-directed and less experienced investors about investment risk. We are targeting younger investors to help them understand how to take a more sustainable investment approach. We are using TikTok and Instagram to reach and engage audiences seeking information and guidance. We have also partnered with influencers to promote good investing behaviours.

Competition in Retail banking

You have noted that digital players have taken advantage of new and more agile technology and systems. However, you are less confident about the future, with medium-sized firms already struggling to compete, and likely consequences for sectoral consolidation and retrenchment.

There are signs that some of the historical advantages of large banks may be starting to weaken through innovation, digitisation and changing consumer behaviour. Digital challengers now have around 8% market share for Personal Current Accounts (PCA). Larger banks have adopted digital innovation leading to improved service quality for many consumers, while the gap in profitability between large banks and smaller challengers has reduced.

We recognise the Panel's concerns about the future challenges to competition in retail banking. Some mid-tier banks have struggled to scale in the PCA market and have suffered from high funding and operating costs.

There remains significant room for further strengthening of competition and innovation in retail banking. Our focus is on enabling easier sharing of consumer data in secure and convenient environments via Open Banking or Open Finance. This will deliver benefits through personalised products and advice, price comparison, facilitating switching among service providers, spurring innovation and empowering consumers to make more informed decisions.

At the end of October, we published a discussion paper on the opportunities and potential benefits from Big Tech's entry into financial services and we look forward to discussing this work with the Panel.

Market Volatility and the crisis in Ukraine

Your report recommended that we remove the requirement for depreciation notifications because of the extreme volatility in the markets during the crisis.

The requirements in MIFID that require notifications to end investors, when price volatility exceeds 10% are set out in instruments we cannot change. The Treasury consulted on this question as part of its Wholesale Markets Review, and we are working with them to put forward appropriate change. We will feed the Panel's views into those discussions.

Understanding the industry

You have encouraged us to make full use of trade associations and professional bodies, using communication channels as an efficient and effective way of getting messages across quickly.

Our communications division currently maintains relationships with trade associations and professional bodies to make maximum use of their existing communication channels, getting messages across quickly.

We meet with a range of trade associations and professional bodies to seek feedback on how our communications are landing with their members. We discuss recent announcements and emphasise key organisational messages. Through this, these organisations can raise any areas of concern, which we'll flag with relevant business areas within the FCA. We stay in close contact with industry and ensure that firms are kept up to date through Regulation Round Up, which is sent to around 60,000 stakeholders monthly.

We arrange meetings and roundtables to engage with relevant trade bodies to use and maximise communication opportunities. We did this recently on the FCA's Business Plan and the issues arising from the increasing cost of living.

I am grateful for your support and collaboration and look forward to working with you this year.

Yours sincerely,

Nikhil Rathi
Chief Executive