

12 Endeavour Square
London
E20 1JN

Tel: +44 (0)20 7066 1000
Fax: +44 (0)20 7066 1099
www.fca.org.uk

Marlene Shiels
Smaller Business Practitioner Panel
c/o Panel Secretariat
12 Endeavour Square
London
E20 1JN

15 January 2021

Dear Marlene

We know that many smaller firms are currently facing extraordinarily difficult challenges. Over the past year the Panel has played a vital role in giving us particular insight into the impact of our policies and other interventions on smaller firms.

You have played an important role in both advising and challenging us, bringing deep understanding and expertise on the specific risks and challenges that smaller firms face. We particularly welcomed your insights into how we communicate with smaller firms about Brexit, helping us to increase our level of communication with the sector.

I would like to thank you for your commitment and hard work to help ensure that we continue to fulfil our statutory objective to ensure that relevant markets function. In line with our statutory requirement, I would like to respond to some of the key issues that were raised in your 2019/20 Annual Report and update you on relevant work.

Coronavirus response

Coronavirus has affected the lives of millions of people and the economic impact is significant.

At the outset of the pandemic we provided space for the firms we regulate to concentrate resources on serving their customers. We gave firms flexibility over some regulatory requirements and significantly scaled back our programme of routine business contact. We only contacted firms on business-critical requests or about their response to the situation, so that they could focus on responding to coronavirus.

We looked closely at our own work plans and postponed activities that were not critical to protecting consumers and market integrity in the short-term. We chose to continue some regulatory reform, particularly work to help the most vulnerable and some long-term change programmes, such as our own transformation work. Our transformation programme is underway and is intended to make us a more efficient and effective regulator during the challenging times ahead. It will strengthen the UK financial system and in turn, will increase public confidence and enhance the UK's reputation as an international financial centre.

Future of Regulation

Small firm regulation

We note the Panel's comments on our portfolio approach. Firms are placed into a portfolio based on their business model. If a firm has a business model that spans more than one portfolio, we place them in the portfolio where they make most of their revenue.

Firms receive portfolio letters relating to the portfolio they sit in. They will also have access to any other portfolio letters that may be relevant to them through our dedicated [correspondence page](#) on our website. This provides a list of all the portfolios and a link to all letters published to date. We now publish all portfolio letters.

We have now created a [correspondence page](#) on our website that provides a list of all the portfolios and a link to all letters published to date. We will now publish all portfolio letters.

In our 2020/21 [Business Plan](#) we said that over the coming year we will be shifting our focus towards smaller firms. We also explained our Business Priorities. These include ensuring consumer credit markets function well, enabling better consumer investment decisions and making payments safe and accessible. These priorities look at improving conduct in sectors and portfolios with large numbers of small firms, reflecting the closer scrutiny we will provide in these areas.

In [Our Approach to Supervision](#), we explain our approach to portfolio supervision, which gives the framework for our supervision of smaller firms: 'We supervise most firms as members of a portfolio of firms that share a common business model. We analyse each portfolio and agree a strategy to take action on firms posing the greatest harm. We communicate our expectations, priorities and examples of good or poor practice.'

Costs & benefits of regulation of smaller firms

We recognise both the increases in the Financial Services Compensation Scheme (FSCS) levy affecting many firms at present and the difficulties both in getting adequate Professional Indemnity Insurance (PII) cover, and higher premiums, for some advisory firms.

It is important that consumers get redress when they have been harmed by a regulated firm's act or omission and that the costs of this redress are met in a fair and sustainable way. Despite efforts from industry and from us, redress continues to be needed too often, and the overall bill for it in the advice market is too high.

In September 2020, we published a Call for Input on the Consumer Investment Market. This looked at areas where this market is not working well for customers and sought views on what changes we can make to improve protections and outcomes. The deadline for responses has now passed and we are reviewing all the information submitted.

Overall, our aim is for all advice to be suitable. As more advice is suitable, fewer consumers will find themselves let down and needing redress and, over time, this will drive down the cost of unsuitable advice for the industry. Over the coming months we will be examining evidence given in response to this Call for Input. We are keen to continue to engage with the Panel on these issues and will update the Panel at our February meeting.

Duty of Care

In our [Feedback Statement](#) on Duty of Care and potential alternative approaches we committed to reviewing how we apply the regulatory framework, particularly the Principles for Businesses, and how new or revised Principles could strengthen and clarify firms' duties to consumers. We said we would do further work to examine the options that are likely to be the most effective and proportionate, so we can understand their likely impact on all areas of our operation, industry and consumers.

Over recent months, we have had to make a number of reprioritisation decisions in order to protect consumers from harm arising from the impacts of the pandemic. We had planned to seek views on options for change by the end of this year. Due to the coronavirus, we have had to delay publication and now we aim to consult in Q1 2021.

LIBOR

A key area of focus for authorities and the Working Group on Sterling Risk-Free Reference Rates (RFRWG) is increasing the awareness of and preparedness for LIBOR transition for those less familiar with the topic. This has involved working closely with a broad range of industry bodies.

In March 2020 the FCA and Bank of England sent a joint [letter to trade associations](#), including Responsible Finance, setting out how LIBOR transition may affect their members and stakeholders. The RFRWG has also published a range of material including a series of educational videos covering the basics of LIBOR transition, and [practical steps](#) to help businesses prepare.

To ensure messaging on LIBOR transition reaches as broad an audience as possible, our communication strategy involves participating in a wide range of speaking engagements, and utilising existing communication channels such as the Regulation Round-up. We continue to welcome feedback on what more the official sector and RFRWG could do to help smaller firms and other users engage with the transition away from LIBOR.

Innovation and new entrants

Open Finance

Our aim is to ensure that Open Finance progresses in a way that delivers good outcomes for consumers and that the right incentives exist for all parties to participate.

In December 2019, we published a [Call for Input](#) to explore the opportunities and risks of Open Finance. The CFI deadline was extended to 1 October 2020, due to the impact of coronavirus.

We plan to publish a feedback statement in Q1 2021. Based on the responses, we will consider our next steps and will keep the Panel updated as our thinking progresses.

Payments

Many payment and e-money firms have entered the market in recent years, resulting in a rapidly growing sector of over 1,500 firms.

We use authorisation as a tool to prevent harm from occurring. During authorisation, we assess a variety of factors to ensure our minimum requirements are met, including whether a

firm has adequate financial resources for the regulated activities it wants to provide. We also consider if there are risks of harm in a firm's business model or culture.

We are aware that not all firms are sustainable in the long term, whether due to their business models or stressed circumstances, and the pandemic has accelerated some of these issues. We have been increasing our supervisory work in this area to match the level of risk we are seeing in the sector. We expect all payment and e-money firms to safeguard customer funds, meaning that in the event they fail, customers' money should be protected.

We are working with the Treasury to consider how we can strengthen the overall regime that payments and e-money firms operate in, including by enhancing the protections in place for consumers and SMEs.

We encourage innovation in the payments market through direct support to firms and through accepting applications to the FCA Sandbox. The Sandbox gives firms the ability to test products and services in a controlled environment, while helping them to identify appropriate consumer protection safeguards which can be built into new products and services. We also expect the implementation of Open Banking to foster competition and innovation as it grows.

Culture and Governance

Senior Managers & Certification Regime (SM&CR)

We have worked with the PRA to agree an approach to resolve the issue where staff members, who have been approved under the Senior Managers Regime, are on long-term leave.

After an initial delay, resulting from the pandemic and the need to prioritise our response to those challenges, we have resumed this work. We, and the PRA are consulting on our proposed approach to addressing long-term leave. Our proposals can be found in Chapter 2 of [CP20/23: Quarterly Consultation Paper No. 30](#)

We are proposing to clarify that, in cases where an individual who performs a Senior Manager Function is temporarily absent from their role, and the firm intends to keep the role open for that individual to return to in the future, the firm will not need to notify the FCA (and, where applicable, the PRA) that the individual's approval should be removed. Firms should still ensure that where the individual taking long term leave is carrying out a FCA required function, another individual is appointed to perform that required function during the interim period.

Fair Outcomes

Vulnerability guidance

We welcome the Panel's support on our work in this area. The key aims of our vulnerability guidance, and our common definition of vulnerability, are to help ensure that firms take vulnerability seriously and prompt them to embed the fair treatment of all vulnerable consumers into their culture, policies and processes throughout the whole consumer journey.

Our Financial Lives 2020 research, carried out in February 2020, found that just under half of UK adults (24.1 million people) display one or more characteristics of vulnerability. Our recent research has found that since the start of the pandemic the number of UK consumers with one or more characteristic of vulnerability has increased by 3% (1.5 million more people), mostly due to low financial resilience.

Pension transfer advice

There is an inherent conflict of interest in charging on a contingent basis for DB transfer advice. We listened to the views of the Panels and other stakeholders when considering the issues of contingent charging and concluded that a ban was appropriate, as part of the package of measures that we put forward for pension transfers. We took this decision in the context of a significant proportion of advice given being not suitable. We believe it is a proportionate response given the consumer harm in the market.

General insurance distribution chains

In November 2019, we published finalised guidance to address consumer harms arising from distribution chains for non-investment insurance products. This set out our expectations for the design and distribution of non-investment insurance products and followed a thematic review that identified potential for harm to arise from the operation of some distribution chains.

We discussed our findings that poor practice exists in some areas of the market with you, and you acknowledged this. You raised concerns that the FCA should not use findings in specific areas of the market to develop guidance for areas which were not within the review without clear evidence that they are appropriate, and urged us to avoid a simple one-size-fits-all approach.

We would like to reassure the Panel that we take this issue seriously and always consider the scope of our proposals carefully, only proposing guidance and rules where we think it is appropriate and proportionate, to avoid adopting a one-size-fits-all approach. In a situation where we have consulted on guidance and rules that would be applied to a wider range of products than in the initial investigatory work, we would only do this because we think that the proposals are relevant. Where we propose to introduce measures based on high-level principles – for example ‘fairness’ – these can be relevant to address risks within markets as a whole, rather than just to individual sectors or products.

In this particular case, the guidance in FG19/05 did not introduce new obligations for firms. Rather, it clarified our expectations of firms under the existing requirements for the manufacture and distribution of non-investment insurance products. Specifically, it clarified that firms’ existing obligations, when taken together, require them to consider the product’s value to the customer. In terms of non-investment insurance products, the underlying rules apply to all general insurance and pure protection products; the guidance follows this same application.

The Panel should be reassured that as with other policy proposals, we consulted on the guidance before finalising it in order to give all stakeholders the opportunity to provide feedback on our proposed guidance, including its scope.

Mortgage advice and selling standards

We note the Panel’s views on our work on mortgages, including the findings of the Mortgage Market Study and on the subsequent remedies such as the rule changes set-out in Consultation Paper 19/17 and Policy Statement 20/01 (‘Mortgage advice and selling standards’).

Our changes were to address 3 potential harms identified by the Mortgages Market Study:

1. our rules and guidance may have been a barrier to firms developing tools that help consumers choose a mortgage
2. consumers looking to buy an execution-only mortgage (i.e. without advice) were diverted to advice, and execution-only sales channels were not always easy to use
3. many consumers were overpaying for their mortgages even when they received advice

To enhance the value of advice our rule changes also require advisers to explain why they have not recommended a cheaper mortgage, where other products meet the customer's needs and circumstances.

In terms of mortgage protection, our rules do not provide a barrier to the discussion of protection in an advised sale. Equally, they do not prevent prompts regarding mortgage protection in execution-only sales. Execution-only sellers are likely to have similar incentives to advisers in raising protection issues with mortgage customers.

Funeral plans

We recognise the concerns of the Panel on the impact of regulatory change on small businesses, including funeral directors. We are currently awaiting HM Treasury's final legislation to be made and are beginning to develop our regulatory regime for the market.

We are in the process of designing rules in line with our statutory competition objective and the principle that our rules be proportionate to the benefits they give consumers.

We are also considering the standard of protection that is appropriate to the harm in the market and the size and role of firms within it. For example, our prudential and conduct rules will consider whether firms are designing and carrying out plans, or just selling them on behalf of others (the latter being the role of most funeral directors). We expect that many small funeral directors will choose to become appointed representatives tied to larger funeral plan providers, so they will not need to become fully authorised and have support in meeting the rules.

We will engage with industry on our approach to regulation during our consultation phase, and will aim to identify aspects of our regime which could be problematic for smaller businesses in the funeral sector. We will use this, as part of our broader range of information collection, to inform our approach to regulation.

Claims Management Companies

We note the Panel's comments about some claims management companies (CMCs) allegedly bringing spurious claims and for the need to publicise that consumers do not need to use CMCs if they wish to raise a complaint.

Since April 2019, when we took on responsibility for the regulation of CMCs, we have been through a process of assessing applications for FCA authorisations from around 950 CMCs. Our authorisation process has been rigorous and involved the close scrutiny of business models, advertising, prudential and financial resources and individuals.

We also have a number of rules which specifically apply to financial promotions, including that CMC firms must prominently state that a claim can be made for free without using a CMC. We have taken steps to publicise these rules among CMCs, for example by issuing a Dear CEO

letter and have taken action where we have found that firms are not complying. This has resulted in many CMCs amending or withdrawing adverts.

We have welcomed engagement with you on this and other matters relating to CMCs including issues raised about the practices of some lenders to which a CMC has submitted claims.

We agree with the Panel that CMCs can provide a role in facilitating genuine claims. We are keen to promote a constructive dialogue between CMCs and other firms to address issues on both sides and to make the process as effective as possible for the customers who choose to use a CMC.

Increase in number and failures of Individual Voluntary Arrangements (IVAs)

We are alert to the risk of increasing numbers of IVAs and an increasing proportion of failures. We are actively using supervisory tools to mitigate the risk of poor debt advice which could lead to consumers entering the wrong debt solution. We set out our expectations of debt advice from debt packager firms in a [Dear CEO letter in 2018](#) and more recently set out key risks that debt advice firms pose to consumers in a [Portfolio letter to debt advice firms](#) in July this year.

There are complex perimeter issues in this area and there are limits to the action that we can take to address the risks from high rates of IVA failures. Where the risk of harm lies outside the perimeter, we liaise closely with the relevant regulators, sharing intelligence and discussing issues of mutual interest and concern.

We raised the issue of unregulated lead generators channelling consumers towards unsuitable insolvency solutions in our [Perimeter Report](#), noting the actions taken by the Insolvency Service and their ongoing consultation on oversight arrangements for insolvency.

We look forward to your continuing support as we work to help firms to continue to operate and maintain high standards of conduct

Yours sincerely

Sheldon Mills
Executive Director, Consumers and Competition