

EVIDENCE BY THE PRACTITIONER AND SMALLER BUSINESSES PRACTITIONER PANEL ON THE FSA'S 2006-06 ANNUAL REPORT

Introduction

1. In the Treasury Committee's consideration of the FSA's 2005-06 Annual Report, the Practitioner Panel and Smaller Businesses Practitioner Panel would like to draw the Committee members' attention to a number of high-priority issues for regulated firms, which might merit greater scrutiny during the oral evidence sessions. These include:

- The FSA's principle of Treating Customers Fairly
- The principle of *caveat emptor*, as included in the Financial Services and Markets Act 2000 (FiSMA)
- The move by the FSA towards a more principles-based regime
- The cost of regulation, especially for smaller firms
- The implementation of EU directives and the FSA's international work

2. The aforementioned points will be explored more deeply later in this memorandum, following a quick introduction of the two Panels and their work.

About Us

Practitioner Panel

3. The Practitioner Panel was established in November 1998, comprising senior figures from a cross-section of the financial services industry, to provide a high-level body available for consultation on policy by the FSA and to communicate to the FSA views and concerns of the regulated industries. It has a statutory basis under Section 9 of FiSMA. The Panel sees its main role as that of a 'constructive critic' of the FSA. To help the Panel monitor the FSA's effectiveness, it conducts a comprehensive biennial survey of regulated firms, the latest of which is currently ongoing and will be published by the end of this year.

4. Further information on the role and work of the Panel and its current composition can be found on its website: www.fs-pp.org.uk.

Smaller Businesses Practitioner Panel

5. The Smaller Businesses Practitioner Panel (SBPP) was set up by the FSA in 1999 to represent the views and interests of smaller regulated firms. It is composed of independent industry practitioners from a variety of smaller firms, covering the major sectors of financial services activity. Even though the SBPP does not have statutory status, the FSA has committed to treating it in the same way as the Practitioner Panel, and the SBPP Chairman also serves as an *ex officio* member of the statutorily independent Practitioner Panel. This helps to ensure that smaller firms are properly represented at the very highest level within the FiSMA framework.

6. Further information on the role and work of the SBPP and its current composition can be found on its website: www.sbpp.org.uk.

7. Both Panels meet formally on a monthly basis to discuss current and future issues of relevance to regulated firms - some of which are driven by the FSA's priorities and some of which are raised proactively by the Panels themselves. In addition, both Panels convene smaller sub groups on specific matters to engage with the FSA in greater detail.

High-Priority Issues

The move by the FSA towards a more principles-based regime

8. Both Panels are supportive of principles-based regulation, which they considers the appropriate approach towards a modern, proportionate and effective risk-based regulatory framework in the UK. However, if this is to succeed, they have urged the FSA to properly consider the implications of this new approach to its work in a number of areas, including supervision and enforcement. The Panels recognise that principles-based regulation is a new and largely untested concept, and that a clear-cut, definitive approach might be an unrealistic expectation at this point.

9. In a recent letter to John Tiner, Practitioner Panel Chairman Roy Leighton conveyed some commonly held concerns by practitioners to senior FSA management. As the SBPP has pointed out repeatedly, smaller firms, in particular, appear to struggle with some aspects of principles-based regulation (*please see reference item 6 for further detail*).

The FSA's principle of Treating Customers Fairly (TCF)

10. One of the major principles that the FSA has introduced as part of its evolving principles-based framework is TCF. While both Panels have been supportive of the TCF concept generally, they share many of the industry's concerns regarding its implementation, supervision and enforcement. Consistency of approach will be crucial to ensure that TCF is applied fairly across the industry. At present, a lack of clarity persists, especially among smaller firms, over the regulator's expectations regarding firms' embedding of TCF, and evidencing thereof.

11. Anecdotal evidence has reinforced the fear that FSA supervisors' application of TCF in practice might sometimes be too detail-oriented and meticulous, signalling a disconcerting departure from the FSA's commitment to high-level principles. Moreover, it also appears to hint at a possible disconnect between senior FSA managers' public stance on principles-based regulation and the day-to-day application of this concept throughout the organisation. The Panels appreciate that this will be one of the regulator's major challenges going forward (*please see reference items 2 - 5 for further detail*).

The principle of Consumer Responsibility, as included in FiSMA

12. The Practitioner Panel dedicated considerable time over the past year to developing a practical articulation of "consumer responsibility" (or *Caveat Emptor*) and engaged in a series of discussions with members of its counterpart, the Financial Services Consumer Panel, and the FSA. The original aim of those discussions was to define what exactly was meant by "the general principle that consumers should take responsibility for their decisions," as outlined in section 5(2)(d) of FiSMA. FSA Chairman Callum McCarthy's speech to the Financial Services Forum in February 2006 was helpful in highlighting the principle of consumer responsibility and stimulating further debate.

13. As a balance to the principle of TCF it is important not only to focus on the obligations of firms during the retail sales process – which already are prescribed in great detail in the regulatory regime - but also on what could reasonably be expected from the consumer; "fairness," after all, is a concept that usually is not applied in a unilateral manner. Both Panels maintain that the lack of a clear definition of the principle of consumer responsibility is one of the main drivers of high regulatory costs in the retail sector, as firms in search of legal certainty often incur additional costs in being extra careful in complying with existing rules and regulations; these costs eventually getting passed down to the consumer (*please see reference items 2 - 5 for further detail*).

The cost of regulation, especially for smaller firms

14. The Practitioner Panel in partnership with the FSA has conducted a Cost of Regulation study which focused on regulatory costs across three chosen sectors – corporate finance, institutional fund management and investment and pension advice – with the objective of identifying specific rules from the FSA Handbook where incremental costs may not be justified by the benefits they aim to secure. The Panels will use the results of this exercise to engage in a constructive dialogue with the FSA about the burdens of regulation – in particular, on the retail side - and how these might best be relieved.

15. The SBPP has long held the view that the costs and burdens of regulation are not only too high, but that smaller firms feel their impact in a disproportionate way – a view that was reinforced by the findings of the Cost Survey. It continuously urges the FSA more generally to be rigorous in its drive for Better Regulation and deregulatory measures; without that, there is a real prospect of smaller firms being forced out of business (*please see reference items 2 - 5 for further detail*).

The implementation of EU directives and the FSA's international work

16. The Panels strongly support the trade associations' view that EU and international regulatory measures must be implemented in a pragmatic manner that avoids superequivalence (the implementation of EU Directives beyond their immediate requirements), unless there is a compelling case for it – and FSA senior executives, including CEO John Tiner, have publicly embraced such an approach. The implementation of the Markets in Financial Instruments Directive (MiFID) will prove to be an interesting test case for the FSA's commitment in this regard, and the Panels will closely follow developments in this area.

17. The UK financial services industry pays approximately one third of all Corporation Tax paid in the whole of the UK and 11% of PAYE and NHI. Much of this is export led. The UK has the highest contribution to its trade balance of any nation in the world from financial exports provided by firms located here. Consequently, the Practitioner Panel feels that the UK financial regulatory system needs to be internationally competitive and attractive and encourages the FSA to maintain a high profile in world regulatory fora on a bilateral basis, especially with key overseas developing markets (e.g. China, India, The Gulf, etc.) Much good work is being done by the FSA on international issues and should this be maintained (*please see reference items 2 - 5 for further detail*).

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