Financial Services Authority

Business Plan 2009/10

Promoting efficient, orderly and fair markets

Helping retail consumers achieve a fair deal

Improving our business capability and effectiveness

The Business Plan covers the financial year 1 April 2009 to 31 March 2010. References to quarters in the body of the text are to the calendar year – for example, 'Q3 2009' is the period July to September 2009.

Financial Services Authority
Business Plan
2009/10

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Foreword by the Chairman

Adair Lord Turner, FSA Chairman

In the last 18 months and with increasing intensity over the last six, the world has faced the worst financial crisis in more than 70 years. We cannot overestimate its scale or impact, or the implications that it will have in years to come. Our financial system has changed significantly and will continue to do so; the regulatory system in the UK and globally must also adapt and change.

2009 will continue to be a difficult year and financial regulators will be under intense public scrutiny. I am confident that the FSA is well prepared to face the challenges ahead.

It is essential that we learn lessons from what has occurred. In its Internal Audit report on Northern Rock, which was published in March 2008, the FSA identified and publicly admitted weaknesses in its own supervisory approach. In response, the FSA designed and launched a Supervisory Enhancement Programme which entails important changes in our internal processes, a significant intensification of our supervision of large systemically important firms, and major investment in the number and skills of our staff devoted to that supervision. In total, about 280 additional staff will be recruited, and around two thirds will already be in place as we enter the next financial year. When I joined as Chairman this programme was already well under way: I am confident that it is the right response to the problems identified and that we are well advanced on the implementation path.

But as 2008 progressed, it became apparent that deficiencies in the supervision of any one institution played only a minor role in causing this huge financial crisis. It is now clear that the crisis is global in scale and its causes are fundamental. Major macro economic imbalances had a significant influence. There was a failure to conduct and act on macro-prudential analysis. Regulatory policies relating to, for instance, capital adequacy, which had been extensively debated and embedded in international agreements, turned out to be deficient.

There was also a wide ranging intellectual failure. It was believed and said by many influential authorities that the development of the model of securitised credit, structured credit, and credit derivatives, extensively traded between banks and near-banks, had diversified the holding of credit risk, and contributed to a ‘Great Moderation’ in financial and economic risk. This turned out to be diametrically wrong.

In addition to improving its supervisory processes and resource, the FSA therefore needs to review a wide range of regulatory policies, many of which should ideally be agreed at an international level.

Our participation in international fora such as the Financial Stability Forum and the Basel Committee and their various sub-groups, has therefore increased in importance. And in March we will publish the major review of the regulation of banks and bank-like institutions which the Chancellor asked me to conduct when I took over as Chairman. This Review will be accompanied by a detailed FSA Discussion Paper, setting out proposals for the changes in regulation and supervisory approach which we need to make. It will make clear where we have already taken action, where we can and will act on a national basis, and where we will need to work to gain international agreement on a coordinated approach.

That Review may have further implications for the resources needed to do an effective job. It is, for instance, likely that we need improved ability to conduct macro-prudential analysis, identifying in close collaboration with the Bank of England the key developments in overall systemic risk which need to be reflected in our supervision of individual firms. It might also involve some further intensification in our supervisory approach to major firms, going beyond that already being implemented by the Supervisory Enhancement Programme. But my current belief is that we do not need to move to a radically different supervisory approach – for instance to what is sometimes referred to as the US 'bank examiner model' – with large further resource requirements beyond these to which we are already committed.

The more intense regulatory approach which we do believe essential will inevitably, however, involve a significant increase in resources, and therefore significant increases in fees. The Chief Executive's Overview and Section Five of this Business Plan set out the scale of the increase required, and the specific drivers. I and the whole Board of the FSA believe this increase is essential to support a one-off shift to a more effective regulatory and supervisory approach, but we will ensure that alongside this shift, there is a continued focus on ensuring cost efficient operation.

Much of the focus of top management and of the Board of the FSA over the last six months has been on issues of financial stability, working clearly and I believe effectively with the other Tripartite Authorities, and this will continue to be the case in the year ahead. But it is important to recognise the other vital FSA activities to which resources need to be devoted.

We remain determined to ensure that markets work effectively and fairly, and we will use our enforcement powers to reinforce our policy objectives, and to ensure as effective deterrence as possible to irresponsible behaviour by firms or individuals. We are devoting extra resources to achieving this end. And our work on Financial Capability is of increasing importance to better equip consumers to make appropriate choices in a world where trust in some parts of the financial services industry has been seriously eroded.

The coming year will undoubtedly raise new and unexpected challenges for the FSA. I am confident that we are well placed to deal with these as they arise.

As always, we welcome your views on our plans.

Adair Turner

Adair Lord Turner
February 2009

Chief Executive Officer's Overview

Hector Sants, FSA Chief Executive

This Business Plan sets out our work programme for 2009/10 and explains how we plan to mitigate the risks set out in our Financial Risk Outlook (FRO). Our focus for this year is to ensure that we respond effectively to the financial crisis and recessionary climate, whilst retaining the necessary emphasis on our other priorities. In doing, so we will seek to minimise new initiatives. Our purpose, in essence, is to strengthen our supervisory process, seek to improve the policy framework and ensure we have focused on the right priorities in relation to our other responsibilities. In all these aims we will ensure we have incorporated the relevant lessons from the financial crisis.

Our regulatory philosophy

Historically, our regulatory philosophy has been defined by the strapline of 'more principles-based regulation'. This has often been misunderstood. Principles-based regulation means, wherever possible, moving away from prescriptive rules to a higher-level articulation of what we expect firms to do. This has the major advantage of placing on firms explicit responsibility to decide how best to align their business objectives and processes with the regulatory outcomes we have specified. The focus of our philosophy, however, is not per se on our principles, but rather on judging the *consequences* of the actions of the firms and the individuals we supervise. Given this philosophy, a better strapline would be 'outcomes-focused regulation'.

In our view, the global financial crisis and the problems in specific firms have demonstrated more than ever the need to adhere rigorously to this regulatory philosophy. We will therefore take into 2009/10 a clear commitment to embed fully outcomes-focused regulation in our supervisory processes, working in a proportionate and risk-based way. We also believe that events have demonstrated the importance of an integrated approach to the supervision of individual firms. To analyse fully the risk inherent in a given firm the supervisor must have oversight of both the full range of the firm's business and its prudential and conduct issues.

We are determined to incorporate the lessons we have learned from recent events in our drive to improve the delivery of this regulatory philosophy through our supervisory process.

Ensuring our supervisory process is aligned to risks identified

As outlined in Adair's Foreword, and in the FRO, we see the coming year as another difficult one with significant challenges for us, the market place and consumers.

From the prudential perspective, the key risk is the need for firms to adjust to the changed economic circumstances and, in particular, the likely deleveraging process and shrinkage of the 'shadow banking sector'. We will be working with firms to ensure they are fully prepared for and understand the risks emerging from this adjustment. This focus will involve specific adjustment for firms' funding, business models and strategies. We will, in particular, be challenging firms on how effectively they are managing their exposures, long-term capital and liquidity risks.

An effective supervisory process needs to form an overall assessment of the firms' sustainability and to achieve this it needs to focus on both prudential and conduct risks – the latter, in particular, with regard to management conduct. In this area our current focus is on compensation structures, managerial competence and risks from mis-selling.

We must also adopt a balanced approach to conduct and prudential risk because we recognise that consumers are particularly exposed in these difficult economic times. We will ensure that we are heavily engaged in mitigating the detriment which will stem from this fact. We will strengthen our supervisory focus on 'Treating Customers Fairly' (TCF). The embedding of the

TCF agenda into our supervisory process is critical to ensure that it is an enduring feature of our regulatory regime.

In addition to responding to the current economic downturn, we will continue our focus on the key areas of financial crime and consumer capability; we will adjust these programmes appropriately in the light of the changed economic circumstances. Our focus on consumer issues will also continue to include work on transparency to ensure that, where appropriate, we properly equip consumers with the best information to make informed decisions.

Improving the regulatory framework

We are, of course, not only a supervisor in the UK, but also a key contributor to the overall regulatory framework in the EU and globally. We will therefore work to ensure the overall policy framework continues to be improved and takes into account recent events. In his Foreword, Adair has outlined the planned Discussion Paper on reforming international banking regulation. In addition, we will pursue our wider agenda in the EU, in particular with regard to improving the effectiveness of a European regulatory regime, planning for the implementation of the next phase of Solvency II and implementing the new regime for credit rating agencies. Globally we will work to strengthen regulatory cooperation and in particular Supervisory Colleges.

In the UK, the Banking Bill, currently before Parliament, is a major policy initiative that will significantly affect the UK banking industry and its customers by providing mechanisms to reduce the likelihood of a bank failing. The Bill will also minimise the impact on depositors if a bank does fail, ensuring effective compensation arrangements are in place in which consumers can have confidence. We will also launch or continue a number of other policy projects in the coming year to: review the structure of the UK Listing Regime; review the prudential rules for Personal Investment Firms; and implement the Retail Distribution Review.

Enforcement

Enforcement continues to be at the forefront of our 'credible deterrence' philosophy, therefore it is crucial that the FSA has a strong and visible enforcement function. We expect to see significant enforcement activity in the coming year. To achieve credible deterrence, wrongdoers must realise that they face a real and tangible risk of being held to account and expect to suffer meaningful consequences. We will seek to ensure that the sanctions we impose are fixed at levels that are sufficient to deter potential wrongdoers and, where necessary, we will increase penalties to achieve this. In line with our increased focus on senior management responsibility and oversight, we expect to see more cases where individuals, especially those holding significant influence functions, are subject to enforcement action.

We now expect all firms to be able to demonstrate that they are consistently treating their customers fairly. We expect to see continued substantial enforcement action against firms, at all levels in the supply chain, if they do not do this. Where appropriate, we will require firms to pay compensation to customers.

We have a range of disciplinary sanctions available – criminal, civil and administrative – and we will be bold and resolute in using our powers to bring about necessary behavioural change. We will continue to act with the cooperation of the police to conduct searches and arrests, and in appropriate cases we will seek court orders to restrain the proceeds of crime. We consider the threat of a custodial sentence to be a significant deterrent against market abuse and we will continue to bring insider dealing prosecutions against those suspected of abusing the markets. We recognise that not all such prosecutions will be successful but believe that visible activity of this sort is an important part of credible deterrence.

People

More rigorous application of outcomes-focused regulation has implications for our staff as well as for firms. It requires us to increase significantly the supervisory resource we apply to major systemically significant firms and requires our supervisors to have excellent industry knowledge and sound judgement. As we have said, we believe that focus on outcomes delivers more effective regulation but all regulatory judgements carry risk, and in particular judgements on the future will, necessarily, not always be correct with hindsight.

Against this backdrop, it remains critical for us to continue to improve the quality of our staff and ensure effective recruitment and retention. We believe we have made good progress on this agenda over the last 12 months, both in terms of getting the right mix of regulatory and market experience and also in improving our culture and training. There is, however, more to do and a key driver in the 2009/10 budget is further investment in recruitment and training and competence. Our objective is to achieve the standards and levels of resource we need by the end of 2010.

The budget

It is generally recognised that the FSA needs to adopt a more intrusive and effective regulatory approach. In order to achieve this objective, last year we undertook a fundamental review of our supervisory practices and processes. We concluded that we needed to increase the resource dedicated both to direct supervision and the supervisory process – the majority of this increase being directly targeted at the higher impact firms. This upgrade began in 2008/09 with the Supervisory Enhancement Programme. By the end of 2008/09 we will have recruited two-thirds of the required additional staff, and will complete the recruitment programme by the summer of 2009. This programme will lead to an increase of around 280 staff involved in the supervisory process, and including the relevant support expenditure has an annual running cost of around £40m.

In addition to increasing our staff numbers we will also be investing in improving the quality and competence of our existing supervisory resource, and on ensuring effective retention. Total recoverable costs in 2009/10 for our supervisory activities will increase by £70.8m; included in this figure is the recovery of £13.6m of the Supervisory Enhancement Programme costs already incurred in 2008/09 but not included in the initial 2008/09 budget. As a direct result of the increases in our staff levels and the implementation of new technology to support our supervisory process, a further increase of around £12m is required in relation to our technology and property infrastructure.

Recoverable costs in other areas of the FSA will rise by £25.1m. These include a number of smaller operational costs and financial adjustments (e.g. reserve movements, pension actuarial adjustment). In addition to these increases in specifically targeted costs, contingency costs will increase by £9.1m. We expect this to cover legal fees, particularly in strengthening our enforcement effort in such areas as our capacity to pursue criminal cases where appropriate, and any additional regulatory policy initiatives that may arise in the course of the year. In the coming year we expect to face considerable uncertainties as to the nature and pace of change. This additional contingency will only be used if necessary; if unspent, it will be rebated the following year.

In total, the amount of money we need to raise from firms in fees – our Annual Funding Requirement – will increase by 36.5% (£117m) to a total of £437.7m. In raising this funding from the industry, we will ensure that the fee structure fairly apportions the increase and as part of this we are proposing not to increase our minimum fee rates, which will benefit 10,000 of the smallest firms we regulate. An additional factor that will impact the actual amount paid by firms is the redistribution of fines collected in 2008/09. In 2008/09 this lead to a reduction of 1.4% in the amount paid by firms; current estimates indicate that this will be approximately 6% in 2009/10.

We propose to recover the majority of costs for 2009/10 relating to implementing the requirements of Solvency II from the firms affected through a Special Project Fee. Recovery of these costs in this way is subject to the FSA Board approving the related fees rules, following completion of the consultation process beginning today.

We recognise that these increases are significant and come at a particularly difficult time for the financial services industry. However, we believe that they are necessary to deliver the structural improvements required and to equip the FSA to respond effectively to the current financial crisis.

Further responsibilities for the FSA

We anticipate that in the coming year we will take on and be tasked with additional responsibilities. These include: retail bank conduct regulation; sale and rent-back schemes; and unclaimed assets. As we develop our work in new areas we will ensure that we adhere to our outcomes-focused regulatory philosophy and encourage market-led solutions.

It is well understood that a national regulator alone cannot solve the current financial crisis. However, I am sure that implementing the plan set out in this document will make a significant contribution to restoring confidence and stability in the UK financial system, to the benefit of all.

Hector Sants
February 2009

1 Financial stability and supervision of firms – responding to the crisis

INTRODUCTION

As we said in our Financial Risk Outlook (FRO), in the past year we have witnessed perhaps the most significant financial crisis of the modern era. These events have rocked the foundations of the global economy. In response, authorities around the world have taken a number of measures, including government-led recapitalisation of banks; extensive government guarantees of deposits to maintain confidence; and various initiatives to improve market liquidity in structured products. A large number of significant institutions have failed, been forced to merge, or have been taken over by governments.

We have an important role to play, together with other authorities in the UK and internationally, in responding to this crisis. In this section we set out our planned work for 2009/10, in the UK and in cooperation with international colleagues, focusing on restoring and securing financial stability. Complementing this is our strong commitment to carrying out our supervision of institutions in a more effective and, where necessary, intrusive and directive manner.

FSA SUPERVISION

As outlined in the FRO, we must in particular manage and address the risks associated with valuations and asset quality; deleveraging; the lending outlook; business models; corporate defaults; and competition and market consolidation.

At the heart of our efforts to promote financial stability and manage these risks is our supervision of firms. In the coming year we will focus on delivering more effective supervision. We believe that analysis of the global events over the period since August 2007 supports the basic FSA supervisory philosophy but also demonstrates the importance of our making significant operational improvements in our implementation of this philosophy.

We continue to operate a risk-based, proportionate, outcomes-focused regime. We believe that recent events demonstrate the continuing importance of a unified approach to regulation, both in terms of integrated regulation of banking, insurance and securities, and also combining prudential and conduct regulation. A full understanding of a firm's business model requires an assessment of both prudential and conduct risk.

Effective and focused supervision by the FSA is critical to ensuring that firms are well positioned to respond to the risks arising from the more challenging economic and financial market conditions.

We will step up our efforts to ensure that individuals working in key roles in firms remain competent to do so. A key focus in 2009/10 will be on the competence of **Significant Influence Functions** (SIF) individuals, especially in high-impact firms. The ongoing work to review the competence of SIF individuals and our strong commitment to pursing credible deterrence delivers a clear message that those who fail to perform their functions will be held accountable.

Strengthening our supervisory processes

In 2008/09 we launched and completed the Supervisory Enhancement Programme. This was designed to lay the foundations for a significant strengthening of supervision. 2009/10 is the year in which we fully embed these improvements.

In order to strengthen our supervisory processes in 2009/10 we will focus on the following five key areas.

Resource

- We will have appointed around 280 staff involved in the supervisory process in the first half of 2009/10, through external recruitment and staff deployment. External recruitment will be used to fill specific skills or knowledge requirements and ensure the right mix of regulatory and market experience.

Competence

- In Q1 2009 we will launch an upgraded Training and Competence (T&C) scheme for relationship-management supervisors. This includes eight core modules for existing supervisors and an updated induction programme for new supervisors. Further core and specialist training will be developed during 2009 to address ongoing business needs. The T&C scheme requires supervisors to demonstrate competence across technical and behavioural competencies, sector-specific knowledge and skills, and on-the-job activities. We will develop and roll it out for other groups of our staff during 2009/10. The T&C scheme will allow us to demonstrate to external stakeholders the ongoing competence of our supervisory staff.

Tenure

- To provide continuity of supervision for relationship-managed firms, we will introduce a tenure policy. This will provide a framework for the minimum and maximum time a supervisor should manage a firm. It will provide benefits for firms by ensuring continuity of knowledge and experience in the FSA teams.

Risk identification

- Critical to effective supervision is risk identification. We have revamped our risk-identification process; in particular we are strengthening our industry-sector capability, which is designed to identify and analyse industry and overall risks, and equip our supervisors to work more effectively with firms to mitigate risk. Fully staffing and implementing this process will be a key focus for 2009/10.

Technical support

- We have significantly strengthened our technical support on prudential and conduct issues through the creation of specialist areas for prudential and conduct risk and during 2009/10 we will further strengthen these areas. For instance we will be recruiting specialists in liquidity risk management.

REFORMING INTERNATIONAL BANKING REGULATION – POLICY AND PRACTICE

In reaction to the past year's events, and in response to the Chancellor of the Exchequer's invitation to our Chairman, we will publish a Discussion Paper (DP) in March 2009 on reforming the banking regulatory policy framework. The main purpose of this work is to set the direction of domestic policy and define the changes which we believe are required in international regulations and which we will be proposing in discussions with international colleagues and in the EU.

The DP will address some fundamental questions raised by the unprecedented events in financial markets over the past year. It will set out our thinking on liquidity and capital policies, our wider view on a global regime, and some observations on the regulatory architecture that determines such policies.

It will outline a range of concerns and possible solutions to deal with them, including the following.

- **Capital:** Important issues include the level of capital that we expect banks to hold, the quality of capital and whether risk-based capital needs to be supplemented by a non risk-sensitive measure (such as a leverage ratio or revenue-based measure). We will also address the questions around cyclicality/pro-cyclicality of risk-based capital requirements and, related to that, the complementary roles of micro-prudential and macro-prudential regulation.
- **Liquidity:** In December 2008 we issued a Consultation Paper (CP) proposing a tighter surveillance regime for liquidity. The DP will consider whether any additional action is required, including dealing with macro-prudential considerations.
- **Accounting:** We will consider the extent to which accounting standards contributed to the swings in the market, and the wide-ranging proposals that have been put forward to deal with them.
- **The institutional coverage of prudential regulation:** Significant steps have already begun to extend accounting and regulatory coverage to the so-called 'shadow banking' institutions (such as investment banks, off-balance sheet vehicles, and hedge funds). The DP will consider whether these actions go far enough.

- **Cross-border cooperation and coordination within Europe and globally:** We will consider whether there is scope for better coordination and cooperation between regulators in normal times and during periods of crisis. We will also comment on regulatory cooperation in the EU.

BANKING BILL

As outlined in the Chief Executive Officer's Overview, the Banking Bill will significantly affect the UK banking industry during 2009/10.

The Banking Bill, currently before Parliament, will give the Tripartite Authorities a broader range of tools to reduce the likelihood of a bank failing, minimise the impact if a bank does fail, and have effective compensation arrangements in which consumers can have confidence.

We will continue to work with the Treasury, the Bank of England and the Financial Services Compensation Scheme (FSCS) to achieve our shared objective of preventing and managing financial difficulties.

The main elements of the Bill

- The introduction of a special resolution regime (SRR) to allow the Tripartite Authorities to intervene when a bank gets into severe difficulties. This includes the introduction of a special insolvency regime for banks. In consultation with the other Authorities, the FSA will decide if a bank should be placed into the SRR. After consulting with the other Authorities on the appropriate tool, the Bank of England will take on the role of overseeing the SRR.
- The provision of short-term liquidity to the FSCS, by enabling it to borrow from the National Loans Fund. This is one of the steps necessary to ensure fast payout of compensation.
- A statutory basis for the Bank of England to oversee inter-bank payment systems.
- Providing the Bank of England with a financial-stability objective, and amending the size and composition of the Bank's Court.

Activity for 2009/10

- It is expected that Royal Assent will be given to the Banking Bill in February 2009. Secondary legislation, including our rules, will follow, so we will publish CPs at the appropriate times.

In addition to the proposals in the Bill, we will work with the other Authorities to:

- revise the Memorandum of Understanding (MoU – which sets out how the Tripartite Authorities coordinate their activities) and introduce new mechanisms for coordination both at times of crisis and in 'normal times'; and
- strengthen the global financial system's resilience in cooperation with international partners, including a focus on banks' governance and risk management, and review of their prudential regulation and enhancements to the global financial infrastructure.

During Q1 2009 we will be finalising a Cooperation Protocol with the Bank of England, which will build on and codify the bilateral relationships that have developed since 1997 and also reflect the Bank's new responsibilities under the Bill. This will sit alongside the revised Tripartite Memorandum of Understanding and other existing arrangements.

As part of our commitment to developing consumers' financial understanding, we will also work with the FSCS to review how consumers can be better informed about changes to the compensation arrangements. In Q3 2009 we will publish a Policy Statement (PS) and make rules following on from our CPs published in 2008 and early 2009. This will outline how fast payout of compensation can be facilitated; eligibility for the scheme; how we will raise consumer awareness of the FSCS; and the treatment by the FSCS of temporary high-deposit balances and client accounts. We will continue to review whether changes need to be made to the tariff measures, classes and cross subsidy arrangements within the current structure of the FSCS, and will take account of the possible movement toward pre-funding.

LIQUIDITY

As discussed in the FRO, the risks associated with liquidity, or lack of it, represent one of the fundamental drivers of the market turbulence that started in summer 2007 and has continued over the past year.

We will maintain our focus on liquidity in 2009/10, ensuring that firms take a suitably prudent approach to their liquidity arrangements. Our work in this area will build on the 2008 CP *Strengthening Liquidity Standards*, and will focus on finalising the new regime and subsequently its implementation. The CP moved forward our initial policy thinking on a new liquidity regime for banks, building societies and investment firms first discussed in a 2007 DP. It proposed full implementation of the international standards agreed by the Basel Committee on Banking Supervision (BCBS) in 2008 in its *Principles for Sound Liquidity Risk Management and Supervision*. The CP also took into account parallel workstreams on liquidity in the EU, as well as lessons learned from the difficulties faced by several financial institutions since 2007. Our initiatives around liquidity continue to build on the sound work executed by our supervisory functions over the past year.

Our new liquidity policy proposals will lead to a considerable strengthening of UK firms' resilience to a range of liquidity stresses. In line with our objectives, our regime will continue to put the responsibility of adopting a sound approach to liquidity risk management on firms and their senior management. To comply with this liquidity policy, some firms may find it necessary to revise their business models significantly.

In Q1 2009 we will publish a liquidity-reporting CP, which will also include our proposals on transitional arrangements. This will be followed by Feedback Statements (FSs) and PSs in Q2 2009, which will set out the final rules of the new regime, as well as the reporting requirements. The new regime will be gradually phased in throughout 2009, with all provisions coming fully into effect by Q4 2009. We are developing an extensive internal and external training programme that we will deliver to ensure all relevant stakeholders are fully aware of how the new policy will affect them. This will be coupled with a clear communications strategy, tailored towards the needs of individual external stakeholders.

CAPITAL

We must respond to a number of issues on capital, many of which are outlined in the FRO. We will continue to work on the **definition of capital**, both in the Basel Committee's ongoing work, and in the EU where the work on hybrid capital instruments continues.

In Basel, our views are informed by responses to our 2007 DP setting out our early thinking on the definition of regulatory capital, as outlined in the FS08/5 *Definition of capital*, which we published in July 2008. We co-chair the relevant Basel sub-committee. The work has become more urgent because of the increased global focus, in particular on the part of the Financial Stability Forum (FSF) and the G20, on banks' capital adequacy, and on current initiatives to recapitalise banks.

In the EU there are two immediate priorities. The first is the negotiation of amendments to the **Capital Requirements Directive** (CRD) on hybrid capital instruments. This is expected to be agreed in the first half of 2009 with implementation at the end of 2010. We will also play an active role in the Committee of European Banking Supervisors (CEBS) discussions, which has been mandated to provide guidance for the convergence of supervisory practice in relation to hybrids. We plan to publish a CP on the package of CRD amendments, including those to hybrids, at the end of Q2 2009.

In 2009/10 we will also maintain our work on **stress and scenario testing**. We published a CP in December 2008 highlighting that those firms with robust stress-and-scenario testing fared better during recent market events, particularly those firms where it was embedded in the senior-management decision making. The CP proposed that banks, building societies, CRD investment firms and insurers should undertake a 'reverse-stress test', which would require them to consider plausible scenarios that could cause their business model to become unviable. In addition, we proposed amendments that clarified existing Handbook requirements and we gave industry-wide feedback on conclusions drawn from our ICAAP reviews as well as the outcomes of EU and broader international work. The consultation closes at the end of March and we plan to publish a PS with our final Handbook rules in Q3 2009.

REMUNERATION POLICIES

Remuneration policies in many firms may have been inconsistent with sound risk management – giving staff incentives to pursue risky policies that undermined the impact of systems designed to control risk. This concern is widely shared by our stakeholders and is addressed in the FRO.

In 2008 we sent a 'Dear CEO' letter to the chief executives of around 25 major UK-based banks, both British and foreign owned. This asked chief executives to review their remuneration policies against a set of criteria and if necessary, take action to change them. It also announced that we will engage in detailed discussions with firms about their policies and publish a review of our findings early in 2009. At the same time we will seek further meetings with the firms we judge to fall short of the criteria, and discuss with them plans for how to bring their policies up to an acceptable standard.

We are also involved in international work on remuneration policies. A working group of the FSF has commissioned a survey of remuneration practices in global wholesale-banking firms, and is consulting with experts in the field. It will produce a report for the G7 towards the end of Q1 2009. The FSA is an active member of this working group.

SUPERVISORY COLLEGES

We are leading work in the FSF on Supervisory Colleges. The EU proposals for the revision of the CRD contain suggestions for enhancing the current arrangements for ongoing cooperation between supervisors in Colleges. We will continue to argue for a proportionate and flexible approach to the running of regulatory Colleges, as advocated by the FSF. We believe this offers supervisors the optimum structure within which to tailor their cooperation on day-to-day supervisory matters, to take account of the differing sizes, structures and business profiles of the firms they regulate. We will also continue to assert our belief that, while closely linked, Supervisory Colleges and cross-border stability groups (CBSGs) have separate and distinct roles to play.

CROSS-BORDER STABILITY GROUPS

In response to risks associated with a lack of international coordination and communication during a financial crisis, the UK Tripartite Authorities are coordinating work to implement CBSGs. These groups include representatives from the relevant central banks and finance ministries, who will work together to focus on crisis management and planning with the various international groups of most importance to the UK. We are leading a Banking Supervisors' Committee subgroup (Task Force on Crisis Management) to provide guidance on CBSGs in early 2009. This work will enhance our ability to manage any cross-border financial crisis, through establishing good working relationships and planning how the Authorities would cooperate in particular circumstances.

2 Promoting efficient, orderly and fair markets

INTRODUCTION

In the coming year we will continue to set standards that firms and other market participants must follow; we will challenge firms to be well governed, financially sound and to manage their risks effectively; we will monitor compliance with those standards and take action where we find shortcomings; and we will maintain our commitment to being an international leader in financial regulation. This section describes how we will execute and enhance these core activities, which are vital in delivering efficient, orderly and fair markets.

Reducing financial crime and market abuse is another core activity that we will continue to focus on in 2009/10. We will maintain and look to advance our programme of work to prevent, detect and investigate market abuse and misconduct. We will also continue our engagement with international bodies such as the Financial Action Task Force (FATF).

OUTCOMES IN FIRMS AND MARKETS

Supervision of firms remains at the heart of our efforts to secure market confidence. As we explained in Section One, our supervisory approach in 2009/10 will be marked by a greater emphasis on firms' business models and their management's understanding of the key risks in those models. Firms can also expect intense scrutiny of the prudential aspects of their models, with an increased emphasis on liquidity issues. We will give continuing attention to firms' risk management systems, as well as their compliance with conduct-of-business standards.

EU AND INTERNATIONAL POLICY MAKING

In 2009/10 our work will continue to reflect our commitment to promoting more outcomes-focused and risk-based approaches in global fora. We will continue to champion good regulation at EU level and engage with the debate on upgrading international financial regulation.

We will keep supporting the Treasury in the negotiation of a new European registration regime for **credit ratings agencies** (CRAs) and we will prepare for subsequent implementation. This work is important in responding to the risks identified in the FRO. We believe there is a need for international consistency in the approach to overseeing CRAs and we will continue to contribute to the various international fora considering this issue, particularly the FSF, the International Organization of Securities Commissions (IOSCO) and the Committee of European Securities Regulators (CESR). We will also continue to work with market participants to mitigate the risk that investors could rely on ratings as a guarantee of asset quality (both now and in the future), or could assume that it is intended to carry implications for price levels rather than purely for probability of default.

We will work with our international regulatory counterparts, market participants and infrastructure providers to make trading and operational arrangements for **Over the Counter (OTC) derivatives, including credit default swaps (CDS)** more robust. The risks associated with OTC derivatives are discussed in the FRO. In particular this work will support the further development of central counterparty (CCP) facilities for the majority of CDS trades. The FSF has laid out steps to strengthen OTC market resilience, the European Commission has formed a working group to take forward these issues, and the NY Fed is driving change in the US alongside both the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC). We will work with others to ensure that any CCP facilities are appropriately structured and risk-managed, with a suitable level of regulatory cooperation to reflect the international nature of these markets.

We will carry on our work to encourage convergence of **International Financial Reporting Standards** (IFRS) and the US Generally Accepted Accounting Principles (GAAP). This work is important to achieve consistent application, interpretation and enforcement of IFRS in the EU, and to reach a position of mutual recognition of standards between the EU and the SEC. However, as outlined in the FRO, there is a risk that pressures for further amendments to the accounting for financial instruments under IFRS could reduce the convergence of IFRS and US GAAP. Currently, the SEC is considering a road map to permit US companies to use IFRS. This will change the SEC's approach to enforcement. The timing of this work depends on political considerations.

Subject to political agreement, we will proceed with work on the **Undertakings for Collective Investment in Transferable Securities (UCITS) Directive**. We will work with the Treasury to implement the recast UCITS Directive and as part of this initiative we will also carry out the associated Level 2 work within the CESR.

We will advance our review of standards for firms' protection of **client assets**. This work will take into account policy proposals to address issues arising from recent market events, including the administration of Lehman Brothers (International) Europe. The issues associated with the collapse of Lehman Brothers are highlighted in the FRO. We will also take this opportunity to consider the distribution rules that were not included in the review of the Client Assets Sourcebook undertaken in 2008. The rules require updating to take into account changes in bank insolvency procedures brought about by the Banking Reform Project. We anticipate publishing a CP on this work in Q2 2009.

Box One: Solvency II

In 2009/10 we will proceed with our work to review the solvency and risk management requirements for insurers. The Solvency II Directive aims to strengthen the prudential regulation of the insurance sector. The new rules will replace the current Solvency I Directive requirements and our existing individual capital adequacy standards (ICAS) for insurers in the UK. Our work in this area will have two major strands: elaboration of the detailed implementing rules and implementing the new framework in the UK.

As a member of the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) we will help prepare technical advice that will be submitted to the European Commission. The CEIOPS will formulate advice on all the central parts of the new regime, including the new European Standard Formula, internal models, the Own Risk and Solvency Assessment, governance, and reporting requirements. This advice to the Commission will play an important role in informing the Level 2 implementing measures needed to operationalise the new solvency and risk-management regime.

The second strand of work concerns the eventual implementation of the new requirements in the UK. In connection with this, we will review our existing supervisory practices, including the interaction of Solvency II requirements with ARROW. We will consult on new reporting requirements for insurers and make changes to our IT systems to accommodate them before they are implemented.

We will dedicate significant resources to this project over the coming years to ensure that:

- the detailed implementing rules required to operationalise Solvency II will be practical and reflect the economic, risk-focused approach likely to be adopted in the Directive;
- we and the industry are well prepared to make the transition from ICAS to Solvency II; and
- the requirements of the Directive are applied proportionately.

We will continue to update market participants regularly, for example through the regular Insurance Standing Group and its sub-group meetings, as well as through publications and workshops. In addition, partially depending on the progress of the Level 2 implementing measures, we plan to publish a DP in Q3 2009.

We will carry on supporting the efficient working of the **Lamfalussy** committees in promoting regulatory convergence. The Commission has established a High-Level Expert Group on EU financial supervision under the chairmanship of Jacques de Larosière that will, among other things, consider how the supervision of European financial institutions and markets should best be organised.

Following the introduction of qualified majority voting and 'comply or explain' principles in each of the Level 3 committees, we believe there remains considerable scope for them to achieve much more within the current Lamfalussy structures. We will enhance our contribution to Lamfalussy work on the Level 3 MiFID workstreams and support the CESR secretariat functions and CESR MiFID projects. We will contribute actively through CEBS and the CEIOPS to the current regulatory initiatives on banking and insurance. We will continue to promote the inclusion of impact assessments and press for pragmatic arrangements of proven value.

DOMESTIC POLICY WORK

Over the coming year we will continue to help deliver appropriate regulation for a competitive trading landscape. Our work in 2009/10 will take into account the fact that global infrastructures, new technology and new regulation (such as MiFID) is intensifying competition in financial markets. We are strongly focused on enhancing the delivery of our supervisory and policy effort to meet the demands and expectations of a more competitive environment.

As the UK Listing Authority, our broad objective is to protect investors and maintain the integrity of the UK market for Listed Securities. In meeting this objective we will continue our work on **reviewing the structure of the Listing Regime**. We have published a DP and a CP setting out our proposals on how the UK Listing Regime may be clearly defined into 'Premium' and 'Standard' segments. A key aim of this is to provide greater clarity on the different standards that apply in each segment. We have also set out proposals on improving the corporate governance and pre-emption rights disclosure by overseas companies with a UK listing. We aim to provide feedback on this work in Q3 2009. Once we have implemented the changes in the next financial year, we will work with a range of market participants to help increase awareness of the new structure.

In January 2009 we consulted on shortening **rights issue subscription periods**. In a report to the Chancellor of the Exchequer in November 2008, the Rights Issue Review Group (RIRG) identified two other areas on which we aim to consult at the end of Q1 2009. These are open offers with compensation and document vetting fees in relation to equity shelf registration. The report set out a number of other recommendations that we will also take forward.

Market transparency

Over the coming year we will carry on with our **review of short-selling**. The market turbulence over the past year and debate over the role of short-selling has reinforced the need to undertake this work. In normal market conditions we view short-selling as a legitimate technique that promotes price efficiency and assists liquidity, and is not in itself abusive. However, in some circumstances, especially in times of market uncertainty, short-selling can have a negative effect. Firms involved in rights issues are particularly vulnerable to these effects.

In our DP on short selling, published in February 2009, we set out our views that publishing significant individual short positions would improve market transparency and the regulatory regime in this area. This approach would also complement the existing regime for the disclosure of significant long economic interests that will soon be extended to cover economic interests held via certain derivatives (see next paragraph). However, we do not consider that the disclosure thresholds for long and short positions should be symmetrical. Short positions are usually significantly smaller and applying the existing 3% initial thresholds to short disclosures would not provide a meaningful regime.

As part of our ongoing work to improve market transparency we will implement a new regime for disclosure of **Contracts for Difference** (CfD). After consulting on the final rules for CfD disclosure in 2008, we plan to proceed with implementation as soon as practicable in 2009. This work will establish a disclosure regime that will address market failures in relation to using CfD on an undisclosed basis to influence corporate governance and to build up significant stakes in companies.

Over the coming year we will continue to review, including within the CESR and IOSCO, whether there is sufficient **transparency in non-equity markets trading**. The credit crisis (among other things) has prompted regulators to revisit arrangements for fixed income, credit derivatives, structured products and commodities, where a significant amount of trading takes place OTC. We are committed to ensuring that any changes to the transparency regime are justified by market failure analysis and have costs proportionate to benefits. The CESR and IOSCO will publish CPs and subsequent conclusions on this work in 2009.

During the current challenging market conditions it is important to continue to focus on **strengthening the resilience and recovery arrangements for firms** in an event of major disruption (such as from a terrorist attack, severe weather etc). From Q1 2009 we will make the Resilience Benchmarking tool available to firms for self-assessment purposes. In response to recent market events, we will also introduce a survey to build on the work we have done in the past year to gauge how well firms are prepared to respond effectively to an increase in outflows of retail deposits. The next full-scale benchmarking of firms is scheduled for 2011. The next Market-Wide Exercise (MWE), scheduled to take place in Q4 2009, has been designed to explore the potential impacts of widespread severe weather, and in particular to pursue the key issues arising from the previous exercise and the benchmarking programme. A simplified version of the MWE will be rolled out to a wider range of firms in 2010.

We will carry on with our review of regulation for the **mortgage market**. By Q3 2009 we will publish a paper on the future shape of regulation and how our approach should evolve to reflect this. The review will cover the complete value-chain in the market (e.g. lenders, intermediaries and consumers), and will cover all aspects of regulation, including prudential, conduct of business, and financial crime. We will also determine whether any read-across to the mortgage market, from the proposals made by the Retail Distribution Review (RDR) in relation to the investment market, is appropriate. This work will also enable us to engage with and influence the developing EU regulatory agenda in this area.

We will maintain our work on developing an effective regime for **Islamic finance** in the UK. During 2009/10 we will monitor developments in the Islamic finance sector and will work with industry practitioners and the Treasury to ensure a suitable regulatory environment is in place. We will also assist international organisations and standard-setters, such as IOSCO, in their work on these markets. We plan to publish jointly with the Treasury an FS in Q2 2009 on the recent consultation on the regulation of Sukuk (Islamic bonds) in the UK.

Tripartite Factbook initiative

Factbooks enable us to gather and share key information relevant to financial stability for a subset of our largest firms. We are developing a new release of the Factbooks system that has been available to the Tripartite Authorities in the last year. The concept of Factbooks for information sharing in a crisis is also being rolled out across Europe, through the work of the CEBS Crisis Management Task Force.

REDUCING FINANCIAL CRIME AND MARKET ABUSE

We will retain our focus on risks to our statutory objectives, reducing the extent to which it is possible for a financial business to be used for a purpose connected with financial crime. Financial crime includes any offence involving money laundering, fraud or dishonesty, or market abuse.

Insider dealing and market abuse

We are committed to bringing about real changes in behaviour to guard against abuse in the markets. We will continue to take tough enforcement action as part of our **credible deterrence agenda**; wrongdoers face a real and tangible risk of being held to account and can expect to suffer meaningful consequences. This will see us bringing criminal prosecutions, imposing civil penalties and conducting search warrants and arrests as required throughout 2009/10.

In 2009/10 we will implement the next phase of the **Sabre II programme**. Implementation of the programme will help increase our capability to detect and pursue insider dealing, complementing other initiatives to enhance our fight against market abuse, as well as ensuring that we comply with our transaction-reporting obligations under MiFID. This next phase of the programme will include installing functionality to provide us with automatic alerts of transactions that might represent insider dealing. It will also deliver the capability to process securities derivative transactions using the Alternative Instrument Identifier, which is necessary to complete the implementation of our MiFID obligations.

Working with others to combat financial crime

In the coming year we will maintain our engagement with the FATF, other international standard setters, and key jurisdictions, to encourage implementation of an effective risk-based approach to financial crime. We will continue to develop and maintain relationships with law enforcement, regulators, government, and others that enhance our ability to apply a risk-based approach, and will encourage domestic and international information-sharing so that we have the intelligence needed to fulfil our statutory responsibilities. Domestically, we argued for greater cooperation between firms in the same sector and between different sectors, and for a national strategy to combat fraud. The recently established **National Fraud Strategic Authority** (NFSA) will deliver that national strategy, and we will work closely with it to promote effective collaboration between firms and law enforcement.

Encouraging firms to prevent financial crime

During 2009/10 we will encourage firms to improve and maintain their **operational risk controls** as a key measure to decrease criminals' ability to exploit firms and consumers. Through our supervisory activities we will encourage firms to balance the management of prudential and operational risks to mitigate the ongoing risk of financial crime. This is particularly relevant against the background of the difficult economic conditions.

We are carrying out a thematic review of **anti-bribery and corruption systems and controls** in commercial insurance brokers' systems to assess whether the industry is taking appropriate action in this important area. We plan to publish our findings in Q4 2009. We will also consider whether we should follow up this work with a similar review of anti-corruption systems and controls in other business sectors.

We will also continue with our **review of small firms' financial crime systems** and controls in the areas of anti-money laundering and counter-terrorist financing, fraud, financial sanctions, and data security. The project will report in Q4 2009.

3 Helping retail consumers achieve a fair deal

INTRODUCTION

We are committed to promoting resilient, effective and attractive retail financial services markets that deliver fair outcomes for consumers. To achieve this we:

- challenge firms to be well governed, be financially sound and to effectively manage the risks inherent in their business models and markets;
- focus on consumer outcomes and seek to ensure firms adhere to our conduct principles and treat their customers fairly;
- drive forward work on consumer capability, enabling consumers to engage proactively and responsibly with financial matters;
- act to prevent and deter regulated firms and other market participants from engaging in or facilitating financial crime; and
- apply a risk and more outcomes-focused regulatory approach and regime, intervening proactively and proportionately to deliver credible deterrence and redress.

Our work to improve consumer capability and responsibility is essential to ensure that consumers receive a fair deal. As part of the National Strategy for Financial Capability, we will maintain our proactive approach to communicating with consumers – through information, education and guidance – to empower them to take greater responsibility for their financial affairs.

As discussed in Sections One and Two, the central economic scenario for the coming year presents significant challenges for firms, consumers and market participants. It is important that we work with firms to recognise and respond to risks that could materialise as a result of the negative economic outlook, particularly increased risks to consumers – as outlined in the FRO. A fundamental part of this work is executing our supervisory focus on conduct of business, liquidity, stress testing, capital adequacy, sound management, and sustainable business models. This core activity lays the foundations for our work to develop and maintain a financial sector in which consumers can have confidence.

FAIR TREATMENT FOR CONSUMERS

We will increase our focus on consumer outcomes and seek to ensure firms adhere to our conduct principles and treat their customers fairly. As part of our focus on **conduct risk**, and the risks outlined in the FRO, we will monitor firms' engagement with markets, consumers and counterparties. Undertaking this work is important to reduce the risk of firms causing consumer detriment or jeopardising consumers' confidence in financial services markets.

Supervisory focus

We will continue to embed the Treating Customers Fairly (TCF) agenda within our core supervisory work, as well as assessing firms' delivery of the TCF Outcomes through ARROW, which we announced in November 2008. This includes continuing to use our full range of regulatory powers to take tough action against firms who fail to achieve the TCF Outcomes.

This work complements the TCF assessments as part of the **small firms enhanced supervision strategy** (see Box Two). We will also enhance our prudential supervision of small firms through targeted work on their financial reporting to us.

Box Two: Small firms enhanced supervision strategy

In January 2008 we introduced our enhanced supervision strategy for small firms. This is designed to increase our contact and communication with small intermediary firms to help them in treating their customers fairly and to increase our chances of identifying those firms that cannot or will not do this.

The enhanced supervision strategy will continue to be a priority for us over the next two years. During 2009 we will continue with our rolling programme of regional assessments of around 4,000 small firms in a further four regions of the country. Building on what we have learned so far we will continue to provide encouragement to small firms whom we judge to be embracing TCF Outcomes. We will identify and take action against firms who are unwilling or unable to change. Firms should understand that there will not be any let-up in our work in this area.

Ahead of each regional assessment programme we invite small firms to attend interactive roadshows so that they can learn more about the TCF assessment process and our expectations regarding TCF.

The rolling programme of assessments will be carried out alongside our other supervisory and thematic work to ensure that we have some form of contact every three years with most of the 17,000 small retail firms we supervise.

An example of persistent failure by firms is in the sale of **payment protection insurance** (PPI). We support the work of the Competition Commission and its proposals to bring about a change to this market. We will focus on driving through more appropriate product design and better complaint handling by firms. In doing so, we will continue to develop ways of applying our powers to take strong action against firms that still do not meet our minimum standards.

We will continue our focus on specific elements of firms' business activities where they persistently fail to adhere to the conduct principles. For example, the quality of firms' **financial promotions** should enable consumers to shop around on an informed and fair basis. To improve consumer confidence in this area, in the coming year we will focus on raising the standards of financial advertising in the challenging market conditions. We will do this by ensuring that any new risks affecting financial products or services arising from the economic downturn are clearly and explicitly communicated in financial promotions.

We have highlighted in the past the significant risks faced by consumers and firms when consumer contracts contain unfair terms. We are still finding that some firms are failing to comply with the **Unfair Terms in Consumer Contracts Regulations** (1999). We will continue to work with consumers and industry and use our powers to stop the use of unfair terms where we identify them through our monitoring and consumer alerts.

Reviewing our policy

We have now had some experience of operating the new regime for reattributions from the **inherited estates of with-profits funds** that we introduced in 2005. In light of this experience we will set out what our intended outcomes are in reattributions and any improvements that we believe can be made to the process. We will communicate any further lessons once the current Aviva transaction is concluded. Early in 2009 we will publish a further CP on whether firms should be allowed to continue to charge mis-selling costs to with-profits funds.

By undertaking an information-gathering exercise on the wider **with-profits regime**, we will seek to determine how firms' senior management have implemented the rules, both individually and collectively. We will conduct this review and publish the results by the end of Q4 2009. The review should enable us to focus our supervisory attention on areas of concern and we will also consider whether aspects of the rules need amendment or clarification. In the meantime we will continue our supervisory work with individual with-profits firms.

We will continue our work on reviewing the prudential rules for **Personal Investment Firms** (PIFs). In 2007 we published a DP that set out our early thinking on potential changes that would help us reduce market failures in the sector. Stakeholders have expressed concern that the current rules are no longer fit for purpose. This is a parallel project to the Retail Distribution Review (RDR – see Box Three). In November 2008 we issued a CP proposing amendments to the financial resources and professional-indemnity-insurance requirements currently applied to PIFs. A key outcome of this work will be a more proportionate set of requirements, which appropriately mitigates the prudential risks and market failures in this sector, while also taking account of RDR outcomes. We plan to publish an FS in Q3 2009.

The government is currently reforming the legislation for cooperatives and credit unions in Great Britain, and we are consulting on consequential changes to the rules and guidance in our **Credit Unions sourcebook** (CRED). Also included in our consultation are proposals to strengthen credit unions by increasing the minimum levels of capital and liquidity that they are required to hold. The changes to legislation and CRED would take effect for UK credit unions on 1 October 2009. In its Pre-Budget Report in November 2008, the government announced a Treasury review of the regulation of industrial and provident societies and credit unions in Northern Ireland. These mutuals are currently the responsibility of the Department for Enterprise, Trade and Industry, Northern Ireland. We will contribute to the review as needed.

CONSUMER CAPABILITY AND RESPONSIBILITY

National Strategy for Financial Capability

In these difficult economic times, as outlined in the FRO, our financial capability initiatives are more important than ever. We are in the fourth year of our five-year strategy to improve the capability of consumers in the UK. Our education, information and guidance-focused initiatives will continue to provide people with the skills and knowledge to deal with their finances more confidently and capably.

Box Three: Implementation of the Retail Distribution Review (RDR)

The RDR is one of the core strands of our retail market strategy. We launched it in June 2006 in response to recurrent problems in the market for the distribution of retail investment products. Our work in the coming year will build on the November 2008 FS, which set out our key proposals to mitigate the problems in the market.

The key proposals outlined in the FS included:

- **providing greater clarity for consumers** about the advice service being offered, by making a distinction between independent advice and sales advice, and including the connection with the proposed free Money Guidance service;
- **raising professional standards** of all advisers by setting minimum qualifications for different types of advice, and establishing a Professional Standards Board to boost consumers' confidence in the industry;
- **modernising the way advice is paid for** by requiring independent advisers to agree the cost of financial advice with customers up-front, removing the possibility of remuneration bias, and ensuring the cost of all advice is clear to consumers whenever it is given; and
- **introducing a new standard for independent advice** by ensuring advice is unbiased, unrestricted and extends to all types of investments.

Next steps

In Q2 2009 we intend to consult on our proposals. To inform the consultation we will carry out consumer research on descriptors of the various services and on how best to explain remuneration. We will also carry out research with firms on the costs of implementing the package of proposals.

Following consultation, we expect to publish a PS containing the final Handbook text in Q1 2010. Our intention is that all firms will have implemented the changes by the end of 2012.

We will continue to encourage industry to take more immediate steps to transition ahead of regulatory requirements to do so, as many have already, for instance by upgrading qualifications and changing their remuneration practices and systems.

We have revised the initiatives set out in our five-year Delivering Change strategy (March 2006), and more recently in the Joint Action Plan for Financial Capability (July 2008), to ensure that they are relevant to today's consumer needs. Over the course of 2009/10 we will spend £22.7m on improving the financial capability of people in the UK.

We set out a summary of our plans below. We will publish a detailed description of our financial capability plans on our website in Q1 2009.

- We welcome the government's announcement that economic wellbeing and financial capability will become a statutory part of the **schools** curriculum in England in 2011, in the context of Personal Social and Health Education. We will continue to fund Personal Finance Education Group (pfeg) for our Learning Money Matters programme in England, albeit at a reduced level, bridging the gap over the next two years as the curriculum changes come into force. We will maintain our funding to the devolved administrations to help embed personal finance education across the UK.
- We will maintain our efforts to embed personal finance education into **further and higher education** to help students manage their money better. In further education, we will further develop networks to encourage colleges to plan a coherent and sustained approach to financial capability. We will encourage more universities to adopt our **Money Doctors** programme of training and support.
- We will scale back our national programme of training and support for youth intermediaries, designed to reach vulnerable **young adults Not in Education, Employment or Training** (NEET). We will target those who may be affected by the challenging economic climate, such as young people seeking employment, particularly in areas where there are high levels of unemployment.
- We will continue our already successful **Making the Most of Your Money workplace programme** of seminars and printed guide. The programme will take account of those looking for work as well as workplaces considering redundancies. We will also seek to work more closely with the government's Financial Inclusion Champions, and develop closer links with Jobcentre Plus and private and third-sector employment support organisations.
- We will continue to build relationships with midwives and Children's Centres now that the *Parent's Guide to Money* has been rolled out across the UK. We will work with trusted intermediaries to embed the guide as a key and necessary resource for new parents.
- We will explore new ways to reach adults in these difficult times, to address the needs of **people in mid-life and older,** planning for or managing in later life, and those going through **divorce and separation.**
- We will continue to work to address the needs of **vulnerable groups** by working with our partners to embed financial capability in the non-profit sector. We will be concentrating our resources on five key sectors: autism; learning disabilities; mental health; offenders; and social housing.
- As valuable sources of clear, impartial information on money matters, including financial products and services, our **Moneymadeclear** website for consumers and our **Whataboutmoney** website for young adults are more important than ever. We will continue to review the content of websites, guides and online tools to ensure that they are relevant to today's priorities.

In the coming year we will continue the **Money Guidance Pathfinder** project in partnership with the Treasury, to test the provision of free, impartial guidance on money matters. The next phase of the project, starting early in 2009, will deliver face-to-face, web and phone-based services to between 500,000 and 750,000 people in the North East and North West of England.

In December 2008 we set out in our DP, *Consumer Responsibility* our views on the current balance of responsibility between firms and consumers. This included some thoughts on ways to help and encourage consumers to better protect their own best interests. We continue to discuss ideas and will provide feedback in Q3 2009.

SAFEGUARDING CONSUMERS

As outlined in Section Two, we will continue to take tough enforcement action as part of our credible deterrence philosophy. Throughout 2009/10, we will take action against firms that fail to deliver TCF Outcomes and, where appropriate, we will require firms to pay compensation to customers.

Share fraud – combating 'boiler rooms'

Share fraud is a serious financial crime, with potentially severe financial consequences for its victims. We are committed to tackling this, by targeting the criminals and those that help them, and by educating people so they recognise the scam and can help themselves avoid becoming victims. In 2009/10 we will continue to pursue our strategy, which falls into three broad categories: disruption, deterrence and discouragement.

- We disrupt criminal activities by disabling websites and preventing access to telephone services.
- We deter criminals by using the full force of our powers against criminals operating in the UK, acting swiftly to freeze assets, restrain activities by injunction, wind-up firms using insolvency powers and make individuals bankrupt. At our first ever International Boiler Room Conference in 2008 our international colleagues committed to working together to combat share fraud.
- We discourage people from dealing with these brokers when they call and the best way of doing this is through consumer education.

Improving industry defences against **mortgage fraud** continues to be an important objective for us in 2009/10. We will encourage market-led initiatives and work closely with relevant trade bodies to deliver these, but we will continue to supervise both brokers and lenders to ensure that the industry actively raises its defences against mortgage fraud. We will continue to take enforcement action, such as prohibition of intermediaries, where necessary.

As part of our ongoing work to mitigate risks in the mortgage sector we will look at the emerging risk of '**phoenix firms**' – where directors of one firm try to close it and transfer all the business to a new entity, leaving only the liabilities behind. We will tackle this by requiring directors to sign undertakings to honour the liabilities in relation to customer claims on their previous business; to ring-fence funds to be held by the departing firm to meet any further potential liabilities; and refusing the application for authorisation of a new business where the directors cannot show they shut down their previous business in an orderly manner.

FURTHER RESPONSIBILITIES FOR THE FSA

As we develop our work in new areas, where possible we will ensure that we adhere to our commitment to applying an outcomes-focused regulatory approach and to encourage market-led solutions.

Payment Services Directive (PSD)

The key aims of the PSD are to enhance competition, efficiency and innovation in the European payments market by removing barriers to entry and ensuring fair market access. It also seeks to establish a set of rules on the information requirements, and the rights and obligations that would be applicable to all payment service providers and those using them in the EU.

To achieve these aims, the PSD:

- introduces a new prudential authorisation regime for larger payment-services firms that are neither banks, building societies nor e-money issuers;
- allows smaller payment-services firms operating beneath a certain threshold to be registered under the PSD instead of obtaining authorisation; and
- sets out conduct of business requirements on the information to customers, as well as the rights and obligations of providers and customers.

Box Four: Delivering consumer compensation

When firms do not meet our minimum standards, customers can and do suffer financial loss. We will therefore work closely with the Financial Ombudsman Service (FOS) to ensure that customers whose complaints are upheld receive appropriate redress. We will also continue working with the FSCS to help deliver an effective approach to compensation when firms fail. We will work with the Treasury and the FSCS to ensure that European initiatives deliver effective harmonised minimum standards for guarantee schemes. We will be fully engaged in the negotiation and implementation of the amended Deposit Guarantee Schemes Directive and any European initiative on insurance guarantee schemes.

The government has decided that we should be the UK competent authority for most of the PSD, which will be implemented on 1 November 2009 by means of Treasury Regulations. As a result we will be responsible for regulating banks' and building societies' payment transactions under the PSD. On 1 November 2009, the PSD will come into force, introducing conduct of business rules for payment transactions applying to most retail bank accounts. The PSD brings a further 3,000 firms into the scope of FSA regulation, both for authorisation/registration and conduct of business. It is intended that supervision will be on a complaints-led basis.

Following our consultation on **Regulating Retail Banking Conduct of Business** in 2008, in the coming year we will decide whether to change the existing arrangements. Currently, the Banking Code Standards Board (BCSB) monitors and enforces the voluntary Banking Codes governing current accounts, personal loans and overdrafts, savings, card services and ATMs. If we decide to introduce a new framework, we propose to implement it with the PSD. As this work progresses we will continue to liaise with industry representatives, the BCSB and the Office of Fair Trading (OFT) to achieve a framework that supports the fair treatment of retail banking consumers.

Sale and rent-back schemes

Our FRO identified a number of risks that could arise from the housing market slowdown. One such risk is that consumers may be offered sale and rent-back schemes and find they are unable to afford the rental payments beyond the initial incentive period. These schemes are unregulated and the Treasury is currently consulting on extending our scope to regulate the sale and rent-back market. In parallel we are developing proposals to allow us to introduce consumer protection quickly and reduce the potential for detriment in this market. Alongside the government proposal for industry regulation, we published a CP in February setting out our proposed interim regulatory regime for this sector, which is expected to apply as soon as our powers come into force. During 2009/10 we will implement the interim regime (taking into account the responses to our and the Treasury's consultations) and continue work on developing a full regulatory regime.

Unclaimed assets – Dormant bank and building society accounts

The Dormant Bank and Building Society Accounts Act 2008 allow banks' and building societies' existing liabilities to dormant account holders to be extinguished and replaced with a new statutory liability to repay customers. These assets are placed in a new type of firm called a 'reclaim fund'. Participation by banks and building societies in the scheme is voluntary.

Reclaim funds will be under an obligation to transfer surplus money (after meeting our requirements and their expenses) to the government's Big Lottery Fund for distribution for social and environmental purposes. We will authorise and regulate Reclaim funds, bringing a new type of firm into our regulatory scope. We plan to publish a CP setting out our proposals for a sound outcomes-focused and cost-effective regime for the regulation of reclaim funds in Q1 2009. The CP will explain our proposed authorisation process, prudential requirements, and other consequential changes we will need to make to our rules. The government aims for the scheme to be operational as soon as possible in 2009.

4 Improving our business capability and effectiveness

INTRODUCTION

Improving our business capability and effectiveness is an important commitment that we will continue to focus on in 2009/10. This is driven by our strong desire, and accountability to stakeholders, to ensure that we use our resources efficiently and provide a good customer service in our transactional processes. Delivering on this commitment will make it easier for firms and consumers to do business with us.

The delivery of the initiatives in this section is vital to help us meet our statutory objectives. We will continue to focus on effectively running our infrastructure, operational policies and processes in a smooth, efficient and effective way – keeping the building and systems running, managing the finances and looking after the interests of staff.

As a result of the continuous improvements in our people strategy and technical infrastructure outlined in this section and earlier in this document, over the course of 2009/10 firms and consumers will continue to see improvements in their dealings with us.

PEOPLE

Our people strategy continues to focus on attracting, motivating and developing talented people to achieve our objectives. Successful delivery of this strategy has four key elements:

- building a reputation as an employer of choice within financial services, which enables us to attract and retain the talented people we need;
- an approach to managing talent that enables us to identify and develop talent at all levels in the organisation, including more effective performance management and a more structured approach to career development and succession planning;
- relevant and focused training that enables our people to engage constructively and credibly with the industry and other stakeholders, and make the kind of judgements that will be required under a more outcomes-focused regime; and
- leadership development to ensure that our organisation is led and managed effectively to deliver high levels of individual, team and organisational performance.

The Training and Competence scheme, outlined in Section One, is a key initiative in the coming year that will improve the knowledge and skills needed for all supervisors and managers who look after relationship-managed firms. Complementing this is the nine-week induction programme for new relationship-management supervisors, which includes a mix of classroom-based learning, e-learning and on-the-job coaching.

We will continue to invest in improving leadership and management competence across the FSA. In the coming year we will embed talent management initiatives across the business and continue to build a culture of energetic, business-driven and positive behaviour.

As the Chief Executive Officer says in his Overview, it remains critical for us to continue to improve the quality of our staff and to ensure that we are able to retain our best people. We will deliver this through a combination of recruitment, training and offering competitive reward packages. During 2009/10 we will start implementing our new reward strategy which aims to move staff to a common reward platform. Our aim is to ensure a more equitable distribution of total reward spend and to provide increasingly transparent links for staff between skills, contribution and reward. The salaries we offer must be comparable with the external market for relevant financial services skills. The 2009/10 budget includes the costs of implementing this strategy. We will also consult with current members of the final salary section of the pension plan with a view to ceasing future accrual within that section from April 2010. If this change were to go ahead, it would generate savings at an expected rate of £4.8m per annum in future years and reduce the uncertainty of future pension costs.

INFORMATION SYSTEMS (IS) CONTINUOUS IMPROVEMENT

We are now in the final phase of the programme of work to transform our Information Services (IS) Division's processes and procedures. In 2005 we began an IS **Transformation Programme** to deliver a reliable and scalable technical infrastructure, which is responsive to changes in our business needs. By 2007 we had achieved, and in some instances exceeded, our target of Industry Standard operation. We plan to reach the next level of maturity by the end of Q1 2009. Our targets are based on standard 'maturity model' metrics – a measure of process compliance for the Information Technology (IT) industry. The external assessment of our progress will report by the end of Q2 2009.

We have launched an IT **Strategy Programme** which will build on the success of the IS Transformation Programme. Over the next three years we will rationalise our IT infrastructure, retire legacy applications, and implement a more logical, robust and resilient IT architecture platform.

Strategic IT programmes

We will continue to work effectively with our Application Development Framework partners Capgemini, Steria and Tata Consultancy Services to ensure our stakeholders receive the most efficient outcomes, and that we deliver projects on time and within budget. As outlined earlier in the document our major programmes include the upgrade of our transaction monitoring system, Sabre II, to meet our EU obligations and enhance our capability to combat market abuse, as well as technology changes to facilitate the implementation of Solvency II and the PSD.

We remain committed to implementing a facility for firms to make online applications and notifications. We now expect to start the roll out of the programme in Q3 2009. This will make it easier for firms seeking authorisation, approval for individuals or a waiver, or to notify us of a change of control or an outward passport, or to apply to establish a collective investment scheme. It will also allow for more efficient processing of applications.

As outlined in Section Two we have begun work on a strategic review of the operations of the UK Listing Authority (UKLA). Central to this is a review of the IS systems, the Electronic Listings Management System (ELMS), the Electronic Listing Submission System (ELS) and supporting business processes. The UKLA's work has become more diverse over the last few years, with significant changes in the types of issuers dealt with and the complexity of the securities that they issue. We will review the UKLA's systems to ensure they are able to deal adequately with these changes and continue to be fit for purpose.

The new system will modernise the way the UKLA operates and will increase efficiency. This will stretch over a number of years. Detailed planning work will start in 2009/10.

2009/10 will see the completion of the first phase delivery of our new risk-management database. It will provide a platform to integrate two systems that currently support ARROW, and will cover firm, thematic and internal risk management. Development of the database will enhance the IT system support provided across the FSA, contributing to improved visibility of information and the potential to act on risks more quickly, allowing the organisation to work more effectively.

SERVICE STANDARDS STRATEGIC REVIEW

Service standards are specified levels of performance that we have agreed to meet in performing our regulatory functions. Most of these are voluntary commitments, although some are statutory and relate to provisions in the Financial Services and Markets Act 2000 (FSMA) or other legislation. Our current portfolio of 57 standards enables us to provide information about how we are performing and how satisfied our customers are in key areas of our service. Results are published in the Performance Account on our website. In 2009/10 we plan to carry out a review of the existing standards to ensure that they continue to be relevant, challenging and the most appropriate indicators of our performance. We will continue to report our performance against the existing standards while we conduct this review.

Customer satisfaction surveys

We will continue to commission independent research companies to undertake customer satisfaction research for our contact centres and other transactional services, such as authorisation and waiver processing. We will use the feedback where appropriate, to review and further improve our performance.

OFFICE ACCOMMODATION

As we increase our staff numbers it is important that we have appropriate office accommodation. In anticipation of our lease on a floor in 25 Bank Street expiring in 2010, in the coming year we will assess our property options to ensure we have suitable arrangements in place to accommodate our staff.

FEES

Alongside this Business Plan we are publishing the second of our annual fees Consultation Papers, *Regulatory fees and levies 2009/10*. This sets out our proposed fee rates and levies for the FSCS and FOS for the next financial year, as well as a number of policy proposals. This follows on from CP08/18 published in October 2008 which contained proposals relating to changes in our fees and FOS policy for 2009/10.

To help budget for the year ahead, firms can take advantage of our online fees calculator and information on our website to calculate their FSA/FSCS/FOS fees and levies based on historic rates and the rates we are now proposing.

In previous years firms have been able to pay their fees and levies by instalment through an industry-negotiated arrangement with Premium Credit Limited. The current three-year deal has now ended and following positive feedback, we are keen to ensure that firms continue to have the opportunity to pay through an instalment option if they wish. Premium Credit Limited have indicated that they will be interested in providing this facility to firms, however, we are inviting any other credit providers who are interested in this market to come forward with their proposals by 28 February 2009. We will then facilitate a working group with representatives from the trade associations and the Smaller Businesses Practitioner Panel to review any proposals. We aim to have a new arrangement in place by May 2009.

We recognise that our fee structure has evolved since N2, when we received our powers under the FSMA. We have seen significant changes to both the industry and ourselves, particularly due to EU directive implementation, since the current regime was introduced in 2001/02. As a result our costs are higher, which raises the question of whether our current fee structure and cost allocation model continue to be appropriate. In CP08/18 we said we would carry out an internal strategic review to establish whether a wider review involving external consultation is necessary. In Q2 2009 we will be seeking informal input from firms and trade associations and aim to announce in Q3 2009 whether a new fees regime framework would be beneficial and what shape it would take. We plan to consult formally on any new framework in Q1 2010.

5 Budget for 2009/10

INTRODUCTION

Much has changed within the financial sectors we regulate since we set the budget for 2008/09 and, as a result, we have reprioritised those areas of our work that are more urgent. In response, the budget for 2009/10 is driven by the enhancement of our supervisory processes and our greater focus on executing our core activities effectively, as outlined in Sections One to Four.

As the economic situation remains volatile and the international regulatory environment continues to evolve, we will retain a level of flexibility within the budget so that we can reassess our priorities and react to risks as the need arises. We are also aware of some externally driven changes to our regulatory scope as outlined in Section Three. We will be undertaking IT development and other preparatory work, in relation to these scope changes, the cost of which may eventually affect the 2009/10 budget, but are not included at this stage as the full costs and scope are not known. We will explain our proposals on how we will levy firms for these costs during 2009.

This section explains our budget and funding needs under three headings:

- ongoing regulatory activity;
- capital expenditure; and
- funding the FSA.

ONGOING REGULATORY ACTIVITY (ORA)

Our budget for 2009/10 is £415m as illustrated in table 5.1 below. This is £76.6m (22.6%) higher than the equivalent budget of £338.4m for 2008/09.

The original budget published for 2008/09 (£323m) was adjusted during the course of the year. The FSA Board approved an additional expenditure of £13.6m for the Supervisory Enhancement Programme and a required change in accounting treatment from the 'RightSpace' programme (£1.8m), leading to a revised budget of £338.4m.

Our staff costs will increase as we invest to embed and deliver higher quality supervision, especially of high impact firms, and focus on more effective execution of our core activities. The Supervisory Enhancement Programme includes an increase in about 280 staff involved in the supervisory process; two-thirds will be recruited by the end of 2008/09. We currently employ around 2,800 staff, and we expect this number to increase to around 3,000 as we continue the drive to recruit quality supervisors and supervisory support.

Table 5.1: Expenditure by type

Budget	2009/10 £m	2008/09 £m	Change £m	Change %
Staff costs (inc. travel, training, recruitment and pension scheme deficit reduction contributions)	306.4	246.4	60.0	24.4
Accommodation, office services and depreciation	47.6	47.7	(0.1)	(0.2)
IT costs (including IT delivery outsourcing)	34.5	26.6	7.9	29.7
Professional fees – services	14.7	11.9	2.8	23.5
Professional fees – projects	32.9	23.7	9.2	38.8
Other (including printing and publications)	5.0	5.4	(0.4)	(7.4)
Total costs	441.1	361.6	79.5	22.0
Sundry income	(26.1)	(23.2)	(2.9)	12.5
Total cost of ORA	415.0	338.4	76.6	22.6

As outlined in Section Four, we will commit resources to improving and maintaining the quality of our staff. During 2009/10, we plan to spend up to £10m on the development and implementation of our new reward strategy. This expenditure would be partially offset in future years by the proposed change to the final salary pension scheme, which, subject to consultation, we expect would generate savings at a rate of £4.8m per annum.

The budget for increases in pay will be set at 3.3% of the total salary bill, but this will not lead to across the board pay rises for all FSA employees. This rate is based on our assessment of pay levels in the relevant sectors and reflects our focus on attracting and retaining the right people, many of whom have specialist skills in risk analysis, law, and compliance, which remain in high demand despite the credit downturn in the financial sector. The overall increase, including pension costs, will be 3.5%.

The increase in our IT costs is driven by three key factors: first, by the ongoing support costs for new business applications implemented in 2008/09, including Phase 1 of Sabre and our new financial reporting system GABRIEL; second, by the cost of providing systems and system support for our increased staff numbers; and finally, by the initiation of our new IT strategy programme outlined in Section Four.

During 2009/10 we will maintain investment in the delivery of our National Strategy for Financial Capability as part of our commitment to increasing consumer awareness.

We will continue to look for savings from reprioritisation and improvements in efficiency, and have committed to operational savings of £4.9m in 2009/10 to offset investments in our supervisory processes. We have done this through non-staff cost efficiency gains year on year.

In table 5.2 below, we set out the planned cost of our ORA for each Business Unit. The figures include central service costs (regular IT costs and overheads) distributed to the business units based on the number of staff in each unit.

The main drivers for the increase in budgets for the Retail, Wholesale and Operations Business Units are the staff and IT costs covered above. In addition to the resource required to help deliver and support the enhanced supervision strategy, the increased budgets include the costs of the other priority initiatives described in Sections One to Four.

We will continue to invest in credible deterrence, combating financial fraud and market abuse in line with our three-year financial crime strategy. The increase in the Enforcement budget is due to additional resource with the necessary expertise to handle an increased number of complex cases, including criminal investigations and prosecutions. For the same reason the budget for external enforcement case costs (such as barristers and forensic experts) will increase from £3.7m in 2008/09 to £5.1m in 2009/10. This amount has been based on predicted caseload and we will invest further resources if the need arises.

The Corporate Services and Board budget includes the £10m of centrally held costs for the development and implementation of a new reward strategy as mentioned above. It also includes £13.5m of contingency designed to cover costs that may arise from the need to mitigate major risks to our business plan. This contingency fund has been increased from 2008/09 by £9.1m. It includes allowance for additional external legal costs which could arise if we decide to prosecute in major criminal cases. It also includes an allowance to cover further intensification in our supervisory approach to major international firms which might

Table 5.2: Expenditure by Business Unit

Budget	2009/10 £m	2008/09 £m	Change £m	Change %
Retail markets	172.3	160.0	12.3	7.7
Wholesale and Institutional Markets	106.3	85.1	21.2	24.9
Operations	40.2	34.0	6.2	18.2
Corporate Services and Board	79.0	47.2	31.8	67.4
Enforcement	43.4	35.3	8.1	22.9
Total costs	441.1	361.6	79.5	22.0
Sundry Income	(26.1)	(23.2)	(2.9)	12.5
Total ORA	415.0	338.4	76.6	22.6

arise out of the Discussion Paper on reforming international banking regulation. If these contingencies are not required they will be returned to firms in 2010/11. The remaining increase includes the cost of additional resources in the Banking and Compensation Reform Division (£2.3m), redistribution of central service costs (£1.6m), increased firm events and improved stakeholder and consumer communications within our Communications Division (£1.2m), and a number of other smaller volume driven increases.

The majority of costs relating to implementing the requirements of Solvency II are expected to be recovered from affected firms by Special Project Fees (£7.4m in total for 2009/10). The Special Project Fees will be directed towards our change management programme to implement Solvency II, including reviewing and redesigning our supervisory processes, reviewing and making the necessary changes to our business information and analysis systems and providing guidance to UK firms to assist their own implementation planning. This includes development of an Internal Models Approval Process to enable UK firms to benefit from the opportunity to calculate their regulatory capital through the use of a full or partial internal model. Recovery of these costs through Special Project Fees is subject to the FSA Board approving the related fees rules following completion of the current consultation process. £2.4m of costs relating to Policy Development and Level 2 Negotiation form part of our ORA for 2009/10 and are to be recovered from fee payers through the normal annual fee.

The changes in budgets also reflect some realignment in our business model that took place in 2008/09 following the reorganisation of the FSA which saw the regulatory functions of the old Regulatory Services Business Unit transfer into our Retail Markets Business Unit, as well as the centralisation of our previously devolved Finance, HR and Risk functions.

Contribution to reducing the deficit in our final salary pension scheme

We maintain our commitment to reducing the deficit in our final salary pension scheme. Since 1 April 2004 we have made additional pension contributions of £53.6m, and in 2009/10 we plan to make a further £9.8m of pension contributions.

We regularly monitor the funding level of the pension scheme which over the past year has been volatile. However, funding decisions about the pension scheme are made having regard to the long-term nature of the liabilities and the long-term period over which the pension assets will be held. The FSA and the pension scheme Trustee consequently have taken note of the recent fall in asset values but will make decisions based on a long-term prognosis for the scheme's assets and liabilities.

CAPITAL EXPENDITURE

The original published capital budget for 2008/09 (£54.0m) has been adjusted as a result of deferral of work relating to Knowledge Infrastructure and Sabre II. The impact of these deferred costs is currently estimated at £9.5m, and results in a revised budget of £44.5m for 2008/09. These deferred costs are included in the capital budget of £42.2m for 2009/10. The actual impact of the deferrals will be confirmed in our Annual Report for 2008/09.

As explained in table 5.3 below, we are reducing our capital requirement by 5.2% from £44.5m in 2008/09 to £42.2m in 2009/10. This is due to an increase in IT development costs and the initiation of our IT Strategy Programme, as outlined in Section Four, offset by a significant reduction in leasehold improvement costs following the completion of the 'RightSpace' programme.

We recognise that the exact timing of capital expenditure is difficult to define, so there may be a need for further transposition between years.

Table 5.3: Capital Expenditure

	2009/10 £m	2008/09 £m	Change £m	Change %
IT development	31.8	21.6	10.2	47.2
IT infrastructure	8.4	5.5	2.9	52
Leasehold improvements	2.0	17.4	(15.4)	(88.5)
Total capital expenditure	42.2	44.5	(2.3)	(5.2)

FUNDING THE FSA IN 2009/10

Revolving credit facility

In the coming year, we plan to increase our credit facility from £100m to £150m, and we are carrying out a tender exercise to identify the most appropriate providers for this facility. It will be used to fund the three-year cash flow implications of our move to more outcomes-focused regulation, our capital investment needs, the delayed recovery of our expenditure on the Supervisory Enhancement Programme, and short-term funding needs at the beginning of the fiscal year due to the timing of our fee invoicing cycle. We will call on the use of the credit facility as the impact of these items takes effect.

Annual Funding Requirement (AFR)

The AFR is the amount of money that we need to raise from fees. The total amount required to fund our budgeted costs and to allow us to make an appropriate repayment on our borrowings is set out in table 5.4. The total AFR for 2009/10 is £437.7m, an increase of 36.5% on 2008/09. Table 5.5 gives a fuller explanation of the £117m increase to our AFR by business driver.

In 2007/08, we explained our intention to spend up to £50m over a number of years on a programme of change across the organisation, including upgrading the skills and expertise of our people, staff reorganisation, improving our knowledge management capability and the acquisition of additional office space required as part of our accommodation strategy.

Table 5.4: AFR

	2009/10 £m	2008/09 £m	Change £m	Change %
Budget for ORA	415.0	323.0	92.0	28.5
Funding the transition to more outcomes-focused regulation	5.0	5.0	–	–
Movement in reserves	4.1	(7.3)	11.4	n/a
Recovery of 2008/09 expenditure on improved supervisory activities	13.6	–	13.6	n/a
AFR	437.7	320.7	117.0	36.5

Table 5.5: Explanation of movements in AFR by business driver

	£m
AFR 2008/09	320.7
Recovery of 2008/09 expenditure on improved supervisory activities	13.6
Ongoing increased expenditure on improved supervisory activities (which includes increased Enforcement activity)	57.2
Subtotal of expenditure on supervisory activities	*70.8*
Increased technology and property infrastructure for expanded FSA operations	12.0
Additional contingency	9.1
Other operational costs	9.4
Other financial adjustments (including pension and reserves movements)	15.7
TOTAL MOVEMENTS IN AFR	117.0
AFR 2009/10	437.7

We continue to make good progress with this change programme and still expect to complete it by March 2010 within the budgeted £50m. As explained in previous years, this investment will lead to benefits that will be realised over a longer period and will contribute to our move to a more outcomes-focused regulatory approach. To avoid passing the whole cost on to fee-payers immediately in a single year, we are spreading the cost of the change programme over a number of years by borrowing funds, when necessary, and recovering that cost in fees over a period of up to ten years, thereby timing the cost to firms to coincide with the benefits. Consistent with our approach over the last two years, we have included £5m in the 2009/10 AFR to cover this expenditure.

Alongside this Business Plan we are publishing the second of our annual fees CPs for 2009/10. Further details can be found in Section Four under FEES.

Box Five: Financial management and reporting framework

The scope of activities falling within our remit is wide and varied. This includes some activities that are intended to be temporary in nature and/or are subject to considerable variation from year to year. We cannot forecast these with the same reliability as regular recurring activities. We will continue to:

- exert sound financial management and budgetary control over all areas of our expenditure and income; and
- seek to manage any unavoidable volatility to minimise the impact on fee-payers from year to year.

Our Board believes it is helpful to have a framework within which to manage and report on our costs and funding. The following 'streams' of activities, which have distinct cost and funding characteristics, have been identified.

Ongoing regulatory activity (ORA)

This includes our core operating activities, managed year on year as part of our budget process. The ORA is the key figure, along with the explanation for any material movements, which shows how we have met our obligation to be economic and efficient in using our resources.

Changes in scope (increase or decrease)

Sometimes the Treasury legislates to change the scope of activities that we regulate. Any scope changes, as with our other core operating activities, are subject to financial management as part of our budget process. However, until the supervisory process is established, material activities resulting from a scope change are best controlled separately, so they are individually identifiable. When the supervisory requirements of the scope change have been introduced, we include these activities as an integrated part of our ORA for the following year.

Exceptional items

We have included these costs in the ORA and we will report on material movements each year.

External enforcement costs

Total enforcement costs depend on the number of cases and their complexity. We will continue to manage these costs in total and try to optimise the mix of internal and external enforcement resources when we do this. We have included these costs within ORA and we will report on any material movements each year.

While we will maintain strong financial management of these costs, the actual amounts may be materially higher or lower than the budgeted level set before the financial year. If this happens, we will review any surplus or reduction in costs from the budgeted level and may try to smooth the impact on fee-payers over a period of time subject to us being able to maintain satisfactory reserves.

Panel costs

The Financial Services Consumer Panel and the Practitioner Panel have a status under the FSMA that guarantees their independence from the FSA. These bodies, along with the Smaller Businesses Practitioner Panel control their own costs against budgets. They are, however, subject to our approval and are funded through our fees. We have included these costs within our ORA.

Complaints Commissioner

The FSMA requires us to have arrangements in place to investigate complaints against us. On 3 September 2001 we introduced our Complaints Scheme to do this. The FSMA requires us to ensure the Complaints Commissioner can conduct a full investigation into any complaints. The Complaints Commissioner controls his own costs against his budget, which are subject to our approval, and is funded through our fees. These costs are included within our ORA.

Pension scheme deficit reduction

The amounts required to fund our pension liabilities over time are inherently variable, and depend on several variable factors including current investment values and projected investment returns. We intend to eliminate our current deficit over a ten-year period.

Revolving credit facility

This is currently a £100m revolving credit facility contract with Lloyds TSB Bank plc taken to finance the costs of delivering more outcomes-focused regulation, overhauling our IT delivery and technical infrastructure and funding our commitments to our final salary pension scheme.

Depending on the timing of our fee collection cycle, there will be periods of the year when we will use the new borrowing facility to fund such expenditure and other times when we will have surplus funds available for investment. Therefore, our revolving credit facility will run alongside and operate within an integrated agency treasury service, allowing us to minimise our net financing costs. We will repay borrowings and financing costs under this facility using funds we raise as part of the AFR, over the periods in which we expect the corresponding benefits will be realised. This allows us to improve the way we manage the volatility in the level of our fees, and the matching of our assets to our liabilities.

Transition costs

The changes necessary to improve the effectiveness of our people and move towards a more outcomes-focused regulatory approach will be controlled separately over a three-year period until 31 March 2010. We have set up a separate multi-year budget of £50m for that expense.

Reserves

In line with our Treasury Management Policy, we maintain the equivalent value of six weeks of our ORA as a contingency fund. We now anticipate that we will have sufficient financial capacity within the revolving credit facility to meet any expenditure required to address unforeseen events. We plan to keep our reserves at -2% to 2% of ORA.

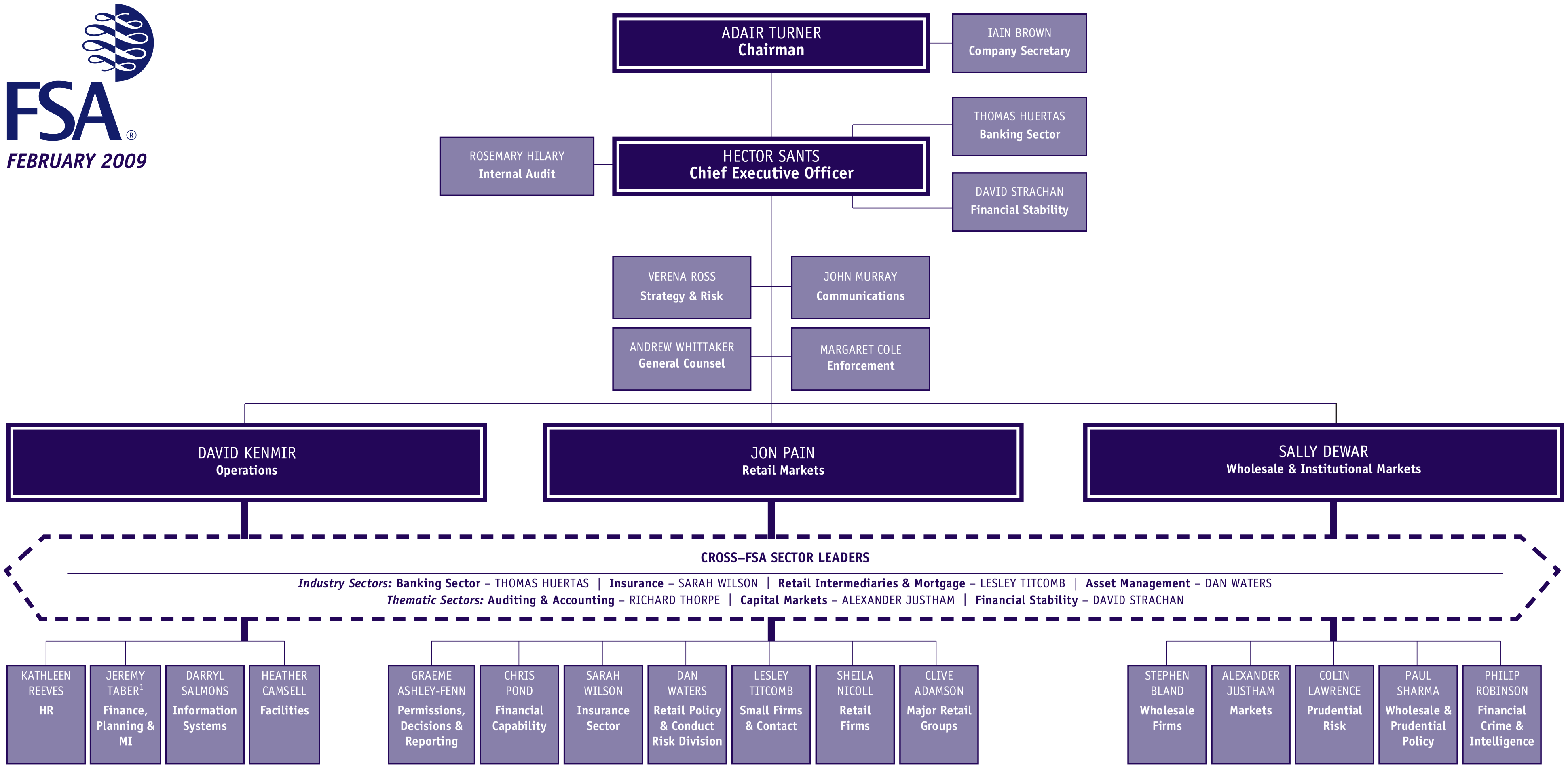
Appendices

Appendix One:
The Board of the Financial Services Authority at February 2009

Adair Lord Turner	Chairman, the FSA
Sir James Crosby*	Deputy Chairman, the FSA Senior Independent Director, ITV plc. Senior Independent Director, Compass Group plc. Trustee, Cancer Research (UK) Non-executive Director, Mysis plc.
Hector Sants	Chief Executive, the FSA
Jon Pain	Managing Director, Retail Markets, the FSA
Sally Dewar	Managing Director, Wholesale and Institutional Markets, the FSA
Carolyn Fairbairn	Director of Group Development and Strategy at ITV plc. Non-executive Director, Digital UK Deputy Chair, Royal Television Society Chair, Freesat
Peter Fisher	Managing Director, BlackRock Inc.
Brian Flanagan	Non-executive Director, William Morrison Supermarkets plc. Advisor to Jet Environmental Ltd.
Karin Forseke	Non-executive Director, Eniro AB Non-executive Director, Wallenius Lines Member, Swedish Financial Markets Advisory Council Non-executive Director, Royal Opera in Stockholm
Sir John Gieve	Deputy Governor (Financial Stability), Bank of England
David Kenmir	Chief Operating Officer, the FSA
Professor David Miles	Managing Director and Chief UK Economist, Morgan Stanley and Co. Ltd. Visiting Professor of Financial Economics, Imperial College, London Directorship, Global Economics Ltd.
Michael Slack	Chairman, The Fyfe Group Ltd. Chairman, Temporary Cover Ltd. Director, British Insurance Brokers' Association
Hugh Stevenson	Chairman, Equitas Ltd. Chairman, Merchants Trust plc.

*Sir James Crosby resigned from the FSA Board on 11 February 2009

Appendix Two



[1] Acting

Appendix Three: Milestones for 2009/10

FINANCIAL STABILITY AND SUPERVISION OF FIRMS – RESPONDING TO THE CRISIS

	2009 Q1: January-March	2009 Q2: April-June	2009 Q3: July-September	92008 Q4: October-December	2010 Q1: January-March
Reforming international banking regulation – policy and practice	Discussion Paper				
Liquidity reporting regime	Consultation Paper	Feedback Statement/ Policy Statement		Implementation	
Training and Competence (T&C) scheme for supervisors	Implementation				
Review of short-selling	Discussion Paper				
Banking & Compensation Reform					
FSCS Reform: fast payout for depositors and consumer	Consultation Paper				
FSCS Reform: temporary high balances	Consultation Paper		Feedback Statement/ Policy Statement		
Financial stability and depositor protection: FSA responsibilities					

PROMOTING EFFICIENT, ORDERLY AND FAIR MARKETS

	2009 Q1: January-March	2009 Q2: April-June	2009 Q3: July-September	2009 Q4: October-December	2010 Q1: January-March
EU and international policy-making					
Tripartite Factbook initiative				Implementation	
Review of standards for firms' protection of Client Assets		Consultation Paper			
Amendments to Capital Requirements Directive		Consultation Paper			
Solvency II			Discussion Paper		
Domestic policy work					
Resilience Benchmarking Tool for firms' self assessment	Implementation			Market Wide Exercise	
Personal Investment Firms (PIFs)			Feedback Statement		
Review of the structure of the UK Listing Regime			Feedback Statement		
Regulation of Sukuk (Islamic bonds)		Feedback Statement			
Reducing financial crime and market abuse					
Implementation of next phase of Sabre II programme			Implementation		

HELPING RETAIL CONSUMERS ACHIEVE A FAIR DEAL

	2009 Q1: January-March	2009 Q2: April-June	2009 Q3: July-September	2009 Q4: October-December	2010 Q1: January-March
Focusing on consumer outcomes					
With-profits regime				Publish findings	
Implementation of Retail Distribution Review		Consultation Paper			
Consumer capability and responsibility					
Financial capability plans	Publish planned activities				
Consumer responsibility			Feedback Statement		
New rules for regulating travel insurance – known as Connected Travel Insurance	Implementation				
Further responsibilities for the FSA					
Reclaim funds	Consultation Paper				
Payment Services Directive				Implementation	

IMPROVING OUR BUSINESS CAPABILITY AND EFFECTIVENESS

	2009 Q1: January-March	2009 Q2: April-June	2009 Q3: July-September	2009 Q4: October-December	2010 Q1: January-March
Information systems					
Transformation Programme	External assessment				
Online facility for applications and notifications			Implementation		
Regulatory fees and levies					
Arrangements for payment by instalment		Implementation			
Fees and levies for 2010/11				Consultation Paper – Policy	Consultation Paper – Rates
Strategic Review of Fees Regime	Assessment	Assessment	Feedback on assessment		Consultation – New framework

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