

## Appendix 3: Panel Responses

### Practitioner Panel

In its Annual Report for 2012/13, the Practitioner Panel comments on the work of the FSA and looks forward to key concerns for the new regulatory structure.

#### Working with the Panel

The FSA welcomed the Panel's support and close working relationship and the FCA looks forward to maintaining this level of engagement.

The role of the Financial Services Practitioner Panel was to provide senior level industry input into the FSA, with membership selected to reflect the major sectors of the UK financial services industry. The Panel continues in the same manner now. This is an important role in helping us deliver effective regulation of the financial services industry.

#### Responding to the Panel's concerns

##### *Good practice*

The Panel emphasised the importance of the regulator working with industry in a constructive way. It recommended that the FCA build positive engagement with firms, and suggested ways in which good practice could be shown instead of solely focussing on firms who were performing the worst through complaints and enforcement procedures.

The FCA intends to be an externally focused and engaged regulator, and to work with industry and the firms it supervises more closely in order to effect change and make markets work well. Through its regular interaction with firms, the FCA aims to be balanced and note good practice as well as underlining areas where improvements are required. In its public statements on work with the industry, such as the recent statement on interest only mortgages, the FCA has highlighted positive steps taken by the industry in reaction to risks to consumers.

##### *Transparency*

The Panel engaged with the FSA on how the FCA would use the greater emphasis on transparency in its remit. The Panel highlighted the importance of putting into context the data published by firms and how it may be interpreted.

The FCA is considering all the feedback received to its transparency discussion paper, including that from the Practitioner Panel. It will shortly publish a Feedback Statement and its new Transparency Framework. The Panel highlighted the importance of putting data published by firms into context and how it may be interpreted. The FCA is considering how best to take this forward and will also be looking at contextualisation of data published by the FCA in the context of transparency and our data strategy.

#### *Value for money*

The Panel emphasised the importance of rigorous cost control and asked the FCA to consider other regulatory costs faced by firms, as well as the general economic climate and the cost impact of dual regulation.

The FCA routinely consults the industry on fees, and considers the impact on firms of the overall cost of regulation during its annual planning cycle. The FCA is developing its VfM strategy, which will be supported by detailed plans. The strategy will be shared with the panels. The FCA will also be subject to its first VfM audit this year and the findings of this will be an important benchmark for the FCA's approach.

#### *Secondments from industry*

The Panel were supportive of the change to the structure of supervision work to reflect the change in focus for the FCA. The biggest risk highlighted by the Panel was the need to ensure that the FCA had people with the right calibre and experience to undertake this work. The Panel suggested setting up a formal system of regular secondment from industry.

The appointment of suitably experienced candidates into the newly created director roles in Supervision is a priority. The FCA also acknowledges the mutual benefits of a formal system of regular secondment from industry into FCA roles and it is currently exploring ways of expanding its current schemes.

#### *Bank culture*

The Panel emphasised the importance of creating a culture in firms where the people running banks deeply and thoughtfully consider the outcome of their actions on their customers and the broader community, while still delivering an attractive return for shareholders. They suggested that regulators and policymakers should seek to incentivise positive cultural change.

The Parliamentary Commission on Banking Standards has published a series of recommendations as to how the banking sector should be regulated; we are currently reviewing those recommendations and what they mean for the FCA and the future of banking services in the UK. The FCA is committed to addressing the root causes of conduct risk within firms as a key strategic priority, and this includes culture and incentives. The FCA is focussed on changing these so that firms prevent past errors from being repeated. As set out in the FCA's Business Plan, it will do this by creating an environment supportive of good conduct, but where the incentives and opportunities for poor behaviour are low and the potential costs are high.

Assessing the governance and culture is a key component of the way the FCA supervises firms through both the Firm Systematic Framework (FSF) and Thematic reviews. As a forward-looking approach to supervision, the FSF seeks to tackle the underlying causes of conduct failures and it will use this approach to drive firms to focus much more on the outcomes for customers and the integrity of markets in the way they run their businesses. The FCA is also committed to ensuring the culture is set from the top in firms, with a greater focus on the role of individuals, and as such is looking for those carrying out Significant Influence Functions to support a culture that delivers the fair treatment of customers.

The FCA has identified that incentive structures are a key driver of behaviour within firms and, while the role of the regulator is not to set levels of reward or be prescriptive about incentive structures, the Remuneration Code (the Code) seeks to align firms' remuneration policies and practices with effective risk management and ensure that they do not reward excessive risk-taking. While the original design was not explicitly set as a key cultural driver, nor conduct failures used as examples of poor risk management, the FSA has previously been able to use the Code to incentivise the right behaviours by applying reductions to current year bonus pools and clawing back unvested awards, or the applying malus adjustments. The FCA has also asked firms to adopt a positive culture of collective responsibility coupled with individual accountability.

In 2012/2013 there was evidence of significant bonus pool reductions and malus applied to unvested awards because of the number of risk management failures in 2012. Now that the FCA and PRA have come into being, both regulators have maintained a focus on the issue of remuneration and intend to continue with an independent but co-ordinated approach to the application of the Code.

The FSA issued guidance in January 2013 about the risks from financial incentives for sales staff and it welcome the encouraging signs that many firms have either already changed their approach, or are improving the way they manage risks. The FCA is now undertaking further thematic work to test the effectiveness of the changes firms have made and this work is a strategic priority for us in the current business year.

#### *FCA tone of voice*

The Panel raised concerns that if the FCA is too aggressive towards the industry in its public statements, it may have unintended consequences. Such messages could undermine trust in the industry and over-promise on the FCA's powers to act and prevent all wrong-doing. The Panel suggested that the FCA should provide positive examples of industry making improvements, as well as highlighting faults where they occur.

The FCA seeks to be balanced in its messages about the industry it regulates and therefore highlights good practice as well as bad practice. Recent examples include interest-only mortgages and faster payments where the FCA worked with trade organisations and firms to get a good result for consumers and industry, which it publicised through the media. In recent speeches, Martin Wheatley has included praise for some of the achievements of the UK financial services industry, including the insurance and investment management sectors. The FCA continue to actively engage trade organisations and firms, and encourage them to tell it about any improvements they have made so it can refer to these examples as appropriate.

#### *Temporary product intervention*

The Panel supported the need for temporary product intervention rules as part of a more pro-active and interventionist approach. However the Panel felt that this should be used as a last resort, where a lack of intervention would lead to unacceptable levels of detriment. The Panel suggested that the FCA should consider a full market impact and cost-benefit analysis and ensure that it consults with industry as a whole. It also questioned on what redress may be available to firms if this power was used inappropriately.

The FSA published a statement of policy on the FCA's use of temporary product intervention rules (TPIRs) in March 2013<sup>1</sup>. The FCA's intention is that TPIRs will be reserved for cases where prompt action is deemed necessary in seeking to reduce or prevent consumer detriment arising from the problem identified. The Policy Statement said that, 'in most situations, the FCA will expect to consult on permanent rules which aim to advance its statutory objectives'. However, the specific statutory provision empowering the FCA to make TPIRs recognises that there may be cases where it may be appropriate to intervene quickly and without going through the detailed (and usually lengthy) process of consultation and cost-benefit analysis for a new rule.

Where such prompt action is necessary, the FCA would need sufficient information about the issue to back up the proposed interim intervention. As noted in the Policy Statement, 'TPIRs will be subject to the same forms of challenge as other rules the FCA makes. The FCA will be subject to proportionate evidential standards, and will need to satisfy itself it has enough evidence to decide whether to make a TPIR.'

The FCA would need to make sure the TPIR is the right course of action, balancing the risks to consumers if it does not act promptly against the risks that the measure may not work as expected due to the lack of prior consultation. This would always include considering to the likely impact of any rule on firms and consumers, but circumstances may require the FCA to act without publishing any detailed assessment.

On the question of redress to firms, making a TPIR is no different from making other rules in terms of liability. While the decision to make a TPIR may be challenged via judicial review proceedings, generally speaking the FCA are not liable for damages for making regulatory judgments that later turn out to be wrong.

1 <http://www.fca.org.uk/your-fca/documents/policy-statements/fsa-ps133>

### *Section 166*

The Panel asked the FSA for more information on the use of section 166, or skilled person reviews, as they were concerned about the increasing cost of these and the burden on firms. It highlighted that the industry is concerned that the FCA has committed to making greater use of section 166 in the future. The Panel also asked the FSA to look at the use of informal or shadow section 166s. This is where a firm is asked to provide proof that their systems or processes are robust and the only way often that a firm believes it is able to do this, is to commission a skilled person to undertake a review.

The FCA is committed to monitoring the use of all of its supervisory tools, including skilled person reviews. Regulator monitoring, including the production of management information, is carried out on the use of skilled person reviews. Regular training is also provided to supervisors to ensure they are aware of the considerations, including cost and proportionality, that should be made before using any supervisory tool.

The FCA does not have a policy of using shadow section 166s, as this would not enable the FCA to be transparent about its use of supervisory tools.

The FCA will continue to publish quarterly information on the use of Skilled Person Reviews to ensure the industry and the Panel are kept up to date with the level of use of this particular supervisory tool.

### *Definition of consumer*

The Panel had previously registered concern about the single definition of 'consumer' during the development of the legislation for the FCA. They were concerned that this means the industry has to rely on the regulator being clear on a proportionately different approach towards wholesale and retail consumers, without there being any formal differential which can be used as a point of reference.

The Panel was concerned about the focus on retail consumers in the 'Journey to the FCA' document and the feeling that the majority of the rationale for taking action in wholesale markets was on the basis of the ultimate impact on retail consumers, rather than on the need to have clean markets for wholesale players.

The FCA's approach to wholesale conduct supervision recognises that key drivers of wholesale conduct risks engage all our statutory objectives. These risks – and in particular the mismanagement of inherent conflicts of interest – can damage market integrity, cause consumer detriment and undermine effective competition.

These risks have a particularly strong bearing on the market integrity objective. Evidence of widespread poor behaviours in wholesale markets undermines trust and confidence in market integrity even where, at the level of individual transactions, the contracting parties are sophisticated enough to protect their own interests. The FCA will be adopting a more assertive approach to supervising activity among wholesale participants, particularly in respect of securities markets.

While the Financial Services Act 2012 does set out a broad definition of 'consumer', the FCA will continue to maintain a graduated level of protection which is calibrated according to the varying needs and sophistication of different groups and the nature of the activities that they are engaged in. This approach is hard-wired into the FCA Rules.

## Smaller Businesses Practitioner Panel

In its 2012/13 Annual Report, the Panel focussed on the move to the new regulatory structure, together with its other priorities of cost effectiveness of regulation, engagement with small firms, and the balance of responsibilities between firms and consumers.

### Working with the Panel

The FSA welcomed the Panel's support and regular engagement, which helped it to develop a close working relationship and better understanding of the needs of smaller firms. The FCA looks forward to continuing this relationship in the new regulatory structure.

The role of the Smaller Businesses Practitioner Panel is to provide the FSA, and now FCA, with input from the perspective of smaller regulated firms who may otherwise not have a strong voice in policy making.

Eligible practitioners for the FCA's Smaller Business Practitioner Panel have now been defined by the FCA – as required by the Financial Services Act 2012 – as being: practitioners representing firms of small or medium size within their sector – whether by market capitalisation, funds under management, size of balance sheet and employees etc.

### Responding to the Panel's concerns

#### *Small firms supervision*

The Panel was supportive of the FCA's planned approach to supervision but wanted the FSA to consider how the smaller firm voice will be incorporated into the FCA's operations to ensure that it acts in a proportionate manner in its dealings with smaller firms. Although the Panel will represent the interests of smaller firms at a strategic level, the Panel wanted to include some form of 'small firms' champions in the organisation to consider the impact on small firms at a working level.

The FCA recognises the importance of ensuring that its supervision of smaller firms remains proportionate and consistent. To this end cases involving smaller firms will have more senior management oversight than has previously been the case.

At this stage the FCA does not propose the adoption of internal small firm champions. However, it does think that both the Panel and the FCA would benefit from more on-going dialogue rather than discussions mainly taking place at specific Panel meetings. This could be achieved through regular meetings between the Panel Chair and relevant Supervision Heads of Department as well as ad hoc meetings on particular issues as and when they arise. This would prevent the need of having to wait until the next Panel

meeting to discuss an issue. These ad hoc meetings would be particularly helpful when Panel members see new risks emerging.

#### *Warning notices*

The Panel urges the FCA to be cautious with its new power to give earlier notification of enforcement action being taken against firms through the publication of statements on warning notices. This is especially the case as the final notice can sometimes be significantly reduced from that stated in the first Warning Notice. The Panel also encourage both the FCA and PRA to main a similar system to the Regulatory Decisions Committee (RDC) structure for the FSA, in order to provide independent challenge to the executive on regulatory decisions.

The FCA notes the Practitioner's Panel's comments about Warning Notices. The FCA asked for responses from the industry on its new Warning Notice Power in its recent consultation. The FCA is currently reviewing the responses to this consultation and will publish a summary of its conclusions later this year. The FCA acknowledges that this is a contentious issue.

#### *Coordination between regulators*

The Panel highlighted that one of the particular concerns for dual regulated small firms is the burden in responding to the demands of two separate regulators. There is a risk that the new regulators will not always coordinate on their engagement with firms, such as for the timing of visits. This may cause problems for smaller management teams. The Panel have asked for the FCA and PRA to make clear that smaller firms can request a delay if there was too short a space between the timing of conduct and prudential visits and requests for information.

It has been made clear that the PRA and the FCA are two separate regulators pursuing their own respective objectives and work programmes. However, supervisory teams in both the PRA and FCA that engage with firms recognise the desirability of co-ordinating their work and minimising disruption for firms. FCA supervisors maintain an ongoing awareness of the interests and work plans of their opposite numbers in the PRA and meet regularly to discuss these. This will include, for example, keeping each other up-to-date with when and how they will be engaging with firms and data and other information requests. Firms can request changes to the timing of interactions with the regulator, and we will seek to accommodate those where possible.

#### *Small firms communication*

For smaller firms who do not have a dedicated contact person in the regulator, the Panel continued to emphasise the importance of coordination and effectiveness of general communications. As part of that, they encouraged the FSA to give clear and consistent messages to firms and to continue to invest in free roadshows and seminars for firms around the country. The Panel suggested that the FCA should consider providing a certain number of seminars for free to each regulated firm – with the possibility of charging a penalty if a pre-booked place is not used. They also suggested making better use of modern communication tools such as webcasts, or filming roadshows to be made available on the FCA website.

The newly formed Business to Business (B2B) team in the FCA will take an active role in supporting Supervision with communication to smaller firms. The FCA is committed to increasing engagement with firms via roadshows, workshops and local forums and is increasingly using social and digital media to make our communications more easily accessible. It will also ensure that FCA surveys, such as the Firm Feedback Questionnaire, are designed in a way that allows it to collect better information on how successful the FCA is in communicating with small firms.

#### *Communicating dual regulation*

The Panel raised the concern about consumers misunderstanding the role of the different regulators and how this will be identified on publications from firms. The FCA suggested that there was a need to ensure that the messages around what each Regulator is responsible for does not result in consumers believing that firms with two regulators are of better quality than those firms with only one regulator.

The FCA has produced a concise 'Financial Regulatory Directory' for consumers and consumer organisations.

The directory acts as a road map highlighting which organisations consumers should go to for the relevant query, ie. Who do I contact if I need to make a complaint/who provides information about firms going bust?

The FCA produced this in consultation with the organisations that feature on the directory alongside FOS, FSCS and MAS.

The FCA has recently received of the final copies and will now distribute them as part of our ongoing engagement with consumer representatives.

## Consumer Panel

In its Annual Report the Panel highlights the following priorities for 2012/13:

- the shape of future financial services regulation;
- the future effectiveness of the FCA as a conduct regulator;
- moving consumer credit regulation to the FCA;
- identifying poor practices in general insurance;
- improving consumer outcomes in income in later life; and
- more effective consumer representation at EU level.

As well as these priorities the Panel also provided input into the FSA's activities including banking, mortgages, the RDR and consumer vulnerability.

#### *Working with the Panel*

The Panel's role was to advise the FSA, and now the FCA, its policy and practice. The Panel provided constructive challenge to the FSA to improve



its effectiveness in meeting its consumer protection objectives. The Panel continues in this manner in the new regulatory structure and the FCA looks forward to continuing its productive relationship with the Panel.

#### Responding to the Panel's concerns

##### *Consumer credit*

The Panel welcomes the transfer of consumer credit regulation to the FCA as it believes a single regulator will provide a consistent and integrated regulatory approach. It highlights the following areas as being those where significant focus and effort will be needed:

- Ensuring key protections from the Consumer Credit Act are not lost
- demonstrating a strong appetite for enforcement that promotes effective competition and delivers real value for consumers;
- ensuring flexibility (e.g. between risk categories) and ensuring greater early evaluation of relevant parts of the regime to ensure their effectiveness; and
- cooperating and building new partnerships, not only to clarify roles, but also to coordinate enforcement, achieve proactive compliance and to ensure all operators are aware of new arrangements.

The FCA is undertaking a major programme of work to ensure it is ready to regulate consumer credit when it moves from the Office of Fair Trading on 1 April 2014. The Government set two objectives for the new regime: strengthening consumer protection and creating a proportionate regime for firms.

The FCA will ensure an appropriate continuity between the OFT and FCA regime, particularly where this benefits consumer protection. In the autumn it will consult on which aspects of OFT guidance it intends to bring into the Handbook as rules or guidance. Furthermore, the FCA is mindful of the role the Consumer Credit Act, the Consumer Credit Directive and various other legislation or guidance impact the way it regulates. It has, in its first consultation paper in March 2013, already set out its proposals to create a proportionate regime, based on different risk categories. More details will be published in the autumn consultation paper.

The Panel quite rightly stresses the importance of cooperating and building relationships with stakeholders for the new regime. The FCA has already established close working relationships with the various trade associations, industry bodies and consumer groups and look forward to developing those relationships further. It has also begun to communicate directly with OFT licensees. Its engagements at this stage are to help build understanding of and confidence in the FCA's approach to consumer credit regulation, and to get firms ready for interim permission and in due course full authorisation.

Enforcement action will be just one of the many regulatory tools the FCA will use to promote competition and protect against consumer detriment.

Firms that are currently OFT licensed will experience more proactive, forward-looking supervision, targeted use of powers around product intervention and financial promotions and a more stringent authorisations process. The FCA's aim will be to work with firms to quickly take action if it feels they are not meeting its requirements, and to use the powers at its disposal to deliver real value to consumers.

### *Mortgages*

The Panel are monitoring developments on the Mortgage Directive and are keen to ensure that it integrates seamlessly with the MMR.

The FCA, and previously the FSA, has been very closely engaged with European institutions over the negotiations on the Mortgage Credit Directive, and took full account of it when finalising the MMR. Consequently, the MMR changes mean that the UK is already well placed to give effect to many elements of the Directive because the policy objectives are aligned.

The approach adopted with the MMR has been to ensure that the FCA Policy and Supervision Divisions work closely together, to aid the successful implementation of the reforms; this model will continue for the Mortgage Credit Directive.

### *General insurance*

The Panel highlights that they believe there needs to be more focus on treating customers fairly in the general insurance market. In particular it is concerned that policies tend to be promoted on price alone and there is little other information for consumers to focus on.

The FCA's approach to general insurance is holistic. Through its thematic and supervisory work it is working to tackle strategic problems and risks to consumers that are driven by structural issues, as well as focussing on tactical solutions. The FCA is looking at risks and issues related to focus on headline price, and its work in this area will include a review of the risks that price comparison websites present to consumers. The FCA will work collaboratively with consumer and industry representative bodies, where it can, to deliver increased consumer and market trust and confidence.

### *RDR*

The Panel still has some concerns around the implementation of the RDR. In particular they are concerned about the possible manipulation of the passporting facility by firms based elsewhere in the EU. The Panel is keen that the FCA remains vigilant in scrutiny of the implementation of the RDR and ensures that firms are complying with the spirit of, not just the letter of, the law.

The Long Term Savings & Pensions Sector Team has a broad risk identified that highlights conduct risks arising from inwardly passporting firms. This risk was also identified by the RDR implementation team specifically in relation to the post 2012 COBS and Threshold Condition changes. Some analysis of the market and the level of risk has been undertaken, findings indicate that

at present this risk shows no sign of crystallising to a degree that will impact the FCA's risk tolerance. However, the Sector Team will continue to monitor market trends and changes, and will escalate any changes through their standard risk reporting framework.

#### *Enforcement (higher penalties)*

The Panel commended the FSA's tougher stance on enforcement and has urged the FCA to continue this – and to go further. They have called for higher penalties to discourage poor industry practice.

The FCA notes the Consumer Panel's comments about penalties. It will keep under review whether its enforcement actions, including – but not limited to – fines, are achieving credible deterrence.

#### *Consumer vulnerability*

The Panel are concerned that terms such as consumer disadvantage and vulnerability are used interchangeably in public debate. They also highlight that vulnerable consumers are not just those on low incomes and that equally consumers in poor health or in rural communities are not always vulnerable or disadvantaged. The Panel encourages the FCA to adopt a more sophisticated framework to define consumers who are vulnerable or disadvantaged.

The FCA is aware of the need to define such terms in ways which are relevant for us as the regulator of financial services in the UK. As such, it is developing a narrative to define what it means, recognising that the way it defines and talks about risk will be a central plank of its risk architecture. The FCA has focussed initially on the terms consumer detriment and vulnerable consumers. It is informally discussing these ideas with stakeholders. The FCA needs to ensure that any definitions work for consumers and industry and also help the it meet its objectives. The FCA recognises that consumer vulnerability is a dynamic rather than static state.

