

Financial Services Authority

Fourth Annual Report of the FSA Small Business Practitioner Panel

May 2003



This is the fourth Annual Report of the FSA Small Business Practitioner Panel to the Board of the FSA.

The Annual Report describes another busy and challenging year for the Panel. It sets out details of the key issues that we particularly wish to draw to the Board's attention and a number of other matters of current and future importance. The Report also includes summaries of our responses to FSA consultation papers.

We are grateful to Panel members for the time, commitment and effort at our formal meetings and more generally. Their expertise in representing the interests of small firms and the valuable contribution that they make on behalf of this important industry sector should not be underestimated.

On behalf of the Panel, we would also like to thank FSA staff for their contribution to the Panel's work over the last twelve months.

We believe that the Panel has had and will continue to have a crucial role to play in helping to shape the FSA's policies in the way that they will affect small firms, and in monitoring the FSA's performance in the delivery of these policies.

Michael Quicke and Roger Sanders OBE
Joint Chairmen
FSA Small Business Practitioner Panel
May 2003

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Panel press release, December 2002

1 Executive summary

This is the fourth Annual Report of the FSA Small Business Practitioner Panel (the Panel) to the Board of the Financial Services Authority (the FSA). The FSA set up the Panel in 1999 to represent the views of small regulated firms. The Panel's membership is drawn from small financial services firms across all sectors, and so it is well placed to offer input and views on the impact of regulatory policy (and other relevant issues) on smaller firms. The membership and terms of reference are included as Annexes A and B respectively to this Report.

The Panel believes that small firms have an important part to play in delivering competitive financial services to consumers and in providing access to financial advice. The Panel believes that the current pace of change for small firms (not all initiated by the FSA) will result in an unnecessary reduction in their number and prosperity. So, the Panel asks that the FSA takes whatever action it can to reduce this adverse effect on small firms.

Section 2 of this Report sets out in detail the issues that the Panel particularly wishes to draw to the Board's attention; it considers these issues to be of key importance and concern. In doing this, the Panel endeavours to both revisit the issues raised in its previous Annual Report, to review progress and identify where there is continuing concern, and to bring matters of emerging concern to the Board's attention.

This section gives particular prominence to issues and concerns arising from the recent Survey (the Survey) of regulated firms undertaken by the Financial Services Practitioner Panel (the Practitioner Panel). This is an important area of focus for the Panel as the results are supported by hard data and statistics from the industry. **Whilst a number of individual performance criteria have improved, it is notable that where the results were negative, small firms felt even more strongly than larger businesses.**

Regulatory overload and the cost of compliance – given the more limited resources available to small firms – remain of concern. At the same time, difficult economic and market conditions are putting pressure on the industry. **It is important that the FSA recognises the need to consider the overall impact on small firms when deciding if, how and when to implement its policies.** Following the current raft of reviews and initiatives (many of which are fundamental in nature) a period of relative stability would be welcomed.

The Survey also identified the need for the FSA to **improve the navigability of the Handbook**. It is important that the Handbook should be easy to read and navigate, and be readily understood. Small firms would find the development of an easy-to-use search facility particularly beneficial.

The way in which the FSA applies and enforces its Rules and Guidance is also of importance to small firms, with **the concern that the FSA will fail to apply and enforce its Rules on small firms in a proportionate and common-sense way**. The Panel is also concerned that Guidance will be interpreted as a best practice for all firms, whatever their size – this could have the effect of further increasing costs for small firms.

Section 3 of the Report gives background to a selection of other matters which the Panel has discussed on a number of occasions during the previous year and which are likely to continue to have an impact (and therefore a place on the Panel's agenda) going forward. In particular, this relates to the Panel's work on the **impending regulation of mortgage and general insurance intermediation, depolarisation (and related matters), professional indemnity insurance, capital adequacy requirements and money laundering**.

Section 4 summarises the work of the Panel over the last year and, in particular, the responses that it has made to the FSA's consultation papers.

Section 5 – This looks forward at the Panel's forthcoming agenda. The Panel plans to build **stronger links with external stakeholders** such as the trade associations and will also be considering how best to measure its **effectiveness**, to enable it to add more value to the FSA and others. Whilst the timetable and scope is presently unconfirmed, the Panel also expects that it will have a contribution to make to the **Treasury's intended review of the Financial Services and Markets Act 2000, two years on (N2+2)**.

2 Key issues

2002 Survey by the Financial Services Practitioner Panel

The Survey of regulated firms undertaken by the Financial Services Practitioner Panel and published in November 2002 provides a valuable insight into the regulated community's perception of the FSA's performance. The Panel feels that the Survey is a natural backdrop to this Report given that the results are supportable by reliable and quantifiable data, rather than predicated on suggestion or opinion.

The Survey results give positive feedback as well as criticism of the FSA and, overall, small firms do not perceive a deterioration in the FSA's performance since the previous survey in 1999. Ratings for some individual performance criteria have in fact improved. However, where the results were negative, small firms felt even more strongly on the issue in question than larger firms.

A number of matters arising from the Survey are explored in greater detail elsewhere in this Report. These mention particularly, the cost and complexity of compliance, the ease-of-use of the Handbook of Rules and Guidance and the availability and provision of individual guidance. However, it is opportune here to mention briefly several other issues from the Survey for completeness.

Smaller firms did support the FSA's tough line with offenders and considered that it was effective in listening to consumer views. That said, small firms had a lower regard for the perceived inflexibility of the FSA to interpret the Rules with common sense and to use its resources economically and effectively. The FSA has already indicated that it will be working to address the concerns expressed in the Survey in the coming year and the Panel will continue to monitor its progress. The Panel understands that the FSA will publish a formal response to the Survey in its own forthcoming Annual Report and will review that response with interest.

The section of the Survey that deals with small firms as a separate group is appended as Annex C, as is a copy of the Panel's press release issued when the Survey results were published. Also, the Practitioner Panel has recently launched its own website – at www.fs-pp.org.uk – containing more detail and context.

The number of initiatives and the regulatory impact

Initiative fatigue is a concern expressed across the industry. At the moment, there is a whole series of proposals and reviews on the table, a number of which overlap or impact one another. Although it is acknowledged that some of these matters are driven by forces outside of the FSA's direct control – for example, by the Treasury or directives from the EU – dealing with these initiatives is particularly difficult for small firms. They find it harder to devote sufficient time to considering and responding to papers from the FSA and to cope with the subsequent implementation of new Rules and Guidance.

Firstly, small firms generally have more limited resources to apply to compliance. These resources are already stretched to breaking point in dealing with the changes that have already happened. And there is an increased risk that small firms will inadvertently break Rules because of the added pressure caused by their difficulty in absorbing the speed and detail of change. This is especially the case given the current difficult and uncertain economic and market climate.

Further, there is confusion and anxiety about the consequences and implications of change on the industry. The number of reviews makes it hard for small firms to envisage how the **overall effect** of implementation will work in practice and impact on their ability to continue operating profitably.

Cost benefit analyses should consider more carefully the impact on smaller as well as larger firms. It may well be possible to defend each individual provision on the basis that the benefit justifies the costs involved. But the Panel asks whether it is time for the FSA to consider how best the **totality** of these changes could also be the subject of similar assessment. The risk of small firms failing or otherwise reducing in number is very real and the effect that this would have on competition and the services available to consumers must not be underestimated. These comments should also be seen in the context of many other financial pressures bearing on small firms, some of which are referred to in Section 3. These include the widespread increased cost of professional indemnity insurance and the likely increase in capital requirements.

The Panel asks that the Board take the above comments into account and that, **wherever possible, the pace of change be reduced.** Ideally, the Panel would welcome a period of relative stability where small firms have a chance to consolidate their position in the market rather than having to contend with the seemingly continuous cycle of change. We would urge the FSA to **consider**

carefully the timetable of proposals to ensure that undue burdens are not placed on small firms by premature or early implementation. To paraphrase from the recent Annual Report of the Practitioner Panel, to prioritise ‘must-dos’ over ‘nice-to-dos’ – to do so sensibly and with small firms very much in mind.

The FSA Handbook

By the FSA’s own admission, its Handbook of Rules and Guidance has been found by many to be both difficult to navigate and to understand. These concerns were highlighted in the Practitioner Panel Survey, which indicated that views on the Handbook were generally negative, particularly with smaller organisations. It should be remembered that, unlike their larger counterparts, smaller firms will generally not have large numbers of dedicated compliance staff or extensive technical expertise in this field. **While the Panel acknowledges that some improvements to the Handbook have been rolled-out in recent months (since the Survey), it does not believe that these enhancements go far enough.**

For example, the Panel considers it of great importance that small firms have an easy-to-use search facility to enable them to locate the relevant Rules and Guidance applicable in any given set of circumstances. This would be useful in particular where firms are considering embarking on new activities or initiatives. Small firms would also benefit from the separation of core and non-core provisions – those that are regarded as a mandatory requirement of authorisation and those that only apply in particular circumstances. They would also benefit from, as far as possible, the provisions being further split by type of business or industry sector. A separation of Rules from Guidance would also be well received by smaller firms.

The attitude of practitioners to the Handbook of Rules and Guidance (especially towards new provisions), and to compliance generally, is an important step towards effective compliance and is fundamental to success. The Panel believes it is important that the FSA recognises this. It is one thing to make an amendment to the Handbook, it is quite another to educate those affected in both the letter and, equally importantly, the meaning of that change. This is largely a communications issue and the Panel is aware that the FSA is actively working on ways to improve communication with small firms. The Panel welcomes the FSA’s invitation to participate in that exercise and hopes that it will make a valuable contribution on this important subject.

Finally, there is a concern among the Panel that Guidance may become, and is being interpreted as, a best practice benchmark by the FSA, thereby rule-making by the back door. The Panel will continue to keep this particular aspect under close review. **It hopes to ensure that the capacity exists within the**

FSA, and in particular among its front-line supervisors, to deliver what is intended by policy at the coal-face, and to do so proportionately in light of the different market position of small firms.

It is important that the ability of small firms to operate in a flexible, pragmatic fashion, where innovation and competition is able to flourish, is not stifled by a heavy-handed application of the status and purpose of Guidance. The Survey also noted that small firms found it difficult to get individual guidance from the FSA. The Panel welcomes the FSA's assurance that it is working on a programme to streamline its processes for giving reliable and prompt guidance in order to address this important concern.

3 Other matters

Professional Indemnity Insurance

The position of the PII market is of particular and immediate concern to the Panel. This appears to be attributable to a number of factors, including the general economic and market conditions and the growth in demand for compensation both generally and in certain high-profile areas of activity (for example, endowments and split capital trusts).

This raises real concerns both in terms of availability and price. A significant number of small firms have been unable to secure cover at all (on either a compliant basis or otherwise) and, where they are able to do so, it is often at a much higher price. This adds further financial pressure to the firms involved. It is reported that underwriting capacity in the market is extremely limited, that in some circumstances there is a 'rationing' of capital, and that very limited risk assessments are being undertaken.

The Panel understands that the FSA has limited power over the price and availability of PII, and welcomes the proposals in the recent FSA Consultation Paper (CP169), which seek to increase market capacity and encourage underwriters to write more business. The Panel has considered this paper carefully and has responded to the wider options (including the possibility of establishing an industry mutual) set out for discussion. While the FSA's policies are under development, **the Panel would urge them to act with pragmatism when it comes to deciding what (if any) action should be taken against those in contravention of the requirements.** And, the Panel asks the FSA to put these considerations in the context of the market conditions. That said, the Panel appreciates that there may well be cases where strong action is justified.

Reforming polarisation and connected proposals

The Panel continues to follow keenly the development of the proposals for depolarisation (along with, in particular, the proposed regime for simplified ‘Sandler’ products). The Panel welcomes the news that the FSA will not be pursuing the introduction of the ‘defined payment system’ but has instead proposed a ‘menu’ approach to help achieve more transparency in the cost of advice. It is important that the ‘menu’ is introduced throughout the market and not just for those who continue to be called ‘independent’. The Panel has responded formally to CP166 and is, amongst other things, concerned about the right and appropriateness of the use of titles such as ‘independent’ and ‘adviser’. The Panel has also expressed anxiety at how best a firm or individual’s status could and should be designated and disclosed to minimise the risk of consumers being confused or misled. But, at the same time, ensuring that the services being supplied are described in a manner that does not detract from the professionalism and standing of the firm or individual involved.

The Panel has continuing concerns about the overlap of depolarisation with the findings of the Sandler review and the outcome of these on the proposals. It understands that the FSA is fully aware of the need to co-ordinate work in this area and to make clear to the industry the work being done to draw the various strands together. The Panel will continue to watch closely the impact of these various reviews on small firms.

The future regulation of mortgage advice and general insurance intermediation

The Panel supports the decision to bring regulation of these areas within the FSA’s remit and the views it makes known in response to consultation and discussion papers will be set in this context. It is however a significant area of work, with a large proportion of firms in both sectors being small businesses. So, the Panel expects to continue to have a significant input as the policy framework makes its way into the Handbook. **It is important that there is consistency in the use and definition of the term ‘independent’. And that regulation in these two new areas is applied with as light a touch as possible to reflect the nature of the business and the risks involved.** The Panel will continue to work with the FSA to help it ensure that the authorisation process for what will be a significant number of firms and individuals operates smoothly. In particular, there will need to be an effective communication plan in place so that those affected by the new regime are properly aware of and understand the impact that regulation will have on them. This will need to cover both the timetable and management of the authorisation process and, of course, their regulatory obligations thereafter.

Money laundering

In last year's Annual Report the Panel expressed concern about the processes for designing and implementing money laundering rules and guidance notes. Since then, discussions about money laundering requirements have progressed considerably. The Panel have been pleased to see far greater clarity on the respective responsibilities of the Treasury, FSA and Joint Money Laundering Steering Group.

However, whilst understanding the intent of the initiative between the FSA and the six largest banks to undertake a money laundering customer review, the Panel would like to raise a point of principle here. Although this will be subject to consultation before being implemented across the industry, **there is a risk that the original agreement with the six banks could pre-empt the results of that consultation.** The importance of preventing money laundering is fully understood, but we seek reassurance that the approach taken here was extraordinary and will not be repeated as a routine regulatory tool. The Panel's concern is that what might be a successful initiative with larger banks might not be the best approach for smaller firms.

Finally, the Panel has been involved in the early stages of a project underway within the FSA to produce a CD ROM training package on the money laundering provisions, aimed principally at IFA firms, for low-cost distribution. The Panel welcomes this initiative and hopes to continue to participate in developing a valuable tool for a sector that consists of a large number of small firms.

Capital adequacy

The Panel's concerns about the application of capital adequacy standards to small firms have not lessened. In its last Annual Report the Panel stated that its two main areas of concern were how the FSA used its discretion in the implementation of EU directives, and the way in which the FSA generally applied capital adequacy standards. **If small firms are required to hold proportionately more capital than are larger firms, this will impact on their ability to compete.** The Panel will also be considering, against this backdrop, the proposition of a trade-off between PII and financial resources held by firms (as discussed in CP169) and whether any such arrangement could work in practice to the benefit of small firms and without creating further financial pressures.

4 Summary of matters considered by the Panel

This section summarises all the formal responses made by the Panel to consultation papers from the FSA since the previous Annual Report in May 2002.

Topic	Main points
CP128: Liquidity risk in the integrated prudential sourcebook: systems and controls chapter	The Panel found the proposed flexibility, with standards to be proportionate to the size and complexity of firm, encouraging for small businesses. The response did however reiterate concern expressed in the earlier response to CP97 that what was proposed as Guidance should not become Rules in effect by becoming expected as best practice. There was also concern about the applicability and impact for small firms of stress and scenario testing.
CP132: The presentation of past performance and bond fund yields in financial promotions	The Panel gave a reasonably detailed response to this CP. The concerns covered in the response included worry that insisting that past performance in advertising should not be the predominant message would disadvantage small firms. This is because smaller firms do not have the same advantage in the market place of a well-recognised name and widely known reputation, and therefore rely far more on performance as a selling point. They favoured instead a standard presentation of past performance.
CP136: Individual capital adequacy standards	The main tenor of the Panel's detailed response was concern about the proportionality of the effect on small firms and their ability to cope with a significant burden of change management and uncertainty, particularly in light of their lower impact.

Topic	Main points
CP140: The interim prudential sourcebooks for insurers and friendly societies and the Lloyd's sourcebook: guidance on systems and controls	<p>The Panel welcomed the introduction of the systems and controls module guidance, but had a major concern that the PSB as envisaged would generate a considerable increase in the number and level of complexity of control monitoring requirements. There was a potential burden for smaller firms in general in terms of resource and management time. This was linked to concern that the regulatory framework was in danger of becoming so specific and complex in its requirements that it was becoming inflexible and may reach the point where it in effect dictated the structure of a firm's organisation. Small firms may have a less formal structure but often have strong informal control arrangements, and this should be recognised.</p>
CP142: Operational risk systems and controls	<p>The response referred to the anxiety that Guidance would become Rules by becoming expected best practice. Although costs of implementation were seen as reasonable, the Panel said it intended to keep a watching brief on costs creeping upwards due to increasing expectations.</p>
CP143: Integrated prudential sourcebook: feedback on chapters of CP97 applicable to insurance firms and supplementary consultation	<p>The Panel commented on a range of issues in the consultation, in particular on the increased dependence of small firms on reinsurance. There were resultant concerns that the Rules for measuring reinsurance credit risk should not be rigidly applied to the detriment of small businesses. This greater involvement in reinsurance might also involve smaller firms in a disproportionate share of the overall cost. There was a further specific concern about the effect of changing the tax status of resilience reserves.</p>
CP145: Interim prudential sourcebook: insurers and friendly societies	<p>The Panel gave a brief response to this consultation, questioning the logic for deducting internally generated goodwill from market value.</p>
CP146: The FSA's approach to regulating mortgage sales	<p>The Panel gave a detailed response to this consultation, and emphasised the importance about consistency in use of the term 'independent'. The main thrust of further comments included:</p> <ul style="list-style-type: none"> • a concern to see the availability of standardised and clear information for consumers balanced against ensuring information was not so long that consumers are put off from reading it properly; • a desire to see the regulation of lifetime mortgages handled carefully; and • the need for acknowledgement that there are many consumers who are well-informed of the options available to them.

Topic	Main points
CP146: Best execution	The Panel supported the deferral of the review of best execution arrangements pending progress in respect of the Investment Services Directive. The existence of a clear and effective benchmark against which to measure best execution was considered important. The Panel remained unconvinced that the impact on small firms would be low. It was unclear how the FSA would monitor compliance with best execution on a risk based approach.
CP157: Examination framework for retail financial services	The Panel was concerned to ensure that the proposed new structure did not create barriers of entry to the industry or an unattractive career path for recruits. There was broad support for the desire to enhance the overall level of professionalism, although it was difficult to estimate the number of modules required in order to achieve qualified status. It was considered important that consumers were able easily to identify the competence of their adviser through designatory letters or descriptors. The Panel would not welcome the introduction of formal periodic assessments prescribed by the FSA.
CP159: Appointed representatives – extending the regime	The Panel submitted a detailed response in respect of the specific questions posed in the paper. It was generally in agreement, although it was important that the new regime did not impose undue restrictions on firms or disadvantage consumer choice and protection. Nuances of the mortgage and general insurance marketplaces needed to be properly recognised. Option 3 was considered to be the most appropriate model.
CP160: Insurance selling and administration	The Panel made a detailed response which included, in particular, concerns about super-equivalence and the need for a proportionate regulatory regime in the context of; for example, cost implications, training, access to FOS and the definition of private customer.
CP163: The UCITS Management Directive	The Panel welcomed the proposal to allow the full 5 year transitional period but was concerned about the prospect of super-equivalence in certain areas. We also commented on the ability to provide discretionary fund management services, and on various other implementation issues of relevance to small firms.

Topic	Main points
CP166: Reforming polarisation	<p>The Panel submitted a detailed response that was generally supportive of the proposals contained therein. The Panel expressed the need for stability and a level playing field for small firms, along with stressing the importance of the disclosure provisions. We welcomed the decision to replace the defined payment system with a menu option. The Panel was concerned about the use of certain titles and terms; further clarification and/or greater prescription from the FSA may therefore be required.</p> <p>At the same time, the Panel submitted a response to the FSA's DP19 – Options for regulating the sale of simplified investment products. This indicated that the Panel felt that option 2 was the closest to being a workable and sensible solution, although certain aspects thereof would require further consideration to avoid potential concerns materialising. The right of access to FOS would also require clarification.</p> <p>In addition, the Panel produced a response to the HM Treasury paper on the proposed suite of 'Sandler' stakeholder products. This focused principally on the need to ensure that the level and structure of charging arrangements were such that the manufacture and marketing of these products to those on low to moderate incomes was encouraged.</p>
CP168: Fees 2003/4	<p>The Panel acknowledged the financial pressures faced by the FSA. Whilst welcoming the relatively modest rise in minimum fees, small firms would be concerned about the proposed increases in annual fees, which averaged between 9 and 10%. Further such increases in the future could cause the cost of regulation for small firms to become disproportionate and harm their ability to compete.</p>
CP169: Professional indemnity insurance	<p>The Panel submitted a lengthy response which rehearsed its concerns about the PII marketplace generally and, whilst broadly welcoming the proposals, was uncertain whether these will have the desired positive effect on insurers and underwriters. The relationship between PII and capital is worthy (with some reservations) of further exploration, as is the establishment of an industry mutual. The granting of wholesale temporary relief should also be considered by the FSA if the market fails to improve.</p>
CP170: Informing customers – product disclosure at the point of sale	<p>Whilst supportive of the proposals in principle, the Panel's response dealt mainly with issues over the timing and cost of implementation, certain super-equivalence aspects, the detail of the cost benefit analysis and the format/content of Key Facts and suitability letters. Concerns relating to the FSA's supervision and enforcement of the proposed Rules and Guidance were also raised.</p>

5 Looking forward

The Panel held an away-day in September 2002. This was a productive and useful meeting at which it focussed on how it should organise and prioritise its business and time. The Panel will also shortly be undertaking an exercise designed to measure its effectiveness and the value that it adds for the FSA and small businesses.

Not that long ago the Panel had expected, post-N2, to be seeing a lessening of the number of consultation and discussion documents. What has been seen is a continuation in the number of important papers of interest to small firms. Considering and responding to these will remain a major part of the Panel's work. It will wish not only to comment on the detail of these proposals, but also to seek to ensure that the interests of small businesses are generally being considered and taken into account. In anticipation of the impending mortgage and general insurance regulatory regime, the Panel has recently appointed two new members specifically to represent the views of this sector, which includes a large number of small firms.

As stated earlier, the Panel does not believe that cost benefit analyses are fully taking into account the combined effects on small firms of the various proposals being considered. Therefore, the Panel will continue to press on this point.

The Panel will also consider how its links and relationship with other stakeholders, including the trade associations, could be enhanced. Some amendments have been made to the Panel's terms of reference to help achieve this aim.

Whilst the scope and timing is currently unconfirmed, the Panel will also consider whether and how best it might be able to contribute to the Treasury's intended review of the Financial Services and Markets Act 2000, two years on. This is potentially an important opportunity to examine how FSMA and the FSA have operated in practice and whether there are any areas arising

which the Treasury may consider would benefit from refinement in light of experience.

The Panel will also continue to make itself available to the FSA to give feedback on the development and evolution of the Handbook.

Finally, the Panel continues to enjoy an excellent relationship with FSA staff and, in particular, those that prepare and present papers to the Panel, who always do so in a suitably professional and helpful fashion. The Panel appreciates the time given by FSA staff in explaining policy proposals and developments and in listening to its views. The Panel is particularly appreciative of Michael Folger for the time, assistance and information that he gives at our regular meetings.

The Panel is also most grateful for the invaluable support it received and continues to receive from its secretariat function; in particular, Claire Strong, Chris Cherlin and Amanda Scott. Their efforts in helping to manage our workload and output have contributed greatly to our overall operation and success. The Panel can be contacted by email through its secretariat at the FSA – claire.strong@fsa.gov.uk or chris.cherlin@fsa.gov.uk; or in writing to the FSA's offices.

6 Background to the Panel

The Panel has 13 members covering the full range of small businesses operating in financial services. The current membership includes representatives of credit unions, friendly societies, sole practitioners and independent financial advisers, as well as the smaller banks, building societies, insurance companies, professional regulated firms, fund managers, derivatives and securities houses. There is a list of current members in Annex A and the Panel's terms of reference are in Annex B. The Panel has also recently appointed representatives from mortgage and general insurance intermediaries in light of the decision to bring these activities under the FSA's regulatory regime.

Michael Quicke and Roger Sanders are the joint chairmen of the Panel. They also represent the interests of small businesses as ex officio members of the Financial Services Practitioner Panel, which has statutory status under the Financial Services and Markets Act 2000.

Michael Quicke and Roger Sanders OBE
Joint Chairmen
FSA Small Business Practitioner Panel

Membership of the Small Business Practitioner Panel

Michael Quicke – Joint Chairman	Banking and investment management: Group Chief Executive, Leopold Joseph, Private Bankers.
Roger Sanders OBE – Joint Chairman	Independent financial advice: Employee benefits consultants Principal, Roger Sanders Associates. Director of Rasmala Investments (UK) Ltd; Former member of the Board of the PIA. Deputy Chairman of the Association of Independent Financial Advisers.
Rod Ashley	Credit union: General Manager, Scotwest Credit Union. Awarded a Young Credit Union Professional scholarship in 2002 by the World Council of Credit Unions.
Stephen Atkins	Mortgage brokers: Compliance Director, Mortgage Next; Director of The Association of Mortgage Intermediaries, a Divisional Board of AIFA.
Simon Bolam	General insurance intermediation Principal, E.H. Ranson & Co; Chair of the General Insurance Standards Council (GISC) Smaller Practitioners' Committee and member of the Board of GISC; Chair of the Chartered Insurance Institute Audit Committee; Past President of the Chartered Insurance Institute (CII) and Past Chairman of British Insurance Brokers Association (BIBA).
Graham Doswell	Insurance company: Managing Director, Ecclesiastical Insurance Group; member of the Board of the Association of British Insurers; Vice President of the Chartered Insurance Institute.

Ruthven Gemmell	<p>Investment Management and Solicitors, Accountants and Actuaries:</p> <p>Partner, Murray Beith Murray WS. Member of The Council of the Law Society of Scotland and Chairman of its Investor Protection Committee; Member of the Financial Services Committee and the Law Society of England and Wales.</p>
Philip Ireland	<p>Stockbroking and investment management:</p> <p>Director, TD Waterhouse Investor Services; Managing Director TD Waterhouse Bank NV.</p>
Ian Jolliffe	<p>Unit trust managers:</p> <p>Managing Director Exeter Fund Managers Limited. Member of the Board of IMA. Former Deputy Chairman of AUTIF.</p>
Mark Rothery	<p>Friendly society:</p> <p>Chief Executive, Ancient Order of Foresters Friendly Society Limited; Member of the Board of the Association of Friendly Societies (AFS); Chairman of the Legislation sub-committee of the AFS.</p>
Chris Thompson	<p>Derivatives firms:</p> <p>Director, Berkeley Futures Limited.</p>
Neville Thompson	<p>Building society:</p> <p>Chief Executive, Earl Shilton Building Society; Chairman of the Midlands & West Association of Building Societies; Director of the Financial Services National Training Organisation.</p>
Gavin Tisshaw	<p>Independent financial advice:</p> <p>Corporate and personal financial planning</p> <p>Chairman, Executive Advisory Services Limited; Director and Past-President of the Life Insurance Association.</p>

Terms of reference for the Small Business Practitioner Panel

- 1 To consider from a small business perspective, and to advise the FSA, on the cost and practicability implications for small businesses of:
 - the overall impact of regulation and its potentially disproportionate impact on small businesses;
 - the implementation and development of the FSA Handbook of rules and guidance, and proposals for changes to rules and guidance;
 - proposals contained in FSA consultation and discussion papers;
 - the FSA's implementation and continuing development of its policy and procedures in the following areas
 - authorising firms and approving employees, including grandfathering provisions
 - supervision, and the effect of the implementation of the risk assessment framework and consequent move away from front line contact with small firms.
 - enforcement and disciplinary processes
 - the level of FSA fees and their distribution across types of firm and 'fee blocks', paying particular regard to the impact on small firms
 - training and competence requirements
 - cost-benefit analysis, research and performance measurement;
 - the policies and procedures for handling consumer complaints (the Financial Ombudsman Service) and compensation (the Financial Services Compensation Scheme) and the FSA's input to developing strategy in these areas;

- FSA's theme related work;
 - any other aspects of the FSA's operations and functions which are of particular significance to small businesses.
- 2 To advise the FSA on emerging regulatory, consumer protection, public awareness and industry structure issues which the Panel considers to be of special significance to small businesses.
 - 3 To consider and make recommendations on any matters referred to the Panel by the FSA, or by the Practitioner Panel or Consumer Panel.
 - 4 To report annually to the FSA Board on the work of the Panel, at the May Board meeting, and to present a written interim report in November.

Relationships with other bodies

- 1 The Chairmen of the SBPP to attend Practitioner Panel meetings as ex-officio members and to provide the Practitioner Panel with updates on issues specifically affecting small firms as appropriate.
- 2 The Panel to meet informally with the Consumer Panel to discuss issues of mutual interest at least once a year.
- 3 The Panel to meet with the Complaints Commissioner, Chairman of the RDC, representatives from FOS and FSCS as necessary to discuss relevant topics.
- 4 Members of the Panel will keep in regular contact with their relevant trade bodies.
- 5 Members will communicate to the Panel relevant issues of concern from their relevant trade or professional bodies and also raise issues of concern to smaller firms with their trade or professional bodies, having regard to the confidentiality of issues raised at Panel meetings.

Membership

- 1 Representatives to be drawn from small businesses from across the spectrum of activities regulated by the FSA.
- 2 FSA will appoint members and seek nominations for membership from any relevant trade and professional bodies.
- 3 The Chairman/Chairmen of the Panel to be selected from amongst its membership by FSA, subject to the Panel's agreement. The Chairman, or joint Chairmen, will normally serve a three year term, having been a member of the Panel for at least a year prior to appointment as Chairman.

- 4 All Panel members to serve for a three year term, which can be renewed with the support of the Chairman/Chairmen. Shorter terms may be agreed between FSA and individual Panel members as appropriate.
- 5 If Panel members wish to retire during their term, the relevant trade or professional body to be asked to put forward two names from whom a replacement can be selected by the Panel. The individual can then serve a full three year term.
- 6 The Director of CoB Standards at the FSA to attend meetings as a matter of course, together with other members of the FSA as appropriate for particular agenda items.
- 7 The Panel to be supported by a Secretariat, comprising the Secretary, a member of staff providing policy support and an administrator.

Extract from the survey carried out by BRMB Social Research, part of BRMB International, on behalf of the Practitioner Panel and published in November 2002

Smaller organisations

The performance scores given to the FSA by practitioners in smaller organisations were lower in most instances than the ratings given by other practitioners, with mean performance scores ranging between 4.3 and 6.3. The overall mean was 4.9, compared with 5.4 for chief executives and 5.6 for heads of compliance.

Chart 3.13: Performance of FSA – Smaller organisations 1

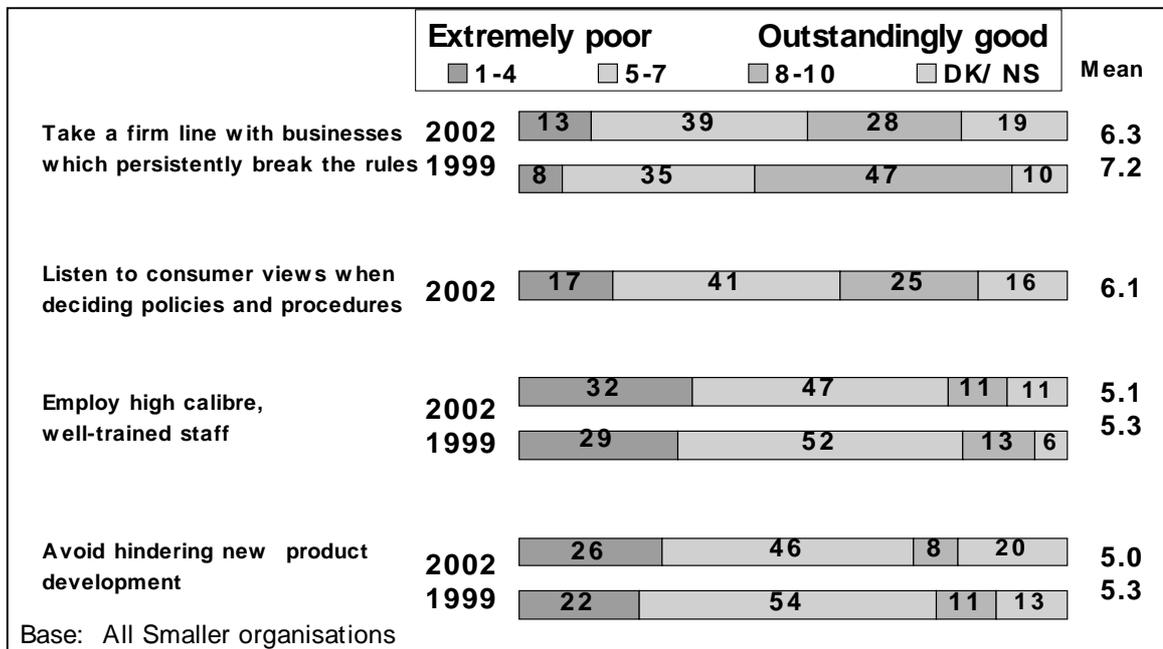


Chart 3.14: Performance of FSA – Smaller organisations 2

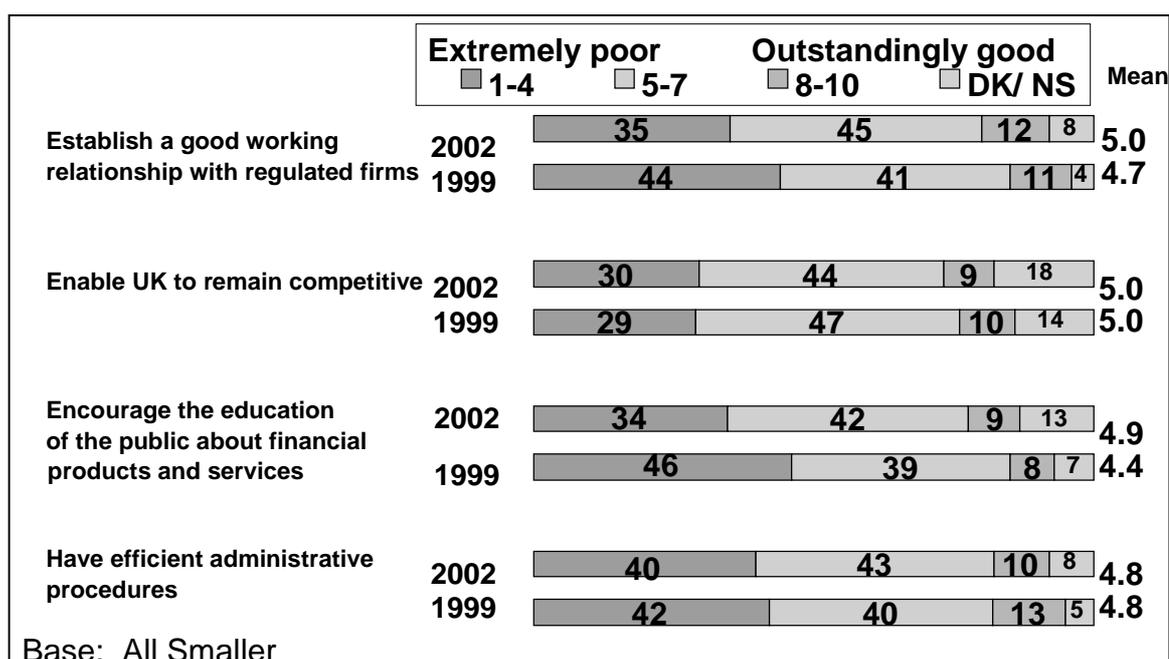


Chart 3.15: Performance of FSA – Smaller organisations 3

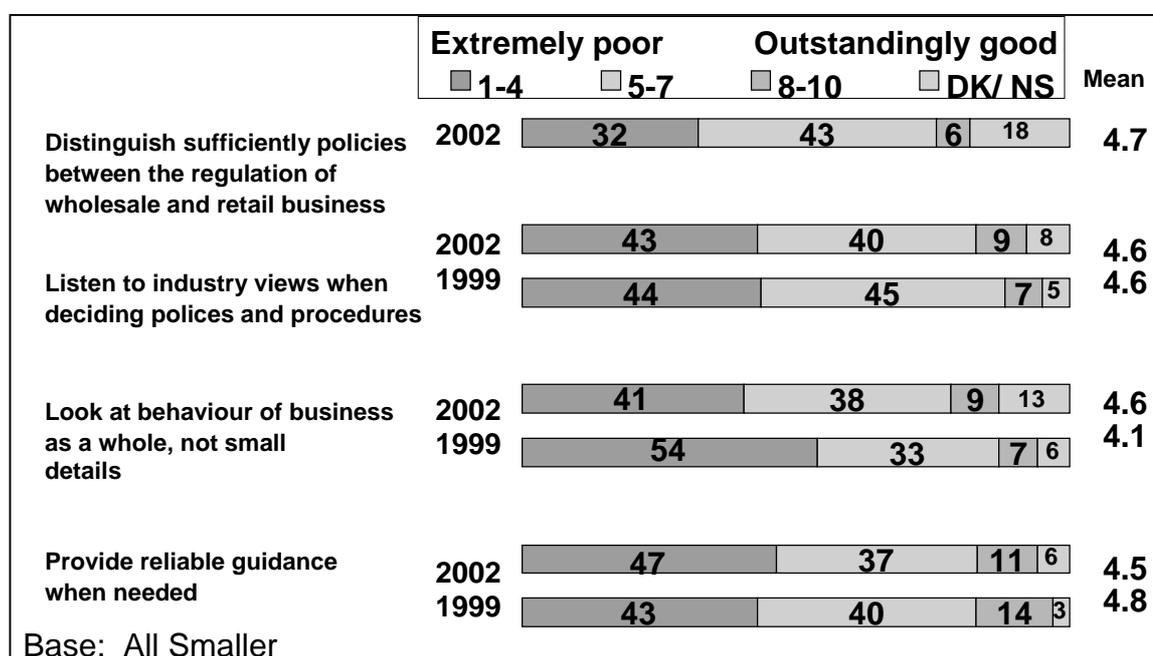
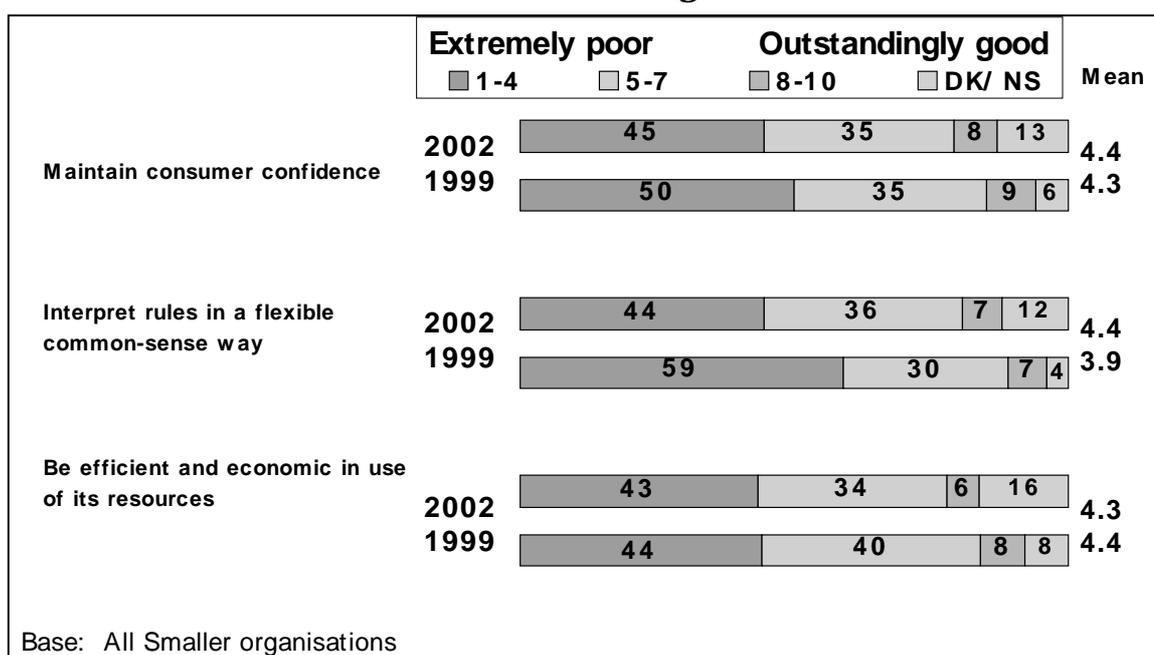


Chart 3.16: Performance of FSA – Smaller organisations 4



The two aspects most highly rated by smaller organisations were the same as for chief executives and heads of compliance. ‘Take a firm line with businesses which persistently break the rules’ had a mean score of 6.3, but as was the case for other practitioners, this was a decrease in perceived performance compared to the 1999 survey when the mean score was 7.2. The new aspect ‘Listen to consumer views when deciding policies and procedures’ had a mean score of 6.1.

The aspects which were given the lowest ratings by smaller organisations were different from those given the lowest ratings by other practitioners. They were ‘Maintain consumer confidence in financial products and services’ with a mean score of 4.4, ‘Interpret rules in a flexible and common-sense way’ also with a mean score of 4.4, and ‘Be efficient and economic in use of its resources’, with a mean score of 4.3. Among smaller organisations, IFAs and firms with life and pensions business tended to give the lowest ratings.

Compared to the 1999 survey, three aspects saw an improvement in terms of average performance ratings, with an increase in mean score of around 0.5 (‘Encourage the education of the public’, ‘Look at the behaviour of the business as a whole, rather than focussing on small details’ and ‘Interpret rules in a flexible ‘common-sense’ way’). Four aspects saw a decrease of between 0.9 and 0.3 in terms of mean score (‘Take a firm line with businesses which persistently break the rules’, ‘Avoid hindering the development of new financial products and services’, ‘Establish a good working relationship with regulated firms’ and Provide reliable guidance when needed’). The rating of the other aspects remained largely unchanged.

This pattern was again different from the results for chief executives and heads of compliance, where only 'Encourage the education of the public' showed any improvement in performance rating, compared with 1999. One possible explanation for this difference is that, in 1999, two-thirds of smaller organisations (compared with between a quarter and a third of the other practitioner groups) had the Personal Investment Authority (PIA) as their regulator. In the 1999 survey, PIA stood out as having lower performance ratings than all other regulators at the time, on 12 of the 13 criteria about which practitioners were asked to judge their regulator.

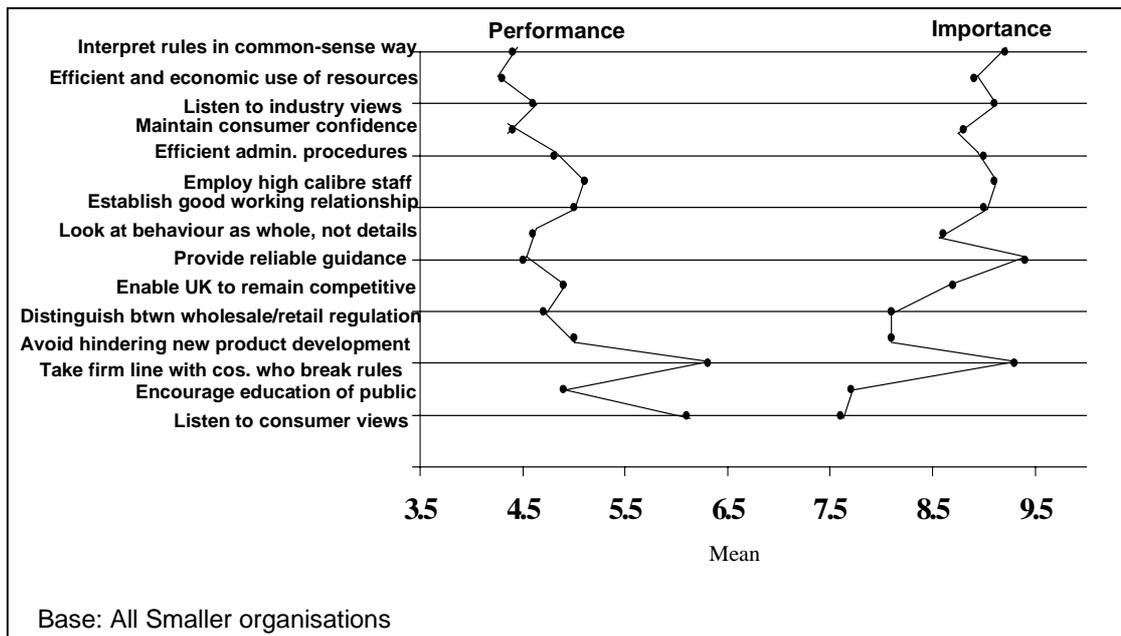
In spite of the improved scores in some areas, smaller organisations were still more negative overall in their perceptions of the FSA's performance than the other practitioner groups, as were their counterparts in the 1999 survey.

The relative distance between what is most important to smaller organisations and how the FSA performs can be seen by plotting the mean scores for both importance and performance on the same chart.

For smaller organisations, the largest gaps between importance and performance were for 'Interpret rules in a flexible common-sense way' 'Listen to industry views when deciding policies and procedures' and 'Be efficient and economic in use of its resources'. Mean scores for importance were around 9 but the mean scores in terms of perceived performance were around 4.5. Again, smaller organisations differ from chief executives and compliance heads, for whom the largest gaps were for 'Interpret rules in a flexible common-sense way', 'Provide reliable guidance when needed' and 'Have efficient administrative procedures'.

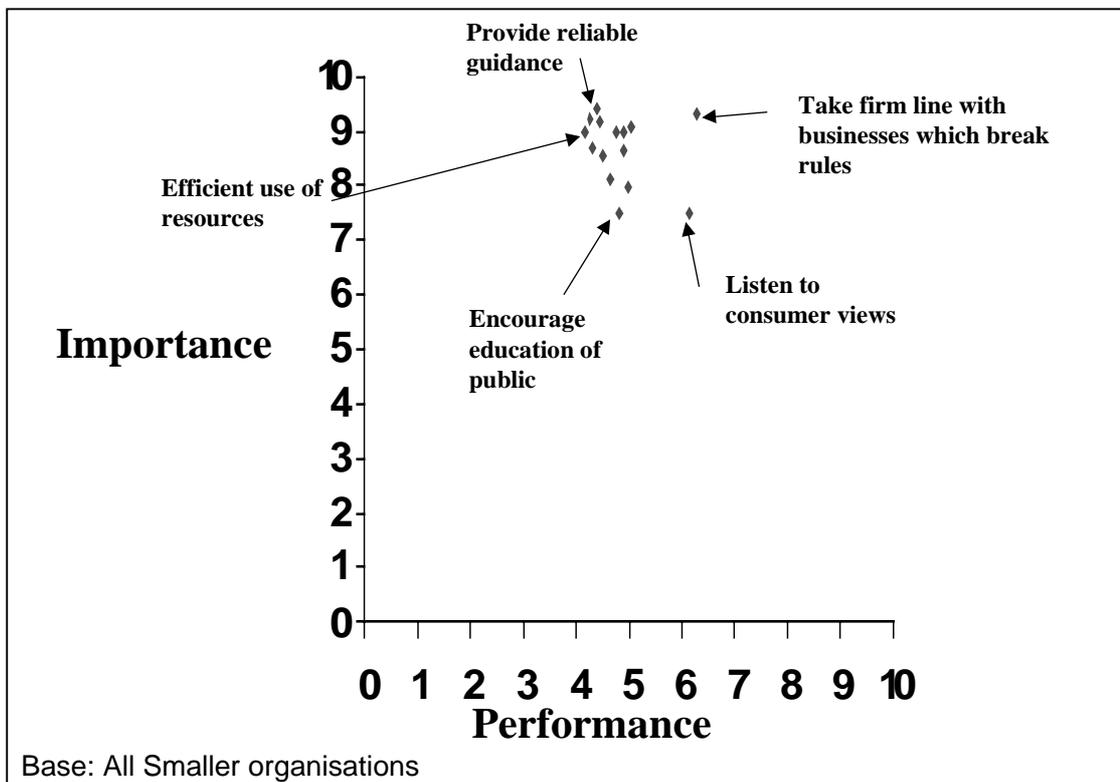
However, the smallest gaps between mean scores for importance and perceived performance were the same as for other practitioner groups: 'Take a firm line with businesses which persistently break the rules', 'Encourage the education of the public about financial products and services' and 'Listen to consumer views when deciding policies and procedures', although the gaps themselves were wider, at around 2-3 points.

Chart 3.17: Importance vs performance Smaller organisations 1



As for chief executives and heads of compliance, mean scores for both importance and performance can be plotted onto a quadrant to show the relative dispersion of the aspects.

Chart 3.18: Importance vs performance Smaller organisations 2



The outliers from the cluster are very similar to the outliers for chief executives and heads of compliance.

For smaller organisations, the aspects of most concern to practitioners were 'Provide reliable guidance when needed' and 'Be efficient and economic in use of its resources', both of which had relatively low performance, but were of high importance.

SMALL BUSINESS PRACTITIONER PANEL – PRESS RELEASE

**For immediate release
6 December 2002**

Small firms feel “burden of regulation” more

Practitioners in small financial services firms are feeling the burden of regulation more strongly than larger firms. This is one of the findings of the Practitioner Panel's survey of regulated firms, published on 29 November 2002.

Speaking on behalf of the FSA's Small Business Practitioner Panel (SBPP), its joint chairman, Roger Sanders, said, “The survey results raise some issues for the FSA's relationship with small firms. Smaller businesses are feeling the burden of regulatory pressure and cost. The FSA needs to decide how it can take better account of their views, particularly with new entrants to regulation from general insurance and mortgage intermediaries being mainly small firms.”

Roger Sanders and Michael Quicke, joint chairmen of the SBPP, are both also members of the Financial Services Practitioner Panel which conducted the research, an authoritative survey of firms in the U.K. and which follows a similar survey in 1999.

Mr. Quicke added: “The survey results give positive feedback as well as criticism of the FSA. Small firms do not perceive a deterioration in the FSA's overall performance since their response to the 1999 survey. Ratings for some individual performance criteria have improved, whilst others have worsened. What is interesting is that in most of the cases where the result was negative, small firms felt even more strongly on the issue than larger businesses. This was also true in 1999. The FSA will need to establish the reasons for this, though some, such as the greater proportionate impact on small firms of meeting regulatory requirements, are obvious. Many of the particular problems for the small firms sector – provision of guidance, using the Handbook – come down to good communication and fair management of expectations. We look forward to the FSA's response to the survey.”

The survey separately analysed the results for small firms, enabling comparison with the results for larger businesses. Some of the key findings were:

- Overall, smaller firms had a lower opinion of FSA's performance than larger firms. They did support the FSA's tough line with offenders and considered it to be effective in listening to consumer views. Small firms however had a lower regard for the perceived inflexibility of the FSA in interpreting the rules; its economic and effective use of resources; and on its maintenance of consumer confidence in financial services and products.

- In contrast to larger firms, of whom only one third felt the FSA was not taking account of industry views, 60% of smaller firms thought this to be the case.
- Small firms were more likely to say that guidance given by the FSA was unclear.
- Only 1 in 7 of small firms thought the FSA's Handbook of Rules and Guidance was clear and easy to understand.
- More small firms found the costs of compliance excessive, with 35% saying their compliance costs were 10% or more of their total costs.

“The Small Business Practitioner Panel has for some time been drawing to the FSA's attention key concerns about the disproportionate impact of regulation on small financial businesses”, said Roger Sanders. “We have found them always open to our views, and we hope the action they take in response to the survey will begin to address these anxieties.”

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