



Annual Report 2003/04

[www.fsa.gov.uk/sbpp](http://www.fsa.gov.uk/sbpp)



## The Panel's Commitment

From our position within the FSA, we will work to ensure that the interests of small financial services firms and their critical importance in a healthy, successful and vibrant marketplace are properly reflected in the development and application of FSA policy and operation

In particular, we will monitor how FSA regulation is affecting small firms, and challenge proposals that may have a disproportionate impact on them. Wherever possible we will work together with the FSA to eliminate provisions which would discourage enterprise, innovation and competition in the small firms sector



## Reflections from the outgoing Chairmen

This will be the last Annual Report that we will introduce as Joint Chairmen of the FSA Small Business Practitioner Panel. After five years and over 50 meetings, we now hand over the chairmanship of the Panel to **Ruthven Gemmell**, who will be supported by **Mark Rothery** as his deputy chairman. We are convinced that Ruthven and Mark will be very effective in guiding the Panel through the next era, which is likely to be challenging for the FSA and for the industry at large, and we look forward to supporting them from the back-benches.

Our period as Joint Chairmen has straddled both the lead-up to, and the initial period following, the FSA assuming its full powers at N2 (1 December 2001). This phase in the evolution of the regulator was largely concerned with the development of policy. It was a crucial time to ensure that the impact of the new regime and the interests of small firms were properly represented and taken into account by the FSA in delivering a proportionate regulatory environment for all concerned. **Whilst we believe that the Panel has been able to make a significant difference on behalf of its constituency, it unfortunately remains the case that regulation continues to favour larger firms over small firms.** As a result, the Panel still has much to do to ensure that the regulator understands and responds positively to the pressures that our particular businesses face.

We hope that the FSA's new internal structure will deliver a number of benefits for small firms. We also hope the forthcoming authorisation and subsequent supervision of the mortgage and general insurance intermediation sectors, which will substantially increase the number of small regulated firms, are handled in a proportionate and pragmatic fashion. The Panel will continue to monitor developments in these and other areas, as well as the FSA's performance generally, to satisfy ourselves that the statutory objectives and principles of good regulation are being appropriately applied to smaller businesses.

**We believe that small firms have a crucial role to play in the financial services industry.** This role includes providing services to consumers in a manner that is often more attractive and accessible than that available from larger firms. We have put pressure on the FSA to ensure that they appreciate that a 'one size fits all' regulatory regime will have serious disadvantages - particularly for small firms and their customers. **Whilst an industry dominated by large firms may well be easier to regulate, this would be an undesirable consequence for the marketplace at large.** We are anxious that the FSA's strategy for dealing with and improving standards in small firms - in principle a sound approach - is applied intelligently and consistently.



We are keen that as many small firms as possible become aware of the work of the Panel. With this in mind we have made certain changes to this Annual Report, which should make it easier to read. We are also using this report to emphasise that the Panel is an independently-composed body, ideally placed at the heart of the FSA. We really do care about the wellbeing of small firms, and are actively fighting their corner from our position within the regulatory framework – the Panel will not hesitate to take a firm stand where the circumstances require. We hope that you will take the time to read this Annual Report, and that it proves to be interesting and informative.

Finally, we are reminded of an old proverb - *no hair shall cast its shadow*. We feel that this expression sums up the position and enthusiasm of small firms and of the Panel itself. Individually, the importance of small firms is often underestimated, but the Panel strongly believes that as a sector, we are a powerful force and are able to make a real difference.



*Roger Sanders OBE*



*Michael Quicke*

Joint Chairmen of the FSA Small Business Practitioner Panel  
June 2004



# 2003/04 – The Panel's year in review

## OVERVIEW

This is the **fifth Annual Report** of the Financial Services Authority (FSA) Small Business Practitioner Panel (the Panel). It covers the period 2003/04.

### What is the Small Business Practitioner Panel?



The FSA set up the Small Business Practitioner Panel in 1999 to **represent the interests of small regulated firms**. Its main purpose is to ensure that the FSA fully considers the impact of its actions and policies on small firms, thereby enabling them to continue to compete and prosper. It also **monitors the FSA's performance** in the context of the treatment of small firms generally.

The Panel **meets every month** and receives regular presentations from FSA staff on the development of regulatory policy and operation. In addition, sub-groups consider specific sectoral issues when required. The FSA then uses the Panel's views to help shape its thinking on the matters in question. The Panel also responds formally in writing to FSA consultation and discussion papers where there are small business implications.

Our chairmen or chairman are members of the influential Financial Services Practitioner Panel ([www.fs-pp.org.uk](http://www.fs-pp.org.uk)), which has statutory independence from the FSA. This ensures that small firms are properly represented at the very highest level within the Financial Services and Markets Act 2000 (FSMA) accountability framework.

### Why do small firms matter?

The Panel believes that small firms have an important role in delivering competitive financial services to consumers. They provide consumers with **choice, service and flexibility**. As such, they are instrumental in helping the FSA to deliver on some of its statutory objectives and principles of good regulation. These include the protection of consumers' interests and the facilitation of competition within the regulated markets.

In the near future, small firms will become even more important to the FSA, as its regulatory scope is extended to include **general insurance brokers and mortgage advice**. This will include a large proportion of smaller firms, many of which will be regulated for the first time. So, it is all the more important that their voices are properly represented in the policy-making process and in the overall review of the regulator's operation.

At the same time, several developments are fundamentally changing the way in which small firms operate. These include European Union directives and Basel negotiations relating to capital adequacy requirements, depolarisation, the proposed Sandler regime, developments in the regulation of with-profits funds and concerns about Professional Indemnity Insurance. All of this means that the Panel has had a busy year.

### Regulation favours larger firms

There is no question in the Panel's mind that **heavy or over-regulation typically provides a significant competitive advantage to larger firms**. That said, through our links with the



Financial Services Practitioner Panel, we know that even the bigger players in the market recognise the fact that driving smaller firms out of business would not be in anybody's wider interests. Such a proposition would also not sit comfortably with mainstream government policy relating to facilitating and encouraging smaller enterprises. We know that John Tiner and Callum McCarthy are committed to ensuring that small firms are accommodated within the regime in a sensible and pragmatic manner, such that they are not squeezed out simply by virtue of the pressures and burdens of regulation. The Panel welcomes this assurance.

### What do we mean by 'small'?

Well, even though you may not think so, it could well mean you. For example, a small bank, which is naturally significant in size compared with a sole trader IFA, would nevertheless fall within the coverage of the Panel by virtue of its relative size within its own sector.

To help stakeholders better understand more about the Panel, we have produced a list of **10 things that you probably didn't know about us**. We hope that this item (included later in this Annual Report) indeed does just that.

### Room for improvement – results of our effectiveness study

We have recently undertaken an extensive piece of research work designed to measure the effectiveness of the Panel, and the value it adds for the FSA and small firms. This work included in-depth interviews with Panel members and senior FSA staff, along with a survey of over 200 small firms across all sectors.

We were pleased to note that, broadly speaking, **the Panel does appear to operate effectively, and plays an important part in ensuring that the FSA is appreciative of the views and concerns of small firms.**

That said, there are one or two areas where certain enhancements would make us (and make us seen to be) even more influential and valuable – for example:

- creating greater awareness within the industry of our role and work;
- improving the Panel members' interaction with each other, with the FSA executive, with the Financial Services Practitioner Panel, the trade associations and with the outside world generally;
- devoting proportionately more of our time to focusing on issues where there is a clear and legitimate small business impact (rather than on those that affect regulated firms generally);
- continuing to be suitably assertive in communicating our views to the FSA.

### Our new-style Annual Report

One of the key findings of the effectiveness research was that many small firms have little detailed knowledge about the Panel's role and that our last Annual Report was read by a very low percentage (in fact, many firms had no recollection of even having received the report). We are addressing these points by making this Annual Report more distinct from the look and feel of most other FSA publications, punchier in terms of the nature of information included, and shorter overall.

We have articulated a Panel Commitment, as seen at the beginning of this report, which captures succinctly our main objectives and *raison d'être*. **It is our commitment to the FSA and, more importantly, to all small firms operating in regulated financial services in the UK.**



The Annual Report also includes a section that briefly summarises a number of our main areas of work and output during 2003/4. For those who want to know more, the Panel's recently-launched website pages - [www.fsa.gov.uk/sbpp](http://www.fsa.gov.uk/sbpp) - contain a much greater depth of information, including the Panel's full terms of reference and objectives.

## SOME OVERARCHING CONCERNS

Generally, we are encouraged by the extent to which the FSA is conscious of the issues affecting small firms, and we welcome the responsible and pragmatic way in which it reacts to many of our submissions.

However, some concerns remain:

- There is still a need for the FSA to recognise and mitigate the pace, complexity and financial/operational burden of change wherever possible. This statement applies not only to individual initiatives, but to the cumulative effect of the regulator's actions;
- The FSA must do more to ensure that any new rules do not have a disproportionate or disadvantageous impact on small firms, and are applied and enforced with suitable flexibility;
- There is a need to continue to improve the ease-of-use of the FSA Handbook of rules and guidance;
- We would like to see an improvement in the reliability and timeliness of individual guidance provided to firms by the FSA, and see the availability of this facility better promoted to small firms;
- There is a need to better stimulate the engagement of small firms in FSA policy-development and decision-making, for example, through the wider use of industry roadshows, and a system whereby the relevance of particular consultations to small firms (or certain sectors) is clearly signposted;
- It is important to clarify the purpose and application for small firms (and the FSA's own supervisory staff) of guidance in the FSA Handbook;
- The FSA must reduce the damaging effect of super-equivalence in the context of international legislation, unless there is a clear and identifiable justification or risk to consumers;
- The FSA should consider developing further the use of de minimis thresholds, below which it might be appropriate to modify or waive the application of certain rules for small firms. The FSA should also consider the more routine introduction of dedicated transitional periods for small firms to assist them in the implementation and assimilation of new provisions;
- It is sometimes the case that initiatives that appear to be fundamentally and directionally sound at first, become damaging to small firms by the time the detailed rules are developed and put in place. The FSA must ensure that its processes are sufficiently robust to guard against this, as will the Panel itself.

**The Panel believes that there remains room for further improvement in the FSA's treatment of small firms.** And although we have been encouraged by many of John Tiner's and Callum McCarthy's messages to the industry, the key to continued progress will be to turn these positive statements into concrete actions on the ground.

That said, we are happy to acknowledge that, in a number of areas, improvements have already been made – for example, the production of fewer and shorter consultation documents, and the construction and user-friendliness of the Handbook and associated material. We believe that the ongoing pressure and influence exerted by the Panel has



contributed to these positive developments. The new internal structure of the FSA, which took effect in April 2004, should also naturally foster benefits for small firms and make the regulator an easier and better organisation to do business with.

Most small firms do not have access to dedicated compliance resource and expertise - unlike their larger counterparts. Against this background, it is all the more vital that the Panel and the FSA remain alert to ensure that small firms are listened to, supported and actively encouraged.

## THE PANEL'S JOB – MORE IMPORTANT THAN EVER!

As the pressures on small firms are building from all sides, the Panel's work is becoming ever more important. **Increasingly complex rules and regulations are adding to the cost burden on small firms, and changing the overall structure and shape of the industry itself.** At the same time, margins have been squeezed by lower stock markets and higher PI insurance costs. The prospects of higher capital requirements and the proposed Sandler regime for simplified products further add to the difficulties faced by small firms.

The Panel has been working hard over the past year to defend the interests of its stakeholders by challenging regulatory proposals that could undermine the competitiveness and, in some instances, **threaten the very existence of certain small firms.**

### Reforming polarisation and Sandler

The Panel continues to be heavily involved in the development of the proposals on depolarisation and the sale of Sandler products, and will continue to contribute to the process where appropriate.

There remain real reservations about the proposed Sandler regime, and the ability to design a completely harmonious and cost-effective system of regulated products and simplified selling. **We do not believe that smaller providers will be in a financial position to manufacture and market Sandler products.** We are also concerned that advisers will not be prepared to run the (at present, unquantifiable) risk of future FSA/FOS sanctions for such modest economic benefit.

On depolarisation, the Panel sees a number of issues of concern for small firms; the main ones being the format and content of the menu – which we feel has been somewhat over-engineered - and the basis for calculating commission equivalence and market averages. In particular, we consider that the calculation of market averages should be based on the level of commission *available* rather than the actual net amount paid, in order to reflect what is actually happening in the market. This would avoid commission levels becoming distorted to the detriment of smaller firms.

### The future regulation of mortgage advice and general insurance

The Panel has submitted full and detailed responses to the recent series of consultations relating to the impending regulation of mortgage and general insurance intermediation. This is a significant area of work for the FSA, with a large proportion of firms in both sectors being small businesses, and it is therefore something that has featured (and will continue to feature) prominently on the Panel's agenda.

Broadly, the Panel welcomes the positive and pragmatic manner in which the FSA has listened and responded to the views and concerns of the mortgage and general insurance sectors whilst formulating the forthcoming regulatory regimes. We hope that the overall regime will indeed prove to be generally proportionate, workable and affordable. That said, **anecdotally, we remain anxious about the extent to which these firms fully appreciate the degree of change required of them going forward.** (We hope that the FSA's excellent simplified Handbook for mortgage and general insurance firms will help here.)



In the first instance, it is vital that the FSA manages the authorisation process for mortgage and general insurance firms in a properly-resourced and timely manner. Of course, the firms themselves must take responsibility for their side of this process.

### Capital adequacy

Our concerns about the application of capital adequacy standards to small firms have not lessened. There are a number of proposals currently on the table which are likely to result in a direct requirement to hold more capital. **A requirement on small firms to hold proportionately more capital than larger firms will affect their ability to compete and prosper.**

### Financial Ombudsman Service

The Panel enjoys regular meetings with FOS staff, in particular Walter Merricks, the Chief Ombudsman, and welcomes the positive spirit in which these discussions are held. **We support the move towards allowing firms two 'free' cases**, but shall continue to stress the importance of a robust system for filtering out complaints that are clearly frivolous or vexatious.

The Panel has also encouraged the FOS to raise awareness of and better promote the various checks, balances and accountability arrangements that exist within its procedures for determining individual cases (and more generally - for example, the role and profile of the FOS Board and of the Independent Assessor). A greater understanding of these by small firms might well provide a greater degree of reassurance of fair process and avoid any further uninformed criticism.

### Professional Indemnity Insurance

The position of the PII market remains of ongoing concern to the Panel. We shall continue to keep this under regular review **to ensure that the FSA is doing all it can to facilitate a healthier marketplace and to otherwise act with suitable flexibility when dealing with individual firms.** This is bearing in mind that a significant number of small businesses are experiencing difficulties in securing compliant and affordable cover. The Panel also wishes to signpost at this point the potential difficulties that small firms may have in obtaining cover for the proposed sale of Sandler products by lower-qualified, less-experienced staff.

### Treating Customers Fairly / with-profits policies

CP207 contains fundamental issues for small (in particular, mutual) providers that could impact on such firms' business models, wellbeing and viability; on their staff and policyholders, and on the marketplace in general. This would be an unattractive and unfortunate consequence for all. We are concerned that this is another step towards an environment where innovation and competition - the cornerstones of a successful industry - are severely constrained. This would also be a scenario where consumer choice (and consumers' ability to satisfy investment objectives and profiles) became increasingly limited. We very much hope that the FSA will be prepared to amend the proposed policy following consultation in order to address these serious concerns. **And it is imperative that any such significant or fundamental changes are subject to a further round (whether on a statutory basis or otherwise) of consultation/dialogue.** This would enable small firms to have a proper opportunity to digest and consider the detailed implications. Otherwise, we fear that the FSA would be faced with the highly undesirable prospect of implementing a series of provisions of which major elements of the industry remain sceptical and unsupportive.

With regard to the FSA's Treating Customers Fairly initiative, we look forward to reviewing the first public iteration of this strategy shortly which, we understand, will include a number of case studies setting out examples of perceived good and bad practices. It is clearly not (and has never been) in small firms' interests to treat their customers poorly. We therefore



would be concerned to see this concept based on the unreasonable suggestion that most firms currently do not treat their customers fairly or without acknowledging any of the positive steps and improvements that the industry has made in recent years. The Panel is also anxious about this initiative creating the unattractive prospect of small firms facing subjective sanction from the FSA and/or FOS on a retrospective basis even though the rules themselves had been followed conscientiously at the time.

## FORMAL RESPONSES TO FSA CONSULTATIONS

The Panel has submitted formal written responses to the following FSA consultation papers during the preceding 12 months:

- CP174:** Prudential and other requirements for mortgage firms and insurance intermediaries
- CP176:** Bundled brokerage and soft commission arrangements
- CP180:** Fees for mortgage firms and insurance intermediaries
- CP181:** Implementation of the Solvency 1 Directives
- CP186:** Mortgage regulation
- CP187:** Insurance selling and administration and other miscellaneous amendments
- CP189:** Basel and EU Capital Adequacy Standards
- CP190:** Enhanced capital requirements and individual capital assessments for non-life insurers
- CP191:** Miscellaneous amendments – Chapter 8
- CP193:** PII for personal investment firms
- CP195:** Enhanced capital requirements and individual capital assessments for life insurers
- CP196:** Implementation of the Distance Marketing Directive
- CP197:** Reporting requirements for mortgage, insurance and investment firms, and supplementary consultation on audit requirements
- CP198:** Regulatory reporting – a new integrated approach
- CP199:** Miscellaneous amendments – Chapter 10
- CP201:** Implementation of the IMD for long-term insurance business
- CP202:** Insurance regulatory reporting: changes to the publicly available annual return for insurers
- CP207:** Treating with-profits policyholders fairly
- CP208:** Funding the Financial Ombudsman Service 2004/05
- CP209:** FSCS management expenses levy limit and other funding issues
- CP04/3:** Reforming polarisation - a menu for being open with consumers

Summaries of these responses can be viewed on our website ([www.fsa.gov.uk/sbpp](http://www.fsa.gov.uk/sbpp)). We have also held numerous meetings with the FSA executive on these and many other issues, on which we have made representations. Much of our dialogue with the FSA is less formal in nature, and we do not publish ongoing details of these discussions in order to preserve the open and constructive relationship with the regulator that we currently enjoy.



# 10 things you probably didn't know about the FSA Small Business Practitioner Panel

1. The Panel was set up by the FSA as long ago as 1999 – we have recently celebrated our 5th birthday. Since then, we have met formally over 50 times. We have done our best to ensure that the concerns and views of smaller firms are properly represented to the FSA, and that their interests are not adversely affected by regulation.
2. No members of FSA staff sit on the Panel. Although we have close links with and access to senior management and policy-makers at the FSA, our membership exclusively comprises practitioners from a cross section of small firms operating in a variety of industry sectors. However, we are careful not to operate as a group of disparate individuals – we are most effective when functioning as a strong and committed collective body.
3. We rotate our membership to ensure that it is at all times suitably experienced, relevant and balanced. Currently, our expertise includes practitioners from IFAs, banks, insurance companies, credit unions, friendly societies, stockbrokers, derivative traders, building societies, mortgage advisers, general insurance intermediaries (both as a primary and secondary element of their business), professional firms and fund/investment managers.
4. Our chairmen or chairman are members of the influential Financial Services Practitioner Panel ([www.fs-pp.org.uk](http://www.fs-pp.org.uk)), which has statutory independence from the FSA. This ensures that small firms are properly and rightly represented at the very highest level within the FSMA accountability framework.
5. The Panel has recently launched its own website – [www.fsa.gov.uk/sbpp](http://www.fsa.gov.uk/sbpp). Here you will find a host of regularly updated information about our objectives, composition and the important work that we do within the regulatory structure on behalf of small firms.
6. You may not necessarily regard yourself as a small firm, and the Panel acknowledges that the word small can mean different things to different people. But we deliberately do not define this term too strictly, allowing us the freedom to contribute on an extensive range of issues, and on behalf of the widest possible array of firms of all types.
7. The Panel responds formally to many FSA consultation papers; specifically, where there appear to be implications for smaller firms. Summaries of those responses are posted on our website. We also provide comment on many FSA documents before they are published, and we continuously monitor the FSA's overall performance regarding its treatment of small firms.
8. Members give up a significant portion of their time to undertake Panel business. We meet formally once a month, and also convene regular sub-groups to consider particular issues when necessary. We have access to the FSA Board and regulatory staff at the highest level, and senior FSA management frequently attend our meetings to discuss current issues and to hear our views.
9. Panel members are appointed following a thorough nomination and interview process, which involves the Panel chairmen and, typically, the relevant trade bodies. So, it is clear that our members are selected in an objective and independent manner and are not simply stooges of the FSA.
10. We publish our Annual Report around May/June each year. The Panel also normally produces a shorter, interim mid-year report around November. To demonstrate how seriously our views are taken, the FSA prepares and publishes a detailed response to our Annual Report in the same way that it does for the statutory Practitioner and Consumer Panels.



# Membership of the Small Business Practitioner Panel

## **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 broker**

Compliance Director, Freedom Finance; Director of The Association of Mortgage Intermediaries, a Divisional Board of AIFA

## **Simon Bolam**

### **General insurance intermediary**

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**

### **Investment management and professional firms**

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 of the Law Society of England and Wales

## **Andrew Gibbs**

### **Fund manager (from January 2004)**

Managing Director, CCLA Investment Management Limited

## **Fraser Gillespie**

### **General insurance intermediation**

### **(secondary business) (from March 2004)**

Regional Finance Manager, Marshall Motor Group

## **Philip Ireland**

### **Stockbroking and investment management**

Director, TD Waterhouse Investor Services; Managing Director TD Waterhouse Bank NV

## **Ian Jolliffe**

### **Unit trust manager (until July 2003)**

Managing Director, Exeter Fund Managers Limited; Member of the Board of IMA; Former Deputy Chairman of AUTIF

## **Michael Quicke**

### **Banking and investment management**

Group Chief Executive, Leopold Joseph, Private Bankers

## **Mark Rothery**

### **Friendly society**

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

## **Roger Sanders OBE**

### **Independent financial advice - employee benefits consultant**

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

## **Chris Thompson**

### **Derivatives trading**

Director, Berkeley Futures Limited; Director, Berkeley (Bahamas) Limited

## **Neville Thompson**

### **Building society**

Chief Executive, Earl Shilton Building Society; Former Chairman of the Midlands & West Association of Building Societies; Director of Earl Shilton Financial Services

## **Gavin Tisshaw**

### **Independent financial adviser: Corporate and personal financial planning**

Chairman, Executive Advisory Services Limited; Director and Past-President of the Life Insurance Association



**Small firms are  
a BIG success**

**SMALL FIRMS  
LEAD WAY**

**Red tape is  
top problem**

(3 headlines from a national newspaper business supplement, 1 April 2004)

Headlines reproduced courtesy of The Sun/NI Syndication





## ***The FSA Small Business Practitioner Panel***

---

25 The North Colonnade  
Canary Wharf  
London E14 5HS

Tel: +44 (0)20 7066 1000

Fax: +44 (0)20 7066 1099

Website: [www.fsa.gov.uk/sbpp](http://www.fsa.gov.uk/sbpp)

E-mail: [sbpp@fsa.gov.uk](mailto:sbpp@fsa.gov.uk)

ISBN: 1-84518-187-5

