



Annual Report 2004/5

“We work, from our position within the FSA, to ensure that the interests of smaller financial services firms and their critical importance to 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 smaller firms, and challenge proposals that may have a disproportionate impact on them. Wherever possible we will work together with the FSA to eliminate provisions that would discourage enterprise, innovation and competition in the smaller firms sector”

www.sbpp.org.uk

Chairman's Introduction

It gives me great pleasure to introduce the Panel's Annual Report for 2004/5, following my first year as Chairman. I and my Deputy Chairman, Mark Rothery, have had an interesting year, in particular, dealing with the vast number of new smaller firms which have come under statutory regulation as a result of the inclusion of mortgage and general insurance business. Throughout, we have had the enormous support and benefit of the Panel members and those within the FSA with whom we have worked closely in achieving, where possible, proportionate, good and sensible regulation for smaller firms. We do, however, recognise that the FSA must work within a legislative framework and in line with its strategic aims to maintain efficient markets, improve its business capability and effectiveness, and help retail customers achieve a fair deal.

The work of the Panel is important and often complex. Many of the matters it has to deal with are of a specialist technical nature, while others have more widespread and potentially wide ranging effects for the whole regulated community and, in particular, smaller businesses.

Since the appointment of Callum McCarthy and John Tiner and the reorganisation of the FSA and its Board, there has been a marked drive towards making the FSA easier to deal with for smaller businesses; and this has been observed by the Panel. This does not mean to say that we have reached a level of satisfaction in everything that the FSA does or is proposing to do in relation to smaller businesses, but it is clearly a move in the right direction.

We believe the Panel has been able to make a significant difference on behalf of smaller businesses but there is still much to do and we will continue to work collaboratively with the FSA and through the Financial Services Practitioner Panel to achieve this.

Although the Panel does not have a statutory basis in the same way as the Practitioner Panel or the Financial Services Consumer Panel, we see ourselves as performing a no less important role. The FSA aims to treat and engage with us on the same basis as the other panels, and to permit us equal access to its Board and senior management.

The Practitioner Panel survey (on which there is more detail later in this Report) highlighted a number of disturbing matters in relation to smaller businesses, and the Panel was pleased that the FSA has acknowledged these concerns and put forward proposals to tackle them. The debate will continue as to whether these measures will prove sufficient, but whatever view practitioners may take, they represent a clear statement-of-intent and foundation on which to build for the future and towards a better financial services industry.



Increasingly, regulation is being implemented in the United Kingdom not at the simple behest of the Government or the FSA but by the European Union. We have urged the FSA to ensure that, as far as possible, there is a level playing field between different EU States although, to some extent, given that smaller businesses typically operate only in the domestic arena, this is less important.

What is more significant for smaller businesses is the breadth and burden of regulation, and this is an area where the FSA is sometimes only a part player. We have, therefore, also opened up a dialogue with HM Treasury to ensure that they are well versed on small business issues, both generally and in the context to their proximity to the EU decision-making processes.

Again, as noted in the Report, we are concerned at the lack of visibility of the Panel and its work throughout the financial services industry, and we have taken steps this year to attempt to raise our profile. This has involved meeting with professional and trade associations, and will also include a presentation at the forthcoming FSA Annual Public Meeting. We are conscious that we need to do more, especially as much of the good work that we carry out for the smaller businesses community is at an early stage where it is not always obvious publicly that the Panel has been engaged on a particular issue. Instead, the point has often been successfully and logically argued in private.

The Panel has also expressed concern about whether the word “small” in our name – which does not carry any rigid definition – is itself a possible barrier to firms’ affiliation with us and our work. So, in order to provide greater flexibility in that regard, the FSA has agreed to the Panel’s recommendation to change our name to – the Smaller Businesses Practitioner Panel.

Smaller businesses are vitally important to the success of the financial services industry and, within the regulated community, they represent the vast majority – by number – of businesses. The Panel is committed to ensuring that this community is able to flourish and cope with regulation, and that regulation is applied in a consistent and risk-based way.

I hope you will read this Report and that it provides some interesting insight into the activities and views of the Panel. The Panel now has its own website and I, the Panel and the Independent Panels Secretariat provided by the FSA, are always willing to hear from smaller businesses either directly or through their trade associations.

Finally, I would like to take this opportunity to thank publicly those Panel members that have stepped down during the course of 2004/5 for their efforts and commitment – Michael Quicke, Gavin Tisshaw and Graham Doswell. In addition, Roger Sanders, a founding member and (along with Michael Quicke) the former co-chair of the Panel, left us at the end of May 2005 in favour of a position on the FOS Board – he goes with our appreciation and good wishes.

Ruthven Gemmell
Chairman
June 2005



Summary

This section provides a high-level summary of the FSA Smaller Businesses Practitioner Panel's (the Panel's) Annual Report for 2004/5. We acknowledge that smaller firms may not have the time or opportunity to read this document from cover to cover. This section therefore allows readers, at a glance, to identify those areas which are covered in greater detail over the course of the following pages and on which they may wish to take a particular interest.

The Panel was set up by the FSA in 1999 to represent the views and interests of smaller regulated firms. It is composed of independent industry practitioners from a variety of smaller firms and covering the major sectors of financial services activity.

This Annual Report includes the Panel's commentary and information on the issues that have occupied much of our focus during 2004/5 and those that will continue to do so during the next 12 months. In particular:

- The recent survey undertaken by the Financial Services Practitioner Panel, which contained a significant number of particularly strong views from smaller firms;
- The general issues that continue to concern smaller firms – e.g. the costs of compliance, the pace of change, the FSA Handbook – along with the FSA's reaction and steps to address these;
- Some specific issues – Treating Customers Fairly, Mortgage & General Insurance regulation, depolarisation, enforcement, international considerations, with-profits, regulatory fees & levies, and the Panel's own effectiveness;
- A summary table of the Panel's responses to relevant FSA Consultations Papers.

We would ask that you consider this Report in the context of these 3 crucial questions:

Why are smaller firms important?

What more can the FSA do to understand, help and restore the confidence of (and in) smaller firms?

What can smaller firms themselves do to allow the FSA to regulate them (and the marketplace) better?





A typical Panel meeting.



Ruthven Gemmell
(Chairman)

Background

This is the sixth Annual Report of the Financial Services Authority (FSA) Smaller Businesses Practitioner Panel (the Panel). It covers the period 2004/5.

Smaller firms have a crucial role to play in delivering competitive financial services; and provide consumers with choice, service and flexibility. The FSA therefore set up the Panel in 1999 to specifically represent the interests of smaller regulated firms. The Panel's main purpose is to ensure that the FSA fully considers the impact of its activities and policy on smaller firms, thereby helping them to continue to compete and prosper in a secure and suitably proportionate environment. We also monitor the FSA's overall performance and effectiveness in the context of its treatment of smaller firms.

We achieve these purposes by giving advice and making recommendations to the FSA management and Board on how the views and concerns of smaller firms should be taken into account in the development and effect of new regulatory policy and operation. We expect these representations to be taken seriously and to be used to help the FSA shape and – if appropriate, review – the thinking on the matters in question.

Our membership is made up of individuals with a balance of experience and expertise from smaller regulated firms and operating across many of the major sectors of business – IFAs, insurance companies, friendly societies, stockbrokers, professional firms, banks, building societies, general insurance and mortgage intermediaries, derivative trading and fund/investment management. We currently have 14 members.

Our Chairman, Ruthven Gemmill, is an *ex officio* member of the Financial Services Practitioner Panel (www.fs-pp.org.uk), which has statutory independence from the FSA. This helps ensure that smaller firms are properly represented at the very highest level within the Financial Services and Markets Act 2000 (FSMA) accountability framework.

Smaller firms are increasing in importance for the FSA, following the extension of its regulatory scope to include general insurance brokers and mortgage advisers. In fact, the FSA itself estimates that over 90% of all regulated firms are now broadly classified as “small.” At the same time, other developments are fundamentally changing the way in which smaller firms operate - these include capital adequacy requirements, regulatory reporting, depolarisation, the sale of simplified stakeholder products and the governance of with-profits policies. Set against this backdrop is Government policy with regard to the facilitation, support and encouragement of smaller firms and the inevitable fact that regulation typically favours larger, more-resourced organisations.

So, it is *all the more important that there is a dedicated and authoritative voice for smaller firms from within the FSA's decision-making processes and procedures*. Regulation must be applied with appropriate cognisance, care and pragmatism when it comes to smaller firms – or the FSA will face the wholly undesirable, but very real, prospect of these firms being squeezed out of existence simply by virtue of the pressures and burdens of regulation.





Mark Rothery (Deputy Chairman) and Keith Morris



Fraser Gillespie and Rod Ashley

2004/5 - The Panel's year in review

Practitioner Panel survey of regulated firms

Shortly before Christmas, the Financial Services Practitioner Panel published the results of its third biennial survey of regulated firms into the FSA's regulatory effectiveness and performance. We were involved throughout the development and progress of this work, so as to ensure that the views of smaller firms were properly and fairly captured. We were pleased to note that a significant number of smaller firms – across all sectors of business – responded to this research; thereby ensuring it was a powerful and truly representative study.

The Panel accepts that the survey was undertaken during a period of change at the FSA. We also acknowledge a number of areas where things have improved in recent times, or where steps have already been put in place to help facilitate such improvement. However, this does not detract from the fact that the responses from smaller firms were striking and stark in their nature and strength.

In particular,

- Over 80% of smaller firms considered that the FSA's regulatory framework was too burdensome;
- Over 80% of smaller firms believed that the costs of compliance were either high or excessive;
- Over 80% of smaller firms saw compliance costs as continuing to rise;
- Over 50% of smaller retail firms estimated compliance costs to be more than 10% of their total expenditure;
- Over 80% of smaller retail firms felt that the costs of compliance were harmful to their business;
- Over 60% of all firms – large and small – thought that the FSA did not properly understand the nature and impact of regulation on smaller firms; and that it failed adequately to accommodate such firms in a proportionate way;
- Overall levels of satisfaction in the quality of guidance provided by the FSA, and in the effectiveness of the Contact Centre (which services the majority of smaller firms), remained disappointingly low.



The survey results emphasised some key differences between large and small firms, and also underlined and underpinned many of the issues repeatedly raised by Panel members during our meetings and in our previous Annual Reports. There is clearly much more that the FSA must do to understand, accommodate and help smaller firms meet the difficult and everyday challenges that they face. The Panel will seek to contribute to that process. A one-size-fits-all framework is something that the Panel has fought hard to avoid – and we continue to believe that a **suitably lighter-touch approach for smaller firms is not incompatible with the objective of maintaining the right and proper degree of consumer protection.**

The Panel is encouraged by the FSA's messages in response to the survey. We believe that the levels of frustration and discontent emerging from the survey were simply too forceful for any responsible regulator to ignore. The FSA has made it clear that the treatment of smaller firms will be a major and central priority during 2005/6 – more so than ever before. The initiative between the FSA and the Practitioner Panel to quantify the drivers of compliance costs, with particular focus on smaller firms, is a crucial plank towards achieving this aim and identifying areas where the burdens and impact of regulation on smaller firms might be mitigated or relieved. It is a very important project for the industry, and our Chairman, Ruthven Gemmell, was invited to sit on the small steering group that is overseeing this study.

General concerns for smaller firms during 2004/5

Our previous Annual Report was issued in June 2004 and highlighted a number of significant issues of importance and anxiety for smaller firms. It included our thoughts about the number of reviews and regulatory initiatives that were ongoing, and the burdens that these created – the Panel believed that smaller firms needed a period of relative stability. Despite ongoing pressure from the industry and the Panel itself, we are somewhat disappointed that many of those concerns failed to diminish significantly during the course of the last 12 months.

We consider that the main issues for smaller firms continue to be:

- *The costs of compliance;*
- *The pace, complexity and burden of change;*
- *The disproportionate and/or disadvantageous impact of regulation (both in respect of individual initiatives, and cumulatively);*
- *The need for the FSA to apply and enforce regulation in a risk-based way and with suitable pragmatism;*
- *The usability of the FSA Handbook of rules and guidance;*
- *The helpfulness, reliability and timeliness of individual guidance;*
- *The development and subsequent implementation of EU legislation.*

Over the past few months, the FSA has made a number of firm public commitments regarding the regulation of smaller firms and the Panel welcomes these statements. For its part, the FSA clearly accepts that small firms find regulation (in its current form) a real challenge, and therefore intends to take forward a number of steps and measures designed to mitigate the difficulties and burdens that they face and to make the FSA generally easier to do business with. These various initiatives are summarised in the FSA's Business Plan for 2005/6 – published in January 2005 – and the relevant extract is annexed to this Report.



Two areas where there is already evidence of improvement in recent times are: the Handbook – we have been very supportive of and participative in the FSA's efforts to make this material more accessible and digestible for smaller firms, with considerable progress having been made here; and in the bare number of conventional consultation documents being released by the FSA (although the Panel remains alert to the possibility of regulations being made by the back door).

As a further example, we are pleased to note that future FSA Cost Benefit Analysis (CBA) work will explicitly address the anticipated impact of new policy on smaller firms and, assuming such assessments are robust, this will be a major step forward. These CBA also need to be supplemented by greater use of post-implementation assessments. In any event, the Panel will continue to argue for the FSA to impose more flexible transitional arrangements, and *de minimis* thresholds, to specifically help smaller firms in the introduction and assimilation of new provisions.

Improving the overall quality and approach of FSA staff – in particular, those with supervisory or Contact Centre roles – will be a significant component if these aims are to be delivered. Ensuring that the processes which govern the work of the FSA's Regulatory Services Business Unit, and of its Small Firms Division, are efficient and productive - including the need to enhance the use of technology and system capabilities - will be another critical element.

The Panel will be monitoring the success of these initiatives, and the overall impact and effect that they are having on smaller firms – individually and as a sector – over the coming year. It is imperative that they are delivered and prove to be effective, and the Panel shall ensure that the FSA has a sufficient degree of engagement with us to help meet this goal. We shall be suitably proactive and forthright where we believe the advertised benefits are not being achieved.

Some specific issues

Treating with-profits policyholders fairly

Following the issue of CP207, the Panel wrote directly to the FSA Chief Executive and Board articulating strongly our concerns about the impact of these proposals on smaller insurance firms and their customers. The Practitioner Panel was also supportive of our robust stance on this. The FSA took those submissions seriously and, as a result, agreed to a further round of formal industry consultation.

Towards the end of 2004, the FSA believed that it had reached a position with which the industry would be broadly content. We were assured that it was not the intention to impose unreasonable or intolerable obligations on smaller firms. However, although things had indeed progressed considerably, the Panel continued to have some reservations about various practical aspects of this initiative – such as the application of target ranges - and felt that the FSA could do more to recognise and mitigate the potentially deleterious impact on smaller firms, their consumers and shareholders. We were especially concerned about the production and circulation of the Consumer-Friendly Principles and Practices of Financial Management (CFPPFM) document, as this would not be the inexpensive and straightforward task that the FSA appeared to think.

More recently, we were pleased that the FSA has agreed to allow a longer period to implement the CFPPFM requirements. The Panel also welcomes the fact that a number of our other anxieties have – we believe, rightly – now been taken into account by the FSA in making the final rules.



Forthcoming EU legislation

The Panel continues to expect the FSA (and, where appropriate, HM Treasury) to ensure that the interests of smaller firms are being properly taken into account in the negotiation and implementation of EU and international legislation in the UK. Where appropriate, there should be a greater preparedness to use whatever flexibility and discretion exists so that smaller firms are not disadvantaged by such legislation. In any event, the FSA must seek to avoid instances where the relevant provisions are imposed in the UK in a way (directly or indirectly) over-and-above what the bare requirements may set out.

The various strands of work on Strengthening Capital Standards – for example, in the context of goodwill and the proposed application of the standardised approaches – illustrate the need for the FSA to understand and think carefully about smaller firms. The risk of a significant detrimental effect on smaller firms' finances, and in respect of their ability to compete on a level playing field, is very real – a point which the Panel has made in response to the relevant consultation documents.

The Markets in Financial Instruments Directive (MiFID) is an item likely to affect a great many smaller intermediary firms. We have held a series of discussions with the FSA in order to help identify those aspects of particular and ongoing concern as this piece of legislation moves closer. The proposition of requiring smaller firms to introduce an independent compliance function is one that we feel the FSA must argue against strongly through the relevant EU communication channels.

The UK Government is committed to the modernisation of the UK's consumer credit arrangements. This is linked to the draft EU Consumer Credit Directive (CCD) currently under discussion. The Panel understands that all secured lending is to be excluded from the CCD – we welcome this (albeit with the possibility that an EU mortgage-related directive could follow in due course). We will continue to monitor developments in this regard, and will try to help reduce any undesirable burdens that might fall on both smaller firms and the FSA.

There has also been a recent suggestion that the FSA might be asked to assume responsibility for regulating all consumer credit business. This could well have a dramatic and fundamental impact on the shape and work of the FSA – while we have not yet considered the respective arguments in detail, the Panel is not convinced that this would be a positive development.

Treating Customers Fairly

We continue to be troubled by exactly what TCF will mean for smaller firms. We cannot argue with the principle of TCF and, as it gathers momentum, the Panel is working to secure the necessary clarification on how this initiative is intended to operate in practice. There is the danger that it will fail to be applied by the FSA in a suitably proportionate and consistent way, without due regard for the differing size, nature and risk of the various types of regulated firm and their main areas of activity, and of the costs as against the benefits.

The Panel does not believe that smaller firms set out to treat their customers unfairly, nor is it in their interests to do so. Any clear examples of where the FSA considers this to be the case could legitimately be pursued through the appropriate use of supervision and enforcement tools. The Financial Ombudsman Service (FOS) also already acts as a necessary safeguard where individual consumers feel that they have not been treated fairly. So until such time as the FSA fleshes out exactly what it regards as good and bad industry practice, and states how it will actually expect smaller firms to demonstrate compliance with TCF, our concerns are unlikely to diminish.



Notwithstanding the cost, resource and system implications for smaller firms, TCF will only be successful if it delivers real and clear benefits for consumers and market confidence. There is a risk that it could have the opposite effect, with firms cautiously adopting burdensome and overly-bureaucratic processes which, in turn, would be contrary to the FSA's strategic aims; for example, in the volume and content of material that firms disclose to their consumers.

The Panel will continue its close dialogue with the FSA on this issue.

Enforcement

We are pleased that the FSA has embarked on a review of its enforcement framework and the Panel has recently met the new Regulatory Decisions Committee Chairman and the FSA team undertaking this review. We have been keen to stress the need for the FSA to use its enforcement powers against smaller firms in a risk-based and proportionate manner – with appropriate regard for the pressures that they face and the consequent possibility of inadvertent breaches. In any event, more work needs to be done to ensure that such firms are not disadvantaged by virtue of their size and to enhance their confidence in the overall fairness and objectiveness of any such investigatory and/or disciplinary proceedings. In addition, general awareness in and transparency of the various arrangements must be improved.

Perhaps the Panel's most significant concern is the apparent lack of direct, smaller regulated firm expertise and experience on the RDC - it is crucial that cases are (and are seen to be) judged by individuals with an appropriate degree of knowledge and empathy with those sitting before them. This will help ensure that decisions are made on a necessarily informed basis and any alleged wrongdoing viewed in its proper context.

As a footnote to this issue, one area which the Panel intends to watch closely during the next 12 months is the way in which the FSA operates the Financial Promotions regime, as we are aware that some smaller firms consider certain aspects of the current approach to be somewhat heavy-handed.

Mortgage and General Insurance regulation

The Panel provided a significant amount of input and advice to the FSA in support of its work to design and introduce a suitably proportionate and broadly cost-effective framework for the ongoing statutory regulation of Mortgage and General Insurance intermediation.

We have been particularly pleased to see the careful and responsive manner in which the FSA has listened to our own, and the industry's representations as the various consultation processes have progressed towards conclusion.

In the first instance, the FSA deserves credit for the manner in which it managed the authorisation process for such a large number of firms. Overall, this considerable task was handled smoothly, successfully and with relatively few problems arising.

On an ongoing basis the Panel will monitor the marketplace and continue to hold discussions with the FSA as the new regimes bed down and sufficient time elapses to measure how implementation has taken place and how smaller firms are adjusting to their regulatory responsibilities. For example, some lenders within the mortgage sector appear to be producing unhelpfully long disclosure material. The Panel was also quick to identify the practical difficulties experienced by firms regarding the interaction between the FSA's Financial Promotion rules and the Consumer Credit Act - we remain in dialogue with the FSA on this issue and are hopeful that a satisfactory solution can be found.



The Panel is mindful of the concerns already expressed by practitioners that some features of the new regulatory regimes are creating expensive administrative processes (including FSA fees and reporting requirements) which may not be commensurate with the levels of consumer protection or overall benefit that they are seeking to achieve. Further, although it is recognised that elements of these regulatory regimes have a suitably lighter touch, the sheer volume and frequency of transactions that take place - compared to some other regulated sectors - is itself creating a significant cumulative compliance burden. It is important to remember that excessive bureaucracy or costs could well have the undesirable effect of dissuading consumers or restricting access for those seeking to arrange essential protection and house-purchase products.

Regulatory fees and levies

Many firms were taken aback with regard to the level of regulatory fees and levies for 2004/5. In particular, the amount of Financial Services Compensation Scheme (FSCS) liabilities falling on certain fee blocks had increased dramatically and, to compound things, there was a sense that such firms had not received adequate forewarning of this. Many smaller firms were hardest hit.

The Panel recognises the challenge of predicting FSCS liabilities against a moving and evolving market and consumer backdrop. In respect of 2005/6, the accuracy and timing with which the FSA and FSCS were able to estimate default claims appears to have improved - but there remains room for further improvement, and we have been in discussion with both parties about this. It is important that smaller firms are able to plan ahead financially with a degree of confidence.

While it is naturally disappointing that the headline FSA budget has increased beyond inflation for 2005/6, the FSA has sought to minimise and mitigate the effect of this increase for the majority of smaller firms. The Panel welcomes this. We also consider it to be a worthwhile investment if real benefits for smaller firms are to be achieved in the longer term - in line with the FSA's Business Plan.

Lastly, the Panel has been particularly happy to play an instrumental role in the development of a market-led solution to enable firms to pay their upcoming fee and levy invoice through a competitive instalment facility. Smaller firms have been calling for such an arrangement for some time, and we are pleased that our own efforts have been successful in helping to secure this option.

Depolarisation and the menu

With the commencement on 1 June 2005 of the depolarised marketplace, the Panel took an active involvement in contributing to the development of the FSA's rules in readiness for their introduction. From the smaller firm perspective, we were concerned that the menu had been somewhat over-engineered and would be too complex for consumers to understand. We were also particularly worried that the current method for calculating market averages could be imperfect, and may have a negative impact on smaller firms' ability to compete.

It is important that the FSA monitors closely the way that the market is adjusting to depolarisation and, in due course, is prepared to revisit any aspects that appear not to be functioning as intended. The Panel shall do the same. Consistent with its strategic drive to help and accommodate smaller firms, the FSA also needs to act with suitable pragmatism and proportionality in the event that any such firms are unable to demonstrate full compliance in time (despite making reasonable attempts to do so).



A connected area where the Panel shall take a keen interest in the coming year will be the FSA's proposals with regard to *Helping Consumers Get A Fair Deal* – that being, the anticipated review of the point-of-sale disclosure regime.

Maximising the Panel's effectiveness

The senior management at the FSA have said that they are fully committed to engaging with the Panel in an open and constructive manner and, since its structure and cultural change in April 2004, we have been pleased to see some positive signs in this regard. In particular, we believe that the key to getting the most value from the Panel is for the FSA to talk to us at a suitably early and developmental stage, where our expertise and influence can have greatest advantage. We do not wish to be seen as an adversary of the FSA; but rather as a source of knowledge and collaboration to help reach the best possible solution for all concerned. It is also important that the FSA sends the decision-makers and opinion-formers to talk to us, with an appropriate balance of seniority and technical proficiency. Our aim for 2005/6 is to be less reactive and more focused in determining the issues on which we wish to devote the majority of our time.

While the Panel considers that it is performing a valuable role (and the FSA itself believes that we are), we are not convinced that the smaller firm marketplace and the relevant trade associations know enough about our work and activities to be convinced of this. *We therefore need to be more visible to the industry.* In the first instance, as well as speaking at the FSA Annual Public Meeting in July, we have begun building a stronger relationship with the professional bodies and trade associations by holding six-monthly briefing sessions to facilitate an open, frank and confidential forum for dialogue and the exchange of views. Furthermore, we have now launched our own independent website – www.sbpp.org.uk – where stakeholders can find out more about what we do (and how) and bring any particular issues to our attention.

Finally, one reason why the industry's engagement with us may be relatively limited could be as a result of our identity. The term 'small' means different things to different audiences – and it may even carry a derogatory undertone for some. Therefore, in order to help correct any misapprehension about the scope of our responsibility and, specifically, the nature and scale of our constituency, we intend to refine the language in our name to help allow for a more flexible understanding and interpretation. As the title of this Report indicates, we now intend to call ourselves; the Smaller Businesses Practitioner Panel.



Summary of responses to FSA consultation papers

The following table summarises all the formal consultation responses made by the Panel since last year's Annual Report. The Panel also considers and comments on many items from the FSA at the pre-consultation and feedback stages. However, we do not routinely set out publicly the detail of these discussions and the views that we provide, in order to preserve confidentiality and the open (and constructive) relationship with FSA staff that the Panel currently enjoys.

<p>CP207: Treating with-profits policyholders fairly</p>	<p>The Panel highlighted the significant amount of work – in cost and resource – involved in implementing the provisions (as drafted) and the very short timetable for doing so. This included the process for developing and producing CFPPFM documentation. In addition, it appeared that firms would be expected to hold more capital while, at the same time, investment returns for policyholders were likely to reduce as a consequence of portfolio re-allocation.</p> <p>All in all, the paper contained fundamental issues for small providers that could have a grave impact on such firms' wellbeing, and cause the further erosion of innovation and competition. The Panel strongly urged the FSA to allow another round of formal consultation to ensure that the proposals could be properly scrutinised and their effect better understood by all concerned.</p>
<p>CP208: Funding the FOS 2004/5</p>	<p>The Panel supported the shift towards funding being more directly related to actual usage of the FOS. The notion of a "two free cases" arrangement was particularly welcomed. The potential impact on smaller firms of the continuing increase in mortgage endowment complaints was regrettable, although this was not necessarily a consequence of the FOS's own actions.</p>
<p>CP209: FSCS management expenses levy and other funding issues</p>	<p>Whilst it was noted that the FSCS had performed well against its recent budgets, it remained important that the FSA was satisfied that the overall cost of the compensation scheme was proportionate to the number of cases being considered, and that it was otherwise operating with suitable efficiency.</p>



CP04/03: Reforming polarisation – a menu for being open with consumers	While welcoming the broad overall concept set out in the paper, the Panel felt that the proposals were too complex and would benefit from simplification. For example, the menu itself looked over-engineered. It was also believed that the proposals could well operate to the disadvantage of smaller firms – specifically, in the method for calculating market averages – and create scope for consumer confusion.
CP04/04: Insurance and mortgage firms – funding FOS/FSCS	The Panel considered the proposals to be broadly reasonable. That said, some reservations were expressed about the possible underestimation of the number of such firms applying for FSA authorisation (which could therefore increase the fees for others) and the bases for calculating the respective levy caps.
CP04/05: Miscellaneous amendments #13 – Chapter 2	The Panel supported the proposals insofar as they related to smaller professional firms.
CP04/09: Fee issues for mortgage and general insurance firms	There was concern that the proposals could place proportionately higher regulatory costs on small firms as a result of the sliding-scale approach, and that these may be significantly higher than the fees that such firms were currently paying. Any substantial underestimation in the number of applicants could also have an adverse impact. The proposals regarding post-N(M&GI) application fees and the discounting arrangements for those that operated in more than one fee block were broadly supported, subject to some supplementary suggestions for refinement.
CP04/10: Child Trust Funds	With regard to Credit Unions joining this market, the Panel considered that the potential barriers to entry (and ongoing obligations) continued to make this an unviable option for such firms – this was unfortunate, and more thought on this aspect was needed. Various elements of the proposed disclosure and cancellation requirements were also of particular concern – the Panel put forward a number of suggestions for how these provisions might be improved.
CP04/11: Sandler simplified sales regime	<p>The Panel did not believe that the consumer research supported the proposal that the full range of products be made available through the simplified sales route to consumers across the board, unless additional safeguards were incorporated. The simplified regime should certainly not be extended to non-stakeholder contracts until a successful period of operation had passed. Some issues also remained about the robustness of the FSA's Cost Benefit Analysis.</p> <p>In any event, the Panel's comments on CP04/11 were set against its wider view that guided self-help was not a suitable process for those inexperienced investors on low incomes.</p>



Building Financial Capability – Generic Advice	The Panel argued that the Generic Advice model should be built along the lines successfully employed in the professional firms arena. The question of delivering a workable liability and accountability arrangement would also be a challenge in the absence of any prevailing legal framework. It was crucial that advisers and consumers understood clearly the nature (and limit) of the service being provided; the undesirable possibility of poor “advice” being given – and acted upon – needed to be mitigated.
CP04/12: FSMA 2 Year Review: Financial Ombudsman Service aspects	The Panel supported the intention to raise awareness in and clarify the purpose/use of the wider implication mechanism, and to improve the overall transparency of FOS processes and decisions. The proposition of an individual right of appeal had certain benefits, but practical and perception difficulties made this – on balance – an undesirable addition to the existing (duly strengthened) arrangements.
CP04/13: Quarterly consultation #1 – Chapter 5, Client Asset Sourcebook	The proposal to permit co-mingling was welcomed, and the FSA had clearly responded positively to the industry’s concerns in this regard. The Panel submitted that the client money regime for Property Managing Agents might benefit from extension so as to include commercial, as well as residential properties.
CP04/14: Treating with-profits policyholders fairly	The Panel considered that the further round of consultation had been particularly valuable, and many of the concerns it had expressed in response to CP207 had been met in a largely satisfactory way. There were however a number of remaining anxieties – in particular, relating to the need to allow small firms more time to implement these measures, and on the production and delivery of Consumer-Friendly PPFM material. The prospect of investment mixes and rates of return no longer meeting policyholders’ reasonable or initial expectations was also an issue that required further attention.
CP05/01: Quarterly consultation #3 – Chapter 2	The Panel observed that the paper did not attempt to address the wider issue of third-party mortgage packagers and clubs, many of whom would be unregulated but would nevertheless play an active role in the transmission of funds between consumer, intermediary and lender. In the absence of any clear accountability or responsibility arrangements, the risk of misappropriation was of concern
CP05/02: Regulatory fees and levies 2005/6	The Panel agreed with the principle of the proposed administrative charge for late returns, subject to the need for pragmatic application. The fact that mortgage firms would be paying up to 6 times more than was the case under their previous arrangements was noted with disappointment. Concern was also expressed about the budgeted contribution from investment management firms and the significant uplift in such firms’ FSCS levy. The Panel conveyed the general view that the FSA and FSCS should endeavour to establish an earlier and more accurate estimation of future FSCS liabilities – in order to permit smaller firms to plan their finances more confidently.



Annex 1

Extract from the FSA's Business Plan 2005/6 – published in January 2005

Section Three – Improving our business capability and effectiveness

Making it easier for small firms to do business with the FSA

What is currently available:

- A **Firms Contact Centre** that handles queries from authorised firms about regulation and the Handbook.
- **Regional visits**, with surgeries to enable firms to discuss topical issues with an FSA representative.
- **Roadshows**, to feed back issues raised during regional visits and discuss the latest developments.
- **Industry Training** sessions designed and delivered by FSA staff across the UK. These sessions help firms improve their understanding of our requirements. We also provide distance learning materials including audio and computer-based products.
- Sector-specific **newsletters** and **conferences**.
- **Liaison with relevant trade bodies** to help them keep abreast of what is happening in specific sectors and to consult early on proposed changes.
- **Tailored handbooks** (for mortgage and general insurance intermediaries, containing only the rules relevant to these firms).
- **Handbook Guides** (for example, for IFAs, mortgage and general insurance intermediaries, to help firms in those sectors find the rules relevant to them).
- A **guide for IFAs on buying Professional Indemnity Insurance**. This guide helps firms to understand our PII rules and the process for obtaining PII cover.
- **'Firms Online'** service on our website, allowing electronic submission of forms notifying the FSA of changes to, for example, static data (e.g. address), varying their permission etc.
- A **section of our website** dedicated to small firms.
- **'Short form' application packs** for particular categories of firm: sole traders, IFAs (including mortgage intermediaries) and general insurance intermediaries.
- A **Fees Calculator** for mortgage and general insurance firms.
- A **fees section** on our website including answers to the most common questions.
- A **single invoice** showing all direct regulatory costs in one place.
- **Targeted electronic distribution** of FSA material, on request, via our website.

What we intend to make available to small firms in 2005/06:

- A wider range of sector-specific **newsletters** and **conferences**.
- Further **tailored handbooks** and the ability to build a personal handbook.
- Rolling out the **'Firms Online'** service to all firms.
- **Fee discounts** for multiple activity firms undertaking small amounts of business (e.g. firms giving investment advice and engaged in mortgage and general insurance business).
- **Capped fee increases** in 2005/06 for the vast majority of firms undertaking small amounts of business.
- The possibility of a facility, run by a third party, to enable firms to pay FSA, FOS and FSCS **fees by instalments**.



Annex 2

Terms of reference for the Smaller Businesses Practitioner Panel

1. To consider from a smaller business perspective, and to advise the FSA, on the cost and practicability implications for smaller businesses of:
 - the overall impact of regulation and its potentially disproportionate impact on smaller 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 individuals, including grandfathering provisions
 - supervision, and the effect of the implementation of the risk assessment framework and consequent move away from front-line contact with smaller 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 smaller firms
 - training and competence requirements
 - cost-benefit analyses, research and performance measurement
 - the policies and procedures for handling consumer complaints (Financial Ombudsman Service) and compensation (Financial Services Compensation Scheme) and the FSA's input to developing strategy in these areas
 - the FSA's theme-related work; and
 - any other aspects of the FSA's operations and functions which are of particular significance to smaller businesses.
2. To advise the FSA on emerging regulatory, consumer protection, public awareness and industry structure issues which the Panel considers to be of specific significance to smaller businesses.



3. To consider and make recommendations on any matters referred to the Panel by the FSA, or by the Financial Services Practitioner or Consumer Panels.
4. To report annually to the FSA Board on the work of the Panel, and to publish a copy of that report.

Relationships with other bodies

1. The Chairman of the Panel (or his Deputy, as his alternate) to attend Practitioner Panel meetings as an ex-officio member and to provide the Practitioner Panel with updates on issues specifically affecting smaller 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, the Chairman of the Regulatory Decisions Committee, and representatives from FOS and FSCS as necessary to discuss relevant topics.
4. Members of the Panel to keep in regular contact with their relevant trade bodies.
5. Members to 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 smaller businesses and from across the spectrum of activities regulated by the FSA.
2. The FSA will appoint members and seek nominations for membership from any relevant trade and professional bodies.
3. The Chairman/Deputy Chairman of the Panel to be selected from among its membership by the FSA, subject to representations made by the Panel itself. The Chairman, and Deputy Chairman, will normally serve a two-year term, having been a member of the Panel for at least a year before any such appointment.
4. All Panel members to serve for a three-year term (including a formal review after 1 year), which, at the FSA's discretion, can be renewed with the support of the Chairman. Shorter terms may be agreed between the FSA and individual Panel members as appropriate.
5. If Panel members wish to retire during their term, the relevant trade or professional body will be asked to put forward a maximum of two names from whom a replacement may be selected by the Panel. The appointed individual can then serve a full three-year term.
6. An appropriate senior manager (ideally, a director) shall be selected to attend Panel 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.



Annex 3

List of members (as at 1 April 2005)

Panel member

Position

Ruthven Gemmell (Chairman)

Partner, Murray Beith Murray WS

Mark Rothery (Deputy Chairman)

Chief Executive, Ancient Order of Foresters
Friendly Society

Rod Ashley

General Manager, Scotwest Credit Union

Stephen Atkins

Director, Freedom Finance

Simon Bolam

Principal, EH Ranson and Company

Gill Cardy

Principal, Professional Partnerships

Andrew Gibbs

Managing Director, CCLA Investment Management

Fraser Gillespie

Regional Finance Manager of Marshall Motor Group

Bella Hopewell

Managing Partner, C Hoare & Company

Philip Ireland

Director, TD Waterhouse Investor Services

Keith Morris

Chief Executive, Sabre Insurance Company

Roger Sanders

Principal, Roger Sanders Associates

Chris Thompson

Director, Berkeley Futures

Neville Thompson

Chief Executive, Earl Shilton Building Society

From 1 June 2005

Paul Etheridge

(succeeding Roger Sanders)

Prestwood Etheridge & Russell



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