



## Annual Report 2005/6

*“From its position within the FSA, the Panel works 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, the Panel monitors how FSA regulation is affecting smaller firms, and challenges proposals that may have a disproportionate impact on them. Wherever possible it works together with the FSA to eliminate provisions that would discourage enterprise, innovation and competition in the smaller firms sector.”*

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# 1. Chairman's Introduction

It gives me great pleasure to introduce the FSA Smaller Businesses Practitioner Panel's Annual Report for the year 2005/6, especially given that my period as Chairman has drawn to an end and I now assume the role of Deputy Chairman. Mark Rothery – who has been a Panel member for several years and who has provided great support as my deputy in the preceding two years – takes over the chairmanship. I know he will perform that role with the enthusiasm and commitment that it deserves, and will prove to be an excellent leader of our group.

I would characterise my two years as Chairman – from the Panel's perspective – as ones of steady progress. In particular, the Panel has helped ensure that the FSA now gives far greater focus to the concerns, needs and interests of smaller firms. Smaller firms must be treated by the FSA with suitable understanding of the day-to-day challenges that they face and with appreciation of their value in the marketplace. We are pleased that smaller firms – which account for more than 90% of the FSA's constituency – are now given much higher priority on the regulatory agenda. We do not have the same financial and operational resources as many of our larger counterparts – the FSA should not overlook this, and must allow us to compete on an equal, stable and otherwise viable footing.

It is also the case that the Panel's engagement with the FSA now typically takes place at an earlier stage of the regulatory thought process, thereby giving us the best possible opportunity to apply our expertise to maximum advantage and exert influence where necessary.

However, it is important that the FSA's reassuring and positive words to the Panel, and to the industry, are translated into real action and that the smaller firm community continues to benefit from this increased consideration, emphasis and interaction. As we move towards a period of transition to a more principles-based regime, smaller firms expect to see further improvements taking place in the way that they are regulated; and for some of the associated costs and burdens to be alleviated. The ongoing Practitioner Panel survey, the Costs of Regulation study and smaller firms' experiences more generally, will inform and guide the FSA – and the Panel's representations – over the year to come, on the extent to which that is indeed the case.

Mark, I know, is excited by the challenges that lie ahead. He sees the Panel's priority for the next twelve months as building on the good work that we have done in recent times and to ensure that the FSA and the Panel continue to engage with each other in an open and collaborative way, helping to foster the pragmatic, proportionate and risk-based environment that smaller firms seek. This is especially important in the context of principles-



based regulation and all that that entails for smaller firms. You will see elsewhere in this report our general commentary on this subject and the continuing fears of smaller firms.

We continue to believe that the Panel is an effective, independent and authoritative voice for smaller firms; sitting, as it does, as an important part of the FSA's accountability framework. Delivery of the FSA's Better Regulation objectives and the aspiration to make itself easier for smaller firms to do business with, will be the main cornerstones that we shall measure the FSA against.

This report provides a summary of the Panel's work over 2005/6, the issues that have occupied our time and efforts during that period, and those that are likely to do so in the immediate future.

I commend its content to you – please do take the trouble to read it.

Finally, I would like to express thanks to my fellow Panel members for their comradeship, diligence and significant contributions; to our small team of conscientious support staff for their guidance and loyalty; and to the FSA – at all levels – for their willingness to listen and respond to our views.

**Ruthven Gemmell**



## 2. Background to the Panel

The Smaller Businesses Practitioner Panel (the Panel) was set up by the Financial Services Authority (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. The Panel's main purpose is to ensure that the FSA fully considers the impact of its activities and policies on smaller firms, thereby helping them to continue to compete and prosper in a stable, competitive and suitably proportionate environment; and provide consumers with choice, service and flexibility. The Panel also monitors the FSA's overall performance and effectiveness in the context of its treatment of smaller firms.

The Panel's membership is made up of individuals with a balance of experience and expertise from smaller firms and operating across the major sectors of regulated business – IFAs, insurance companies, friendly societies, stockbrokers, professional firms, banks, building societies, general insurance and mortgage intermediaries, credit unions, derivative trading and fund/investment management. There are currently 15 members.

In the context of the Panel, the terms “smaller” and “small” are often misunderstood. Its composition is a function of its Terms of Reference – set by the FSA – that provide for the Panel's members to be drawn from the full spectrum of regulated activities and not simply from what might conventionally be regarded as the very smallest firms (such as retail intermediaries). This necessarily encompasses firms at the smaller end of their own particular sector of business – for example, banks and insurance companies.



So, the Panel's membership is made up from firms that are not only supervised by the FSA's Small Firms Division but also from some of those that have a dedicated relationship manager. This ensures that the Panel is able to act as a necessary and valuable complement to the Financial Services Practitioner Panel, which is made up almost entirely of extremely senior individuals from the very largest firms.

The Panel Chairman is an ex officio member of the Financial Services Practitioner Panel, which has statutory independence from the FSA. This helps to ensure that smaller firms are properly represented at the very highest level within the Financial Services and Markets Act 2000 (FSMA) framework.

The Panel meets formally on a monthly basis, when it discusses current (and future) issues of relevance to smaller firms – some of which are driven by the FSA's priorities and some of which are raised proactively by the Panel itself. In addition, smaller groups of Panel members convene to discuss certain matters with the FSA at greater length – the use of such groups is increasing, providing the value of more focused and detailed deliberation.



## 3. The Panel's year in review

This section of our Annual Report focuses on those issues that have taken up much of our time during 2005/6 and that, inevitably, will continue to occupy us over the coming 12 months. These are areas that the Panel believes are fundamental in terms of determining the nature and style of FSA regulation and which, ultimately, will be most important in shaping the strategic and economic environment in which smaller firms do business.

### a. Principles-based regulation

The Panel is cautiously supportive of the general notion and purpose of principles-based regulation. However, it continues to be uneasy about how this approach will be applied in practice. There is a real fear among smaller firms that the FSA will fail to supervise and enforce against principles in a suitably pragmatic, proportionate and broadly consistent way. Smaller firms not only pose a different risk but also typically lack the legal/compliance resource of their larger counterparts – they are therefore likely to be understandably nervous about, and find it much more difficult (financially and expertise-wise) to adjust to and have confidence in what is a fundamentally new method of FSA regulation.

The FSA has a programme of work underway to develop its vision for the future, which includes the transition to and the implications of the shift towards more principles-based regulation. It is hoped that this will pick up many of the concerns identified by the Panel; such as the skills and training that the FSA's supervisory, enforcement and policy staff will require to make effective and proportionate judgements when developing, using and interpreting principles.

The Panel will seek to engage with the FSA in an open and collaborative way as this vision for a more principles-based regime, and all that that entails for smaller firms, moves forward. We would encourage the FSA to put our industry expertise to best use, and to do so consistently at an early stage, so that we can add real value. This will be a crucial area for smaller firms in years to come, and it is imperative that the FSA has sufficient understanding of practitioners' views before the thinking is too far developed, thereby enabling it to react more positively to them.

The FSA is also looking at the feasibility of encouraging (and cooperating with) the industry to help set standards through the use of industry codes and guidance. The Panel would like to emphasise that such industry codes must never become a substitute for FSA rules, and it would not be desirable for trade bodies to become quasi regulators (nor might they wish, or have the resource to be so). There are also various status and practical issues that would need to be considered if such a system was to be successful. In any event, the development of such codes would work best where a particular gap has been identified in a specific sector or there is a danger that they will simply become a second-tier layer of best practice requirements, with the real spirit and benefits of principles-based regulation being lost.



## b. Treating Customers Fairly (TCF)

TCF is the FSA's first meaningful iteration in its move to a more principles-based regime. We commented last year that – at the strategic level – smaller firms already see treating their customers fairly as a fundamental principle of successful business and a basic necessity for survival. Put simply – and given that they do not have the same brand identity as larger, household-name firms – it is not in smaller firms' best interests to engage in poor practices and run the risk of losing their valued customers. That is not to say, of course, that the regulator's expectations (in so far as they are defined) will always be met in full – the FSA itself acknowledges that we operate in a non-zero failure environment. Instances of non-compliance can and inevitably will occur from time-to-time at an individual rule level, in firms of all sizes and for a variety of reasons. But the Panel was never convinced that the high-profile TCF initiative was the appropriate way for the FSA to tackle any such perceived market weakness. However, given that TCF is here to stay, we focus our remarks at this time on the day-to-day aspects of its application.

Despite a strong commitment to the general principle of TCF, the Panel has repeatedly expressed concerns to the FSA about its operation in the smaller firm community. In particular, the Panel continues to feel that there is a significant lack of clarity and an unhelpful ambiguity about exactly what TCF means for smaller firms and how it will be applied by the FSA in practice. At present, it seems to fall awkwardly and unhelpfully between a prescriptive and a principles-based framework, achieving authority and implementation without any formal consultation or quantitative assessment of the inevitable cost implications.

Similarly, we are uncertain what records the FSA would expect to see retained by smaller firms in order to demonstrate compliance with and their commitment to TCF – this is especially pertinent in light of the Costs of Regulation findings (see below) on the burden of certain evidential obligations. In fact, and disappointingly, we have already seen examples of where FSA supervisors have sought detailed and technical information from some smaller firms regarding their approach to TCF.

We welcomed a recent presentation from the Small Firms Division that suggested the FSA was now taking smaller firms' concerns regarding TCF more seriously, and was proactively exploring the best ways of providing practical assistance and information. The Panel is also pleased that the FSA is taking the various concerns on internal training and development more seriously – in particular, in relation to relationship-managers and Contact Centre staff – and that a number of initiatives are already underway (such as the Core Curriculum). We are aware that FSA staff are sometimes seen by industry as overly-bureaucratic, unduly critical and having poor interpersonal skills. It is essential that these “cultural” aspects or perceptions can indeed be addressed, as well as improving their overall technical abilities and market understanding.

We welcome the FSA's assurances that TCF will be operated in a proportionate and risk-based way with regard to the different size, type and nature of regulated firm – including in relation to smaller firms. The Panel was also involved in the development of the Self Assessment Tool designed to help smaller firms help themselves in considering how TCF would apply in their individual circumstances, and how they might best go about meeting the FSA's expectations. We welcome the helpful intentions of this document

However, it is fair to say that smaller firms remain to be convinced that TCF will prove in practice to be what the FSA says it is. The Panel will be watching this closely over the year ahead, and will be robust in its representations should these concerns fail to diminish over time.



### c. Costs and burdens of regulation

The Panel has long held the view that the costs and burdens of regulation are not only too high, but that smaller firms feel the impact of these in a disproportionate way. That belief is repeatedly borne out by the findings of the biennial survey undertaken by the Practitioner Panel.

The joint FSA/Practitioner Panel Costs of Regulation research (undertaken by Deloitte, and published on 28 June 2006), in our view reinforces this, especially in the retail advice sector – and the Panel hopes that this project will be a major driver for the FSA to treat the issue of costs for smaller firms more seriously and take positive steps to remove/reduce these (where justifiable). The Panel was involved and informed throughout the currency of that work – in particular, in helping to secure the necessary response rate from smaller firms, many of whom were understandably somewhat daunted by the complex methodology and lengthy questionnaire. This was the most in-depth study of its kind ever attempted (whether in the UK or elsewhere) and it does provide a solid and reliable basis for tackling the issue of costs in times ahead.

The full text of the report – with individual Forewords by Roy Leighton (Chairman of the Practitioner Panel) and John Tiner (FSA Chief Executive) – can be accessed on [www.fs-pp.org.uk](http://www.fs-pp.org.uk).

It should also be noted that the Deloitte research only explored the costs of regulation in three distinct sectors. The FSA should ensure that its onward thinking does not exclude those other sectors of business which may include smaller firms.

More generally, the FSA must be rigorous and relentless in its drive for Better Regulation and deregulatory measures. Without that, the prospect of smaller firms being forced out of business is very real indeed.

The Panel also sees a connected issue here regarding the barriers for new entrants to financial services – and there is concern that if the price and effort of regulation is commercially prohibitive for those looking to choose financial services as a prospective career, there will be a reluctance to do so (or they might choose to base themselves offshore).

Again, this is an area that the Panel will be watching closely in coming months and we shall be expecting to see the FSA act quickly and decisively.

### d. FSA supervision of and engagement with smaller firms

The Panel has been keenly supportive of the FSA's efforts to make itself "easier to do business with" both generally and in relation to smaller firms. Given that the vast majority of small firms will not have a dedicated relationship manager – although some Panel members are sufficiently large that they do – it is all the more important that (for example) the guidance available from the Firm Contact Centre is clear, meaningful and reliable; that the Handbook is accessible and easy-to-use; and that the method/means of communication with smaller firms are appropriate and helpful. The Panel believes that the FSA is making progress in these areas, for which the Small Firms Division deserves much of the credit.

On the communication front, the Panel sees the key being for the FSA to develop and creatively use a range of tools – for example, roadshows, surgeries and good practice guides. We feel that there remains some scope for the FSA to explore other – mainly Internet based – means of maximising accessibility to material and events, and which smaller firms are likely to find easier (and less time consuming) with which to engage. Linked to this is the issue of cost – information and attendance should be competitively priced to ensure that they are not prohibitive for the majority of smaller firms.



In its Business Plan for 2005/6, the FSA undertook to develop and introduce a number of specific measures to help smaller firms. While we do not list those individually here, the Panel is pleased to note that in large part these initiatives have indeed been brought into effect. In its Business Plan for 2006/7 the FSA, once again, set out a number of workstreams designed specifically with smaller firms in mind – we shall be following these over the coming year to ensure that they are delivered.

With regard to the use of supervision tools, the Panel welcomes the FSA's promise of greater clarity and feedback on its thematic work. However, concerns prevail about certain aspects, in particular regarding the role and use of mystery shopping exercises. Mystery shopping may be a helpful tool in the FSA's armoury to learn more about industry practices in the smaller firm sector and, where problems are identified, to encourage/incentivise better conduct – but the findings must be seen in context and should not be used as an automatic precursor to enforcement action. Such exercises also often lack statistical relevance due to small sample sizes and can be predicated on unrealistic scenarios, which throws further doubt on the ability to draw wider conclusions. Given these limitations, the FSA must consider carefully how it acts upon and publicly communicates the results of such exercises to ensure that negative messages do not do serious, unrepresentative and undesirable damage to the industry's reputation and to consumer confidence.

The Panel is keen to get more regularly and collaboratively involved in the FSA's thematic programme – both strategically and in relation to individual initiatives, and plans are underway to ensure that this happens.

### **e. The FSA's approach to enforcement**

Alongside members of the Financial Services Practitioner Panel, we contributed at a number of sub-group meetings as the FSA's review of its enforcement powers and processes moved forward during 2005. Throughout those discussions, we felt that David Strachan (the FSA Director who led this review) and his team engaged in an open and collaborative way, genuinely seeking input from the smaller firm perspective.

The vast majority of the steps and measures introduced as a result of the review received the Panel's warm support – and took suitable account of the representations that we made. Once fully embedded, we hope these will indeed help improve and enhance the fairness (and perceived fairness), transparency and overall effectiveness of the FSA's investigatory and decision-making procedures, as well as helping raise general awareness and understanding of the way the FSA's approach to enforcement works in practice. It is vital that smaller firms can be confident in, and trust the way that they would be treated if ever facing potential (or actual) disciplinary or authorisation sanction by the FSA.

One area on which the Panel expressed disappointment following the review related to our feeling that the Regulatory Decisions Committee (RDC) appeared to be under-represented in the context of direct, financial services expertise from the smaller firm sector. While we agreed that having the right overall mix of skills and experience on the RDC was preferable to a specified quota or representatives of particular interests, given that over 90% of regulated firms are now generally classed as "small," we felt that it was crucial for credibility and industry confidence that the FSA sought to address this apparent imbalance in the RDC's membership.

Since we made those representations, the Panel has been pleased to note that effort has indeed been made in the most recent round of RDC appointments to increase its smaller firm input. In



the meantime, the Panel will be alert to any evidence to suggest that the FSA (and/or RDC) appears not to be taking proper account of smaller firm dynamics or, more worryingly at face value, cites the smallness of a firm as a negative factor in and of itself.

With regard to any increased emphasis on negotiated settlement of enforcement cases, it should also be said that, typically, such discussions (which are often legal, complex and finely-balanced in nature) are likely to have most benefit for larger firms and their lawyers – smaller firms, who may not have access to such advice or the in-house capability to enter such talks with the desired expertise, may therefore be disadvantaged as a result. And it will also be important that the FSA is not (and is not seen to be) exerting unreasonable or unfair pressure on smaller firms to settle cases which they might otherwise be minded to contest. Again, the Panel shall monitor this aspect in operation.

## f. Summary of consultation paper responses

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-publication 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.

<b>CP05/03: Strengthening Capital Standards</b>	The Panel was concerned that the CP was voluminous and complex. While, at the same time, not all relevant issues were adequately covered – firms would still need to refer to the actual directive text, which smaller firms would likely find difficult to understand and assimilate. The Panel urged the FSA to properly consider and respond appropriately to the needs and concerns of smaller firms, both in the context of the provisions themselves and in the manner of their presentation. In particular, the Panel was concerned about the treatment of goodwill and the consequent impact on competition and innovation in respect of smaller investment firms. We argued that a judicious acquisition could have a positive and strengthening effect on a firm's financial position, and goodwill should not therefore be excluded on the basis of it being an intangible asset. This would put smaller firms at a disadvantage to their larger counterparts when it came to pursuing a strategy that included growth by acquisition.
<b>HM Treasury consultation on the Credit Union Interest Rate Cap</b>	The Panel considered the proposals to be broadly reasonable and pointed out that the increase in the interest rate cap would allow credit unions more flexibility in deciding whether or not they could offset some of the higher risk by charging a higher interest rate. The ability to operate a more flexible risk-based lending programme would allow credit unions to offer loans to a wider spectrum of borrowers and, specifically, to expand the work they carry out in relation to social inclusion.
<b>CP05/08: Suitability Standards for advice on Personal Pensions</b>	The Panel supported the FSA's intention to remove COB 5.3.12R(3) – often known as "RU64" – along with the general thinking behind and reasons for doing so set out in the paper. The Panel also agreed with the strategy for monitoring the marketplace and mitigating any increased risk that its removal might give rise to.
<b>CP05/12: Investment product disclosure: proposals for a Quick Guide at the point of sale</b>	The Panel voiced its concerns about the sheer volume and depth of material currently required to be provided to consumers at the point of sale. But we supported the general principle of the Quick Guide along with the associated proposals relating to its production, content and delivery. However, the Panel encouraged the FSA to undertake a more wide-ranging review and tackle the information overload problem in a more suitably coherent, fundamental and holistic way. The current piecemeal approach to disclosure was not beneficial, and the FSA would be better advised to revert to first principles.
<b>CP05/11: Enforcement process review</b>	The Panel supported the vast majority of measures emerging from the review. We pointed out that if the measures were implemented and applied in the manner and spirit as they were intended, they should indeed help improve fairness (and perceived fairness), transparency and the overall effectiveness of the FSA's investigatory and decision making procedures. More detailed views were submitted in respect of individual aspects of the paper – the relevant section in the main body of this Annual Report sets these out in summary.



<b>CP05/10: Reviewing the FSA Handbook</b>	The Panel considered that it was crucial for the FSA to see the Handbook in not only the context of its format, structure and content but also in the way that these provisions were applied in practice. It would be important for the FSA to have due regard to the differing size, nature and risk of the various types of regulated firms – and not effectively adopt a simplistic one size fits all approach, and in a way that disadvantaged smaller firms. The Panel urged the FSA not to restrict its Handbook Review simply to individual provisions or aspects but to adopt a suitably holistic approach that covered significant issues such as the M&GI regime and Depolarisation. The Panel also pointed to the IMD and DMD as pieces of regulation that many smaller firms considered to be excessive, and which had not achieved what they set out to do at the European level. This was further compounded at the UK level because of FSA gold-plating.
<b>Mortgage Credit in the EU – Commission Green Paper</b>	The Panel stated that it would be undesirable for further legislative intervention in what was a relatively newly regulated marketplace in the UK following the commencement of statutory regulation in late 2004. While the Panel supported the removal of unhelpful cross border barriers, there was wider concern about any measures that might destabilise the current (suitably lighter touch) regulatory regime, which was seen to be operating well at present and in accordance with the nature and objectives of the UK sector.
<b>CP05/13: Bundled brokerage and soft commission arrangements for retail investment funds</b>	The Panel supported the proposals in so far as they related to smaller firms.
<b>CP05/14: Quarterly Consultation (No. 6) – Chapter 5</b>	<p>The Panel commented on Chapter 5 – specifically questions 8 and 9 – that would give insurers the option of whether or not to provide status disclosure information to retail customers, and to remove the requirement to provide a demand and needs statement for non-advised sales to retail customers.</p> <p>The Panel pointed out that there was widespread opposition within the general insurance intermediation sector to the proposals, and that nothing in the paper did anything to enhance consumer protection, which was one of FSA's statutory objectives. In any event, the Panel could see no persuasive case as to why these particular provisions should be repealed at this stage and in advance of the wider M&amp;GI reviews being completed.</p>
<b>HM Treasury consultation on the Proposed changes to the eligibility rules for establishing a pension scheme</b>	<p>The Panel was unclear about the objectives of the exercise and whether the proposals (as framed) would be sufficient to meet these. While some firms might benefit from a liberalisation along the lines set out, there was a risk that the intended approach could have the opposite effect, by opening up the market to abuse and make FSMA boundaries/protection even more unclear for consumers.</p> <p>Given that the proposals would leave a significant element of the market outside the scope of regulation – and in a way that could be exploited – the Panel recommended that the part of the new pensions tax regime that related to a wider choice of pension investments should be delayed until April 2007, when SIPPS would become regulated by the FSA – this would go some way towards mitigating the aforementioned risk during the intervening period.</p>
<b>CP05/15: Review of FSCS and FOS limits</b>	The Panel supported the FSA's case not to increase the FSCS and FOS limits in the absence of any evidence to suggest that there was any fundamental consumer disadvantage by virtue of the current limits. In forming this view, the Panel took account of the fact that there was no formal right of appeal against FOS decisions and that such decisions were effectively binding on regulated firms (though not on consumers).



## 4. Other Panel priorities for 2006/7

In addition to those issues referred to above which will continue to feature on the Panel's agenda going forward, the following section summarises a number of additional items of business that we shall expect to be engaged in during 2006/7.

### a. Practitioner Panel Survey of Regulated Firms

The Financial Services Practitioner Panel recently launched the quantitative stage of its 4th Survey of Regulated Firms. This survey, which is carried out every two years – and is being undertaken on its behalf by GfK NOP market research – is aimed at gathering industry views on the FSA and establishing a track record of the regulator's effectiveness and performance. Previous surveys have achieved a high response rate, providing the Practitioner Panel with robust and authoritative feedback from the financial services industry. The findings are used to inform subsequent representations made by the Practitioner Panel and, in turn, help the FSA to determine its priorities and objectives for the future. We are confident that the FSA takes the results seriously – in fact, in response to the 2004 Survey, the whole issue of the treatment of smaller firms (which was one of the main concerns raised at that time) has now been given much higher prominence and commitment by the FSA, and many of the improvements and developments mentioned elsewhere in this report have been a direct result of that.

Through our Chairman, we participate in the Practitioner Panel working group that is overseeing the day-to-day strategy and methodology for the 2006 round, the results of which are due to be published in November.

A sample of smaller firms (such as Mortgage brokers, General Insurance intermediaries and Financial Advisers) and the majority of larger, relationship-managed firms will have received a postal questionnaire from the Practitioner Panel in mid June, asking for their views on a wide range of subject matter including the FSA's performance against its main objectives, authorisation processes and the role of the Firm Contact Centre, the approach to supervision and enforcement, the quality of FSA staff and the overall costs/burdens of regulation.

This year, and for the first time since the introduction of statutory regulation, those firms operating in the Mortgage and General Insurance sectors will be included in the Survey. While their experiences of the FSA may be somewhat "newer" than those that have been regulated previously (and who would have been included in previous rounds of the Survey), they are no less relevant and it is vital that firms operating in these sectors have the opportunity to complete the questionnaire in so far as they feel able. This is especially important given the sheer volume of firms that undertake M&GI business, the preponderance of which are small in size.

If your firm has been selected to take part in this important research, the Panel would greatly encourage you to complete the questionnaire and provide the Practitioner Panel with your views.



Any such views will be treated in total confidence, and not shared with the FSA. It is in all our interests to help secure the best possible rate of response and ensure the credibility of the data.

## **b. Markets in Financial Instruments Directive (MIFID)**

From a smaller firms' perspective, the FSA has clearly worked hard (alongside HM Treasury) and has made significant progress in attempting to manage at EU level the likely impact of this complex and wide-ranging directive – for example, by seeking to mitigate the original proposal for a separate and independent compliance function. The Panel appreciates these efforts.

But it remains vital that smaller firms are afforded the maximum possible lead time to understand, implement and assimilate the MIFID requirements. The FSA's "Planning for MIFID" document is a valuable way of raising awareness and helping smaller firms understand how to deal with their future obligations in this regard.

However, the Panel continues to be anxious that slippages in the timetable for finalising the terms of the directive could well – insofar as smaller firms are concerned – present significant difficulties with the subsequent schedule for implementation. Secondly, on a maximum harmonisation basis, MIFID may require the FSA to roll back certain provisions, some of which have only recently been introduced (at no small cost); for example, the menu. We are also monitoring closely the FSA's attempts to resolve the commission offset problem which, because of the terminology in MIFID, may include many more financial advisers within the client money framework – something that must be avoided if at all possible.

The Panel has established a sub-group to discuss these important issues with the FSA in more detail as the directive moves closer.

## **c. Mortgage and General Insurance (M&GI) regulation**

As far as GI (intermediary) regulation is concerned the last year has been largely one of monitoring the effectiveness of the new regulatory regime to see how it has been working in practice. The Panel welcomes the forthcoming review of the GI sector in the hope that experience and feedback will demonstrate to the FSA that there are certain parts of the regulatory requirements (for example, those that are super-equivalent to the IMD/DMD) that could be refined or rolled back.

Much good work has emanated from the Small Firms Division in support of GI intermediaries – the recent Client Money Guide; Newsletters; relaxation of the audit requirements; and others. The one big disappointment related to the outcome of the debate on status disclosure set out in CP05/14 (see the table above) – the Panel remains unconvinced by the rationale for this rule change.

On the Mortgage side, the regime seems to have operated smoothly during the last 12 months which – to a certain extent – reflects the work that the FSA and the Panel undertook as the regulatory framework was being developed. This has also been an area that has generated relatively little consumer complaints activity.

The one matter on which the Panel has expressed unease has been the unhelpful interaction of the respective financial promotion rules set by the FSA and the Office of Fair Trading (OFT). This has been especially confusing for firms that offer both mortgage and consumer credit arrangements. We are pleased that a joint FSA/OFT action plan is now in place to address this issue, and the Panel is represented in that process.



We would also draw attention to the Panel's response to the Commission's Green Paper on Mortgage Credit in the EU. The Panel does not consider that further legislation and/or change in this sector would be necessary or advisable, for a number of reasons. However, we do welcome HMT's intention to bring all loans secured on UK property within the FSA's remit – this would be a helpful and sensible step.

A sub-group of Panel members is engaged with the FSA as the M&GI reviews progress – we shall be contributing our views about whether the intended and desired outcomes for industry, and benefits to consumers, are (or are not) being realised.

#### **d. Depolarisation**

The depolarised marketplace became effective on 1 June 2005. There are a number of issues surrounding the operation of the new regime that the Panel shall be feeding into the ongoing FSA effectiveness review, which is tasked with evaluating whether the arrangements are working and having the benefits which had originally been hoped.

In particular, the recent FSA mystery shopping exercise to test firms' compliance with the prevailing requirements – while disappointing at face value – may indicate flaws in (or lack of proper understanding of) the rules as currently drafted. The cost to smaller firms of regularly changing menu documentation to reflect the movement of market averages is also unfortunate to say the least (this was an aspect that the Panel had been concerned about prior to implementation).

There is also the matter of whether some firms are truly operating within the spirit of depolarisation in relation to the use of the term “independent” to describe their status (which requires them to give consumers the option of payment by fee). The Panel is anxious that some firms might not genuinely be offering the fee option, but yet are continuing to hold themselves out as independent – it is important that the FSA has the means and the motivation to identify and tackle such instances.

#### **e. FSCS funding review**

In May 2005, the FSA announced that it was to conduct a fundamental review of the Financial Services Compensation Scheme (FSCS) funding framework. In large part, this was in response to calls from certain sectors of the industry where smaller firms were finding themselves having to absorb significant year-on-year increases in FSCS levies. This threatens the very existence of such firms and, consequently, puts further strain on the FSCS and those similar firms that remain trading.

The Panel – alongside the Practitioner Panel, Consumer Panel and other stakeholders – was regularly involved as the FSA's work in this regard developed, culminating in the issue of Discussion Paper 06/01 earlier this year. We feel that the FSA entered into this process in an open, objective and collaborative manner; and did well to meet the not inconsiderable challenges that a review of this nature presented – there were many complex elements, with a variety of (often opposing) viewpoints and interests.

The Discussion Paper lays out four options, which attempt to provide a framework for funding that would apportion liabilities as fairly as possible across the industry, would be capable of smoothing volatility and be sustainable for the future. The Panel will be submitting a formal response.



It must be said that no one solution is likely to be wholly supported by all market participants. From the Panel's perspective, it is therefore important that we endeavour to focus our input on the impact of FSCS on smaller firms as a group, rather than necessarily what might benefit one industry sector over another. That said, there are some important issues of principle to consider – in particular, the extent to which providers/manufacturers should (or should not) properly be expected to contribute to claims against the distributor sector and, in addition, the merits and legitimacy of introducing a degree of pre-funding.

It should also be noted that the Panel has a continuing dialogue with the FSCS and – beyond the aforementioned review – an issue that we have raised several times is the way that the FSCS seeks to anticipate and quantify future claims. Our sense is that more could be done (especially in the insurer marketplace) to predict these on a more accurate and timely basis; although it must be said that there is evidence of recent improvements in this regard.

On the matter of FSA fees more generally, we welcome the FSA's efforts to mitigate the undesirable impact of further increases for smaller firms – for 2006/7, most smaller firms saw either no increase or a relatively modest one. The success of the instalment arrangements – which were developed in close consultation with the Panel – is also noteworthy, with over 1,600 firms taking advantage of this facility last year.

#### **f. FOS fees**

The FSA and the Financial Ombudsman Service (FOS) have recently issued a Discussion Paper setting out possible options for the future funding of the FOS. There are some synergies here with the FSCS funding review (see above). The “two free cases” system that was introduced two years ago, continues to be supported by smaller firms. However, there may well be other ways to maximise the interplay between annual fees, case fees and the volume of complaints in a way that produces an even more equitable and proportionate framework for smaller firms (who, in relative terms, account for a very small percentage of FOS cases). Again, the Panel shall be responding formally to this paper.

In the meantime, we continue to enjoy an open and constructive relationship with the FOS and Walter Merricks, its Chief Ombudsman. Regular meetings take place between him and the Panel (or a sub-group of members thereof). We have been particularly pleased that the statutory regulation of M&GI business does not appear to have caused any major problems insofar as the FOS is concerned.

#### **g. Disclosure and Conduct of Business simplification**

As noted above in the context of the Panel's response to CP05/12, we have expressed concerns to the FSA about the nature and shape of the current disclosure provisions which, in our view, work to the disadvantage of both consumers and smaller firms. The point-of-sale requirements are cumbersome and costly for smaller firms, while at the same time complex and difficult for consumers to digest and understand. Little protection is offered against subsequent complaints made by consumers (often with the benefit of hindsight).

The Practitioner Panel has been strong in its representations that the FSA should undertake a more fundamental review of the disclosure regime. We support that proposition. Similarly, this Panel would prefer a regime based around a limited number of short, concise documents which clearly state a product's downside risk, provide links to additional information and urge the consumer to seek further advice/ask questions if they are unclear on anything therein.



We are pleased that the FSA is indeed now carrying out a review along the lines suggested above. And the Panel welcomes the recent (logical) decision to link that work with the incoming expectations of MIFID. In any event, it will be crucial that the associated cost/benefit analyses are undertaken in a suitably consolidated, objective and robust manner.

The Panel will be engaged with the FSA as work in this important area progresses during the latter half of 2006.

## **h. Integrated Regulatory Reporting**

For those firms subject to the FSA's mandatory electronic reporting arrangements – a predominance of which are likely to be smaller firms – those requirements took formal effect during the course of 2005. The Panel is aware that some firms found it hard to properly understand and get fully to grips with their obligations in this regard. The system was considered to be complicated, problematic and time-consuming to operate.

By the FSA's own admission, there were indeed some teething issues and aspects of the framework that would benefit from refinement after the first phase. That said, the vast majority of firms were able to submit their returns on time.

Smaller firms will no doubt become more familiar and comfortable with the reporting process over time. But the Panel is pleased to note that the FSA is actively responding to industry feedback in seeking to improve and simplify the usability, accessibility and communication around this matter.





# Annex A

## TERMS OF REFERENCE FOR THE FSA 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:
    - o authorising firms and approving individuals, including grandfathering provisions
    - o supervision, and the effect of the implementation of the risk assessment framework and consequent move away from front-line contact with smaller firms
    - o enforcement and disciplinary processes
    - o the level of FSA fees and their distribution across types of firm and 'fee blocks,' paying particular regard to the impact on smaller firms
    - o training and competence requirements
    - o cost-benefit analyses, research and performance measurement
    - o 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 B

## LIST OF MEMBERS (as at 1 April 2006)

<b>Panel member</b>	<b>Position</b>
Ruthven Gemmell Chairman until 31 May 2006	Partner, Murray Beith Murray WS
Mark Rothery Deputy Chairman until 31 May Chairman from 1 June 2006	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
Chris Brennan	Legal and Compliance Director, Cube Financial
Gill Cardy	Principal, Professional Partnerships
Paul Etheridge	Principal, Prestwood Etheridge & Russell
Andrew Gibbs	Former Managing Director, CCLA Investment Management
Fraser Gillespie	Group Finance and Insurance Manager, Marshall Motor Group
Chris Gomm	Director, Gomm Insurance
Bella Hopewell	Managing Partner, C Hoare & Company
Philip Ireland	Director, TD Waterhouse Investor Services
Keith Morris	Chief Executive, Sabre Insurance Company
Neville Thompson	Chief Executive, Earl Shilton Building Society





# Annex C

## **THE FSA'S FORMAL RESPONSE TO THE SMALLER BUSINESSES PRACTITIONER PANEL ANNUAL REPORT FOR 2004/5**

We welcome the Panel's support for a number of aspects of our work, in particular, our drive to make the FSA easier for smaller businesses to do business with. We look forward to continuing our discussions with the Panel on many of these subjects over the coming year.

In this response we focus on the issues on which the Panel expresses concern.

### **Practitioner Panel Survey of regulated firms**

We are sensitive to the impact our requirements have on smaller firms and our approach recognises that, individually, smaller firms pose less of a risk to our objectives than larger ones, so we have tailored our supervisory regime accordingly.

We look to investigate and communicate examples of good and bad practice so that smaller firms understand clearly what we expect of them. Our strategy is designed to help raise standards taking account how smaller firms are managed and how they deliver products and services that meet consumer needs.

We recognise that for many thousands of small firms statutory regulation is new. We aim to help these firms adjust to the new obligations this brings so that they can continue to trade effectively in the regulated environment. We have a range of initiatives to make it easier for smaller firms to do business with us, including road shows and 'surgeries', industry training, tailored handbooks, and electronic reporting.

### **General concerns for smaller firms during 2004/05**

We work to ensure that our staff understand the financial services industry and that they apply our risk-based values (characterised by swift and proportionate decision-taking) in day-to-day dealings with firms. Around 60% of staff recruited in the last year joined directly from the financial services industry. In addition to the training they receive on-the-job, we continue to invest heavily in our formal training programmes.

In addition, we are further developing our core training with a "regulatory curriculum" to help build the overall knowledge and skill of our staff. Our sector teams are building expertise in specific industry areas, often in collaboration with trade bodies or individual regulated firms. We continue to support staff in acquiring industry qualifications and we have an active two-way secondment programme with industry, including into small firms.

As the Panel acknowledge, the survey was undertaken during a period of change at the FSA.



Our Firm Contact Centre (FCC) doubled in size from August 2004 to January 2005. The quality of FCC staff is high. Of course, the knowledge and performance of new starters improves with coaching, familiarisation, and time.

The FCC receives around 8,500 calls per month and significantly has very few complaints. We are trying to ensure that firms understand our answers and the reasoning why we have given a particular response. Quality is a key focus for us and we have changed our monitoring process to assess performance better. We have already introduced Customer Satisfaction surveys and will be making more use of these, to help ensure that we are delivering the services that smaller businesses want, to appropriate quality standards.

We will continue to enhance our technology and system capabilities, in the interests of all regulated firms and the efficiency of the FSA.

### **Some specific issues: Treating with-profits policyholders fairly**

We considered carefully the Panel's views and those of other respondents during the two consultations on treating with-profits policyholders fairly. Our final rules and guidance were published in PS05/1 in January 2005.

As the Panel acknowledges, we made a number of important changes to our rules and guidance to reduce the practical difficulties with our proposals on target ranges and surrender values. We also made changes to address the concerns voiced about the costs of compliance and the confusion or anxiety that could be caused to existing with-profits policyholders by requiring firms to send them CFPPFM out of context.

The changes we made included:

- giving guidance on how firms can demonstrate whether their surrender values meet the new standards;
- giving firms up to an additional six months (until 31 December 2005) to implement the proposals on target ranges and surrender values;
- requiring firms to provide CFPPFM to existing with-profits policyholders with the next annual statements (if any) they send; and
- giving firms additional time (until 31 December 2005) to produce the CFPPFM.

### **Some specific issues: Upcoming EU legislation**

We take the interests of smaller firms into account in our contribution to EU policy discussions and in considering how the domestic implementation of EU requirements will affect different industry sectors. However, the UK is one of 25 Member States and its proposals will, therefore, not always secure the agreement of other Member States. We wish to see full regulatory impact assessments as part of an evidence-based approach to EU policy-making and for the full range of non-legislative solutions to be explored before proposals for further EU legislation are brought forward. In implementing EU legislation, our policy is that our rules will be super-equivalent (that is, going beyond the strict requirements of a Directive) only where this is necessary to maintain standards in UK markets and to help us achieve our statutory objectives. We apply this policy pragmatically, taking into account the need to implement Directives on time and cost-effectively.



As reflected in our consultation paper, “Strengthening Capital Standards” (CP 05/3 January 2005), we fully recognise the challenges that implementation of the Capital Requirements Directive will pose for smaller firms. The key issues depend very much on the nature of the firm and its business. In some areas – “limited licence” investment firms for example – there could be easing of certain current requirements. However, as hitherto, firms in any sector which have grown by acquisition will have to make a deduction from their calculated financial resources in respect of the consequent goodwill. And groups – including groups containing small firms – will under the CRD have access to a rather narrower range, than currently, of exemptions from consolidation requirements.

We continue to work closely with the trade associations whose memberships are most affected to handle UK implementation of European capital requirements as proportionately as is possible for smaller firms within the constraints of Directive obligations. In the longer term, Basel and EU reviews of the definition of capital will provide an opportunity to debate some of the underlying issues.

Discussion of the requirements in the Markets in Financial Instruments Directive (MiFID), for a firm’s compliance function, continue in the European Securities Committee, with HM Treasury – representing the UK – seeking a proportionate outcome.

### **Some specific issues: Treating Customers Fairly**

The requirement to treat customers fairly is a long-standing regulatory requirement. We recognise the importance of assisting firms – and particularly small firms – to meet it. We have carried out detailed supervisory work over the past year examining current industry practice in a number of areas which is summarised in our latest TCF report and explained in more detail on our website. This material sets out some of the issues which firms need to consider in ensuring that the way their business is organised does treat their customers fairly. In smaller firms we recognise that engagement and attention by management in the effective consideration of TCF and its requirements will often be key, rather than reliance on detailed documentation and extensive new processes.

We have discussed with trade bodies how best to assist small firms in this area. A number are seeking to help their members identify key TCF issues. In our latest paper, we will set out the work which we will be doing in this area over the coming period. These plans have been discussed with the TCF Consultative Group (which includes representation from the Smaller Businesses Practitioner Panel and certain trade associations with a small firms focus).

We are developing further training for our staff on TCF, an important objective of which will be to ensure a consistent approach is adopted across our supervision of different firms. We will discuss our approach with the Consultative Group. Trade association involvement here will help firms understand what our supervisors will be looking for when discussing TCF.

### **Some specific issues: Enforcement**

The Enforcement Process Review welcomes the contribution it has received from the Smaller Businesses Practitioner Panel. The Review’s report will be published in July. Its primary objective is an enforcement process which is fair and seen to be fair, whilst also remaining economic and efficient. We recognise that both aspects are important for smaller firms. The revised enforcement process will be capable of being operated proportionately and in a risk-based way. The Review agrees with the Panel’s view that general awareness in and transparency of the enforcement and decision-making arrangements could be improved. While approaches have been developed both for large and for small firms, the Review sees value in a clearer articulation of the FSA’s enforcement approach for medium-sized and smaller firms in particular.



Membership of the Regulatory Decisions Committee includes practitioners and non-practitioners, chosen for their ability to assimilate cases before them on a fair and reasonable basis, taking into account all the relevant circumstances, including the size of the firm. All RDC members act in the public interest rather than as representatives of a particular sector or stakeholder group. The composition of the RDC will be reviewed once the outcome of the Enforcement Process Review is known and there will be an opportunity for those with direct, smaller regulated firm expertise and experience who have the required skills and can make the necessary time commitment to apply.

### **Some specific issues: Mortgage and General Insurance regulation**

We have reviewed a sample of lender and non-lender produced mortgage disclosure documents, in particular Key Facts Illustrations (KFIs). Overall, we found that the quality of these documents needed improvement – in line with the Panel’s own comment, we found that many KFIs were longer than necessary. As a result, we have contacted firms (via Dear CEO letter to mortgage lenders and a fact sheet to intermediaries) to outline our key findings and to help them improve the quality of the documents. We have also provided some indication of how long KFIs should be (5 pages or fewer).

We are carrying out a range of further work to help firms comply with our requirements on mortgage disclosure. For example, we are providing individual comments to the firms sampled, discussing industry concerns with trade bodies and publishing more detailed feedback on our website.

We have published frequently asked questions (FAQs) on our website giving firms guidance on how they can comply with the new Consumer Credit Act (CCA) and FSMA regimes for financial promotions within the same promotion. We are also exploring the possibilities of making a rule change relating to the risk warning which will remove one of the problems in complying with both regimes. We have had a helpful dialogue with the SBPP, and we continue to liaise with the DTI and OFT on these issues.

In terms of minimising the burdens/impact of the new regulatory regimes, we look forward to continuing discussions with the Panel as the new regimes continue to bed down. As is the case with all major policy initiatives, we will keep the regimes under review to see whether the objectives and benefits are being achieved as intended. This will need to take account of the fact that many of our conduct of business provisions arise from EU directive requirements (the Insurance Mediation Directive and the Distance Marketing Directive). As set out in our Business Plan for 2005/06, we have committed to starting a review of the effectiveness of the mortgage regime by the end of this year.

### **Some specific issues: Depolarisation and the menu**

In developing the menu we carried out extensive consumer research on consumers’ understanding of the key messages. This research influenced the final format and content of the final version. While recognising the panel’s concerns about the potential complexity of the document, we are confident that the menu will help consumers to better understand the cost of advice and their payment options. Our procedures for calculating the market averages were subject to full consultation and the calculations have been carried out in accordance with the methodology set out in Policy Statement 04/27. We also commissioned a review by independent consultants of the data collection, calculations and resultant figures. Their statement confirmed that these figures fall in the range they would expect.



We agree with the Panel that post-implementation reviews are important. We are committed to carrying out a full review of depolarisation. This will look at the effects depolarisation has had on the market and whether or not it has met its objectives.

We have made significant efforts to help smaller firms prepare for the changes. These included: providing a direct policy helpline and email address, organising industry training events, providing a menu commission calculator to help firms assess commission levels quickly and simply, as well as providing information, document templates and an IFA fact sheet on our website. We continue to assist firms with individual queries.

### **Some specific issues: Regulatory fees and levies**

We are very conscious of the concerns regarding the Fees and Levies and their impact upon regulated firms. In particular, the main concern relating to the volatility and increases in the Financial Services Compensation Scheme (FSCS) levy. The current nature of compensation arrangements means that firms contribute to the compensation caused by “departed” firms. The bulk of the levy is determined by number and scale of the failures in the industry. Last year there was a significant increase in the sum raised under the FSCS sub scheme covering investment advisory firms, from £5.5m for 2003/04 to £25m for 2004/05. A major reason for this increase was the number of claims relating to investment products, most notably endowments.

In the light of these concerns, we were significantly more transparent this year, providing firms with clear and early guidance. Hence in January 2005, we published detailed indicative examples in our Regulatory Fees and Levies 2005/06 consultation paper, which enabled early insight into the likely FSA, FSCS and Financial Ombudsman Service costs for 2005/06. As the Panel is aware, we have made a policy decision to cap the increases on smaller firms for 2005/06 and have also facilitated the introduction of an optional market based instalment payment plan to ease cash flow. The industry has welcomed these further steps to take into account the circumstances of smaller firms. Finally, we have announced that we will be undertaking a review of the funding regime which will focus mainly on the FSCS levy but may have consequential changes to the FSA and FOS arrangements. The FSA will continue to work closely with the industry and panels in this regard and will publish proposals for consideration before the end of 2005.





# Annex D

## **PANEL CHAIRMAN, RUTHVEN GEMMELL'S SPEECH TO THE FSA ANNUAL PUBLIC MEETING – JULY 2005**

Good morning. As Sir Callum indicated, this is the first time that there has been a report from the Smaller Businesses Practitioner Panel at an FSA Annual Public Meeting. It is encouraging that this is illustrative of the high priority that is now being given to smaller firms by the FSA.

I would like to say a couple of introductory words about the Panel and how we work. The Panel was set up by Clive Briault, now a managing director of the FSA, in 1999 to represent the views of and the interests of smaller regulated firms. Like the Practitioner Panel, we are composed of independent industry practitioners, but from smaller firms covering the relevant sectors. We meet monthly and hold open and frank discussions with senior FSA staff on all aspects of the regulator's treatment of smaller firms and respond formally to FSA consultations, where necessary. The Chair of the Panel sits as an ex-officio member of the statutory Financial Services Practitioner Panel to provide a link with that Panel, which is set up within the framework of the Financial Services and Markets Act.

We are often asked what we define as smaller and whether we apply a limit in terms of turnover or market share to our membership. We deliberately do not apply a single definition to the term. For example, a small firm would often be regarded as having a minor market share in relative terms; therefore a firm of a given size might be seen as smaller in one particular industry sector, but not in another. The number of employees, the financial position and whether the firm is owner-managed may also be relevant.

Furthermore we do not want to limit ourselves to representing only the very smallest firms, such as the High Street independent financial advisers (IFAs) and general insurance brokers that might employ only a handful of staff. This could leave a large segment of firms unrepresented in the regulated framework, as they might fall in the middle ground between the two practitioner-based panels. Accordingly, smaller-sized banks, insurance companies and fund managers also fall within our membership and general remit. I should also add that the composition and balance is kept under constant review and, where appropriate, adjusted to reflect the evolving marketplace and demographics of the regulated community.

To further enhance this flexibility and remove any potential barriers to firms' affiliation with us and our work, we recently changed our name from the Small Business Practitioner Panel to the Smaller Businesses Practitioner Panel.

Although we do not have statutory status, which means the FSA are not obliged to explain in writing when they disagree with our views, as is the case with the Consumer and Practitioner Panels, both practitioner panels are treated in a very similar way by the FSA. Both the Practitioner Panel and the FSA recognise that the Panel has a vital role to play as smaller firms are crucial in delivering competitive financial services to consumers and providing them with choice, service and flexibility.



Due to that smaller size and large number, they do not usually have a regular, consistent and personalised contact within the FSA. Large firms tend to have a relationship manager and know who to approach with specific queries and comments. Many smaller firms do not, nor do they typically have dedicated compliance expertise, on which to rely, in house. The Panel's role, therefore, is to ensure the FSA fully considers the impact of its activities and policies on smaller firms and that the views of smaller firms are heard within the FSA's policy-making infrastructure, at as high a level as possible.

Following last year's extension of the FSA's regulatory scope to include general insurance and mortgage advisers, smaller firms have become even more important to the FSA and as Sir Callum has mentioned represent more than 90% of all regulated firms. At the same time regulatory developments such as depolarisation, capital adequacy requirements and the sale of simplified stakeholder products are radically changing the way in which smaller firms operate. Consequently, we feel it is more important that smaller firms have a dedicated, authoritative and independent voice battling for their interests from within the FSA's management structure.

As Jonathan has mentioned, the Practitioner Panel survey of regulated firms showed that the smaller firms' view of the regulator are overall much more negative than those of larger organisations. Not unsurprisingly perhaps, smaller firms feel the burden and especially the cost of regulation much more heavily. The recent survey showed that 50% of small firms estimate compliance costs to be more than 10% of their total expenditure and over 80% believe those costs will increase further going forward.

The survey results again underline the crucial importance of the work and the role of the Smaller Businesses Panel. Unless regulation for smaller firms is proportionate and pragmatic, we face the very real prospect of smaller firms being squeezed out of existence by the pressure and burden of an increasingly onerous regulatory regime.

The Panel believes the crucial challenge for the FSA is to ensure that consumers receive the correct degree of protection, but with allowances made to enable smaller businesses to exist to service their needs. Following the survey, smaller firms have moved up considerably in the FSA's priorities. We believe the Panel's ongoing work has played a significant role in achieving this and, under the leadership of Sir Callum McCarthy and John Tiner, there has been a genuine effort within the FSA to make it easier for smaller businesses to deal with the regulator. This is a development we wholeheartedly welcome and to which we have been pleased to contribute.

In its Business Plan for 2005/6, published in January, the FSA dedicated a large section to its attempts to making its organisation and regulations more accessible for and accommodating of smaller firms. Many of the various initiatives and improvements that the FSA has already or intends to roll out have been directly influenced by the Panel's input, for example, the usability of the handbook and the ability to pay fees by instalments.

I cannot stress enough how supportive we are of these initiatives, which are clear moves in the right direction and which we will continue to support. We urge the FSA to maintain this encouraging momentum.

The regulation of mortgage advice and general insurance allowed the Panel and the FSA to work together to ensure a system of regulation without any baggage from the past. The Panel provided a significant amount of input and advice to the FSA to help it design a proportionate and cost-effective framework. We have been pleased to see the careful and responsive manner in which the FSA has listened to our own and the industry's representations during the consultation process, although our views were not always accepted. We will continue to monitor the market and hold discussions with the FSA as the new regimes bed down and smaller firms adjust to their new regulatory responsibilities.



I have already mentioned cost and Jonathan elaborated on this in his speech. As was demonstrated by the Practitioner Panel survey, this issue is much more pronounced for smaller firms with their more limited resources, which is why we are pleased the cost of regulation research project will include a particular focus on smaller firms.

Following the release of the Panel's 2004/5 Annual Report, many firms have taken the time to write to us stating that they find it nearly impossible to deal with the volume of material they receive from the FSA on a regular basis. We understand the FSA recognises this problem and is taking steps, amongst them some of the initiatives mentioned earlier, to address this. But this remains an area of concern, as does the cumulative cost of regulation.

Although there has been a noticeable reduction in the number of consultation papers, as much as possible needs to be done to reduce the overall burden and costs of regulation.

Similar to the Financial Services Practitioner Panel, we encourage the FSA to ensure that regulation is proportionate, risk-based and pragmatic. This is particularly important when implementing EU in legislation in the UK, ensuring that the singular interests of small firms are not neglected when negotiating and introducing EU requirements.

Lastly I would like to raise the issue of Treating Customers Fairly, which Jonathan has already mentioned. Naturally we cannot disagree with the basic principle of TCF; in fact, we would argue that smaller firms must do this to a greater degree or else they would put themselves out of business rather quickly. We continue to be concerned, however, that there is a danger of disproportionate and inconsistent application, without due regard for the different size, nature and risk of various firms. This stems from a natural uncertainty about how the transition from a generally prescriptive and rules-based process to a principles-based one will be implemented. The FSA have responded to our initial concerns and the Panel hope this will lead to a successful implementation of a principle-based and less rule-based regulation.

This raises the general problem, as Sir Callum has already mentioned, that smaller firms have with a 'one size fits all' approach, where applying the same requirements across the board could place smaller firms at a competitive disadvantage. Treating Customers Fairly can only be successful if it delivers clear benefits for consumers, but it could have an opposite effect if smaller firms cautiously adopt burdensome and overly bureaucratic processes, in order to protect themselves against the FSA. Perhaps this also reflects some of the comments Ann made about the amount of information they then give customers. This would be contrary to the FSA's strategic aims and we will be watching closely as the TCF initiative moves on.

In closing, I would like to thank the FSA on behalf of the Panel for the continuous open dialogue we have enjoyed with its staff. Whereas we do not always agree, we enjoy what we believe is a constructive and mutually beneficial relationship that has benefited smaller firms.

Although it is easier to say than to prove, a lot of our work is unseen and unreported, but it is still there. The Panel also receives considerable assistance from the Practitioner Panel and we enjoy good links with the Consumer Panel.

In a rapidly changing environment, these are developments that can only be commended and in the long term should benefit all participants, including consumers, and the financial services market. You have each been given a copy of our recent Annual Report, which is the pale blue document with no smiling faces, and I would encourage you to take it away and read it.

Thank you very much.







## *The FSA Smaller Businesses Practitioner Panel*

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