

Smaller Businesses Practitioner Panel

Chairman's Foreword

This will be the last report of the Smaller Businesses Practitioner Panel that I will introduce as Chairman as my term finishes on 31 May 2008.

It is produced at a time when many regulatory developments have a huge impact upon the operation of a smaller firm in the Financial Services Authority's regulatory environment. Over 90% of regulated firms are considered 'smaller' by the FSA.

Smaller firms will often feel overwhelmed by communication about regulatory matters – so why should they read this report?

Well firstly, it captures the most obvious points all in one place. It describes those issues succinctly and then expresses the views and representations of a group of practitioners – drawn from smaller firms – that the FSA Board and Senior Management have consulted, engaged with and allowed unique access to the regulatory thought process.

The FSA itself is going through organisational change. Some of that change directly impacts upon smaller firms – in particular, the enhanced small firm strategy, which the Panel fully endorses. Greater contact with the FSA can only assist smaller firms to comply with a complex regulatory framework.

The FSA is also dealing with the post Northern Rock fallout. The regulator has been open and honest about its failings around that matter, and for this it should really be congratulated. Going forward, the FSA should be allowed – with input from the industry – to address those shortcomings identified.

As my term on the Panel has progressed I have become more and more impressed by a sense that good, well run firms and the FSA are not polar opposites. Instead they are both trying to achieve the same thing – successful, compliant and properly managed financial services firms.

The Panel is comprised of senior people from a number of sectors regulated by the FSA. As Chairman I would like to express my gratitude to all that have served on the Panel and also to the very professional members of the secretariat that the FSA provides to support the Panel in its efforts.

The chairmanship of the Panel will now pass to Simon Bolam. Simon has extensive experience, enthusiasm and natural leadership - all of which qualities will help ensure that the Panel continues to interact constructively with the FSA; is focused on the issues that matter; and remains an important and influential voice for the smaller firm community.

I commend the Panel's Annual Report for 2007/8 to you.



Mark Rothery
Panel Chairman
May 2008

Executive Summary

Background

The Panel was established by the Financial Services Authority (FSA) in 1999 to represent the views and interests of smaller regulated firms; and to provide advice on policy, strategic and operational developments in financial services regulation.

The Panel seeks to ensure that the FSA – and others – impose an overall regulatory framework which is proportionate; and which takes due account of the day-to-day impact on and challenges faced by the smaller regulated firm community.

Smaller firms make up around 90% of the FSA's total regulated population. The Panel strongly believes that such firms have a crucial role to play in a vibrant and competitive financial services marketplace – and in providing consumers with choice, service and flexibility.

The Panel's membership is drawn from senior practitioners across smaller firms operating in all the main sectors of regulated business – for example, building societies; credit unions; general insurance and mortgage intermediaries; insurance companies; stockbrokers; investment managers; banks and independent financial advisers. In addition, the Panel Chairman serves, ex officio, on the Financial Services Practitioner Panel.

The Panel is treated by the FSA in the same way as the Financial Services Practitioner and Consumer Panels – even though it does not itself have the same statutory status.

Further information about the role, work and membership of the Panel can be found on its website: www.sbpp.org.uk

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Key Issues

The Panel has welcomed the FSA's intention to increase regulatory contact and engagement with smaller firms, as announced in October 2007, through the **Enhanced Small Firms Strategy**. The FSA has now started to implement its new strategy by introducing an ongoing programme of structured visits, including telephone assessments, to test the progress made by smaller firms towards, in particular, embedding the Treating Customers Fairly (TCF) initiative into their business culture.

The Panel is continuing to work closely with the FSA on this initiative to evaluate its effectiveness and monitor how smaller firms are experiencing its application in practice.

The **Retail Distribution Review** is an extensive piece of work and the Panel has been supportive of the FSA's decision to look at the distribution framework. However, there are aspects which continue to cause the Panel concern – not least its potential impact on the IFA sector.

The Panel welcomed the FSA's decision to delay the next formal stage of the RDR until October 2008, to allow time for careful and critical deliberation, and looks forward to playing an integral part in assisting the FSA in reaching some firmer policy conclusions leading up to this date. In any event, clarity of communication and open engagement with smaller firms continues to be imperative.

In terms of **Panel effectiveness**, and in discussion with the FSA, we will in future operate with a slightly smaller membership of approximately 11/12 rather than the traditional 14/15.

This is with a view to Panel members becoming more focused and strategic in their contribution. This, in turn, will hopefully produce better and more influential engagement with the FSA (and others) in support of those smaller firms whose interests the Panel seeks to represent.

The Panel has had regular contact with the **Financial Ombudsman Service (FOS)** during 2007/8 and, more recently, has been pleased to note the proposal to increase the number of "free" cases from 2 to 3 – which should be beneficial for smaller firms – and the FOS's creation of a dedicated taskforce to deal with smaller firm issues in a more focused way.

Lord Hunt recently published his review of the FOS, the conclusions and recommendations from which the Panel is currently in the process of reviewing.

The Panel has been supportive of the FSA's commitment to upgrade the structure and quality of the **Firm Contact Centre (FCC)** as, for many smaller firms, this is their first point of contact at the FSA.

The Panel has been supportive of **more principles-based regulation (MPBR)** and has engaged in regular dialogue with the FSA on this issue. However, some smaller firms still tend to prefer the certainty provided by prescriptive rules. So, although many strive to adapt to a more principles-based approach, the Panel continues to stress the need for the FSA to provide better support for and information to those smaller firms that are finding it harder to do so.

The Panel has had regular and constructive meetings with the FSA on the **insurance selling and administration** framework. Among other things, while agreeing with proposals to retain stricter rules for certain higher risk products, the Panel has urged the FSA to critically review those aspects that continue to be super-equivalent to the prevailing EU legislation.

The Panel has received regular updates from the FSA in relation to the **Quality of Advice (Outcomes) Project**, but remains unconvinced that the benefits from this work will justify its cost.

This pilot is now drawing to a close and the Panel strongly feels that unless it proves possible to undertake this exercise in a way that will produce credible and valuable conclusions, then the FSA should decide not to proceed to the next stage.

2007/8 saw the culmination of the discussion process into the operation and funding of the **Financial Services Compensation Scheme**.

The Panel expressed reservations about the appropriateness of smaller firms being expected to cross-subsidise the liabilities of larger businesses. In addition, further research into the underlying reasons for firm insolvencies, and measures that could be taken to ameliorate these, was recommended.

The launch of the fifth Survey of Regulated Firms by the Financial Services Practitioner Panel took place earlier in 2008, which will give smaller firms an opportunity to provide their input – in confidence – on topical issues as well as on general regulatory performance and effectiveness.

The results are due to be published in the last quarter of the year and the Panel would very much encourage smaller firms to take part if they are invited to do so.

In October 2006, the FSA announced its intention to undertake thematic work to review commission disclosure in the **commercial general insurance market**. The Panel was opposed to any introduction of mandatory commission disclosure and, in December 2007, the FSA announced that its analysis indeed showed that such disclosure was not justified – in line with the Panel's view.

The Panel was therefore disappointed at the FSA's subsequent decision to publish a formal Discussion Paper on this issue; but will nevertheless work with the FSA to help ensure a credible, pragmatic and objective outcome is reached insofar as smaller firms are concerned.

The **cost of regulation**, particularly fees, is a considerable concern to smaller businesses, and the Panel has advised the FSA that continuous increases will cause some smaller firms problems and, at the same time, has urged the regulator to monitor and control its budget more effectively. The overall **burden of regulation** also continues to present practical difficulties for smaller firms, especially the pace and cumulative impact of change.

The Panel feels that the FSA should place greater emphasis on supervising and enforcing smaller firms' adherence to existing rules rather than continue to create new policy and/or propose any further regulatory changes.

The Panel remains supportive of the **Treating Customers Fairly** initiative, but continues to be concerned about its direction; and also the consistency and proportionality with which it is being applied to smaller firms. The Panel has worked with the FSA to ensure that clear and practical guidance is being made available to smaller firms.

The FSA's report against the 31 March 2008 TCF deadline – expected shortly – is awaited with interest by the Panel.

The Panel has raised concerns about the results of various FSA thematic reviews in relation to the **mortgage market**. We have stressed the need for the regulator to take swift and decisive action to improve standards, in particular in the mortgage intermediary sector, and have also continued to urge the FSA to ensure it communicates thematic findings in a balanced, controlled and proportionate manner.

