House of Commons

Treasury Committee

Work of the Financial Services Authority, 2007–08

Oral and written evidence

15 December 2008

Witnesses:
Financial Services Consumer Panel
Financial Services Practitioner Panel
Smaller Businesses Practitioner Panel
Which?
Financial Services Authority

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The Treasury Committee

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List of witnesses

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Oral evidence

Taken before the Treasury Committee

on Monday 15 December 2008

Members present

John McFall, in the Chair

Mr Graham Brady
Mr Colin Breed
Mr Stephen Crabb
Sir Peter Viggers

Witnesses: **Mr Adam Phillips**, Acting Chairman, Financial Services Consumer Panel, **Mr Nick Prettejohn**, Chairman, Financial Services Practitioner Panel, **Mr Simon Bolam**, Chairman, Smaller Businesses Practitioner Panel, and **Mr Peter Vicary-Smith**, Chief Executive, Which?, gave evidence.

Q1 Chairman: Good afternoon and welcome to this session on the FSA Annual Report. Can you introduce yourselves for the shorthand writer, please, starting with Nick?
Mr Prettejohn: Nick Prettejohn, Chairman of the Financial Services Practitioner Panel.
Mr Bolam: Simon Bolam, Chairman of the Smaller Businesses Practitioner Panel.
Mr Phillips: Adam Phillips, Acting Chairman of the Financial Services Consumer Panel.
Mr Vicary-Smith: Peter Vicary-Smith, Chief Executive of *Which?*.

Q2 Chairman: You are all welcome, particularly yourself, Mr Phillips. You are just taking up your appointment as Acting Chair—so congratulations. Your predecessor Lord Lipsey's letter of resignation called for a broader remit, with greater resources than the Panel currently enjoys. Do you share that ambition with him?
Mr Phillips: I suppose I should start by saying first of all that I deeply regret the fact that Lord Lipsey decided to resign. His resignation will be a loss to the Panel. Having said that, I think that his letter of resignation created a rather unfortunate impression: first of all that the Panel's remit is rather narrow and, secondly, that the Panel sees it that way. The terms of reference we have, agreed with the FSA, give us a fairly broad remit, which goes well beyond the areas that the FSA regulates in financial services. As far as the Panel is concerned, we had a discussion with Lord Lipsey, when he joined in July, about his wish to set up an inquiry into the effectiveness of the financial regulatory system from the consumer point of view. The Panel agreed at that time that it was the wrong time to be doing something like that. As we have seen subsequently, it was definitely the wrong time to do it, and that was a good decision. We agreed that we would defer a discussion until the end of the year, with the idea that we would do something next year. In fact, the discussion was planned and is still going to be held this Wednesday. I think that we will still take the decision as a Panel that to have such a broad inquiry into the effectiveness of the regulatory system is probably too big an issue for the Panel to take on at the present time.

Q3 Chairman: That is maybe taking us a wee bit further than I want at the moment. Perhaps I could therefore put it to you again if you share his ambitions for the Panel. I gather the answer is no, because you think that you have a broad enough remit and, if a perception has been established, it is a bit unfortunate.
Mr Phillips: I think that is a fair analysis. We think that we already have a broad enough remit; it is the extent to which we use it.

Q4 Chairman: Lord Lipsey did make a speech in the House of Lords and I do not think that it is a perception. I have read his speech on that. How many staff do you have?
Mr Phillips: We have five full-time equivalent staff working for us at the moment in the secretariat. In fact, it is six people but two of them work part-time for the Panel.

Q5 Chairman: How does that break down then?
Mr Phillips: In . . . ?

Q6 Chairman: In the remit; in what they do?
Mr Phillips: Two of them are policy people. One of them is a liaison person who is effectively dealing with outside organisations and also some of our relationships inside the FSA; then we have a part-time manager and a part-time PR person who deals with relationships with the media.

Q7 Chairman: If I am looking at it from a policy point of view, you have two full-time people working with you?
Mr Phillips: Yes.

Q8 Chairman: Do you think two is adequate?
Mr Phillips: When we have asked the FSA for additional resources and we have made a reasonable case, we have got the resource. Looking back at the last year, we have had the secretariat reorganised and it certainly has not been a particularly comfortable experience for the Panel. We have been under-resourced. I would hope that, going forward, we have enough to do the basic work of the Panel. I think that we will need additional resource

probably, if we decide on Wednesday that we need to look at the effectiveness of the financial regulatory sector.

Q9 Chairman: Do you think that two people are enough to take on the might of the financial services industry?
Mr Phillips: No, I do not. I think that you need a lot more than two.

Q10 Chairman: So we really need to step this up quite a bit then, do we not, if we want consumer examination of the financial services industry?
Mr Phillips: I think that the Panel would certainly welcome additional resource. There is no doubt about that. The only question I would ask is whether the Panel, on its own, is the best place to look at the effectiveness of the regulation of the financial services industry.

Q11 Chairman: What are you established for then?
Mr Phillips: We are established to represent the consumer interest to the FSA and the FSA regulates part, but not all, of the financial services industry.

Q12 Chairman: When I read my papers every day, there are huge issues coming up for consumers in the financial services industry. I will be asking Mr Sants about the PPI. We raised this issue with him five years ago in 2004–05, and we still have this issue going on. I think that there is a panoply of issues, and it seems to me that two people to tackle that—
Mr Phillips: I would say that of course you do have the Panel as well. The work does not rest entirely on the shoulders of the policy people. The way in which the Panel is set up is that it is designed to work with the FSA, as we see it, as a critical friend; and the difficulty that the Panel has is to balance the role of the friend with the critic.

Q13 Chairman: Why do you need to be a friend?
Mr Phillips: The FSA comes to the Panel early on to talk about issues to do with the consumer interest so that it understands better the consumer interest. To that extent, we have to have a reasonable working relationship with the FSA.

Q14 Chairman: If you are a friend, they have got you in their web.
Mr Phillips: That is why we have the discussions about the balance of our relationship with the FSA and the extent to which we are critical.

Q15 Chairman: That seems to me to be a little out of kilter with two policy people. I think there needs to be an examination in your committee to say, "Are we adequately representing the consumer?".
Mr Phillips: I think that is a fair point.

Q16 Chairman: How many members of your Panel have significant experience working in consumer organisations, as opposed to industry experience?
Mr Phillips: I would say that at least a third of them have experience of currently working in consumer organisations. Another third are people who have a broader experience of working in the financial services industry, but only one of whom has worked in the financial services industry directly. The remainder are a couple of journalists and someone who has worked in government.

Q17 Chairman: Would you like to see consumer representation on the board of the FSA itself?
Mr Phillips: Yes, definitely. There is no doubt about it.

Q18 Chairman: We therefore have a bit to go on that yet. Do you think that the FSA is too dominated by the industry on their board?
Mr Phillips: I would agree with that view. I think that it is too dominated by the industry, yes.

Q19 Chairman: You have the chairman of the board who worked in industry and you have the deputy chairman who is a former chief executive of one of the banks in the industry, but there do not seem to be many consumer representations in the really senior positions.
Mr Phillips: I think that one of the issues for the FSA is that it needs people who are experienced in the industry on the board of the FSA. One of the problems the FSA faces is that people who have worked in this industry are not necessarily best equipped to understand the consumer interest, and there is a need to balance that up.

Q20 Chairman: How many times since your appointment to the Panel in March 2004 has the FSA changed its mind as a result of the Panel's influence and lobbying?
Mr Phillips: There are a number of situations where the FSA has been influenced by the Panel; relatively few where you would say that the FSA directly changed its mind. I will give some examples of where we have influenced it and some examples of where we have changed its mind. The recent consultation on the Banking Code has been something that the Panel has been pressing the FSA over for some years. However, in the form in which it has come out, you would not necessarily notice that the Panel had had the influence, because a lot of other people have been campaigning for that too. In a similar way, the work on the Retail Distribution Review: it has been a long-term objective of the Panel to take bias out of the advice relationship. More recently, we felt that the FSA was moving rather slowly to deal with the issue of mortgage repossessions and approached the judges directly, to talk about the requirements of MCOB—the Mortgage Conduct of Business Rules—which are placed on advisers and banks who are seeking repossession. We were able, we think, to speed up the process and, as a result, the protocol was issued by the Ministry of Justice. Another area where the FSA was not doing something a couple of years ago, which we think is very important for a regulator, is in mystery shopping. The FSA now does regular mystery shopping, which highlights the lack of impact that many of its regulations are having on changing industry behaviour.

Q21 Chairman: Have you been pushing the FSA on payment protection insurance?
Mr Phillips: We have been pushing the FSA on payment protection insurance for at least three years.

Q22 Chairman: And nothing has happened?
Mr Phillips: No, and one of the points we made in our written submission was that the FSA, as a regulator, frequently expresses disappointment about what it is observing, but we would like to see a change in behaviour beginning to happen. The answer is no.

Q23 Chairman: After four or five years, we want a change of behaviour?
Mr Phillips: Yes, we do.

Q24 Chairman: If you were to trumpet your successes with the FSA from the rooftops, would it come out as a squeak?
Mr Phillips: I would hope that it would come out bigger than a squeak. I do not think that we have done a particularly good job of making a case for ourselves, but I do think that we have been quite influential with the FSA.

Q25 Chairman: Peter Vicary-Smith, obviously the credit crunch has dealt a severe blow to consumers' trust in the financial services industry. Do you therefore see a need for greater consumer representation on the FSA in order to advise on how that trust can be rebuilt?
Mr Vicary-Smith: Yes, I think there is a need for that, not just in terms of making sure that the Panel is resourced—because we think that the Panel does a good job within the FSA—but also in terms of some 10 of the 14 members of the FSA board being either company-employed or previously employed in the industry. We feel it is important that a strategic board has a diversity of views. Otherwise, you will come to any issue with just the perspectives and the history that you have accumulated in your lifetime. Certainly if one looks at the board of other bodies—the Food Standards Agency, OFT and so forth—the boards there are much more diverse. The other dimension of the governance of the FSA that is important is where it is accountable to. The FSA is not accountable to the Parliamentary Ombudsman. The National Audit Office has a very narrow remit. When we have talked to the Treasury about issues, we are told that the FSA is an independent regulator and therefore the Treasury cannot really get involved. In fact, our view is that it is this Committee that has performed most of the regulatory oversight of the FSA. While it has done that well, we do not feel that is necessarily a healthy position to be in for such a vital regulator.

Q26 Chairman: Do you think that there is a conflict of interest at the heart of the FSA, in that it is charged with Treating Customers Fairly and it is charged with prudential regulation?
Mr Phillips: I think that there is undoubtedly a conflict there. One of the key issues for the FSA is how it manages that. One of the areas about which the Panel is concerned is to try and understand whether the consumer interest is being addressed too low down in the system.
Mr Vicary-Smith: I would agree with that. The FSA of course needs to have a whole host of people with experience of the industry but, when it comes to the strategic board, it needs to have a diversity of views and a diversity of perspectives, and we think that is lacking.

Q27 Chairman: And that conflict of interest at the end of the day could be too much for the efficient working of the FSA?
Mr Vicary-Smith: Yes, I think it could be. It asks a lot of individuals. There was a time when James Crosby was on the FSA board and running HBOS. How you would expect someone to build Chinese walls through their heads and that kind of thing? I think that it must be a very difficult position.
Mr Phillips: The only thing I would add to that is that I think there is a potential conflict between the need to maintain a prudential system and to look after the consumer interest. A conflictual relationship is not necessarily the best one to bring the best result.

Q28 Chairman: In June, the FSA reported that only 13% of relationship-managed firms met the March 2008 deadline for having appropriate management information on treating customers fairly. That is a pretty disappointing statistic, is it not?
Mr Phillips: Absolutely. Terrible. It may well be that the management information systems have improved, but we think that if the FSA had carried out its planned survey/assessment at the end of this year, they would have found that the majority of firms were still not treating their customers fairly.

Q29 Chairman: So pretty woeful?
Mr Phillips: Yes.

Q30 Chairman: Nick Prettejohn, your Panel's Annual Report expressed disappointment at the FSA's reluctance to conduct a cost-benefit analysis of Treating Customers Fairly, and the FSA responded that it did not amount to a new regulatory requirement. Have your concerns been addressed?
Mr Prettejohn: We welcome the move to put Treating Customers Fairly as part of the business-as-usual supervision. I think that is the right place for it to be. The ARROW process is the most important process that regulated firms go through with the FSA, and that is the right place for the examination of TCF to be.

Q31 Chairman: The themed visits on Treating Customers Fairly have now been scrapped. Which of you welcomed the FSA's decision not to proceed with that and to merge it into the ARROW visits?

Mr Prettejohn: I think that the ARROW visit is the right place for it to be. Our view is that a disproportionate amount of resource within the FSA and within regulated firms was devoted to Treating Customers Fairly. We think that it is an extremely important programme and the overwhelming majority of regulated firms thoroughly support the principles behind it; we just felt that, in terms of the balance of regulatory emphasis, on the margin, Treating Customers Fairly was getting more resources relative to prudential supervision than was appropriate.

Q32 Chairman: Mr Phillips, I am reminded of the ARROW visits to Northern Rock. I do not think that Treating Customers Fairly would have featured high there, never mind prudential regulation; so it worries me that that has been merged into the ARROW visits. Do you have the same concerns as myself?
Mr Phillips: It was always the case that at some point Treating Customers Fairly would become part of standard supervision. What we have been trying to establish with the FSA is exactly how they will make sure that these supervisory visits to check on TCF are in fact effective. We think that they have to go beyond straightforward looking at the management information systems and a few cursory checks. We think that there has to be a lot more in there than is currently planned.

Q33 Chairman: Would you express concern about it being incorporated into ARROW visits, given that Lord Lipsey's memo expressed an outright disbelief that the TCF failings would be identified?
Mr Phillips: We would have preferred it not to happen so soon. There is no doubt about that.

Q34 Chairman: What about you, Peter?
Mr Vicary-Smith: We were disappointed by it, but I would like to pick up one thing that was said there, if I may. The idea that a disproportionate amount of time is being absorbed on looking at TCF I find extraordinary. This is one of the centrepieces of the new regulatory environment. What we have seen in the original March deadline was that 87% of firms did not even have the management information in place. It was not to say that they were even treating customers fairly; they simply did not have the management information in place. There is a long way to go on TCF. In my view, what gets measured gets done. Therefore, if the FSA needs to absorb it into its regular assessments, I think that two questions arise. One is what happens between now and when the next supervisory visit takes place; because that could be many months, and so there is no tracking with those firms as to whether there is any progress being made. Secondly, in the interests of transparency and accountability, I think that the FSA should publish details of the number of supervisory assessments it is conducting each month on this, and how many companies are meeting the deadline; because I think that they really need to keep on top of this.

Q35 Chairman: To be fair to the FSA, it was the FSA that dragged the industry along on TCF in 2004–05. Do you think that it has lost its nerve a little bit?
Mr Vicary-Smith: It has dragged the industry along and we are supportive of the TCF approach, but the important thing is that they now need to go further and ensure that it is embedded; that it does not just become a wish.

Q36 Chairman: Simon, how will small firms' TCF compliance be assessed and how long will this process take?
Mr Bolam: About 18 months ago, the FSA set up an Enhanced Strategy for Small Firms. This is where they target a particular part of the country and invite all the regulated intermediaries, smaller intermediaries, to complete questionnaires; they are invited to go to conferences and seminars; they are assessed. By going through this particular process—and we are now on to about our third large area—quite large numbers of smaller firms are now being assessed. By doing it in large numbers, this obviously helps. The idea is to see 11,500 firms over a period of three years.

Q37 Mr Brady: Mr Vicary-Smith first and then perhaps Mr Phillips, to what extent do you share the concern about the number of consumer credit agreements that are not compliant with the Consumer Credit Act?
Mr Vicary-Smith: I think it is important that, if things are being sold to the consumer, they are compliant. Where we see evidence that things are not compliant, then those firms need to be named and shamed so that consumers know to steer clear of them, and we need to ensure that there is a robust amount of follow-up.
Mr Phillips: I would hope that the introduction of the Payment Services Directive will give the FSA the powers, which it should take, to ensure that consumer credit agreements are fair.

Q38 Mr Brady: It has been put to me that obviously we have had 34 years to get the Act right, but that a very high percentage of credit agreements are not compliant. Would you share that analysis, or have you made any estimate of the extent of non-compliance?
Mr Phillips: We do not have any estimates of that.

Q39 Mr Brady: Would you say, from your experience of looking at credit agreements, that practice is improving, or is it something which is simply being missed?
Mr Phillips: Again, I do not have any information on that, I am afraid.

Q40 Mr Brady: Mr Vicary-Smith . . . ?
Mr Vicary-Smith: No. The only information I would have would be of an anecdotal nature. There what we see is—across the whole area of credit agreements, of advice given and so forth—precious little improvement in the overall standard of the

industry. However, that is not specific to credit agreements; it is a general tale of woe about the industry and its progress.

Q41 Mr Brady: Can I suggest that it may be worth a more detailed look at that?
Mr Vicary-Smith: Certainly.

Q42 Mr Crabb: Mr Prettejohn, we hear what you are saying about the Treating Customers Fairly initiative being welcome in principle; but would you say that the burden entailed in complying with TCF for small firms is an unwelcome burden at a time of economic downturn?
Mr Prettejohn: I think that all firms, as you say, thoroughly support the principles of Treating Customers Fairly. I would say that the FSA's definition of the outcomes around Treating Customers Fairly was a very useful contribution to the thinking of the whole industry and has made a big difference to firms, large or small. I will perhaps let Simon comment on the smaller firms, if I may.

Q43 Mr Crabb: Perhaps you would just respond to my question about the burdens involved with complying with TCF. Is that an unwelcome burden at this time for small firms?
Mr Prettejohn: In general, our criticism of the Treating Customers Fairly initiative was that it applied a one-size-fits-all approach to the industry, rather than concentrating on the areas of greatest risk. Whether that is actually for a larger firm or a smaller firm, or a particular issue within a large or a small firm, we feel that all firms were treated equally and the same approach and process was applied to each. Almost by definition, therefore, the burden would seem on some firms, large and small, to have been too high.
Mr Bolam: As far as small firms are concerned, there is a basic concept within them that their very survival is dependent upon treating their customers fairly; that if they did not treat their customers fairly, then their local reputations would soon be damaged and their businesses would contract. The difficulty over the volume of work as far as small businesses are concerned is this. I run a small general insurance-broking business in Edinburgh. *This* is my TCF policy. It is 16 pages long. This is what a well-run business should have in order to prove compliance. It is the way you have to extract management information to show that you are actually physically treating your customers fairly, even if you think you are. It is the extraction and the documentation of some of that information, or all of that information, that is quite time-consuming—when people in smaller firms are also trying to run the business, be the financial director, do the banking, and all the other responsibilities that you have within a small business. It did seem a bit disproportionate.

Q44 Mr Crabb: Given that the very survival of these firms would be at the forefront of many of their managers' minds at this particular time, do you think that firms should be given more leeway in how they conduct their business?
Mr Bolam: I very strongly support the FSA's more principles-based regulation, which gives that flexibility as you move away from rules—whereby a firm can actually sit down and work out, in a more flexible way, the manner in which they should be running their business. That certainly helps smaller firms run their businesses, as long as their brains are focused sufficiently to understand that they still have to prove that they are complying with the regulator's requirements.

Q45 Mr Crabb: So more leeway in terms of complying with TCF?
Mr Bolam: I would welcome that in terms of smaller businesses, yes.

Q46 Mr Crabb: Mr Vicary-Smith, what evidence are you seeing of any deterioration in firms' commitment to the Treating Customers Fairly agenda at this time?
Mr Vicary-Smith: I think that it is less a question of the deterioration of commitment but rather that, when you measure who is doing it, it is such a small number that it is hard to think of deterioration. I would argue that, if anything, Treating Customers Fairly is even more important for the consumer in harder times, because the financial pressures on firms to cut corners are greater. It is not something that we can select as being only for the good times; it applies all across the board. I would not support the idea of leeway, therefore. I think that there are some important dimensions that the credit crunch raises about TCF, for example on mortgage repossessions, which raise new issues that were not really thought of at the beginning. For example, if the FSA is finding that firms are not treating customers fairly on mortgage repossessions, it will not be good enough if their home has been repossessed and they find out that they should have been given some information before that happened. We therefore need to see a more up-to-date and a more transparent process of regulation through it. It has to work in the bad times as well as in the good times.

Q47 Mr Crabb: Mr Phillips, would you like to comment on the implications of the current economic downturn on TCF?
Mr Phillips: There is a real risk that firms will abandon the efforts that they have been making to treat customers fairly, because they will inevitably be forced to focus on prudential issues, and that things could get worse. We have no evidence of that yet. We have asked the FSA to provide us with evidence of what they observe going forwards, but there is a real risk that things could get worse—yes.

Q48 Mr Crabb: Coming back to Mr Bolam, if I may, the FSA's December deadline requires firms to be able to demonstrate that they are consistently treating their customers fairly. Perhaps you could describe for us what this will entail for a typical small firm?

Mr Bolam: First of all, a small firm should have its policy in place, similar to the example I showed you from my own business. It means that you need to collate information that is seen as relevant, such as how many complaints you have had; how many cancellations you have had; checking files to make sure that the process within the office in terms of giving advice to consumers is good and robust; making sure that your staff, in terms of competence and training, are up to scratch. There are a large number of measures that need to be down in writing so that, if the FSA walks through your front door, they can actually see that you have done it. It is that documentation area that takes up a lot of time.

Q49 Mr Crabb: What if firms do not bother about complying with this by December? What will be the consequences for firms of just not doing it at this time?
Mr Bolam: We accept that that may happen. As a Panel, we obviously would be very against it; but the FSA are doing their best, with the resources they have, to try and see 11,500 smaller firms over a period of three years. It would be great if that could be accelerated, but there are cost implications.

Q50 Mr Crabb: Mr Prettejohn, your Annual Report expressed disappointment at the FSA's progress on the issue of consumer responsibility and looked forward to the publication of a discussion paper from the FSA in late 2008. Can you update the Committee on what progress has been made on this issue since then?
Mr Prettejohn: We have seen a draft discussion paper from the FSA at a recent Panel meeting. We think that the notion of consumer responsibility is extremely important. Efficient and effective markets work best when you have empowered and well-informed consumers, and the notion of consumer responsibility actually equips consumers better in their interactions with firms and also, if the worst comes to the worst, if they have complaints or they have to go through a process of law. Having empowered consumers who are conscious of their responsibilities, therefore, seems to us to be a very good defence and protection for the consumer, as well as also making sense for firms.

Q51 Mr Crabb: Mr Vicary-Smith, given the level of financial capability held by the public, what do you believe is the appropriate level of consumer responsibility?
Mr Vicary-Smith: Clearly consumers have a responsibility to act honestly, to declare information openly, to provide information that is asked for by advisers, and to deal in an honest way. What is not rational, I think, is to expect a consumer to be given a lengthy and complex document, drafted by lawyers and teams of investment experts and then to say, "As you have had your document, it is clearly your responsibility". I think that the key thing here is what is going to persuade consumers to engage in this marketplace. What is going to get people to invest, to save, to take out protection, and so forth? That will be when they feel that they are being treated fairly and they are being looked after and looked out for. Telling people "It's your responsibility. You had the document. It's your fault" will not get them to play in this marketplace—and that is what society desperately needs. I would say that pushing too far on a *caveat emptor* principle beyond "You must deal truthfully" raises real risks that consumers will simply disengage from the industry and will go further back to where we were.

Q52 Mr Crabb: Are you satisfied so far with the progress and the tone that the FSA has adopted on this?
Mr Vicary-Smith: I have not seen things yet with which I am dissatisfied. I am sorry if that sounds rather cautious and negative. This debate has raged on, and I have had conversations with too many in the industry who have wanted to pass so much responsibility onto a consumer that it looked like an abdication of responsibility from the firm, and so I am nervous about this debate and where its implications could lead consumers. Consumers need to be absolutely engaged and we want to make consumers more empowered. We tell people to shop around; we tell them to negotiate; we give them as much advice as we can; but there is a limit to what you can really expect an individual consumer to do, in all the other things they have to do in their lives.
Mr Phillips: I would just like to add to what Mr Vicary-Smith has said. The law is fairly clear that people cannot be required to understand what they read. I think our concern is that the FSA may try to circumscribe that in some way, in order to provide the industry with more certainty about redress claims. I think it would be a great pity if they tried to do that and it would work against, as Peter says, the interests of the consumer and, ultimately, the interests of the industry.

Q53 Chairman: Mr Bolam, this may not be for the record, but you did say that the FSA ensure that you "physically" treat your customers fairly. You would not think of bashing them on the head, would you?
Mr Bolam: No!

Q54 Chairman: Just in case! Eleven and a half thousand firms over a three-year period—is that not a tall order? Are you not afraid of that figure?
Mr Bolam: It seems like a tall order but I have heard nothing from the FSA to indicate that that target will not be met.

Q55 Sir Peter Viggers: Is the FSA deadline for full implementation of the Retail Distribution Review by 2012 realistic and achievable, and what are the problems that they face?
Mr Bolam: We have two IFA representatives on our Panel. They have been working very closely with the FSA in terms of developing the RDR up to this particular moment in time. They are reasonably optimistic that this deadline can be reached. There are obviously certain things that are cropping up, which might cause certain delays, such as IFAs struggling at the moment in terms of getting business as the economy slows down. As far as our Panel is

concerned, we are absolutely behind the RDR. We feel that, as the thing develops, we should make sure that such things as professional standards are realistic; that we are not, in the process, going to bring another layer of costs on top of what we have already; that the professional standards are achievable. The one thing at the end of the day that we do not want to see is a meaningful contraction of advice to consumers, good-quality advice, in the small towns of the country where the people need that type of advice. Hopefully it will be achievable, but there are certain things there which could slow the process.

Q56 Sir Peter Viggers: Mr Phillips, the Consumer Panel has been concerned, among other things, about complexity. Would you like to expand on that?
Mr Phillips: We have been encouraging the FSA to make sure that it has the details sorted out. We have been pleased by the general direction of movement, although we found that the latest statement issued by the FSA was a bit of a step backwards; but nevertheless they are moving forwards. The particular issue that concerns us is to make absolutely clear to the consumer whether or not they are receiving independent advice and whether the person talking to them is actually working in their interests or in the interests of their employer. We think that the current approach of the FSA to call this "sales advice" is not a very helpful approach. We hope that the research they are doing will lead them to something better. We would like sales to be called "sales".

Q57 Sir Peter Viggers: And from the point of view of the Practitioners Panel, Mr Prettejohn . . . ?
Mr Prettejohn: I think that it will be a difficult transition. It is challenging in terms of its timescale, as Simon described. There is a risk in the short run that there will actually be less advice available to UK consumers through the transitional period, and I think that is a very considerable concern. It is already the case that the regime around advice at the moment means that only the better-off and the best-off can really afford the financial advice that many people need; because, whatever your income and your financial position, life is becoming more complicated and the financial issues are becoming more difficult to disentangle. More people need advice, therefore. Unfortunately, there may well be less, because a number of the advisers who are advising at the moment may choose not to apply for the professional qualifications that will be required and therefore may leave the market. In the short run, therefore, there may be less advice.

Q58 Sir Peter Viggers: Do you perceive that practitioners are being sufficiently alive and alert to the need for change?
Mr Prettejohn: I think that most practitioners, the overwhelming majority of practitioners in fact, would say that they welcomed the change and, in particular, the raising of professional standards.

Q59 Sir Peter Viggers: What about the employment prospects of the IFAs throughout the United Kingdom?
Mr Phillips: We are concerned that there should continue to be an independent sector in advice which is thriving. The issue for us is that the people who are doing it have to be giving good advice and to be well trained.

Q60 Sir Peter Viggers: Lord Lipsey was robust in his view of the expression "sales advice". He said that it was "devoid of meaning". What is your view on that?
Mr Phillips: Absolutely. I concur with that. We have a very similar concern to the practitioners: that advice should still be available to consumers. Our concern is that, if it is advice, it should be clear whether that advice is independent or whether it is biased in some way, and that that should be clearly expressed in the way in which the person describes themselves to the customer.

Q61 Sir Peter Viggers: Do you think that the RDR framework is sufficiently clear on this point?
Mr Phillips: At the moment, no, I do not think it is; but we hope that the FSA will continue to listen to the industry and to the consumers, and to get them to somewhere which is better.

Q62 Sir Peter Viggers: On the very difficult issue of remuneration and bias, commission-based IFAs have pointed out that people do not want to pay a fee upfront. What is your view on this difficult issue?
Mr Phillips: I think that the IFAs are right in this. I think that some people are prepared to pay a fee and that most people would like to see the charge deferred in some way. There are ways of doing that, however, which do not increase the customers' costs and which give them some control over the service that they are getting from their adviser.

Q63 Sir Peter Viggers: On a commission basis?
Mr Phillips: It would not be done as commission; the money has to be recycled in another way. However, the effect would be that, instead of the provider of the product buying the adviser by offering them commission, they would provide funding for the customer to buy the product.

Q64 Sir Peter Viggers: There would be transparency on this basis?
Mr Phillips: There should be transparency.

Q65 Sir Peter Viggers: Would you regard transparency as essential?
Mr Phillips: I think that transparency is essential. I also think that the regulator has to get involved, to make sure that the fees are reasonable. One of the possible outcomes is that fees could rise, because customers, as has already been pointed out, do not shop around a lot in this market.

Q66 Sir Peter Viggers: Mr Vicary-Smith, your memorandum refers to some mystery shopping which found that bank staff are not always clear in describing whether their advice is free. How should the RDR address this issue?
Mr Vicary-Smith: I would first like to say that I think the thrust of the RDR is very good, in the right direction, and we have been very supportive of it. The FSA has done a lot of good work in pushing through the RDR. I think that the adviser remuneration part has perhaps been one of the more useful elements for consumers. Part of the problem is that, in our mystery shopping exercises, people have been told for a long time that the advice is free. It is not; it never has been; nor should it be; nor will it ever be. In fact, it sounds rather like current account provision to me. However, that is what people have been told: that the advice was free. Therefore, we are now having to tell people that they pay for advice. Well, they always have done. The key thing is that, in paying for advice, people are clear what they are paying, what they are paying for, and that they are able to shop around and compare the prices being charged by different people. I think that the RDR will help in that regard, because this has been a very obfuscated area for too long. Could I say one other thing? It is the point about the level of charging, which I think is an absolutely key one. We see some product providers currently allowing advisers to deduct up to 10% of a consumer's lump sum investment in advice fees. We think that is far too high a level. There does need to be some way that guidance can be given—but that is not an appropriate level of deduction.

Q67 Mr Breed: Mr Vicary-Smith, I was intrigued by the responses about treating customers fairly. Is that what we used to call "integrity"?
Mr Vicary-Smith: Treating customers fairly? Yes. Certainly it does seem bizarre that you have to tell them. I cannot imagine that if you had Terry Leahy here, he would need to be told to treat his customers fairly in that way. I think that it is the indicator of where we are. We are where we are in terms of the industry and how it is regarded by customers.

Q68 Mr Breed: Which, on that basis, is not very good.
Mr Vicary-Smith: The performance of the industry has not been very good, but what is important is that we all ensure that performance improves. I think that the Treating Customers Fairly initiative is one way in which consumers could be helped to have a better level of confidence in the industry with which they have to deal.

Q69 Mr Breed: It seems to me that the extraordinary growth in financial services regulation over the last few years has been matched only by the number of disasters, failures and scandals, which have cost taxpayers and individual purchasers of products millions, if not billions, of pounds. What does that say about regulation in the industry?
Mr Vicary-Smith: One of the things it does say is that the notion that provision of information is a substitute for good advice, for treating people fairly and for good regulation, has been disproved. Too much regulation has focused on firms having to tick a box and say, "We provided this piece of information". You get your statement of key facts on your mortgage and you have to confirm that you have read it—which of course very few people ever do. You just tick the box at the bottom and say that you have. Moving to a Treating Customers Fairly initiative has the potential to reverse that, but only if firms treat it seriously and if the FSA continues to devote the resources necessary to make it work.

Q70 Mr Breed: From what you have already said, I think that you agree with the FSA that this Retail Distribution Review is, as they say, a "golden opportunity" for the industry. You all subscribe to that view, do you, that it is a golden opportunity?
Mr Phillips: Yes.
Mr Prettejohn: Yes.
Mr Bolam: Yes.
Mr Vicary-Smith: Yes.

Q71 Mr Breed: On that basis, Mr Prettejohn, you will be aware of the survey done by Standard Life, which indicated that if these proposals went through, 16% would basically give up and not be prepared to go ahead. A vast majority of those are likely to be in places like Cornwall, which I represent—a lot of rural areas and small places. Therefore, while it may be only 16%, it may be specific to certain areas. How realistic is 16% and how worried are you that we would see an absolute flight out of this by the smaller firms?
Mr Prettejohn: I am extremely worried about the level of advice that will be available to the UK consumer. I think that financial advice is in danger of becoming ghettoized amongst higher net worth individuals, and I think that presents us with a major problem. I think that there are a number of IFAs who will withdraw from the industry rather than go through the process of getting professional qualifications. We all applaud the raising of professional standards. It is a necessary step but does carry with it a risk, through that transitional phase. The answer for many people will be if we can come up with a model, with the FSA, for guided sales, which enables consumers to get some more information. When you call it "advice" you start to get into a difficult area, and hence the problem in coming up with a model. It is really important, however, given the complexity of people's lives and the financial decisions they face, that they can get something more than execution-only sales but do not necessarily have to go through the full advice process that higher net worth people can afford.

Q72 Mr Breed: Mr Bolam, some IFAs believe that this is just a means by which the FSA, which is very friendly with the banks, can basically get rid of all the competition, confine it to the big banks, and reduce the numbers of firms they have to regulate. It will therefore be a nice, cosy arrangement

between the FSA and the banks to get rid of these wretched small IFAs that they have to keep looking at, and hand something to the banks. Do you believe that?
Mr Bolam: I can assure you that we are fighting on behalf of the smaller businesses to ensure that there are IFAs in Cornwall and the various other parts of the UK. The outcome of this has to be proportionate. There still has to be a supply of good advice to people. The way in which we seek to achieve this has to have an examination system that, yes, works, but which has to be proportionate in such a way that the people in your constituency do get access to advice. The one thing that we have perhaps omitted to highlight in this process is that there is also work in parallel to this. It is a stream of work that is looking at the prudential requirements of the IFAs and what capital adequacy they should have. That also represents a potential threat to the supply of firms throughout the country.

Q73 Chairman: Mr Prettejohn, you have mentioned people leaving the industry. That is perhaps a bit unfortunate. However, I have chaired quite a number of sessions on confidence in the retail industry and I well remember examples, such as the split capital investment trusts, the precipice bonds, the endowment mortgages—which were pretty scandalous situations. Surely we cannot focus on people leaving the industry? It is restoring the confidence in and the integrity of the industry that is of the utmost importance. There is therefore only one way to go here.
Mr Prettejohn: I think that you are absolutely right. We would support very strongly the implementation of higher professional standards. Implementation of those standards may, in the short run, result in some people who do offer good-quality advice leaving the industry because they do not want to go through the process of getting the qualifications, because they are at the end of their career. However, I would fully accept your argument that we need higher professional standards.

Q74 Chairman: Mr Phillips, your Annual Report labelled the FSA's work on with-profits as "weak". Our Committee went further, in calling for a "reopening of the debate about the overall regulatory system for with-profits funds" in our *Inherited Estates* report. What progress has the FSA made in the last six months?
Mr Phillips: We were very pleased when this Committee took this up and we were somewhat disappointed by the FSA's response. We continue to be very concerned about the governance of closed and quasi-closed with-profits funds. We would like to see an objective and independent test of the fairness of the principles and practices of financial management that these firms are using and not just, as the FSA put it, better communication with policyholders.

Q75 Chairman: Mr Vicary-Smith, you have also made comments on that.
Mr Vicary-Smith: I would go further than Adam. I think that the FSA's response to the report, which I thought was an excellent report, was woeful. At a time when bonuses are being slashed and swingeing exit costs are being imposed, with-profits policyholders who speak to us are dismayed by the FSA's failure to stand up for their interests. We are very sceptical of the value of the systematic information-gathering exercise the FSA has undertaken. Sarah Wilson, the director responsible, said, "Our starting point in conducting the review is not that significant changes are needed to the regime". I do not think that was the view of this Committee when it produced its report. It certainly is not our view that significant changes are not required to the regime. This is a very clear issue, where we believe policyholders' interests are not being dealt with fairly; in fact, I think that the FSA needs to get a grip on it.

Q76 Chairman: If the FSA is unwilling to conduct a root-and-branch review of with-profits regulation, what are the most important aspects of their work which we should focus on as a Committee?
Mr Vicary-Smith: Within the with-profits area?

Q77 Chairman: Yes.
Mr Vicary-Smith: Stopping companies charging shareholder tax boosts in inherited estate; stopping firms taking further money out of the inherited estate to pay mis-selling claims—which of course is being looked at at the moment; the issue of Norwich Union's phasing of its special bonuses—which I think is an appalling example of a large firm not treating its customers fairly; and also, crucially, ensuring that the with-profits committees stand up for policyholders, rather than simply rubber-stamp the decisions of companies. We have said for a long time that the with-profits committees should not be appointed by the firms concerned but should be appointed by the FSA, because if you appoint a committee from the firm that removes the incentive of that committee to stand up to the firm.

Q78 Sir Peter Viggers: I was going to ask about the "regulatory black holes" that you refer to in your submission, Mr Vicary-Smith. I see in the memorandum that the FSA submitted to us they say, "Historically we have not made comprehensive rules governing the conduct of retail deposit-taking business because they have been covered by the Banking Code Standards Board". Some people may have been rather surprised that the FSA had not been more closely involved in this area before. Do you recommend that the FSA should take control of retail banking regulation?
Mr Vicary-Smith: I would say that regulatory black holes need to be closed. Purely closing regulatory black holes will not remove the risk of detriment to consumers. To my mind, the point is this. If the FSA take over this area, will the outcome for consumers be better or not? I do not mean that to

sound evasive, but there are some things within the Banking Code where there is a good degree of protection given to consumers. For example, on issues of online fraud and card usage, there are some good restrictions in there. We would like to ensure that the taking-over of regulation of this area ensures that the positive elements of protection are carried through, and that any rules drawn up are done so in conjunction with consumer groups and others, to ensure that they genuinely serve the consumer interest.

Q79 Sir Peter Viggers: Mr Prettejohn, what benefits does the self-regulatory nature of the Banking Code bring? Do you think that these are outweighed by the obvious disadvantages—their lack of teeth?
Mr Prettejohn: In general, self-regulation can sometimes mean that changes in regulation can move faster and that regulatory changes can have a greater immediate buy-in from the regulated. However, my overall view is that, particularly where there are issues of confidence involved, probably self-regulation has to give way to statutory regulation. We have yet to discuss this in great detail at the Panel, so I must stress that these are probably more personal views. I think that, with the advent of the Payment Services Directive and the number of, if you like, competing regulatory bodies that there are around the banking industry—OFT, the FSA and the Standards Board—some rationalisation of that and a clearer division and assumption of responsibility is probably required to ensure that consumer confidence in the regime as it applies across banking is improved and maintained.

Q80 Sir Peter Viggers: Mr Phillips, has the Consumer Panel addressed this?
Mr Phillips: Yes, and we have been pressing for some considerable time for the FSA to switch on the principles and to take control of banking regulation. We think that that would be more straightforward; it would have a consistent definition of Treating Customers Fairly; and there would be more chance that the introduction of Treating Customers Fairly would be properly supervised within large organisations. I would also like to pick up on a further point, which is the Payment Services Directive. Where the OFT overlaps with the FSA in regulation, we would like to see that much more joined up. We see an opportunity here for the FSA to extend its reach and to provide genuine protection for the consumer and also a more straightforward working environment for the industry.

Q81 Chairman: The FSA deadline for the implementation of the Retail Distribution Review by 2012—is that realistic and achievable? What are the major roadblocks to that?
Mr Phillips: I think that is more of a question for the industry than it is for the consumers. We would certainly like to see it in place.

Q82 Chairman: Is it achievable, Mr Prettejohn?
Mr Prettejohn: I think that it is achievable, yes.
Mr Bolam: Our Panel believe that it is achievable.

Q83 Chairman: Will firms be able to make a smooth transition from their current business models to the new requirements, and how many firms have started to make that? Has yours, for example, started to make that, Simon?
Mr Bolam: My own firm is involved with general insurance, and so we do not actually get involved in that area. However, I would suspect that most firms will wait until these proposals are set more in stone before they start seriously getting involved.

Q84 Chairman: What is the best way to remove bias and the perception of bias from the remuneration of financial advisers?
Mr Phillips: I think that there are two issues here. The first is the obvious one of commission: where, if the adviser is acting as the agent of the customer rather than the agent of whoever is providing the product, there is a lot more chance that there will be no bias and that there will be a better relationship. Coming back to the point that Mr Prettejohn made earlier about the middle of the market, people in that part of the market are probably unlikely to be able to pay, or be willing to pay, significant amounts of money for advice. There we are looking to the industry to come up with constructive solutions which can deliver unbiased advice. One of the areas that the FSA has explored, but so far with little success, is the area of guided sales—which we think is a real opportunity to provide products that are affordable, hard to mis-sell, and which will be attractive to the middle part of the market.

Q85 Chairman: Mr Vicary-Smith, I remember being at a conference in Gleneagles when the then chairman of the FSA, Callum McCarthy, made a big declaration about the business model and industry being bust, and that they would have to start on it from scratch. Has that road been travelled?
Mr Vicary-Smith: I think there are some indications that, shall we say, the first, early steps have been taken: things like addressing the issue of paying for advice; addressing the issues of professionalism of the industry—or, rather, the professionalism of the advice given. However, there are two really important steps that the FSA can take if this industry is to be brought up to scratch. One is the issue of naming and shaming, where we feel that the FSA has not taken the steps it could take. All our history at *Which?* is that the glare of publicity and saying who is doing things well and who is doing things badly is an enormous prompt to change. We believe that FiSMA gives more opportunity than the FSA actually takes for that to happen. The second thing is on the level of fines. Where steps are not being taken, then the consequences need to be much more severe. For example, I think that Alliance & Leicester's record fine represented 3% of the revenue gained over that

period of mis-selling. At that level there is a danger that fines are seen as a regulatory cost of doing business, and that is not what they should be doing. If we are to see this industry transformed in the way we all have said we want, then the FSA has a role to play both in exposing bad behaviour, accrediting good behaviour and also, where it does need to intervene and fine, to ensure that is at a level that really discourages bad behaviour.

Q86 Chairman: This Committee has been taken away from the consumer and the retail element for the last year or so with understandable problems elsewhere in the economy. Should this be an area we focus on more over the coming months or will the self-regulation and the good relations between industry practitioners and regulators sort it out itself?
Mr Vicary-Smith: I would argue that this would really benefit from more attention because there are two sides to this equation: there is the provision of the product but there is also what happens to the consumer and, in all the sorting out of the problems that exist, we do not want to see the consumer forgotten as everyone focuses on the wholesale side.

Q87 Chairman: Simon, what element of the package of proposals contained in the Retail Distribution Review will be the most significant in driving existing practitioners away from the industry, in your opinion?
Mr Bolam: Too high professional standards.

Q88 Chairman: Too high?
Mr Bolam: If the professional standards are too high, that would drive practitioners away.

Q89 Chairman: Let us get a handle on that. Too high? They should not be at degree level, should they?
Mr Bolam: No.

Q90 Chairman: At what level should they be? First year university level? A-level?
Mr Bolam: At the level 4 for advisers, as is currently recommended

Q91 Chairman: That is first year university-type level?
Mr Bolam: Yes. Again, we are down to what the final model is going to produce in terms of the number of firms that there are likely to be at the end of the day. If the level is too high, or if people find it just too difficult to get there, we will have to monitor the effect on the contraction of the market.

Q92 Chairman: One of the aims of the Government is to get 50% of people into higher education and to become graduates. Their ambitions are a bit low if we are talking about first year university level for people giving advice which is very sensitive to many people and could involve their life savings and their investments. Should we not be aiming a little bit higher? There is a paucity of ambition here, I would suggest to you.
Mr Prettejohn: I think it is a reasonable place to start but in the long run we should probably be expecting higher standards than that.

Q93 Mr Breed: How many people in the FSA have such qualifications?
Mr Prettejohn: I am afraid I cannot answer that.
Mr Breed: We will ask Mr Sants.

Q94 Chairman: That is a good question, so the advance question to Mr Sants is, what percentage of your workforce is at graduate level? I think we have covered almost everything here. Mr Phillips, if I could just review a couple of things you have said because they have been very important and very helpful to us, we agree that there is a potential profound conflict of interest at the FSA between prudential regulation and treating customers fairly. Presently the FSA is full of people with industry experience, and even at the Strategic Board level the FSA is dominated by industry people, so there is a stronger case, a greater case for consumer representation on that Board.
Mr Phillips: Agreed.

Q95 Chairman: The Consumer Panel, having two policy staff, really need to lift their ambitions on that. Agreed?
Mr Phillips: I accept that point.

Q96 Chairman: On the credit crunch, the firms at present have an incentive to cut corners so it is even more important to have consumer representation and consumer interests safeguarded.
Mr Phillips: Absolutely, but the issue there is that the FSA should be tracking the performance of the industry.

Q97 Chairman: If I can say to you that your evidence has been very helpful. I would suggest that there is not a cigarette paper of difference between the views of your predecessor, Lord Lipsey, and your views. Is that unfair?
Mr Phillips: You would have to ask him.
Chairman: He is not in the room as far as parliamentary convention is concerned. However, can I thank you very much for your evidence today. It has been very helpful to us.

Witnesses: **Mr Hector Sants**, Chief Executive; **Mr Dan Waters**, Director, Retail Policy and Conduct Risk Division; and **Ms Lesley Titcomb**, Director, Small Firms and Contact Division, and Retail Intermediaries and Mortgage Sector Leader, Financial Services Authority, gave evidence.

Q98 Chairman: Mr Sants, welcome to the Committee. We do appreciate that Lord Turner is in Hong Kong today at the Financial Stability Forum, and it was with that in mind that I was quite happy to go ahead with our rearranged session on that, but you are due to come back in March and we will have a further range of questions, particularly for Lord Turner, on these issues. Can I start with payment protection insurance. Five years ago we referred this matter to yourselves and the OFT and the Competition Commission and we are still dizzying around. We have a fine on Egg at the moment. What has happened? Can we not get it sorted out?
Mr Sants: I think it is very fair to say that progress by firms in sorting out that key issue has been disappointing. We made that clear. We have a very determined enforcement programme under way. We have significantly increased our fining in that area and if I could pick up on one of the earlier comments, of course, the cost to firms is not just in the fine. Indeed, you would expect the fine not to be the greatest cost that they in fact bear because we are also asking them to provide redress, and our expectation in many cases is that that redress, the compensation to consumers, will be multiples of the fine. So just looking at the fine is not in itself the best way to judge the deterrent effect being delivered. However, we do agree that firms have been slow to alter their behaviour and we are determined to see that changed. I believe that message has now been put over and that we have seen significant changes in firms' behaviour. Dan, you may want to comment on some of the detailed changes.
Mr Waters: Thank you. Yes, we have done a number of rounds of thematic work, as the Chairman is probably unaware. Some improvements have been made but the work done by the Competition Commission makes it pretty clear that there are some fundamental structural problems in this market and, frankly, the tools we have to deploy have not been able to crack the backbone of the problem. We have nonetheless, as Hector has said, fined something like 20 firms a total of about £12 million. We have said that we are escalating current regulatory work with firms. A number of firms have voluntarily agreed to stop selling single premium PPI. So I think it is fair to say the writing is on the wall. We just need to get on with further improvements.

Q99 Chairman: Let me just give you my personal example. I went to my bank and got a short-term loan a couple of years ago. I told them at the time that PPI is not suitable for me but I was a recipient of eight separate letters from the bank over the next three or four weeks impressing on me that I had really made a mistake in the first instance. That, to me, is not far away from harassment. It is a well-respected bank and I do not want to name it and shame it here.
Mr Waters: That kind of behaviour I think was probably not untypical a couple of years ago. We think some things in that respect have improved in terms of the banks and other sellers of PPI not actually forcing or pretending to tell people that it is required. That has improved but other issues have not.
Mr Sants: The general point, Chairman, is well taken. There is no question that effective deterrence requires swift and effective action and a higher level of fines and sanctions than we have historically, if you go back over the full period you are alluding to, deployed but I think our actions in the last 12 months in respect of those 20 firms shows that we are taking a much tougher approach.

Q100 Chairman: Lord Lipsey's letter of resignation, as you have heard, called for a broader remit with greater resources than the Panel currently enjoys. Having applied the Rizla cigarette paper test, there is not much difference between Mr Phillips and Lord Lipsey. Why did you reject Lord Lipsey? Why is he not there making the case for a broader consumer representation, then both of you can work together?
Mr Sants: We did not actually reject any proposals from Lord Lipsey. I have to say that neither I nor the Chairman nor the senior executive team received any.

Q101 Chairman: That is not what Lord Lipsey is saying. Was there any communication between yourselves and Lord Lipsey?
Mr Sants: I do have meetings with the Chairman of the Panel on a regular basis, and they also know that my door is always open and my telephone will always ring but there was no formal proposal made to us which had the support of the Panel. We do think the Panel is well resourced but of course, we would look carefully at any proposals made.

Q102 Chairman: So you and Lord Lipsey, if you met, were mute and you smiled at each other and enjoyed the cappuccino and the croissants. Is that it?
Mr Sants: I was aware that he was considering the resourcing and looking at this issue but, as I say, he made his decision to resign without getting to the point of bringing me a proposal.[1]

Q103 Chairman: Mr Phillips' comments, as you see, are not much different to Lord Lipsey's. Are you willing to go away after this meeting and have a look at that and see if consumer representation can be enhanced? It seems pretty inadequate consumer representation.
Mr Sants: Of course. We would always look at any seriously constructed, thoughtful proposal from our panels and from our panel chairs. They are a really important part of the work. I would make the point, of course, it is not just the direct resource committed to them; they do have the ability to leverage the whole of the FSA. So looking at those individual figures that were quoted earlier is rather misleading. To the straight question, absolutely, we take the panels extremely seriously. The consumer panel has

[1] *See* Ev 45 for Memorandum from Lord Lipsey.

a keen role, to represent the consumer interest forcibly, to challenge the FSA, and to provide us with a useful sounding board and advisory forum. To deliver this task, they need to be properly resourced, and we will, of course, listen carefully to any proposals they might have.

Q104 Chairman: At the moment your Deputy Chairman is a former chief executive of one of the retail banks. Would you advocate the Deputy Chairman being from the consumer side if the Chairman is from the industry or has had industry experience?
Mr Sants: I hope you will not mind me making the point, as you kindly observed, that our Chairman is in Hong Kong and of course, the composition of the Board is not directly a matter for the executive. It is for the Board and the Chairman, and indeed HMT, so I would rather not comment, in all honesty, on the direct question. I am happy to make a general observation as an executive member of the Board.

Q105 Chairman: Do you need more consumer representation?
Mr Sants: Of course, board members are not meant to be representing sectional interests, they are there as individuals but, as an executive, we would welcome greater consumer engagement at the Board level; if it is consistent with delivering effective Board governance.

Q106 Chairman: Paragraph 6 of your memorandum details your recruitment policy and it contains the following phrases: (1) "We are aiming for the right balance of career regulators and market practitioners"; (2) We are "recruiting external candidates from a range of backgrounds, including retail and investment banking, risk management, quality assurance and consultancy firms" but there is no mention of any attempt to recruit staff who might have a background in consumer organisations.
Mr Sants: As I think you are aware, those comments are, of course, targeted at the earlier debates we have had in this Committee exhaustively where Committee Members and myself shared a mutual concern that the regulator was not necessarily as well-equipped as it might be to deal with financial stability and prudential issues. So those recruitment characteristics are framed around that particular debate. Of course, we recognise the importance of ensuring we are also properly resourced for our task in conduct regulation and I can completely agree with you; if I use the phrase "market" as reflective of the outside world, then the comment is relevant, we are looking to recruit from areas outside of career regulation. In respect of conduct regulation I would take the same philosophy, that we ought to have the balance of those that bring the consumer viewpoint alongside those who bring the career regulatory perspective as well. As I say, those original phrases are targeted at a different question. I quite agree with the point.

Q107 Sir Peter Viggers: Thank you for your memorandum. You discuss principles-based regulation. Would you just like to say a word or two about that because you make the point in your memorandum and it might be quite useful for us to hear.
Mr Sants: We have discussed this in the past. The FSA, right from its genesis, has described itself as a principles-based regulator to seek to distance itself mainly from the concept of a more legalistic approach of the regulator being there just to ensure that rules are complied with, without necessarily giving thought to the consequences of the actions of the firms in question, the individuals in question, the rules in question. That principles-based approach has been in place from the genesis of the FSA but it was revisited, I think, with the benefit of experience in the last couple of years. It has also been right to revisit it with the benefit of the experience of the last 18 months, an extraordinary period in financial markets. What we are saying as a result of those reflections, in particular the reflections of the last 18 months, is that the basic concept of principles-based regulation does look to us the right way forward, is the right regulatory philosophy to have, and indeed, when you look at the issues arising from the last 18 months, they arise not from principles-based regulation falling over but rather from maybe the failure by the regulator to follow through its own principles. I have however sought to nuance our "strap" line, when I have been here in front of the Committee before, and to draw out some of the other phrases that we use to describe our regulatory approach because I do feel some of those other phrases better describe what we mean. The problem with principles is that people then tend to focus entirely on the size of the rule book. I think it is more important to also focus on the outcomes and to really emphasise the point that what we want management of firms to do is to think about the consequences of their actions, whether that be in the conduct or the prudential space, and to decide whether those consequences are aligned with our principles, and that we, as a regulator, should be seeking to make that judgement as well as to whether the consequences of their actions, of the firms' actions, are going to deliver the results that we all want. The emphasis is more on that phrase "outcomes-based regulation" but that in no way suggests that we have moved away from the concepts of trying to do so with as minimal a rule-based framework as possible and emphasising the compliance with our 11 principles.

Q108 Sir Peter Viggers: Not everyone is happy with this. The Association of Chartered Certified Accountants—I do not know if you have had a chance to see their evidence to us—have been quite critical. They say that ACCA believes that the supervision carried out by the FSA has been regulation rather than principles-based and they go on to say, "We believe that the problem is not one of a lack of regulation but of a failure of the FSA's existing supervisory powers." How do you respond to that?

Mr Sants: A couple of points. First of all, just to make clear, of course, the policy framework which we regulate to is not entirely within our control. Of course we are a significant driver and influencer of that policy agenda but it may be worth reminding ourselves that the majority of policy nowadays emanates from the European environment and to a lesser extent from the global and international environment, as it should do, but of course, that does mean that not every aspect, not every Directive is necessarily written in the way that we would choose. If you look at the rules and policy here, it may well be that at times that does not comply with a purist approach to principles-based regulation. I think it is worth reminding ourselves of that point. To the second point, how effective are we at delivering in a principles-based way, of course, as I commented before, when we do deliver in a principles-based way, I believe that does give the best result for the system, for the users of the system, and where at times we deviate from that, as there have been occasions in the last 18 months, as we have discussed in this Committee, the results have not necessarily been as good as they should be.

Q109 Sir Peter Viggers: Meanwhile, the Association of British Insurers comes back at your comments in a different way. The FSA, they say, should also place greater emphasis on prudential regulation rather than on the conduct of business regulation and they go on to say, "Ultimately, the most important outcome for consumers is that their claims are paid and firms can only do this if they have adequate capital." Do you understand their point?
Mr Sants: I certainly do. It is a crucial topic. I am conscious of time and I do not want to give you too lengthy answers, so I shall try to keep this very short but if you would like us to expand on this topic when we next come back, I will be delighted so to do. The first point is, we have discussed here before that in our retail supervisory area there have been criticisms from industry, as we heard today from Nick Prettejohn, that historically we did not focus enough on prudential issues and were focusing too much on conduct within the supervision of our retail institutions. In terms of that balance point, we would agree with that. So we have rebalanced but what we have also sought to do, of course, is to increase the total amount of capacity in the system through our supervisory enhancement programme and through our recent recruitment programme. We will have something of the order, as you know, of 20% more supervisory capacity and a reorganised supervisory process. We believe overall that that will deliver more capacity for both prudential and conduct, and I think it is absolutely critical to have a balance. We need to be extremely careful that we are not sitting here in a few years' time, looking back and saying, "You were all focused on prudential. What happened to conduct?" It is very important that we deliver a balanced agenda and that is how we have now set up the supervisory process, to make sure it is a balanced agenda, with more capacity, and delivering in a more effective way, which will take us on, I think, to some later points about why we have embedded TCF. A final point I would like to pick up from earlier observations around is the assertion, which is obviously a perfectly theoretically correct assertion, that there is an inherent conflict between prudential and conduct regulation. Of course, there is an inherent potential conflict but first of all I would have to say it is not clear to me why moving that into two separate administrative organisations will necessarily remove that conflict. Whatever happens, the regulatory system in the round has to manage that conflict. Secondly—and I think this is a really important point—I think history is showing us, and the last 18 months are definitely showing us, that prudential and conduct are completely intertwined. As the submission you have there mentioned, at the end of the day, if firms fail, consumers lose out. So the idea that somehow or other prudential is not a consumer issue is missing the point. Furthermore, effective prudential regulation requires conduct issues. We have discussed in this Committee before issues like compensation, competency of management—these are conduct issues which intertwine with prudential in the same way as prudential intertwines with conduct. I would suggest that if you do not have that overall view, you would have a worse regulatory system than you do now have. So I think history is showing at the moment that the integrated approach is the right one but, of course, there is a conflict and that conflict has to be managed.

Q110 Chairman: On that conflict of interest, there is one issue that we are going to be taking up more because there are different views on it, Mr Sants. It came up at the Northern Rock time.
Mr Sants: Absolutely.
Chairman: It is something I think we need more clarity on and, as a Committee, we will be pursuing along those lines to understand it more.

Q111 Mr Brady: Given Lord Lipsey's description of the term "sales advice" as being devoid of meaning, what should a consumer understand by the term?
Mr Sants: As a general point, may I just remind everybody that these are preliminary suggestions from the FSA which we now intend to test with consumer research. Obviously, it is critical that whatever terminology we come up with has to be terminology that is understood by the consumer. That is self-evident and we are certainly clear about that goal. I have a lot of sympathy with taking a view that there is a case for arguing in terms of terminology that you have a straightforward division between independent advice and straightforward sales terminology, which indeed is a proposal that has been in our documentation, but there are considerable issues about that and, as ever, when you unpick the problem, it is a more complicated story than it may at first sight seem, not least because we do not want to lose that service which the banking industry delivers, which does have an advisory component. We also have to recognise, that given the way the Directive is framed, they are delivering advice in many cases as the MiFID framework allows them to do. I think there

are Directive issues here as well. There is research to be done but we also need to recognise the limitations of what we are able to do within a national context. We also have to recognise the importance of maintaining an important segment of low-cost service to consumers. Dan, I do not know if you want to add a bit more.
Mr Waters: I think the only thing I would say is that we have had discussion with the European Commission, as you would have expected, on the overall Retail Distribution Review, in which they are very interested and are generally very supportive of what we are trying to achieve. On this particular point, they were very clear that MiFID is the governing legislation in terms of what is advice and what is not. The recommendation being given by an employee of a bank is advice covered by MiFID and the idea that that person could not make clear to a consumer that they were giving advice is unlikely to be an acceptable outcome under MiFID. There is that limitation. The other thing to say is, a consumer needs to know that, if something goes wrong, they do or do not have access to the FOS; they do or do not have access to the protections of our advice regulation.

Q112 Mr Brady: Under your latest proposed framework that has independent advice and sales advice, do you think it will be clear to the consumer in whose interests a sales adviser is working?
Mr Sants: We hope so but we are open to further suggestions. We are still working with consumers and industry to refine and develop the terminology we apply. That matter is not closed; that is a suggestion on the table, and we welcome any further contributions to that debate. I do think the point that my colleague has just made is very important about ensuring that consumers continue to have the benefits of the protection offered by the FOS and that framework, and the point that both of us have now made twice, which is that we have to recognise that within the Directive framework banks are offering advice and we cannot change that.

Q113 Mr Brady: Given that both might be under the same kind of pressures to meet sales targets from above, what is the fundamental difference between somebody selling a car in a car showroom and a bank employee selling a financial product? Why can they both not be called a salesman?
Mr Waters: The fundamental difference of course is the nature of the market. Consumers behave a lot more competently and confidently in dealing with many retail markets. Financial services is one of the most difficult because of the nature of the products. We have that problem. In terms of the difference we have now put in place, there are rules about the suitability of advice and there are constraints therein. There are also propositions in the RDR which are meant to break the drivers of selling; commission-driven selling as we know it, where the provider is basically competing for distribution by paying commission will be broken by the RDR. There will still be issues in the tied sector about the incentives put upon sales forces and we are very clear about that. The TCF programme is very clear about looking closely at remuneration structures, looking at the training of staff and looking at the monitoring of the quality of the outcomes.
Mr Sants: Just to give the plain English answer, I think the banks would argue that they are offering advice in the service they proffer. It is not, in the eyes of the FSA, full independent advice, assuming it is not that type of advice which gives full access to all product options, but they would argue that they are offering a degree of advice, and certainly within the MiFID framework they are offering advice, and cars are not sold under the MiFID framework.

Q114 Mr Brady: When *Which?* did its mystery shopping survey, they found a number of bank advisers claiming to be offering free advice whilst the cost of that advice is obviously loaded on to the product. Should purchasers of bank products know the true cost of that advice?
Mr Waters: The answer to that question is yes, and we have agreed and are already beginning work with both the BBA and the ABI on transparency about the cost of advice, and transparency about the cost of the product.

Q115 Mr Brady: What support are you going to give to firms in managing the transition to the new adviser charging model?
Mr Waters: That is a very good question and one that we will consult on. It may be that there are intermediate steps that we can take along the way that will smooth the transition. That is something we need to look at in consultation.
Mr Sants: There was a general point made by Peter Vicary-Smith, and to be straightforward, we completely agree with. It is a question of finding how to navigate through that. There is no disagreement on the points he made.

Q116 Mr Brady: Have you made progress on dealing with trail commission, a problem that was highlighted in our report on restoring confidence in long-term saving?
Mr Waters: The basic change that the RDR intends to make is the removal of the reliance of the advisory community on commissions being rolled up and paid up front, so that by 2012 there will be perfect matching between the cost of advice and the money coming from the client. So this business of funding by the provider will be removed. That is quite a fundamental change.

Q117 Mr Brady: Can I move to a different issue, the whole question of offshore deposits? Obviously, there has been severe detriment suffered this year by a number of consumers who invested offshore, particularly in the subsidiaries of Icelandic banks. Do you think the FSA did enough to make sure that consumers were warned of the dangers of saving offshore?
Mr Sants: I think you have to ask the question as to what is the extent of the FSA's remit in that, in the sense that in many cases here we are talking about companies that not only are not regulated by the

FSA, but they are not even owned by companies which are regulated by the FSA, and of course, they do not fall within the FSCS and the consumer protection regime in the UK. I think these are issues clearly outside our regulatory boundary in the supervisory sense. We certainly have an obligation to make sure that, where those firms are marketing into the United Kingdom and fall within our remit in that respect, the information is clear as to their regulatory status and the status of their consumer protection offering, their consumer protection process. I do believe that that was clear to consumers, but I make the point that these are not firms that are regulated by the FSA and I see no reason why people would believe that firms outside the United Kingdom would be those regulated by the FSA.

Q118 Mr Brady: Clearly, a lot of people who saved offshore in these banks would have done so under advice from IFAs. Do you think those IFAs themselves were fully aware of the risks of investing offshore?
Mr Sants: Clearly, if they feel they have been mis-sold to by a UK-regulated entity, they have a case that they should pursue and that would be the right thing for them to do. Again, we are always interested in hearing and keen to hear from consumers who feel that they have been mis-sold to and would take action in those cases.

Q119 Mr Brady: Do you think, looking ahead, there is a case for more information, more education, both for consumers and for advisers about these risks?
Mr Sants: I would certainly hope that events have demonstrated the importance of understanding the risks involved in offshore investments. I think that is an important lesson for advisers to learn and I would expect they would have learned that lesson.

Q120 Mr Brady: Would you acknowledge that one of the things that has come out of this problem is the number of people, particularly British expatriates, who felt that the UK's "know your customer" regime meant that they were unable to hold their savings legitimately in UK onshore banks?
Mr Sants: Technically, that has been a decision for the banks themselves but, as you rightly say, this has been an issue which has been highlighted by this set of events and we would reasonably expect the banks to give consideration to those facts.

Q121 Mr Brady: Is it not the case though, would you say, that if a person has been told by their bank that they will not take those deposits in a UK bank account, the bank should have told them that others would?
Mr Sants: It is an interesting question. I think you would have to hesitate to say that it is an obligation on a firm to give advice about other firms' services unless they are setting themselves up so to do. It is entirely the right of a firm to decide it does not want to take on a particular type of business, and unless they have set themselves up as providing general advice, it is not necessarily the case that they have an obligation to refer the business on to a competitor. Dan, I do not know if you have anything to say?
Mr Waters: I have nothing more to say.

Q122 Mr Brady: Will you be undertaking further work in the future to ensure that people working offshore are aware that they are able to hold their savings onshore?
Mr Sants: It is an interesting question, a question maybe for the Committee and maybe for a future discussion as to whether you feel our financial capability objectives extend to UK citizens wherever they are living or whether we are seeking to address those living within our national boundary. It is probably fair to say at the moment our financial capability agenda does not include provision for providing advice services to UK citizens living outside the United Kingdom.

Q123 Mr Brady: I finally have a couple of questions specifically about the situation of KSF Isle of Man. First of all—and I recognise, obviously, that your Chairman is not here with us today and that may place some constraints on your ability to respond to this. You were with him on 3 November when, in response to a question from me, Lord Turner said of the transfer of funds from the Isle of Man to the UK by KSF, "That deposit became a general creditor like other general creditors." Would you accept that that was not an entirely accurate statement given that the Treasury has taken powers by order that give the Treasury specific control over any payment of that money to a related party?
Mr Sants: I think he was making a general comment about the status of a wholesale deposit in an administration, so obviously, from the point of view of the UK entity of Singer & Friedlander. Although if I may remind the wider audience—I am sure you are already aware of that—the Isle of Man subsidiary was not a subsidiary of the United Kingdom company. It was a subsidiary of the parent bank in Iceland: so there was no direct connection between those two entities. It is not analogous to the Bradford & Bingley situation, for example. This is clearly an example of a foreign bank with no regulatory connection with the FSA in that sense. That bank had placed a deposit with a UK-regulated entity and the status of that deposit in normal administration would be of a general creditor. That was the answer he was giving. As you say, there may have been subsequent actions away from the general administrative process by the Treasury which would change the status of that deposit but I think he was answering it in the generality, from the point of view of normal administration and with regard to any regulatory obligations we might, or in this case did not have for that deposit.

Q124 Mr Brady: So it clearly did not take account of the specific legislation the Treasury was taking powers under. That is a very helpful response. Finally, you will also be aware there was a degree of controversy relating to the discussions that took place between the FSA and the Isle of Man

regulatory authorities prior to the transfer of the £500 million plus to the UK. Have you undertaken any further investigations internally into the nature and content of those discussions?
Mr Sants: Yes, I have looked into the matter, and indeed, had conversations subsequent to the sad events with the Isle of Man regulator, and we are satisfied that the answers we have given in the past are absolutely fair and accurate. Namely that there was the normal engagement between regulators but there was no suggestion that somehow or other we had provided any additional reassurances or made any additional communications with the Isle of Man regulator other than that which you would expect in terms of normal exchange of information between regulators, nor have we received any representations from the Isle of Man regulator since to suggest that they take a different view. To confirm, we have had no communication from them suggesting they disagree with that fact set.
Mr Brady: Thank you.

Q125 Mr Breed: Ms Titcomb, perhaps we can direct a few questions to you concerning the interesting concept of treating customers fairly. In June in the executive summary you indicated that a paltry 13% had actually met the deadline of March 2008 but you were pretty confident that by the December deadline 80%—which is still, obviously, not 100%—would have done it. We are a few days away now, so how many have complied now?
Ms Titcomb: I am afraid I cannot answer that question directly. I am principally concerned with the supervision of the small firms within the FSA and the figures you quote relate to the relationship-managed firms, which are larger.

Q126 Mr Breed: I will ask one of your colleagues then, who may know: how many firms have now met or are about to meet the December deadline?
Mr Sants: We laid out when we published the 13% figure that we expected something in the order of 80% to be able to meet it but, of course, obviously, we have not reached that yet, so that will be a question to ask us as we move through the course of next year. We do have an expectation that considerably more than the 13% figure which we reported earlier in the year will have achieved the target. I will remind you that the target is having a formal and appropriate MI framework to ensure that they have the ability to judge whether they are treating customers fairly. It is not necessarily a test of whether they are treating customers fairly.

Q127 Mr Breed: In general terms, there is a remarkable relationship between late results and bad news. When things are going particularly well, it is remarkable how results are often very timely. On the basis that you do not appear to have got anywhere near 80% perhaps, otherwise you might have indicated to us that that was the case, are you not concerned at this appalling level of meeting this deadline?
Mr Sants: We would agree with you, and one of the reasons why—and why we disagree with some of the earlier comments—we have brought forward—and it is bringing forward; it is not a new departure altogether—the embedding of the TCF propositions within our mainstream supervisory agenda, supervisory process, is to deliver what we believe will be the most effective way of ensuring that we get results in this area. I am a firm believer—and that is reflected in the changes I have made in the FSA—that we are a supervisor. That means that really important things should be done in supervision. They should not be done elsewhere, in some little programme over on the side. They should be handled by our mainstream supervisors, whose job it is to supervise institutions properly on both conduct and prudential issues—back to the earlier point. Treating customers fairly is an absolutely essential part of conduct regulation and we should have TCF in the mainstream of the FSA, not off to one side. That is responding precisely to the point you have made, which is that we think progress is not as good as we would like and we need to turn up the pressure, get better results, and getting better results means putting it into the supervisory process where we are hiring 20% more supervisors.

Q128 Mr Breed: What greater intensity of effort have you made in the supervisory process then, bearing in mind this current situation?
Mr Sants: Precisely the point I have just made. As you know, we are in the middle of a major hiring programme, which, as we reported in our note, we are some 40% of the way through. We are altering our mainstream ARROW framework, which is the review process which firms have really concentrated on to make sure that it effectively picks up this issue. Dan, you might like to give a little bit more detail on how we are doing that. It is a very important point that the Committee rightly should be reassured on.

Q129 Mr Breed: Just before you do that, can you respond to Lord Lipsey's view of the normal ARROW supervisory process, which he describes as "an unambiguous retreat"?
Mr Sants: As far as I know, Lord Lipsey has never enquired as to how we intended to embed TCF in the ARROW process but I am sure Dan will be happy to explain it to you.
Mr Waters: We certainly do not think it is a retreat, ambiguous or not. What is happening is the ARROW framework itself is being changed in a very significant way to require outcomes testing, that is, what is happening in the real world between real consumers and the sales force or the advisers, whatever the interface with a particular firm is, what is happening there, and you are testing that in real terms. Either the firm has its own mystery shopping results or we will go in and look at files, or we may do mystery shopping ourselves in the supervision line to find out.

Q130 Mr Breed: You have cancelled the whole process of visits based upon treating customers fairly.

Mr Waters: We have transferred that work into the actual ongoing supervision of firms.

Q131 Mr Breed: That is the retreat.
Mr Waters: We do not think that is a retreat. We think that is bringing forward from September—

Q132 Mr Breed: You mean specialised visits on TCF now being conducted into just the ARROW programme is not a retreat?
Mr Waters: I do not see why it would be. In fact, it is more important actually to reform the general supervisory framework so it addresses this as part of the day-to-day work. Otherwise, as soon as the project is over, it dissipates. This means it will be built into the fabric of how we supervise, and supervisors need to understand how to do this. My division, which has a conduct risk function, is designed to help train them to do this kind of examination.

Q133 Mr Breed: By what date will all firms have been looked at or checked for their compliance with TCF?
Mr Waters: That will depend on the timings of the ARROW visits, so the higher impact firms are on a rolling—

Q134 Mr Breed: Can you give me a date?
Mr Waters: I do not know that I have a single date. We have a three-year time period for the smaller firms we talked about before.
Mr Sants: Of course, the ARROW framework has full ARROW visits on a three-year framework but there will be additional contact during that period as part of the close and continuous framework. A straight answer is that the longest period for relationship managed firms would be three years and for small firms Lesley will elaborate. Effectively, that is no change from where we would have been under the previous process, so it is not a retreat. If I may add, that is the longstop answer based around the ARROW framework but I think you are missing the creation here of the Conduct Risk Department, which is a key element in our agenda. We are not just moving the process into the supervisory process, where, as I said before, we will have 20% more supervisors than we had previously. We are not just making sure that it is in the key assessment process which the senior management of the banks pay attention to, but we have also restructured the rest of the retail area of the FSA to concentrate expertise in respect of key conduct projects inside a Conduct Risk Department in Dan's area, to give us real delivery in the consumer issues in the conduct area which matter. The reality is, treating customers fairly is a principle. What actually matters is the events on the ground, the outcomes, and the outcomes are around products and events, just like PPI, which we have been discussing earlier, where the Chairman rightly pointed out the FSA has been fairly slow off the mark, which he is absolutely right about. We need to focus on actual failures and the Conduct Risk Department will provide extra resource to tackle real events which are actually affecting consumers in the here and now. So we have a rebalancing of the process around embedding it in supervision to make sure senior management are engaged and putting extra resource into task groups, which will address real problems as opposed to thematic groups looking at the concepts. I think we are moving into the hard, nitty-gritty of real deterrence by beefing up the conduct risk area. I really do think the fears which have been understandably expressed by the consumer areas will be seen to be misplaced but obviously that is a question you can ask us again as the next year or so unfolds.

Q135 Mr Breed: One last one. We do not want to see TCF going the same way as PPI. Let us put it that way. Your response to the Practitioner Panel contends that the TCF initiative has not resulted in an increase in the regulatory burden. Many of us would find that somewhat difficult to believe. So there is no requirement to carry out any cost benefit analysis. A number of firms, as you know, would completely disagree with you on that. What is your response to them via us?
Mr Sants: I think the point which we have all explored—and Lesley may want to add to it for small firms—but let us be clear; TCF, as our submission to you made clear, encapsulates a regulatory objective which has always been part of the FSA's agenda. It is part of our 11 principles. We have four principles which are particularly focused on consumer issues. The TCF is a shorthand way of describing what we are seeking to do to effectively deliver on those four principles. We were not creating a new policy agenda; we were seeking to effectively deliver on the mandate we had been given. In that sense, that is exactly the point that has been made to the industry. It is not a new policy initiative. Dan, I do not know whether you want to say anything else?
Mr Waters: I do not think I have anything to add to that.
Mr Sants: You might want to add a little more on the small firms' burden, which is an area of principal concern, quite understandably.
Ms Titcomb: The small firms have two concerns, one of which Simon Bolam brought out very well, which was the issue about proportionality of what we are asking small firms to do. I think it is important to understand that we do ask small firms to deal with this issue and to embed the culture of treating customers fairly in a way which is proportionate to the size and nature of their business. What we would require of a sole trader business is very different to that which we would require of a substantial network, and the MI that we would expect them to be collecting, all that kind of thing, would be different as well. At the same time, we have heard from small firms that what they wanted from their supervisory relationship with the FSA was more face-to-face contact with us, more help from us to understand our requirements, and this is what our enhanced strategy for assessing whether small firms are treating their customers fairly is about.

Q136 Mr Breed: And that is not going to cost them anything more?
Ms Titcomb: We have been investing more in it but it has not led to direct fee increases for them.

Q137 Mr Breed: And it will not do?
Ms Titcomb: I cannot say that going forward because I do not know what the fee plans are.

Q138 Mr Breed: So their fears are well founded?
Ms Titcomb: We have to understand that the burden of regulation on firms is not only about the direct costs of FSA. They are also concerned, as Simon amply illustrated, about the time that it takes for them. We have to have regard to that.

Q139 Mr Breed: I hear what you say.
Mr Sants: We have said repeatedly here that we believe the FSA in general—there may be exceptions—should be delivering advice and delivering a proposition which is aligned with good business practice. If there are small firms that feel there is an unreasonable burden being placed on them, Lesley and the team will always listen. That is the purpose of having more face-to-face contact with small firms, which is why we changed the strategy a little over a year ago now, in the autumn of 2007, and launched the revised strategy with many more people on the ground so people can have face-to-face conversations with us. I think that strategy has been well received.

Q140 Mr Crabb: I would like to pick up a couple of points, if I may. You talk about the 20% increase in supervisory staff. That is the 50 extra staff that is referred to in your annual report, is it?
Mr Sants: No. Since then, as you will be broadly aware, following on from the lessons learned exercise we did on the events of the last 18 months or so, and in particular Northern Rock, we have brought forward further enhancements to our supervisory capacity and technical support and have talked in terms of hiring something of the order of 216 or so extra people, of which half would be in supervision. That is the overall supervisory enhancement programme.

Q141 Mr Crabb: So will the result of the change to embedding the TCF compliance supervision within the main ARROW supervisory process lead to a reduction or increase in the number of hours spent on TCF compliance, or will it stay the same?
Mr Sants: It is going to be difficult to do a like-for-like comparison because the nature, going forward, of the initiatives we will take will change in character. I have said this before and it is also reflected in some of that discussion around more principles-based regulation. It does reflect some of the concerns that the Committee has rightly brought up about success in some of these areas historically. We do need to change the balance somewhat in our regulatory style. Our principal focus historically has been on systems and controls, and that is reflective of the discussion that has been had around TCF so far, where we have been looking for management to demonstrate they had the requisite MI, management information, to manage that, take responsibility for treating customers fairly. I think going forward we would like to do more. We have been doing some, as the Consumer Panel kindly reflected, outcomes-based testing, mystery shopping and other related initiatives. I would like to see more of a shift away from systems and controls into outcomes-based testing because, in my view, the best way to ensure that management are doing the job they should be doing is for them to realise that if at the point of delivery it is not giving consumers what they want, we will actually see that and know that, as opposed to making a judgement based on whether or not the management themselves have sufficient MI. So I think a like-for-like comparison between the two activities will be difficult to do. Having said that, broadly speaking, as I said earlier, with that sort of increase, we would expect, conducting regulation in the round, to not see any diminution in our focus on the big issues. I think you will see us focusing more going forward on making sure that we are really addressing the important issues, and maybe not dissipating ourselves quite as widely as we have done in the past. That comes back to the formation of the Conduct Risk Division, which will focus on the big issues like PPI, so we get an earlier and more effective grip on those sort of key issues when they arise.

Q142 Mr Crabb: Ms Titcomb, you were talking previously about the proportionate level of the compliance burden on firms. Mr Bolam previously very helpfully described to us some of the burdens that he has to face, and he showed us the 16-page document that he and firms like his have to produce by the end of December. Do you regard that as the right level, knowing presumably the size of firm that Mr Bolam operates?
Ms Titcomb: I do not think I can really comment on a specific firm's situation here but what I would stress is it is not having a piece of paper that is important here. It is having the culture of treating your customers fairly embedded in your firm. So when we go to, for example, look at a small firm in this context, if they employ people, we look at their recruitment policies, their training and competence, how they make their business decisions about which products they are prepared to offer advice on, that type of thing. So we are looking all the time to see the attitude embedded in the firm, particularly in the senior management of the firm, that they treat their customers fairly. That is far more important, to be frank, than the document. The document is one part of the evidence for us but it is by no means everything.

Q143 Mr Crabb: When your staff make these visits, it is the documents they are looking for, is it not? They want to see those bits of paper. They want to see time spent on completing these documents. That is exactly the evidence they are looking for. That is where the burden kicks in, is it not?
Ms Titcomb: Not entirely. For example, when my staff do one of these follow-up visits, if we have concerns with a firm and we think they may not be

treating their customers fairly, we go in and review customer files as well, and actually see what the outcome is, what advice has been given to a consumer.

Q144 Mr Crabb: So you will go through the filing system of a small business?
Ms Titcomb: Not all of them, I hasten to add; a sample, but we do go in and look at files. Obviously, we want to try and see the evidence that management can demonstrate to us, and one of the ways they can demonstrate to us is that they have these documents and so on in place but, as I said, very much the requirement is that they are proportionate to the size and nature of the business.

Q145 Mr Crabb: This December many of these firms are basically clinging on for dear life, for survival. The last thing they need is—forgive me—you guys turning up and poring through their filing systems and wanting to see 16-page documents.
Ms Titcomb: When it comes to the small firms, we are not just turning up and doing that. We are taking a very focused approach. We are expecting to visit 11,000 firms over the three-year period starting at the beginning of this year. The process is that first all they are invited to a roadshow, which is free. We strongly advise them to come. They learn about what our requirements are. They have a lot of chance to interact with other firms. We then follow that up with an hour and a half's assessment, either face-to-face or by telephone, when we go through a series of issues with them—and we are talking to the principle of the firm here—to understand their attitude. We then follow up with a number of firms where we find the results of that assessment are not satisfactory, and we follow up with a random sample as well, just to check we are being consistent and so on, where we actually go in and do a visit at the firm's premises. We are trying not to impose too great a burden on them. We think it is proportionate for this important issue, because we want to ensure that they are securing good outcomes for consumers.
Mr Sants: We do have to recognise—and I am sure you do—that we have all been talking about the need to improve the quality of service for consumers, for depositors, for borrowers for savers. We all recognise that there have been significant issues in the past. The Chairman has listed a number of them. We all recognise, and all the previous speakers here have acknowledged that, the need for change in the industry. In bringing in change, that obviously is a burden. Change is a burden. Change requires you to change your practices, but I think there is a collective agreement amongst everyone, from the consumer perspective, the industry perspective and the regulatory perspective, that change is necessary. We do not disagree that change runs the risk of being a burden. We are trying to do it as sensitively as possible. The reason we put extra capacity into the small firms sector, which was welcomed by the Small Firms Panel, was because we do believe face-to-face contact is a much more sympathetic and constructive way to take it forward. Wherever possible, we are trying to coach and help firms. We are not trying to put them out of business; we are trying to help them to adapt to what we believe will be a better structure and a better industry, delivering a better result. Obviously, it is a tension between delivering change, which carries cost, in a time of economic difficulty for the small firms. We have to try and manage that sensitively.

Q146 Mr Crabb: Finally, Mr Sants, your Financial Risk Outlook identified as a priority risk the potential for firms to reduce their commitment to treating customers fairly. Can you back that up with any evidence at this stage about what we are seeing out there?
Mr Sants: I will let Lesley answer on the small firms, which is a key area, I think.
Ms Titcomb: In previous recessions you would have to have observed that one thing firms may do in order to try and improve their income stream is, for example, if they are finding it difficult to advise on mortgages, they will try and go into other forms of business to try and maintain their income stream. They may get into products that they are not very well qualified to advise on, that type of thing. The other thing which is obviously observable in recessions is that fraud can increase. We have identified a number of areas, particularly working with Dan's new Conduct Risk Division, where you can see the potential for enhanced risk in an economic downturn. Diversification into unfamiliar products is one. Another one would be in the area of mortgage arrears and how mortgage lenders treat people who are in arrears. We go through an exercise, as the FRO shows, and then focus on that.
Mr Sants: As you say, we are trying to anticipate events here and I think it is important that we try to anticipate events. We agree with you. I think going forward this whole issue of consumer detriment in a difficult time has to rise up the agenda of the regulator and of the authorities in the round. It is more us seeking to anticipate potential issues rather than saying we have identified them so far.

Q147 Mr Crabb: So at the moment it is assumptions based on previous experience rather than any hard evidence that you can show the Committee at this stage?
Mr Sants: Primarily, yes, but, as I say, I think you would expect us to try to anticipate issues.

Q148 Chairman: Mr Sants, the criticisms about the with-profits approach of the FSA—you have our comments from our report and *Which?*, as we heard, as well. What progress has been made in the past six months, if any?
Mr Sants: I think we need to recognise the set of circumstances which we are in. We clearly set out in our submission back to this Committee that we see this as a two-stage process. We are committed to reviewing how that reattribution regime works, the practicalities of the operational processes, and that would pick up, for example, the effectiveness of the with-profits committees and so forth. We will be doing that, and I think it is appropriate to do that when we have some case histories to look at. So we

committed ourselves to doing that on the conclusion of, assuming that were to be the case, and it is an ongoing process, the reattribution issue. I think we feel we need to do that at the appropriate time, but we are committed to doing that at the appropriate time. We have also made reference, both when I was here the last time on this topic and on the submission that we made to you, that we do need to keep the general policy regime under review. Good practice for all regulators is to keep their policy regime under review and at the appropriate time we will do that, but I think it is important we are not seen to be constantly moving the goalposts. I think it is also important to recognise, as I have said a number of times here before, maybe not necessarily persuaded everybody who has heard what I have had to say here but I still believe it to be true, namely we need to be very careful if you move the dial in this process to where it is entirely in favour of the consumer then I think the product would cease to be a viable product for the industry and we would expect to see considerable repercussions from doing this. Any regime has to be a pragmatic compromise that delivers a viable product or else one should just acknowledge upfront that the regulatory objective is to say the product is not a suitable product, which is not our view. Having said that, we have committed ourselves to the first stage review. We committed ourselves to keeping the second stage review under review for the appropriate time. Then, thirdly, of course, we are in the middle of consulting on the specific issue of mis-selling. I think out of the four points that were mentioned on the list which was just discussed, we have specific action points for two and a commitment to review the other two in due course.

Q149 Chairman: Okay. You mentioned the appropriate time but you have promised to report on the information gathering exercise and how management are implementing your rules by the end of 2009. The question I would ask on behalf of quite a number of people who have contacted the Committee is how does kicking this issue into the long grass tie up with your assertion that the with-profits sector remains high on the agenda?
Mr Sants: We are not kicking it into the long grass.

Q150 Chairman: The end of 2009?
Mr Sants: It is just that I think realistically if you want to review how something has worked in practice you need the principal elements, they are not the only elements but the principal elements, to come to conclusion. We do have a reattribution process in train and it is our intention to allow that to complete and then to see the lessons to be learnt from that. We have to be very careful about revisiting frameworks in the middle of processes. I think that might well then prove to be detrimental to the consumers.

Q151 Chairman: Mr Sants, it was this Committee that undertook a very short inquiry into inherited estates which was seemingly, by all accounts, welcomed by people because it moved the agenda forward. It seems that the end of 2009 is a heck of a time to wait for that information gathering exercise. Surely you have got the staff and expertise to do that and if you do not have the staff and expertise then maybe it is a case of saying, "Look, we are inadequately resourced and we had better look at this again".
Mr Sants: It is not a question of staff and expertise, we are perfectly adequately resourced to do that review.

Q152 Chairman: Okay.
Mr Sants: It is a question of doing the right thing at the right legal time.

Q153 Chairman: Can I ask you then why do you get a consumer panel and why do you get *Which?* and all the representations from people being dissatisfied with yourselves?
Mr Sants: I think because they have some deep-seated views over the effectiveness of the regime. We recognise that they hold deep-seated views, not all of which we would agree with but we absolutely recognise that they hold them. We agree with this Committee that in the light of that, it is right to look at the operational effectiveness of the regime. I am just pointing out, however, that doing that in the middle of a reattribution process is not realistic or desirable.

Q154 Chairman: Okay. I do not think we are going agree. Your long answers are not helping us. We will come back to that again. The minimum level qualification, you have heard mention in the previous session that we cannot afford qualifications to be too high and I hope you do not accept that view. I just wonder if you would agree with Lord Lipsey, that quiet shrinking violet who does not seem to say anything to you, when he asserts that advisers should be qualified to QCA level 6, the full degree level.
Mr Sants: I think we heard Nick Prettejohn on this point earlier and Dan may want to add on to this in a moment. I do think we need again to be practical, pragmatic and sensible. We are trying to evolve the industry at a pace which it can achieve. The answer is I think our proposals are appropriate for the short-term, we are still consulting on them. I think longer term you would aspire to a higher level than that.

Q155 Chairman: Okay. Dan, John Blackmore, an IFA, has written in and told us, "The proposed solution of CII level 4 for all could hardly be more inappropriate. It is not demanding enough for independent advisers and yet it is unnecessarily complex for sales advisers. IFAs need to be qualified to a far higher standard and sales advisers to a much lower level". Why do you think the one-size-fits-all approach is appropriate"? Surely in this day when, as I mentioned earlier, the Government have got aspirations for 50% of all school leavers to be graduates we should be having that level for IFAs?
Mr Waters: I guess a couple of points, if I may, Chairman. We think it is wrong to establish a new regime that would set a lower standard for people who are giving advice in tied services. They have

responsibilities of suitability, they have responsibilities to act in the interest of the client. Admittedly, there is a limited range of products on offer but those duties are clear. We would not want to lower standards or provide a safe haven for people to move into that kind of space. I think it is also true to say at the other end, if you like, that there are many advisers now who have much higher qualifications than level 4, and there will be specialist qualifications for specialist kinds of product services being provided. That is sensible and ought to continue. I think we also have sympathy with the idea that over time level 4 probably is not high enough, but we are talking about a transition.

Q156 Chairman: If that is the case, Dan, would you expect them to be at graduate level? Would that be your aspiration?
Mr Waters: I think in the long-term we are looking at that.

Q157 Chairman: What is the long-term?
Mr Waters: We have not set that out, that is what we need to talk about. Once we get these stakes in the ground and this process moving forward then you look at the longer term. If you want to have a profession that is a profession you need to attract the best of your young people to come into that profession. There is a lot of talk today about people exiting, it is important to know who is going to enter this market as well.

Q158 Chairman: Can I ask you what your qualifications are, Dan?
Mr Waters: I have a doctorate in law. I am a lawyer by training.

Q159 Chairman: At graduate level?
Mr Waters: Yes in the US.

Q160 Chairman: Why is it good enough for you, but not good enough for IFAs, come on, get your ambitions up.
Mr Waters: I would not wish to compare myself to IFAs on that point.

Q161 Chairman: Okay. What about at your level, Dan?
Mr Waters: As I say, I think we have sympathy to the view that a higher level over time is probably desirable.
Mr Sants: The point is well taken. We are consulting and it is a good point.

Q162 Chairman: The RDR contains many measures to address the supply side issues of retail investment, but there are concerns about the demand side too. Hopefully the RDR will lead to increased trust in the industry, and financial capability may also play a role, but large numbers of young people and low earners will continue to have little interest in taking advice on investing for the future. There was mention made earlier and in our report on restoring confidence in long-term savings in 2005 we mentioned that the savings industry is a middle class industry, we are not getting to everyone. What plans does the FSA have, if any, to encourage the industry to better respond to the needs of these groups?
Mr Sants: Of course, we have our financial capability agenda, if that is where the question is going, which is designed to be and is indeed a partnership with industry as well as with all other relevant stakeholder groups that can assist us in that endeavour. We have a programme there of reaching out to, as you know, 10 million people or so by 2011. We are 5.4 million into that, so just over halfway through, so we are tracking in line with our expectations, and we do obviously think that a successful retail marketplace requires more than that which is within the RDR framework. For example, it does need to include raising financial capability, financial awareness and the capability of consumers to effectively engage with their saving agenda. We recognise it needs to be a twin track strategy and the financial capability agenda seeks to do that and, of course, now we are complementing it with working with Government on the pilot for what was previously called Thoresen Review of Generic Financial Advice/Money Guidance.

Q163 Chairman: The vexed question of bank lending. In recent evidence both the Governor and the Treasury to this Committee highlighted the resumption of bank lending as critical to the economy. The Governor also noted that banks must act collectively in their best interest by lending more rather than individually holding cash because that is what the markets want them to do. Do you agree with that position?
Mr Sants: Broadly speaking, yes. Of course, as a financial regulator we have an obligation also, as you would expect, again referencing previous discussions here about events of the last 18 months, to ensure that they hold the appropriate level of capital which would realistically anticipate any losses that they might expect to incur in the downturn. That has been the purpose of the recent recapitalisation exercise.

Q164 Chairman: But the Governor also told us that he thought, and I quote: “It was of the utmost importance that the tripartite authorities make crystal clear that regulatory minimum requirements have not been raised and if anything in these circumstances might be lowered because banks will need to see their capital used to absorb losses in order to maintain lending”. Now do you agree with his statement and have you been making that clear to banks and the markets if you do agree with that?
Mr Sants: Yes, we have made a public announcement on the framework that we used over the weekend of the bank recapitalisation exercise in which we made clear that was not a policy shift for the long term, indeed, the policy shift for the long-term would come with the requisite consultation and cross-benefit analysis and so forth. We certainly have not changed our long-term policy framework and, as I have just said, and as the Governor’s comments made clear, the purpose of the recapitalisation was to create excess capital or

capital above the regulatory minimum which was there to absorb the expected losses. It obviously follows that as the losses are incurred then the capital of the banks will come down. That was the purpose of them having that capital in the first place.

Q165 Chairman: That is a very important point because I am going on from this meeting to speak in the Queen's Speech economy debate and I am going to quote you saying that you agree with the Governor on the issue of regulatory minimum requirements. Am I going to be fair by quoting you?
Mr Sants: Yes. I might, if I may, just expand a little bit further. The answer is yes but for the purposes of adding to your background information for the benefit of the comments you will be making, I think we do need to understand, of course, that those capital ratios were designed on the basis of a stress test done by the FSA which was a stress test against the business plans which the banks submitted to us, their expectations of the amount of risk weighted assets they would be deploying over the medium term. We have done stress tests on those plans and ensured that they have sufficient capital to absorb the expected losses against that set of business plans. Obviously it follows that if the banks decided they wished to conduct extra activity which involved extra risk weighted assets over and above that which was in the original business plans then we would have to revisit those capital assumptions. So I absolutely agree, with the Governor that those ratios will come down over time, they are designed to absorb losses, the banks expect them to absorb losses and they are not new capital rules. But if the banks change their expected lending patterns then obviously we would have to revisit their expected capital arrangement.

Q166 Chairman: You and the Bank have got a close working relationship on that and both of you would be aware and come to a common view on that issue?
Mr Sants: Absolutely. We share the stress test models with the Bank.

Q167 Chairman: I can go ahead and say it then?
Mr Sants: You can indeed.

Q168 Chairman: That is fine, okay. Now when the Governor was here he made three points, lastly, Mr Sants, on better monitoring, which you will agree with, on the tripartite authorities making crystal clear their intentions, which you have agreed with, and he did say lastly on recapitalisation, "we may not have come to the end of this process". Do you agree with him on that?
Mr Sants: I think that picks up the point I have just made, in fact, namely that if the plans were to change then the capital might have to change, so that point needs to be borne in mind and, of course, we also need to recognise that the real economy scenario is a set of forecasts about the future, the outturn may not always follow the forecasts.

Q169 Chairman: I can take that as a yes as well.
Mr Sants: You can take that as a yes as well.

Q170 Chairman: Good. Can I thank you very much for your attendance today, particularly the rearranged session. Will you give our regards to Lord Turner when he is back and maybe tell him he was not missed because you did very well, but we do look forward to him coming again in February or March. Thank you very much.
Mr Sants: I will pass that on to him. Thank you, Chairman.

Written evidence

Memorandum from the Financial Services Authority

1. This Memorandum is submitted to the Committee in advance of the hearing on 15 December.

Response to Market Events

2. Conditions in financial markets, in the UK and globally, remain extremely difficult and uncertain. With the UK now in recession, the FSA is continuing to focus on intensive and close supervision of firms and markets, working closely with the Treasury and the Bank of England, and on helping consumers deal with these very challenging times. We believe the Tripartite Authorities have functioned well in the last year and that we have dealt effectively with the inevitable difficulties some firms have faced.

3. We would highlight three key areas where FSA has played a full role. First, where firms have failed we have worked intensively to find private sector solutions, in the interests of consumers. Specifically, following the recent failure of two UK bank subsidiaries we arranged for retail depositors to be transferred to another bank with no customer service disruption. Second, we have worked closely with the Tripartite Authorities on the recapitalisation scheme; specifically, we were responsible for determining the appropriate level of capital required by deposit-taking institutions. Third, we have worked intensively with the building society sector facilitating the required restructuring. More generally, over the last 15 months we have stepped up our supervision of firms in all sectors.

4. Early in the New Year we will set out, in our Financial Risk Outlook (FRO) and Business Plan, our view of the risks in the external environment in 2009 and our work programme to mitigate those risks. Our FRO will focus very closely on the risks in the market, to firms' business models and on risks of consumer detriment. Our Business Plan will be carefully aligned to address these risks.

5. Work has also begun to learn the policy lessons from recent events and to decide what changes need to be made to the domestic and international framework for regulation in order to build a more robust regime for the future. The FSA will play its full part in those discussions, including in the Financial Stability Forum and in the European Union. The Chancellor has asked Lord Turner to examine the existing policy framework and as a result the FSA has begun work on a Discussion Paper to be published by the end of March. We look forward to contributing to the Committee's continuing inquiry into the banking crisis in the New Year.

Modernising our Supervisory Process

6. Alongside dealing with external issues, we continue our programme of work to ensure that we continue to attract, retain and develop the staff we need to do our job well in such challenging market conditions. As we have said before, we are aiming for the right balance of career regulators and market practitioners. We have already begun to increase the number of people in relationship management supervision and specialist support areas through internal moves and recruiting external candidates from a range of backgrounds, including retail and investment banking, risk management, quality assurance and consultancy firms. So far we have recruited 38% of the total we need. We have recently strengthened our senior management team with the appointment of Jon Pain as Retail Managing Director; Jon has 30 years' experience in UK financial services. Additionally, we have brought in more industry expertise by increasing our number of senior advisors to support supervision, for example Graeme Hardie, formally executive director at Abbey National Plc, and prior to that Managing Director at Natwest Retail Banking.

7. We are upgrading our Training and Competence scheme to require all supervisors of relationship-managed firms to demonstrate competence across technical and behavioural competencies as well as sector-specific knowledge and skills. By the end of 2009 all our existing supervisors will have been required to demonstrate the required level of competency.

8. As we will have already indicated, the actions we are taking to ensure higher quality supervision will lead to increased costs and we expect to exceed the levels of expenditure shown in the Business Plan for 2008–09. With further rises in both expenditure and headcount in the following year.

9. We now turn to the specific topics the Committee has highlighted:

Future of More Principles-Based Regulation

10. Historically, our regulatory strategy, set out in our April 2007 "Principles Based regulation: Focusing on the outcomes that matter", has had the tag line principles-based Regulation. This has often been misunderstood.

11. Principles-based regulation means, where possible, moving away from dictating through detailed, prescriptive rules how firms should operate their business and giving firms the responsibility to decide how best to align their business objectives and processes with the regulatory outcomes we have specified. We have shifted the balance of our activity towards setting out desirable regulatory outcomes in principles and

outcome-focused rules, enabling our people to engage with firms' senior management in pursuit of these outcomes. We want to focus attention on the outcomes and consequences of actions. Given this philosophy, we would observe that a better tag line for commentators to use would be outcomes-based regulation.

12. In our view, recent events have demonstrated both the value of this approach to supervision and the risks of deviating from it. In particular, market events over the last year drive home the critical importance of ensuring that a firm's senior managers engage with our regulatory objectives, adjusting approaches to delivery as circumstances change, rather than focusing mechanically on compliance with prescriptive rules. More principles-based, outcome-focused regulation is an essential tool both for informing senior management about our objectives and for making them accountable for delivery.

13. The FSA as a "regulator" has two key roles: we formulate policy and we supervise firms. Our more principles-based approach impacts on both of these, in different ways.

14. On policy, it is important to note that we are only part of the policy process—we design policy in partnership globally with international bodies, other regulators and finance ministries. This is also driven by global frameworks. Policy outcomes, in consequence, will not always conform to the FSA's approach. We also note that our control of the policy agenda is more limited as EU influence grows. We still, however, have a significant role to play in influencing these outcomes and we will continue to do so using our principle and outcomes-based philosophy.

15. We are also responsible for delivering effective supervision. Here we focus on the outcomes and consequences of actions taken by firms' senior management and make judgements on the judgements made by firms. We also remain firmly risk-based and proportionate. As we have already laid out in our Supervisory Enhancement Programme, effective outcomes-based regulation requires a more intrusive and intensive approach with greater resource than the FSA has employed in the past.

16. In formulating policy and executing our supervisory agenda we benefit from extensive input from industry and consumer interests, including the two practitioner panels and the consumer panel.

17. We recognise that more outcomes-focused regulation has implications for our supervisors as well as for firms. It requires that we work together to be alive to particular business models and the implications these models have for the firm's risk profile and, consequently, for risk management. It requires our supervisors to have excellent industry knowledge and sound judgement. As we have said, this focus on outcomes delivers more effective regulation, but it has to be that all regulatory judgements carry risks, and in particular judgements on the future necessarily will not always be correct with hindsight. The fact that the FSA is not infallible of course poses significant communication challenges.

Retail Strategy

18. The rest of this Memorandum covers our work in retail markets. We have refined our retail strategy and will set out more details in our Business Plan. The strategy builds on the principal components of our historic one and has two main elements: first, we recognise that difficult economic conditions are likely to create issues for consumers and for firms and we will focus particularly on possible areas of consumer detriment arising from the recession. Second, we will be employing an integrated approach which will ensure that supervision is at the heart of our activities. In particular, our operating model will embed major initiatives, such as TCF into our overall supervisory process, supported by specialist teams with expertise in conduct risk identification and mitigation. Historically the FSA's principal emphasis was on ensuring that firms' systems and controls were robust and that senior management took responsibility for their actions. We will continue to have a focus on systems and controls but will also adopt a more intrusive supervisory approach, which will include more rigorously assessing outcomes and making faster and if necessary more intensive interventions.

19. Our overall focus is on promoting resilient, effective and attractive retail financial services markets that deliver fair outcomes for consumers. We have four key priorities that we structure our work around to meet our objective:

- Enhanced supervisory capability.
- Full integration of the project based approach such as the Treating Customers Fairly (TCF) programme into overall supervision and adherence to the conduct principles for firms.
- Consumer capability and responsibility.
- Credible deterrence and reducing financial crime.

20. The four key priorities seek to deliver an appropriately balanced focus on prudential and conduct regulation. This balance of course needs to be calibrated to the particular circumstances of the market place but it is critical at all times that we retain a focus on both aspects of regulation. Currently for our largest firms, given recent market events, the balance is of necessity tilted towards prudential, but the extra supervisory resource we have added in the last six months will ensure that the absolute time on conduct issues has not declined on a year-on-year basis.

Conduct Risk Supervision

21. The rest of this memorandum focuses on specific initiatives within the retail strategy. Our conduct of business supervision addresses high risk conduct issues as identified by our Retail Policy and Conduct Risk Division. Our starting point is our eleven conduct Principles for Businesses, four of which deal with conduct issues between firms and consumers. These are:

— Treating Customers Fairly.

— Ensuring suitability of advice.

— Managing conflicts of interest.

— Providing clear, fair and not misleading communications with customers.

22. An additional element in the consumer protection framework is consumers' ability to complain, including to the Financial Ombudsman Service. We work closely with the FOS to share intelligence on emerging issues and to respond to concerns about individual firm's performance.

23. We now comment on a number of focus areas within our conduct risk supervisory approach, notably TCF, PPI, pensions switching advice and a set of mortgage related issues. Our operational approach is to ensure that supervisors at all times are focused on ensuring firms are effectively managing their conduct issues. But our newly formed Conduct Risk Division seeks to ensure that where there are potential consumer risks we are able to deploy specialist resource to support the supervisors. We discuss below areas where we are currently particularly focused.

Treating Customers Fairly

24. Treating Customers Fairly was initially run as a project in order to raise its profile amongst regulated firms and consumers and to ensure that firms had adequate systems and controls in this area. Treating Customers Fairly (TCF) is an important example of More Principles-Based Regulation and of our focus on outcomes for consumers, firms and markets.

25. The Committee will also be aware that we have recently announced that from next year we shall be including treating customers fairly within our core supervisory work, making it an integral part of our ARROW framework. This is an acceleration of our original timetable. We believe that is more appropriate that TCF sits in our core activities of supervision rather than continuing as a standalone project. Our risk assessment of firms will change to include more testing of outcomes being delivered by the firm and harder, faster, more decisive action where we are not satisfied with firms' progress. This will have a key impact on ensuring firms deliver outcomes for consumers.

26. It is clear to us that difficult market conditions pose particular risks to these outcomes, and we will take that into account in our continuing supervision. Notwithstanding current conditions, we do still expect firms to meet the standards we set.

PPI

27. Tackling poor PPI sales practices is a priority for us. Following poor results from our earlier work we are escalating our regulatory intervention to limit consumer detriment and ensure firms treat complaints fairly. We are engaged with firms and other stakeholders to secure a change in current practices and better outcomes.

28. We welcome the Competition Commission's proposed ban on single premium policies and the introduction of a point-of-sale-ban. We believe that together our actions will drive changes in the market and deliver better consumer outcomes.

29. We continue to believe that PPI can be a helpful product for consumers wanting certain specific protection when it is sold in a way that is focused on meeting the customer's needs. When, however, consumers are sold a product they don't need and that doesn't suit their circumstances, they suffer detriment, which impacts market confidence. We have told firms that if they cannot sell PPI in a compliant manner, they should stop selling it. We have backed this up with a series of enforcement cases addressing PPI failings and requiring redress for consumers who suffered detriment.

Pensions Switching Advice

30. FSA monitoring identified there had been a significant growth in single-premium transfers into personal pension plans (PPPs), including self-invested personal pensions (SIPPs) following the pension reforms at A-Day (6 April 2006). We were concerned about the potential risk that consumers may have been switched into higher charging pensions with features or additional flexibility they did not need.

31. We took action through a thematic project assessing the quality of pension switching advice, the results of which we published on 5 December. We found variable standards across firms. Unsuitable advice was found in 16% of the 500 transfer cases reviewed. However, this was unevenly spread across the firms reviewed: some were giving suitable advice consistently, but some were found to be giving unsuitable advice at significant levels. In a quarter of firms all cases reviewed were assessed as suitable, but in another quarter a third or more of cases were assessed as unsuitable.

32. We are determined that all firms meet our required standards of suitable advice. We also have published details today of the action we are taking with firms to mitigate the risks of unsuitable advice on past and future sales and remedy cases where necessary. We are taking action against firms where advice standards have proved inadequate, including through referral to enforcement and requirements to review past sales.

33. We have also produced guides for consumers who may be concerned about the advice they have been given or who are considering switching their pension in the future.

Mortgage Arrears

34. We know that in current market conditions many borrowers are struggling to meet their mortgage payments. It is therefore especially important that mortgage lenders adhere to the conduct principles when dealing with consumers. We have been doing targeted work in this area to monitor compliance with our standards and deal with unfair practices and treatment where we find them. In August we published the results of a review of 13 mainstream and specialist lenders. We found that mainstream lenders were largely complying with our requirements, though we had some concerns about some charging practices and insufficient oversight of third parties contracted to carry out mortgage arrears and repossession handling activities on behalf of lenders. We had particular concerns with specialist lenders, including that they were too ready to take court action, were too strongly focused on recovering arrears according to a strict mandate, without reference to the borrower's circumstances and had lower standards of systems in controls in place to control arrears handling. We have published examples of good and poor practice and are following up issues with individual lenders. In addition, several firms are being considered for enforcement action.

35. We have recently taken our work on mortgage arrears and repossessions a stage further. On 27 November we wrote to the Chief Executives of all mortgage lenders and administrators reminding them of their obligation to ensure that they comply with our conduct principles, asking them to review their arrears management policies and practices and report back to us by the end of January.

36. We are now undertaking some further focused work on arrears handling practices in lenders who are no longer lending, and third party administrator firms, as well as investigating the application of arrears fees and charges.

Responsible Lending

37. We also reviewed 15 additional and three of the same lending firms to check their compliance with our standards for responsible lending and published the findings in August. Some lenders (particularly those which offered mortgages to consumers with impaired credit) were not checking income where they should have had reason to doubt the amount declared, and self certification of income was being used without adequate justification being recorded by the lender. Some lenders' responsible lending policies were vague on the factors used to assess customers' ability to repay and did not include any factors to assess ability to repay in retirement. We have published examples of good and poor practice in lending policies and lending decisions.

Mortgage Fraud

38. Mortgage fraud has been perpetrated on a large scale in recent years. Easy credit conditions and streamlined application processes have prompted fraudsters to target the mortgage sector. We have taken a number of steps in this area:

- A letter in July 2008 to the key trade bodies setting out our approach to toughen the industry's defences against mortgage fraud.
- Targeted visits to 200 mortgage intermediaries to assess their systems and controls.
- Increasing intelligence received from lenders by streamlining reporting processes and providing more clarity on the information needed.
- Enhancing the way intelligence is used in supervising firms and bringing about enforcement actions.
- Strengthening engagement with regulators and law enforcement partners including the National Fraud Strategic Authority (NFSA).
- Encouraging improved information-sharing and intelligence analysis in the industry.

- Reviewing the Approved Persons regime as it relates to mortgage intermediaries including brokers.
- Taking enforcement action where necessary; this year we have banned 17 individuals, and fined one of them £129,000 for their part in mortgage fraud.

Mortgage Quality of Advice

39. We have carried out two projects into Mortgage Quality of Advice. The first Mortgage Quality of Advice project in 2007 found weaknesses in key areas of firms' advice processes. This second review was carried out at the start of 2008 to determine whether firms had made improvements in these areas. The overall findings in this sample were disappointing.

40. Many areas identified during our first review remain a concern as firms have not made sufficient progress in key areas; management controls, assessment of customer needs, affordability and suitability.

41. Seven small mortgage firms have been referred to our enforcement team and 23 firms have been asked to take remedial action. It is our intention to assess all small firms within the next three years as part of our enhanced strategy with the aim of raising standards.

Banking Conduct of Business Supervision

42. Historically we have not made comprehensive rules governing the conduct of retail deposit-taking business because they have been covered by the Banking Code Standards Board. In November we started consulting on this issue.

43. The proposals would extend FSA regulation to all aspects of banks' deposit-taking relationships with their retail customers. This would not include consumer credit, such as credit cards and unsecured loans, which will continue to be regulated by the Office of Fair Trading under the Consumer Credit Acts 1974 and 2006.

44. We are consulting on the banking conduct of business proposals until mid-February 2009. As we take this work forward we will continue to work closely with the sponsors of the Banking Codes (BBA, BSA, and APACS), the Banking Code Standards Board, the OFT and a number of consumer bodies.

Initiatives to Improve Market Structure

45. In addition to our responsibilities for supervision and policy, we have a role to seek to facilitate improvements to market infrastructure. Our principal initiative in this area is the Retail Distribution Review.

46. The problems witnessed in the retail investments market are well known. It is a market which over many years produced a distressingly large number of mis-selling problems: pensions, mortgage endowments, Splits and Scarps. In 2006 we concluded—and many who know this market well agreed with us—that certain structural characteristics of that market have been a material obstacle to effectiveness. As the FSA's Chairman at the time, Callum McCarthy said: "We have a system which serves neither the provider of the services nor the consumer". The Retail Distribution Review (RDR) set out to address these issues, which have perplexed firms, consumers and regulators for over 20 years. It is also intended to reflect market developments such as the coming introduction of Personal Accounts, and advances in technology which are changing the way that firms and consumers interact.

47. Following extensive deliberation, in close collaboration with the industry and consumers, and involving a number of public consultations, we recently announced the changes we want to see in the retail investment market. There are four measures that we regard as most fundamental to delivering the market outcomes we set out to achieve, which will materially alter and improve the interactions between consumers and the industry. These are:

- Providing greater clarity for consumers about the advice service being offered by making a distinction between independent advice and sales advice, and including the connection with the proposed free Money Guidance service.
- Raising professional standards of all advisers by setting minimum qualifications for different types of advice and establishing a Professional Standards Board to boost consumers' confidence in the industry.
- Modernising the way advice is paid for by requiring independent advisers to agree the cost of financial advice with customers up-front, removing the possibility of commission-bias and ensuring the cost of all advice is clear to consumers whenever it is given.
- Introducing a new standard for independent advice by ensuring advice is unbiased, unrestricted and extends to all types of investments.

48. We will consult on these policy proposals during the first half of next year with the intention that all firms will have implemented the changes by the end of 2012. Details are set out in our Feedback Statement issued on 25 November.

49. We recognise that these proposals will create challenges for many industry participants, but we also believe that for the industry as a whole, they represent a major opportunity to define new ways of working, new incentive structures, new professional standards, and new ways of signalling to customers what they can expect in terms of independence of advice and of responsible sales in different distribution channels. These proposals, we believe, represent a golden opportunity to put the industry on a sounder footing for the future, better able to deliver good quality products to consumers and to earn their confidence and trust. We are committed to working with the industry to implement these changes over the next three years.

50. The proposals have received a positive response from the key parts of the industry, in particular those representing the life assurance sector and banks that provide investment services. However, the Association of Independent Financial Advisers (AIFA), the body representing financial advice firms, expressed on publication of the Feedback Statement its concerns that a combination of increased capital requirements (where we are proposing changes in the minimum level of capital from £10,000 for the first time since 1994) and a new professional standards board (designed to bring the profession into line with others, overseeing minimum qualifications, codes of ethics etc) will increase costs. Until now, AIFA has been very much in favour of our proposals to modernise the sector and raise standards, in particular through changing remuneration structures and increasing professional standards. We are clear that we will introduce new requirements only where we believe they deliver real benefits for consumers and firms, and will continue to work with AIFA and other bodies to deliver this aim.

Consumers

51. Along with the FSA's work on regarding policy initiation, supervision and improvements to market infrastructure, our other agenda is educating consumers and building consumer awareness. There are two components to our work in this area:

52. First, we do this primarily through our National Strategy (from 2006) designed to improve the financial capability of UK consumers through targeted, generic education, information and guidance. We are now half-way through our five-year programme and have so far reached 5.4 million people against our overall target of 10 million people by 2011. A particular recent highlight has been the UK-wide distribution, established in November, of the "Parent's Guide to Money", designed to help people plan financially for parenthood.

53. As part of the strategy, we are building on the work we already do through intermediaries to help meet current consumer needs in these difficult economic times. Over the next year we will be developing new ways to reach adults to address the needs of older people planning for or in retirement, and those going through divorce and separation. In October, with the Treasury we launched a campaign to help consumers who may be struggling in the current climate keep a better grip on their money and finances. The campaign promoted the authoritative, impartial information on our Moneymadeclear consumer website (MMC) and Consumer Contact Centre to help people manage their money better. For those struggling with their finances, MMC signposted to specialist advice agencies that could help. Over the course of the campaign we received over 650,000 web visits.

54. Second, building on the recommendations in the Thoresen Review of Generic Financial Advice, we are in the final stages of preparing to launch the Money Guidance pathfinder. This is a £12 million HMT/FSA-funded pilot project to deliver free personalised help on money matters including budgeting, money management and planning to help hundreds of thousands of households across the North West and North East of England. It will be an interactive face-to-face, internet and phone-based service.

Small Retail Firms

55. We expect our small firms to meet the same standards as our larger firms. Because of the differences in the way we supervise small firms we have a number of specifically designed initiatives in place to help small firms understand and meet our requirements. In January 2008 we introduced our enhanced supervision strategy for small firms. This is designed to increase our contact and communication with small intermediary firms to help them in treating their customers fairly and to increase our chances of identifying those firms which cannot or will not do this.

56. The strategy is delivered through a three-year regional assessment programme which aims to cover every eligible firm in every post code over a three-year period. There are three elements to each regional programme; free interactive roadshows, assessments and follow up visits.

57. In 2008, three full assessment programmes were delivered to firms in Northern Ireland, the North West and the West Midlands. In addition, roadshows were also delivered in November in the South West—ahead of assessments in early 2009.

58. So far over 1,400 firms have been assessed and over 2300 have attended Roadshows. Approximately 20% of assessed firms have received a follow-up visit. Now that we have embedded our assessment processes we anticipate assessing over 4,000 firms in a further four regions in 2009 and a similar number in 2010. In total we aim to see around 11,000 firms over the three year period.

59. An assessment is a 1–1.5 hour interview with a member of FSA staff, either by telephone, or face-to-face at a nearby venue. The assessment will comprise of a discussion about the small firm management behaviours framework. We ask the firm questions about leadership, business decisions, controls, recruitment/training, and reward—to establish the approach of management within the firm. We will give the firm oral feedback at the end of the assessment, which we confirm in writing to them within 10 working days.

60. Up to one quarter of firms assessed will receive a follow-up visit. These will either be a half-day visit to verify the assessment process and the information provided during the firm's assessment; or a full day for firms whose main assessment raised concerns.

61. We will identify and deal with poor firms who are unwilling or unable to change to ensure that appropriate action is taken. It is therefore important that firms understand that there will not be any let up in our work in this area.

5 December 2008

Memorandum from the FSA—Smaller businesses practitioner panel

1. Executive Summary

1.1 The Smaller Businesses Practitioner Panel (the Panel) is submitting the following information:

— Annual Report 2007–08.

— The Chairman's speech to the FSA's Annual Public Meeting held on 24 July 2008.

— An update on the Panel's current position in relation to the items upon which the Committee is keen to focus at its meeting on Monday 15 December.

1.2 Since the preparation of the Annual Report the then Chairman, Mark Rothery, after completing his two-term of office, has been replaced by Simon Bolam, who with the support of the FSA has redefined the objectives of the Panel to improve its effectiveness in terms of support to the FSA. This paper seeks to inform the Committee of these changes.

2. Background

2.1 As outlined in the Annual Report the Panel was established by the 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.

2.2 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 community.

2.3 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.

2.4 The Panel is treated by the FSA in the same way as the Financial Services Practitioner and Consumer Panels.

3. Panel Membership

3.1 The Panel has 12 members. The membership is drawn from senior practitioners, very largely nominated by trade and professional bodies, from smaller firms operating in all the main sectors of the regulated community.

3.2 Currently the membership consists of practitioners appointed from the following sectors:

> Building societies, credit unions, friendly societies, general insurance and mortgage intermediaries, independent financial advisers, insurance companies, banks, stock brokers and investment managers.

3.3 The Panel Chairman serves, ex officio on the Financial Services Practitioner Panel.

3.4 The current Panel Chairman, Simon Bolam, is the owner of a smaller general insurance broking business, based in Edinburgh, specialising in providing cover for personal lines and SME customers.

4. Panel Effectiveness

4.1 Earlier this year, the Panel entered into discussions with senior FSA staff to consider methods by which it could become more effective in terms of promoting the interests of the "smaller" regulated community.

As a result of these discussions the Panel has now repositioned itself, within the FSA, to fulfil a rather different set of functions than has previously been the case.

4.2 In future the Panel, maximising its practitioner skills, will work more closely within the FSA, by providing input, guidance and support in relation to any emerging issues as they might potentially impact upon smaller businesses. Through the Secretariat, by being given access (for example) to the agenda of forthcoming meetings, we are now able to identify what issues are being discussed and when; thus enabling us to focus our input in a more effective manner to the right people at the right time. The aim is to track smaller firm issues from their very conception, within the FSA, to the point of their implementation and then subsequent review. Equally the FSA staff at all levels have been encouraged to engage with us in a more pro-active way and this largely entails higher levels of presentations made at our monthly meetings.

The support we have received from the Chief Executive and senior staff, to achieve these revised objectives, has been fantastic and greatly appreciated by the Panel.

4.3 So in future the role of the Panel will be more "below the parapet" and that is where we believe we can achieve the greatest advantages for smaller businesses and hopefully, and of equal importance, to the FSA itself.

4.4 In recent years the Panel has been fulfilling an almost pseudo-trade association position which in our terms was very largely duplicating the work already undertaken by the many trade and professional bodies operating in the financial sector. So unless the Panel feels someone has missed some significant issue it will no longer respond to Discussion Papers, Consultation Documents and so on.

4.5 The Panel will however continue to liaise with the relevant trade and professional bodies. This is seen as being significantly important to ensure that it constantly remains in touch with market issues. The ultimate objective is to ensure that our combined input, using different routes, to the FSA will be that bit more effective and productive.

5. The Current Position in Relation to the Specific Items upon which the Committee Wishes to Focus

5.1 The purpose of this section is to update the Committee on the Panel's current position in relation to the specific items that it would like to discuss at the meeting.

5.2 *The future of More Principles Based Regulation (MPBR)*

The Panel's supportive view, as outlined on Page 10 of its Annual Report, is very largely unchanged.

However, since the production of its Annual Report, the Financial Services Practitioner Panel has very recently released its "Fifth Survey of the FSA's Regulatory Performance".

The results of the Survey in relation to "Attitudes towards MPBR" are outlined in Section 4.5 (on pages 33 to 39). As an important part of its extended advisory role, the Panel is now keen to engage with the FSA to address the principal issues that are concerning smaller businesses; many of which relate to improved communications and the reduction in the degree of uncertainty operating within a more MPBR regime, as opposed to the greater comfort factor provided by specific rules.

The Panel does however acknowledge the work already fulfilled by the FSA's Small Firms Division following the launch of its new website, with many helpful features, in support of smaller firms.

5.3 *The Treating Customers Fairly initiative (TCF)*

The Panel's position is outlined on Page 13 of its Annual Report.

From the perspective of the vast majority of smaller businesses the concept of TCF was already one of the most fundamental features of their businesses long before the FSA TCF initiative was launched. Indeed, without such a culture, the majority of smaller customer-facing businesses would not survive!

The Panel, in line with the results outlined in the Financial Services Practitioner Panel Survey (pages 39–47), has therefore strongly supported this initiative as representing good business practice.

However the Panel, in more recent times, has become somewhat concerned about the extent to which smaller firms were being expected to dedicate considerable amounts of their limited resources (in terms of time and costs) towards creating sophisticated systems, to provide evidence, that they were in fact "treating their customers fairly".

At times the extent to which this subject was being promoted towards smaller firms seemed disproportionate. The Panel therefore welcomes the decision to transfer this project, on an operational level, to "Business As Usual" during the early months of 2009.

5.4 *The Retail Distribution Review (RDR)*

Since the publication of its Annual Report the Panel has greatly appreciated the manner in which the FSA has extensively engaged with it leading up to the publication of its RDR Feedback Statement on 25 November.

The Panel includes two highly experienced and respected Independent Financial Advisers whose considerable experience and understanding have been placed at the disposal of the FSA during this important developmental period.

The Panel, understanding the importance of this project, is nonetheless keen to ensure that the final proposals are reasonable and proportionate to ensure that smaller well-run businesses are still able to survive and thrive.

The importance of maintaining a strong network of good advisers throughout the country is an extremely important feature towards providing consumers with easy access to good quality products and to encourage savings.

5.5 *Financial Capability*

This subject is not covered in the Panel's Annual Report but is an issue that has increased in importance in more recent times.

As practitioners the Panel members have very extensive personal experiences of interfacing with customers of all abilities.

The Panel welcomes this initiative but, from the personal experiences of its members, believes that improving the current position, in any significant way, will take a very long time and a great deal of money; which, if not carefully focussed, could just be wasted. This then raises the question as to how this very costly exercise should be funded. To a smaller regulated business, the thought that the regulated community, without substantial support from elsewhere, should fund such a scheme seems unreasonable.

In addition, from personal experiences, the Panel members are aware that many retail customers simply are not interested in advancing their own financial capabilities; believing that the responsibility, for assessing the relevance of the financial product, lies with the adviser and not with them.

5.6 *Regulation of retail banking conduct of business*

This is a subject that would generally fall outside the normal course of business conducted by the Smaller Businesses Practitioner Panel.

5 December 2008

Memorandum from the Financial Services Consumer Panel

Executive Summary

1. The Financial Services Consumer Panel is pleased to have this opportunity to contribute to the Treasury Committee session on the work of the Financial Services Authority (FSA).

2. The FSA has faced many challenges since the publication of its most recent Annual Report with the fallout from the unprecedented financial crisis. Its performance with respect to that crisis is not the subject of this Committee session. However the committee should note that the crisis has obviously impacted on the FSA's ability to carry out its other workstreams. As the events of the last year have resulted, not surprisingly, in the FSA shifting focus towards capital and liquidity issues, the Panel is concerned that the shift in priorities to address the current problems should not adversely impact the FSA's ability to meet its consumer-facing statutory objectives in the longer term. As firms focus on recovering their "bottom line" we are concerned that the FSA ensures that firms do not overlook their obligations to consumers.

3. Overall, we have been concerned that the FSA frequently appears to accept low levels of compliance by the industry. The FSA often expresses disappointment at its own findings on levels of compliance but shows a marked reluctance to act on them. For example despite the importance the FSA places on clarity of information, widespread poor practice continues. What is required is widespread change in firms' behaviour so that they can deliver positive outcomes for both their business model and for consumers. We have yet to be satisfied that the FSA is using its enforcement and supervisory tools effectively to ensure that consumer detriment is tackled.

4. Our views on each of the areas is set out below, but in summary:

a) The Panel has been a supporter of the FSA's Treating Customers Fairly (TCF) initiative and welcomed the FSA's deadline that by the end of December 2008, firms would be expected to demonstrate that they treat their customers fairly. We are concerned that the FSA's decision to cancel the proposed assessment of firms against that deadline signals that achieving fairer outcomes for consumers has been downgraded.

b) We support many of the latest FSA proposals on the Retail Distribution Review. We remain convinced that investment advice should be free of provider, product and sales bias. There are still some important issues which have yet to be resolved, in particular the lack of clarity over the boundaries between sales and advice. Getting the detail of the regulations right will be very important and we would urge that expediency is not pursued at the expense of long-term benefits for consumers.

c) We are pleased with the work done so far on financial capability, but would like the Money Guidance project to be able to deliver meaningful guidance. We hope that these initiatives will continue to receive sufficient resources in spite of the difficult economic environment at present.

d) We generally support more principles-based regulation, but its success depends on effective supervision and enforcement. As stated earlier, we believe that the FSA has problems changing firms' behaviour. There is not yet sufficient evidence to take a view on the benefit of principles-based regulation for the consumer.

e) We have been pressing the FSA to take over the conduct of business regulation of retail banking for some time. We are pleased that the FSA will be consulting on this. The Panel has had longstanding concerns about weaknesses in the Banking Code, to the extent that the Code becomes industry guidance we expect there to be formal consultation and approval by the FSA before it is implemented.

The Work of the FSA and its Impact on Consumers

5. The FSA has a strategic aim of helping consumers achieve a fair deal, which reflects its statutory objectives of public awareness and the protection of consumers. In its most recent Annual Report it distilled this aim into four distinct workstreams:

— Treating Customers Fairly.

— Retail Distribution Review.

— Financial Capability.

— Principles-based approach to regulation.

6. We have therefore concentrated our submission primarily on these four themes and the level of progress we believe the FSA has or has not made since its Annual Report in delivering benefits for consumers in these areas. In addition, and as directed by the focus of the Committee session, we also consider the likely impact of the FSA's proposals to bring conduct of business regulation for banks into its remit.

Treating Customers Fairly

7. The Panel has generally been pleased with the work the FSA has done on TCF and we believe this initiative from the FSA has significant potential to deliver better consumer outcomes for consumers The emphasis on fair outcomes and the use of deadlines put clear obligations on senior management in firms to deliver.

8. The FSA launched the TCF initiative in 2004. We would expect that by now it should be delivering fairer outcomes. The FSA set a deadline that by December 2008 all firms should be able to demonstrate that they were consistently treating their customers fairly, and that it intended to assess firms accordingly. In November the FSA announced that it would no longer undertake the planned programme of assessments and would instead bring forward the embedding of TCF into the supervisory process.

9. The results of the FSA's earlier work showed an inadequate response from large numbers of firms[1]. Only 13% of relationship managed firms met the March 2008 deadline that firms should have appropriate management information systems in place to measure whether they are treating customers fairly. Although the FSA believes that firms have made significant progress it is unlikely that a large part of the industry have significantly improved in time to meet the the December deadline. We cannot therefore be confident that the initiative has delivered the change in firms' behaviour which was its overall objective.

10. We accept that in the FSA had little choice in the decision to abandon its programme of assessments in view of the current market conditions. We have asked the FSA for evidence about how its supervisory framework will take account of TCF and we expect the FSA to report on progress with embedding TCF in the annual report. We expect the FSA to take robust enforcement action against those firms that fail to comply.

[1] Treating customers fairly—Progress update June 2008

11. It is still too early to say whether the TCF initiative has had any impact on customer experience. We expect the FSA to review this in due course with the aim of better understanding whether principles based regulation is an effective way of maintaining consumer protection in the retail financial services market.

Retail Distribution Review (RDR)

12. The Panel has been supportive of the FSA's work on the RDR from the time of its inception. We were happy to see the over-complex landscape set out in the first discussion document in June 2007 abandoned by the time of the FSA's interim report in April 2008.

13. The latest proposals in the FSA's feedback statement published last month have much in their favour. They should eliminate commission bias and improve the qualifications required of independent advisers—although we believe the standard should be set at degree level (QCA level 6), higher than is proposed.

14. However, there are still significant issues which have not yet been adequately resolved. In particular, there is a return to the lack of clarity over the boundaries between sales and advice. We do not think that consumers, under the proposed arrangements, will be clear about what service they are going to get when offered what the FSA is describing as "sales advice". We would prefer this to be clearly described as "sales", which is what it will be. We have asked the FSA to consider if there is any way that this can be reconciled with the requirements of MiFID.

15. We believe that incentive structures could lead to significant sales bias towards particular and possibly unsuitable products. We want to see reward, remuneration and incentives tackled in the tied and multi-tied arenas so that consumers can be confident that the advice they are getting is not linked to sales targets but is appropriate for their needs. We are not convinced that the FSA yet has a clear strategy, beyond the application of TCF, for ensuring that this happens.

16. The guided sales process could be a valid and worthwhile option to keep the cost of sales low and minimise the risk of mis-selling, but at the moment it is still not clear exactly how this would work. We would like to see development work continue since it could well be a more attractive option for people who want to save but who do not have the time, need, inclination or resources to take full advice.

17. The FSA has made considerable progress on the RDR. However, there are still some important issues which have yet to be resolved, including ensuring that consumers obtain value for money for their savings and investments under the new arrangements. The review needs to retain impetus, but we would urge that expediency is not pursued at the expense of genuine long-term benefits for consumers.

Financial Capability

18. We have been very pleased with the progress being made on financial capability and the work on the Money Guidance initiative in particular. The FSA is entering an important phase of this work as the pilot to test out the Money Guidance structure is shortly to be rolled out. The FSA needs to be clear in its intentions and devote appropriate resource to ensure the pilot is a success. The current programme also focuses very much on the younger age groups but with the 2012 introduction of personal accounts the FSA should make sure it does not ignore older consumers.

19. As pointed out in our reply to the FSA's interim report on the RDR[2], improving financial capability and an effective money guidance operation will be a significant component of a successful implementation of the RDR. It is important that the programme is not under resourced because the FSA is having to focus on capital and liquidity issues arising out of the financial crisis.

20. Many financial products are complex and their ability to deliver "the goods" depends on a myriad of variables. Consumers (at all levels) will need to have access to good quality advice and guidance. We would like to see Money Guidance to develop so that it delivers meaningful guidance rather than acting as a basic information signposting service. We believe it should provide information and guidance on budgeting, saving and borrowing, protection, retirement planning, and basic information about tax and welfare benefits.

Principles-based Approach to Regulation

21. We have supported the introduction of the new shorter Handbook and the FSA's more principles based approach. Those sourcebooks which have been changed to adopt a more principles-based approach, such as COBS for investment products and ICOBS for insurance, have only been in use for a matter of months. It is too early to say how the move towards principles-based regulation has impacted on consumers. The impact of TCF in delivering better outcomes for retail consumers will be the first serious test of this approach to regulation.

[2] Published on the Panel's website at www.fs-cp.org.uk

22. The success of more principles based regulation will depend on effective supervision and enforcement. We are concerned that uncertainty about the interpretation of principles will result in disappointing levels of compliance with accepted good practice. While we believe enforcement has recently been strengthened, we believe that supervision is an area where the FSA has found it difficult to change firms behaviour as reviews of areas such as quality of documentation and advice continue to illustrate. We remain of the view that more evidence is required properly to assess the effectiveness and long-term benefits of PBR.

Regulation of Retail Banking Conduct of Business

23. We have been pressing the FSA to take over the conduct of business regulation of banks for some time. We were therefore pleased to see that the FSA Board has agreed to consult on the basis that the FSA would take over this area of regulation. The combination of consumer dissatisfaction with the current, fragmented regulatory structure and the need for the UK to implement the Payment Services Directive appears to offer an excellent opportunity for the FSA to step in.

24. The OFT produced a damning indictment of practices in the current account market in its market study earlier this year. These are not issues which the FSA will be able to regulate effectively unless it is adequately resourced and has a clear sense of its role in relation to bank charges. We believe that TCF is a valuable principle for reaching a settled view on charges paid by different classes of bank customers. We are expecting the FSA to continue to produce evidence of the effect of its regulation on consumer experience, to demonstrate its effectiveness and ensure that it has sufficient resources to meet its consumer protection objective.

25. The Panel has had serious long-standing concerns about shortfalls of the Banking code with regard to consumer protection. These concerns have been dismissed repeatedly over the years by the Code's sponsors. We will be pushing the FSA to address these as it moves to regulate retail banking. It is important, however, that the outcome should be consumer-focused and measured against consumer needs. To the extent that the Banking Code becomes incorporated in industry guidance, we would expect there to be formal consultation and approval by the FSA before it is implemented.

Role of the Consumer Panel

26. The Panel was established by the Financial Services and Markets Act to provide advice to the FSA. The Panel's terms of reference as set out in our annual report allow it to comment and seek to influence the financial landscape beyond that which is regulated by the FSA. Examples include policy proposals by H M Treasury, the OFT, the Personal Accounts Delivery Authority and the impact of European developments on UK consumers.

December 2008

Memorandum from Which?

Summary

1. The regulatory failings of the Financial Services Authority (FSA) over the past year have been well-documented. While the major focus has been on wholesale regulation, Which? believes the FSA's approach to its retail agenda needs similar scrutiny.

2. Which? is the leading consumer organisation working on retail financial issues. As a result, we have worked closely with the Financial Services Authority (FSA) on numerous issues. It is clear upon review of its performance over the past year that the regulator needs to do considerably more to ensure that consumers are treated fairly and properly protected.

3. Which? is not calling for more legislation or regulation. What consumers need is better regulation. The FSA must use its existing powers more flexibly and imaginatively to ensure proper enforcement and be an effective deterrent against the unfair treatment of consumers.

4. We believe that Lord Turner and Hector Sants have a huge task to turn the FSA into a truly effective, consumer focused regulator. We very much hope the increased focus on prudential regulation and the wholesale markets will not distract them from this important task.

Structure of the FSA

5. The way the FSA is led has a significant impact on its ability to fulfil its two consumer focused objectives. We are extremely concerned that the almost complete dominance of board members with a financial services industry background may limit the regulator's ability or willingness to protect consumer interests against those of the industry.

Principles-based regulation

6. The FSA's move to principles-based regulation, and its "Treating Customers Fairly" (TCF) initiative, has not yet resulted in measurable improvements for consumers. If this initiative is to deliver concrete improvements there is an urgent need for reforms. We are concerned that the FSA decided not to proceed with its survey of whether firms can demonstrate by the December deadline that they are treating their customers fairly. Instead, it will conduct these assessments as part of its normal supervisory work. In the interests of accountability the FSA should publish each month the number of assessments undertaken and the proportion of firms which met the December deadline. We believe the FSA has significant work to do to demonstrate that they have not let the industry "off the hook".

Improving incentives for firms

7. Practices will only improve when companies which fail to treat their customers fairly suffer damage to their reputation and bottom line. We were always concerned that the FSA was delegating more responsibility to directors for defining and measuring fair treatment of customers without putting more robust measures in place. We do not believe the FSA's current approach is strong enough to achieve the improvement in fair treatment so badly needed by UK consumers. The FSA needs to review its approach to "naming and shaming" and the level of fines it levies in order to incentivise firms to treat their customers fairly.

Retail Distribution Review

8. We welcome the FSA's commitment to proceed with the Retail Distribution Review as it offers a significant opportunity to make the market work better for consumers. For the most part we support the approach set out in the most recent feedback statement. We are keen to ensure that the new system will lead to outcomes where consumers are protected and understand the distinction between independent, unbiased advisors and salespeople.

Financial capability

9. We welcomed the Thoresen Report earlier this year and believe significant benefits will flow to consumers once a national system is in operation.

Banking—Conduct of Business

10. The decision of the FSA to activate the conduct of business rules for banking could bring consumer benefits. However, if the FSA lets the banking sector set the framework, continue to draft industry guidance which does not take full account of the needs of consumers, and if supervision and penalties are inadequate, then consumer outcomes could possibly worsen.

Depositor protection—Financial Services Compensation Scheme

11. Which? does not believe that the current proposals for the reform of the FSCS go far enough to provide adequate consumer protection. Changes are needed to ensure that: payout limits apply to brands, not institutions; payouts should be gross, not net; and institutions take out insurance to cover temporary high balances. We understand the complexity of the changes required but feel that the FSA has had adequate time to get to grips with this and put forward proposals that work for consumers.

With-profits funds—Inherited estates

12. Which? is extremely concerned about the FSA's approach to the regulation of with-profit funds. We wholeheartedly supported the Committee's recommendations, and thought the FSA's response to the report was completely inadequate. We believe the FSA needs to fundamentally re-think its approach.

The FSA's Approach to Consumers' Interests

13. The way the Financial Services Authority (FSA) is led has a significant impact on its ability to fulfil its two consumer focused objectives. Giving the current economic crisis, it is vital that the consideration of consumer interests is an integral part of FSA decision making.

14. We are extremely concerned that the almost complete dominance of board members with a financial services industry background may limit the regulator's ability or willingness to protect consumer interests against those of the industry.

15. Which? is supportive of the work of the Financial Services Consumer Panel. However we strongly contend that the existence of the Consumer Panel in no way mitigates the need for proper consumer representation on the FSA Board. We believe an increase in consumer representation at the very top of the organisation would help to drive cultural change to ensure consumer interests are put at the heart of the FSA's decision making. Of the current 14 members of the Board 10 are currently or have previously been employed in the industry. This brings a lack of diversity of opinion and we see a clear danger of a lack of challenge to standard industry practice. The fact that Chief Executives from major financial institutions regulated by the FSA sit on its Board increases this risk.

16. A number of FSA non-executive board members retired in 2007. Which? called for a major increase in consumer representatives, or at least, non-industry representatives to balance out the Board. We were extremely disappointed this has not happened—indeed, with the recent departure of Deputy Chair Dame Deirdre Hutton, consumer representation has actually decreased.

Principles-based Regulation

17. Which? continues to support the move to principles-based regulation as the previous approach of relying on detailed rules and box-ticking compliance did not deliver fair treatment of customers. However we believe the FSA should take a risk-based approach. Proper cost-benefit analysis should be conducted and rules should stay in place where there is a significant likelihood of consumer detriment or where the removal of rules could reduce clarity about what consumers can expect from the firm. Any industry guidance on how to interpret what the principles mean should be drafted in consultation with consumer groups and include appropriate protection for consumers.

18. Where principles-based regulation is deemed appropriate, the FSA must ensure that the move results in improved outcomes. It is concerning therefore that the jury is still out over whether the Treating Customers Fairly (TCF) initiative has seen an improvement in outcomes for retail consumers.

19. Some firms and senior management have taken the TCF initiative seriously. However it is deeply disappointing that only 13% of firms sampled by the FSA met the March 2008 deadline to have appropriate management information in place to test whether they are treating their customers fairly.[3]

20. If firms are to be expected to treat customers fairly, it is important that progress is capable of being measured. We are therefore concerned that the FSA has decided not to carry out a survey of whether firms can demonstrate by the December deadline that they are treating their customers fairly. Instead, it will conduct these assessments as part of its normal supervisory work. In the interests of transparency and accountability the FSA should publish each month the number of assessments undertaken and the proportion of firms which met the December deadline.

21. The extremely low compliance rates with the March deadline raised concerns about industry's lack of commitment to the TCF agenda. This means the FSA should increase, not reduce the resources put into TCF. The FSA will have to work hard to prove that the industry is not off the hook on TCF and that principles-based regulation can deliver for consumers.

Improving Incentives for Firms to treat their Customers Fairly

22. Given the FSA's move towards high level principles of regulation and its decision to devolve more responsibility for treating customers fairly to directors, a more robust approach is needed to investigate firms' behaviour.

23. The FSA is taking a considerable risk removing rules without more robust enforcement being in place to provide a deterrent against firms exploiting less intrusive regulation. The regulator cannot simply create principles and regulations and hope that firms comply with them—it needs to put incentives in place to ensure compliance.

24. The current economic environment only increases the need to ensure that customers are treated fairly and for prompt action to be taken by the FSA. It has been reported that the Council of Mortgage lenders expects 75,000 houses to be repossessed next year.[4] It is too late if a consumer finds out after their house has been repossessed that they had not been treated fairly and should have been offered options to pay off arrears over a longer period of time or move to an interest only mortgage.

25. Which? does not think the FSA's current approach acts as a significant deterrent to corporate malpractice. Nor are the necessary market forces in place to provide incentives for good corporate behaviour. As a result, we would recommend that the FSA reviews the incentives it has in place, and in particular reconsiders its traditional opposition to "naming and shaming" and reassesses the level of fines it imposes.

26. Consumers need better regulation. The FSA must use its existing powers more flexibly and imaginatively to ensure proper enforcement and be an effective deterrent against the unfair treatment of consumers.

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[3] FSA, Treating Customers Fairly: Progress update, June 2008

[4] http://news.bbc.co.uk/1/hi/business/7762627.stm

Regulatory transparency (Naming and Shaming)

27. Which?'s experience over the past 50 years is that the spotlight of publicity and the resulting changes in what people buy does more than anything else to improve standards in an industry. As a result we believe that regulatory transparency in financial services could have a powerful effect towards incentivising firms to improve their practices. More detailed disclosure would inform consumers and send a strong message to the industry.

28. A culture of secrecy only protects the firm breaching the rules, not the consumer. Transparency must be a one of the key mechanisms to hold the FSA to account for its performance.

29. We support the FSA's proposal that league tables of firms receiving the most complaints should be published. However we believe the proposals do not go far enough. We believe that, in order to be useful to consumers, complaints must be broken down by product, individual firms within a group, and type of complaint. In addition, Which? would like to see further details published about firms which issue misleading financial promotions and more detail of the results of mystery shopping exercises and thematic work. We believe that the FSA should take a similar approach to the ASA and publish details of occasions where it has found a misleading financial promotion and required it to be withdrawn or amended.

30. When it comes to disclosure of information the FSA continues to put firms' commercial interests above the interests of consumers. Part of the problem undoubtedly lies with the text of the Financial and Services Markets Act (section 348) that prevents the FSA from disclosing information it receives in the discharge of its regulatory duties, except in certain defined circumstances. However, Which? believes that the main issue lies with the extremely cautious interpretation of the legislative provisions by the FSA. Other regulators have similar legislation-based restrictions on their public disclosures (eg the Office of Fair Trading), yet they appear to be less hamstrung by these provisions.

31. By way of example, Which? has asked the FSA to provide a copy of the letters sent out to customers by regulated firms fined for mis-selling PPI. Our requests have been refused due to the non-disclosure obligations placed on the FSA under s348 FSMA—notwithstanding that the letters are in the hands of a large number of the public already. The FSA has also refused to disclose information about what action it has required firms who have been fined for mis-selling PPI to contact customers, review past business and compensate customers. Although Which? was not asking for information received by the FSA, we were told s348 nevertheless prevented disclosure because the instructions provided by the FSA necessarily reflected information received from the regulated firms.

32. The FSA also asserts that greater disclosure would undermine the willingness of regulated companies to engage in an open dialogue with it, but has failed to put forward any evidence to support this claim. We note that in the context of a number of Freedom of Information (FOI) disclosure requests, the Information Commissioner has not accepted this argument. This is perhaps an example of the FSA sacrificing too much to maintain cordial relations with those it regulates.

33. We believe the best way to examine these issues is to for HM Treasury to commission an independent review of the FSA's use of regulatory transparency and disclosure of information. This should compare the FSA's performance and principles with those of other regulators including its approach to Freedom of Information (FOI) requests, how it has interpreted the existing requirements under FSMA, and making proposals for changes to FSA practice and, if necessary, amendments to FSMA.

Remuneration and bonus structures

34. When firms have put in place Management Information to measure fair treatment, the FSA's supervisory approach should ensure that remuneration and bonus structures within the firm—from the boardroom through branch managers to front-line advisers and sales staff—are aligned with the fair treatment of customers. If Directors and staff are clear that failing to treat customers fairly or breaching regulations could impact on their personal reward packages then they will have a greater incentive to ensure their firm meets the required standards and exercise proper oversight.

Fines and enforcement

35. At present we would question whether the fines imposed by the FSA are significant enough to act as an effective deterrent against corporate malpractice.

36. Looking at recent examples in Payment Protection Insurance (PPI) cases:

— In January 2008, the FSA imposed a fine of £1.085 million on HFC Bank Limited for failings in selling PPI.[5] The sales figures for the period suggest sales revenue was in excess of £260 million. The fine therefore represented less than 0.4% of revenue.

— In October 2008, the FSA fined Alliance and Leicester £7 million for "particularly serious" breaches of the PPI rules.[6] Over the relevant period, revenue from PPI sales was £266 million. Despite the increase in the level of the FSA's fines, it represented less than 3% of revenue.

5 http://www.fsa.gov.uk/pubs/final/hfc_bank.pdf
6 http://www.fsa.gov.uk/pubs/final/alliance_leicester.pdf

37. Given the level of fines compared to the revenues generated, it is unsurprising that the FSA's regulatory activity in the market for Payment Protection Insurance has not had the desired outcome in ensuring that customers are treated fairly. We would suggest the FSA looked to the OFT who levy substantial higher fines for abuses of competition law. British Airways was fined £121.5 million for collusion over fuel surcharges.[7] Argos and Littlewoods were fined a total of £22 million for fixing the price of toys and games.[8]

38. If the FSA is serious about using fines as a deterrent, these fines will need to be significantly higher. The current approach risks fines being seen by firms as simply the regulatory cost of doing business.

39. Which? recommends that revenue from fines should be spent on financial capability projects instead of being recycled into lower regulatory fees for the industry.

Retail Distribution Review

40. Which? welcomes the FSA's commitment to proceeding with the Retail Distribution Review (RDR) despite the current economic turmoil. We believe the reform process offers a significant opportunity to make the market work better for consumers.

41. As our mystery shopping exercises show, too much of the advice currently offered fails to meet acceptable benchmarks. Our latest mystery shopping survey found that just 32% of bank advisers gave acceptable advice. IFAs performed better but still only 48% met our benchmarks.[9] The financial impact of bad advice can be disastrous for consumers.

42. For the most part we support the approach set out in the FSA's most recent feedback statement of November 2008, albeit with the caveats set out below.

Structure of the market

43. Which? has consistently argued that there must be a clear distinction in the market between those offering independent, unbiased advice which is in the best interests of the consumer and those simply trying to sell products. The labels attached to the proposed services will be important and must give the desired clarity for consumers. We remain to be convinced that "Sales Advice" is an appropriate label, preferring "Sales Representative" as it removes the illusion of impartial advice being given. We look forward with interest to the results of the FSA's consumer research on this issue.

44. In addition to ensuring clear labels, the FSA must monitor how the services offered are described to consumers. In our mystery shopping research, 37% of tied advisers gave misleading disclosures about the service they were offering—implying that they could provide a larger degree of choice than was actually the case. This bad practice must not be tolerated under the new regime.

Guided sales

45. Which?'s primary concern is to ensure that any "guided sales" process should be subject to the regulatory requirement to recommend a suitable product.

46. We were concerned that some in the industry had set out to design a service that would indicate "appropriate" products to consumers whilst seeking to remain outside the regulatory requirements. There would be substantial scope for this service to be misrepresented to consumers, damaging confidence and leading to mis-selling. We therefore welcome the FSA's clarification that where such services offer a "personal recommendation" they will be subject to the suitability requirement.

47. We will be monitoring any guided sales process put forward by the industry. We will assess any process against the following criteria:

- Does it provide good outcomes for consumers?
- Does it offer good value for money simple products?
- Can it be clearly explained to consumers?
- Does it include an appropriate degree of consumer protection?

48. In order to increase access to advice, the industry would be better off thinking about the type of service consumers would want to engage with, rather than trying to reduce suitability standards.

[7] http://www.oft.gov.uk/news/press/2007/113-07
[8] http://www.oft.gov.uk/news/press/2003/pn_18-03
[9] Which? magazine, Financial advisers, October 2007

Product regulation

49. Which? believes financial products have been a neglected aspect of the RDR. The FSA has concentrated its analysis on the advice and sales process, without examining in enough detail the complex products which are a reason why consumers do not engage with the industry. As the FSA proposes to allow the "Sales Advice" channel to offer product recommendations, we would like to see a debate about the suite of products which could be offered. The FSA should also conduct further work into whether it is possible to develop a common terminology for describing the risk of products as recommended in the Treasury Committee's report into long-term savings.[10] Further questions should also be asked about whether competition between firms will be sufficient to ensure that the products offer consumers value for money.

Modernising the way advice is paid for

50. We believe that remuneration structures have been one of the root causes of consumer detriment and mis-selling scandals in the pension and investment sectors.

51. The use of commission/sales targets gives the adviser an incentive to override the consumer's interest and recommend a product or course of action that pays the adviser the most commission rather than the one which is best for the consumer. In addition to actual commission bias, there is a perception of bias amongst some consumers which could be an important factor contributing to a lack of trust and confidence.

52. Whilst much of the focus has been applied to commission payments to independent advisers, the same problems apply to bank advisers who are rewarded according to the volume of sales through commission or sales targets.

53. We support the FSA's move towards "Adviser Charging" which should remove the influence of product providers on adviser remuneration, reducing the potential for bias. There must be a level playing field between "Independent advice" and any new "Sales Advice" sector. As we find in our mystery shopping, some bank advisers claim that their advice is free, where as the consumer is actually paying for the advice through an increase in the cost of the product. The FSA must take a rigorous approach to rooting out remuneration structures which lead to bias in the "Sales Advice" channel.

54. We do not underestimate the challenge both culturally and technically of moving to a new system. In our mystery shopping, 82% of advisers failed to have a meaningful discussion about the cost of advice or how it would be paid for while others made misleading statements about how remuneration worked.[11]

55. In order to ensure the new regime is successful, we believe the FSA must clarify:

— Whether they acknowledge the previous reliance on information disclosure to move away from commission was a failure and, if so, what lessons they draw from this experience in their move towards adviser charging.

— What action they are proposing to take in order to prevent consumers from being overcharged for the advice.

— How much they believe the cost of the product should come down if product providers are no longer required to fund commission through Annual Management Charges levied on the product.

— How the proposals for payment for advice will work in the "Sales advice" channel where firms say they are providing regulated advice on their own products.

— Would firms in the "Sales Advice" channel be prohibited from saying that they are providing "free" regulated advice?

Trail/renewal commission

56. We agreed with the Committee's conclusion in its report into restoring confidence in long-term saving that "For IFAs to receive trail commission whether or not they are providing any real on-going advice to the client is unacceptable".[12] We would urge the Committee to ask the FSA what progress has been made in dealing with this practice five years on. We continue to see cases of money being paid to advisers and no work being provided in return. In some cases, the commission payments may have been transferred to a different IFA who has never had any contact with the customer. If commission is no longer being paid to an IFA it should be returned to the customer and not pocketed by the product provider.

[10] Treasury Committee, Eighth report of session 2003–04, Restoring confidence in long-term savings, para 30
[11] Which? magazine, Financial advisers, October 2007
[12] Treasury Committee, Eighth report of session 2003–04, Restoring confidence in long-term savings, para 50

Professionalism

57. Our research suggests that consumers expect "professionals" to be properly trained and up to date, to comply with standards of conduct, ethics and practice and not to exploit their position of trust. They also expect protection from bad professionals with effective procedures to detect poor performance and sanctions against those who breach rules.

58. We support the proposal to raise the minimum professional standards to QCA Level 4.[13] However, we would like to see this increased in the longer term to degree level (QCA Level 6) to reflect the increasing complexity in the marketplace and meet consumer expectations for higher qualifications. In addition to the level of the qualification, it will need to be of an appropriate breadth and involve practical assessment and Continuing Professional Development. There is already a template available in the form of the ISO Standard for Financial Planning which lays down high level but achievable requirements for process, competence, experience and ethics in financial planning.

59. We also believe there must be simplification of the current "alphabet soup" of financial adviser qualifications if consumers are expected to drive demand for qualifications. Consumers need simple qualifications which clearly identify the standard reached by the adviser. This should be an early priority for the new Independent Professional Standards Body. The ISO Standard could be the perfect mechanism for achieving this simplification whilst at the same time raising professionalism across the industry.

Financial Capability

60. In 2002 Which? called for a national financial advice network to help consumers with basic financial decision-making. We therefore welcomed the Thoresen Report earlier this year, which took forward the concept of "Money Guidance", and will be piloted in the North West and North East of England from early 2009. Whilst we believe that "Money Guidance" should have prioritised earlier by the FSA within its financial capability work, we very much welcome the new dynamism that has been lent to the project by the appointment of an FSA Director of Financial Capability. Significant benefits will flow to consumers once a national system is in operation. Going forward, we would hope a regime is created which enables "Money guidance" to help consumers engage with the financial services industry.

61. We hope that the FSA will be bold in developing a sustainable "Money Guidance" system which incorporates internet, telephone and face-to-face delivery vehicles. The service must be unambiguously on the side of the consumer, and must give the consumer assistance in making financial decisions. Extreme care needs to be taken if the service is delivered directly in the retail arena. Any conflicts of interest that could develop would seriously undermine the perception and thus value of the service. The FSA should explore the potential of delivering "Money Guidance" through Post Offices, doctor's surgeries, libraries, places of worship and other community organisations.

Banking: Conduct of Business Regulation

62. Which? believes that the FSA's proposal to take on retail banking regulation will only be a success if it is used as an opportunity to improve consumer protection in this sector.

63. Which? has, in the past, been supportive of the Banking Code Standards Board and the principle of self-regulation for the banking industry. However, we were always committed to monitoring the banking code review process carefully to ensure a good outcome for consumers.

64. Over the last year this work has resulted in the emergence of some serious concerns about the way the code review was conducted, the powers (or lack thereof) of the Banking Code Standards Board and the lack of future-proofing in the code and the ensuing regulatory black holes. Last year, some banks closed the accounts of consumers who had complained about bank charges. The consumers had otherwise not displayed any kind of behaviour that could have reasonably justified the termination of their banking relationship. We tried to raise the issue with both the BCSB and the FSA but were told by the former that this issue was not explicitly covered in the code and by the latter that they did not regulate retail banking and that both regulators were therefore not responsible, a clear example of a regulatory black hole. The issue has been addressed in the latest version of the banking code which came into force this year but this was too late for the affected consumers.

65. In addition, we were particularly concerned about industry's failure to introduce the much-demanded overarching commitment to treating customers fairly into the code which would have gone some way to addressing the issues of future-proofing and regulatory black holes. The fairness wording finally inserted into the code fell significantly below the FSA standard and therefore has failed to close any gaps in regulatory oversight. This became quite clear earlier this year when consumers experienced problems and significant delays with transfers of cash-ISAs and it materialised that there was no regulatory authority responsible for this area, as transfer arrangements for cash-ISAs were not specifically covered in the banking code.

[13] This is judged to be equivalent to the first year of a bachelors degree.

66. The current review process itself also lacks effective external control which allows the code sponsors to put their own interpretation on the recommendations of the independent reviewer. The reviewer is not required to check that the sponsors' interpretation of his recommendations is in line with his desired interpretation. We experienced serious issues with this during the last code review. There is also a lack of genuine accountability, the rebuttal of proposals is not evidence-based, and many external proposals are never publicly acknowledged.

67. However, although the Banking Code has its flaws, it does at least provide clarity over some areas of consumer rights. We are concerned that this clarity would be lost unless consumers are involved in the future regulatory framework.

68. We therefore believe that FSA supervision of the retail banking regulatory regime has to fulfil the following criteria to deliver an actual improvement in consumer protection:

— Active monitoring of the application of the TCF principle in all banks' activities.

— Approval of any industry guidance by the FSA with meaningful and genuine consultation with consumer bodies.

— Issue of specific guidance in areas that have the potential to cause particular consumer detriment or have given cause for concern in the past.

69. We also have concerns that the split of retail banking activities between activities falling under the Payment Services Directive (PSD) and activities regulated by the new BCOBS could potentially lead to a reduction in consumer protection. To avoid this, the FSA will need to issue guidance for those parts of their regulatory regime for PSD regulated activities that have the potential to cause consumer detriment. One area we are particularly concerned about is liability for losses related to online banking and card usage.

70. In our view, the last code review showed an apparent reluctance by the industry to deliver on necessary improvements in consumer protection. We therefore came to the view that supervision of the code should be carried out by an independent third party and that reviews of the code should be evidence-based. Whilst we welcome the FSA's review of the retail banking regulatory regime we believe that any changes must ensure a fair and robust regulatory regime that improves consumer protection.

71. The proposed FSA regulation of banking does not include regulation of credit. At this time we are happy for the OFT to retain responsibility in this area.

Reform of the Financial Services Compensation Scheme

72. The FSA is responsible for dealing with the majority of consumer concerns relating to the reform of the Financial Services Compensation Scheme (FSCS). Which? has been working closely with the regulator during the consultation process, as we do not believe that the current proposals for the reform of the FSCS go far enough to provide adequate consumer protection.

73. We believe the FSA needs to make the following changes to the FSCS:

— Payout limits should apply to brands not institutions: It is extremely difficult for consumers to understand the corporate structure of a bank and determine whether they are covered. A change is needed to ensure consumers who have been diligent in spreading their deposits are not caught out.

— Payouts should be gross, not net: A net payment system could create significant problems and serious financial hardship for consumers whose savings and debts are held with one institution. It could also delay the entire compensation system while banks calculate each individual's total exposure.

— Institutions must take out insurance to cover temporary high balances: Many people will face situations during their lifetime where they hold temporary high balances in their bank accounts—for example if they sell a house, receive a redundancy pay-out or benefit from an inheritance. It is currently not feasible for consumers to cover themselves in these instances.

74. Proposals on these issues are likely to be forthcoming in a consultation paper in the New Year. We understand the complexity of the changes required but feel that the FSA has had adequate time to get to grips with this and put forward proposals that work for consumers. If these changes are not made to the FSCS we would find it very difficult to support anything other than unlimited compensation for deposits. Consumers use the products covered by the depositor protection sub-scheme to deal with their basic financial needs. It is difficult to justify the instances in which consumers' deposits are not protected.

With-profits Funds—Inherited Estates

75. As the Committee will be aware from our previous submissions on this issue, Which? is extremely concerned about the FSA's approach to the regulation of with-profit funds. We warmly welcomed the recommendations of the Committee's report into inherited estates[14] and fully support the conclusion that the regulatory framework and the FSA's current oversight are not sufficient to protect policyholders' interests.

[14] Treasury Committee, Twelfth report of session 2007–08

76. The FSA's response to the report was completely inadequate in its failure to respond to the Committee's concerns.

77. Instead of committing to a review in order to ensure the regulatory framework is used in the best interests of policyholders, the FSA has introduced a "systematic information gathering exercise to determine conclusively how senior management in firms have implemented the rules, individually and collectively". Which?'s scepticism of the benefits to policyholders of such an exercise was confirmed when the Director responsible at the FSA stated "Our starting point in conducting the review is not that significant changes are needed to the regime"[15]. This seems far from "a reopening of the debate about the fundamental design of the regulatory system" recommended by the Committee.

78. We were further dismayed that the FSA rejected the Committee's recommendation that companies should not be permitted to charge shareholder tax to the estate and refused to justify the phasing of the special bonus to Norwich Union policyholders—a move that will see 40,000–50,000 of the company's most loyal policyholders lose out.

79. The only glimmer of hope offered is the consultation on proposals to prevent mis-selling costs from being charged to the inherited estate. Which? is seeking reassurance that the FSA is not going to water down its proposals and propose that they only apply to mis-selling that takes place after the rule changes rather than immediately stopping firms taking any further money out of the inherited estate to pay mis-selling claims. If the FSA were to change its mind on this, it would make the change in policy essentially worthless to policyholders.

80. At a time when bonuses are being slashed and swingeing exit costs (known as Market Value Reductions) are being imposed, with-profits policyholders are dismayed by the FSA's refusal to stand up for their interests. The regulator needs to fundamentally re-think its approach.

December 2008

Memorandum from Lord Lipsey

I was originally invited by the committee to give evidence at its session on 16 December on the work of the Financial Services Authority. That has been overtaken by my resignation as Chair of the Financial Services Consumer Panel on 2 December, and my place will now be taken by my admirable former deputy, now the acting chair, Adam Phillips.

I resigned following a civilised row with the Financial Services Authority about the role of the panel and the resources devoted to supporting it. This difference of opinion is very relevant to the committee's present inquiry; and in particular to the FSA's plans and priorities over the period ahead. It is for that reason that I am submitting this memorandum of evidence.

As I hope the committee would agree, we have survived the financial crash but we are only now confronting the full consequences. That applies particularly to the Financial Services Authority which, because it has been preoccupied in fire fighting, has yet to crystallise a viable approach over the months and years ahead. One debate lies at the heart of determining what that approach should be.

There is one school of thought which says: what the FSA should be doing going forward is to concentrate exclusively on its prudential and supervisory activities. That is by no means a stupid view: and it is held in high places. For example, a former Treasury permanent secretary something similar at an excellent seminar on the crash arranged by the Speaker of the House of Lords last month. He and others wanted the FSA to downgrade its consumer-focussed work. The specific example cited was its Treating Customers Fairly initiative. For in current circumstances protecting consumers was a luxury that the financial services sector could no longer afford.

I profoundly disagree with that analysis. In the short term it is true the FSA has to beef up its supervision. However, in the long run, the restoration of confidence cannot be brought about just by restoring the balance sheets of companies. In the long run, we face an even bigger challenge: how is consumer faith in financial services and in the financial services industry to be restored? A recent MORI survey, for example, confirmed how low financial services now stood compared with other industries in terms of popular confidence.

By common consent we as a nation have spent too much and saved too little. We put inadequate amounts of money into protection policies, into savings, into pensions. Yet the danger is that many people, their nest eggs damaged by greedy financial institutions, will turn in precisely the opposite direction.

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[15] Speech by Sarah Wilson, 29 October 2008, "TCF and with-profits: The FSA's perspective"

Let me illustrate. Lord Turner, who now chairs the FSA, was also responsible for a report on pensions which has shaped the new consensus on the issue. One feature of that report was auto-enrolment in pension schemes. When Lord Turner now contemplates his report, how has the crash changed his estimate of the likely number of people who will contract out? As more and more people contemplate a future when many people's pensions are worth less and less, the answer must surely be a big increase. If that is to be avoided, confidence must be restored.

In fact, there is no fundamental tension between actions designed to save financial services companies and actions designed to restore consumer confidence. Indeed as financial services companies all insist that their business interests are served by doing well by consumers, the two work in parallel. And so should the FSA. As it enhances its supervisory activities, so too should it enhance its efforts to restore consumer confidence through appropriate regulation.

Is it doing so? At best, and making every effort to restrain any bias as a result of my experiences, the jury is out. On the one hand, the FSA is pressing ahead vigorously with its money guidance work. The Retail Distribution Review is being progressed and includes important gains for consumers—for example, the end to commission-driven independent advice.

On the other hand, the Retail Distribution Review was watered down between the April consultation document and the November follow-up document reporting progress. In April advice was advice, provided only by independent advisers. Today banks are to be enabled to sell their in-house brands under the rubric "sales advice". Some consumers fear that this will be the sort of sales advice you get from a timeshare dealer at a free weekend at their resort! Much of the detail has yet to be settled and that may be an exaggeration: much depends, for example, on what range of products the banks are allowed to sell in this way and what qualifications precisely are required of advisers in the final rules. On the RDR, as on the FSA's approach generally, the jury is still out.

An unambiguous retreat concerns the FSA's flagship "Treat Customers Fairly" programme. Themed visits to firms to see if they are have been dropped from its programme. Firms will no doubt be mightily relieved: visits as the programme was evolving showed some 80% of companies lagging far behind where they were supposed to be in embracing TCF. The FSA claims that shortcomings will be picked up in the course of its routine supervisory activities. Yes, and the other one has bells on it!

And then there is the Consumer Panel. I was appointed, so I thought, on a prospectus agreed with the FSA whereby the panel would become more outward-facing, more proactive, and more concentrated on major priority issues. Whatever the case for that when I accepted the job last May, it has been immeasurably strengthened by developments since which positively require the panel to take a more proactive stance. Examples are the reform of the compensation scheme for depositors, and home repossessions. That requires a reinvigorated panel with proper staffing. Instead, the word came down that the panel was to get back to basics, and confine itself to the job the FSA wants it to do, as in-house adviser. When it suits the FSA to listen, it will; when it chooses to ignore the panel, it will.

As Lord Turner told this committee the FSA plans to appoint a further 318 supervisory staff. When I left the panel had a total of two full-time non-admin staff in post, a reduction of two on the number in post when I arrived. though a vacancy or two is to be filled in due course. I was denied the substantial increase in staff—perhaps half a dozen or so—that would have enabled it to do its job effectively.

What should your committee recommend? May I be so bold as to suggest three things?

First, the FSA has decided that the Consumer Panel should concentrate on a core role of acting as an in-house critic of FSA proposals. Even your committee is unlikely to persuade it to change its mind. However, even to fulfil that more limited role it requires a larger staff than is at present envisaged—perhaps three times as many people as it now has. I argued and continue to believe that it should also have at its disposal an outside adviser of weight, to reinforce its independence from the FSA executive.

Secondly, this narrow—though still valuable—role for the Consumer Panel creates a vacuum representing consumers on the wider stage. In the circumstances, that vacuum should be filled by a body outside of and properly independent from the FSA. The report of the House of Lords Select Committee on Regulators (HL 189-1 of November 2007" considered this and concluded that (para 5.65) "stand-alone consumer representation bodies are more transparent and more effective." My experience confirms this for the FSA. The best candidate to carry this forward would be Consumer Focus, the old NCC, now revived under the leadership of Lord Whitty, its chair and Ed Mayo, its chief executive.

Consumer Focus has already been dabbling in financial services matters, though it would be the first to admit that it currently lacks the expertise of members of the FSA Consumer Panel. It has to acquire that expertise and that locus. If that puts the FSA's nose out of joint, the FSA has only itself to blame.

Thirdly however and more speculatively, we need to look further ahead. As we enter the inevitable debate about the future of regulation after the failures of the past, we have to ask ourselves a more fundamental question. Is it sensible for prudential regulation on the one hand, and retail regulation on the other to be combined in a single institution?

That the two functions should be divided was a current argument up to the introduction of the Financial Services and Markets Bill 1999, and it was then labelled the "twin peaks" solution. Under it, prudential and retail regulation would be run by separate institutions, each with its own last to stick to.

There are strong arguments for and strong arguments against this approach; and it would doubtless be impossible to come to a clear conclusion in the course of the committee's current inquiry. But if the Financial Services Authority neglects its consumer responsibilities—I hope it won't but fear it will—then the case for such a divide will acquire a new momentum.

9 December 2008

Supplementary memorandum from Lord Lipsey

At Q100 in the Committee's evidence session on 15 December 2008, Hector Sants, the chief executive of the Financial Services Authority, the Chairman noted that I had called for "a broader remit with greater resources than the Panel currently enjoys" and asked why that was rejected. In reply to that question, Mr Sants said: "We did not actually reject any proposals from Lord Lipsey. I have to say that neither I nor the Chairman nor the executive received any".

I was surprised to hear this response.

The executive channel through which I discussed the role and resourcing of the panel was Mr Iain Brown, the company secretary. We had been in constant verbal dialogue on the subject since my appointment. I minuted Mr Brown by email on 10 November {certain references to personnel involved have been redacted}:

> "Following discussion at and around the margins of the panel meeting last week, I want to put on record my concern and that of members about the resources available to us.
>
> As you know, we have discussed this on a number of occasions….. I remain extremely concerned about the situation as do a number of members of the panel. Several have said to me that they believe that this reduction in resources is part of a deliberate FSA strategy to emasculate the panel….
>
> This comes at a time when the burden on the panel has been greatly increased by the financial crisis which has thrown up priority issues that we cannot ignore. For example, the mortgage repossession issue was clearly one that the panel needed to seize. Moreover new ways of working, though they may economise on panel members' time, if anything add to the burden on the secretariat.
>
> I have, I believe, leaned over backwards to accommodate the FSA's need for due economy. I have been prepared to make substantial cuts in the research budget. I suspended my request—to which at one point you had acceded—for an outside adviser to the panel. I am taking steps to explore whether the inquiry into the FSA's regulatory style which I initially proposed is carried out in a way that means it will not absorb substantial FSA resources….. However early and visible changes on the resources side are needed."

I followed this email up with a further memorandum on 13 November where I said: "The panel….requires supporting resources of all kinds: policy work, panel management, press work, briefing of and dialogue with the industry. In my view our resource should be substantially expanded at this time—far beyond the two extra people required to sustain the present model. After all, compared with the new resources being put into supervision, any increase in our full time staff—we have approximately four at the moment—is a drop in the ocean. If this prospectus is now embraced by the FSA, we can discuss precisely what is required in terms of staffing."

18 December 2008

Memorandum from Citizens Advice

Citizens Advice is the national body for Citizens Advice Bureaux in England, Wales and Northern Ireland. The CAB service is the largest independent network of free advice centres in Europe, with 430 main bureaux in England, Wales and Northern Ireland. Bureaux provide advice from over 3,300 outlets, including bureaux in the high street, community centres, health settings, courts and prisons. All Citizens Advice Bureaux are registered charities.

The CAB service has twin aims: to ensure that individuals do not suffer through a lack of information about their rights; and equally to exercise a responsible influence on the development of policies and practices, both at a local and national level.

A survey carried out in summer 2008 showed that over 180 Citizens Advice Bureaux in England and Wales are engaged in delivering financial education direct to the public, or in training frontline workers in partner agencies to do so.

SUMMARY

— Citizens Advice welcomes the achievements of the Financial Services Authority in driving forward the National Strategy for Financial Capability and for the successes it has had in targeting key groups such as new parents, school children and NEET young adults.

— It is essential though that effective evaluation practices are introduced to gauge the longer term impacts of this work.

— Citizens Advice would welcome an additional emphasis by the FSA to target harder to reach groups with financial capability work.

WORK OF THE FINANCIAL SERVICES AUTHORITY IN FINANCIAL CAPABILITY

1.1 Establishing financial capability as one of the key strands of work of the Financial Services Authority has reinforced, and significantly shaped, the priority which the Government has articulated regarding the need to increase the abilities and confidence of people to deal with their finances. We greatly welcome the early and sustained leadership they have shown in this increasingly important area of work.

1.2 The Financial Capability Action Plan, jointly published by the FSA and Treasury in July 2008, complements the clear vision set out in the FSA's original National Strategy for Financial Capability, and the description of the challenges provided by the FSA's 2006 "Baseline Survey". The national financial capability agenda has undoubtedly been driven forward by it being clearly established as one of the FSA's core areas of work. The 2008 strategic initiative simultaneously announced the roll out of pathfinders into Money Guidance, following the findings of the Thoresen review. These will be a substantial and welcome complement to financial education work already being undertaken by Citizens Advice Bureaux and their partners in the North East and North West of England.

1.3 The involvement of both public, private and voluntary sector organisations on the Steering Group of the FSA's work on financial capability is essential. David Harker, Chief Executive of Citizens Advice is a member of this group and has found this interaction beneficial in producing concerted tripartite engagement in developing and delivering a coherent strategy and action. We also welcome the FSA practice of seconding staff to organisations like ourselves to help develop financial education capacity. We want to continue to play a full role in this important public, private and voluntary sector partnership.

1.4 The FSA Baseline Survey, published in March 2006, remains a valuable tool in measuring the need for improved financial capability in the UK. It is a comprehensive study which will be useful for comparative studies to measure the long term impact of the work of the FSA and other agencies in financial education.

1.5 The work of the FSA at the outset has understandably targeted groups which are relatively easy to reach, such as children of school age, those in workplaces, and new families. This work is vital in ensuring that financial education is mainstream and something which touches all consumers. The work of Citizens Advice Bureaux when carrying out financial capability also has an element of this, but as a priority also seeks to reach low income adult groups. This is a more challenging audience to reach; it often requires additional resources and repeated intervention attempts. The FSA has helped promote work in this area though its challenge fund, and initiatives such as the NEET Young Adults programme, But we would welcome increased emphasis and support from the FSA to reach more socially excluded groups of consumers, such as those not in employment, those on long term benefits and those with English not as their first language.

1.6 The three year programme of the FSA in targeting NEET Young Adults is something which we particularly welcome. Citizens Advice and Fairbridge piloted and produced the training materials for this work, and local bureaux are assisting in their delivery to frontline workers. This imaginative work reaches a socially excluded group and is a positive example of partnership working. Partnerships with third sector organisations such as Fairbridge and the private sector (A4e) have demonstrated the value of collaboration in boosting the priority given to financial education.

1.7 Independent evaluation of the impact of financial capability is crucial for gauging the results that sessions and materials are having. Such evaluations of our own work have provided evidence of clients being better able to budget and handle their borrowing, and generally feeling more confident in handling their finances. The FSA Baseline Survey is welcome and groundbreaking longitudinal work, but by its very nature the results will only become clear following repeat surveys over the following five to 20 years. There is currently limited monitoring carried out after initial end of session evaluations. We consider there is a need for additional evaluation of the medium term impact of financial capability work in communities to be developed and shared amongst the various financial capability deliverers. Citizens Advice welcomes the recent establishment of the FSA evaluation unit, and hopes it will help provide leadership in filling this perceived gap. If successful, such evaluations could provide the evidence needed to convince local authorities—which at present provide only relatively limited funding to financial education initiatives—that there are genuine local social and economic benefits to be gained from this work.

1.8 Citizens Advice recognises the importance of the FSA in committing resources to its regulatory role, particularly in the present circumstances. But we are concerned that immediate demands should not crowd out the FSA's commitment, and resources dedicated, to the objective of improving the financial capability of consumers. After all, better informed consumers are less likely to build up the levels of unmanageable debt that underlie many of the present problems in the financial sector.

Work of Citizens Advice in Financial Capability

2.1 Citizens Advice believes that financial capability is about giving people the ability to budget, borrow and save with confidence. This proactive work is important as bureaux try to stem the tide of "debt emergency" cases which continue to grow.

2.2 Citizens Advice's vision is for every bureaux to be engaged in financial education work in some way by 2011. At present, over 180 bureaux carry out some kind of financial capability training in their area, this represents a doubling between 2006–07 and 2007–08. Citizens Advice has made significant progress in this area through the Financial Skills for Life programme. This began in 2002–03 thanks to substantial and exceptional long term funding from Prudential plc. This funding was renewed for a further three years in October 2008, making a total of nine years dedicated support.

2.3 This funding has been augmented by projects funded by others, including the FSA and a range of government departments. But most of our central financial education funding comes from substantial assistance from the financial sector. As well as the charitable foundations of Abbey, Bank of America, Friends Provident and Citibank, Barclaycard and Nationwide Building Society are particularly substantial supporters. The Horizons programme partnership with Barclaycard and two other charities works with lone parents on money management and debt issues. Horizons, has reached well over 100,000 people in the last three years. Now in its fourth year, with significantly enhanced funding for a further three years, we plan to reach over 400,000 people by the end of 2010. More recently, in October 2008, we announced a three year, £3 million partnership with Nationwide Building Society to recruit and train1, 300 financial capability volunteers to bureaux throughout the UK. This will significantly enhance the ability of bureaux to engage in this area.

2.4 Whilst we aim to develop the capacity of bureaux to deliver financial capability work, we are keen to do so with other local delivery partners, such as housing associations, credit unions, and those working with a range groups from youths to the elderly groups. Supported by the Bank of America Foundation, we have successfully launched 14 regional financial capability forums throughout England and Wales which are enabling local interests to identify and try and meet particular financial capability needs in their areas. These forums have already attracted over 500 organisations in their first year. We therefore welcome the recent FSA initiative to build their regional presence, and their involvement in the forums' work.

December 2008

Memorandum from the Chartered Insurance Institute

Summary

— The Chartered Insurance Institute is supportive of the FSA's work on the Retail Distribution Review. The recent Feedback Statement echoes many of the ideas around professionalism championed by the CII.

— Principle-based regulation should continue at the centre of the FSA's work and we welcome Lord Turner's focus on the outcomes within the framework of a principles based regime.

— The recent economic downturn has highlighted the importance of financial capability and we are a strong proponent of the FSA's work in this area. However we would like to know how the FSA is going to promote the Money Guidance service to the public and how they will ensure it will be a person's first port of call and not a last resort?

EVIDENCE

1. *About the CII Group*

1.1 The CII Group is the world's largest professional body for insurance and financial services and one of the UK's largest awarding bodies. We offer qualifications to those working in insurance and financial services, many of which are accredited within the national qualification frameworks. Our qualifications range from Certificate (Level 3) to Advanced Diploma (Level 6). With over 93,000 members in 150 countries, we are committed to maintaining the highest standards of technical expertise and ethical conduct in the profession. The Personal Finance Society is part of the CII Group and has nearly 25,000 members—many are IFAs as well as non-independent advisers and will be affected by the RDR proposals.

1.2 We would like to comment on three of the five topics you requested evidence on.

2. *Retail Distribution Review (RDR)*

2.1 The Chartered Insurance Institute (CII) has been supportive of the FSA's work on the Retail Distribution Review (RDR), not just in terms of developing ideas to enhance professionalism as part of the FSA's Professionalism working group in the lead up to the November publication of the FSA's RDR Feedback Statement; but also in practical terms by developing the capacity needed to ensure the RDR can be implemented both in terms of delivering capacity for qualifications as well as other support mechanisms for the wider professional standards proposals.

2.2 The CII Group believes that the recommendations on raising standards of professionalism laid out in the FSA's Final Feedback Statement will help to deliver the desired step change in professional standards within financial services and should be welcomed by the industry.

2.3 Much within the Feedback Statement echoes the ideas championed by the CII Group in its initial response to the FSA and, subsequently, by the principles agreed with the leading professional bodies and outlined in the Edinburgh Declaration of April 2008—in particular, the establishment of an Independent Professional Standards Board.

2.4 The CII is particularly encouraged that the FSA has recognised the "significant steps" that have already been taken by the industry with regard to professionalism.

2.5 Our President Trevor Matthews, said, on the launch of the FSA's Feedback Statement that "The biggest challenge for the long term future of this industry is to restore trust in financial services which has been dented for too long. RDR gives all of us the opportunity to move to higher levels of competence and professionalism and to kick-start that process."

2.6 The CII Group firmly supports the proposals to raise the minimum qualifications benchmark to Ofqual/QCA Level 4 (broadly first year graduate level) for all those giving investment advice. We also acknowledge the desire of many representing consumer interests, notably the Financial Services Consumer Panel, to raise this still further to meet consumer expectations for graduate level qualifications similar to other professions giving advice. We are pleased that those advisers who are already qualified at this level, or are working towards it, will be fully recognised in the post-RDR world. The CII's Diploma in Financial Planning is already in place and relevant for Level 4 qualification and approved by Ofqual.

2.7 The CII also welcomes the proposal for the establishment of the Independent Professional Standards Board to oversee the development of professional standards, ensure they are properly monitored and in time raised to meet consumer requirements, and act as a guardian of the public interest.

2.8 Our recent membership surveys, conducted by Ernst & Young in October 2008, have shown strong practitioner support for the sort of measures which were outlined in the FSA's Final Feedback statement (see appendix 1 for details).

2.9 As the body representing 25,000 financial advisers we support proposals which will enhance professionalism and help members be seen as true professionals by their customers.

2.10 This year we have seen a huge increase in candidates enrolling for the Diploma in Financial Planning and we anticipate that the number will grow in 2009. Many of our members are well on the way to raising levels of qualifications and are committed to the wider challenge of developing their professional standards as part of improving their services to customers. Others will need help and support to get there but we are pledged to help them through a range of support services and materials to make the transition easier.

2.11 We believe the professionalism proposals, whilst requiring considerable effort from many of our members, should raise standards and thereby increase the value of financial advice from the public's perspective. That is the prize for the truly professional adviser. But the major prize is the regaining of the public's trust and confidence in the retail financial services sector and the fact the feel more confident about accessing advice at all levels.

Questions for the FSA

How important does the FSA see the professionalism proposals as a way to regain the trust and confidence of the public in this advice sector?

To what extent does the FSA see the idea of an Independent Professional Standard Board (ISPB) as a way of giving a stronger consumer voice in standards of financial advice?

Is the FSA deadline of 2012 realistic and achievable? What are the major roadblocks to achieving this transition?

3.0 More Principles-Based Regulation

3.1 We believe that while the have been concerns raised about the relevance of the principles based approach in the context of all that has taken place we would strongly support its continuation at the heart of the FSA's work. We would caution about the danger of confusing the desire for better regulation with over prescriptive and a rush to more rules-based regulation. The new Chairman of the FSA was right to highlight the importance of focusing on outcomes within the framework of a principles based regime.

4.0 Financial Capability

4.1 The CII is a strong proponent of the Government and FSA's efforts to build financial capability. We believe these are essential not just to improve public access to financial services but to restore much needed confidence in this sector.

4.2 Given this long-standing interest, we have this year published two major research projects:

— CII "Financial Capability—the Public's Perspective in the current economic climate" (July 2008).

— CII/Reform –"Money's Too Tight to Mention—will the IPOD generation ever trust financial services?" (October 2008).

4.3 These explored consumer financial capability issues in the light of global economic downturn this year. Both have highlighted that the delivery of a multi-faceted financial capability project, including a national money guidance service, is absolutely critical (see Appendix 2 for details).

Questions for the FSA

Central to the success of the Money Guidance pathfinder in the Northeast and Northwest next year, and likelihood of a national rollout, is the public's understanding of what Money Guidance is and is not. What steps is the FSA taking to communicate this to the broader public as part of the pathfinder? What percentage of the total Money Guidance Pathfinder budget has been allocated towards marketing?

Is there a danger—particularly in the current climate—that the objective of Money Guidance to be a first port of call for financial guidance is overshadowed by the demands of customers using Money Guidance more of a last port of call ie a "999" service?

A key finding of our IPOD research project (CII/Reform—"Money's Too Tight to Mention—will the IPOD generation ever trust financial services?" October 2008) is that the financial services industry has not sufficiently responded to the needs of adults aged 18–34. What plans does the FSA have, if any, to encourage the industry to better respond to the needs of this group?

APPENDIX 1

RESULTS OF CII/PFS MEMBER SURVEY ON RDR PROPOSALS CONDUCTED ON HALF OF CII BY ERNST&YOUNG (OCTOBER 2008)

Summary

— A representative survey of over 860 CII/PFS members revealed an overwhelming support for increased professional standards advocated by the CII and other bodies in response to the RDR.

— There was a near consensus (95%) supporting a single set of professional standards across the bodies, and four-fifths (81%) support an independent standards board having disciplinary powers. A similar proportion supported a single independent professional standards board sitting above the professional bodies.

— An overwhelming majority (91%) supported the idea of a standardised qualification framework to tackle the "alphabet soup" of qualifications.

- Yet again, four-fifths (80%) support mandatory professional body membership, and two-thirds (67%) believe that better qualifications mean higher quality of service to clients.
- There is also an overall improved attitude towards the RDR since the last surveys. For example, confidence that it will improve customer perceptions has increased from a fifth one year ago to 42% now.

APPENDIX 2

RESULTS OF THE CII FINANCIAL CAPABILITY RESEARCH PROJECTS

CII "Financial Capability—the Public's Perspective in the Current Economic Climate" (July 2008)

The study involved a poll of over 1,000 consumers to gauge their attitudes and confidence in money matters, especially in the light of the credit crunch.

- The overall majority of consumers (58%) feel less financially secure as a result of the worsening economic climate with over one in three (35%) feeling less secure in their jobs.
- Nearly two-thirds of consumers (65%) stated they would experience difficulty dealing with even modest rises in interest rates. The study shows areas where a national money guidance service could help people deal with the difficulties presented by the current economic downturn.
- Nearly half (45%) of consumers said they would use the proposed "Money Guidance" generic advice system.
- Almost two out of three consumers (61%) lack confidence in the Government's oversight of the banking system.
- Over half (53%) are less confident that their savings are safer than 12 months ago.
- Consumer confidence generally has been eroded over the past year with 58% believing they are less secure financially.
- One in 10 homeowners are worried their home might be repossessed.
- The Citizens Advice Bureau (CAB) is the most relied upon source of financial advice ahead of family and friends.

CII/Reform—"Money's Too Tight to Mention—will the IPOD Generation ever trust Financial Services?" (October 2008)

The CII in association with the think tank Reform have conducted a major project analysing the financial habits of adults aged 18–34, a group coined by Reform in a previous report as "Generation IPOD" (Insecure, Pressurised, Over-taxed and Debt-ridden). Work involved two focus groups plus two surveys totalling over 2,100 IPODs and other adults (conducted by Populus Research).

- Over half of IPODs have debts excluding mortgages of up to £10,000 and a fifth has debts of over £10,000. The mean debt among 18–34 year olds is close to £6,000.
- Nearly a third of IPODs have no savings. Sixty per cent have either no savings or less than £1,000.
- A third of IPODs think that financial advisers are out of touch with younger generations. Half rely on friends and family as their main source of financial advice. Sixty per cent of IPODs cite trust as the key driver of this decision; clarity of explanation is another important factor.
- IPODs have a strong sense of personal responsibility when managing their money.Seventy per cent feel that they should take most, if not all of the responsibility. Thirty-nine per cent of IPODs produce a household budget at least once a month (10% more than over 35s) and 73% check their bank balance at least once a week.
- A lack of clear information is the most common obstacle cited by IPODs as impeding them in making financial decisions. All this points to the need for an information revolution within retail financial services.
- When seeking advice, IPODs instinctively turn to friends and family and are much more likely to do so than other adults. On average, less than 8% of IPODs would consider using an IFA.
- A third of IPODs view IFAs as being out of touch with young. This view is not shared by the over-35s. Only 10–12% of IPODs view IFAs as good value for money.
- The growing regulatory burden since the 1980s has pushed up the cost of providing financial advice exponentially, and has priced the IPOD generation out of the market.

4 December 2008

Memorandum from Shelter

Summary

1. We welcome the Committee's decision to examine the work of the Financial Services Authority and the opportunity to contribute to its inquiry. Our submission focuses on regulation of mortgage lending.

2. Mortgage lending has only been regulated by the FSA since 2004; Shelter believes that this relatively new system of regulation and scrutiny still has some room for improvement.

3. The Mortgage Conduct of Business (MCOB) offers some degree of protection to consumers but the regulations are not very well enforced, nor do they go far enough.

4. The FSA is not a very transparent or consumer-focused organisation. We would welcome more external clarity on enforcement actions and the protections available to consumers.

Monitoring and Enforcement

5. Shelter believes that there are flaws in the way that mortgage regulations are monitored and enforced, and we have particular concerns about the effectiveness of the regulatory regime within the sub-prime sector.

6. The FSA's own investigations, backed up by Shelter's experience in our advice centres, have shown significant gaps in arrears management practice.[16] This is particularly the case among intermediaries in the sub-prime sector, who are not always thorough and responsible in their sales and marketing when it comes to checking that products are affordable and/or suitable for customers.

7. Among this group, the FSA found that in one third of cases investigated there had been no adequate assessment of affordability. In one-half of the cases surveyed, no adequate assessment of the suitability of the product for the customer's needs had been carried out. None of the lenders surveyed had covered all responsible lending considerations in their policies.

8. In August 2008 the FSA completed a review of 18 lending firms' responsible lending policies and 250 firms' mortgage advice. Both areas were found to have serious weaknesses.

9. The usual result of an enforcement action is a fine and an agreement sought that the company will review its business practices, or in some cases the company will agree not to continue the practice any more. However, fines are often neglible when compared to the company turnover. Shelter does not believe that the penalties for misconduct are stringent enough.

10. We recognise that the FSA has been able to identify some of the problems with enforcement, but we are concerned that they have been apparently unable to improve the situation. If this is due to lack of resource then this is something that the Treasury should address urgently.

The Mortgage Conduct of Business (MCOB)

11. The problem of weak enforcement of regulations is compounded by weaknesses in the regulatory framework itself. The FSA's approach to regulation is "principles based", giving firms a flexible, rather than prescriptive remit.

12. Much of the language used in MCOB is vague and open to interpretation. Terms such as "fairly" and "reasonably" are frequently used without clear definition. This gives lenders the ability to define those words in a way that suits them. Shelter believes that the FSA should revise the language and make it more prescriptive.

13. Shelter is awaiting the results of the FSA review of arrears management. The review does not have a fixed timetable but has now been ongoing for some time. We urge the FSA to outline a clear and expedient timetable for the conclusion of the review.

14. MCOB allows for self-certification of income "where appropriate" and says that lenders should find "no reasonable grounds for doubting the information provided". The review should look at how lenders interpret this in practice and definitions of "appropriate", as lenders currently have quite a lot of leeway on this.

15. The rules could also be clearer on defining ability to repay. At the moment, the FSA "would expect" lenders to take certain factors into account (such as the impact of coming off an introductory or short term rate, or the ability to repay from sources other than income). This could be strengthened: irregularity of income, impact of retirement and other long-term issues should also be considerations.

16. Some lenders impose unreasonable default charges on their customers, which just add more and more debt and are particularly unfair if a repayment plan has been negotiated. For example, some will charge fees for every letter or call regarding arrears. Shelter believes that MCOB should explicitly state that it is unreasonable to continue to add default charges when the borrower has agreed a new repayment plan with the lender and is keeping up with this.

[16] FSA, Thematic review, 2007, www.fsa.gov.uk/pages/About/What/thematic/subprime/index.shtml

Lack of Transparency and Consumer Focus

17. The fact that MCOB does not require lenders to publish their arrears policies makes it difficult to challenge them in possession cases. The FSA should require lenders to publish their policies.

18. There should also be greater transparency about the enforcement process, which often happens behind closed doors. It would give consumers and stakeholders more confidence to know more about enforcement action when it is taken.

19. The FSA should be reformed so that it has a more consumer-focused approach. For example, the FSA Board is mainly comprised of industry representatives, and could include more consumer spokespeople.

20. As mentioned earlier, there has been very little external clarity or stakeholder engagement around the current review of arrears management.

21. The dual system whereby second charge and buy-to-let loans are regulated by the OFT causes confusion for consumers, for whom there is very little clarity about what protection is available. This would be improved if the FSA were responsible for regulating all loans secured against residential property.

December 2008

Memorandum from Unite

Executive Summary

1. This response is submitted by Unite the Union. Unite is the UK's largest trade union with two million members across the private and public sectors. The union's members work in a range of industries including financial services, manufacturing, print, media, construction, transport, local government, education, health and not for profit sectors.

2. Unite, as the largest trade union in the finance sector, should be recognised as a key stakeholder in the financial services industry and overhaul of the regulatory structures should include trade union involvement in order to enhance the accountability of finance institutions.

3. There should be trade union representation on the boards of all key agencies involved in the regulatory system. The trade unions are ideally placed to provide a "checks and balances" overview on behalf of employees who have many valuable insights into the industry.

4. There should be some form of independent external oversight process to assess, prior to appointment, the probity and competence of senior executives and directors to run the large financial institutions which the Government owns or part owns.

5. All relevant organisations in the sector should be required to have robust and properly resourced risk management structures.

6. There needs to be a forum to allow examination of the inter-relationship between regulation and employment practices and the impact for staff and customer service.

7. Unite calls for a more "holistic" approach, recognising that remuneration systems, and many other employment practices, do not work in isolation.

8. What steps are the FSA now taking to follow up on its earlier conclusions concerning the positive role of trade unions in promoting financial capability?

9. The FSA's own "employee engagement" should include collective representation through an independent trade union (it is currently through an in-house Staff Consultative Committee).

Introduction

10. Unite represents some 180,000 workers across the finance sector. The union represents staff in all grades and all occupations, not only in the major English and Scottish banks, but also in investment banks, the Bank of England, insurance companies, building societies, finance houses and business services companies.

11. Unite welcomes the opportunity to present written evidence to the Treasury Committee on the work of the Financial Services Authority (FSA). The union has made a number of submissions to the FSA concerning its work (including Retail Distribution Review and Treating Customers Fairly) and these are reflected in this response.

Better Regulation—A Trade Union Role

12. In October 2008 Unite launched its "Social Contract for Financial Services". One of the key points contained in the contract is "recognition of Unite as a key stakeholder in the future of the financial services industry and overhaul of the regulatory structures of the financial services sector to include trade union involvement in order to enhance the accountability of finance institutions".

13. Unite has a wealth of experience in representing and campaigning for its members in the finance sector dealing with the key challenges the sector has faced including mergers, takeovers, off-shoring, outsourcing, restructuring, pension changes and changes to pay systems.

14. There needs to be tighter regulation of the market and strengthening of the framework which regulates the finance industry together with increased powers to hold to account, including criminal proceedings, those who contribute to failings on a massive scale.

15. The internal audit division of the FSA identified a number of systemic failings in the supervision of Northern Rock, in particular the failure of the FSA supervisory team to deal sufficiently rigorously with Northern Rock's management in questioning the vulnerability of the bank's business model.

16. Unite believes this was not an isolated incident but a systematic failure of the procedures and practices of the supervisory systems within the FSA. It is evident from the current financial situation that the FSA has failed as a regulator. It is necessary to consider in the regulatory overhaul to make the FSA a publicly accountable and independent regulatory body to include trade union representation as well as independent and academic experts.

17. Unite wants to see trade union representation on the boards of all key agencies involved in the regulatory system. It is essential that the employee voice is heard among those with only the interests of shareholders in mind. The trade unions are ideally placed to provide a "checks and balances" overview on behalf of employees who have many valuable insights into the industry.

18. In addition, Unite would like to see some form of independent external oversight process to assess, prior to appointment, the probity and competence of senior executives and directors to run the large financial institutions which the taxpayer, through the Government, owns or part owns, on account of the significant impact these institutions can have on the economy at large.

19. All relevant organisations in the sector should also be required to have robust and properly resourced risk management structures, which would have dual reporting lines direct to the chief executive and the regulator. Risk management should be treated as a core activity for a financial institution.

Regulation and Employment Practices

20. Unite would also like to take this opportunity to raise the issue of finance industry regulation and employment practices. Unite understands that employment relations is not within the remit of the Financial Services Authority. However, the union has experienced occasions when the strict demarcation between the two has created a vacuum whereby it is very difficult to pursue issues or identify accountability. Employers justify practices on the basis that the regulator requires them and the regulator does not get involved in employment relations issues.

21. The Financial Services Authority already has "practitioner" and "consumer" panels. There needs to be a forum to allow examination of the inter-relationship between regulation and employment practices and the impact for staff and customer service.

22. This is a point we have raised on a number of occasions in various exchanges with the FSA, the Treasury, the Bank of England and the Treasury Select Committee.

Remuneration Systems and Treating Customers Fairly

23. An example of where employment practices can impact on customer service is remuneration systems.

24. The incentivisation and target driven culture associated with commission based selling and synonymous with the finance sector has faced much criticism from both trade unions and consumers groups.

25. This type of selling can increase stress, lower morale and prevent positive employee engagement. Consumer groups believe that it increases the risks of mis-selling by employees in a drive to meet often unrealistic and unattainable targets; none of which does anything for consumer confidence or a motivated and productive workforce.

26. Unite welcomes that the FSA's recent Feedback Statement on the Retail Distribution Review gives a high priority to the need to "reduce the conflicts of interest inherent in remuneration practices". The union is keen to see further detail in how this is to be taken forward.

27. In earlier dialogues with the FSA, Unite's predecessor unions have called for the need to consider a more "holistic" approach, recognising that remuneration systems (and many other employment practices) do not work in isolation. Such an approach is necessary to provide both a response on how the industry could better serve its customers but also to deliver fairness in its treatment of employees.

28. The FSA conducted its own work on remuneration and in relation to "Treating Customers Fairly" published a "cluster report" in 2005 which stated that "all remuneration structures will impact on staff behaviours and it is important to recognise the risks associated with particular incentives and control for them."

29. The "cluster" report also concluded that TCF may be relevant for all factors that can incentivise staff, including target setting, promotion, salary increments and disciplinary issues.

Financial Capability

30. The FSA's National Strategy for Financial Capability identified the workplace as one of the priority areas to deliver a step change in financial capability in the UK.

31. A report by the FSA's Financial Capability Workplace Working Group found that trade unions have an important role to play in improving people's financial capability and that the potential for trade unions to promote financial capability in the workplace should be explored further[17].

32. What steps are the FSA now taking to follow up on these conclusions and how are trade unions being involved in the process, including its Money Guidance Pathfinder?

Employee Involvement

33. Finally, as part of the Committee's inquiry relates to the FSA's Annual Report, Unite would take this opportunity to make a point in respect of the section in the FSA's Annual Report headed "employee engagement". The FSA reports that it has a Staff Consultative Committee which is the forum through which it complies with the EU Information and Consultation Directive 2004. However, the SCC is not an independent registered trade union and Unite hold the view that employee involvement needs to include collective and independent representation and would be happy to discuss this further with the FSA.

December 2008

Memorandum from the Association of British Insurers (ABI)

The Association of British Insurers (ABI) is the voice of the insurance and investment industry. Its members constitute over 90% of the insurance market in the UK and 20% across the EU. They control assets equivalent to a quarter of the UK's capital. They are the risk managers of the UK's economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings, and investment matters.

Executive Summary

Principles based regulation

— Compared to the banking sector the UK insurance industry is relatively well placed to face the current financial crisis.

— Principles-based regulation must remain at the heart of FSA policy-making, supported by a spine of rules, where appropriate.

— The FSA should focus on smarter regulation, not more regulation, shifting emphasis and resources from policy-making towards ensuring effective supervision.

Treating customers fairly

— TCF has been good for the insurance industry, as it has enhanced the focus on the customer experience rather than business processes.

— The industry recognises that the accelerated integration of TCF assessments into the ARROW supervision process is not a downgrading of the initiative. This will necessitate further learning for the industry and the FSA.

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[17] Make the Most of Your Money: a report on the FSA Financial Capability Workplace Working Group educational pilot activities (FSA 2006)

RDR

- The ABI believes the RDR's core proposals will help improve consumer confidence and build profitable and sustainable businesses.
- We are pleased that the FSA has set out an "Adviser Charging" model that will set remuneration independently of the product provider.
- We welcome the proposals on professionalism but there is an urgent need to define the curriculum for QCA Level 4 so that it covers all the necessary areas.
- It is essential that the RDR increase access to advice.

Financial capability

- The industry has been engaged with the FSA's work on improving financial capability from its inception.

Principles Based Regulation

1. Compared to the banking sector the UK insurance industry is relatively well placed to face the current financial crisis. The prudential regime for insurers has proved to be effective and wholesale change to the regulatory regime for insurance companies is unnecessary, would be disruptive and would risk raising unfounded concerns. The FSA must avoid knee-jerk regulatory responses during this crisis. Any wider changes to the regulatory system stemming from this crisis should encourage and reward sound practices that promote a strong financial services industry.

2. Lord Turner made clear in his interview with the *Financial Times* on 17 October that it is outcomes that matter; and positive outcomes for consumers and markets cannot be delivered by rule driven regulation alone. Principles-based regulation must remain at the heart of FSA policy-making, supported by a spine of rules, where appropriate.

3. The ABI supports outcome-based regulation. It offers firms greater flexibility to achieve the right outcomes for their customers, and allows the FSA to adapt more quickly to dynamically changing markets. But regulation must be implemented effectively. The FSA should focus on smarter regulation, not more regulation, shifting emphasis and resources away from policy-making towards ensuring effective supervision. Its supervisory processes should be future-proofed enabling a flexible response to changing risks. The FSA should also place greater emphasis on prudential regulation, rather than on conduct of business regulation. Ultimately, the most important outcome for consumers is that their claims are paid and firms can only do this if they have adequate capital.

4. The FSA should ensure that the use of consultation and robust cost benefit analysis is firmly embedded in its regulatory culture—ultimately it is customers who pay the costs of regulation. The Government should also extend the concept of regulatory budgets to financial services regulation to reduce the regulatory burden. The FSA's assessment of the impact of regulation is too narrow. It should take account of broader public policy goals, such as the need to promote a savings culture. At present, the COBS regime is more prescriptive for savings products than for debt.

5. The role of the FOS is also vital. Uncertainty regarding the FOS's approach must not encourage a culture of over-compliance that undermines the shift towards principles. As recommended by Lord Hunt, the FSA and the FOS must strive to achieve regulatory alignment. Otherwise, the industry's ability to embrace new initiatives will be hampered and consumers will get less choice.

6. The EU is an important originator of financial services regulations; approximately 70% of UK financial services regulations have EU origins. The FSA should enhance its strategic focus on the competitiveness of the UK, seeking to ensure that EU initiatives are principles-based and do not put UK firms at a competitive disadvantage to their European peers.

Treating Customers Fairly

7. Treating Customers Fairly (TCF) is a pertinent example of outcome-based regulation in action, given the December 2008 "embedding deadline".

8. TCF has been good for the insurance industry, as it has enhanced the focus on customer experience rather than business processes. However, it has meant a significant cultural shift both for firms, and for the FSA and the way it supervises. Both parties have had to go through a learning process, as this way of working was unchartered territory. Firms have considered their businesses in a new way, using outcomes rather than detailed rules, to ensure they are treating customers fairly. They have then produced the evidence to demonstrate this. The FSA has had to enable its supervisory staff to take more judgements on firm activity rather than relying on a "tick box" approach based on the rulebook.

9. While ensuring delivery of TCF will be an on-going process, the experience of embedding this, shows that outcome-based regulation can improve the customer experience. Firms have for example changed documentation to make it clearer for customers, incorporated "fairness" into staff objectives and enhanced mechanisms for feeding customer feedback into product development processes. TCF therefore provides valuable learning, which should be built on to ensure outcome-based regulation is successful.

10. The industry recognises that the acceleration of the integration of TCF assessments into the ARROW supervision process is not a downgrading of the initiative. Earlier integration into ARROW is consistent with the FSA expectation of firms that TCF becomes "business as usual". It also accords with an emphasis on smarter regulation as it focuses on effective supervision, through a risk-based approach, using the FSA's existing supervisory infrastructure.

11. Full integration into ARROW will represent further learning for the industry and the FSA. The ABI welcomes the FSA's assurances that assessments will be made robust through internal challenge processes and enhanced supervisor training. The FSA must ensure this happens so that the industry, and consumers, can have confidence in FSA supervision of TCF.

RDR

12. The Retail Distribution Review is a major opportunity to reform the distribution of retail investment products for the benefit of its customers. The ABI believes its core proposals (reforming adviser remuneration structures, improving and increasing consumer access to information and advice, and raising the minimum level of qualifications required to practise), will help improve consumer confidence and build profitable and sustainable businesses.

Remuneration

13. On reforms to remuneration, we are seeking a model that will reduce actual and perceived bias in the system. This will play a key role in helping to align the interests of providers, financial advisers and customers, and in improving public trust and confidence. The ABI proposed a model where remuneration is set independently of the product provider, and we are pleased that the FSA has set out an "Adviser Charging" model that achieves this. However, such a radical change to a new Adviser Charging model of the whole market will need significant investment of resources from both financial advisers and product providers. It will need more flexible systems that allow different charges for advice to be applied, and new disclosure to inform consumers of the consequences of their actions. The ABI believes the FSA's commitment to, and regulatory support for the new system will be critical in facilitating the necessary investment by providers and advisers.

Consumer Access

14. With regard to improving consumer access to retail financial services, we are pleased the FSA has recognised that regulation needs to support the development of new channels. We believe that increasing access to financial advice is an essential aim of the RDR, and if it were the case that only IFAs were able to carry out a fact find and make a recommendation, this would significantly reduce advice capacity to the detriment of consumers.

15. The ABI believes it is important that the new market caters to all consumers and that reform benefits not only existing market participants but also those currently not engaged in financial services. Alongside "execution-only", we see independent advice and a series of other advice services or operating models. Each model offers consumers a distinct choice, whether they are looking for an adviser selecting products from across the market, branded products from a single provider or a simpler process with a limited range of products.

16. It will however be vital to research the new service labels with consumers, and the ABI is pleased that the FSA has committed to carry out research on this. We also believe research will need to address and help clarify the definition of the different types of roles, and the way advisers communicate and manage the expectations of their roles to the consumer, including disclosure on charges and where they fall.

17. Findings from joint ABI/BBA research, which tested prototypes of a new distribution channel on over 200 consumers, showed that consumers do not make a clear distinction between advice, information and guidance, and do not think they are mutually exclusive terms. The research also however showed that consumer impressions of the process were positive, believing it can help them identify and meet their financial needs.

Professionalism

18. The FSA has committed to raise the minimum qualification for financial advisers to operate to QCA Level 4 (equivalent to the first year of a degree), to the establishment and enforcement of common ethical and behavioural standards, and to support this by implementing a common framework for professional standards to govern standards of practice, through the establishment of a Professional Standards Board. The ABI supports these proposals, however there are some immediate pressing concerns:

— With a deadline of 31 December 2012 for all advisers to be qualified to the new minimum standards, there is now an urgent need to define the curriculum for QCA Level 4 so that it covers all the necessary ground required for advisers to carry out their particular function to a high standard of competence, and meet the needs of industry and consumers.

— The Professional Standards Board (PSB) must also ensure that the roles of the FSA, FOS, PSB, Financial Services Skills Council and professional bodies are clearly demarcated both to industry and consumers. This will be critical to ensure a seamless and helpful regulatory "package", which serves industry and consumer efficiently and cost-effectively.

Financial Capability

19. The insurance industry is committed to making consumers more financially capable, and to improving their financial decision-making so they are properly protecting their families and possessions and providing for their futures. We believe that this will bring benefits to consumers, the industry and wider society.

20. The industry is committed to taking preventative action to avoid people finding themselves in financial difficulty rather than taking action after the event. We have been engaged with the FSA's work on improving financial capability from its inception, and we have been working with the FSA on the Money Guidance Pathfinder that is due to begin early in 2009. ABI members fund this work through their contribution to the FSA levy.

21. Individual brands also produce their own material for customers to improve their understanding of the services and products on offer eg information sheets on products, explanations of technical terms as well as specific resources like tools to help customers assess their financial situation and decide what action to take.

22. The ABI produces leaflets for customers explaining products and why they might be beneficial. Recent examples include a guide for small businesses on insurance products relevant for their sector and a guide explaining the differences between protection products eg critical illness, income protection and payment protection insurance. We also produce guides for specific customer groups eg homeowners whose homes have flooded and customers who come from areas with high prevalence of HIV.

23. The industry is also aware that it needs to improve its communication to customers. Under the ABI's Customer Impact Scheme, good practice guides are produced for firms on areas such as language and format of documentation so we communicate key information to customers in a way they can understand. We are also researching the feasibility of developing a standard way of depicting investment risk to customers when they buy an investment product eg through use of graphics.

December 2008

Memorandum from the Association of Independent Financial Advisers

Introduction

1. The Association of Independent Financial Advisers (AIFA) is the representative body for the IFA profession. There are approximately 16,000 adviser firms that employ 128,000 people, and turnover is estimated at £6.5 billion (including £4.5 billion from life policies, £1 billion from fund management and £1 billion from mortgages and general insurance). Around 45% of the UK population use an IFA.

2. AIFA represent over 85% of all IFAs, who, in turn account for around 70% of all financial services transactions in the UK. As such, IFAs represent a leading force in the maintenance of a competitive and dynamic retail financial services market. AIFA's role is to help deliver a better business environment for members, through working with policy makers and regulators to deliver an improved market. By our work, members are better able to serve their clients.

3. We therefore welcome the opportunity to submit evidence to the Treasury Select Committee on the work of the Financial Services Authority (FSA).

Executive Summary

4. AIFA is happy to welcome and acknowledge the many positive proposals contained in the Retail Distribution Review (RDR). These include:

- 5. Adviser charging as replacement for indemnity commission. This is a move to a more transparent charging structure, which we have supported all along. The removal of the provider from the remuneration process should now eliminate any perceived bias that exists, and improve the reputation of the profession. However, we must ensure all firms operate the same disclosure policies, as we are worried consumers may be misled that tied advice, from say a bank, is free or available at a cost below the actual economic value.
- 6. The broad concept of professionalism. AIFA has long pushed for the development of the profession and we strongly support the positive message it sends to consumers.

7. However we are concerned about the rationale and driving forces behind certain aspects of the Review. Specifically:

- 8. We feel that FSA has repeated many of the same mistakes it made with the Treating Customers Fairly (TCF) programme, including the failure to conduct a market failure analysis, impact analysis or detailed cost benefit analysis before undertaking the programme. Other failings of TCF which are reflected in the RDR process include unclear objective setting and lack of specific definition of purpose.
- 9. Most importantly, at a time when firms are already facing difficulty in a tough financial climate, we fail to understand how a regulator can propose changes which they acknowledge will put firms out of business and reduce consumer access to advice. We especially fail to see the rationale for disproportionately increasing small firm's requirement to hold regulatory capital when the IFA sector poses a minimal risk to the economy in comparison to banks, and other large institutions. A small firm of 20 advisers with £1.6 million costs could be forced to increase its capital from £10,000 to in excess of £300,000. Worse still, this capital cannot be put to any purpose by the firm, must be readily realizable and many firms thus hold the capital in a separate account.
- 10. At a time when money is clearly tight we do not believe millions of pounds spent on establishing a new Professional Standards Board is money well spent. We would like to know the consumer benefit of this Board, and what part consumer groups played in the decision to establish it, as we believe their voices weren't heard.
- 11. We also fail to see the consumer benefit from FSA's proposals for a fudged separation of the role of the advice profession and company sales representatives, which will only create customer confusion. The model is based on a particular interpretation of MiFID which is hampering FSA from fulfilling their duty to consumers.

12. Going forward we believe FSA need to shift their focus and resources onto the major firms who pose the highest amount of risk, and not disproportionately allocate their resources towards small, low risk firms such as IFAs.

The Retail Distribution Review

13. The three areas we would ask the Committee to examine closely are prudential requirements, the Professional Standards Board, and FSA's interpretation of MiFID.

Prudential requirements

14. While we understand the need to review the prudential requirements, in the current economic climate we are at a complete loss as to why and how FSA has decided to disproportionately increase minimum capital requirements when they acknowledge it will "drive some firms out of the industry". For a regulator to knowingly propose changes which will put those firms it regulates out of business is illogical and unacceptable.

15. The requirements will be a heavy burden for IFA businesses and pose a serious risk to firms that are already facing difficulty in a tough financial climate.

- Large firms will be required to triple their capital.
- A small firm of 20 advisers with £1.6 million costs could be forced to increase its capital from £10,000 to in excess of £300,000.

16. There is also a strong chance that "Expenditure Based Requirements" could be counter-productive and penalise good firms who have invested in extensive compliance support. To reduce capital requirements firms will consider ways to reduce their fixed costs, which could encourage advisers to become self-employed. The impact of the requirements could ultimately lead to some firms reconsidering their authorisations with the FSA and actually result in less overall capital in the industry. This is not good for firms, or consumers.

17. Over the last 10 years the IFA community has thrived, with increased levels of professionalism and higher standards of advice. AIFA strongly supports the development of our profession but during this difficult time additional capital requirements for the sector are simply inappropriate. It is not our members who have damaged the economy through under capitalisation. The IFA sector of community is the sector that poses the least threat, a fact acknowledged by Lord Turner himself in an interview with the *Financial Times*:

18. "If you look at what we were charging the biggest banks in the world, and what we were charging some small regional IFA, the differential was nothing like as big as I think it logically should be, just given the scale of their economics and the scale of the threat to the system."

19. AIFA aims to work constructively with the regulator to achieve good outcomes for firms and consumers. However, FSA has not provided any justification for this phenomenal increase in capital and could not have chosen a more damaging time to introduce it. We oppose this proposal and call on FSA to demonstrate the rationale for making this change.

Professional Standards Board

20. We do believe this is the time for better, more focused regulation. We worry that new regulation or new regulators will provide an appearance of action that delivers little by way of consumer benefit. The Board threatens to muddy the regulatory scene and risks creating double jeopardy and double cost. Indeed the cost of this Board is due to run into millions at a time at a time when all firms are under finanacial pressure.

21. We would therefore like to hear FSA clearly explain their process of work regarding its decision to establish the Board, and its long term objectives. There appears to have been a lack of involvement and consultation on the decision, and we are concerned that a group of vested interests were allowed to design the regime.

22. We would especially like to know what role, if any, the consumer industry played in the decision process, considering the Consumer Panel and Smaller Business Practioner Panel only attended one meeting each, and the FSA Practioner Panel did not attend any.

MiFID

23. The FSA said in their feedback statement that the original sales/advice partition put forward in their interim report "may be inconsistent with MiFID". They said that the idea of restricting the term "advice" to those firms that offer independent advice, would, in their view, conflict with the broad concept of "investment advice" that MiFID sets out. Furthermore, FSA stated that if they allowed non-independent advice services to continue but prevented them being described as "advice", some firms would not be able to describe their services accurately.

24. We believe this is an unfortunate interpretation of MiFID as the Directive was not written to prevent consumers from getting a fair deal. A fair deal for consumers would have been the scenario put forward by FSA in its interim report, which set out a clear demarcation of "advice" from "sales". Consumers would have known exactly who was acting in their best interests, and would understand when they were being sold to and when they were being advised. We believe it is important that the consumer understands: I am dealing with someone who is on my side "my agent in the legal sense", or the representative of a company "the agent of another party".

25. We also strongly agree with Which? when it says, "We need to put the 'independent' back into IFA. There has to be a clear distinction between those offering unbiased advice and those simply trying to sell products. It must be made crystal clear to consumers what type of service they are receiving and how they are paying for it."

26. Our extensive research with YouGov proved that this clear distinction between advice and sales was something that consumers wanted, and something that would build their trust in financial services. Seventy-four per cent of the consumers we questioned agreed or strongly agreed that making consumers aware of whether they were being sold a product or advised to buy one was a good idea, with only 5% disagreeing. Sixty-nine per cent of those questioned agreed or strongly agreed that this move would increase the trust they have in Financial Service Institutions (FSIs), while 81% thought knowing whether they were being sold a product or advised to buy one, would build trust.

27. The FSA had the perfect opportunity to rebuild this trust through clearly differentiating advice from sales. However, following the particular interpretation of MiFID we are now left with the confusing middle ground where sales people, who the FSA itself acknowledges are "obliged" to sell a product, can hold themselves out as "advisers". We agree fully with the Financial Services Consumer Panel which shares our belief that the term sales advice is "devoid of meaning". Former Chairman Lord Lipsey has rightly said that consumers will be extremely confused by a sales advice channel and that MiFID was designed for European banks.

Principles Based Regulation

28. AIFA has welcomed FSA's move to more principles based regulation as we believe an outcomes-based approach benefits both consumers and our members. However we feel there is an issue with the role and status of "Guidance" in the FSA handbooks. The interpretation of this guidance can, at times, see different practices and procedures emerge from firms conducting similar business. As a result this makes consistency of supervision a harder challenge for FSA.

29. We also question why there has not been a cost benefit analysis of the £50 million FSA committed to moving towards principles based regulation.

30. The FSA has talked a lot about a regulatory dividend for the industry if it embraced the new principles based regime. AIFA is keen to see what shape this dividend will take and when. The FSA must remember that regulatory change for the industry costs money, and firms need to be recognised for good corporate behaviour and supported, not penalised, by their regulator.

31. To assist in this process, we believe the National Audit Office (NAO) should conduct a review of FSA's existing and future projects of note, for example TCF and RDR. We believe good regulation is accountable regulation, and regular reviews by the NAO will improve FSA efficiency and effectiveness and deliver better consumer outcomes.

December 2008

Memorandum from Public Concern at Work

Introduction

1. Public Concern at Work (PCaW) is the independent authority on public interest whistleblowing. Promoting individual responsibility and organisational accountability are at the heart of the charity's work and PCaW has been instrumental in putting whistleblowing on the good governance agenda. PCaW's approach has been endorsed by the Committee on Standards in Public Life, courts and regulators. PCaW was instrumental in developing the statutory framework for whistleblowing, the Public Interest Disclosure Act 1998 (PIDA), which was widely supported by banks who recognised its value as an early warning system.

2. PCaW was set up in response to a spate of disasters in the 1980s and 1990s including financial disasters such as the collapse of BCCI, Barings' Bank, Enron and Worldcom. What was clear from the inquiries into the above disasters is that staff knew of the risks and were either too scared to speak up or spoke to the wrong people in the wrong way. These scandals resonate within the recent banking crisis. Now is a good time to refresh and renew some of the key messages from the past.

The Value of Whistleblowing

3. The recent banking crisis has confirmed that no company is immune from unknowingly harbouring malpractice. Effective whistleblowing arrangements form an important part of the ability to manage this risk.

4. An unfortunate side-effect of economic downturn and recession can be an increase in financial crime and market abuse. This will often be accompanied by an understandable reluctance on the part of employees to risk their own position by raising a matter where they are doubtful of readily finding employment elsewhere. These two factors mean now more than ever, there is a need for clear, cogent guidance on whistleblowing. The plain message should be that it is safe and accepted for staff to speak up.

5. Commitment to the careful review of whistleblowing arrangements by banks and regulators alike will ensure that staff are encouraged to raise any concern about malpractice and that those responsible will either address the concern or have to say why they failed to do so. Staff will understand that their values count and the firm can demonstrate accountability. In a time of decreasing confidence, this will play a key role in reassuring investors, customers and the wider public.

Promotion of Whistleblowing Guidance to Employees of FSA Regulated Companies

6. Whilst AuditCo carried out a review of the FSA's own whistleblowing policy, the FSA may wish to consider reminding their regulated entities of their existing guidance in *SYSC 18: Guidance on Public Interest Disclosure Act: Whistleblowing* in order that businesses may keep abreast of good practice.

7. Our approach has always been to emphasise the critical importance of good whistleblowing practice to effective management and good corporate governance. To this end, we recently launched BSI Code of Practice *PAS 1998:2008 Whistleblowing Arrangements Code of Practice*, to provide a guide for firms and agencies as to how they may incorporate best practice into their own policies and procedures which is available at www.pcaw.co.uk/bsi. The FSA may wish to take advantage of this guidance and promote the key good practice principles it contains.

8. While many firms have embraced good whistleblowing practice with the leadership the issue requires, there remain those firms who are reluctant to encourage employees to come forward and raise suspected misconduct. We continue to receive calls from employees at FSA-regulated firms who are confused as to how to go about raising their concern, or face difficulty in doing so. What we find particularly disturbing is that some employees continue to face considerable difficulty in raising their concern and have legitimate fears they will be "blacklisted" if they have the tenacity to push for their concern to be addressed.

9. We acknowledge the increased efforts the FSA plans to make to boost its monitoring and regulatory efforts in the City. However, while it is undeniably important that the FSA is able to employ "poachers turned gamekeepers" to provide sufficient expertise to properly scrutinise and regulate practices in the City, ensuring the flow of intelligence from those employees who remain with regulated firms is equally important. Encouraging employees to raise concerns, and letting them know of the confidential support available are key to this objective.

Relevant Concerns for the FSA in Relation to PIDA

10. What is especially worrying is that where employees are raising concerns, there is emerging evidence that firms in the financial services sector are settling ensuing claims under PIDA specifically to avoid scrutiny by the regulator. In a survey of City financial services firms by law firm Osborne Clarke "Whistleblowing—Sword or Shield"[18], 10% of respondent firms said that a business reason relevant to their decision to settle a whistleblowing claim was "Triggering an FSA investigation", with a smaller percentage citing "Concession that there may have been regulatory breaches".

11. The FSA may want to consider how they monitor or gather any information contained in claims made under PIDA that is of relevance to their regulatory or enforcement powers. At present, such claims are immune from scrutiny by any agency, regardless of the seriousness of the underlying concern.

12. We continue to receive calls on our helpline from employees of FSA regulated entities regarding when or how they should speak to the FSA when offered a settlement that they are concerned is an attempt to buy their silence.

13. The FSA may wish to highlight the preclusion of "gagging clauses" under PIDA (s.43J).

14. This provides that any clause or term in an agreement between a worker and his employer is void insofar as it purports to preclude the worker from making a protected disclosure. In particular it should be noted that it covers settlement or compromise agreements.

15. In practical terms, their most significant effect will be in clauses in settlement agreements where the employer seeks to stop the worker from contacting a prescribed regulator under s.43F.[19]

16. The risk to (and in) such gagging clauses is particularly clear where the employer's response to a concern raised internally is to dismiss the whistleblower and to cover-up the malpractice.

17. However employees may either be unaware of this provision or be persuaded that their settlement is at risk should they wish to talk to raise their concern with the FSA. The FSA may want to highlight the invalidity of gagging clauses under PIDA when promoting whistleblowing arrangements as a good governance tool and the circumstances in which an employee is protected when raising concerns with their regulator.

December 2008

Memorandum from Resolution Foundation

1. The Resolution Foundation welcomes the Committee's evidence session on the work of the Financial Services Authority.

Summary

2. The Foundation will work with the Financial Services Authority (FSA) and its consumer panel. In particular, the Foundation is concerned with the FSA's areas of work which have a direct impact on the well-being of low earners. The FSA's work in the area of financial capability, and in particular the pathfinder of the Money Guidance Service, is of specific interest to the Foundation. We believe that this service has the

[18] Osborne Clarke October 2008

[19] Where important issues are at stake and the employer is seeking an injunction to restrain the disclosure of confidential information, it is suggested that the key issue for the court will be the identity of the recipient of the disclosure. This is because under the common law, courts are most unlikely to restrain a worker disclosing confidential information to a regulator or to the police, even where it is unclear the worker is acting in good faith or with reliable evidence (see Note on s.43F, supra). Where the employer fears the worker will make a media disclosure, it will be open to the employer to seek an order or a declaration from the court that such a disclosure was not a protected one within this Act, even assuming the worker met the conditions in s.43G(1) and (2).

potential to address the advice needs of people on below median incomes, a group overlooked by existing advice sources but particularly vulnerable in the current economic climate. This submission therefore focuses on the following key points:

a. Money Guidance can play a crucial role in enabling low earners to mange their finances more effectively. Low earners face distinct challenges which mean the financial choices and decisions they make can have lasting repercussions if they are not fully thought through.

b. The Money Guidance service which is now at Pathfinder stage is a welcome development of the Thoresen Review's findings. The Foundation fully supports this pathfinder but believes, given the current economic climate, that it should be rolled out nationwide as a matter of urgency.

c. Comparison websites, as an important tool in enabling people to make better product choices and therefore contributing to financial capability, ought to be reviewed by the FSA in the light of the Foundation's findings published last year.

d. There is a greater need for a joined up approach to financial capability and inclusion, so that activities can be coordinated and act in a mutually supportive way.

About the Resolution Foundation

3. The Resolution Foundation, established as an independent research and policy organisation in 2005, seeks reform of the mixed economy to achieve better outcomes for low earners—people independent of state support but on below average incomes.[20] We aim to deliver change in areas where this income group is currently disadvantaged by producing new research and actively engaging in the policy-making process.

4. The 15.1 million low earners in the UK fall into an "advice gap" when it comes to receiving financial advice. Their relatively low incomes mean that they are not a target market for IFAs or the financial services industry who often provide advice bundled with financial products to people on higher incomes. Polling carried out by the Foundation last year found only 25% of low earners reported using an IFA, compared to 32% of the population on average.[21] On the other hand, as this group are not the poorest or reliant on state benefits, they are also unlikely to be given advice through government or third sector schemes aimed at the socially excluded and most vulnerable in society.

5. The Foundation believes that the lack of access to financial advice for this group results in poor financial decision-making, often at significant cost to the individual and the State. We are therefore committed to the roll-out of the Money Guidance Service, to provide generic financial advice targeted at this often overlooked group.

Low Earners and the need for Advice

6. People in the UK today are faced with making increasingly complex financial choices, whilst the emphasis on them to take personal responsibility for their financial affairs is increasing. The current economic climate has created additional complexities and increased the risks associated with poor financial decision making.

7. Low earners are particularly vulnerable in such a climate—not only because they have limited access to financial advice (explained above), but also because they do not have the buffer of savings and protection products that many higher earners do. In a time of economic downturn, high inflation and increased unemployment, this leaves them particularly exposed. For example, only around half of low earners are members of an available employer's pension scheme, compared to over 80% of those on higher incomes. In 2007, only 42% of low earners said that they made savings from their income, compared to 55% of those on higher incomes. Finally, only 25% had considered making provision for an unexpected drop in income, compared to 35% of those on higher incomes.[22]

8. In the light of this, it is critical that low earners are given support, in the form of generic financial information and advice, to help them prepare for and protect themselves against the risks they face in an increasingly insecure economic climate. This group is particularly vulnerable to falling into benefit dependency—implying increased cost to the state and a range of negative effects on individuals and familes. Providing advice and guidance at such a crucial time may be the most effective way of preventing this outcome.

9. However, it is not just low earners who need support: evidence from the Financial Service Authority's "baseline" survey into financial capability[23] suggests that whilst most people in the UK are capable of exercising the basic financial skills needed to make ends meet and keep track of their money, significant

[20] We define this group as those individuals who earn less than median incomes but who are receive less than 20% of their incomes from state benefits. Households earning between around £11,180k and £25,790k are likely to be in this group
[21] YouGov omnibus of 2010 adults, carried out July 2007
[22] Resolution Foundation (2007) *Closing the Advice Gap*
[23] *Financial capability in the UK: establishing a baseline;* FSA, March 2006

numbers are unable to plan their finances effectively or choose the right products. The survey indicated that pension provision, long term savings and insurance protection is generally inadequate amongst large numbers of the population, and people choose financial products poorly and often without any advice. As such, better access to generic financial advice is important for the entire population at this current time, and growing numbers of people face situations that, in the preceding extended period of economic growth, they had ill-prepared for.

Financial Capability and Money Guidance

10. The Foundation strongly supports the FSA's efforts to improve financial capability through financial education and information. Providing a bedrock of capability in early age and reiterating key messages (eg regarding planning for the future) throughout life are important tools to encourage positive financial behaviour in general. However, the gulf shown by the FSA's findings between people's competence in basic financial matters and their ability to choose products and make key financial decisions, suggest that providing education and information will not, on its own, be enough to help people prepare for the future and make the best choices for them. To achieve this, people must have access to advice and guidance at critical life stages, and at points where they need to make important financial decisions.

11. As such, the Foundation strongly welcomes the FSA's piloting of Money Guidance, working towards a national generic financial advice service as envisaged by the Thoresen Review. However, we are concerned by the potential length of these pilots, during which the majority of the UK population will be unable to access the generic financial advice that many so desperately need at this time. We are also concerned that there may be a loss of momentum if the pilot phase attempts to seek definitive conclusions to all the operational questions that remain outstanding before a national rollout is undertaken. This could create significant delays in implementation, a lack of continuity for those in pilot areas using Money Guidance, and many millions of people unable to take advantage of a free advice service that could be potentially so valuable.

Coordination of Financial Capability Activity

12. The FSA's activities in promoting financial capability run alongside a wide range of other programmes undertaken by the third sector, statutory agencies and private organisations. These range from education in schools through to savings campaigns and insolvency services.

13. The Foundation believes this disparate group of activities should be coordinated more effectively so that key messages around positive financial behaviours can be reiterated throughout a person's life, and so that all activities work towards a unifying set of outcomes. One way of achieving this is to consider financial capability activities within a broader framework of "financial health". Activities then fall into three broad categories—"preventative" services (such as education and financial literacy schemes); "primary" services (mainly generic financial advice) and "remedial" or acute services, (debt and crisis advice and support). Although there is certainly overlap between the three fields, by applying this conceptual framework:

a. Greater clarity can be achieved regarding how each complements and supports the other.

b. Consistency of message across the life-course and between different organisations' activities can be introduced.

c. Gaps in types of provision can be more effectively identified and remedied—indeed, the Foundation's work on promoting generic financial advice came about as we identified a distinct shortage of "primary" services when compared to the vast array of crisis advice services currently on offer.

14. We would suggest that the FSA adopts this holistic approach when considering its financial capability programmes, and those of its partner agencies, to create a more comprehensive and integrated range of activities.

Comparison Websites

15. The FSA's baseline survey of the UK's financial capability indicated that the majority of the population choose financial products poorly, often without regard to key products features such as price and fees, and without looking at a good range of alternatives. By helping consumers choose appropriate financial products, therefore, comparison websites have an important role to play in promoting financial capability. It is also likely they will have an important role in supporting the Money Guidance service, in that the generic financial advisers who are unable to recommend specific financial products, will be able to refer their clients to comparison websites to help them make specific products decisions.

16. As they are unable to access financial advice easily, comparison websites are also very important tools used by low earners to select a financial product. It was for this reason that the Foundation looked into the comparison website industry to assess how well it was serving consumers.

17. Our research showed that these sites achieve high levels of market coverage, enabling consumers to readily access a wealth of information on a wide range of products, and allowed consumers to sort, filter, and shortlist product information to suit their needs. We also found that previous criticisms of the sector—in particular sites' excessive focus on price, and their processes which increase the risk of consumers making multiple credit applications and damaging their credit ratings—are now unfounded.

18. Nevertheless, we were concerned with some sites' accuracy, ease of use and reliance on technical jargon, and, more importantly, a general and sector-wide lack of transparency regarding how many sites were sponsored and linked to specific providers, which was potentially undermining the independence of the information being passed to consumers. Based on these concerns, the Foundation created a voluntary code of conduct which we hoped the sector would adopt and essentially self-regulate. A positive response from many sites and subsequent meetings between them to discuss the code made us optimistic of progress.

19. We have been disappointed, therefore, that the adoption of a code seems to have stalled and no progress has been made, over a year after our concerns were first raised.

20. Yet comparison websites have become even more important and popular in the current economic climate: a growing proportion of the population from all income groups are using the sites in an attempt to save money by switching utility, credit card and loan providers, and others, perhaps through growing distrust of the banking industry, are turning to these sites to move their savings and mortgages. Comscore, an internet traffic analyst, estimated a 30% growth rate in the comparison website market between 2006–07,[24] but Moneysupermarket.com reported a 55% increase in net traffic just in the month after the Northern Rock collapse as people sought to move their money.[25]

21. As the use of such sites grows, and the potential consequences of poor product choices become more serious, it is vital that consumers can rely on accurate, independent and transparent sources of product comparison information. The Foundation is concerned that a growing number of financially vulnerable consumers may be exposed to the potential risks and associated costs of not purchasing appropriate financial products through comparison websites.

Conclusions and Recommendations

22. The Foundation strongly welcomes the FSA's activities in the field of financial capability, and in particular its' piloting of a Money Guidance service to provide financial advice. However, our focus on the wellbeing of low earners, and the new economic climate (which has emerged since we first looked at the issue of generic financial advice and comparison websites), means we now have a number of concerns regarding the pace of reform.

23. When Thoresen first reported in early 2008, the need for fast paced implementation was due to the inevitable surge in demand for financial advice in the period leading to pensions reform in 2012. However, the subsequent economic downturn now means that delivering a national financial advice service is now a matter of urgency.

24. We urge the FSA, therefore, to ensure that the momentum built up by the Thoresen Review is maintained, and that the pathfinder does not inadvertently create a delay in progress. In particular we would like the FSA to consider their intention to evaluate the pathfinder before a national roll out, and whether ongoing evaluation and a smoother, faster transition from pathfinder to national service can be achieved.

25. A second area where we would like to see greater progress is in the FSA's review of the comparison website sector. These websites are becoming increasingly popular, yet people remain vulnerable to the risks associated with their lack of transparency. Given the lack of progress made by the sector itself in adopting a voluntary code of conduct, we would urge the FSA to build on its initial review of insurance comparison sites and seek faster improvements across the sector—ie of sites offering information on all financial products. This may involve the mandatory adoption of a code of practice, but regulation of the sector by the FSA to better protect consumers from the opaque practices of some sites should not be ruled out at this stage.

8 December 2008

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[24] http://business.timesonline.co.uk/tol/business/industry_sectors/media/article699533.ece

[25] http://www.telegraph.co.uk/finance/financetopics/financialcrisis/3117509/Financial-Crisis-Northern-Rock-and-other-safe-havens-enjoying-flight-to-quality.html

Memorandum from ACCA

Summary

— ACCA believes the problem is not the lack of regulation, but a failure of oversight and supervision. The FSA has not been robust in its implementation of the regulation.

— During a financial crisis is not the best time to pass financial legislation, as it is likely to be unfit for the long-term.

— We welcome Lord Turner's comments that banks will face tighter supervision.

— The FSA should spend more time identifying, monitoring and seeking adequate explanation from financial institutions that pose a risk to the financial system.

— The FSA should be alert to known dangers, but it should also investigate the impact and risk of new business practices.

— The financial services industry is well-resourced with well-qualified and highly paid people. Organisations representing consumers, on the other hand, are usually poorly resourced, and disparate. This means that consumers are often barely involved in financial processes which impact on them and suffer information asymetry.

— A lack of financial literacy is often blamed for customers buying unsuitable products. This places the onus on the consumer to become more financially literate, however, it should be for the organisation selling it to ensure it is understood.

— ACCA is actively involved around the world in promoting best corporate governance practice. ACCA has recently published a paper entitled *Corporate Governance and the Credit Crunch*. The purpose of the paper is to aid understanding of how we have got to where we are and suggest some of the things which need to be done to avoid it happening again.

Introduction

1.1 ACCA is the largest and fastest-growing international professional accountancy body with over 122,000 members and 325,000 students worldwide, whom we support through a network of 80 staffed offices and centres around the world. ACCA has its headquarters in London and 54,000 of our members and over 60,000 of our students are based in the UK.

1.2 The expertise of our senior members and in-house technical experts allows ACCA to provide informed opinion on a range of financial, regulatory, public sector and business areas, including: taxation (business and personal); small business; pensions; education; and corporate governance and corporate social responsibility.

Evidence

2.0 *The future of principles-based regulation*

2.1 ACCA believes that the supervision carried out by the FSA has been regulation rather than principles-based. The large compliance departments that all banks and other financial institutions have, have been ensuring that regulations are complied with to the letter. This emphasis on "box-ticking" has not prevented the current financial crisis, where a principles-based approach, which allows for greater discretion and use of professional judgement, may have done.

2.2 We believe that the problem is not one of a lack of regulation, but of a failure of the FSA's existing supervisory powers, requiring a cultural change in the regulatory approach. We welcome Lord Turner's comments that banks will face tighter supervision. Supervision of banks needs to be of sufficient intensity and appropriate rigour to challenge the company's board.

2.3 The FSA accepted that Northern Rock was not well supervised. Whilst individual regulations may require amendment, and Basel II certainly has some pro-cyclicality issues that need resolving, ACCA believes that new regulations should not be brought in until enforcement of existing regulations, via improved supervision, has taken place.

2.4 The FSA should be alert to known dangers, but it should also investigate the impact and risk of new business practices. ACCA believes in particular that the FSA should spend more time identifying and monitoring financial institutions that pose a risk to the financial system.

2.5 ACCA welcomes the FSA's commitment to take on additional and better-trained staff, with a new group of specialists targeting "high-impact" banks, which would do greatest damage to the financial system should they fail. However, since 1999, the FSA has grown from 1,362 staff at a cost of £69.2 million to 2,535 staff costing close to £200 million[26]. We believe that the key points that need to be addressed with regard to the staff of the FSA are:

— the independence of the staff and of the board; and

— staff retention and stability.

2.6 Where should the FSA be in five years?

— Focusing on risks of wholesale risk and on risks to depositors.

— Concentrating on supervision and not on regulation.

— Identifying firms which will be a problem and supervising them heavily.

— It should have the power to seek explanation and have a robust and transparent mechanism for reporting the questions it has raised.

3.0 *The Treating Customers Fairly Initiative*

3.1 The Treating Customers Fairly Initiative identifies six outcomes which the FSA believes are critical for the fair treatment of consumers. ACCA supports these outcomes but does not believe that they are all working as they should be.

3.2 Pensions, savings, mortgages, insurance and other financial products all require high levels of consumer knowledge and financial education. Due to the sophisticated nature of these products the often complex and detailed terms and conditions attached to them, the consumer involvement is invariably limited. User involvement is critical in developing well defined policies and better regulation to ensure that the market works effectively and meets the needs of the end user[27].

3.3 The financial services industry is well resourced and is a powerful lobby in the development of policy. On the other hand, disparate nature of consumer groups as well as lack of resources and technical knowledge has created an imbalance of power that has resulted in a market failure, the consequences of which can be devastating. Consider, for example, the ability of industry to respond to policy consultation documents, compared to consumers. Between October 2002 and June 2005 there were 1,680 responses to 46 European financial services consultations. Only 13 of these responses derived from consumer groups. ACCA therefore believes that the Government should make greater efforts to ensure adequate consumer representation.

3.4 Greater efforts need to be made by regulators, to ensure that products such as pensions are marketed and sold in consumer friendly manner. The information presented should not presume a high level of technical knowledge and wherever possible, financial services providers should adopt innovative ways in explaining the implications of the potential purchase. This will have a positive impact on consumer confidence in their decision making, making them informed, confident and ultimately more involved customers in the financial services market.

3.5 Other transparency issues include ideas like the labelling of financial products such as pensions—how much will they actually cost you? Fees, ongoing costs and exit costs and penalties must be clear and transparent and supplied in a timely fashion.

3.6 Confidence must be built back into the system. The FSA needs to talk to the market to reassure and restore confidence.

4.0 *Financial capability*

4.1 The Government is becoming increasingly aware of the importance of savings, pensions and good credit management in our society. The crisis in the financial markets has reiterated the importance of credit management and exposed the role of consumers in the efficient functioning of these markets. It has also highlighted a need for ensuring greater consumer understanding of their personal financial circumstances and more generally, raising the consumer involvement in the financial services market. Some efforts in this area have already started, most notably the Financial Services Authority has set out seven priorities for achieving financial capability[28] in the UK.

4.2 A 2005 OECD publication[29] looks at a number of factors that are increasing the importance of financial education of consumers, such as the growing complexity of financial products, low levels of financial literacy and the growing demand for pensions and other financial instruments. Consumer education can play an important part in increasing the role of consumers in the financial services market.

[26] FSA Annual Report, 2007–08
[27] Better Regulation Task Force, *Get Connected; Effective Engagement in the EU*, September 2005
[28] FSA, *Building Financial Capability in the UK*, 2005
[29] OECD, *Improving Financial Information*, 2005

Consumers with higher levels of financial literacy are more likely to get a fair deal when saving or borrowing and will not be exposed to unnecessary levels of risk and other consequences of poor financial decision making[30]. There is therefore a convincing case for improving the levels of financial literacy. It is imperative that a multi-stakeholder approach is adopted which would involve not only the education authorities, but a number of other stakeholders who are able to contribute such as financial intermediaries, finance institutions and consumer groups.

4.3 However, is unlikely that education alone can sufficiently equip consumers with the necessary knowledge and experience to participate effectively in the market and become completely self-reliant. Advice is not only crucial for the most vulnerable groups in our society. On average, financial services products are likely to be purchased once in a lifetime or infrequently, often over a significant lapse of time. In cost and benefit terms, it is unlikely that the individuals will be willing to invest time to educate themselves to a degree necessary for them to become completely self-sufficient in terms of fully understanding their purchase.

4.4 Inevitably, customers will often have to seek further advice to be able to make informed decisions. Recognising the importance of the financial intermediaries in the financial services market and the past problems that have been experienced (such as their role in the mis-selling scandals) it is important that the consumers have confidence in the advice they receive. Accountants are in a good position to offer these services. Their extensive knowledge in financial management, as well as their independence and strict rules of professional conduct placed on them, put them in an ideal position to develop their services towards meeting the increasing need for consumer confidence and protection in financial advice provision.

4.5 When selecting goods or services, one of the most fundamental needs of consumers is information provision. In most markets consumers buying goods and services will know what they want, and how much they are prepared to pay. The financial services market is markedly different where the products and services are complex and the benefits sometimes only materialise in the longer term.

4.6 Governments have intervened to ensure that regulatory requirements placed on financial service providers oblige them to set out detailed terms and conditions when selling their products. However, in meeting this requirement, little thought is usually given to the consumer need for understandable information provision. Recent research by the Better Regulation Executive[31] has found that the majority of information requirements are not having their desired outcomes where consumers reject much information because it is considered to be voluminous and presented in complex and unappealing format. Consumer credit agreements were used as one of the case studies in the research and the feedback from consumer groups was that the small size of the print and the language used were off-putting and they gave consumers the feeling that the agreement was primarily for the benefit of the lender and that they would be disadvantaged as a result. The report's recommendations on improving the effectiveness of information provision should be taken on board by the financial services industry including finding innovative ways of making the information simple, inclusive and consumer friendly.

5.0 *Regulation of retail banking conduct of business*

5.1 ACCA is actively involved around the world in promoting best corporate governance practice. We seek to make a strong and distinctive contribution to public debate on all relevant issues concerning the conduct and ethical behaviour of accountancy, taxation and business and, in particular, on technical aspects of the work of professional accountants in business, public practice and the public sector.

5.2 ACCA believes that good corporate governance would have mitigated the effects of the current crisis.

5.3 We have recently published a paper entitled Corporate Governance and the Credit Crunch, which is the result of meetings held by ACCA with experts from financial services, academia and accounting about the causes of and lessons to be learned from the credit crunch. It takes a wide view of the factors leading to the credit crunch then explores how poor corporate governance contributed to the problems. The purpose of the paper is to aid understanding of how we have got to where we are and suggest some of the things which need to be done to avoid it happening again.

5.4 The 10 corporate governance principles outlined and explored in the paper are:

- Boards, shareholders and stakeholders share a common understanding of the purpose and scope of corporate governance.
- Boards lead by example.
- Boards appropriately empower executive management and committees.
- Boards ensure that their strategy actively considers both risk and reward over time.
- Boards are balanced
- Executive remuneration promotes organisational performance and is transparent.

[30] FSA, ibid
[31] Better Regulation Executive, *Warning: Too much information can harm*, 2007

- An organisation's risk management and control is objectively challenged, independently of line management.
- Boards account to shareholders and, where appropriate, other stakeholders for their stewardship.
- Shareholders and other significant stakeholders hold boards to account.
- Corporate governance should evolve and improve over time.

5.5 ACCA also believes that it is imperative that boards understand their own business model.

December 2008

Memorandum from the Institute of Chartered Accountants in England and Wales

Introduction

The Institute of Chartered Accountants in England and Wales (ICAEW) is pleased to be able to submit written evidence to the Treasury Committee as part of its inquiry into the work of the Financial Services Authority (FSA).

As a public interest body, the ICAEW is committed to working with Government and regulators as well as wider market participants in order to help strengthen financial confidence. Over 25,000 of the ICAEW's 132,000 members work across all areas of the financial services industry, including providers of financial services, advisors on financial products, regulators and professional firms advising the industry. The Financial Services Faculty was launched at the start of 2007 and works to promote debate and dialogue on all issues facing the financial services industry. This submission draws on ICAEW member and faculty expertise and insight.

Executive Summary

- We continue to endorse the FSA's risk-based policy approach which recognises that it is undesirable to have a zero-failure regime. However, we would encourage greater public dialogue on this point to ensure that there is not a significant gap between FSA policy, political will and public expectations. (1.3)
- We welcome the level of FSA engagement with senior stakeholders across consumers, providers and regulators on a global basis in the last twelve months. (1.5)
- Given the continuing shift toward principles and the expanding remit of the FSA, the ICAEW believes that there is a case for increased resources for the FSA. (1.6)
- The ICAEW generally supports the FSA's move towards more principles-based regulation. We do not believe that a change in direction on principles-based regulatory policy would be an appropriate response to the financial crisis. (2.2)
- The ICAEW supports the objectives of the Treating Customers Fairly initiative, but we note that its success, in part, depends upon how the FSA teams operate and respond to firms. The Institute encourages the FSA to avoid a heavy handed approach to supervision and enforcement, recognising that different firms make different, but reasonable, judgements in order to reach the same goal. (3.5)
- The ICAEW welcomes the publication of the FSA Retail Distribution Review (RDR) November 2008 "Interim Report". We are encouraged by the emphasis on raising standards of professionalism and, in principle, we support the proposals to create a Professional Standards Board. (4.3)
- We believe that the RDR, complementing the FSA's financial literacy activity, should examine how consumer understanding regarding the distinction between independent financial advice and financial sales can be strengthened. (4.6)
- The ICAEW believes that the FSA could do more to signpost financial capability volunteering initiatives. Further, we believe that up to date research into the impact of financial capability on the macro economy—for example, the effect of existing programmes on levels of GDP, productivity and levels of employment—would be effective in underpinning the value of building a more financially aware and literate society. (5.3)

1. *Analysis of the FSA's Annual Report 2007–08, performance, management, personnel and priorities of the FSA*

1.1 The last year has been a particularly challenging one for the financial services industry as a whole. It is important that comments in relation to the FSA's regulatory priorities, personnel and performance are considered against the backdrop of this extremely difficult environment.

1.2 The ICAEW supports the FSA's stated focus in 2008–09 on (a) reforming bank legislation, including liquidity policy; (b) improving consumer protection, including the Treating Customers Fairly (TCF) initiative and the Retail Distribution Review (RDR); (c) financial capability agenda; and (d) Solvency II.

1.3 Overall, we continue to endorse the FSA's risk-based policy approach which recognises that it is undesirable to have a zero-failure regime and that it is important to base the regulatory system on a framework of principles, rather than the creation of ever more detailed rules to cover every possible scenario.

1.4 However, the ICAEW would support greater public dialogue on the risk-based policy. To remain credible and reliable under pressure, there should not be a significant difference between FSA policy, political will and public expectations. The Government's recent decision to compensate Icelandic bank investors, even where the deposits were significantly above the maximum compensation limits in the UK, highlights an existing disconnect.

1.5 We have welcomed the FSA's engagement with senior stakeholders across consumers, providers and regulators in the last twelve months. The ICAEW believes that the FSA has taken account of concerns raised by key stakeholders, which has helped to avoid oversimplification of complex issues and to improve the quality of legislation and regulation.

1.6 The ICAEW believes that there is a case for increased resources for the FSA. Given the continuing shift toward principles, which underpins the FSA's Annual Report 2007–08, we believe that the FSA should be prepared to increase the issuance of guidance, peer review data and case studies both for firms and its own staff. Accordingly, the FSA will need the proper resources to meet this requirement. More generally, as the remit of the FSA expands, corresponding increases in resource may be required in order to maintain standards.

1.7 The ICAEW believes that FSA staff should be trained to understand issues outside their own specialist areas to improve the ability and effectiveness of FSA staff in responding to issues that cut across sectors and across policy and supervisory issues.

1.8 Based on the representations of our members, we would recommend that the FSA website be simplified in order to be more accessible to practitioners seeking guidance.

2. *The future of Principles-Based Regulation (PBR)*

2.1 Principles-based regulation (PBR) involves developing a framework upon with which to build a regulatory system and does not imply an absence of rules. Under PBR, the principles usually provide objectives for designing more detailed rules, rather than replacing the rules themselves. They also provide a basis against which rules can be interpreted.In addition, PBR should not be confused with light-touch regulation. A principles-based system can be just as, or even more, rigorous than a rules-based system.

2.2 We believe that the FSA's 2007 initiative to move towards more principles-based regulation remains a positive development. In general the ICAEW supports PBR as providing a strong foundation to the regulatory system, adaptable to changing circumstances. However, it is important to bear in mind that in specific circumstances a simple rule can be the most efficient way of achieving a desired outcome.

2.3 We recognise that the success of PBR is dependant upon the quality of the principles underpinning the system. The same is true of a rules-based system. Weaknesses in both rules and principles are normally due to the wrong risks being considered in designing the system, or wrong weighting given to the risks identified. This can be easy to judge with hindsight but difficult to assess looking forwards as not all risks are known. Any risk assessment is itself judgmental and will change over time. However, under a principles-based system, weaknesses in the rules might be addressed through falling back on the underlying principles, increasing the flexibility of the framework to changes in the business environment.

2.4 Rules-based systems can risk creating compliance cultures, where firms focus upon meeting the letter rather than spirit of the rules, or an attitude that "anything goes" so long as not prohibited. Further, it is an oversimplification to suggest that detailed rules provide greater levels of certainty. Detailed rules can merely shift the areas of judgment into more detailed levels. As the English legal system demonstrates, interpreting the inter-relationship between different rules can require as much or more judgment as the application of principles. Furthermore, given that principles tend to be clearly linked to objectives, a principles-based system can be more understandable and transparent to the layman than detailed rules requiring highly specialist skills to understand and apply.

2.5 The ICAEW does not believe that a change in direction on PBR policy would be an appropriate response to the financial crisis.

3. *Treating Customers Fairly*

3.1 The Financial Services Authority's initiative, Treating Customers Fairly (TCF), provides a good example of the application of a more principles-based regulatory regime. The lack of detailed rules has meant that firms have had to apply judgement over whether they are meeting the standards expected of them. It will take time for firms become accustomed to applying judgement in this area and for FSA supervision teams become more used to seeing different firms taking different approaches to reach the same goal.

3.2 It is important to note that any current weaknesses in firms' TCF procedures for appropriately framed information do not necessarily reflect that those firms are not seeking to protect the interests of their customers. There are sound business reasons for firms to treat their customers fairly since doing so leads to long term relationships and a more sustainable business.

3.3 As identified at "Treating Customers Fairly—Making it Happen" roadshows run by the ICAEW Financial Services Faculty in London and Leeds in November 2008, many firms believe they always have had the principles of TCF at the heart of their business models. Firms have faced significant costs in meeting the FSA initiative. These costs have been felt by firms of all size. Firms have faced steep learning curves, not least in respect of the need to deliver more qualitatively orientated measures of organisational thinking, process and performance measurement.

3.4 The costs, coupled to the belief by firms that they have always treated their customers fairly, has led to an element of scepticism that the initiative will achieve the desired goal of fairer customer treatment. However, by ensuring that senior management has a greater focus on positively ensuring fair treatment, the initiative may help to prevent future shortcomings.

3.5 The ICAEW supports the initiative, however notes that its success will in part depend upon how the FSA's supervision and enforcement teams respond. TCF forces management to make judgements due to its principle-based nature. The FSA should not take a heavy-handed approach when a firm makes a reasonable decision just because the FSA supervision or enforcement team might have preferred an alternative option to be taken.

4. *Retail Distribution Review*

4.1 The ICAEW believes the Retail Distribution Review (RDR) represents an important opportunity to help restore confidence in retail financial products and product distribution, particularly in light of the current challenging market environment.

4.2 It is important that the RDR provides a more stable and consistent retail regulatory landscape in the longer term. Efficient markets need a consistent, balanced regulatory approach. Frequent regulatory change is not helpful to either suppliers or consumers.

4.3 In general terms, the ICAEW welcomes the FSA's RDR November 2008 Interim Report. We are encouraged by the emphasis on raising standards of professionalism and, in principle, we support the proposals to create a Professional Standards Board.

4.4 We agree that the RDR provides an opportunity to tackle certain aspects of the savings gap. The causes of the savings gap are complex and cannot be explained by simply looking into the supply side problems in the financial services sector. On the supply side, issues such as endowment, pensions mis-selling and wider confidence in the sector must be addressed. However financial literacy, the high-cost of housing, and a consumer culture have had a substantial role in the low savings ratio in the UK.

4.5 In order for the financial system to operate effectively, consumers need to fully understand the different types of relationship that exist in the retail financial services supply-chain and fully appreciate the costs, risks and implications entailed. Provided consumers fully understand the nature of the services supplied to them, independent advice, simplified advised and non-advised sales, guided sales, money guidance and execution-only business all have important roles to play.

4.6 The ICAEW supports plans set out in the RDR to disaggregate the cost of advice from the cost of products. Complimenting the FSA's financial literacy activity, we would encourage the RDR to further examine how consumer understanding of the distinction between independent financial advice and financial sales can be strengthened. We believe that such a distinction would substantially improve levels of trust and confidence in the retail financial services sector as a whole. ICAEW Financial Services Faculty held a number of roundtable discussions on the RDR in 2008 and we are keen to work further with the FSA and others to raise awareness, publicise information and good practice as appropriate.

5. *Financial capability*

5.1 The ICAEW believes that investing in initiatives that support financial capability is more important than ever during an economic downturn. Over the last eighteen months, our members have been working in secondary schools as part of a partnership with the Personal Finance Education Group (pfeg) and GE Money. Over 300 chartered accountants are participating in the initiative which involves our members mentoring state secondary school teachers to enable them to deliver personal finance education in the classroom. We recognise that the effects of our initiative will be seen over the long term.

5.2 To address the urgent need for financial mentoring and support in communities during the downturn we are considering extending our work to include housing and community associations where our members can help the management of these groups to provide mentoring, support and advice either directly to tenants or through rent officers and community leaders. We are aware of research showing that a basic level of financial education among council housing tenants can reduce rent arrears by as much as 75%. The Institute piloted some work in the summer of 2008 with the Poplar Housing and Regeneration Community Association (Polar HARCA) which involved working with around 100 of the community's 8–13 year old children to provide them with some basic financial knowledge in a fun and interactive way.

5.3 The ICAEW believes that the FSA could do more to signpost financial capability volunteering initiatives. Additionally, we believe that further research into the impact of financial capability on the macro economy—for example, the effect of existing programmes on levels of GDP, productivity and levels of employment—would be effective in underpinning the value of building a more financially aware and literate society.

December 2008

Memorandum from Mr David Crozier, Navigator Financial Planning Ltd

SUBMISSION IN RESPECT THE RETAIL DISTRIBUTION REVIEW (RDR)

Executive Summary

The minimum qualification for an Independent Financial Adviser should be equivalent to an Honours Degree—QCA Level 6. The majority of Sales Advisers are not capable of obtaining QCA Level 4. The minimum qualification for Sales Advisers should remain as now. Sales Advisers should be authorised to sell from a list of products regulated by the FSA. Membership of a professional body should be mandatory.

Submission

1. I broadly welcome the objectives and proposals for the RDR but in the interests of not multiplying words have addressed herein the few points where I feel improvement could be made, rather than listing specifically all the points with which I agree.

2. Increasing professionalism by raising the standard of academic attainment is a laudable and necessary objective.

3. The proposed minimum qualification level of QCA 4 across the board is inappropriate.

3.1 At the professional end, Independent Financial Adviser, a degree or equivalent must be the entry level, to give credibility with other professions and the public. Most professions require a degree qualification as entry level; I would cite law, accountancy, and medicine.

3.2 Other professions permit other routes to professionalism, eg the "articled clerk" route for solicitors and accountants, however this requries seven years or more of working in the profession, learning on the job, followed by professional exams to degree level.

3.3 A person qualified to QCA 4 has not demonstrated the knowledge and skills to advise on complex financial planning situations.

4. I accept that most situations do not require this level of expertise.

5. The "savings gap" requires a large number of Sales Advisers operating in the mass market.

5.1 Imposing attainment of QCA 4 on all advisers by 2012 is impractical. Many Sales Advisers, perhaps the majority, will not bother or not be able to achieve it.

5.2 A combination of Sales Advisers failing to achieve QCA 4 and the growing savings gap will put pressure on the FSA to renege on this requirement, which will render the whole exercise in increasing professionalism fruitless.

6. The majority of the population is likely to require very simple advice on mortgages, savings, and protection. More often than not, this has to be sold to them, rather than them seeking advice. The Sandler review suggested that most advisers were incapable of giving complex investment advice, and that most clients did not need it.

6.1 Very simple products could be designed, and regulated by the FSA, such that, if they were sold within certain parameters could do no harm, even if sold by a Sales Adviser with a basic level of qualification—the current entry qualifications, even.

6.2 The parameters would relate to size of premium, age or circumstances of client, funds invested in; other parameters could be devised.

6.3 Thus a 40-year old builder requiring a £200pm ISA, will be better served with a very simple product, with a passively-managed balanced fund, sold by a Sales Adviser using a simple, cheap sales process.

6.4 Likewise, the Sales Adviser approached by an 80 year-old widow with £250,000 to invest would have to refer the case elsewhere.

6.5 The cost of advice for the Sales Advisers would be much reduced, as most of the regulation would be at the product level.

7. There would be a clear career progression from Sales Adviser to Independent Financial Adviser.

8. I believe a better job would be done in policing professional standards by self-regulation through professional bodies than the proposed arm of the regulator. Other professions exercise self regulation—the Law Society, ACCA for example—and the FSA has not exactly covered itself in glory over its ability to regulate in recent years.

3 December 2008

Memorandum from Mr John Blackmore, Long View

SUBMISSION REGARDING THE RETAIL DISTRIBUTION REVIEW

Executive Summary

The minimum qualification for an Independent Financial Adviser should be Degree Level—CII level 6. The minimum qualification for Sales Advisers should remain as now—Financial Planning Certificate. Sales Advisers should be authorised to sell from an approved list of products or product types with approval being provided by the FSA. The majority of Sales Advisers are not capable of obtaining CII level 4 and even if they were there is not sufficient demand in the market for complex financial advice for all current adviser/ sales people.

Submission

1. It is accepted that the FSA are unable at the present time to draw a clear distinction between Advice and Sales.

2. Improved education cannot be argued against.

3. The proposed solution of CII level 4 for all could hardly be more inappropriate. It is not demanding enough for Advisers and yet it is unnecessarily complex for Sales Advisers.

4. Independent Financial Advisers need to be qualified to a far higher standard and Sales Advisers to a much lower level.

5. The sale of simple products does not justify complex and demanding qualifications and advice in complex areas should not be allowed by those with nothing better than "A" level qualifications.

6. 90–95% of all current "Advisers" are really Sales people who provide advice as part of the Sales process.

7. The market does not need all current Retail Adviser/Sales people to be able to provide complex advice. There is insufficient demand for complex advice.

8. Increased qualifications will result in higher charges to the public with few if any ex Sales people being willing to provide low level inexpensive advice.

9. If CII Level 4 is imposed on all, the failure rate will be unacceptably high. I do not believe that a majority of current adviser/ sales people are capable of obtaining CII level 4.

2 December 2008

Memorandum from John Pilkington, Andrew Edgington, and Philip Meadowcroft, on behalf of Aviva / Norwich Union With Profit Policyholders' Action Group

SOME SUGGESTED QUESTIONS FOR THE HEARING ON 15 DECEMBER 2008

1. *We told you that we would be watching you carefully, so, why has the FSA not taken any visible action to stop the proprietary life insurers like Aviva from continuing to diddle their with profits policyholders? Your response in October to our report lacked any visible concern about the issues we brought to your attention. That can only be regarded as a betrayal of your task and your responsibility—and that is a grave accusation.*

2. *Why haven't you announced that you are well advanced in planning a fundamental redesign of the regulatory system—not just tinkering at the fringes but the construction of a simple, certain, and clear framework as we wrote in our report?*

3. *Why haven't you announced that you are going to beef up the enforcement of transparency in smoothing techniques used by the life insurers whose conduct of fair treatment for policyholders you are charged with authorising?*

4. *Why have you failed to make the strong case we asked you for to support the phasing of Special Distributions like the three-stage Aviva plan announced in February this year?*

5. *Why have we heard nothing from you about the concerns we expressed about the role which With Profits Committees play, that have failed to fulfil the enforcement of the Treating Customers Fairly concept?*

6. *Why did you see fit not to support Lord Lipsey's understandable request to beef up his remit in order to focus the FSA on consumer concerns? He clearly is uncomfortable with the way matters are being handled—so much so he has resigned his post.*

1.a We consider that the resignation of Lord Lipsey on 28 November 2008 from his position as the Chairman of the Financial Services Authority funded Financial Services Consumer Panel is a most damning statement against the FSA.

1.b In his speech at the FSA Annual Public Meeting 2008, Lord Lipsey said:

> "Overall, if consumer confidence in our financial services goes, you would have no businesses, you would have no customers and that explains the actions of the authorities over the past year or so. Even if you take a particular product, confidence can go in the twinkling of an eye and then take an age to return."

1.c Lord Lipsey has also stated:

> "The more you focus on regulation, the more you have to think of the consumer, as without consumer confidence there is no industry."

1.d Lord Lipsey is absolutely right in what he has said and his resignation highlights the fact that the FSA is protectionist towards the financial industry which it supposedly regulates and that it arrogantly refuses to properly consider the consumer, the very foundation of this industry, in the inter-relationship between the financial organisations and the private individual. The Aviva/Norwich Union With-Profit Policyholders' Action Group has consistently argued the case that we, as Norwich Union Policyholders and consumers of financial services, must be properly protected and supported by proactive financial regulation. Lord Lipsey, with his "insider's" experience of the FSA has said:

> "I've been trying to change it for six months, but I've got nowhere—not through lack of trying. I'm sad it's ended this way. It is a lost opportunity."

Clearly, the FSA "genie" needs to be put back into its bottle. The FSA has failed to alert and avoid the financial crisis in which the UK is now immersed because it has failed to protect the interests of consumers. The FSA is provably not fit for purpose and the management has persistently fiddled whilst Rome has burnt. The abject failure of the FSA has now cost the UK taxpayer £1 trillion, and Lord Lipsey's resignation shows that the FSA still pig-headedly refuses to focus on the foundations of the financial services industry, namely the individual consumer. In the case of the Norwich Union reattribution, because this reattribution has yet to be concluded, the FSA still has a golden opportunity to insist on a distribution to policyholders, as per our policy contracts. We ask that the Treasury Committee humiliates the FSA sufficiently to ensure that it takes a step into the future, towards a new era of financial regulation, where the consumer's interest is placed first and that this be demonstrated by the FSA forcing Norwich Union to treat its customers fairly, and distribute the entire CGNU/CULAC inherited estate under the 90:10 rule. At present the financial services sector is regulated by the FSA under the rules of "parasitism", where the consumer is preyed upon by the financial services industry to the detriment of the consumer and the advantage of the financial services industry. This is very short-sighted of the FSA. The only way forward is where the financial services industry is regulated under the rules of "symbiosis", where both the consumer and the financial services industry mutually benefit from the relationship. Of course, this will mean that the financial services industry will have to accept that its consumers must profit and come first before the shareholder profits and the management awards itself performance bonuses. The FSA must ensure that this is so.

1.e In the Fifteenth Special Report of Session 2007–08 HC 1132, entitled Inherited Estates: Financial Services Authority and Office of Fair Trading Responses to the Committee's Twelfth Report of Session 2007–08 it states:

> 29. In establishing whether an excess surplus exists, firms need to make assumptions about the future volume of new business. There are clearly incentives for the shareholder to overstate the quantity of new business, so limiting the size of excess surplus/distribution. The Committee rightly points out that this incentive also exists in the context of a reattribution. It is therefore essential that the With-Profits Committee (or similar arrangement) scrutinises carefully and where necessary challenges new-business forecasts, and also that—where a reattribution is in prospect—the policyholder advocate does the same. We also intervene in the course of our supervision where we see forecasts that appear unjustifiable and which might jeopardise fair treatment.
>
> 30. Considering the possible phasing of any special distribution, our rules do not include any requirements as we believe this should be assessed in the light of the particular circumstances of the firm at the time. It would be for firms, having taken advice from their With-Profits Committee (or similar arrangement), to determine a fair basis for the distribution.
>
> 31. In the case of Aviva, as the Committee is aware, the With-Profits Committee was in favour of the phasing of the distribution.

1.f According to the details about the Treasury Committee found on the UK Parliament website:

http://www.parliament.uk/parliamentary_committees/treasury_committee/treasury_committee_about_us.cfm it states:

> "The House has given the Committee the power to send for "persons, papers and records". It therefore has powers to insist upon the attendance of witnesses and the production of papers and other material. These formal powers are rarely used."

We would therefore like to respectfully ask the Treasury Committee to seriously consider using its rarely used powers to insist that it receives the documentary evidence regarding the information contained within the quoted paragraphs 29, 30 and 31 as above.

1.g In regard to paragraph 29, would it not be reasonable for the Treasury Committee to ask to see the papers and records of the scrutiny and challenges made by the Norwich Union/Aviva With-Profits Committee and the Policyholder Advocate, regarding their assumptions of new business? Maybe the Treasury Committee could also ask for the FSA's papers and records regarding any FSA intervention (or lack of intervention) regarding the forecasts for new business? The FSA papers and records would of course show the checks they made on the forecasts, to justify their action (or inaction). With regard to paragraphs 30 and 31, could the Treasury Committee reasonably request that the Norwich Union/Aviva With-Profits Committee provide your committee with their papers and records regarding the advice they gave on the fairness of the phased distribution?

1 December 2008

Memorandum from Mr Bob Castle, Financial Escape Ltd

This may be short and sweet and look unprofessional, but I have tried the professional approach with the FSA as have eight out of 10 respondents to their discussion paper only to be ignored with a total refusal to even discuss any longstop, let alone the 15 year long stop every othe UK citizen appears entitled to.

I believe the FSA's RDR is fatally flawed, but only re their ignorance of the 15 year long stop and the suggestion of mandatory Professional Body membership/increased min quals. I would draw to your attention the complete lack of confidence IFAs have in the FSA and the believe they have been influenced by political expediency and are NOT independet of the executive. The rest of the RDR I actually think is an own goal on the part of the banks, but very few people have actually realised it yet!

I will be focusing on longstop and Pb/Mandatory Quals only until such time as someone actually realises our Human Rights have been breached and we are NOT going to role over and take our punishment for disobedience as the only profession which is being given NO right to a LONGSTOP for professional negligence.

1 December 2008

Memorandum from Mr Mike Broadwood

I am not very good at putting my point of view across but hope that you will consider the following points which I think are important before the FSA drives every IFA—and effectively shutting out the majority of the general public, to financial advice.

1. I understand it is normal practice to spend money on works of art to hang in the FSA's office. Could the FSA explain where the money for this comes from?

(I do not think for a minute that the FSA staff purchase these but use funds collected via fees levied on IFA's, Mortgage Brokers and various companies who have to pay these fees.)

2. It is normal practice for FSA staff to stay in expensive hotels when visiting IFA's?

(Surely the FSA has a duty to the people it regulates to keep all costs as low as possible)?

3. The FSA has introduced the RDR and TCF, however in both there is a bias towards banks. Historically, it is the Banks who have had the most complaints, whilst the IFA sector the smallest, yet the RDR seems to be a system to remove IFA's out of the advice to the general public altogether.

- The introduction of higher qualifications to people who have been doing the job for years.
- The introduction of the need to hold more money on deposit. In which other trade is this a requirement?

4. The proposal to force IFA's to charge fees.

I do not know the figures, but taking my own practice into account 95% of my clients cannot afford to pay fees and are happy to pay me via commission. Of the 5% that can afford to pay me, I would say that 95% of them would still rather I work on commission. They know they can pick the phone up to me and that no matter how much work I do for them there will never be a bill to pay.

1 December 2008

Memorandum from the Forum for Fee Based Advice

Executive Summary and Submission

I am principal at Tower Hill Associates Limited, an exclusively fee based independent financial adviser practice which I set up in 2006.

I am also founder and current leader of the Forum for Fee Based Advice and it is in this capacity that I make this very short submission.

The Forum for Fee Based Advice is a group of over 100 independent fee based financial advisory firms which are already working on an exclusively fee basis with clients. We believe in "Client-Centred advice free from conflicts of interest" and see ourselves as the blue print for what an IFA profession might look like post 2012 but operating now.

Whilst we fully support the changes contained in FS08/2 we do not think they address the most fundamental influencer of change ie market forces.

Simply put consumers need to know where they can find the different kind of advisers and are not best served with current IFA search sites which do not adequately represent the adviser currently working on a fee basis.

I have already been in contact with David Elms Chief Executive of IFA promotions (www.unbiased.co.uk) who whilst agreeing with the merits of separately identifying fee only advisers is in no great rush to assist his minority fee only adviser subscribers (and consumers who are specifically looking for them) at the expense of his main constituents who are commission based IFAs.

This is something the FSA can do something about without "taking sides" and I would respectfully ask that the Treasury Select Committee considers suggesting the following:

> Independent Financial Advisers that already work on a fee basis (as envisaged post 2012) are given the opportunity to register this fact with the FSA now and this will show up as a ticked box on the individual firm's regulatory data. This information would be in the public domain and could be made available to outside third parties to help consumers find the post 2012 adviser now.

> Because there would be a marketing advantage in firms being identified as "ahead of the game" on the FSA website this will act as a significant incentive for firms to change more quickly. It will also act as a fillip for people like David Elms to not stand in the way of change towards a fee based adviser business model because if he doesn't capture readily available fee based adviser data from the FSA someone else will.

1 December 2008

Memorandum from Mr Mark Bogard, IFG Group plc

You are calling for written evidence for your session on 15 December 2008.

We are a small, listed, regulated financial services advisory and pensioner trustee business.

This is ours:

Success in financial services businesses and regulation is much about spotting trends and points of inflection when those trends change.

This is a hard thing to do. And only those people who really understand, have even a chance of doing it.

There is limited point fighting the last battle, again. And a process will rarely help you navigate the changes successfully.

Financial services businesses, and regulators, need people with imagination and knowledge, experience and understanding, pessimists and optimists, risk takers and the risk averse.

In our experience those who work for the FSA self-select themselves not to have a number of these qualities.

This is not just about money, it is about the nature and culture of the organisation.

It is institutionally process driven and backward looking. There are too few people with any business experience.

The enormous, almost religious, effort expended on the TCF initiative whilst meanwhile confidence in the whole financial system was lost and our clients felt financial fear for the first time in my experience, is an example of the worst symptom of this when I heard some of the smarter fund managers foresee real problems three years ago. Who heard these contrarian voices at the FSA and took up their cause? Why not?

I was at Barclays' investment bank when Callum McCarthy was there. He did not "make it" in what was a second division investment bank. Yet he went on to be head regulator. The FSA needs the best. Secondments to the Takeover Panel seem to work. And those whose careers are in the FSA need to have regular secondments into the best businesses.

1 December 2008

Memorandum from Ashley Kovas

Executive Summary

1. The author of this Memorandum is employed by a financial services institution and is a former regulator. The views expressed are however the author's alone.

Principles based regulation (PBR)

2. PBR is a method of regulation. It is not inherently better or worse than having detailed rules. In reality, a regulatory regime needs both principles and rules. The challenge of PBR lies in the exercise of discretion implied by principles. Unless the discretion is controlled in some way, the result is opacity and confusion.

Treating customers fairly (TCF)

3. The FSA's intentions with TCF are laudable. However, the initiative has fallen into the trap suggested above—trying to regulate from an extremely high level principle requires a degree of process and control that has not been present.

Retail Distribution Review (RDR)

4. This initiative is billed as the "key" to the FSA's retail policy. The intention is that RDR improvements will enhance consumer confidence and lead to greater trust in the financial services providers. This was always questionable: peoples' failure to save is due to deeply embedded psychological factors that the RDR does not address. The RDR on its own will not lead people to save more. This paper advocates an approach driven through an understanding of the reasons why people do not save. This missing link in the strategy will become critical as consumers become too frightened to save as a result of the present market turmoil.

Financial capability

5. This is an intractable problem that will take a generation to improve. Indeed, deeply ingrained human behaviour may make a complete solution impossible. However, consumers may respond to short, sharp messages aimed at their deeply held prejudices.

6. The government may wish to investigate whether employers should be charged with acting as a "conduit" for the provision of financial advice to their employees, particularly given that the investment responsibility for pension provision has now shifted from employers (through defined benefits schemes) to employees (defined contributions).

Detail

The future of principles-based regulation

7. Principles based regulation (PBR) is a regulatory philosophy. It is a manner by which regulation can be effected. As a philosophical approach it is neutral in itself on whether its outcome is good or bad regulation. It does not equate, necessarily, to a "light touch" regime. PBR as a concept is in contrast with a detailed rules philosophy. Detailed rules are not necessarily better than PBR—detailed rules may not cover all the eventualities required and are likely to be inflexible to market developments. PBR, on the other hand, carries a burden of interpretation that might lead to uncertainty.

8. PBR necessitates a greater exercise of discretion than is necessary in detailed rules: the application of Principles requiring "fair treatment", for example, may elicit different responses from those who are fully intent on complying with them. Discretion of this type is the main benefit of PBR because of the flexibility it implies.

9. The FSA has not, to date, effectively set down how the discretion inherent in PBR is to be exercised. Does the discretion fall to the firm, or to the regulator? If the former, the regulator may have lost its bite; if the latter, the regulator is creating effective regulatory standards without going through any publicly accountable process. Rules-making, after all, requires comprehensive cost benefit analysis and full consultation. It is not clear how interpretive disagreements between firms and the FSA are to be resolved. This opacity of process requires resolution. At its worst, the opacity might lead to competing firms being subjected to differential standards of compliance by individual supervisors within the FSA.

10. It is submitted that the Financial Services and Markets Act provides an answer: the FSA is already empowered to give general and individual guidance on the application of its rules. The FSA should adopt an approach driven by the Guidance provisions. General guidance (published to the industry as a whole) can set out the FSA's own interpretation of its Principles-based rules. If a firm wishes to comply with the Principle in that way, all well and good. If the firm wishes to comply in a different way, it can either seek individual guidance or, if it wishes, run the risk that the FSA might disagree with its interpretation. It is submitted that this approach to regulation would improve certainty whilst retaining the flexibility of PBR. The process disciplines around the giving of formal guidance would be helpful.

11. Finally, it should be observed that the FSA is not, in reality, a principles-based regulator in any event. The FSA rulebook is long and very detailed. In reality, a regulatory regime needs to have a balance of high-level principles and detailed rules. The regime cannot be one thing or the other. It must be both.

Treating customers fairly (TCF)

12. This initiative predated PBR. TCF has shown symptoms of the dangers that arise from opacity and the exercise of discretion that have been outlined above. There is no doubt that the FSA's intended outcome from TCF is laudable. However, implementation has led to insufficient precision on what the necessary actions amount to. The main winners from this have been management consultants, rather than consumers. A possible solution (better use of formal guidance) is set out in the section above.

Retail distribution review (RDR)

13. The Feedback Statement on the RDR has recently been published, and the FSA is to approach RDR in three workstreams: (1) Improve clarity for consumers of the different types of advice service and the distinctions between them; (2) Raise professional standards of advisers; and (3) Reduce conflicts of interest arising from remuneration structures (ie that arise from the payment of commission for advice). It is difficult to argue with (3)—a world in which consumers refuse to pay for advice and sanction commission payments from the product provider to the adviser is not an ideal one. This is a fundamental market failure, and deserves attention.

14. Raising the standards of financial advisers is a more finely balanced issue. Higher standards is a good thing, however, it is inevitable that the raising of standards will lead to a fall in the amount of financial advice. This must follow: fewer advisers will be able, or prepared, to leap the higher bar. Yet at the same time, we know that there is a significant shortfall in consumer savings in the UK, and the present market turmoil is certain to dent confidence in the retail investment market. The availability of advice might reduce just when it is most needed (see paragraph 22 for a possible solution to this). In formulating its detailed proposals, it is important that the FSA analyses the effects it will have on the availability of advice.

15. Unfortunately, though, the RDR does not tackle the more fundamental problems of why people do not save. If people are simply unwilling to save, attention to commission bias or the competence of advisers will not cause them to do so—the problem arises earlier in the decision chain. So if the RDR is about consumer confidence (which it says it is), it is essential that the FSA works on how it will restore confidence, particularly in the face of the greatest market turmoil in living memory.

16. There is a received wisdom in the retail financial services marketplace that "investments are sold and not bought". That is, an element of hard selling is necessary to cause people to confront their financial needs. The reasons for that might include the following:

- (i) Foregone immediacy of consumption: Saving for the future necessarily reduces current consumption. Saving is inherently unattractive. Previous generations were aware of the need to make provision for the future, on the basis that nothing should be taken for granted. We live now in a society where societal stability is taken for granted and the norm is now that the State will provide. Recent State interventions in bailing out financial institutions will reinforce that.
- (ii) The "paper promise": Even if the consumer decides to save, all he receives in exchange for his (say) £50 per month is a promise from the product provider. The "piece of paper" may be all that the consumer will have for 25 years. This requires an enormous level of trust in the provider—recent market events suggest that this level of trust mean that this trust may be reduced.
- (iii) Risk aversion on the upside: Psychological studies suggest that consumers are prepared to accept risk on the downside but not on the upside. In other words, they will gamble to avoid a certain loss, but will rather accept a certain gain rather than gamble to gain more. This implies that consumers are psychologically predisposed to enter the investment markets at the top, and then sell at the bottom ("buy high, sell low"). This behaviour would seem to be deeply ingrained. We are about to enter a buyers' market in equities that many consumers, through fear, will miss.

17. Although the RDR is a genuine attempt to correct market imperfections in the retail domain, it is unlikely to succeed in the face of these substantial (and perhaps even genetic) reasons to behave unwisely. Aversion to loss is, for example, a much more powerful reason not to save than not knowing the status of an adviser.

18. It is submitted that the FSA should undertake a deeper analysis of why consumers lack confidence in the financial markets. This may show up some of the issues set out above, and there may be more. This work will, it is hoped, show what can realistically be achieved in the field of consumer confidence. In some cases, it may show that nothing can be done. Or it may reveal ways in which consumers' irrationality can be played back to them so as to show to them that their behaviour is irrational. Frankly, this is issue is now more pressing than the RDR. There is no point having a better market if people are not prepared to use it. The RDR is the FSA's flagship retail policy, but there is a risk that the outcomes it seeks will not be achieved.

Financial capability

19. The psychological barriers that consumers face relate directly to the vexed question of financial capability. The level of adult numeracy is considered to be a general problem across the economy. Improving it will take a generation. Behaviours that lead to people behaving irrationally are similarly difficult to shift, and this may even be impossible to some degree. Increased disclosure is of limited value—transparency is essential, of course, but in itself it is unlikely to enhance confidence or lead to people saving more, even where it is read.

20. It is submitted that the FSA and others who are involved in this field, should concentrate on producing a small number of high level messages for consumers. Those messages will change over time, depending on market conditions. At the moment, the following two messages would seem to be paramount (though (2) would probably stand the test of time in any market conditions):

(1) You must save!: Being frightened out of the financial markets because of the present turmoil is not a sensible decision longer-term. Present market conditions provide buying opportunities. This is a counter-intuitive message for retail investors, but putting it a little facetiously, that is why hedge fund managers are rich, and the average consumer is not.

(2) Diversify!: Spreading risk across different products and suppliers is essential, and this applies to bank deposits as much as to equity investments.

21. The FSA could also usefully devote some study to why it is that consumers buy particular products. What is it about those products that attract consumers? In the period after the last bear market, product providers created a stable of capital protected products. Consumers bought those products because the risk they were most concerned about (capital loss) had apparently been mitigated by the "guarantee". However, the guarantee created risks of its own (eg counterparty risk), that the consumer would have been less familiar with, which may have led to consumers feeling better protected than they were. It will be interesting to see what product features are developed to entice consumers back into the financial markets when the current turmoil ends. That is a legitimate regulatory interest.

22. Turning to a practical matter, it would be useful for the government to look at the position of employers in the provision of financial advice. Many employers have now divested themselves of the liabilities they formerly had to employees through defined benefit pension schemes. The burdens arising from those schemes were significant. However, perhaps employers should be used as a conduit for personal financial advice for employees? This does not necessitate liability on the employer's part for the performance of the employee's investments or indeed for the quality of the advice, but there would seem to be social sense in employers providing the opportunity for employees to take financial advice. That, of course, is a matter for the government rather than the FSA.

26 November 2008

Memorandum from Mr S J Ludlow, Ludlow & Co

I run a medium sized Independent Financial Adviser (IFA) company in Southport and employ 26 people.

In general, I believe that there are significant benefits of the FSA and associated Regulations. However, in recent years, it is my opinion that the FSA have lost their direction and are now no longer an effective Regulator. The following are questions which I believe many in the IFA community would like to ask the FSA.

— Treating Customers Fairly (TCF): The focus is currently on IFAs across the UK and the FSA are looking to "assess" (by way of visits, one to one sessions or telephone assessments) over 10,000 firms over the next two to three years. From up to date information from the FOS, the figures show that only 4% of new complaints to the FOS in the last financial year were complaints against IFA firms. With such a low figure, why are IFAs being targeted, when it is clear that other financial institutions require tighter scrutiny.

— Retail Distribution Review: This review is looking at changing the way IFAs are paid. From a brief review of the recent 220 page paper, it appears that IFAs are to be hit the hardest, with no real reasoning (see above point about FOS). My business actively discusses fees versus commission with all clients. The vast majority do not wish to pay fees.

— Financial Resources / Prudential requirements for IFA firms: The changes are significant and will probably put many small IFA's out of business, when the risks they pose to the FSA's four Statutory Objectives are insignificant.

3 December 2008

Memorandum from Mr Jonathan Plant, First Service Financial Limited

Apart from the "Credit Crunch", the FSA has been working extremely hard in two areas—Treating Customers Fairly and the Retail Distribution Review—both of which will have a significant impact on the application of Financial Advice in the UK.

In respect of the former, I was selected for a telephone assessment by the FSA, and found it a very valuable and useful experience, in so far as it confirmed that we appeared to be on the right track. I did make the comment that as far as we were concerned, it was business as usual, apart from the need to document what we were doing. That is easy for small firms such as ourselves, but anecdotal evidence suggests that larger enterprises are less committed. The fact that banks seem to have a problem in responding positively to the reduction in interest rates, both in terms of improving their own rates and willingness to lend is a clear indicator. I would support the FSA in applying pressure in this area.

My principle concern, however, is with one aspect of the Retail Distribution Review (RDR), the single word advice. As far as qualifications are concerned, I have argued that the current qualification level is too low for professional advice, and I wholeheartedly support the improvement to Level 4 as a minimum standard. However I am concerned that advice becomes devalued if the success of that process is measured in the sale of products.

There is no doubt that a product provider (be it a Bank, Building Society or Insurer) must see as its prime objective successful distribution of its products. It employs people to enable it to better achieve that objective, in the same way that any manufacturer does. The Sales representatives are employed to do just that, and it seems illogical either to suggest that they need the same qualifications or experience to achieve that objective as a qualified adviser, who only as a single product—that product being advice.

The words “Advice” and “Consultant” are over-used in business, with the sole objective of persuading the buyer to assume that they are getting more than a sales pitch. I contrast this with Germany, where the word “Engineer” implies a defined minimum standard of qualifications, and is not just applied to someone employed in the industry.

It is obvious to someone involved in the industry that the back-tracking of the FSA in terms of the words “Independent Adviser” and “Sales Adviser” is pandering to the pressures of the banks and Insurers involved in Direct Sales, whereas the original consultation paper made a clear distinction between the two.

Personally I would take the word adviser out of the mix and make it a banned word, as I feel opinions are too entrenched. The processes involved come into the headings of either “Financial Planning” where products are selected to suit the overall needs of the client or the sale of a product. I can not see how the former can be anything other than from a planner having access to the “Whole of market” unless you are making the proposition that all products are effectively the same.

The other options have the prime process of “broking” (where the objective is to select an appropriate product to meet a need—such as a mortgage or insurance product—where the customer has accepted responsibility for their own generic problem solving) or “sales” where the relationship is clear—the customer knows full well that are negotiating with a product provider over the purchase of a product, as they would be when buying a car or property, for example.

I see no problem in dealing with a sales person, and I don’t see why it seems an issue for banks—what I do feel is an issue is that the British Public does not fully comprehend what the processes are, and the latest paper from the FSA fails to clarify the situation, when it has been given a clear mandate and opportunity to do so.

As a small firm, I would give the FSA nine out of 10 for the principles behind the work that they have done, but on this one issue, they have failed the consumer.

1 December 2008

Memorandum from Stephen Wynn

EXECUTIVE SUMMARY

1. The work of the Financial Services Authority is guided by the Financial Services and Markets Act (2000).

2. There are insoluble problems with this work.

3. There needs to be a new Act.

4. The FSA should be divided into three.

1. *Protecting savings*

1.1 The first duty of the FSA should be to protect savings, rather than “consumers”. Its Annual Report 2007–08 says:

> “consumer protection:
>
> securing the appropriate degree of protection for consumers” (page 1)

which is a tautology, rather than a definition of "consumer protection". The FSA seems to interpret "consumer protection" to mean:

> "Promoting efficient, orderly and fair markets
>
> Helping retail consumers achieve a fair deal" (front page)

1.2 The FSA should protect savings by ensuring they are not locked-in to poorly performing products, with excessive charges and the inability to withdraw cash or move funds elsewhere. Such as the Equitable Life income drawdown plans discussed by Simon Bain in *Whatever happened to principles?* (2008):

> "Thousands of pensions carrying valuable guaranteed annuity rates were wiped off the books, with customers typically not even informed that they had a guaranteed rate, let alone being offered an informed choice. How did Equitable get away with these flagrant breaches of conduct of business rules, not to mention the overriding principles of integrity and diligence?"

1.3 He describes Equitable Life as "a regulation-free zone". Another interesting paper on the Equitqable Members Action Group website is *How the Financial Services Authority and the Treasury betrayed Equitable's policyholders* (2008) by Alex Henney, and this topic is discussed on a board:

> "Many of the products that they were offered by Equitable Life were, in fact, dangerous.
>
> By this I mean that there was a substantial possibility that the customer [policyholder] would suffer financial damage if he/she invested in such a product. Examples abound within the ELAS product range, starting with the later GAR products (only saved by the arrival of the non-GARS) and extending to the Managed Pension policies which had neither GIR nor any entitlement to guaranteed bonus.
>
> The FSA has wriggled into every possible dimension in order to avoid coming to the conclusion that the product was, in itself, unsuitable for its target market. Can it be that Equitable is far from being unique in offering such products?
>
> Surely, the answer to this question is a resounding 'YES'."

1.4 I agree. The FSA needs to study the investment performance of products. This depends on the quality of products rather than "suitability". Howard Davies said to your committee in 1998:

> "The whole learning experience of the last few years has taught us I think, that suitability is at the core of the problem which investors face, whether this is a suitable product for you."

The core of the problem that investors face is obtaining a good return on their investments.

2. *"Neck-deep in bad debts"*

2.1 The FSA's Annual Report 2007–08 says:

> "The last year has presented great difficulties for the financial services industry, its customers and for the FSA." (Chairman's statement)

2.2 In the last year the FSA has been found guilty of maladministration by the Parliamentary Ombudsman. Its management of the banking sector is resulting in expensive rescues for Northern Rock, Halifax Bank of Scotland and Royal Bank of Scotland:

> "The Government will pay £20 billion for a controlling stake of up to 60% in RBS, and £17 billion for a 43.5% share in a new 'superbank' created by the expected takeover of HBOS by Lloyds TSB."

These problems have been caused by mortgage-backed securities:

> "At the heart of its problem was the aggressive expansion of its lending, financed by borrowing on the money markets, which then froze up."

2.3 And there are further rescues for Icelandic bank depositors and Bradford & Bingley:

> "B&B's £50 billion of loans, including £41 billion of home mortgages, will not be sold and will be nationalised on a long-term basis. The mortgages may be given to the nationalised Northern Rock to manage.… 'The Bradford & Bingley mortgage book is a lower quality book of mortgages, it is a worse asset than Northern Rock,'"

2.4 An article about Bradford & Bingley in the Financial Times (6/11/2008) *Mouldering buy-to-let loans are a Treasury priority* concludes:

> "But the government will surely have to abandon arm's length supervision of the banks if the alternative is the electorate ending neck-deep in bad debts."
>
> "Arm's length supervision of the banks" is referring to the FSA. A further potential source of bad debts seems to be the £250 billion Credit Guarantee Scheme.

2.5 Mortgage-backed securities seem to have had a bad press since their inception. Especially the 298 page best selling book *Liar's Poker* (1989) by Michael Lewis:

> "After the first CMO, the young turks of mortgage research and trading found a seemingly limitless number of ways to slice and dice home mortgages." (page 163)

2.6 In view of this bad press and the reliance of Northern Rock on mortgage-backed securities, why did the FSA consider that Northern Rock was low-risk? It said in evidence to your Committee in 2007:

> "in terms of the probability of it getting into difficulty we had it as low-probability"

3. *Vague principles*

3.1 Instead of protecting savings the FSA takes actions which are harmful for savings as discussed on my website (www.comparativetables.com/wraps.htm#emp): wrong projections, the non-disclosure of dealing charges, permitting charges to be taken out of capital rather than income, lifting caps on fund charges.

3.2 The Act and the FSA have replaced protecting savings with various vague motherhhood and apple pie principles, such as "consumer awareness", "the protection of consumers", "helping retail consumers achieve a fair deal", "treating customers fairly":

> Outcome 1: Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture
>
> Outcome 2: Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly

3.3 The Government says:

> "The Government is committed to encouraging more people to save for their retirement."

We then find we have to do "deals" with the financial industry, helped by a regulator which is financed by the industry. The FSA wants providers to be "responsible", markets to be "effective" and consumers to be "capable and confident":

> "As well as responsible providers of financial products, an effective market for financial services requires consumers who are capable and confident to take informed decisions."
>
> "Our concern is to make the market for retail financial products and services operate more effectively by developing capable and confident consumers."

3.4 But the FSA only wants consumers to be "capable and confident" up to a point. It does not want them to examine products closely:

> "Just like buying other consumer products, you need to shop around. Like buying a car or a washing machine, you don't have to get to grips with the detailed workings under the bonnet or inside the case."

3.5 The Annual Report 2007–08 says:

> "We need to implement these principles more effectively, not to change them." (Chairman's statement)
> I disagree. The FSA needs to change its principles.

4. *The Financial Ombudsman Service*

4.1 At the Annual General Meeting of the FSA in 2001 the FSA was asked, by Chris Harlow a member of the Equitable Members Action Group, about the Lord Neill Review of the FOS. Clive Briault (Managing Director, Retail Markets) responded:

> "With all due respect, I think that is the body with which it should be discussed because of its operational independence from us."

4.2 This is not an acceptable response, because the FSA set up the FSA, under the Act (Schedule 17, Part II) and it appoints the directors. There should arguably be a further review of the FOS which is genuinely independent and publishes the responses. The Hunt Review only published about a quarter.

5. *The Retail Distribution Review*

5.1 The FSA proposes to replace commissions from providers to financial advisers with "payments". Is this anything more than symantics? This is discussed in the Interim Report (2008):

> "3.16 In the DP we discussed how we may require remuneration practices for certain advisers to operate in a way that 'reduces effectively any conflicts of interest that might otherwise inhibit them acting in the consumer's best interests. To achieve this, we could go so far as to consider no longer permitting any payments to pass from manufacturers to distributors, but we recognise that this is not practicable at the present time."

5.2 Why not? This is arguably what should happen. In the following paragraph "manufacturers" changes to "product providers" and "distributors" to "advisers".

> "3.17 So we are not seeking to end the role for product providers in organising payments to advisers from customers' accounts or investments."

5.3 There is an article in the *Financial Times* (FTfm, 24/11/2008, page 6) FSA has chance to clarify "sales" and "advice". [x] It does not seem to have done so yet, at the time of writing. Salesmen should not be allowed to described themselves as "advisers". An example is "Adviser lost my pension £250,000" (Daily Mail, 9/4/2008).

6. *Three aspects of the industry*

6.1 The FSA is regulating three different aspects of the industry: 1) cash, 2) markets, 3) savings; which need different priorities: 1) liquidity and stability, 2) efficiency, 3) protecting savings.

6.2 Cash is the business of banks. Markets are "financial markets and exchanges" such as the London Stock Exchange. Savings are held by life assurance companies, building societies, fund management companies. Banks are concerned with liquidity and financial stability. London as a financial centre and talk of "light touch regulation" relates mainly to markets. Market operators seem to benefit from instability, such as the LSE report for September 2008:

> "Volatile market conditions contributed to very strong trading across the equity order books of the London Stock Exchange Group during September. £302.8 billion (€383.1 billion) worth of equity trading was carried out during the month, an increase of 24% on September 2007.
> The average daily value traded in equities across the Group's markets increased 12% year on year to £13.8 billion (€17.4 billion), while the average daily number of trades increased by 48% to 1.2 million."

6.3 This high turnover is a problem. There is excessive dealing and portfolio turnover. Lipper Fitzrovia publishes a report Portfolio Turnover of UK Funds, showing that many funds have a remarkably high turnover—well over 100% per annum.

6.4 The FSA should be split into three. The regulation of banks should be taken away from the FSA and given back to the Bank of England. The regulation of life assurance companies, building societies and fund management companies should also be taken away from the FSA and given to a government department. This leaves the FSA with the regulation of markets.

6.5 The FSA responds to criticism, for example:

— "Our hands are tied" by Directives from Brussels.

— Everyone makes mistakes.

— We live in a "non-zero failure world".

— We are learning lessons.

6.6 But criticism seems largely pointless because the FSA is so resistant to change. A 2003 submission to the House of Lords Select Committee on the accountability of the Financial Services Authority complains about inadequate accountability. It recommends changes such as:

> "We recommend that the National Audit Office should be empowered to undertake efficiency studies of the FSA, and that the Parliamentary Ombudsman should be empowered to investigate it for maladministration."

The FSA should be abolished.

November 2008

Memorandum from Mr Alan Crowley

RDR DISCUSSION

1. Whilst I agree in principle with much of the proposals surrounding the IFA market, such as qualification and moving to a fee charging structure. I feel that moving totally to fee's only will drive many IFA's out of Business and leave only a relatively small percentage of the nation willing to pay for financial advice.

2. RDR won't just be damaging to our business, it will be damaging to every financial advice business. Even worse, it will be damaging to clients who, if they cant afford to pay fees for advice, will end up making execution only decisions on financial products sold by "sales people" who know they should tell the client if they're making a mistake but cant.

3. In respect of fee charging, there should be no problem with this at all, we charge fees as well as receiving commission but it ensures we can dedicate more time, effort and care to the whole process for the client rather than just being a "production line" for arranging financial products.

4. The FSA clearly wasn't a better quality of advice for the customer, but doesn't want advisers to be paid accordingly—they want a top notch deal for bargain basement reward.

5. I do get the feeling that the IFA/ Broker field is under a sustained attack from the FSA (who are largely staffed by failed bankers) in an attempt to eliminate the competition to the banks own 'in house' advisers/ order takers.

1 December 2008

Memorandum from Mr Tim Tilbrook

I would like to let you know my concerns about the review.

The FSA review seems intent on reducing the number of people getting independent financial advice. They will end up with less and less people getting better and better advice until no one gets brilliant advice!

Banks have a vested interest in selling, personal loans, credit cards, mortgages, certain type of investments and protection products. It is difficult to believe that these same people will have the customer as their focus.

I do not believe that education of the public or simple products (although a worthy aim) will work. Stakeholder pensions have not worked. Sometime people have to be sold products.

It must be in the national interest to allow as many people as possible to have access to highly qualified advisers offering independent advice. To allow the payment for this to come from commission. By all means make the commission equal so there is no product bias.

If the RDR goes through as I understand it, then I think it will be the end of independent financial advice accept for a very rich few, surely not what is intended?

1 December 2008

Memorandum from Mr Steve Baker, Alexander Beard Group Plc

Regarding your review of RDR.

As an IFA I would like to say what a waste of time & money the whole issue of RDR & TCF have been & will continue to be.

The FSA continues to try and pick on the easy targets namely small IFA's, instead of looking at the big picture, and properly regulating the people who have caused serious financial problems for the economy as a whole, by which I mean "Banks".

Contrary to popular belief IFA's do not have a commission bias, nor do they seek to actively "rip off", clients.

In the main we do an excellent job for our clients often offering a pro bono service (which is not something you can do if you are fee charging).

A large part of the UK population who benefit from the services offered by IFA's do not have the appetite to pay fees, but do understand that IFA's need to earn a living, they see that commissions are disclosed and take a realistic attitude towards them (it is a pity the FSA do not do the same).

I would also like to point out that IFA's often sacrifice commission to enhance the product offering for their clients.

In these difficult times the last thing IFA's need is more of a administration burden, and more things to worry about.

I believe it is in the interests of the British public to retain a strong IFA base, otherwise the options do not bear thinking about, such as casting them off to be dealt with by truly commission hungry bank assurors offering a restricted range of products and a restricted advice & knowledge base.

1 December 2008

Memorandum from Mr Bob Perry

I am an Independent Financial Adviser with of 30 years of experience in the financial services industry. I am a Certified Financial Planner and expect to be a Chartered Financial Planner within the next few weeks.

My firm is a very small one with two registered individuals and one administrator/secretary. We provide a highly dedicated service to our small number of clients. Our client base has been established over a number of years and is built on excellent client care. We only advise in those areas in which we are:

1. Qualified.
2. Experienced.

We do not mind how we get paid. We are happy to receive payment by fees or commission. There is no problem with commission. The problem is with the commission driven saleforces whose income is dependent upon initial commission. In many cases such salesforce do not clearly explain to their customers (they are not clients because there is little or no aftersales service) that the commission is built into the contract charges and is therefore paid for by the client.

The vast majority of small, owner run IFA businesses thrive on Treating Customers Fairly (way before the FSA thought of this) and have built their firms on client referrals. This would not be possible without ensuring clients are fully aware of how the IFA is to be remunerated and how commission is funded. Nor would it be possible without excellent customer care. Unlike a commission driven salesman, small independent IFA's take a longer term view and put clients first.

The FSA has bowed to pressure from the banks and if the RDR is introduced without major alterations bank customers will continue to be poorly served. It would be interesting for the FSA to investigate how many of the following products have been sold by banks in these turbulent times:

1. With profits bonds.
2. Corporate Bond funds.
3. Structured Products.

I am sure the FOS and FSCS will be receiving numerous complaints re these products over the coming years.

The possible increases in Capital Adequacy will force many small IFA firms out of business. Will the Government plough billions of pounds into small firms?

My firm will continue to trade and provide excellent service to our clients regardless of the outcome of the RDR, However we will continue to grow ever more disillusioned with our Regulator. I am wholly unconvinced that the FSA gave any consideration to small firms of IFA's and listened only to the self centred views of the banks. I am equally wholly unconvinced that the FSA understands how small firms of IFA's operate.

There should be a clear and totally unconfused distinction between advisors and salesmen. Advisers should be qualified to Certified or Chartered Status.

Saleforces should not be allowed to use the words adviser or advice anywhere in their title.

1 December 2008

Memorandum from Mr Alastair Lyon

1) *Can any action taken by the regulator encourage the consumer to save more or take out more protection insurance cover?*

2) *My comments on the above in respect of various current and past actions by the financial services regulators*

3) *Should the Regulator interfere in the markets or let them evolve within a regulated world*

4) *Can the regulator by its actions damage the financial services markets*

5) *Does the regulator understand the businesses it regulates*

I am an Independent financial adviser, and have been since 1986. Mine is a firm with one adviser (myself) and one part time administrator.—A small firm!!

1) I do not believe that anything the regulator does, or can do, or has done, will encourage the consumer to take any significant action to act to reduce the savings or protection gaps. All efforts that seek to justify their actions by this are wasted time and resources.

Perhaps its Financial awareness work may have a small affect on this. But you do not need a regulator to perform an educational role.

I cannot think of a single client who has taken out new business, or incremented existing business as a result of regulatory action. Nor can I think of any regulatory action that would achieve this.

I have no doubt that focus groups and market research may seek to challenge this statement. Of course people will give positive answers to the "what if" scenarios that may be presented to them as theoretical case studies in such work. But I challenge the same market researchers to find a significant percentage of people who have actually taken any action in response to action from the regulator.

Yet despite this they appear to be seeking to justify all the effort devoted to the current Retail Distribution Review (RDR) by the false logic that the market is presently flawed, and that fixing it will have the consumers saving more and protecting more in droves—because the problem has been fixed!

2) *Current and past actions*

Polarisation, depolorisation, the RDR, TCF, capital adequacy of £1, (FIMBRA) £10,000 PIA/FSA, and now maybe £20,000:

- Polarisation—probably good had it ever been properly enforced. There was just a chance that the consumer was beginning to understand the role of the adviser that he chose to talk to.
- Depolarisation—upset the business models and created more confusion that before.

In either of these cases you can of course find market sectors that preferred one to the other.

Treating Customers Fairly—I find it amazing that a regulator should get so involved in the minutiae. Speaking as a small firm my business depends on this, and I do not need added regulatory attention to have this as an essential part of my business without spending additional time recording or proving that I have done this, that or the other.

RDR—has been essentially flawed from the day a non existent problem was invented so that the RDR could become a solution to it.

Capital Adequacy—£10,000 perhaps about to jump to £20,000 for small firms that do not handle clients money.

Why is there such a requirement at all when our friends in the accountancy and legal professions seem to be required to have no provable capital adequacy requirements—and they handle clients money! What went so badly wrong under FIMBRA that justified the need to jump fro £1 to £10,000. What is happening today that would have been solved had the figure been £20,000—not one of my clients has ever expressed any concern about my capital adequacy. And all of this when we have compulsory Professional Indemnity Insurance cover.

Anything that upsets the market, demoralises sectors of it, or even has the effect of practitioners closing down or selling up.within the independent sector deprives the consumer of access to independent advice. Action taken by the regulator for example to push the IFA to fees only, will deprive a large part of the market of independent advice.

Or should Independent advice be restricted by regulatory action to consumers with a minimum portfolio of £100,000 under management by the IFA ? That is the potential effect of current RDR suggestions, whether intended or not.

3) *Should the regulator interfere in the markets?*

I do not believe that it is the role of the regulator to interfere in the markets. Their current role in seeking to change the commission model is a case in point. When a product is sold, the vendor sells and makes a profit, some products are sold with annual maintenance contracts attached.

What is so different, dangerous or unique about financial services products that the regulator seeks to interfere in the commercial process between wholesale and retailer.

If the wholesalers have a problem with the present model, that is for them to address. It is not a role for the regulator.

If a provider believes that the present commission model is wrong or too expensive for them, they have only to change their commission terms. Imposing any such charges is not the role of the regulator.

4) *Can the regulator damage the markets?*

Yes they can, and with the RDR they are in severe danger of depriving all but the wealthy from access to independent financial advice.

If in the new post RDR world, the IFA has been forced to evolve into a fee only business where will the bulk of consumers find access to independent advice?

If you look at some of the fee only firms out there, minimum portfolios of £100,000 are quite typical, and minimum fees of 1% per annum. That is where the RDR looks like putting us all.

Suggestions in THE RDR about guided sales are designed to make the sales process cheaper, and include in that process depriving consumers of the rights they have under current regulations. IFA's can offer their clients all the various levels of service that they seek under the current regime—with full rights. If the banks want to do so they can do it today without the consumer being deprived of existing rights.

The consumer will lose out, and many will be deprived of access to independent advice.

5) *Does the regulator understand the businesses it regulates*

One wonders

Recent problems with the banks, New Star, Equitable Life and others suggests that it does not understand enough about the large firms it regulates.

At the other end of the scale, small firms are largely represented by IFA's. While the FSA has its small firms division, and pays more than lip service to small firms, I really do not believe it understands us, or even (in its ideal world) wants us around. We are too stroppy for them, we have a terrible habit of calling a spade a spade—definitely not done in big business or the treasury. We are dotted all over the place, rather than offer a comfy head office to deal with.

Even today its pronouncements and guidance and help sheets as to what we need to do about for example treating customers fairly are barely translated from a style that assumes that we have a manager for this, and a department for that.

December 2008

Memorandum from FIL Investment Services (UK) Limited

THE WORK OF THE FINANCIAL SERVICES AUTHORITY

THE RETAIL DISTRIBUTION REVIEW

Fidelity International is a major financial services group offering a wide variety of investment funds, segregated portfolio management and distributing its own and other funds through its FundsNetwork← funds supermarket. In the UK it distributes its products through banks, insurance companies, independent financial advisers and direct to the investing public. With its experience of fund distribution in the UK, Europe and elsewhere, and given its commitment to the value of advice, Fidelity can offer informed perspectives on the FSA's Retail Distribution Review.

EXECUTIVE SUMMARY

— The Feedback Statement is a welcome articulation of current FSA thinking but in several key areas its retreat from the sensible and intellectually robust positioning of the Interim Report undermines its own avowed objectives.

— The FSA's objective of clarity for consumers regarding the type of service provided is at risk because of its compromised approach to "sales advice"—we would prefer the term sales recommendations.

— The FSA's reform of remuneration is welcome but to be effective will need to be backed by strong and decisive enforcement against abuses and questionable practices.

— Improved disclosure of the cost of advice should be matched by efforts in education to highlight the value of advice.

— Any form of disclosure based on Reduction in Yield risks not communicating with its target audience.

— The FSA's proposals affecting advisers' capital adequacy and resources risk making them particularly susceptible to failure or inappropriate financial pressures and there seems to be no evidence of significant market failure requiring increases in capital.

— The qualification step-change is a welcome move but the logistical challenges are significant.

1. Introduction

1.1 We broadly welcome the FSA Feedback Statement on the Retail Distribution Review. Although it is not without its faults it remains the basis for a regime that should help restore investor trust. We provide our comments here under the three broad headings set out by FSA, namely:

1.1.1Clarity between service types.

1.1.2Reform of remuneration.

1.1.3Professional standards and capital requirements at advisers.

2. Clarity between Service Types

Whatever sales advice is, it is not advice as most people would understand it

2.1 The April Interim Statement set out a clear dividing line between advice, which was broadly based, independent and impartial, and sales, which were none of those things. We remain supportive of such an approach.

2.2 The Feedback Statement has removed a substantial part of that clarity citing two key influences: the MiFID definition of advice which appears to encompass sales advice and a desire not to outlaw certain business models (specifically tied and multi-tied distribution). We do not dispute the MiFID issue, nor that tied and multi-tied models are valid business models.

2.3 Our concern is that we need to move away from the regulatory lexicon and into the everyday language used by consumers if the FSA is to achieve that clarity on the high street.

2.4 When a consumer thinks of advice he does not immediately think of the limitations that might apply to the particular or technical category of advice he is being offered. He takes the perfectly understandable view that advice means the adviser will try and give him the best answer for his circumstances and objectives. Whereas, when a consumer thinks of sales he understands that the role of the person in front of him is to sell him a product, albeit conditioned by issues of suitability and so forth. Sales, even so-called sales advice, is a perfectly valid service but it is not advice as most people would understand it.

2.5 We should allow any business model that supports consumers in their decision-making. But if we call "advice" or even "sales advice" the process of guiding the man in the street through a limited range of options in the tied and multi-tied world and making limited recommendations, we risk misleading him about what service is being provided.

2.6 Such confusion is at odds with FSA's objective of clarity and we would prefer a term such as sales recommendations.

3. Reform of Remuneration

A structure designed to remove abuses must be complemented by enforcement to be effective

3.1 Our starting point is that it must be possible to present remuneration to customers in a way that allows them to assess whether the advice they are getting represents value for money. We also think it is important that the structure of the remuneration is such that customers can have confidence that the products are being recommended because they are the most suitable. We therefore welcome the move to a structure of remuneration where the adviser sets out up front a basis for charging consumers.

3.2 However, a sensible regulatory regime must also be enforced. We note that the current regulatory environment prohibits advisers accepting or producers offering incentives or inducements which conflict with an adviser's obligation to act in the best interests of the client. Yet, as the Feedback Statement itself points out, certain practices exist today, such as "factoring" or "pay to play" which could be seen to undermine the necessary impartiality.

3.3 If the ability to influence adviser choice through commission is removed, then there will still be those who attempt to curry favour through the provision of preferential loans, guarantees or insurance at preferential rates. The FSA needs to be clear about its commitment to remove such practices not simply though announcements, rule-making and speeches but through action, direct and affirmative.

3.4 One of the intended effects of the approach is to engage consumers more directly with the costs associated with investment products. We believe the proposals will clarify the "cost" of advice and this is progress. It is, however, equally essential that FSA's work on financial capability and education matches this with promotion of the "value" of advice so that consumers are better equipped to evaluate the information being provided.

3.5 It is also important to recognise that value will not always be recognised by the customer at the point of advice, yet this is where payment will be required under the proposals. That value is more often recognised through continued service, the passing of agreed landmarks and a developing trust. We feel that the proposals should make it easier than they appear to, for payment to be made over a period of time. Indeed, when the landscape was one of simply initial or trail commission we preferred trail as it encouraged a longer-term relationship between adviser and client.

3.6 We support clearer communication to the consumer of the separate costs of advice and the costs of the product. Today they are lumped together, impeding a consumer's ability to assess the value for money of either the product or the service. The FSA suggests its new model for disclosure will use Reduction in Yield (RIY), despite general acceptance that consumers do not understand RIY and that it is susceptible to manipulation and gaming. There is no ideal formula for this, but a fund TER set alongside the adviser's remuneration expressed as a percentage of the investment would seem more accessible and straightforward to calculate.

4. Professional Standards and Capital Requirements at Advisers

There is no reason to place greater financial pressure on advisers and in the current climate it will have several unwished-for implications

4.1 The UK financial services is amongst a small number of countries in the world (US, Australia and UK) where there is a vibrant independent advice sector which has managed, against significant competition, to establish a dominant market position which we take as conclusive evidence that customers want and value this service. A research project undertaken by the Association of Independent Financial Advisers (AIFA) in November 2007 revealed that nearly half (47%) of all consumers across the UK have received advice from a professional financial adviser.

4.2 This is a broadly consumed service that needs to be supported. The FSA review raises the question of the need for increased financial resources, but we fail to see why the adviser should be the focus of such an approach as we have not seen any significant market failure that such an approach would need to address. The reality is that the most significant risk for many an investor is with the product and the product provider. Here, the capital adequacy rules of the Capital Requirements Directive at the firm together with rules on the segregation and safe custody of client assets provide a robust and sufficient safety net.

4.3 Aside from the lack of a basis for imposing significant financial burdens on advisers, the proposals create concerns as regards the financial viability of the independent adviser sector. The current market situation has placed great pressures on advisers, both in terms of consumer demand for their services and the fall in revenues from reduced asset values. At the same time the decision not to allow for a long stop date for complaints, creates a degree of financial uncertainty as to future liabilities both directly and by way of the Financial Services Compensation Scheme.

4.4 The UK independent financial sector is a uniquely valuable aid to investors and helps enormous numbers of investors and helps keep the market honest. We do not feel it is sensible to make unwarranted financial demands of directly regulated advisers. If we do not see firms failing, we will at least see them becoming more vulnerable to arrangements with other market players that could compromise their impartiality.

4.5 The upgrading of the benchmark qualification as outlined by the FSA is to be welcomed. Competence and quality of service are crucial to earning consumer trust. We would caution against any belief that equated exam success with daily delivery of a competent service, but we recognise it as a necessary building block and discipline.

4.6 Nevertheless, we believe there are several organisational and logistical challenges in processing all advisers in time and would encourage the FSA to ensure there is adequate capacity in the system to achieve the desired result. It would be an appalling waste if good advisers were barred from practising simply because there were insufficient places at exam sittings for example.

December 2008

Memorandum from Mr Blair Cann, M Thurlow & Co (Ins) Brkrs

I have submitted views on these issues before to both the FSA and in the trade press. Now that certain of the matters at issue have been clarified I am extremely anxious to contribute again, albeit especially in one area which is in my view potentially highly damaging to the industry. I have served in the life and pensions industry for 48 years; I was an employee during that time of Commercial Union Life and CGU Life and I have been an Independent Financial Adviser (IFA) for over eight years.

My concern is the RDR and specifically the proposal that the basic qualification to be allowed to practice should become a "level 4 qualification" ; in current terms this means IFAs would need to acquire the Advanced Financial Services Certificate (AFPC) in order to continue their employment in this industry. This is what could reasonably be described as a serious exam, currently comprising several modules and covering a wide range of specialist knowledge including trusts and taxation (compulsory) and pensions and several other possibilities from which a choice can be made.

The average age of an IFA is some 57 years (this was the figure a few years ago) and the imposition of such a regulation will undoubtedly drive out a number of IFAs who will feel quite reasonably that their days of attending the exam room are over. This is I believe a view widely held within the IFA community. The upshot of this measure if it goes through-I believe the FSA have stated that "grandfathering" is not an option although they have referred the issue to another agency for further recommendations-will be that a large number of IFAs who have served their clients well and with the utmost integrity, in many cases for 20 or 30 years, will finish up being debarred from continuing their professional careers. I believe this to be an outrageous outcome. Few will deny the FSA the right to get rid of incompetent or unscrupulous advisers; the FSA however has no right or mandate to get rid of decent, capable advisers and this aspect of the RDR needs to be revisited. I should stress that I have no personal axe to grind as I already hold the AFPC and as far as I can see will be unaffected by a change in basic educational requirements. I am personally acquainted with many however who will be.

My views on the other issues can be expressed I feel in other outlets such as the trade press. On this issue however I take great exception and am anxious to express them to you.

December 2008

Memorandum from Mr Michael Forbes Bates, Independent Financial Adviser

The Treasury Committee will be examining the Financial Services Authority on the 15 December and they will be specifically discussing the RDR.

I must draw to your attention the following misconceptions which are being used to steer the RDR in a direction which would be to most consumers' disadvantage.

The direction favoured by the product providers and tied distribution channels would certainly sooner or later result in a collapse of the UK savings markets because of lack of consumer confidence.

The misconceptions of the FSA are both conceptual and legal. Permit me firstly to give you the true facts about the conduct and status of IFAs.

An IFA is the agent of the consumer, NOT the product provider. Thus the IFA is legally liable for his advice to the consumer who is the IFA's client.

The IFA establishes by diligent appraisal of his client's needs what product would best serve those needs and with the client's authority, seeks the best product in the full, open marketplace for his client and recommends the best product and product provider (he is legally-bound to do so—and actually as an advisory professional would not do otherwise). This is the IFA's broking activity.

The IFA thus is earns" brokerage" NOT "commission" because he is NOT commissioned by the product providers to sell their products.

Please note this very important point—brokerage has been payable by the product providers and used to mitigate fees otherwise payable by the consumer for the IFA's services. Is everyone happy, yes—except for all the product providers who have not gained a customer because their product is not good enough, they don't provide the right product or good enough terms etc.

Aso and now very crucially, the FSA, further to mistakenly or deliberately referring to IFAs' remuneration as commission rather than brokerage, is seeking to push the cost of purchase onto the consumer who seeks advice on the best product. In this way, the product providers are being allowed to offload their sales and marketing costs onto the consumer.

IT IS THESE POINTS THAT ARE MAKING PRODUCT PROVIDERS AND BIG DISTRIBUTORS DRIVE THE RDR TOWARDS MAKING THEM MORE PROFITABLE—AT THE CONSUMERS' COST AND THE DISAPPEARANCE OF THE IFA FOR ALL BUT THE WEALTHIEST SECTOR OF CONSUMERS.

Please also note the muddying of the waters between "client" and "customer". AN IFA HAS THE FORMER AND A PRODUCT PROVIDER HAS THE LATTER.

The legal status of each is different and the liabilities of the IFA and the product provider are different.

Change is being sought without proper appreciation of the evolved status quo and an evaluation of the legal, cost and anti-beneficial consequences to the consumer should lead the committee to the conclusion that the RDR proposals are regressively inappropriate.

The chairman of Allianz (assurance) of Germany said when the FSA recently undid the conduit system of financial product purchase "the British financial services system has been the envy of the World as it has evolved over the decades but now it is being undone it is becoming a free-for-all for product providers and we are looking to get a share of this, possibly by buying a UK provider". I am sure that there are those who will argue that this is good—but they've missed the point.

Thank you for your attention. I am very willing to attend any conference or consultation where my experience may be of value to help in these vitally important considerations that are being made to encourage a robust and trustworthy savings environment.

I also subscribe to the points below.

1. Abolition of brokerage/commission in favour of a fee only regime will mean that the vast majority of the public will not get independent/impartial advice.
2. This will lead to the banks dominating financial planning in many cases providing inferior and more expensive products which clearly is not in the public interest.
3. The FSA state that TCF applies to both IFA's and the banks. How, in practice, can the banks treat their customers fairly when they are not impartial and only offer their own products.
4. The new capital adequacy requirements will put a large number of small IFA's out of business.
5. The new educational requirements will lead to a large number of IFA's going out of the business and or taking early retirement. What happens in the classroom is very different to what actually happens in practice.

5 December 2008

Memorandum from Mr Nick McBreen, Independent Financial Adviser

1) It is with great disappointment that I read the statement from the FSA last week on the latest stage of the Retail Distribution Review. I had hoped that the delay in hearing from the FSA was due to the need to have more time to evaluate all the feedback given by all interested parties to the FSA. The content of the statement suggests this not to be the case but rather perhaps that pressures from banks and insurers lobbying to protect their particular business interests going forwards has been delaying any positive progress. The content of the November statement would suggest this to be the case.

2) At a time of crisis pervading across global economies, with consumer and investor confidence at critically low levels, the RDR presents an excellent opportunity for the UK regulator to provide clear guidance and clarity and shape the financial services business for the modern age. What is emerging unfortunately is something very different. This is also hardly the right time to be proposing the introduction of yet another regulatory body with all the commensurate cost and disruption—much better to work with what is in place.

3) The statement from the FSA has undone much of the good work that it had done so far on the RDR, setting the clock back to a position where the IFA sector and banking businesses and insurers are now once again locking horns in an adversarial battle for market share. Stuck in the middle of all this is the investor/client—if they were confused before now then the proposal for "sales adviser" designation for individuals employed and targeted to sell "product " will simply add to the confusion and inhibit members of the public from seeking and obtaining financial advice. This in turn will not address the pensions shortfall nor the savings gap or stimulate private investment via equities into UK PLC—the reverse is the likely outcome!

4) One of the major benefits to consumers from depolarisation since June 2005 was that the lines were clearly drawn on the difference between and status of Independent advice and tied advice, thus empowering people to make an informed decision upon which route they followed when seeking advice. This has worked well and a level of trust has been established between consumers and IFAs that should be built upon, rather than undermined by further inappropriate and unnecessary regulatory change. It is alarming to see that the feedback provided to the FSA from consumer groups stating that they welcomed the clarification between sales and advice has been ignored—yet it is the consumer who is the key and end-user of the financial advice.

5) One apparent reason for the FSAs "reluctance to clarify the distinction between sales and advice seems to be based upon MIFID requirements. The broad principles of this piece of Euro legislation has great value and use—but nowhere does it require a regulator of a member country to disadvantage consumers, when understanding the business model and remuneration of financial advisers and choosing who they engage with to obtain financial advice and how they pay for it—via fee or commission or a combination.

6) Professional qualifications form a crucial part of the RDR process and as such can only help to raise standards in the profession and is welcomed by all practitioners. The learning and knowledge gained from professional development, when applied in practice, has the positive outcome of delivering better and better quality advice to the consumer. However, there is no evidence to support any assertion that lack of qualifications results in incompetence or bad advice and therefore any changes in FSA requirements for advisers to reach any new benchmark qualification can only be done by working closely with firms to achieve higher standards agreed by all parties to be useful and relevant. Setting a deadline for end of 2012—with absolutely no proposals to recognise existing experience of advisers and facilitate any non-academic transition—will have the inevitable result that large numbers of advisers will be driven out of the profession due to insufficient time and resources to jump through the hoop! This in turn will leave less and less advisers to deliver the much needed advise to the consumer—just in time for the proposed introduction of Pension Personal Accounts—probably the biggest shift in the UK pensions arena since the introduction of the State Pension. Who is going to advise individuals and businesses on the right course of action?

7) Recruitment into financial services is focussing more and more on attracting bright young graduates into the profession. For an undergraduate a further tranche of examinations may not be a disincentive—but the spectre of lifetime liability for advice certainly is and must be rationalised by the regulator and

removed. Recent proposals for some time-scale on this thorny issue have not been accommodated by the FSA statement and this leaves the sword of Damocles to hang over the heads of the current and future adviser community.

8) The proposals also include a dramatic increase in capital requirements and this will immediately escalate costs for adviser firms. The result of this will be further attrition in adviser numbers in the IFA community who for the most part are small firms, yet nowhere in the FSA statement is there a clear rationale for this huge hike in costs for firms. There can be no questions that any business providing financial advice should of course be financially sound but any additional costs to their businesses has to be justified and fair rather than punitive. Interestingly the FSA have made any indication that IFA firms who run quality advice businesses and meet ongoing requirements should be recognised by an adjustment (downwards) in their ongoing costs eg the FSCS levy. It is worth pointing out that where a firm consistently delivers quality business and low-risk advice their Professional Indemnity costs usually go down as a rule!

Summary

Consumers in the UK need advice that is clear and transparent and delivered to them on a remuneration basis that is mutually agreed and not dependant upon a transactional business model. Independent fee based advice already currently provides this service and the regulator has the opportunity with the RDR to build upon the success of the IFA sector in advising consumers—rather than turning the clock back. A huge amount of time and expenditure has been spent by advisory firms, professional bodies and the FSA in looking at the current situation and working to agree a model for the future—let this not be wasted but capitalised upon by completing the RDR and establishing clear and fair guidelines for the business of financial services for consumers and advisers.

5 December 2008

Memorandum from Gerry Reilly

In my 26 years as a Financial Adviser I have been constantly bewildered by the attitude of the authorities of the day towards regulation of the industry. I watched in my early days as the Life Insurance Association (LIA), which was a large group of financial advisers, lobbied vigorously for regulation on the basis of individual registration of all advisers based on:

1) good character and basic qualifications,
2) on continuing professional development, and
3) a monitoring system that encompassed complaints from the public. They argued that there should also be some form of monitoring of products before and after they were launched.

The financial institutions, which in those days controlled virtually all sales people, consistently refused to consider any of these points. I can only assume the appropriate government bodies did not take any interest in these discussions.

Since the FSMA of course we have experienced great swathes of regulation, constantly changed and replaced, but never at any time do they appear to have they been reduced or simplified. Pensions Simplification doubled the size of the pensions rulebook, and there are other examples of well meaning legislation adding to the problem.

Like the policeman who is too busy completing his reports to be able to go out and feel a few collars, IFAs are now spending less and less time actually talking to clients, but ever more time writing up reports, paying for compliance advisers, and completing various regulatory returns. It has become a well used phrase in our circles, that IFAs cannot comply with all of the rules and make a decent profit.

We cannot and must not go back to the days when fast talking salesmen fleeced the public of their savings for plans that though legal and genuine, were far too complex and volatile for the average man and woman in the street. This does not mean however that we had to take a regulatory hammer to crack the nut, but a development along the lines of the old LIA principles would still cover the majority of transactions in financial services.

Our chronic savings gap would be narrowed significantly if financial advisers were sufficiently freed up to spend more time advising clients, as opposed to covering our backs with reports that keep a whole compliance industry in work. A rebalancing of the scales would work wonders.

5 December 2008

Memorandum from Anita Gatehouse, cre8 Financial Business Planners

QUESTION FOR THE COMMITTEE TO ASK THE FSA

The FSA should explain why IFAs are receiving such attention (plan at least 10,000 TCF assessments etc.) when the IFA community represent only 4% of the complaints against firms at the FOS. I have only a small number of clients and their financial security is paramount to all my decision making.

How much damage do they think can be done by the IFA community in comparison to the outrageous behaviour of the banking fraternity? The issues that indeed are still coming to light now and the danger the banks are prepared to put onto customers through greedy purely profit for personal gain policies has been outrageous. Yet the FSA continue to allow the banks to operate that way again and again, while IFA's are branded unprofessional and inept.

I thoroughly agree that checks should be carried out and standards set to protect my clients, but we are focused on far too readily by the FSA. The figures speak for themselves!

5 December 2008

Memorandum from Mr Nick Byrd, Independent Financial Adviser

I am extremely concerned about recent developments with the FSA, the RDR and TCF and make the following points:

1. The Treasury Committee will be examining the Financial Services Authority on 15 December and they will be specifically discussing the RDR.
2. If the FSA get their way, then commission payments will cease and the only way that IFA's will be remunerated in the future is by way of a fee/hourly rate.
3. As it stands at present when a customer comes to see us they are given a choice of either paying us a fee/hourly rate for the work carried out or agreeing that we receive the standard rate of commission from the investment group/insurer and this commission is disclosed to the customer at the point of sale.
4. In practice, the vast majority of customers agree to us taking the standard commission as they do not want to pay us a fee out of their own pocket for the advice given. The FSA are under the illusion that if commission payments are abolished in future then all customers will be happy to pay us a fee—in reality quite the reverse is the case and in practice less than 5% of customers who come to see us go down the fee route and 95% are happy with the commission route.
5. Take, for example, a young married couple with their first child who need some life assurance. We shop around on the open market for the best product available and typically for around £15 per month suitable cover can be provided. We would normally receive commission of around £225 for setting up such a policy which is fair remuneration for the work done. If the FSA get their way then we will no longer be able to take commission and would there-fore have to charge the customer a fee. I can assure you that in practice customers such as this would not pay us a fee and would simply go to their bank in order to get the required life assurance. The banks do not and would not charge a fee for their advice and they make their money by selling their own product which in the vast majority of cases would be an inferior product (policy conditions and monthly cost) when compared with the whole market.
6. No matter what the FSA may think, in practice, only 5% of the population are prepared to pay IFA's a fee for independent advice and the other 95% either cannot afford or do not want to pay a fee for independent advice and hence they will end up going to the banks. Net result, 95% of customers will be worse off.
7. Another part of the RDR that is causing me great concern are the onerous new educational requirements that IFA's will be subjected to. I set up my own firm in 1985 and I have spent the last 23 years building it up and the new onerous educational requirements may well force me out of the business which is extremely unfair. I firmly believe that the standard of advice given at this firm is second to none and this is demonstrated by the fact that in the last 10 years we have not received a single complaint other than standard complaints encouraged by the media for those who took out Endowment Policies many years ago—some of these complaints got as far as the Financial Ombudsman Service and those that did were rejected outright by the FOS. The fact that we have never had any serious complaints at this firm must mean that we have always given good advice and therefore onerous new educational requirements for somebody such as me who has had over 30 years experience in the business is excessive to say the least. I have the Financial Planning Certificate and G60 pensions exam.

8. Another part of the RDR which causes me great concern is the proposal from the FSA regarding capital adequacy requirements—apparently, the average additional capital per IFA needed will be in the region of £33,000 and many small IFA's simply will not be able to afford this. In practice, therefore, the FSA will split the personal financial planning sector into top level fee only firms working for the rich and the rest which will be dominated by the banks.
9. Other than RDR, the FSA are also heavily promoting the principle of "treating customes fairly". The FSA is insistent that TCF is central to the culture of all firms and this includes the banks. The FSA are coming down extremely heavily on any IFA firms who have not adopted TCF as a central culture. How, in principle, can the banks possibly treat their customers fairly. The banks are not going to tell a customer that a better life policy could be purchased through an IFA offering the whole market. Similarly, the banks are not going to tell a customer that it may be to their advantage to shop around on the open market through an IFA for the best mortgage deal available—they are going to sell their own product.
10. As part of TCF I recently had to submit to the FSA the basis of how I was actually treating my customers fairly and this culminated in a telephone call that lasted more than an hour with two FSA representatives. The FSA asked me a question "when was the last time that a customer asked you if you were qualified to give the advice that you were giving". My reply was that in the 30 years or more that I have been in this business I have never been asked that question by any customer. Following this telephone interview I discussed matters with 2 other IFA's who have both been in the business over 25 years and they both agreed that they also had never been asked the same question by a customer during an interview. You have to ask the question therefore, why did the FSA ask that question and in reality it is yet more evidence that the FSA do not live in the real world.
11. The RDR as it stands plays straight into the hands of the banks. A recent IFA survey confirmed that 87% of IFA's felt that the RDR was fatally flawed. The whole RDR should be brought into question and the FSA closely questioned about their motives for promoting it as it is fundamentally obvious that the RDR is not in the public interest and only favours the banks.

5 December 2008

Memorandum from Raymond & Patricia Hague

Executive Summary

My wife and I make the submission on the basis of the Phasing of the special Distribution being unfair to Norwich Union with-profits policyholders, and it being in complete contradiction to the FSA regulations relating to Treating Customers Fairly. We are original Commercial Union with-profits endowment policyholders, with three in-force with-profits policies that are now managed by Norwich Union.

1. I received a copy of the Twelfth Report of Session 2007–08 HC 496 and I have read the Summary p/4 Phasing of special distribution payouts, and also the Conclusions and recommendations p/49 Special distributions 8. I have also received a copy of the Fifteenth Special Report of Session 2007–08 HC 1132 and have read Appendix 1: Financial Services Authority Response p/6 30. 31.

2. It is my opinion that, at the request of the Treasury Select committee, the FSA did not make a strong case for the phased distribution and that the FSA have by their reply been negligent of their responsibilities towards the with-profits policyholders, who are classified as customers, as evidenced by correspondence received by me from Aviva/NU addressing me as "Dear Customer".

3. On the question of the phasing of the special distribution, I request that in the 15 December Session the Treasury Select Committee insists on the FSA giving a proper answer.

4. I submit to the Treasury select Committee that in the Treating Customers Fairly initiative, the FSA have not exercised proper oversight, as required by their remit, in their reply in HC 1132 appendix 1: FSA Response p/6 30.31.

5. As a With-profits policyholder with Norwich Union, I find it very difficult to accept that the FSA, in stating that as they do not have any rules in terms of requirements for a possible phasing of any special distribution, that they therefore will not intervene.

6. The lack of specific rules for the phasing of any special distributions does not in my opinion excuse the FSA from applying a proper oversight of the Aviva/NU proposal to phase the 5 February 2008 announcement of a special distribution.

7. Because I have a strong sense of unfair play in the Norwich Union reattribution of the inherited estate I have made it my business to obtain as much information as possible about the reattribution process and the protections that w-profits policyholders may have, and since the AXA 2000 reattribution and Court Case, learnt of the special regulations that the FSA introduced for with-profits policyholders and the providers of with-profits products.

8. As the main principals in bringing about a conclusion to the reattribution of the inherited estate, and with particular reference to the phasing of the special distribution, Norwich Union and the Financial Services Authority appear to be at complete odds to the Treasury select Committee, the with-profits Policyholder Advocate, many with-profits policyholders, Which? and many other financial comments and opinions in the press, who by consensus agree that the phasing is unjust, a barrier to exit, and unfair to many thousands of with-profits policyholders, and more importantly, against the meaning and the spirit of Treating Customers Fairly.

9. It is my opinion that the reattribution decisions made by Norwich Union and the Financial Services Authority are acting against the best interests of the with-profits policyholders, and I look to the Treasury Select Committee to demonstrate that the Committee, having held inquiries, has powers to act upon the recommendations that they make, which are based on the views that they have come to from the inquiries, otherwise the public will quite justifiably ask, what are the reasons for calling inquiries if the Treasury Select Committee can only make recommendations?

8 December 2008

Memorandum from Simply Biz Plc

FSA'S RDR FEEDBACK STATEMENT 08/6

EXECUTIVE SUMMARY

2.1 It is impossible to argue with the principles and objectives of the RDR proposals. We all want to see increased professionalism and clarity for consumers in a fair marketplace.

2.2 The acid test is, will the proposals actually achieve these objectives and if so will the likely outcomes justify the potential costs and market disruption.

2.3 Our conclusion is that the current RDR package of proposals represent a significant gamble by the FSA which could damage the interests of consumers by reducing the availability of advice and therefore long term savings in the UK.

2.4 On remuneration, the FSA are gambling that, by putting a price on advice and making the payment of commission more difficult they can change the behaviour of consumers. In reality except for the very well off there is little evidence that consumers are prepared to pay for advice. The likely outcome of the remuneration proposal is that fewer consumers will seek advice and that fewer advisers will be available to serve the less well off.

2.5 It should also be noted that there is little evidence that the IFA sector, which is most at risk from these proposals, is failing consumers to any material degree. Indeed the FSA's most recent qualitative consumer research (FS08/6 page 77—Para 7.17) states in terms of the type of service that consumers would value, "their ideal advice model was very similar to the service provided by independent financial advisers".

2.6 The proposals also suggest a confusing array of titles and types of advice and it is difficult to see how this will benefit the consumer or encourage more saving. There is a real risk of confusion which rather than increasing consumer confidence will alienate the consumer from the advice and savings marketplace.

2.7 The proposed new standards of professionalism and qualification are welcome in principle but without significant changes to the transition they risks forcing many experienced advisers of good standing out of the sector to the detriment of the consumer.

2.8 The changes to the capital resources requirements are not unreasonable though research should be undertaken regarding the timing and proportionality aspects to limit the risks of good quality independent firms being unnecessarily disadvantaged.

2.9 On all these issues, remuneration, professionalism and capital resources whilst we support the RDR's general direction of the proposals we have grave reservations about much of the detail.

2.10 Managing risk is a core competence of the FSA. We urge the Treasury Committee to impress upon the FSA the need to consider carefully the risks the RDR proposals will bring for consumers and the financial advice sector as a whole. The stakes are too high for the FSA to gamble with the future of the UK savings market.

BODY OF SUBMISSION

3.1 Rather like motherhood and apple pie it is impossible to argue with the principles and objectives of the RDR proposals. We all want to see increased professionalism and clarity for consumers in a fair marketplace.

3.2 The acid test is, will the proposals actually achieve these objectives and if so will the costs and market disruption be justified against the likely outcomes.

3.3 Our conclusion is that the current RDR package of proposals represent a substantial risk to the best interests of consumers. As such they are a gamble by the FSA which could result in damaging consumers by significantly reducing the availability of advice and therefore long term savings in the UK.

3.4 On remuneration, the FSA are gambling on the theory that, by putting a price on advice and making the payment of commission more difficult they can change the behaviour of consumers. In reality except for the very well off there is little evidence that consumers are prepared to pay for advice. Currently two thirds of IFA clients are C1 or below. It should also be noted that the full commission receivable by an IFA has been disclosed in cash terms on every investment and saving transaction since 1991. During this period the market share of IFAs has increased from under 30% to in excess 60%. Providing we have transparency and the client continues to have the choice, as at present, it should be irrelevant whether remuneration is via commission or fees. The likely outcome of the RDR's current proposals is that fewer consumers will seek advice and that fewer advisers will be available to serve the less well off.

3.5 The RDR proposals also suggest a confusing array of titles and types of advice which is certainly not the simple landscape which was forecast and it is difficult to see how this will benefit the consumer or encourage more saving. There is a real risk of confusion which, coupled with the remuneration proposals, will alienate consumers from the advice and savings marketplace rather than achieving the RDR objective of increasing consumer confidence.

3.6 It is ironic that the FSA's own recent qualitative research which is included within the RDR Feedback Statement 08/6 (7.17) states that in terms of the type of service consumers would value "their ideal advice model was very similar to the service provided by independent financial advisers". In addition the FSA's market impact analysis concluded that the majority of consumers buying investment products need help "not only to identify their needs but also to encourage them to take action".

3.7 On professionalism the proposed new standard is welcome in principle but without major changes to the transition arrangements it risks forcing many experienced advisers of good standing out of the sector. The CII tell us that someone who currently has the full FPC is likely to require up to 700 hours of study to achieve the new level whilst still looking after their clients and their business. Are the FSA and the Government really saying that thousands of experienced professionals of good standing should be thrown on the scrap heap and their several million clients denied access to advice they have relied on for very many years. Furthermore we are not aware of any other profession that as they raise their standards do not permit existing practitioners of good standing to continue to practice. In addition when the current qualification requirements were introduced in June 1997, without any form of grandfathering, the then Regulator stated that it was a one off exercise to raise standards and would not be repeated.

3.8 As regards capital resources, clearly the current position needs addressing. It is inappropriate that a twenty adviser firm should be required to hold only the same capital as a two adviser firm. In introducing the changes however it is important that the proportionality and timescale is considered carefully. It would be counter productive in the current economic climate to risk damaging good quality firms through a too rapid transition for no material gain.

3.9 On all these issues, remuneration, professionalism, simplification and capital resources whilst we support the RDR's general direction of travel we have grave reservations about much of the detail. We believe the current proposals carry the risk of serious damage to the amount, quality and availability of financial advice to the consumer.

3.10 Managing risk is a core competence of the FSA. We urge the Treasury Committee to ensure that the FSA considers carefully the impact and risks the RDR proposals will have on the availability of advice for consumers and the financial advice sector as a whole. The stakes are too high for the FSA to be allowed to gamble with the future of the UK savings market.

December 2008

Memorandum from Chelmsford Financial Management LLP

1. Executive Summary

Chelmsford Financial Management LLP (CFM) has examined the proposals set out in FS08/6. Whilst we endorse the aim of the Retail Distribution Review (RDR), we are disappointed at the shift from many of the important advances made in the RDR Interim Report (April 2008), particularly the lack of clarity on the service that consumers will receive, the increase in firms' capital requirements and the requirement for advisers to obtain a benchmark qualification of at least QCA Level 4. CFM always strives to achieve the standards set by the Financial Services Authority and allocates 30% of its budget to do this. However, in view of CFM's finite resources and that it is already facing difficulties in the present economic climate, it is likely that CFM will be unable to meet the additional costs associated costs with the RDR. CFM believes that the effects of the RDR will be to wipe out the entrepreneurial spirit present in the small firm sector. The proposals are the same for large and small firms and pose a real threat, in terms of costs and resources, to the small firm, such as CFM.

2. INTRODUCTION

CFM offers independent advice on pensions and retirement planning, savings and investment, mortgages, life and protection policies and tax planning and believes that everyone should have access to the highest quality financial advice whatever his or her income. CFM is a small business in the medium volume sector of the market place, has a client base (a range of high net worth and low income) of just over 3000, is well managed and well capitalised and works on a mixture of initial commission, trail commission, indemnity commission and one-off fees. The majority of our clients are from personal recommendations, including those from solicitors and accountants, (with whom the business works closely) and remain "active". This demonstrates that we have earned a positive reputation and established client trust. Non-advisory sales make up 1% of our business. The business comprises one Partner Controller and three Appointed Representatives with a combined experience of nearly 90 years. All have the Financial Planning Certificate, CeMap and CeLTM; one adviser has the Pensions paper of the Pension Investment Certificate. Through effective financial advice and commitment to providing the highest quality service, CFM places great emphasis on its experience in helping clients achieve their financial goals. Our record of complaints is excellent (indeed we have been congratulated by Walter Merrick on our complaints procedure). It is against this backdrop that we set out our views on FS08/6.

3. ADVICE AND SALES

The distinction between sales and advice proposed in the RDR Interim Report has been replaced with a less than clear distinction which we believe will confuse clients as to which type of service they are selecting and receiving. A much clearer distinction is required. Under the FS08/6 proposals, sales staff can give advice and we feel that this will confuse clients as to who is on their side and who has an obligation to sell a product. As Lord Lipsey put it at the RDR Feedback Conference on 25 November 2008, "Sales advice is wholly devoid." The reason given for the change in the sales and advice distinction was that it would reduce access to advice for the less affluent and was inconsistent with European Legislation. Our present business model allows clients on low incomes to access high quality financial advice. We strongly support AIFA's recommendation that a full review of the term "advice" at European level is needed to establish a definition so that clients understand fully the different services they will receive.

4. QUALIFICATIONS

Whilst we endorse the move towards higher levels of qualifications, with the CII Diploma or equivalent becoming the benchmark, the valuable experience gained by advisers who have been in the industry for many years must not be ignored or even worse lost. Additional qualifications on their own will not make advice more accessible or understandable to the consumer, but they may help to professionalise the industry, indeed young people may feel more inclined to enter the industry. However, this requirement we believe will lead to an exodus from the industry of experienced, independent advisers who have delivered a first rate service to clients. As mentioned above our advisers have been involved in the financial services industry for nearly 90 years and are all near retirement. We do not feel it is it reasonable for them to spend up to four years pursuing qualifications when they only have a working life ahead of them of four to five years. We are not aware of any other profession that is required to fulfil such a requirement.

We believe that professional bodies should be responsible for promoting individual advisers' continual competence through suitable training and development and take appropriate sanctions against advisers who do not adhere to professional standards. As firms invest in their business they should be allocated regulatory dividends. There should be a decrease in FSA fees for firms that become members of a trade body, professional body and uphold the highest standards.

We believe that experience, skills and knowledge enable a person to give appropriate professional advice. Under FS08/6 we could not continue to offer our highly professional, independent financial planning service without our advisers gaining additional qualifications. To achieve diploma level would take two years or more of study and chartered status at least a further two years. We fail to understand why an adviser with over thirty years' experience and an excellent track record of delivering a first class, professional service to clients needs to spend up to four years sitting additional examinations before s/he can refer to him/herself as a professional, independent chartered financial adviser. In view of the dire economic situation, we do not believe that this is the time to impose additional professional standards on already overburdened firms experiencing extremely difficult times.

We place great value on our Continuing Professional Development which enables all our advisers to update continuously their professional knowledge, personal skills and competencies. As an alternative route to higher-level qualifications, we believe existing advisers should be able to demonstrate their competence at this higher level through Accredited Prior Experiential Learning (APEL). The ISO 22222 for Financial Planning would provide such an assessment route. We advocate most strongly that existing advisers should be given a realistic time scale (between four to six years) in which to achieve a higher level both through additional qualifications or APEL.

Research www.unbiased.co.uk (2007) revealed that consumers saw the location of an IFA business and increased prudential requirements as more important than the possession of qualifications.

5. Capital Adequacy

Whilst CFM appreciates that existing capital requirements are inadequate and in need of review, many IFA firms, particularly large national firms, will struggle to meet the capital adequacy requirements proposed in CP08/20 and the move to the expenditure-based requirement of three months of relevant annual expenditure, which will treble the current requirements, is likely to be detrimental to firms with extensive compliance support, as we have. Once again the timing of this proposal could not have come at a more damaging time and poses a real risk to firms that are already facing difficulty in a tough, financial climate. To reduce capital requirements firms will consider ways to reduce their fixed costs which could encourage more self employment. There is a risk that the impact of the increased capital requirements could ultimately cause shrinkage of the IFA community, resulting in less overall capital in the industry.

8 December 2008

Memorandum from Stephen Pett, Editor, IFA Bonus

1. The FSA may well be an excellent Regulator of the Stock Market, and require expensive offices close to the City. This is, of course, quite unnecessary for other branches of Financial Services—but they still have to pay City overheads and salaries to the FSA.

2. The FSA is staffed primarily by Bankers, and is unable to answer questions as to how many experienced IFAs, Mortgage Brokers or General Insurance Brokers it employs. I assume this is because it employs none.

3. The FSA is deeply distrusted by most IFAs, despite recent efforts to put on a good face and talk to those regulated.

4. The FSA has created a totally new set of jargon in a jargon riddled industry, which makes it far slower and more difficult to understand what they are saying.

5. Referring to point 2 above, the FSA only has the ability to Regulate with hindsight, and is quite incapable of risk rating products, a pre-requisite for a decent Regulator. Despite this, the FSA expects advisers to have the knowledge of a Regulator, an Actuary and of the full product design person at the provider as well as their legal team. Relying on product providers (who still provide most of the training in the industry) is not permitted. On this basis it is almost impossible to advise on any product without the risk that it will come back and bite you in the future.

6. The FSA does not understand the difference between FEES and COMMISSION. Towry Law would be classified as fee based, but they charge a 1% up front commission and an annual fee of 1%, irrespective of the amount of work. If they were charging fees, it would be either an hourly rate or a flat fee.

7. Fee only advice is great, if you can afford it and it's ongoing cost. 90% of the population cannot, so they will be left to the mercy of the banks—a prospect which any right minded individual would fear.

8. The FSAs drive to push small firms out of business is doing an enormous disservice to the public, who will inevitably be pushed into using advisers at large organisations who are inevitably profit driven. Examples of the issues are the bulk of regulations and the need to employ experts to put them into plain English, the increase in capital required, the lack of understanding of how Financial Advisers work in the real world (visits help, but there is no substitute for in house experience), the emphasis on exams to the exclusion of experience. Would you rather be advised by someone with 20 years experience or a degree and none?

9. My second biggest complaint about the FSA is their concerted (and expensive) PR campaign to discredit everyone in Financial Services and to destroy public confidence. At the same time, they try to make being a Financial Adviser seem simple to the public via their website…..I guess that shows the depth of their lack of understanding!

10. The worst folly of Regulation is the decimation of advice to the public, through the destruction of direct sales forces, home service companies and IFAs. Numbers are a little buoyed by those of Mortgage Advisers, but theirs is a very limited brief.

To summarise, the FSA are wildly expensive, ignorant and unresponsive, and both the public and the industry would be better off without them.

December 2008

Memorandum from the Financial Services Authority

Sale and Rent Back Schemes

When we gave evidence to the Committee on 22 January this year, we agreed to offer some general comments on new developments in the sale and rent back (SRB) market.

SRB schemes are not a new phenomenon. In the past, typical SRB providers were local authorities and housing associations, the schemes being a means for indebted homeowners to avoid repossession.

We understand that the concern expressed by bodies such as CML, Shelter and Citizens Advice relates to a new breed of SRB companies. These companies appear to target homeowners in financial difficulty, offering to buy their properties at lower-than-market-value prices (anecdotally it can be as low as 40%) in exchange for an assured shorthold tenancy. At the end of the tenancy, however, homeowners may find themselves evicted from the property.

These SRB arrangements may be attractive to some homeowners facing arrears and repossession because they would allow them to remain in their homes. Some of these homeowners will have regulated mortgages and would otherwise have the safeguards of our requirements on mortgage lenders to treat their customers fairly. However, as we explained in our oral evidence to the Committee, Government has not given the FSA responsibility for regulating SRB transactions.

In 2006, when making the legal changes to allow us to regulate home reversions, Treasury specifically considered whether our regime should extend to other forms of flexible tenure schemes (which would include SRBs). Their conclusion was that our scope should focus narrowly on home reversions (and home purchase plans)—to ensure a level playing field with mortgage products we began regulating in 2004. To do this, and to distinguish home reversions from SRB schemes, the legislation only applies to contracts which provide for the right to occupy to end only after:

- entry into a care home;
- the consumer's death; or
- a specified period of at least 20 years. It is this condition that makes it highly unlikely that existing SRB schemes will fall within the scope. Some homeowners may be under the impression that they may continue to live in their homes indefinitely if granted a tenancy by the SRB company. However, market practice is to offer an assured shorthold tenancy of only six to 12 months duration, after which the company has the right to evict.

Decisions on the FSA's scope are a matter for the Government. If the Government were to give us responsibility for this market, we would expect the decision to be informed by evidence of market failure and the appropriateness of statutory regulation as a response to this evidence.

Although sale and rent back is outside our scope, we understand the concerns about the market. We have contributed to some preliminary Whitehall thinking. As announced by the Chancellor in Budget on 12 March, the Office of Fair Trading will lead a study of the market this year, focusing on consumers' experience of these arrangements, and consider options where appropriate to strengthen consumer protections. The study will draw on contributions from the FSA.

Consumers targeted by SRB companies may well not fully appreciate the options available to them. Even though we do not regulate SRB transactions, we recognise that we have several materials the SRB target audience may read:

- for mortgage borrowers newly entering arrears we require lenders to send out an FSA booklet setting out their options, and encouraging them to contact their lender; and
- for consumers more generally, our "Moneymadeclear" webpages cover debt and affordability topics.

Last summer we decided to add information about SRB schemes to both the arrears booklet and our webpages. This information emphasises that such schemes are unregulated and that consumers need to consider both the reduced price they will get for their home and the limited protection the lease provides against rent rises or eviction. Similarly, we included information about SRB schemes in the budgeting guide that we launched for consumers early in the New Year.

Financial Services Authority

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