

THE FINANCIAL SERVICES
PRACTITIONER PANEL
ANNUAL REPORT

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CHAIRMAN'S REMARKS

This is the fourth annual report of the Financial Services Practitioner Panel. It was also my first full year as Chairman of the Panel and it has been a challenging one. The sure foundations laid by our first Chairman, David Challen, have stood the Panel in good stead for the work it has undertaken in the new world following N2.

First, a word about the Panel. It was established under the Financial Services and Markets Act 2000 with statutory powers. Its members are appointed by the Board of the FSA after significant consultation with relevant practitioner groupings. I am pleased to report that the Board has accepted all those whom I have recommended for membership during the year. My own position is subject also to the agreement of the Chancellor of the Exchequer.

The Panel is not part of the FSA although its modest support budget (around £150,000) is carried within the FSA's total costs. It is also not a super trade association. The recent report from the Centre for the Study of Financial Innovation into trade associations suggests that there would be no demand for such a body.

During the development of the Act, the financial services industry pressed strongly for appropriate checks and balances on the substantial power of the FSA and the Panel fulfils an important role in this respect. It meets monthly and, inevitably in its early years, was largely reacting to the cascade of consultation and rule making that emanated from the FSA. Since N2, it is operating against the reality of the new regulation and inevitably some of the focus of its work has changed. The Panel continues to invite senior FSA executives to attend its meetings in relation to particular issues but in addition has also invited representatives of trade associations to present to the Panel to ensure that it is fully sensitised to current issues. It also maintains strong informal links to the trade associations.

The Panel receives support from the Secretariat of the FSA and towards the end of the year the Panel added a researcher to its resources to help improve its understanding of complex issues, particularly those emanating from Europe.

The Panel has enjoyed a productive relationship with the FSA during the past year and I would like to record our appreciation for the access and co-operative spirit we have encountered when dealing with FSA staff at all levels.

Second, a general word about regulation. The body of this report highlights some specific areas of concern but I want to draw attention to an anxiety that I believe is growing amongst regulated firms. Regulation is to some extent an incremental activity; it is relatively easy, in isolation, to justify (almost) every new rule on the grounds that someone benefits. However, there is another side to this. Each new rule,

each examination of process, each report carries with it not just its immediate and identifiable cost but also a complexity cost. To date there is no clear mechanism for considering the total effect of the regulatory burden carried by the regulated firms. All concerned need to remain vigilant to avoid reaching a point of no return where innovation, flexibility and competition are threatened by too much cost and complexity.

The Panel recognises that the FSA, in developing its risk-based approach and its non-zero failure aim, is alert to the danger. In its attempts to be proportionate, the FSA also recognises the balance that needs to be kept if the trust and confidence between the regulator and regulated is to be effectively maintained. Respect for the regulator, not fear of the regulator, should be the natural reaction of well-behaved firms.

Third, the second Practitioner Panel Survey. The survey, which we intend to conduct every two years, provides an important signal to the FSA on the evolving reaction of the financial services industry to its regulatory policies and how they work in practice. There were positive messages about the openness of the FSA and its rigorous consultation processes, but there are also warnings, and a general perception that the costs of regulation and the degree of change are becoming unduly burdensome. The FSA has responded constructively to the findings and has discussed with the Panel the steps it will take as a result. The Panel welcomes the first steps outlined in the FSA Chairman's Senior Executive Briefing No 8 issued in December 2002. It was encouraging that almost 80% of those who were aware of the Panel's existence considered its role to be important in informing the FSA. We have appended the summary and conclusions of the survey results to this report.

Finally, other matters. Apart from the survey, the Panel has had a busy and intensive year considering FSA policy consultations and other issues. The discussions have been intensive not only because of the volume of consultative documents reaching the Panel from the FSA, but also because of the significant number of high-level, important and often complex issues contained within them. I believe, as a consequence, the Panel has been able to assist the FSA's thinking in a number of policy areas.

The Panel has also turned its mind increasingly to Europe and the international arena. From within our particular remit, we have concentrated on the FSA's response to European directives and initiatives and how these will impact on domestic policy.

The Panel has also taken time to consider in particular issues affecting small businesses. We are fortunate to have the co-chairmen of the FSA Small Business Practitioner Panel as members and through them we have been able to reflect the particular views of this important and extensive segment of the industry. The burden of cost is particularly troubling for them.

With such a powerful and almost ubiquitous regulator it would be surprising for the industry not to have some major issues. The key issues at this time are set out in the Report below but it would be balanced to acknowledge that the broad thrust of much of the work of the FSA has the Panel's support.

2003 will be a pivotal year in the life of the Panel. We will have the transition to a new leadership at the FSA and the evolution of much of the regulation emerging from the European Commission's Financial Services Action Plan. At home the settling in period for the FSA will be over and, in potentially difficult operating circumstances, we will see how the industry copes with its new regulatory environment. It certainly promises to be busy.

I would like to thank Geoffrey King and his colleagues, particularly Amanda Scott, and all my colleagues on the Panel, especially those who oversaw the work on the Survey, for the commitment and support they have given to our work over the year. Amanda is moving to a new role in the FSA and we wish her well in her new position.

Donald Brydon
February 2003

Chairman's
remarks

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MEMBERS OF THE PRACTITIONER PANEL

The Panel has welcomed some new members during the year. The full membership is listed below, including those who retired during 2002. Membership is constructed to represent the various sectors within which regulated financial businesses operate, based mainly on nominations made by trade associations. Members are drawn from the most senior levels of the industry. Fuller details of the processes for membership are included in appendix 1.

Jonathan Bloomer, Group Chief Executive, Prudential plc, a member of the Panel since February 2001, was appointed as its deputy chairman from October 2002. He replaces David Challen in that role. David was previously chairman of the Panel and its deputy chairman from October 2001.

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Barry Bateman (until September 2002) <i>President</i> Fidelity Investment Management Ltd.	
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THE PANEL'S FOURTH YEAR

INTRODUCTION

This is the fourth annual report of the Financial Services Practitioner Panel ('the Panel'). It reports on the first full year of the Panel's operation since it gained statutory status and since the Financial Services Authority (FSA) acquired the full range of powers under the Financial Services and Markets Act 2000 ('the Act') on 1 December 2001. The Panel now has a formalised and statutory role within the accountability framework established by virtue of the Act. The Panel was originally set up, under the name of the Practitioner Forum, by the FSA in 1998. The very senior level of membership of the Panel, as then established and since, reflects the intention to create a body with both the experience and authority to inform the FSA of the impact of the developing regulatory framework on regulated firms. The Practitioner Panel was established as a statutory body on 18 June 2001, and is now a key part of the accountability framework set up by the Act.

The Panel's objectives are:

- To monitor the FSA's effectiveness as seen by the industry;
- To communicate to the FSA issues of general concern to regulated businesses about regulation in practice;
- To respond when requested to by the FSA with a practitioner view of key regulatory issues;
- To contribute a broad financial industry view on the formulation of FSA policy and on the response the FSA proposes to make to representations it has received during any formal consultation process.

More details on the statutory role and remit of the Panel are set out later in this report, and in appendices 1 and 2.

The Panel has considered a number of high profile and complex issues during the course of the year. The Panel continues to act within its plan to consider matters presented to it on a high level and cross-sectoral basis. In this way it endeavours not to duplicate the work of the trade associations, but complement the detailed work they put into responding to the FSA consultation papers. The Panel does not itself make formal responses to public consultation papers from the FSA, having had the opportunity to input broad views early in the process.

Therefore, in considering matters such as, for example, the depolarisation proposals and the insurance sector regulatory issues, the Panel's main focus has been to monitor that proper and transparent processes are being followed by the FSA in consulting with the industry. On other matters which set high level precedents for corporate governance (such as the proposal for with-profits committees), or which impact across a broad

spectrum of the industry (such as the discussions on the use by firms of past performance data), the Panel has been more specific in its feedback to the FSA, given its ability to take soundings from across different sectors of the industry.

In 1999, the Panel undertook a survey of regulated firms to seek their views on the regulator. We undertook a second survey in 2002. The executive summary of the results is appended to this report at appendix 3, and the reaction to the results and how the findings will be taken forward are discussed below. The panel will repeat the survey again in two years, and in this way will build up a continuous picture of how the industry's view of the FSA and its regulatory framework is developing.

For further general information about the Panel, you will in the near future be able to take a look at its soon to be established website, at <http://www.fs-pp.org.uk>.

THE PANEL'S KEY ISSUES

The report has alluded above to a number of significant and high level issues to which the Panel has input over the course of the year. This section sets out some of these issues in more detail in order to report back on its deliberations and views as presented to the FSA and the consequence.

Before turning to these specific issues, however, it is worth setting them in the context of some themes that have emerged for the Panel.

- Firstly, the Panel, whilst wholly appreciative of the process of consultation pursued by the FSA, has been concerned about **the number of proposals** that continue to emerge from the FSA. The Panel appreciates that this is to some extent necessary as the FSA sets its regulatory framework, and that some matters for consultation have been outwith its control, such as the decision by Treasury to bring mortgage and general insurance intermediary firms into regulation by the FSA and some necessary harmonisation with European Directives. The Panel has also appreciated the high standards the FSA achieves in its consultation processes.

Nonetheless, there have been some matters presented where the Panel has questioned why early implementation is necessary. Firms already have to cope with implementing a wide range of new or changed regulatory requirements, and with understanding the new rules and guidance. The Panel is anxious that 'must-dos' take precedence over 'nice-to-dos'. Two recent examples where the Panel has signalled a concern are the proposed changes to the examination framework and some aspects of the proposals for point of sale disclosure for retail packaged products.

It would be helpful, whenever possible, if the FSA would share an outline forward work plan to enable the industry to be better prepared to respond to new initiatives.

- Secondly, and partly related to the remarks in the above paragraph, **the number of different regulatory and exploratory reviews** continued in 2002 to cause anxiety and overload. The Panel issued a press release earlier in the year conveying this disquiet. Not all of these are within FSA's gift to control, but the need for good co-ordination and a recognition of the burden they create are both needed.
- Thirdly, **European issues** have increasingly entered the Panel's regular agenda. As individual practitioners, Panel members have naturally been aware of the growing impact of European policies on their sectors. Over the last year however, as a Panel, the focus has increasingly shifted to the overall and increasing impact of European

directives and proposals on home state policy and how the FSA is reacting and negotiating on this front. The Panel is concerned that it, and the wider industry through trade associations or other groupings, should be working to support the FSA in ensuring domestic interests do not suffer whilst caution is exercised in relation to over-rapid or super-equivalent implementation in this country.

- Fourthly, the Panel has some concern about how far **the principles of risk-based regulation** are permeating through the FSA's staff. The Panel strongly supports the policy approach of the FSA in this respect but some early and informal feedback suggests that the principles are not yet fully adopted or understood in the front line of regulatory supervision. This is not a surprise and the Panel understands the major management task facing the FSA. The Panel will continue to monitor this issue as best it can.

Within this context, some specific issues to which the Panel wishes to draw attention are set out below in no particular order.

The presentation of past performance and bond yields in financial promotions

The Panel voiced concern, widely felt in the industry, that the proposals to restrict use of past performance in promotional material were too prescriptive. This concern was felt for several reasons: consumers want the information; the evidence of the predictive power of past performance information is unclear; and the crux of fair advertising lies in consistency between firms, not in prescription by the FSA. The Panel signalled to the FSA Board the danger that in certain circumstances the relationship between the investment management industry and the FSA could be damaged if the industry felt the FSA had not given proper and due consideration to its views. Discussions are now taking place with the industry and the Panel will be interested in the outcome of these.

Prevention of money laundering

The money laundering guidance and the potential for confusion between the various remits of the Treasury, the FSA and Joint Money Laundering Steering Group (JMLSG) has during the year been the subject of much debate in the industry. The Panel entered this debate, actively seeking discussion with the FSA and the British Bankers' Association as the lead trade body. The Panel also benefited from links with the Small Business Practitioner Panel, which kept it informed of the impact of money laundering requirements on small financial services firms. The Panel feels the outcome of this debate has been to provide much greater clarity and clearer delineation of responsibilities, although there are still anxieties about the full functioning of the new arrangements.

Corporate governance and with profits review

As part of its review of with-profits governance, the FSA consulted the Panel on its proposals that firms establish with profits committees. The Panel expressed serious reservations both about their operation and the wider issues for corporate governance, in particular, how the proposed with profits committee would fit within the legal corporate governance framework in the UK. The Panel's preference was for with profits committees to comprise non-executive Board directors only, taking advice externally as required. The Panel awaits the outcome of this feedback.

Quality of cost benefit analyses

The FSA's policy proposals are often supported by reference to research either undertaken or commissioned by the FSA. This research is important in underpinning the cost benefit analysis (CBA) the FSA is required to do for its consultation proposals. The Panel has therefore been concerned to establish that this research is robust, and has during the year sought evidence of this from the FSA. The Panel referred to this point in the last annual report. Whilst FSA staff have been helpful in entering into discussion on this point, and the Panel has had positive reassurance about the governance of the research, the Panel believes that processes would be improved if the FSA published the outcome of its research when it is used as the evidence underpinning CBAs. It is an area the Panel will continue to monitor.

Regulation of insurance

Regulatory issues in the insurance sector, for obvious reasons, have had a high profile during the year. The Panel's remit has been to ensure the FSA is transparent and robust in the processes it is following to address the various issues raised. It is also important that clear distinctions are drawn between issues in the life and general insurance industries and between poorly managed and well managed firms. Great care needs to be taken to avoid unnecessary additional impact on consumer confidence at a time of stockmarket fragility.

Financial Ombudsman Service

The Panel expressed concern about the potentially effective rule-making impact of the actions of the Financial Ombudsman Service (FOS). The Panel welcomed the agreement between the FSA and the FOS to discuss together relevant issues but the Panel remains concerned that effective regulatory change can still occur without the appropriate consultation and consideration as a result of the actions of the FOS.

International competitiveness

During the course of the past year, the Panel has asked that a formal process be established to consider the effect of each new proposal from the FSA in relation to its impact on the international competitiveness of its likely effect. Such an examination would include matters which affect the domestic market as well as where immediate cross-border activities are concerned, on the basis that international competitiveness is as much determined by the health of the domestic market as by success overseas. To date little progress has been made in this respect.

Caveat emptor

The Financial Services and Markets Act 2000 states that the FSA must have regard to 'the general principle that consumers should take responsibility for their actions'. The Panel has the sense that in the FSA's work in the consumer field the FSA takes this aspect of the Act insufficiently into account in determining its actions. This is a subtle point, and is not universally the case, but the Panel hopes that in 2003 it will see increasing reference from the FSA to the need for consumers to take responsible actions in their financial decision making alongside those advocating better selling practices from practitioners.

The Panel understands the need at the same time for good consumer education and is supportive of the approach taken by the FSA in this area.

FSA's work on 'Harnessing Market Forces'

Some time ago the FSA established a 'Harnessing Market Forces' study which the Panel, at the time, hoped would lead to a systematic examination in due course of areas of regulation where market forces may potentially prove at least as effective in regulating behaviour as further or existing rules. It is understandable that, with such a comprehensive agenda, little progress may have been made in this respect but it remains one of the Panel's hopes for the year ahead.

Issues arising from the survey of regulated firms

A number of issues are given clear focus from the results of the survey of regulated firms. These are specified in the relevant section below.

OPERATION AND GENERAL BUSINESS OF PANEL

General overview

The main themes and issues referred to above are part of a general heavy programme of work for the Panel. The Panel has been increasingly conscious of the need to manage its processes effectively and, on behalf of the industry, to be able to respond robustly and in an informed way to matters on which it is consulted. The Panel therefore reviewed its operation and implemented a number of measures to help ensure that it is able to fulfil its statutory remit and act on behalf of the industry in a more than superficial way. These measures encompass a series of successful and useful meetings with senior trade association representatives, which have helped to construct more effective relationships and lines of communication; the appointment by the Panel of a researcher – Elisabeth Bertalanffy – to give in-depth research support on European and domestic issues; more focussed and better use of individual expertise of Panel members, including through smaller discussion sub-groups. The Panel will continue to monitor its effectiveness.

More generally, the Panel continues to enjoy the benefit of useful and productive discussions at meetings with FSA staff. Nonetheless, the Panel is concerned to find evidence that its views are taken into account by the FSA Board. It would be unreasonable to expect the FSA to always agree with us, but it is reasonable to expect that the views the Panel expresses are considered carefully. The Panel will continue to write to the Board on occasions following discussion at a Panel meeting. The Panel has not found it necessary to exercise its rights under section 11 of the Financial Services and Markets Act 2000.

Sir Howard Davies and FSA Managing Directors have met with the Panel during the year, and these discussions have proved frank and open. The Panel maintains a dialogue with the Consumer Panel, in particular through meetings between the respective chairmen. Others with whom the Panel has had useful discussions during the year are Rosemary Radcliffe, the Complaints Commissioner, and Walter Merricks, the Chairman of the Financial Ombudsman Service.

Earlier in the year, the Panel's Chairman and Colin Brown, the Consumer Panel Chairman, gave evidence to the Treasury Select Committee on the operation of the two Panels and to review how they were contributing to the accountability framework of the FSA. The Select Committee questioned both Donald Brydon and Colin Brown closely on their relationship with the FSA, and challenged the Panels firmly on their approach to monitoring the FSA. The transcript of the oral evidence given to the Treasury Select Committee can be found at:

<http://www.publications.parliament.uk/pa/cm200102/cmselect/cmtreasy/600/2020501.htm>

Matters considered by Panel

Set out below is a full list of the main issues considered by the Panel at its meetings in 2002.

January	<ul style="list-style-type: none"> E-commerce directive Windfall benefits Complaints process for firms Financial promotions review Risk assessment framework – ARROW FSA Plan and Budget 2002/3 Whistleblowing – feedback Stakeholder pensions: data protection and analysis – feedback
February	<ul style="list-style-type: none"> Financial Ombudsman Service: Plan and Budget 2002/3 Past performance and presentation of bond funds in financial promotions FSA theme on harnessing market forces Single pricing review – feedback UCITS directive and limited issues
March	<ul style="list-style-type: none"> Governance of FSA research programme Individual capital requirements Regulatory reporting Future regulation of insurance Cross-sector risk transfer project
April	<ul style="list-style-type: none"> Money laundering Conduct of business rules for securitised derivatives – feedback Feedback on Discussion Paper on the examination review Statutory status disclosure
May	<ul style="list-style-type: none"> With profits review and proposals for with profits committees The role of the appointed actuary Operational risk systems and controls Proposals on innovative tier 1 Proposed changes to Lloyd's regulatory regime Implementation of motor insurance directive Asset valuation for insurers

June	Feedback on proposals for Integrated Prudential Sourcebook Proposals for prudential regulation of insurance Best execution Systems and controls in insurers and friendly societies Stakeholder pensions: maintaining decision trees – feedback
July	Review of point of sale disclosure for retail packaged products Mortgage regulation Financial engineering by insurance firms Review of client money regime Feedback on windfall benefits
September	Future regulation of insurance: progress Presentation of past performance and bond yields in financial promotions – feedback FSA financial risk outlook 2003 Demand led fees and fees for insurance firms
October	Polarisation Money laundering customer review Risk based regulation – ARROW Short selling Regulatory reporting for insurance – feedback
November	Review of point of sale disclosure for retail packaged products General insurance: conduct of business proposals Appointed representative regime Review of strategic plan and 2002/3 priorities Examination review UCITS management directive CIS review Role of appointed actuaries for life insurers Complaints reporting
December	FSA Plan and Budget 2003/4 Enforcement issues Supervision of groups: legislative changes With profits: governance arrangements Proposals for ICAS and capital regime for insurers Status disclosure for firms – feedback Large exposure reporting for banks Policyholder protection arrangements for Lloyd's Mortgage endowment complaints – changes to time limits for making a complaint

SECOND SURVEY OF REGULATED FIRMS

The Panel published its second survey of regulated firms on 29 November 2002. The first such survey was conducted in 1999, and in commissioning this further survey, the Panel sought to assess how industry views of the FSA had developed. The survey was conducted by means of a questionnaire to Chief Executives and Heads of Compliance of all regulated firms, except for smaller IFA firms and the newly regulated professional firms, where a representative sample was surveyed. The survey elicited a response rate of almost 50%, lower than the 1999 survey but still an excellent result for a postal survey of this type. BMRB International, who analysed the results and prepared a full report, undertook the survey on the Panel's behalf. The summary and conclusions of that report are at appendix 3.

The survey showed that, overall, practitioners viewed the move to a single regulator as beneficial for the industry. There was support for strong regulation from the FSA, for the approach to consultation, and supervisory and enforcement processes in general. On the other hand, there was anxiety about the level of continuing change with which firms were having to cope, about the balance between consumer and practitioner interests and a view that processes rather than outputs were being regulated. More generally, there was a perceived deterioration in regulatory performance.

In discussing the results of the survey with the FSA and others, the Panel established three key findings which it considered to be of particular importance for the FSA to address. These were:

Costs of compliance

The survey asked a number of questions about practitioners' experience of the costs of compliance. The response highlighted not only that around 50% of respondents found compliance costs to be excessive, but that there was an expectation that costs might rise further. The Panel welcomes the FSA's decision to conduct research into the source of compliance costs to establish what are the differences between firms and if there are good practice lessons to be learned and shared. The Panel is aware that the FSA is not the source of all compliance costs but remains concerned that the costs of the FSA itself do not rise disproportionately at a time when industry costs are under pressure.

Guidance

There were positive comments about the FSA's frankness and openness with firms and about the FSA's emphasis on prevention rather than enforcement. However, a widely held view was expressed about the willingness, consistency and timeliness of the approach of the FSA in dealing with requests for help and guidance. Responses also indicated a reduction in the clarity of guidance since the first survey in 1999. The FSA has again said it will look into this concern and at its own service standards in handling requests for guidance.

FSA Handbook of rules and guidance

There was a generally negative response to questions about the Handbook, particularly from smaller organisations. A large majority found the Handbook difficult to

navigate, unclear and inaccessible, and too detailed. Again the FSA has committed to reviewing this and to considering routes for making the rules and guidance more user-friendly.

FSA response

The Panel welcomes the FSA's commitment to reviewing these three principal areas of concern, which the Panel has highlighted from the survey results. Obviously the Panel, together with the industry, looks forward to the result of their deliberations. In its next annual report the FSA will be responding formally to the survey, as well as to this annual report.

FUTURE PRIORITIES

Looking ahead, the Panel has a number of priorities on its agenda in 2003.

- The Panel will be focussing more keenly on European issues and the impact and interplay with FSA's regulatory policies in the U.K. The Panel will aim to bring greater influence to bear, both through FSA and, where the Panel can, directly.
- As risk-based regulation beds down into the FSA structure the Panel will need to monitor the impact. The results of the survey show that practitioners support the principles of risk-based regulation. Looking further ahead, one of the Panel's key monitoring mechanisms will be the survey of regulated firms, which the Panel plans next to repeat in July 2004.
- The Panel identified three priorities for the FSA from the lessons learned from the survey, which the Panel will continue to discuss and address with them over the year. These are:
 - To promote caveat emptor. The Act itself states that, in fulfilling its consumer-focussed objectives, the FSA needs to take account of consumers' responsibilities for their decision making.
 - To help maintain consumer confidence in the industry. The industry's reputation has suffered due to a very small number of high-profile failures. The Panel appreciates that the FSA must consider if there is any part of the regulatory framework that needs to change on the basis of the lessons learned. The FSA does not operate in a world without failures (such a world would also be free of innovation), and the majority of firms are working hard to maintain good prudential and conduct of business standards. Care needs to be taken that no actions of the FSA cause the reputation of the whole industry to be damaged.
 - To understand better the diversity of regulation required. There is a need to consider whether, in the interests of harmonisation, the regulatory structure is becoming too inflexible for individual sectors. The needs of the wholesale and retail marketplaces are different and it would be helpful to have fresh thought about the extent to which differentiation is required.

CONCLUSION

This has been a challenging year for the Panel. The expectation had always been that there would be a peak of work around the date of N2, but that from then the new framework would begin to 'bed down' and firms would see a more stable period following, during which they would concentrate on ensuring their standards met the established requirements. What the Panel is seeing instead is continuing change, and a growing anxiety from practitioners that there is 'no end in sight'. The results of the survey of regulated firms might indicate a growing gap between practitioners' expectations and their experience. The next survey in 2004 will tell whether this is a justified anxiety or not.

A P P E N D I X 1

Statutory role and remit of the Practitioner Panel

The Practitioner Panel

The Practitioner Panel was set up, as the Practitioner Forum, by the Financial Services Authority in 1998 to create a high-level body to which it could turn for opinions on matters having an impact on regulated firms. Subsequently, the Financial Services and Markets Act 2000 ('the Act') established the Panel as a statutory body, alongside the Consumer Panel which represents the interests of consumers to the FSA. This was in recognition of the important role of both Panels in the accountability and regulatory framework established under the Act. Both the Practitioner and Consumer Panels became statutory on 18 June 2001, from which date the Panel adopted the name of the Practitioner Panel, as it is called in the Act, rather than its previous name of Practitioner Forum.

Sections 8, 9 and 11 of the Act, which set out the requirements for the FSA to consult practitioners, are attached as appendix 2.

Membership

The membership of the Panel, including members who retired during 2002, is included in the main body of this report. Membership of the Panel is constructed to represent the various sectors within which regulated financial businesses operate, based mainly on nominations made by trade associations. Members are drawn from the most senior levels of the industry. The Act only specifies two sectors which must be represented, these being recognised clearing houses and recognised stock exchanges. Members are formally appointed by the FSA, and the Chairman must have the formal approval of the Treasury.

The Panel aims to rotate its membership to ensure a balance between consistency and new input. Four new members have been welcomed to the Panel in 2002, these being Alan Ainsworth of Threadneedle Investments, James Crosby of HBOS plc, David Grigson of Reuters plc, and David Verey, formerly Deputy Chairman of Cazenove.

David Challen retired as Deputy Chairman of the Panel during the year. He was the Panel's inaugural Chairman when it was set up in 1998, and remained as Deputy Chairman after handing over the chairmanship to Donald Brydon in 2001. Jonathan Bloomer was appointed as the Panel's new Deputy Chairman in October 2002.

Role of the Practitioner Panel

The Panel's remit remains to represent the interests of practitioners, and to provide input to the FSA from the industry in order to help it in meeting its four statutory objectives and seven principles of good regulation.

The Panel takes care to ensure it does not duplicate the important work of the trade associations in representing the views of their members. These associations generally have the staff and resources to promote the interests of their respective members in response to the impact of FSA regulatory policies on the sector they represent. The Practitioner Panel aims instead to speak across all sectors in offering input at a strategic level on important policy issues.

The Practitioner Panel is supported by one researcher whose costs are borne by the FSA. Ad hoc expenditure, such as the cost of this annual report and of the survey of regulated firms, is agreed with and paid for by the FSA. The Panel keeps under review whether this continues to be the most effective way of operating, but for the present considers this the right approach since regulated businesses ultimately pay for the costs of the FSA. This approach does require the generous support of members of the Panel and we would like to acknowledge this alongside the administrative support of the FSA Secretariat.

Statutory status

On 18 June 2001 the commencement order giving statutory status to both the Practitioner and Consumer Panels under the Financial Services and Markets Act 2000 (FSMA) came into force. The relevant sections of FSMA (ss.8, 9 and 11) are reproduced at appendix 2.

Section 11 of the FSMA brought an important part of the formal accountability of the FSA to the Practitioner Panel into effect. This provides that, should the FSA ever reject formal advice offered by the Panel, it should have to explain its reasons in writing. The same also applies to the FSA's relationship with the Consumer Panel, and both Panels have therefore agreed a common process for managing these 'section 11 representations'. It is important to strike a balance between ensuring that section 11 can be applied effectively, whilst at the same time not weighing down free and frank debate by unnecessary formality or bureaucracy. Neither Panel expects that formal representations under the Act will be made often, and none have been made to date since the provision was brought into effect. This is nonetheless an important facility: whilst the Panel has no fear that the present FSA administration would ever seek to sideline the Panel or its views, it is important to protect against such a possibility in the future.

Access to the FSA

The Panel Chairman meets regularly with the Chairman of the FSA, through whom it has access to the FSA Board, and these meetings provide the opportunity to communicate issues of particular import and emerging concerns. The Panel's Annual Report is the subject of a formal presentation to the FSA Board. There are frequent more informal and ad hoc contacts between the Panel members and Directors and senior executives of the FSA. Managing Directors regularly attend Panel meetings to update the Panel on current issues within their responsibility and generally impacting on the FSA's work. Senior FSA executives regularly attend meetings to present on policy developments, seeking the Panel's views before going out to wider formal consultation.

APPENDIX 2

Arrangements for consulting practitioners and consumers

Taken from Part 1 of the Financial Services and Markets Act 2000

<p>The Authority's general duty to consult</p>	<p>8. The Authority must make and maintain effective arrangements for consulting practitioners and consumers on the extent to which its general policies and practices are consistent with its general duties under section 2.</p>
<p>The Practitioner Panel</p>	<p>9.(1) Arrangements under section 8 must include the establishment and maintenance of a panel of persons (to be known as 'the Practitioner Panel') to represent the interests of practitioners.</p> <p>(2) The Authority must appoint one of the members of the Practitioner Panel to be its chairman.</p> <p>(3) The Treasury's approval is required for the appointment or dismissal of the chairman.</p> <p>(4) The Authority must have regard to any representations made to it by the Practitioner Panel.</p> <p>(5) The Authority must appoint to the Panel such –</p> <ul style="list-style-type: none"> (a) individuals who are authorised persons, (b) persons representing authorised persons, (c) persons representing recognised investment exchanges, and (d) persons representing recognised clearing houses, as it considers appropriate.
<p>Duty to consider representations by the Panels</p>	<p>11.(1) This section applies to a representation made, in accordance with arrangements made under section 8, by the Practitioner Panel or by the Consumer Panel.</p> <p>(2) The Authority must consider the representation.</p> <p>(3) If the Authority disagrees with a view expressed, or proposal made, in the representation, it must give the Panel a statement in writing of its reasons for disagreeing.</p>

A P P E N D I X 3

Survey of regulated firms: summary and conclusions

This appendix sets out the summary and conclusions of the Practitioner Panel's 2002 survey of regulated firms. The full report of the survey, published on 29 November 2002, will be on the Panel's website (<http://www.fs-pp.org.uk>) when it is established in the near future. In the meantime the report can be found on the FSA's website by using the link http://www.fsa.gov.uk/pubs/additional/2002performance_report.pdf

This is the Panel's second such survey of the industry's opinion of the FSA, the first having been conducted in 1999. This therefore provides a useful benchmark of industry views, and the report of the second survey compares how opinions have moved on since 1999.

The survey was carried out by BMRB Social Research, part of BMRB International, on the Panel's behalf.

Second survey of the FSA's regulatory performance

The results reported here are based on a survey of 3,890 senior executives in regulated financial services firms. The survey was carried out using postal self-completion questionnaires. The overall response rate was 42% of individuals, and 50% of firms contacted. The survey results are representative of all regulated firms in the industry.

Apart from IFAs with less than 10 registered individuals and accountancy and legal firms, one in three of which were randomly selected, all regulated firms were included in the survey. In most cases, two versions of the questionnaire were sent to firms, for separate completion by the chief executive and by the senior person with specific responsibility for compliance. Where the FSA had only one contact (mainly professional firms, smaller IFAs and other small businesses) only the Compliance version of the questionnaire was sent. These smaller organisations are looked at as a separate group.

The survey was carried out in July/ August 2002. The 2002 survey repeats, to a large extent, the similar survey carried out in the summer of 1999; where possible, comparisons are made in this report between the results of the two surveys.

1. Expectations about regulation

In the 1999 survey, there was strong support among all sectors of the financial services industry for the principle of strong regulation. More than eight in ten practitioners thought this was for the benefit of the industry as a whole. Three out of four, however, also agreed that the current system placed too great a burden on the industry, and half that it gave too much weight to the interests of consumers. These views were most strongly expressed by smaller organisations.

Around half of practitioners had already noticed some changes in regulation, in 1999, which they attributed to the creation of the FSA; for most, these changes were only slight. Around three quarters of practitioners were expecting to see further change, and one in three thought there would be a lot more change to come.

When asked whether the new regime would be better, worse, or the same for their own business, about two fifths of practitioners did not expect there would be any difference. One in four expected the new regime to be better, a similar proportion expected things to be worse, and the remainder were unsure.

There were also mixed views on how the switch to the new regulator would affect the financial services industry. About half of practitioners thought the advent of the FSA would be beneficial to the industry, compared with only one in six who thought it would be harmful, and about a third who did not know or thought it would make no difference. Practitioners in smaller organisations were less likely than others to think the change would be beneficial, and more likely to think it would make no difference.

2. Initial experience

In 2002, there was continuing support in principle for strong regulation – from more than eight in ten practitioners – but chief executives and heads of compliance now felt more strongly than in 1999 that the burden of regulation on the industry was too great. In all practitioner groups, more still agreed than disagreed that too much weight was being given to the interests of consumers. In both surveys, smaller organisations held the most negative views about the burden of regulation and the balance in favour of consumers.

Chart 1
Strong regulation is for the benefit of the financial services industry as a whole

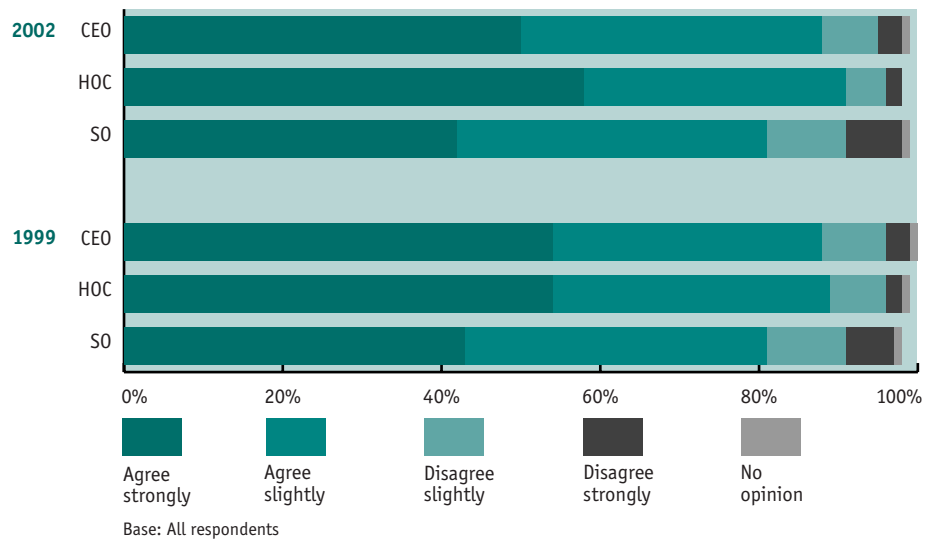
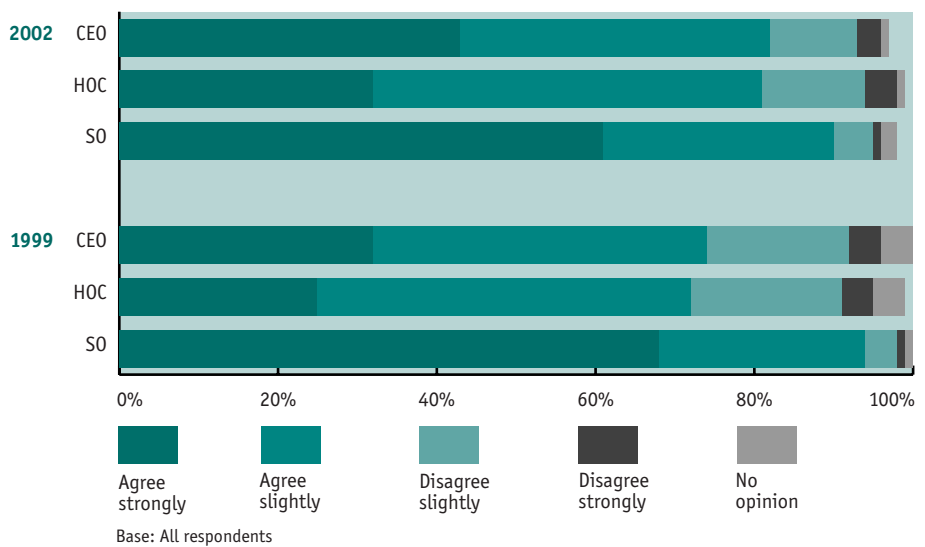


Chart 2
The current regulatory system places too great a burden on the financial services industry



Footnote: For charts showing percentages, figures may not add up to 100% due to rounding.

In the 2002 survey, around nine out of ten practitioners had noticed some change in the regulation of their business which they attributed to the creation of the FSA (compared with around half who had noticed any change in the 1999 survey), and around four in ten felt there had been ‘a lot’ of change. These proportions were similar to the level of change expected by smaller organisations in 1999, but both chief executives and compliance heads had experienced rather more change than their counterparts in the 1999 survey were expecting three years ago.

Asked to comment on the impact of this change on *their own business*, two in five practitioners were unable to express an opinion, with most of these feeling it was ‘too early to say’. Those who did give an answer were about twice as likely to say things had got worse than better; this compares with an equal split between positive and negative expectations in 1999. Opinions were similar in both surveys for all three practitioner groups.

When asked about the impact of the change to the FSA upon the *financial services industry as a whole* (as opposed to their own business) chief executives and compliance heads were more positive in their views, being twice as likely to feel the change had been beneficial as harmful for the industry; the balance of opinion was, however, also less positive than expectations in 1999, when the balance between ‘beneficial’ and ‘harmful’ had been three to one for chief executives, and four to one for compliance heads. For smaller organisations, opinions also shifted from the 1999 survey, in which practitioners were twice as likely to anticipate the change as being beneficial rather than harmful, to being just as likely to say the change had been harmful as beneficial in 2002.

In both surveys, around one in five practitioners across all industry sectors felt the change to the FSA had made no difference, with one in six saying that they didn’t know.

In the 2002 survey, heads of compliance and smaller organisations were also asked to consider the effect on *consumers of financial services*. Around four in ten felt that the change to the FSA had made no difference to consumers, and this opinion was particularly widespread among smaller organisations. Of the remainder, heads of compliance were much more likely to feel the change had been beneficial rather than harmful (by a ratio of four to one) while opinion among smaller organisations was evenly balanced.

3. *A widening gap?*

The survey was designed to quantify the *relative importance* to practitioners of 15 different criteria for evaluating the effectiveness of the FSA, and then to measure their perceptions of *the performance* of the regulator against these same criteria. Similar questions were asked in the 1999 survey (when 13 criteria were used).

Practitioners were first asked to give each criterion a score between 1 and 10, with high numbers indicating a high level of importance. Of the 15 criteria, 13 were given average scores of 8 or above, indicating they were regarded as very important. Two aspects of the regulatory role stood out as particularly vital for practitioners, ‘provide reliable guidance when needed’ and ‘take a firm line with businesses which persistently break the rules’. ‘Listen to consumer views when deciding policies and procedures’ and ‘Encourage the education of the public about financial products and services’ were seen as the least important of the different criteria that practitioners were asked to consider.

Perceptions of importance were relatively unchanged for most criteria from the previous survey. The one exception was 'encourage the education of the public about financial products and services' which all three practitioner groups rated lower in importance in 2002 than in 1999.

Chart 3
Most important criteria for evaluating the FSA – Chief Executives



Practitioners were then asked to rate the effectiveness of the FSA, on each of the same criteria, by allocating a score from 1 to 10, with high numbers in this case indicating a high level of performance. Although some practitioners felt unable to give a rating on some criteria (the proportion generally ranged between 6% and 20%, depending on the criteria), the proportions were not noticeably higher than in the 1999 survey.

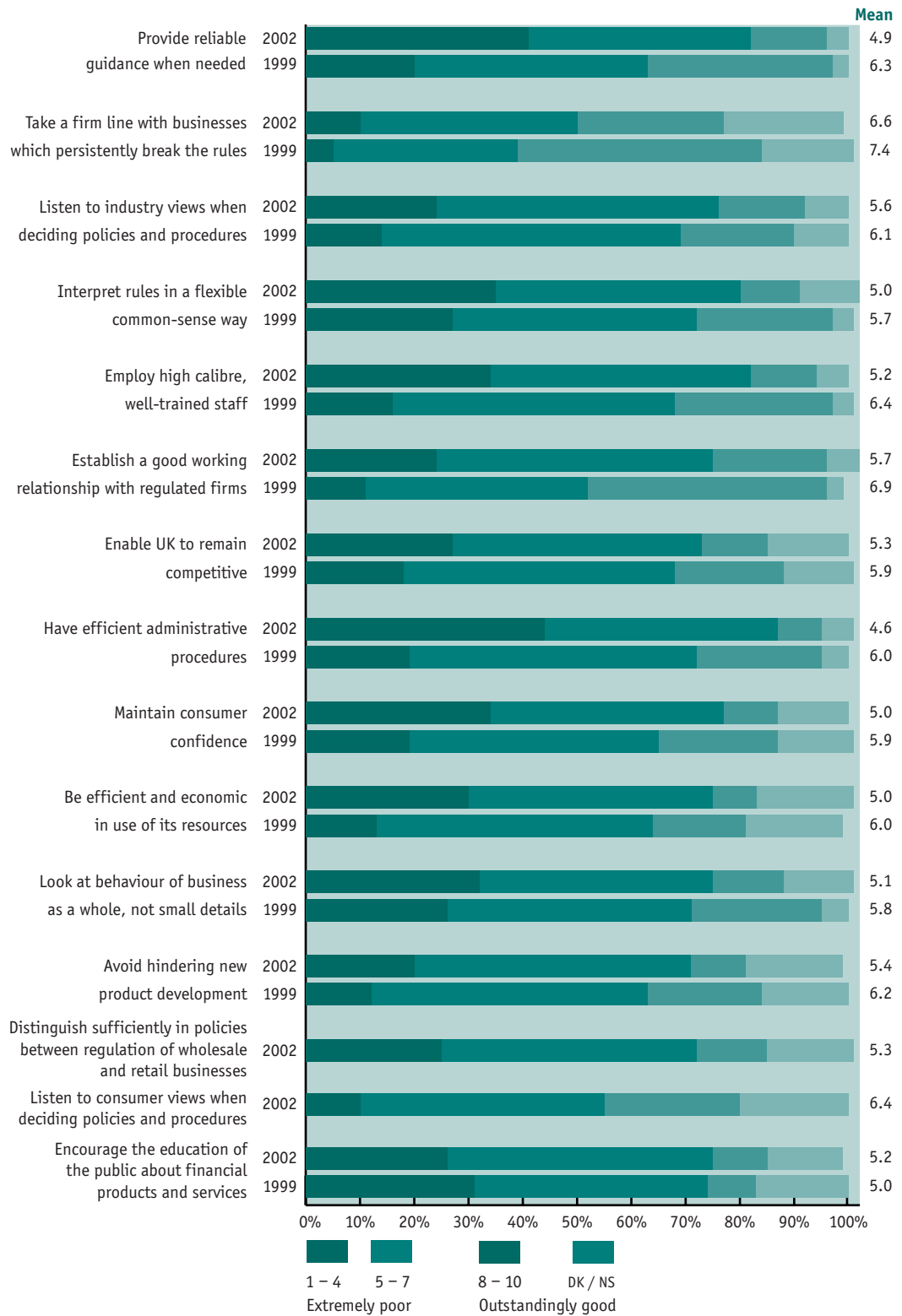
Average effectiveness scores ranged between 4.6 and 6.6 for chief executives (overall average of mean scores 5.4), between 4.7 and 6.8 for heads of compliance (overall average 5.6), and between 4.3 and 6.3 (overall average 4.9) for smaller organisations, suggesting that most practitioners judged the FSA's performance as average rather than good. Banks, friendly societies and general insurance firms tended to give the highest ratings, and IFAs and firms with life and pensions business the lowest.

Two attributes stood out as having the highest perceived performance scores across all three practitioner groups, 'Take a firm line with businesses which persistently break the rules' and 'Listen to consumer views when deciding policies and procedures'. The former was judged as one of the most important attributes of a regulator at the previous question.

For chief executives and heads of compliance, the attributes which had the lowest performance scores were: 'Provide reliable guidance when needed' and 'Have efficient administrative procedures'. The lowest scores for smaller organisations were: 'Interpret rules in a flexible and common-sense way' and 'Be efficient and economic in use of its resources'.

The largest gaps between importance and performance scores, and therefore the biggest shortfall between expectation and delivery, were (for chief executives and heads of compliance) on the attributes 'Provide reliable guidance when needed', 'Have efficient administrative procedures' and 'Interpret rules in a flexible common-sense way'. The equivalents for smaller organisations were 'Interpret rules in a flexible common-sense way', 'Listen to industry views when deciding policies and procedures' and 'Be efficient and economic in use of its resources'.

Chart 4
Performance of the FSA – Chief Executives



It is possible to compare the results of the 2002 and the 1999 surveys, both in terms of importance and perceived performance, with the exception of two criteria which were new for the 2002 survey. It must be remembered that in 1999 practitioners were asked about their current regulator (which only in around a third of cases was the FSA), and in 2002 practitioners were asked about the FSA only. For most practitioners, therefore, the comparison is not between views of the FSA at two points in time, but between views of the FSA in 2002 and their previous regulator in 1999.

In terms of importance, it has already been noted that scores were generally unchanged from 1999; in both surveys, most criteria were judged to be of relatively high importance with mean scores generally between 8 and 9 out of 10. However, when performance scores are compared between the two surveys, it is clear that perceptions of the FSA's performance in 2002 were generally more negative than perceptions of the regulators in 1999. Among chief executives, all except one aspect of performance saw a decrease in mean score (the exception was 'encourage the education of the public') and the overall average score went down from 6.1 to 5.4. Among compliance heads, the result was similar: all except one aspect of performance declined (the exception was again the education of the public) and the overall average score went down from 6.2 to 5.6. The net result was a widening gap between importance and performance scores and hence between expectation and delivery.

For smaller organisations, the results were rather different. Three aspects of performance saw an improvement in perceptions, against four which saw a decline and eight which remained largely unchanged. The overall average of mean scores increased slightly (but not significantly) between the two surveys, from 4.8 to 4.9. In spite of this improvement, the perceptions of the FSA by smaller organisations in 2002 remained generally more negative than those of chief executives and heads of compliance.

The attributes which showed the largest decrease in mean performance score between the two surveys were 'Provide reliable guidance when needed' and 'Have efficient administrative procedures' for chief executives and heads of compliance, and 'Take a firm line with companies which persistently break the rules' for smaller organisations.

Chart 5
Importance vs. performance – Chief Executives

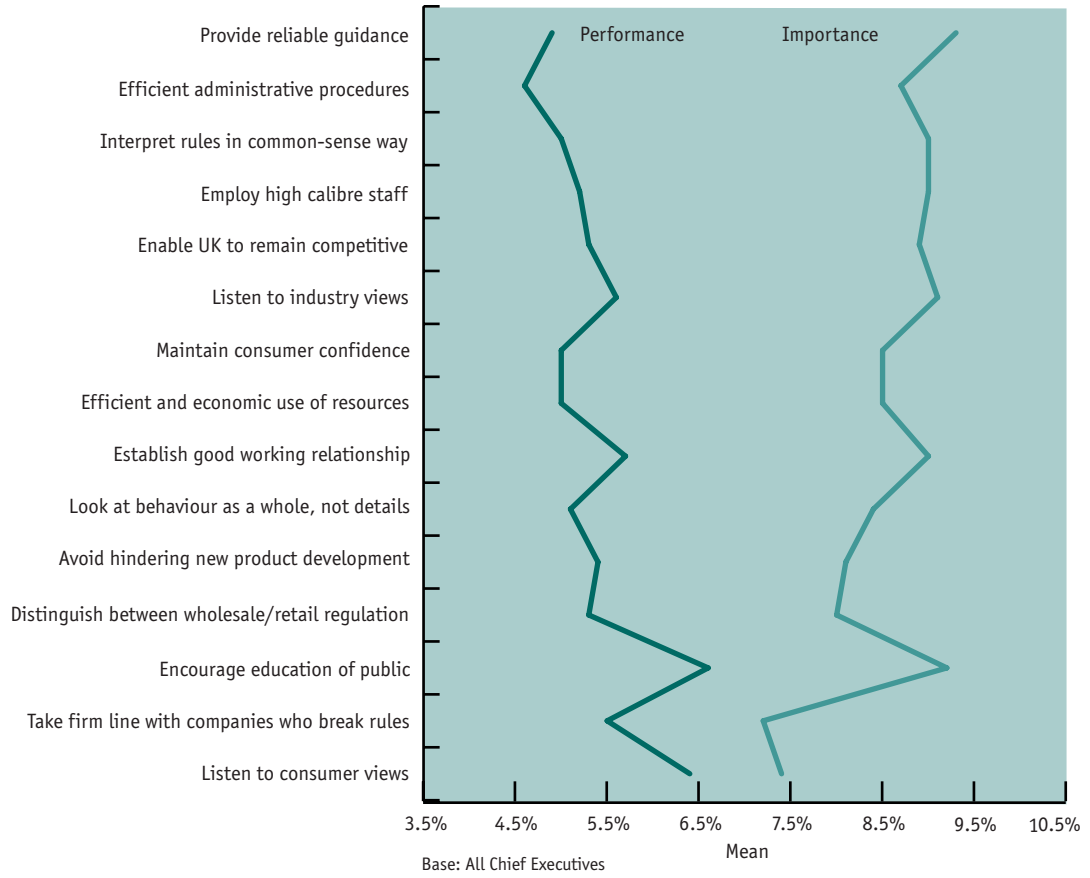


Chart 6
Importance vs. performance – Heads of Compliance

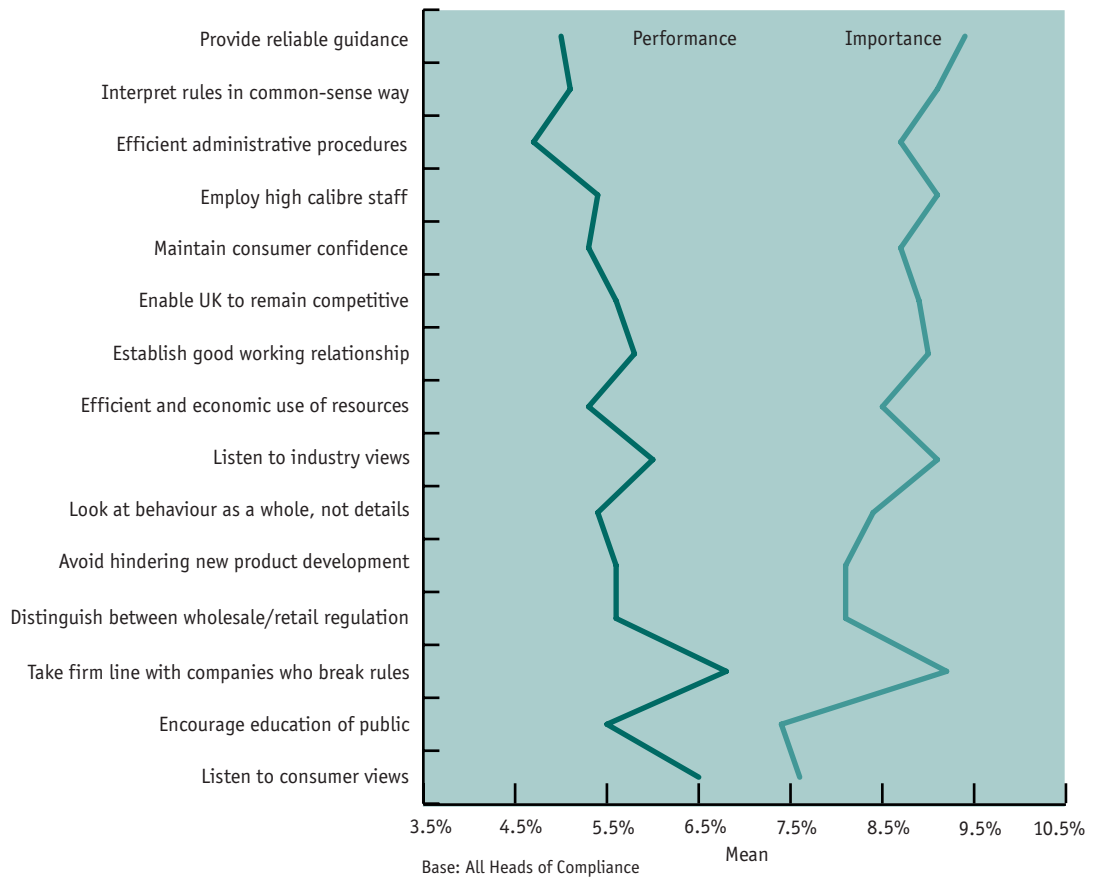
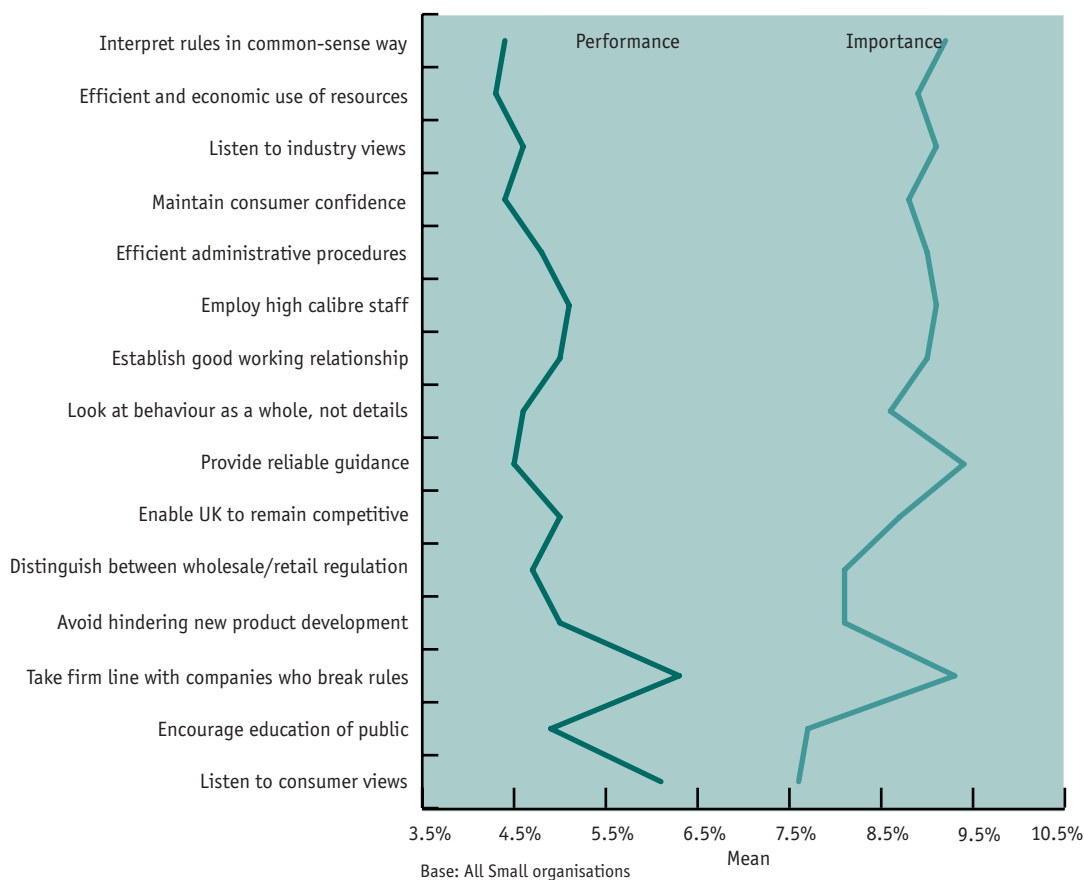


Chart 7
Importance vs. performance – Small organisations



4. Details of experience

Consultation procedure

The general perception among practitioners was that the FSA was making a lot of effort to consult, with around three-quarters of compliance heads and half of smaller organisations agreeing that this was the case.

Six in ten compliance heads also agreed there had been sufficient feedback of the results of consultation exercises, compared with one in four who held this opinion in 1999. However, only around half of compliance heads and a quarter of smaller organisations agreed that the reasons for policy decisions following consultation had been explained satisfactorily, and similar proportions felt that the FSA was taking account of industry views.

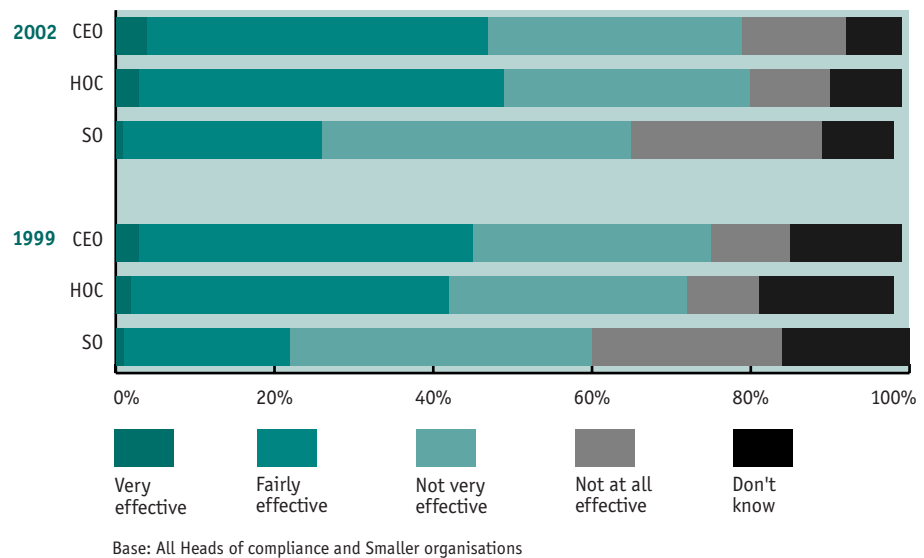
Around eight in ten compliance heads thought FSA consultation papers should be more concise, with a similar proportion of smaller organisations taking this view. With both groups this proportion had increased since the 1999 survey. Similarly, around three-quarters of compliance heads and smaller organisations felt their business did not have time to respond to FSA consultation papers, a significant increase for compliance heads from around two-thirds in 1999 to three-quarters in 2002.

As in 1999, smaller organisations expressed more negative views about consultation procedures on most dimensions.

Among chief executives, opinion was divided as to whether they thought the FSA's consultation process had been effective in collecting the views of their business, with around 45% saying it had been effective and 45% saying it had been ineffective. Heads of compliance were slightly more positive, but smaller organisations were much less positive, being over twice as likely to say the process was not effective as effective. Other than an understandable decrease in the proportion unable to express an opinion on this issue, results were largely unchanged from 1999.

Chart 8

Effectiveness of consultation process in collecting business views



As in 1999, for both chief executives and heads of compliance, the most popular method of communicating their business's views to the FSA was directly to the FSA, although a substantial proportion preferred to put forward their views via trade associations or via surveys such as this one. For smaller organisations, as in 1999, surveys were the first choice, although a lower proportion chose this option in 2002.

Provision of guidance

Detailed questions about the provision of guidance were asked of heads of compliance and smaller organisations with experience of seeking guidance on rules or regulatory policy from the FSA.

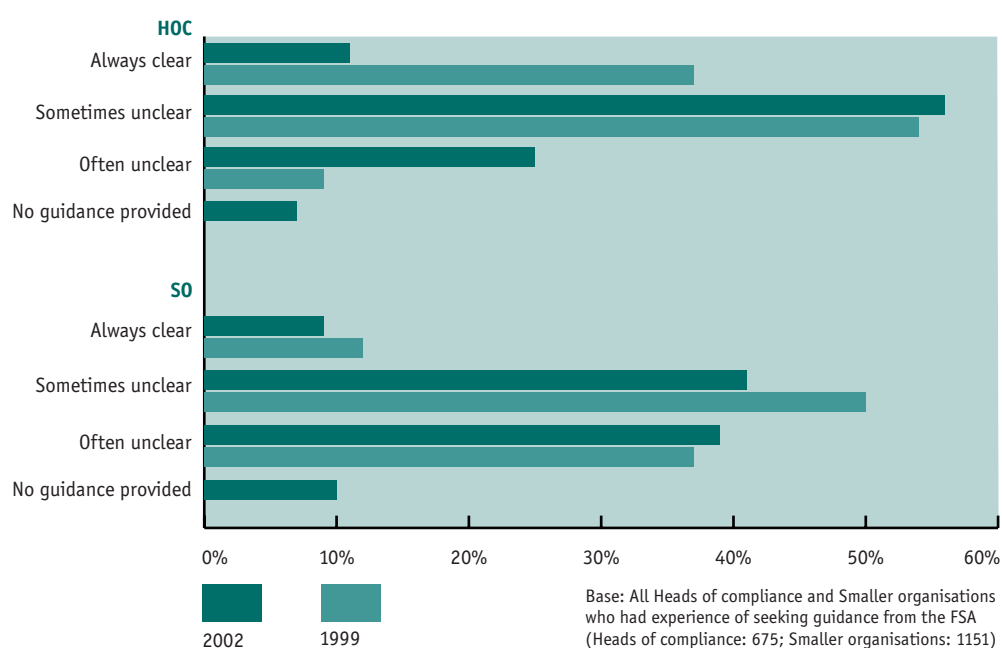
Heads of compliance were positive about some elements of guidance provision, with six in ten feeling that it was possible to be open and frank in discussion with the FSA when seeking guidance, and a similar proportion that the regulator's emphasis was on prevention rather than enforcement.

However, around a half of heads of compliance said it was difficult to work through things informally with the FSA without involving legal people, six in ten felt that FSA staff did not generally provide any informal guidance, and almost as many felt they avoided making decisions altogether. Three quarters of compliance heads disagreed that FSA staff generally give definitive guidance promptly.

Views among smaller organisations were broadly in line with those for compliance heads, with slightly lower proportions feeling that it was possible to be open and frank in discussion with the FSA when seeking guidance and that emphasis was on prevention rather than enforcement.

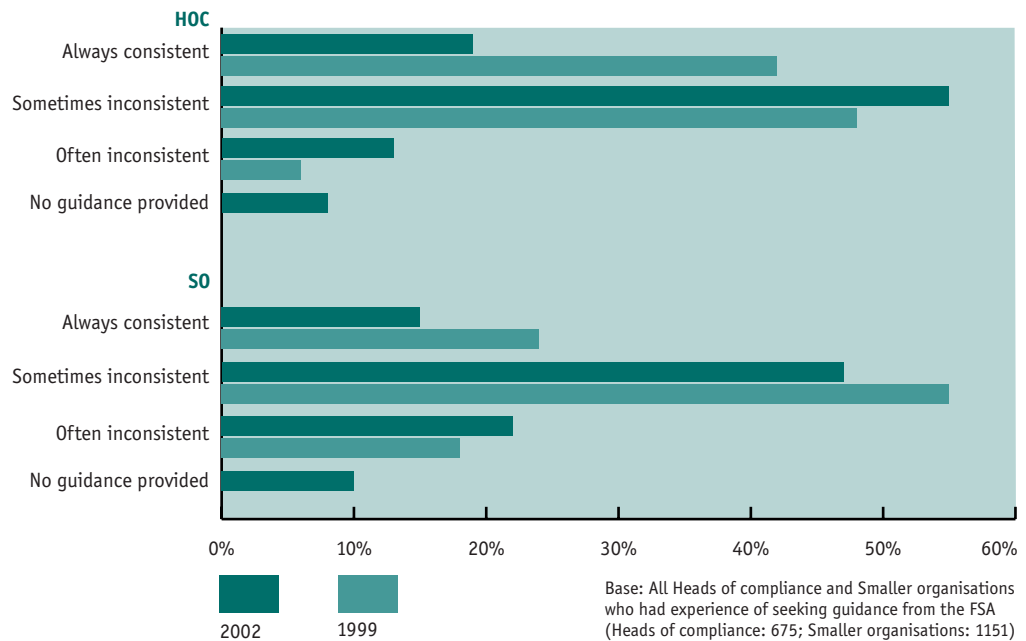
There was a fall in the perceived clarity of guidance provided between the two surveys. In 2002, around one in ten heads of compliance thought that the guidance received from the FSA was always clear, compared with nearly four in ten who held this view in 1999. Similarly, a quarter of heads of compliance in 2002 thought that guidance received from the regulator was often unclear, compared with only one in ten in 1999. Practitioners in smaller organisations were more likely than compliance heads to say that guidance was often unclear (four in ten did so), but results were largely unchanged from the previous survey.

Chart 9
Clarity of guidance provided by current regulator



There was a similar fall in the perceived consistency of guidance provided, particularly among heads of compliance. In 2002, one fifth of these practitioners said that guidance from the FSA was always consistent, compared with two fifths in 1999 who said this about their regulator at the time. There was a corresponding two-fold increase between the two surveys in the proportion saying that guidance was often inconsistent. Among smaller organisations, there was also a drop in the proportion saying guidance was always consistent, and an increase in those saying it was often inconsistent, although the shift was less pronounced than for compliance heads.

Chart 10
Consistency of guidance provided by current regulator (1999)/FSA (2002)



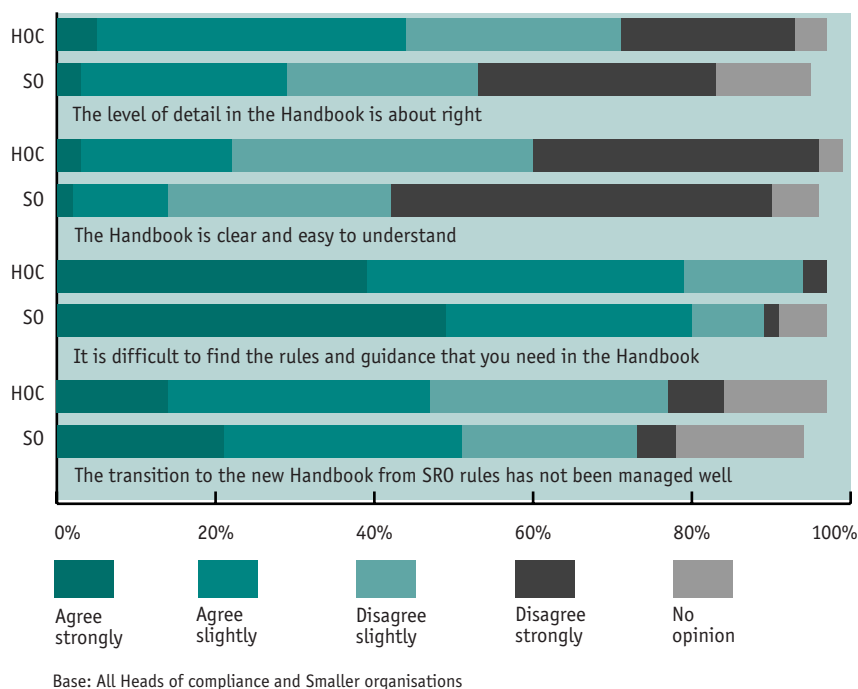
FSA Handbook of Rules and Guidance

Some new questions were included in the 2002 survey about the FSA Handbook of Rules and Guidance. Views on the Handbook were generally negative, particularly so with smaller organisations.

The most pressing issue was finding the rules and guidance needed in the Handbook, with around eight in ten heads of compliance and smaller organisations saying it was difficult to do so. Similarly, around three-quarters of practitioners disagreed that the Handbook was clear and easy to understand. Of those who expressed an opinion, around six in ten also disagreed that the level of detail in the Handbook was about right.

Over half of practitioners who gave an opinion felt that the transition to the new Handbook from SRO rules had not been managed well.

Chart 11
Views on the Handbook of Rules and Guidance



Approach to supervision

Over half of all practitioners described the FSA's application of the rules for Conduct of Business Standards and Prudential Standards as either 'fairly rigid' or 'about right'. Around one in ten described the application as 'highly rigid' and a similar proportion felt it was 'fairly flexible'. Virtually no one described the application as 'highly flexible'. Chief executives were more likely to feel the application was 'about right' or 'fairly rigid', and smaller organisations were more likely to say 'highly rigid', particularly in relation to the rules for Conduct of Business Standards. However, around a quarter of chief executives and four in ten heads of compliance and smaller organisations said they had no experience or didn't know.

Compared with 1999, there was an increase in the proportion of practitioners who were unable to give an opinion about their regulator's approach to supervision. This was presumably due to a relative lack of familiarity with the FSA as a supervisory body, compared with previous regulators who had been operating for many years.

Opinions of chief executives and compliance heads were generally very similar. Among those who could give an answer, the balance of opinion on the majority of issues was positive. For example, around seven in ten practitioners felt that the FSA applied a reasonable level of supervision for a business of their size and type, and six in ten said the regulator was willing to hold a dialogue with them about compliance issues.

However, there were some less positive opinions as well, with four out of five chief executives and heads of compliance who gave an opinion thinking that the FSA tended to look at processes rather than outcomes, and only one in four agreeing that the FSA gave praise as well as criticism.

In most cases, practitioners who expressed an opinion had less positive views about their regulator than in the 1999 survey.

Smaller organisations were generally more negative than chief executives or heads of compliance with regard to the FSA's supervision, being less likely to agree with positive statements and more likely to agree with negative ones. The exception was 'the FSA applies a reasonable level of supervision', with which they were as likely to agree as other groups. Although results for smaller organisations were less positive than those of other practitioners, they are in some cases more favourable to the FSA than the comparable results for small organisations in 1999

Just over half of compliance heads, and four in ten smaller organisations had direct experience of dealing with FSA supervisory staff. Those who had no experience were not asked to comment on the behaviour of staff, so the results are not directly comparable with the 1999 survey. In 2002, among those who had experience of them, practitioners' views of the FSA's supervisory staff tended to be generally positive. Around eight in ten heads of compliance thought they made site visits at reasonable intervals rather than too frequently, and two-thirds thought they had quite good interpersonal skills, read the information that had been provided about their business, and treated the firm's staff as trustworthy.

However, there were also a number of less favourable impressions, with 45% of heads of compliance feeling that FSA staff followed a checklist rather than concentrating on broad issues of principle and one in six feeling that it was difficult to give feedback to the FSA on their supervisory staff.

As before, the views of practitioners in smaller organisations were less positive. The most positive rating was for frequency of visits, with three-quarters saying that these were at reasonable intervals. Almost two-thirds said that staff tended to just follow a checklist rather than concentrate on broad issues of principle, and that their approach varied depending on the individual.

Enforcement

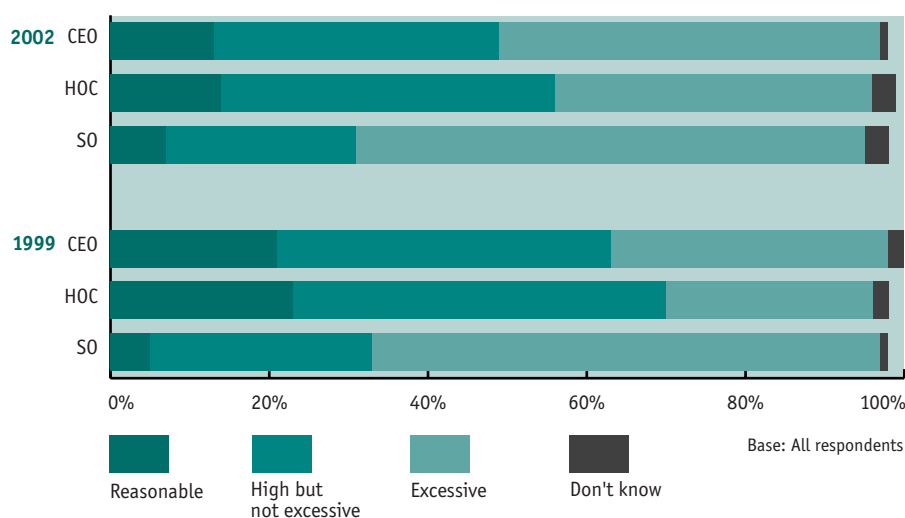
Only around 5% of practitioners had been subject to any enforcement or disciplinary action either by the FSA or by their previous regulator in the last twelve months. As a result, the questions about enforcement procedures were answered by very small numbers and results can only be described in fairly broad terms.

Opinion was split as to whether practitioners thought their regulator was justified in starting enforcement procedures with similar proportions thinking that they were justified to those who thought they were not justified. Smaller organisations were less likely than other practitioners to think that their regulator was justified. Heads of compliance were also fairly evenly split on whether the regulator had treated their business fairly during enforcement, although the balance of opinion was negative for chief executives and smaller organisations.

In terms of whether the regulator had imposed a reasonable penalty, completed the investigation and enforcement process within a reasonable time scale, and made clear the rationale for the penalty, there was again some division of opinion between heads of compliance and the other two groups, with the former taking a more positive view.

Only about one in seven practitioners (one in 14 smaller organisations) considered the costs of compliance to be reasonable. About four in ten compliance heads, five in ten chief executives and six in ten smaller organisations considered the costs to be ‘excessive’. The views of smaller organisations on this issue have not changed from the 1999 survey, but other practitioners were less likely to consider the costs to be reasonable and more likely to consider them excessive than was the case in the previous survey. In 1999 only a third of chief executives and a quarter of compliance heads felt that their compliance costs were excessive.

Chart 12
Costs of compliance for practitioner’s business

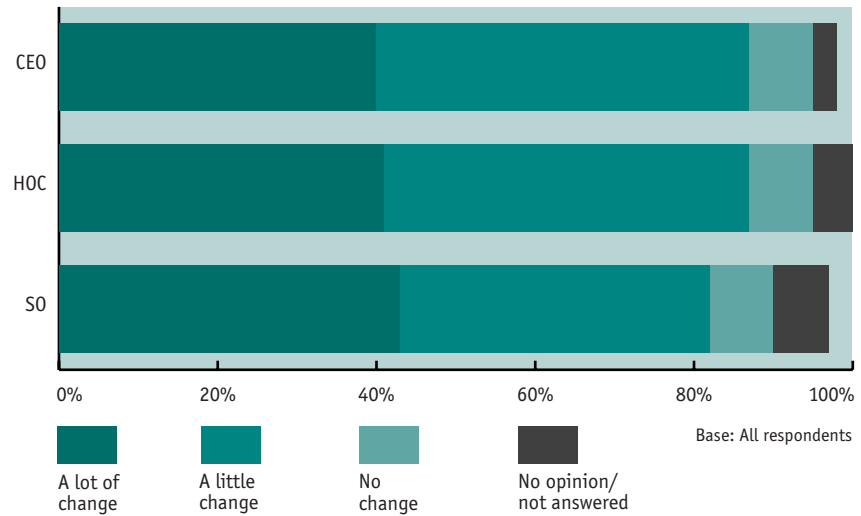


Smaller organisations were more likely to say that their compliance costs were a high percentage of total costs, compared with other practitioners. Around 45% of chief executives and compliance heads reported that their total compliance costs were less than 5% of total costs, compared with a quarter of smaller organisations. Around a third of smaller organisations said their total compliance costs were 10% or more of total costs, compared with around one in seven chief executives and heads of compliance.

5. *Transition or new steady state?*

In the 2002 survey, as we have seen, around nine out of ten practitioners reported some change in the regulation of their business which they attributed to the creation of the FSA, and around two in five had experienced a lot of change. This is not surprising, given the transition from sector-based regulation to a much larger single regulator with more wide-ranging objectives and powers.

Chart 13
Expectation of further change in regulation now FSA has taken over



What is perhaps unexpected is that, six months after N2, the transition is seen by most of the industry as far from complete. When practitioners were asked to gauge the amount of further change in the regulation of their business still to come, almost nine out of ten chief executives and heads of compliance, and eight out of ten smaller organisations, said they expected further change, and two in five thought there would be ‘a lot’ more change. IFAs and insurance firms were the most likely to expect a lot more change in regulation.

Another indication of the perceived incompleteness of the transition is practitioners’ views on the ongoing costs of compliance compared with 1999 i.e. excluding the N2 ‘bulge’. Around two-thirds of practitioners in all three groups felt the costs of compliance for their business would be higher than in 1999, with most of the remainder either thinking there would be no change or unable to estimate. Of those who felt ongoing costs would be higher, around two-thirds expected them to be more than 10% higher, and one in ten said they expected a cost increase of over 50%. These estimates were similar for all three practitioner groups.

On many of the survey questions about the new regime, a substantial proportion of practitioners indicated that they had no experience of the FSA in that area, could not give an opinion, or that it was ‘too early to say’. This applied particularly to questions about guidance, supervision, application of the rules and the overall effect of the change on the firm’s own business. So the financial services industry has not, in the 2002 survey, given a final verdict on the FSA’s performance as a regulator – the jury is still out.

6. Other views of the new regime

The majority of practitioners who expressed an opinion felt that the FSA was being *as open and responsive as possible* in the way it was currently operating, although two in five smaller organisations took the opposite view. This picture was largely unchanged from the 1999 survey. However, on several other aspects of the regulator's role, the balance of opinion was negative towards the FSA.

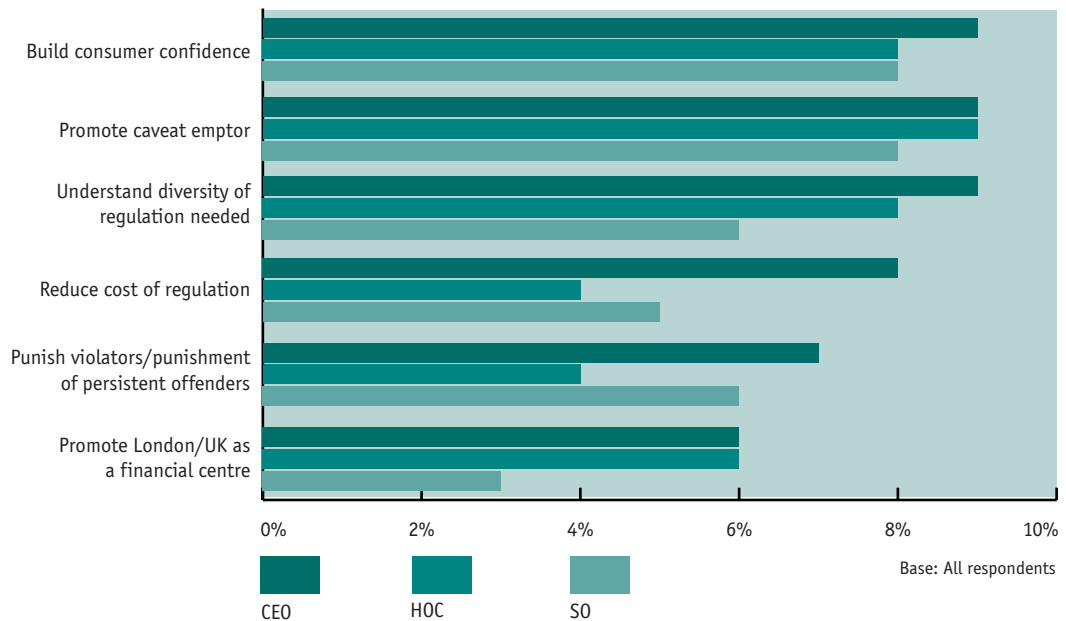
The majority with an opinion (two thirds of chief executives and compliance heads, three quarters of smaller organisations) felt that the FSA's powers were too extensive, which matched practitioners' fears about this in 1999). More practitioners disagreed than agreed that there were *sufficient safeguards in place* to ensure that the FSA was accountable for its activities, and the negative balance was particularly marked among smaller organisations. Responses followed a similar pattern for the statement 'The FSA operates independently of the government', with smaller organisations particularly likely to disagree.

Only around a third of chief executives and heads of compliance with an opinion agreed that the government had *listened to industry views* in its decisions about the FSA, falling to one in five smaller organisations. This contrasts with three-quarters of chief executives, two-thirds of compliance heads and six in ten smaller organisations who felt that the government had *listened to consumer views* in its decisions about the FSA.

All practitioners were asked to describe what they saw as the *most important priorities* for the FSA to address as the single regulator for the financial services industry. Most of the issues mentioned in response to this question had been identified in the qualitative interviews, and covered elsewhere in the questionnaire, but this provided an opportunity for practitioners to sum up their priorities overall.

The issues raised were mentioned by lower proportions of practitioners compared with the 1999 survey, when practitioners were being asked to think about the FSA's future agenda. The priorities most frequently mentioned in 2002, by around 8 or 9% of practitioners, were 'promote caveat emptor', 'build consumer confidence', and 'understand the diversity of regulation needed'.

Chart 14
Important priorities for the FSA to address



As was the case in the 1999 survey, the main sources of information about the FSA were its own booklets and consultation papers. Compared with 1999, the FSA website has become a far more important source of information, now cited by two-thirds of compliance heads as a main source.

Only around a third of practitioners (a quarter of smaller organisation) had had telephone or face-to-face contact with frontline FSA staff, a lower proportion than in 1999. Practitioners indicated that they had had even less telephone or face-to-face contact with FSA policy makers with seven in ten chief executives and compliance heads and eight in ten smaller organisations having no contact at all.

7. *Wider environment issues*

Around seven in ten chief executives and heads of compliance and 85% of smaller organisations felt that there were too many regulatory reviews being undertaken of financial services. Two-thirds of practitioners felt that regulatory reviews should be carried out by the FSA and not by other government departments.

Of those who had an opinion, around three quarters of practitioners agreed that the boundaries between complaints handling by the Financial Ombudsman Service and policy setting by the FSA were unclear. There was no clear consensus as to whether the money laundering rules were clear and practical, with similar proportions agreeing and disagreeing.

There was general disagreement with the statement 'The behaviour of the FSA encourages competition to flourish within the UK', particularly so by smaller organisations where nearly seven in ten disagreed.

8. Views of the Financial Services Practitioner Panel

Around one in three chief executives, four in ten heads of compliance and a quarter of smaller organisations had seen or heard something about the Practitioner Panel before they received the letter about the survey. This result was similar to the 1999 survey.

Opinions of the Panel were generally positive; around 90% of practitioners who had seen or heard anything about the Panel thought it had an important role to play on behalf of the industry with the FSA.

Around 70% of practitioners who had seen or heard anything about the Panel felt it was helping the FSA to understand industry views and was independent of the FSA. Around 60% of practitioners felt that the members of the Panel could represent the industry as a whole.

Of those who had an opinion, around two-thirds agreed that the Panel was able to influence FSA policies and decisions. There were more mixed views on the ease with which firms were able to express their views to Panel members, with around half of practitioners who gave an answer agreeing that this was the case.

There were very few differences on these questions between chief executives, heads of compliance and practitioners from smaller organisations.

9. Differences by main area of operation

Generally speaking, practitioners from retail/ personal banks, smaller corporate/ investment banks, investment management firms and general insurance firms were the most positive in their views of the FSA and its performance. This was the case across most aspects of the survey.

Similarly, practitioners from IFAs and firms with life and pensions business were the most negative in their views of the FSA and its performance, almost without exception.

Practitioners from friendly societies and securities and derivatives firms were mixed in their views, being negative about some aspects (particularly in relation to guidance), but more positive on other aspects.

CONCLUSIONS

The 2002 survey of the FSA's regulatory performance was carried out a few months after the FSA assumed full responsibility for the regulation of the industry on 1 December 2001. The survey findings provide authoritative and up-to-date evidence of what the industry thinks of its new regulator. Because it builds on the first survey undertaken three years ago, this second survey is also able to identify how views of the FSA and of the regulatory environment have changed over time.

What firms expect from the FSA

In the 1999 survey, eight in ten practitioners were in favour of strong regulation, and felt that the UK regulatory system needed to change. A substantial proportion believed the new FSA regime would bring change for the industry, and the majority expected the change to be beneficial. They hoped the single regulator would ensure greater consistency and cohesion of regulation across all sectors of the industry, and that this would lead to greater efficiency and lighten the administrative burden. They were also hoping for a more pragmatic, risk-based approach to regulation.

A notable feature of the 2002 survey findings is the continued widespread support in principle for strong regulation, which most practitioners feel is for the benefit of the industry as a whole. In line with this, one of the most important requirements for practitioners is for the FSA to 'take a firm line' with non-compliant firms. An equally key requirement is for the regulator to provide reliable guidance when needed. In both the 1999 and the 2002 surveys, these were identified by practitioners as their two most important requirements.

Expectations versus reality

The overall view of the changes is that they have been beneficial for the financial services industry as a whole (of those expressing a view, approximately 2.5: 1).

Despite expectations remaining high and largely positive, there are signs of a widening gap between the expectation and the experience of regulation. Practitioners now feel more strongly than in 1999 that the burden of regulation on the industry is too great, and the majority think too much weight is being given to the interests of consumers. Views about the impact of the change on the industry as a whole, although still positive, are less so than they were three years ago about the expected change.

When asked about the impact of the change to the FSA on their own business, those who gave an answer were twice as likely to say that things had got worse as to feel they had got better – again, taking a more negative view about the actual experience than their counterparts predicting the impact of the change in 1999.

There are continuing concerns about the powers and accountability of the FSA, its independence from government and the attention being given by the government to consumer, rather than industry views.

Aspects of firms' experience to date

In the more detailed analysis of firms' experience of regulation, the areas of more specific concern become clear:

Consultation

As in the 1999 survey, the new regulator is given credit for making a lot of effort to consult the industry, and more practitioners now feel there has been sufficient feedback from these exercises. Concerns still remain about the same issues that were felt to be problematic in 1999: the length of the consultation papers, the time needed to consider them, and the general effectiveness of the whole process.

The provision of guidance

The largest gap between what practitioners consider important attributes for the FSA to demonstrate and the regulator's perceived performance is in providing reliable guidance. This also gave rise to the largest gap in the 1999 survey, when most practitioners were commenting on their previous regulator, and there were high hopes that the change to a single regulator would result in clear, concise and unambiguous guidance to practitioners, based on broad principles rather than narrow rules.

What has actually happened since the FSA took over is a reduction in the perceived clarity and consistency of the guidance being provided – or, in some cases, guidance not being provided at all. Although the regulator is given some credit for putting the emphasis on prevention rather than enforcement, many practitioners complained about the FSA's apparent inability or unwillingness to provide definitive guidance promptly, or to provide guidance informally without involving legal advisors.

Supervision

Among practitioners who have sufficient experience to comment on the FSA's approach to supervision, the balance of opinion is generally positive, although less so than in the previous survey when most practitioners were considering their previous regulator. Seven in ten feel the FSA is applying a reasonable level of supervision to their business, and six in ten see the regulator as willing to hold a dialogue with them about compliance issues. On the other hand, over three quarters believe the FSA tends to look at processes rather than outcomes, and less than half feel the regulator has a good understanding of their business. In most cases, practitioners who expressed an opinion had more negative views about their regulator than in the 1999 survey.

The quality of FSA supervisory staff

At the time of the 2002 survey, only around half of practitioners had any direct experience of dealing with FSA supervisory staff. The views of these practitioners about FSA staff are often positive, particularly in relation to the frequency of site visits, the interpersonal skills of FSA staff and the way they treat practitioners' staff. On the debit side, a substantial proportion of practitioners say that FSA staff just tend to follow a checklist rather than broad issues of principle, and that the approach varies depending on the individual.

The Handbook

There is strong criticism of the new FSA Handbook of Rules and Guidance. A large majority find the Handbook difficult both to navigate and to understand. There is a widespread feeling in the industry that the FSA has got it wrong in terms of the level of detail, and that the transition to the new set of rules has not been managed well.

The impact of N2

There is evidence that the impact of N2 has been felt right across the industry with nine in ten practitioners reporting some change in the regulation of their business which they attribute to the creation of the FSA. Practitioners' views on the impact of this change on their business are notable for the sizeable proportion – two in five – who feel it is 'too early to say'. Of the remainder, the general feeling is that things have got worse rather than better. Another area of concern is the increased cost of compliance; more practitioners than in 1999 feel their compliance costs are excessive.

The scale of future change

What is perhaps unexpected is that, six months after N2, the transition is seen by most of the industry as far from complete, with two thirds of practitioners expecting further changes in regulation. Another indication of the perceived incompleteness of the transition is practitioners' views on the ongoing costs of compliance in the future – two thirds expect ongoing costs to be higher than before the 'N2 bulge'.

Other issues

A large majority of practitioners feel there are too many regulatory reviews being undertaken of financial services, and two-thirds believe such reviews should be carried out solely by the FSA and not by other government departments.

The boundaries between complaints handling by the Financial Ombudsman Service and policy setting by the FSA are generally seen as unclear, with around three quarters of practitioners taking this view.

Overall view of the FSA's performance as a regulator

The FSA is given credit for being as open and responsive as possible in the way it is operating. It is also seen as a strong regulator, attracting its highest performance rating for taking a firm line with businesses which persistently break the rules. But on this, as on other aspects, practitioners' assessments of the performance of the FSA are generally less favourable than similar assessments made in the 1999 survey of the financial regulators who were operating at the time. Wider gaps are also opening up between what practitioners identify as important, and how they perceive the FSA's performance, in particular on providing reliable guidance when needed, having efficient administrative procedures, and interpreting rules in a flexible common-sense way – all areas in which hopes of the FSA were particularly high in 1999. The FSA's application of the rules is seen as being rigid rather than flexible.

As already noted, a substantial number of practitioners have had little contact as yet with the FSA and were therefore unable to give an answer to some of the questions, particularly those relating to guidance, supervision, and the overall effect of the change of regulator on their own business. In many respects, it is still 'early days' for the FSA.

It would, therefore, be premature to say that the overall view is turning negative, but there are signs that it could, and this would be in spite of a generally positive attitude by the industry towards the new regulatory regime.

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