

Appendix 6: Accountability

The FSA's response to the Practitioner, Smaller Businesses Practitioner and Consumer Panels

Response to the Annual Report for 2004/05 of the Practitioner Panel

We welcome the positive comments in the Panel's Report, in particular its acknowledgement of the work we have already carried out, or are planning, to address the issues which are of concern to the industry and to the Panel. We look forward to continuing our discussion of these subjects with the Panel in the open and constructive way which has characterised our relationship over the last year.

The costs of regulation

As we have said in our Business Plan, we are aware of the burden of regulation on the firms we regulate, especially small firms. In our view increases in compliance costs over recent years have to some extent been necessary to bring standards of risk management and behaviour in firms up to what is now required. However, we agree that we need to continue to work hard to test whether the benefits of new rules we propose justify the costs. Market failure and cost-benefit analysis will continue to drive our policy thinking. When developing policy proposals we will consider the likely effects of those policies on small firms. As the Panel is aware, we have embarked on a project to identify areas where our requirements can be cut back without damaging our ability to achieve our regulatory objectives.

A majority of our policy work is driven by EU legislation. We wish to see full regulatory impact assessments as part of an evidence-based approach to EU policy-making and for the full range of non-legislative solutions to be explored before proposals for further EU legislation are brought forward. In implementing EU legislation, our policy is that our rules will be super-equivalent (that is, going beyond the strict requirements of a Directive) only where this is necessary to maintain standards in UK markets and to help us achieve our statutory objectives. We apply this policy pragmatically, taking into account the need to implement Directives on time and cost-effectively.

To date there has been no agreement between regulator and regulated on the proper definition of 'costs of regulation' nor on the nature and extent of total regulatory costs and incremental costs (i.e. those costs which well-managed firms would not incur in the absence of regulation). We believe that the research that we have now jointly commissioned with the Panel will provide

an agreed basis for a better informed discussion of this important issue, and we look forward to discussing the results with the Panel and, in due course, with the industry.

The FSA's risk-based approach ('Arrow')

We welcome the Panel's constructive response to our review of 'Arrow' and to our continuing work to embed a truly risk-based approach in our day-to-day work. We recognise that an important part of this is continuing to build and develop the knowledge and skills of our staff. We describe in some detail in our Annual Report the work we have done to recruit, retain and manage effectively the staff we need.

We agree that a proportionate and risk-based approach is needed just as much from the FSA and law enforcement, as it is from firms. Improvements to Arrow must include improving the identification and assessment of Financial Crime risk by our supervisors.

Endorsing trade association guidance

We welcome industry initiatives to improve its own practices. Examples include the Banking Code, the work of the Joint Money Laundering Steering Group and the recent work by the brokerage and fund management industries, in active dialogue with the FSA, on a framework for improved practice in relation to the execution and research elements of commission. If problems are dealt in this way, then market failures may be corrected without the need for further detailed FSA rules.

We would distinguish this situation from the provision of guidance by trade associations to supplement rules that the FSA has made. In such a situation we have decided that rulemaking to address the market failure is appropriate. Where the relevant rule would otherwise be unclear, we stand ready to issue guidance.

Our commitment to open and transparent regulation (including public consultation involving all those with an interest in the rules in question) and our duty to pursue our statutory objectives mean that, where provision of guidance is needed, then it will normally be most appropriate for that material to be FSA guidance. That guidance would be made following public consultation in accordance with the statutory requirements and our public commitments including regarding cost benefit analysis. Of course, the FSA would take account of industry views and, if appropriate, may draw from industry material.

As an alternative to producing FSA guidance, the FSA is willing to consider endorsing industry guidance in appropriate circumstances. For example, in January 2004 the FSA endorsed the statement of recommended practice for financial statements of authorised funds issued by the Investment Management Association. In these situations the normal processes for public consultation would still apply.

Where an industry body elects to produce its own guidance, and if that guidance is warranted and it is appropriate for it to be given by an industry body rather than by the FSA, then the FSA is willing to review it and offer views including, where it is the case, stating that the guidance is consistent with the intended effect of our rules. Any such statement would need to

include an explanation of the effect of the statement. An example of where we have done this is the industry guidance on conflicts issued by the British Bankers Association and other organisations in February 2004.

As the Panel says, we are moving to more principles-based rules, where compatible with our objectives and EU requirements. We consider that this is likely to lead to the need for more guidance rather than less, particularly for smaller firms. We know that there has been some concern in the industry that an unwelcome by-product of trying to simplify the Handbook will be to drop guidance of real value. We can confirm that this is not our intention. But, as has always been the case, firms should not look to guidance from the regulator as a comfort blanket to reassure them that they do not need to take responsibility themselves for complying with the rules, or that the rule does not mean what it says.

Treating customers fairly

We welcome the Panel's involvement in our Treating Customers Fairly (TCF) initiative. We continue to work with the Panel and other industry representatives to ensure that as we develop our work we take account of the views of our stakeholders, including industry, through our consultative group (of which trade bodies, the Financial Ombudsman Service and consumer representatives are also members). We also have regular discussions with trade bodies and meetings with individual firms to gain a better understanding of the implications of TCF for particular types of firm. The TCF principle is not a new requirement – it has existed since N2 – and our supervisors have always considered the extent to which firms treat their customers fairly. Our TCF work aims to reinforce the requirements of the principle and to help firms understand what they must do to comply with it. A key element of our communication with industry is the finding out what material will help firms and their senior management to do this. We have already published reports of supervisory work and a case study for firms. We intend to publish further material for firms in June 2005.

Our primary objective is to raise standards for the future. To do this, we will use the regulatory tools that best achieve our aims, and in many cases these will be supervisory rather than enforcement. But we do not rule out the possibility of enforcement action for a breach of the TCF principle where that is an appropriate and proportionate response. In reaching a view on that, we will take into account the standards of conduct that were considered acceptable at the time of the breach and the extent to which the senior management of the firm had sought to ensure compliance with the principle.

Enforcement

Our review of our enforcement process is under way and its recommendations are due to be published in July. As the Practitioner Panel Report notes, the review team has had discussions with the Panel, as well as with a range of other stakeholders. We welcome the Panel's input. Arrangements for settlement between the FSA and firms subject to enforcement action is a topic on which we sought views in our published Issues Paper, and will be given careful consideration. We also recognise that the industry's understanding of current enforcement and decision-making processes is variable. The FSA and the new chair of the Regulatory Decisions Committee (RDC) agree that we will need to promote greater awareness of the procedures that emerge from this review.

Response to the Annual Report for 2004/05 of the Smaller Businesses Practitioner Panel

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

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

Practitioner Panel Survey of regulated firms

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

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

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

General concerns for smaller firms during 2004/05

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

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

As the Panel acknowledge, the survey was undertaken during a period of change at the FSA. Our Firm Contact Centre (FCC) doubled in size from August 2004 to January 2005. The quality of FCC staff is high. Of course, the knowledge and performance of new starters improves with coaching, familiarisation, and time.

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

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

Some specific issues: Treating with-profits policyholders fairly

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

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

The changes we made included:

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

Some specific issues: Upcoming EU legislation

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

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

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

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

Some specific issues: Treating Customers Fairly

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

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

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

Some specific issues: Enforcement

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

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

Some specific issues: Mortgage and General Insurance regulation

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

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

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

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

Some specific issues: Depolarisation and the menu

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

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

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

Some specific issues: Regulatory fees and levies

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

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

Response to the Annual Report for 2004/05 of the Consumer Panel

Introduction

In its ‘Review of the year’ the Panel comments on a wide range of our policies, plans and activities. We welcome the Panel’s support for particular aspects of our work. In this response we focus on those topics on which the Panel expresses concerns or criticisms. We look forward to continuing our dialogue with the Panel on all these subjects over the coming year.

We would begin with some general observations of relevance to a number of the comments in the Panel’s report. In line with the requirements of the Financial Services and Markets Act 2000 (FSMA) we take a proportionate approach to regulation, and intervene – where we have a choice – only where there is market failure and where the benefits of doing so are likely to outweigh the costs. In addition, we continue to hold firms’ senior management responsible for running their business and treating their customers fairly. Our preference is to work with the grain of the market and to seek market-led solutions, although we will take direct action where this is appropriate.

In the text below, the Panel’s comment is in italics, followed by our response. References in brackets are to the Consumer Panel’s report.

The FSA’s new responsibilities

We broadly supported the regulatory regimes introduced during 2004/05 for mortgages and general insurance, which should increase consumer protection. We supported the Key Facts campaign to highlight important information about the new regimes and new products. Our major disagreement was the FSA’s decision to allow unrestricted use of the term ‘independent’ in general insurance. As we said last year, consumers who purchase both investment and general insurance products cannot be expected to understand that an independent financial adviser offers an entirely different service to an independent insurance broker, especially if they are the same firm or person. The FSA missed an opportunity to make life clearer to consumers here. Inconsistency undermines consumer protection (1.1).

We responded to the Panel’s concerns on this point in our Annual Report last year. We remain of the view, for the reasons given there, that our decision on this issue was proportionate.

We also disagreed with the FSA’s decision to refuse purchasers of insurance or mortgages from interim-authorized general firms access to the Financial Services Compensation Scheme should the firm go out of business. While firms are required to inform consumers of this in disclosure documents, the FSA decided that it would not be proportionate to check that this was happening. We disagreed and asked the FSA to obtain such disclosure documents. At the time, none of these firms had been deemed ‘fit and proper’, so the FSA should have taken this into account when making risk assessments (1.2).

In reaching its decision on the treatment of authorised firms, the FSA Board carefully considered the issues (in full awareness of the Consumer Panel’s concerns) and the need to balance fairness to consumers with fairness to firms.

As the Panel acknowledges, we fully recognised the importance of consumers being properly informed and we put in place arrangements to explain the issues to them. This included information provided through our website and Consumer Contact Centre, a full list of interim authorised firms available through the FSA Register, and a requirement on firms to disclose to their customers their interim authorised status and that the protection of the Financial Services Compensation Scheme (FSCS) would not be available.

On monitoring delivery of this disclosure by interim-authorised firms, we assessed these risks to consumers in the context of our wider supervision priorities. As expected, the number of interim-authorised firms fell sharply over a short period from the start of regulation for mortgages and general insurance – for general insurance, this fell from 941 at the launch of the new regime (14 January 2005) to 144 at 31 March – confirming our view that any initiatives for these firms would not have been cost-effective use of our resources. At end-May 2005 the number of interim-authorised general insurance firms stood at 38.

Consumers' information needs

The FSA's profile should be higher among consumers. The FSA provides consumers with important information which they should know. For example, it encourages consumers to check with it whether a firm is authorised (as little protection exists if dealing with unauthorised firms). The FSA also has an important role to play in giving clear and objective information to consumers, particularly in times of crisis and uncertainty. However, such information can only help customers if they know it exists. It therefore depends on the FSA actively promoting itself and its services (1.6).

We were very pleased that, in early 2005, the FSA recast the objectives of its communication strategy to be as follows:

- *'Ensure that we [the FSA] are seen as the respected regulator of financial services in the UK.*
- *Promote understanding of our objectives, aims, priorities and success.*
- *Promote the services, messages and information we provide to consumers.'*

The Panel believes that these will provide a much-needed focus to communication decisions and looks forward to a positive impact over the coming year (1.7).

The FSA needs to be more strategic in communicating with consumers. A number of different parts of the FSA communicate to consumers and we have pressed the FSA for stronger co-ordination and for someone to be responsible for an overall communications strategy. We are pleased that the FSA is now setting up a new Strategic Communications Team which will centrally co-ordinate all FSA communications activity. We again look forward to positive developments from this over the coming year (1.8).

The FSA must consider how all its methods of communicating with consumers can work more effectively and reach out to as many people as possible. It also needs to recognise, throughout the organisation, that consumers are not homogeneous, and cannot all be treated in the same way. Consumers have diverse knowledge, experience and needs. A more strategic approach to communication should help the FSA to offer information in ways that are useful for consumers (1.9).

We expressed concern that the consumer contact centre's accessibility appeared to be downgraded when the FSA stopped calling it a 'help' line, and did not promote the telephone number so widely. However, we were pleased that the workings of the contact centre are being reviewed and we look forward to improvements next year (1.10).

We have encouraged the FSA to produce publications in a way that engages consumers and looks interesting, and to recognise the diversity of consumers and to reach out to all (1.11).

We have suggested that the FSA develops a diversity policy which looks to identify and meet the financial, communication and consumer protection needs of different sets of consumers such as those from black and ethnic minority groups, and sensory impaired people (1.12).

The FSA issues information as a regulatory tool for consumer protection, but it could be more effective in providing this in ways which engage consumers and meet their needs. We have encouraged the FSA to identify what consumers need to know when a firm is in difficulty and to make such information easily accessible. Similarly, we have encouraged the FSA to promote its consumer alerts (1.13).

We welcomed the use of a marketing firm for the 'Key Facts' campaign, which informed consumers about depolarisation and the new mortgage and insurance regimes. But the budget for this campaign was too small. The FSA should allocate a larger budget to marketing (1.14).

We are pleased that the FSA will assess the effectiveness of its consumer communications. This should include assessing:

- *the reach of current communication and how to improve it;*
- *the accessibility of the contact centre;*
- *the effectiveness of consumer alerts;*
- *the extent to which the FSA is succeeding in making itself easier to do business with; and*
- *what could be achieved with a larger marketing budget (1.15).*

We have emphasised to the FSA that we believe that improving its role in communicating with consumers should be a high priority and we will follow developments closely over the coming year (1.16).

We welcome the Panel's recognition that we have sharpened the objectives of the FSA's communications strategy and put in place better arrangements for executing that strategy. At the monthly Executive Committee meetings delivery of the FSA's communications strategy is assessed. The Strategic Communications team, which reports directly to the Director of People and Communications, has now been in place for three months. The team has already made progress in co-ordinating centrally all FSA communications activity. We look forward to updating the Panel on our work in this area in June.

We are working to improve both the quality and reach of our consumer communications. We will continue to review our current consumer information, and the tools available to us, so that we can further improve the information we provide to consumers. Among other things, we will aim to

make our consumer website and our consumer publications more engaging. In doing so, we will take into account the diversity of consumers, although we will need to prioritise what we do and in what order.

Alerts and messages for consumers can range from warnings about scams (with straightforward ‘do’s and don’ts’) to broader messages (for example, about the new range of financial advice as a result of depolarisation; and the need to consider, before the end of the tax year, whether to opt out of the State Second Pension). We recognise that if we are to deliver consumer alerts and other messages effectively, it is not sufficient simply, say, to put up information on the consumer website. We will be using a range of methods to communicate the relevant messages. We will select which ones we promote in this way in order to avoid overload on the part of consumers and of those intermediaries whose support we will need in passing on our messages.

The renaming of the Consumer Contact Centre took account of the fact that we receive a substantial number of letters and emails, so it was no longer appropriate to call it just a Helpline. Our commitment to provide a good service to consumers is unchanged.

We look forward to working with the Panel over the coming year in helping us to improve further the way in which we communicate with consumers.

We are pleased that the FSA has recognised the need to take a strategic approach to driving up standards in firms’ marketing material and we welcomed the extra resources in the creation of the Financial Promotions Department. However, the FSA should be more ambitious about reaching out to consumers and should report back to them how they have used any information that they provided (1.17).

We believe that the most effective means of protecting consumers in this area is to target the majority of our communications to firms (such as, for example, our recent publication of *Taking Stock and Moving Forward*, the new webpages, and presentations by FSA to industry audiences), and through these means, to assist them to issue promotions which are clear, fair and not misleading.

Consumers are not always in a position to appreciate whether or not a financial promotion is misleading until some years after they have purchased a product. In addition, consumers are not always in a position to understand what would constitute a breach of our rules (unlike in the case of the advertising monitored by the Advertising Standards Authority, where honesty, decency, other criteria are easier to assess).

We do not update consumers on the progress of their particular case for a number of reasons: if we discover a promotion that does not comply with our rules, we believe that it is important that the situation is rectified as quickly as possible by, for example, asking the firm to withdraw the promotion, thereby preventing other consumers from being misled – we currently achieve this by simply asking firms to co-operate; the threat of publicity could compromise this approach. The outcomes of cases that have gone through the enforcement process are, however, publicised. To feed back to consumers may also put us at risk of breaching our confidentiality obligations under FSMA.

Disappointingly, the FSA has still not introduced Key Facts for investment products. This has been put on hold pending the outcome of its review of prescribing projection rates which will not be complete until 2006. This delay is unacceptable. We responded to the FSA's consultation proposing Key Facts for investment products as long ago as May 2003 and, as recorded last year, objected to the delay when Key Facts and a review of projection rates were first linked. The FSA should learn lessons about delaying work pending the outcome of other projects. We are supportive of the current work on providing more meaningful risk information to consumers following recommendations from the Treasury Select Committee. However, we trust this will not further delay the implementation of Key Facts (1.18).

We are actively engaged in completing our work on improving product information for consumers of packaged products; this is central to helping consumers make better buying decisions about investments. We remain convinced that it is right to address the deficiencies in the component parts of 'disclosure' – the review of the Key Features document, information about risk and reward (projections), charge information and post-sale information – as a package. To do otherwise would be to increase the risk of failure of at least one, if not all, of the components when they are ultimately combined and delivered to the consumer. Delivering a package of measures on this scale necessarily involves a complex programme of policy analysis and research.

We allocate our resources carefully to meet a wide range of competing demands. Over the past 18 months we decided to give priority to other policy programmes, such as depolarisation and the development of a low-cost advice regime for stakeholder products. This has caused delays in progressing our disclosure work. But we have made this risk-based judgment in the knowledge that we have not been leaving consumers in an information vacuum. The industry itself is taking steps to improve the information it provides, notably through the ABI's Raising Standards scheme, and to comply with the disclosure regime that is currently in place.

Since publishing our first proposals on improving the Key Features regime, CP170 (*Informing consumers: product information at the point of sale*), we have worked closely with the industry to develop and refine our Key Facts model, and will be publishing a consultation paper on this in July. We have also published a discussion paper on projections and, in the light of responses to that, have developed a new approach to informing consumers about the range and likelihood of possible returns products might deliver. We are currently in the process of researching the performance of this model and refining it.

As the Panel also notes, we have taken up the Treasury Select Committee's challenge to investigate whether it is feasible to develop a standardised approach to explaining product risk to consumers. There is a close link between this work and our work on projections, and we have convened a taskforce of consumer and industry representatives and technical experts in the field of risk to take this forward. We do not intend to allow this work to delay further the disclosure programme as a whole.

We expect to publish a consultation paper covering the entire product information programme in March 2006.

Consumers' advice needs

The advice gap cannot be filled by the commercial sector alone, as providing generic advice for the mass market is not profitable. Purchasing a product may not be the priority for many consumers and so would not generate commission; and even when it does, commission on small premiums may not cover the cost of advice. The inclusion of generic advice as one of the Financial Capability project's priorities was welcome but there has been disappointingly slow progress. At the beginning of the year we were told about work to assess the extent of an advice gap and it is regrettable that we have not yet seen the outcome. We are in no doubt that a significant gap does exist (1.22).

The FSA, and all those involved in the financial capability work, must recognise the diverse range of consumers and their need for different types and amounts of information and support. For instance, workplace advice is unlikely to help the many working in small firms or those already retired. Existing advice agencies are focused on helping people with problems rather than financial planning. Also, web-based tools do not answer important questions – such as those in the box below, illustrating consumers' needs for non-sales related advice – nor are they accessible to those many millions without internet access. We have encouraged the FSA and the Financial Capability Steering Group to be prepared to recommend significant extra provision of generic advice. We look forward to more positive progress from the FSA in this area next year (1.23).

We have also highlighted consumers' need for advice about non-sales related issues, which firms find uneconomic to provide – for example, whether to remain opted out of the state second pension, or how to address a shortfall on a mortgage endowment. A lack of advice on such issues may reduce confidence and reinforce barriers to engaging with financial planning (1.24).

In July 2004 we published a document setting out the Generic Advice Working Group's initial thinking. The Working Group, which we chair, comprises representatives from a range of partner organisations. Since publication of that document, the Working Group has made progress on a number of areas of work and we will be publishing a progress report shortly. This will set out, among other things, the Working Group's current thinking on the definition of generic advice. We have undertaken research into which methods of delivering advice (covering both financial and non-financial advice) work best and why: we will publish this review shortly. We are working with the Financial Service Skills Council to develop a quality assurance scheme for the provision of generic financial advice. In conjunction with BBC Online, we have specified and developed a financial healthcheck, which will be launched in June 2005. This will provide an independent 'entry level' tool which could encourage and help people to understand their financial needs; to identify possible priorities and next steps; and to know where to go for further information and for advice.

Consumers' and firms' rights and responsibilities

The FSA has continued work on 'Treating customers fairly', which we support. We agree that the responsibility for ensuring compliance with the principle of treating customers fairly rests with firms' senior management. Firms need to be accountable to consumers as well as the FSA on such compliance and should be required to demonstrate publicly, for example through annual reports, what they have done to satisfy the principle (1.25).

We welcome the Consumer Panel's support for our Treating Customers Fairly (TCF) work. In the coming year we will continue to develop material to help firms and their senior management in ensuring that fair treatment of customers is embedded in their businesses. At this stage we do not plan to require firms to publish information concerning their implementation of TCF. Some firms have chosen to publish this information and some trade bodies have announced initiatives, which their members will be taking, to support implementation.

Necessary and appropriate regulation

This industry is 'too important to be left on its own to sort out its problems. It is an industry that is key to the well-being of the wider economy.'¹ This presents a clear case for strong regulation and there is much to be done to drive up standards in retail firms. We appreciate that regulation does have to be reviewed from time to time and we understand the reasons for the Costs of Regulation Study that the FSA is undertaking jointly with the Practitioner Panel. We will be very interested in the results of this study; in particular, we will be keen to ensure that proper account is taken of the benefits of regulation. It is not only consumers and Government that have much to lose from weak regulation. So do financial services companies themselves – weak regulation undermines honest companies which set high standards for themselves (1.30).

We welcome the Panel's support for strong regulation of the retail financial services sector. The current study of the Costs of Regulation will only look at cost. The purpose is to help identify where there may be substantial costs from discretionary elements of regulation that are not matched by corresponding benefits. This balancing of costs and benefits is central to the way this exercise is being conducted.

The FSA has stepped up its emphasis on only intervening if there is market failure and if the proposed solution can be demonstrated to be effective and proportionate. We accept this approach – provided the market failure and cost benefit analysis adequately reflect the impact and risk for consumers, particularly for different groups of consumers, and especially for those in vulnerable circumstances. The FSA's record on this is mixed. A cost benefit analysis should take into account any increases in what consumers are required to understand; and should test, through consumer research, whether this is realistic. But it should also include weighting for detriment to weakest consumers, and take account of the unquantifiable nature of many benefits to consumers. We have criticised the FSA where the regulatory solution has imposed an increased need on consumers to understand and evaluate a risk, without the evidence to suggest that they can (1.31).

So, increased determination to tie regulation to market failure, if accompanied by a better reflection of consumer needs in policy development, may lead to more regulation in some areas (1.32).

We have also seen examples of where the FSA's assessment of what is proportionate has meant it has not taken even minimal action, thus risking serious detriment for vulnerable consumers (1.33).

1 Press note from the Treasury Select Committee, 27 July 2004, on the publication of its report on *Restoring confidence in long-term savings*.

There has been considerable pressure from industry to reduce the cost of regulation. Reviewing the costs to firms in order to identify where there is no corresponding benefit is legitimate. However, any proposed reductions in regulatory requirements must not shift the burden and risk to consumers (1.34).

We agree that market failure analysis should take into account the characteristics and behaviour of the relevant consumers. We try to do this by factoring into our analysis an understanding of the ‘demand side’ as well as ‘supply side’ aspects of the market failure, with the former being grounded in consumer research and testing. We also agree that we need to factor this into our formulation and evaluation of policy options, and this is what we seek to do in practice.

It is certainly difficult to quantify benefits to consumers of, for example, an increase in market confidence or to attach weights to the value of such benefits between different groups. Consequently, while we agree that the marginal value of a pound to a poor consumer is greater than the marginal value of a pound to a rich consumer, we are cautious about using this idea in our cost-benefit analysis. Such an assessment would be subjective: whether or not a policy had net benefits would often depend on the values we attributed in our cost-benefit analysis to pounds in the hands of different interest groups. This attribution of values would lack a truly scientific basis and would instead reflect the preferences of the FSA; we therefore think it more straightforward to state explicitly in our consultative papers that a specific interest group particularly merits our protection and we have therefore intervened to look after its interests. And we do believe that through this approach we capture the ‘qualitative’ benefits to consumers.

We asked the FSA to make better use of intelligence on how firms are behaving, such as that from the consumer contact centre, where consumers are having problems with certain firms, or from the Financial Ombudsman Service (FOS) on firms with poor complaints handling. In relation to marketing material, we have asked the FSA to promote its Financial Promotions Hotline to make it easy for consumers to report misleading advertisements. We have repeated our calls for the FSA to undertake mystery shopping to understand what is actually happening in the market. We are pleased that the FSA is now persuaded of the value of mystery shopping and will carry some out to gather information about a particular area of concern (1.35).

We are focusing on strengthening our intelligence capability and we have briefed the Panel during the year on our work in this area. We take information from a variety of sources and work closely with the Financial Ombudsman Service. We are also exploring ways of analysing and using data from calls made to the Consumer Contact Centre to help us identify new and emerging risks to consumers. We have made material available on the risk section of our website, setting out some of the issues we have considered during the course of this work. We will update that regularly. We apply a range of regulatory tools and we recently used mystery shopping in our work on the equity release market. We will consider how we can use the tool in future.

We have noticed an increased push from the industry to set standards via codes of practice. This move could deliver benefits to consumers if the consumer viewpoint was taken into account through consultation in developing those standards. However, we would not want to see codes of practice replacing regulation. We will be monitoring developments to ensure there is sufficient consumer involvement in self-regulation, and to ensure that it does not creep into FSA territory – thus providing second-tier standard setting without sufficient checks and balances (1.36).

In our public response to the Practitioner Panel on this topic we said:

‘We welcome industry initiatives to improve its own practices. Examples include the Banking Code, the work of the Joint Money Laundering Steering Group and the recent work by the brokerage and fund management industries, in active dialogue with the FSA, on a framework for improved practice in relation to the execution and research elements of commission. If problems are dealt in this way, then market failures may be corrected without the need for further detailed FSA rules.

We would distinguish this situation from the provision of guidance by trade associations to supplement rules that the FSA has made. In such a situation we have decided that rulemaking to address the market failure is appropriate. Where the relevant rule would otherwise be unclear, we stand ready to issue guidance.

Our commitment to open and transparent regulation (including public consultation involving all those with an interest in the rules in question) and our duty to pursue our statutory objectives mean that, where provision of guidance is needed, then it will normally be most appropriate for that material to be FSA guidance. That guidance would be made following public consultation in accordance with the statutory requirements and our public commitments including regarding cost benefit analysis. Of course, the FSA would take account of industry views and, if appropriate, may draw from industry material.

As an alternative to producing FSA guidance, the FSA is willing to consider endorsing industry guidance in appropriate circumstances. For example, in January 2004 the FSA endorsed the statement of recommended practice for financial statements of authorised funds issued by the Investment Management Association. In these situations the normal processes for public consultation would still apply.

Where an industry body elects to produce its own guidance, and if that guidance is warranted and it is appropriate for it to be given by an industry body rather than by the FSA, then the FSA is willing to review it and offer views including, where it is the case, stating that the guidance is consistent with the intended effect of our rules. Any such statement would need to include an explanation of the effect of the statement. An example of where we have done this is the industry guidance on conflicts issued by the British Bankers Association and other organisations in February 2004.’