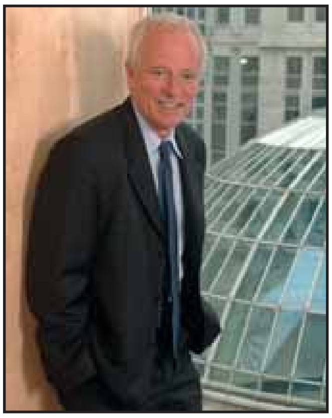
Chairman's statement



Callum McCarthy, FSA Chairman

2006/07 was, like other years, a busy year for the FSA. This reflected the final stages of some long standing pieces of work, including the implementation of the Markets in Financial Instruments Directive (which is likely to have quite profound effects on the European financial services industry) and of the Capital Requirements Directive (the most significant change for banks' and others' capital base for two decades). The year also marked important developments in work which will continue to be central to the FSA; our work on financial capability is a prime example of this. At the same time, we have started a process of far reaching changes in the way in which we run the FSA, designed to improve the quality of our output and the efficiency with which we discharge our responsibilities. This report sets out in some detail what we have done against our original plan. It is a plan which we have broadly delivered.

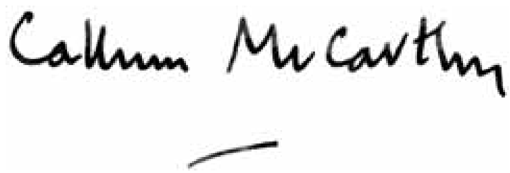
Behind all this activity, there is a consistent set of policy objectives. We continue to apply a double test for any discretionary regulatory activity; we should regulate only when there is both market failure and the prospect that intervention will produce net benefits – and even then, we will see whether informal encouragement rather than regulatory action is the best way forward. The former course has proved effective both in the actions which we have taken to establish much greater contract certainty in the UK insurance market and in our work, jointly with the Federal Reserve Bank of New York and the SEC, to end the backlog of trade confirmations in credit risk derivatives. We continue to review our existing regulations, to see where we can eliminate regulations we judge unnecessary, or replace specific rules with reliance on principles. And we continue to adopt policies which are risk-based and proportionate (a quite different matter from being, as some mistakenly describe the FSA, 'light-touch'). There is a wide range in the way we approach our supervisory responsibilities, with a very small number (less than one per cent of all those we supervise) of the firms which have the potential to affect our statutory duties most being subject to 'close and continuous' supervision, whereas more than 95 per cent are supervised principally through thematic and statistical work, with very little by way of visits or inspection. We accept that we cannot achieve, and that it would be counterproductive to pursue, a zero-failure approach. Investment involves risk, and risk entails occasional failure.

In applying these principles, the greatest difficulties arise in the retail rather than the wholesale markets. I think this will continue. This is because the retail market – particularly for investment products – is much more difficult to make operate as an efficient, orderly and fair market. The reasons for this are many, and intractable: the complex nature of some products, and the difficulty in judging whether they have delivered the performance indicated; the extended timescale over which this judgement has to be made; the acute information asymmetry between providers and consumers; and the low level of competence of many consumers in making financial decisions. We have devoted increased resources and attention to tackling those underlying problems. It will be a long haul to solve them, but we are determined to do so.

The work described in this report has put a heavy burden on FSA staff, which they have carried with enthusiasm and determination. Last year I said that the demands on them were great, and would not diminish – something which has emphatically been true. I am grateful to all my colleagues, executive and non executive, for the way in which they have responded to these demands.

In the past year, three non executives have stepped down from the FSA Board after serving two full terms: Kyra Hazou, Tom de Swaan and Clive Wilkinson. They were all very good colleagues, who contributed greatly, both at the Board and in its various committees, to the strong and constructive role which the Board now plays within the FSA. I am very grateful to all three.

Last year was also the last full year during which John Tiner served as Chief Executive of the FSA, as he will step down from executive duties and resign from the Board at the Annual Public Meeting on 19 July. John has been the Chief Executive of the FSA for nearly four years (the first person to have this undivided executive responsibility), and has worked for the FSA for six years in total. During his time as Chief Executive, the management structure and systems of the FSA have been substantially altered and improved, and we have made strides towards becoming a much more outcome focused, more productive organisation. All of us will miss him, none more than I.



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