

Financial Services Authority

Annual Meeting

20 July 2000

Overview of the FSA's Work in the Past Year

Howard Davies

Chairman

Good morning ladies and gentlemen and welcome to our first annual general meeting. It might be useful if I begin by explaining the background to the meeting and how we propose to proceed. The Financial Services and Markets Act imposes a requirement upon the FSA in future to hold an annual open meeting. Factually, the Act is not yet in effect so there is no such requirement on the FSA this year. Rather than do nothing until the Act is triggered, which may or may not be in time for next year's meeting, we felt that it would be sensible to make use of this first year, when the format is not prescribed for us, to carry out a pilot meeting for next year to see how this process works. The FSA aims to learn from this experience for when the statutory obligation will be in place next year. This is a learning exercise for us and for you and there is a form that we hope that people will fill in either today, or afterwards, for you to tell us if this is a useful exercise and how this may be improved for the future.

This morning, I will begin by saying something about the work of the FSA throughout the past year. Stewart Boyd, deputy chairman, will discuss the role of the non-executive directors, which is in the Act for the future, but we have put into operation in anticipation of the new requirements. Barbara Saunders will talk about the Consumer Panel, which she chairs. Finally, David Challen will discuss the Practitioner Forum, which he chairs. Both of which became part of the future statutory framework due to the parliamentary process.

I will briefly cover three things: first, some of the highlights of the past year; second, the plans for the next 12 months; and third, three specific announcements being made today.

I. Past Year's Highlights

I do not propose to cover all of the detail in the Annual Report. However, I will highlight the key events of the FSA over the past year.

1. Financial

These are important to those who pay for the FSA. The financial results were satisfactory. Cost comparisons, year-on-year, are difficult as the FSA is in a time of transition - there are many different

bodies that are funded in different ways, which are being brought together in different periods of time. Therefore, it is difficult to identify comparisons over the years. To assist with comparison we have focused on mainstream regulatory costs. This excludes the impact of particular enforcement cases, as fines may be received in a period that is different from when the costs were incurred, and specific large exercises such as the pension's review. These figures would distort the results. However, if they were included then a reduction of regulatory costs would become evident throughout the next three to five years. Though, this would be misleading.

Mainstream regulatory costs increased by 6.6%, year-on-year, which was slightly more than 2% below the budgeted amount. Therefore, there were some savings for firms in comparison with their forecasts. The comparison between the financial year 1998/1999 and 1999/2000 was also misleading, because in 1998/1999 the FSA had a significant staff shortage that resulted from the transition. Accordingly, a budget-to-budget comparison has been made. On this basis, over a two-year period, the budget for the current year is 4.5% more than it was two years ago. This is a real reduction in costs, as salaries have increased by more than 10% in the financial sector over the period. In addition, consultancy fees per diem, and our firm looks rather like a consultancy, have increased by 20% in the same period.

On a broad basis, the transition has not increased running costs, even though there was costly work involved in handling the new bill and the new rulebooks. The industry is well aware of the order of costs that were involved for delivering rulebooks, consultations and their management. Furthermore, within this flat budget we have included consumer education work, which is a new activity required by the Act. This has been achieved through savings on amalgamation, especially in the back office and support services. Paul Boyle can answer detailed questions that you may have on the finances; he will be pleased to do this during the meeting or at any other time.

One other regulatory requirement is to show comparative figures of regulatory costs in this jurisdiction and elsewhere. This is not a straightforward process. Ideally, compliance costs should be included, however, after surveying firms it has proved impossible to gain in-house compliance costs for different jurisdictions. The FSA is pursuing these issues in collaboration with other international regulators and it is hoped that progress will be made in the future. The costs that are included in the report are the costs of the regulatory system, which are shown for the main comparative centres in an annex in the report. This data is not complete, as some European countries do not disclose the costs of the regulator. As a benchmark, the USA has approximately 22,500 regulators that perform comparable functions to the FSA, which has 2,400 including the Ombudsman and compensation schemes. So we are 2,400 and they are 22,500, which gives us something to aim at over the next few years.

The future trend of costs will mainly be dictated by market salaries, which are a dominant aspect of the FSA's total costs, but will also depend upon success in retention and recruitment. The industry has made it clear that they want the FSA to have a competitive pay structure, to retain quality employees. This is because the costs of being regulated by those that do not understand the industry are high. At present, the industry is collectively flattering in regard to the quality of staff with the FSA. This is evident as the industry extensively seeks to recruit FSA staff, which places pressure on salaries that the FSA will have to respond to.

2. Regulation

Detail of regulatory issues can be found at the beginning of the Annual Report; for this reason, only the key points will be referred to.

- a. The Pensions Review still occupies more than 200 staff and will continue to do so for two or more years. However, good progress has been made in accordance with the timetable - the amount of investors that have received compensation, guarantees or reinstatement is constantly increasing.
- b. In addition, the FSA is undertaking a small review of FSAVC selling, which is a considerable exercise. With regard to endowments, the FSA has concluded that there is no case for a comprehensive review of past endowment sales, although there is a review of current selling practices and samples of poor selling in the past. These remain a matter of concern and further announcements will be made in the autumn.
- c. Considerable progress has been made in respect to consumer education and information during the past year. For example, FSA fact sheets have been sent to 6 million endowment holders to provide objective information with regard to the action to take if policies do not perform well enough to cover the value of mortgages. Also, the FSA's work on comparative information tables has progressed, with strong support from consumer groups and, after debate, industry representatives. This initiative will be actively pursued during the current year.
- d. The equity markets have experienced an exciting period. There has been a massive increase in the amount of new retail investors, who were initially attracted by the action in TMT stocks. This generated handling difficulties in the brokering market during the autumn, but to my knowledge these problems have been largely alleviated. This exercise was a good example of co-operation between regulated firms, trade associations and the regulators. The FSA has released a considerable amount of information for investors concerning the related risks involved and necessary cautions to take with these stocks. In addition, the FSA carried out an oversight exercise of the performance of firms in handling the waves of new investors that were attracted to them. Overall, this improved the performance of the sector.
- e. Internationally, the FSA has continued to work on the Basel Review of capital standards. I have chaired a group on the regulatory environment for hedge funds under the aegis of the Financial Stability Forum. Presently, the FSA is examining the implications of the proposed merger of the London and Frankfurt stock exchanges in close collaboration with German colleagues. More will be announced about the regulatory environment of the exchange shortly. International activity consists of much of the FSA's work and it is important that the FSA continues with this for the sake of the City. The FSA is the UK's representative to more than 130 international groups. In the light of that it is surprising that British Airways is not more profitable than it is.
- f. The process of transition has been very time consuming, in relation to which the FSA has published many consultation papers— 58 at present. The FSA recognises this to be a burden on the industry and consumer groups. Though, it must also be recognised that they are a burden to create. However, there is no alternative but to continue with the consultation framework imposed by the legislation.

I would like to pay tribute to the two panels that have carried much of the burden and the work of other bodies, such as trade associations of the City, for their assistance in creating the new regime that the FSA is implementing.

The Bill became an Act in June. The terms of the legislation were extensively debated, so I do not intend to review them again. The FSA's opinion is that the Act is good and that extensive debate, which it required, has brought about a broad consensus over the regime and accountability of the

FSA. As far as I am aware, there is no other regulator that has such an extensive accountability structure or operates as openly as the FSA. The FSA has no complaints about this. The belief is that regulation must be built upon a high degree of consent between the regulated and the regulator, especially in the financial services market. Consensus is important, as in essence this is a relationship business. However, this does place considerable burdens upon the FSA and the market place, since the consultation requirements depend upon the FSA receiving a meaningful response from those that are consulted.

II. FSA's Plans for 2001

This week, the government announced that the FSA is looking to implement the new regime (N2) in approximately 12 months. This is a sensible and achievable target, if the deadlines for the delivery of the various parts of secondary legislation are met. The Treasury has also committed themselves to reviewing the progress of the FSA at the year-end.

Although this timetable is longer than initially planned, it is not a slow process. The implementation of the new regime using this timetable, will be quicker than it was in 1986 to 1988 for the Financial Services Act, which was only a third of the regime that the FSA has to put in place. It is because the FSA was already in existence that it is comparatively ahead during the period of Royal Assent, than the regulators were in 1986. This new timetable has enabled the FSA to extend the consultation period on the conduct of the business sourcebook, which was a concern for many bodies, and it will provide more time to ensure that the process of authorising firms in the new regime is correct. It is vital that this process takes place before the regime is in place.

Important issues that will arise in the future will be the impact of the release of a new version of the Code of Conduct on market abuse and manuals on authorisation, enforcement and supervision processes. The FSA's aims are to have completed its consultation process on the majority of the new regime by the year-end, and for the Board to have formally made the new rules in the spring; Michael and Phillip can answer any detailed questions on this. The FSA is also undergoing internal re-organisation and reforming regulatory processes, which is likely to be the most important aspect for both firms and consumers than the detailed rules.

The FSA is only part of the way to forming a single regulator. Although changes were made in 1998, which was more than simply combining the ten constituent bodies, the FSA is still operating several different regulators below the surface. Consequently, in addition to forming the new rules, the FSA has also considered its future structure, which were included in a paper called 'The New Regulator for the New Millennium.' The response to this paper, from both the industry and consumers, has been encouraging.

The paper included three significant points. First, in terms of allocating regulatory resources, the FSA intends to analyse the risks imposed upon its statutory objectives, by firms or market developments, and to have in place a common risk model across all the firms under regulation. Second, there will be a shift towards thematic work across a whole sector, rather than firm-based work, which leads to micro management and poor use of scarce resources. Third, the FSA will examine all possible options in order to identify the appropriate response when identifying regulatory discrepancies. The new FSA's regulatory toolkit ranges from consumer education to enforcement. It is important to ascertain whether the FSA should respond by in-firm supervision, improve the consumers' understanding, or where enforcement

should take place to establish good practice. The FSA plans to publish a related paper on the above in autumn.

III. Announcements

The previous issue implies structural changes to the FSA, which relate to the announcements that will be made today

First, with N2 approaching and with Royal Assent, the roles of the SROs, in the investment area, have changed. The Boards of the SROs now have less to carry out, as they are not involved in rule making, since this is now the responsibility of the FSA Board. Consequently, the Boards have agreed to stand down and become a subsidiary of the FSA, when this is feasible. The PIA and IMRO Boards have concluded that this is now possible. Hence those Boards will stand down this month and will be replaced by small care and maintenance boards that will be chaired by Michael Blair, the former General Counsel, and a practitioner and consumer representative. For the PIA there will be two people representing providers and one person representing IFAs. These Boards will manage the scaling down and distribution of assets of the organisations, but will not be involved in future rulemaking. The SFA still has business in progress, therefore, it will reassess the position and timing to be able to carry out this process in the early autumn. The authorisation and enforcement functions, or disciplinary committees for the PIA, will remain in place with their respective existing members. This is because there will be certain activities that must be dealt with in accordance with the old rulebooks.

Second, today, the Treasury will announce that the Chancellor will be creating a third managing director appointment at the FSA in due course. This is in response to a recommendation by the Board of the FSA in the context of the management structure and the future responsibilities of the FSA. The third managing director's responsibilities will include: consumer relations, insurance and investment regulation, policy on the conduct of business and industry training. Consumer relations will move from the responsibility of Phillip Thorpe, whilst the regulation of insurance and investment will move from Michael Foot. The post will be advertised both internally and externally in the early autumn. The FSA believes that this move will strengthen its decision making ability and add Board level focus on retail and consumer issues. There is no implication for the overall size of the Board, as there has been a vacant executive position since Richard Farrant departed in January 1999. Paul Boyle, finance director, who is originally from Cadburys, will become the chief operating officer and will be a member of the Chairman's Committee, though not formally a member of the Board. He will also take responsibility for human resources functions, which has been under my control. This change will have consequences below Board level, which will be explained in due course. However, these changes cannot be implemented until a new person has been appointed and the new legislation is closer to being in effect.

Third, the FSA will announce today that a chairman is sought for the new Regulatory Decisions Committee. This Committee will be at the pinnacle of the decision making process in the FSA for authorisation, enforcement and key supervisory decisions of the same order. A committee of this kind has been foreshadowed in the FSA's papers on enforcement processes. It will be necessary for the Committee to have a high degree of independence from the executive of the Authority. The FSA is seeking a legally qualified person, who will be independent of the FSA's management and will be accountable to the Board. The successful applicant will chair committees of practitioners and public interest members, assembled for the different types of decisions to be made. The appointment will be made by the Board of the FSA, though external help will be used. Stewart Boyd, the Deputy Chairman,

and the Chairs of the Practitioner and Consumer Panels will comprise the selection committee; there will be no executive involvement.

The Role of the Non-executive Directors

Stewart Boyd QC

Non-executive Deputy Chairman

Good morning ladies and gentlemen, I confess to considerable diffidence to taking what I think must be the driest substance of the morning. Half the audience probably know what I am going to say already, and the rest either do not need to know or do not want to know, but if you bear with me I will only take about five minutes.

This is a subject that gave rise to considerable debate whilst the Bill passed through Parliament. In the course of this debate, propaganda was released to the market of which a great deal was unreliable. Some of this propaganda is still in circulation and arose in a letter to the *Economist* last week. So this is an opportunity to explain how the non-executive element of the Board works.

Over recent years, the discussion of corporate governance has increasingly turned to the role of non-executive directors in adding public accountability to the role of boards of public companies. In this context, the FSA is a rather curious animal. It has no public shareholders and does not seek to make a profit; it is closer to a government agency with independent functions, than a commercial company. For mainly historical reasons concerned with continuity from the era of self-regulation, the FSA is modelled upon a company that is incorporated under the Companies Act. However, the directors are appointed by the Treasury, rather than the nominal shareholders – the only shareholders are the Directors and are scarcely likely to make proper accountability to themselves. The appointments of the Directors are to safeguard the public interest for the good governance of the FSA. In addition, it is to ensure that when the Act comes into place there is a strong and independent body, entrusted with safeguarding the statutory objectives and the principles of good regulation, which are enshrined in the Act.

Paragraph 6, Schedule 1 of the Act entrusts the non-executive directors with specific functions, that largely correspond to those of the audit and remuneration committees of a conventional public limited liability company with some additional functions. During the recent debates of the Bill, it was surprising to discover the widespread idea that the non-executive directors have no other function to perform in addition to the 'pay and rations' function. This would leave Howard and the two other executive directors solely in charge of the regulatory and rule-making functions of the Authority. If this were the case, then there would be good grounds for believing that Parliament had created a monster, capable of wasteful, arbitrary and oppressive excess, without any external control for the public interest. This perception is incorrect. Non-executive directors not only have an equal voice with the executive directors of the Board. They are also in the overwhelming majority.

During the year covered by the Annual Report, there were 14 Board members, of which 11 were non-executives. The new executive appointment will bring the Board to a total of 15, of which 11 will still be non-executives. The non-executives, who recommended this change, have concluded that this small dilution will not diminish their influence on the affairs of the Board.

Non-executive directors are appointed in the public interest; they are not representatives or delegates of any particular constituencies. The Treasury ensures that their appointment reflects the spectrum of interests that are affected by the activities of the FSA. The biographies of these directors can be found in an annex to the Annual Report. They are unlikely to be characterised as a list of Howard Davies' poodles.

The Board meets at least 11 times per year. All members have equal access to staff papers and an equal voice in debate. I regularly meet with Howard between Board meetings to discuss the agenda for the next meeting and important developments since the last meeting. The non-executive directors meet as a separate body three or four times per year, under my chairmanship. This is in order to deal with the functions under their responsibility with the present constitution.

The non-executive directors have discussed how the present functions will tie in with those under the Act. The four functions are: to review whether the FSA is efficiently and economically using its resources to achieve the statutory objectives; to review whether the FSA's internal financial controls secure the proper conduct of its financial affairs; to fix the remuneration of the Chairman and other executive directors; and to report annually on these matters to the Treasury. These functions are reserved for the non-executive directors alone, although it is possible for some of these functions to be discharged to sub-committees. It has been a particular concern to minimise the potential of disruption of the principal of the unitary board, which is integral to the UK company law system, which all the directors support.

At present, the non-executive functions are carried out by the audit and remuneration committees. In addition, a framework has been set up to deal with ongoing performance, which, to some extent, is a new non-executive reporting function. It is expected that the existing committee structures can be made use of without unnecessary duplication of the work of the Board. For the year 1999/2000, the Audit Committee has regularly met to review the internal financial controls, which is assisted by the internal audit department and, where necessary, external advisers. The Audit Committee consists entirely of non-executive directors and I chair it. The head of the internal audit department of the FSA has direct access to me when required. The Remuneration Committee, that I also chair, decides upon the pay package for the Chairman and the other Executive Directors, and recommends the policy for the remuneration of other senior executives. This Committee also consists entirely of non-executive directors. The positioning of executives' salaries in the market is not easy, however, there is the assistance of external advice of potential comparators. So, as far as possible, the same policy is applied to the executive directors as we apply to all the senior staff.

This year, in accordance with the recommendations of the Turnbull Report, performance related pay has been introduced as an element of the Chairman's and other executives' remuneration. The criteria and objectives of this element are set out by the non-executives on an annual basis. Details of this year's decisions are in the Annual Report.

In summary, non-executive directors perform a key part of the public accountability of the FSA. They are the guardians for the public interest of the statutory objectives and principles of the Act and of the application of those objectives and principles by the executive arm of the FSA. Non-executives have a duty to report publicly on their reserved functions and are accountable to the Treasury, and, ultimately, the Parliament and the public. However, the non-executives are not the only mechanism of public accountability within the FSA; there are others that include: consultation requirements, the requirement to hold an annual meeting and the functions of the Consumer Panel and the Practitioner Forum.

The Role and Work of the Financial Services Consumer Panel

Barbara Saunders

Chair, Financial Services Consumer Panel

It is my task this morning to say a few words about the role and functions, and operation of the Consumer Panel during the last year. The Consumer Panel was set up by the Board of the FSA in November 1998, after a recruitment process based upon the Nolan principles. These established the principle that public appointments should be subject to open competition, involving advertising positions and assessing suitability in terms of clear criteria. The FSA appointed 11 members that brought a range of experience, including consumer and money advice, knowledge of regulation within financial services and elsewhere, understanding of the needs of low income and vulnerable consumers, and complaints handling and enforcement.

The role of the Panel is wide-ranging and challenging. The key elements are to advise the FSA on policy and to monitor the effectiveness of the FSA in meeting statutory objectives, particularly consumer protection and awareness. The scale of this task should not be underestimated in terms of identifying the appropriate methodology, to establish effectiveness, and judging whether the activities that have been undertaken are effective and appropriate. In addition, there is the challenge of reviewing the impact on consumers of market developments and to publicly report findings.

The full Panel meets ten times per year and in specialist working groups in between, which is a heavy volume of work for the Panel members – the 56 consultative papers are testament to this. The FSA staff prepares briefing papers for the Panel and attend the Panel's meetings to discuss the various issues on the FSA's Board agenda and other policy issues under consideration. They consult with the Panel on these issues, which occurred at an early stage in the development of the FSA. The Panel has encouraged this from the start, as it wants to ensure that the FSA asks the right questions from the beginning of the process and carries out research on policy development where appropriate, as it is too late once documents are in the public domain.

The Panel has been formally consulted prior to the publication of all the consultative documents, and responds in writing once they have been published - the Panel has commented on more than 20 documents in the past year. The powers and significant budget of the Panel stem from the FSA's commitments and requirements under legislation to have such a panel.

The budget of the Panel is used to initiate the Panel's research, which is considered to be vital to inform the Panel of the attitudes and developments in consumer behaviour. This provides the benefit of current information that would otherwise be impossible and adds value to the Panel's contribution.

It is the intention of the Panel to continue to build upon the annual benchmark surveys that the PIA consumer panel undertook. This is so that it is possible to benchmark changes in behaviour over time, and seek to assess the impact and effectiveness of the FSA in the light of changes in the market and consumer behaviour. The Panel provides the Board with a quarterly report, and I regularly meet with Howard Davies to discuss matters of concern. The FSA has formally responded to the representations that the Panel has made, and is has indicated where the views of the Panel have been taken into account.

Under the Act, the Panel has statutory force that the Panel has welcomed in terms of strengthening the role and accountability of the Panel. The Act also requires the FSA to regard the representations that the Panel makes and in future it will be required to explain in writing if it disagrees with the Panel. I am sure there will be times when both parties wish that this did not exist. However, it is a very good and important discipline that greatly enhances the accountability of the process for both parties. I believe that some of the good practice that has been collectively developed over the past 18 months is enshrined in law.

The Panel is also conscious of its own accountability to the consumer movement, the wider public, and the customers of firms, the Treasury and Parliament. To fulfil this accountability, the Panel meets regularly with consumer organisations, government departments, including the Treasury, but also the OFT and DTI. In addition, the Panel tries to maintain contact with the practitioner and small business panels and industry trade associations. This is because it is important that a consumer panel is not seen as being out of touch with developments in the market, and remains informed of the challenges affecting the regulator, as well as those of individuals.

The Consumer Panel has always been committed to a policy of openness and accountability. A website has been developed so that the Panel's comments on FSA issues can be scrutinised, along with press releases and research reports. When the Panel was appointed, there was substantial debate comparing the merits of internal and external consumer panels at representing the interests of consumers. The Cruickshank Report also regarded this issue. The Panel strongly believes that its involvement within the FSA provides the Panel with access to information at the outset. It also tests the openness of the relationship between the two parties. Indeed, the FSA has always responded to requests for information and analysis on its activities. It is important that the Consumer Panel does not take on the functions of the regulator, but ensures that it is accountable for its actions and can effectively explain to consumers the way it is pursuing the objectives of consumer protection and awareness. Although working within the FSA, the Panel has not been inhibited in any way. For example, it has made comments to government ministers on the scope of the legislation and stakeholder pensions. In addition, the Panel has made strong representations in regard to what it believes to be government failure to include mortgage advice in the legislation. This area continues to cause concern, as the Panel believes that it is essential for the FSA to be in a position to effectively regulate the market and to have the powers to do so.

During the past year, the Panel believes that the FSA has made significant process, despite its uncertain statutory position, in implementing the new regulatory framework and establishing a 'one-stop shop' for consumers. In the Annual Report, which is available on the website and as a publication, the Panel has also identified ways in which the FSA should consolidate its consumer protection activity and speed up its response to the emerging consumer problems.

The aim of the Panel is to work with the FSA and comment on its activities. It is also to ensure that it is able to listen to the views of an informed and effective Consumer Panel and consult with those that understand the technicalities of their efforts and appreciate their role in the process. As the statutory objectives require, the Panel must also continue to be responsive to the need to empower and protect the customers of the firms that are regulated. I am sure that the Panel will continue to engage in robust and informed discussions as to how this can be best achieved in a rapidly changing market.

The Role and Work of the Practitioner Forum

David Challen

Chair, Practitioner Forum

Good morning ladies and gentlemen.

The Practitioner Forum was established in November 1998, as the FSA felt that it would be invaluable to have a group of senior representatives from the regulated industries to use as a sounding board. The government agreed with the proposition and included it in the Bill, so it will become a statutory entity. Membership of the Forum was initially drawn from the recommendations of the leading trade associations. Subsequently, two additional members have been added which are the co-chairmen of the Small Business Practitioner Panel, which the FSA also set up. This does not have statutory powers and since the Forum does, it included them to ensure that the opinions of small businesses are properly expressed.

The terms of reference of the Forum are to assist the FSA fulfil its objectives and ensure that it takes proper account of the consideration set out in the legislation. The terms of reference are designed to ensure that regulation is efficient; not needlessly burdensome; allows the financial services industry to be innovative and competitive; and allows the industry to maintain the UK's position in the international market for financial services. Consequently, there are many issues that are of interest to the industry, that we attempt to safeguard.

In practice, the Forum considers that it has four areas of activity, which include: monitoring the effectiveness of the FSA from the perspective of the industry; to communicate to the FSA any issues of general concern of regulated businesses in regard to regulation in practice; to respond to the FSA when it requires a practitioner's view; and, to contribute a broad financial industry perspective on issues that are raised.

It must be stressed that the role of the Practitioner Forum should not be confused with the role of trade associations. Trade associations are extremely well staffed with very able people, who have a great contribution to the whole consultation process. It is important that trade associations advance the views that are in the interest of their members. The Practitioner Forum, or panel as it will be known in the future, must act as an interpreter between the industry and the FSA and offer a dispassionate, albeit forceful, view from the industry on matters of importance to regulated firms. At the same time, this view must recognise that the FSA has duties to other constituencies.

The Forum has no staff and has not requested a budget from the FSA, although items such as the Annual Report and research are funded by the FSA. The Forum also has direct access with the FSA; I have access to Howard Davies, the top executive team and the Board upon request.

The Bill has occupied a great deal of the Forum's attention since it was created. The combined efforts of the Forum, the trade associations and many individual firms has resulted in a Bill that is a satisfactory framework for a regulatory process to be built upon. One other key area of activity has been the massive consultation exercise. The Forum consists of a handful of individuals and does not intend to speak for the industry in consultation. However, when the FSA informs the Forum before a consultation exercise of a proposed policy, the Forum uses the opportunity to state an opinion and steer the initial proposal in a more

appropriate direction if necessary. The Forum does not aim to offer a formal consultation response once the Paper has been released. Though when the consultation period is over, the FSA produces a synthesis for the Forum of all the issues that have been raised through their consultation and how it believes it should respond. This provides the Forum with the opportunity to express whether it believes undue weight is being given to particular points of concern or if the response is inappropriately directed.

Another major area of activity for the Forum was the industry survey that was conducted last year. The results of which were published in the Annual Report in January. The report is available on request or via the website. The FSA proposed this research programme when the Forum was created to regularly test the opinion of the industry on the effectiveness of regulation. The purpose of the survey was to establish a benchmark to observe trends in the attitudes of the industry from time to time of the effectiveness of regulation and development of regulation. One other activity of the Forum is to review the budget of the FSA. Since industry funds the FSA, this is an important part of the Forum's duties.

For the Forum to be effective, it must ensure that it knows about the issues that trouble the industry. The Forum offers a valuable conduit to the FSA that ought to be used. Therefore, the Forum invites those that have issues of general concern to the financial services industry in relation to regulation, to approach the Forum. To facilitate this, the contact details of all of the members of the Forum are in the back of the Annual Report.

Chairman

This concludes the formal presentation, which has been longer than we would have hoped. This is because we have had to explain both the activities of the panels and their mechanics. We are now happy to take questions. We cannot at this meeting take up individual cases or concerns, although we are happy to take questions on any topic that is relevant to the report or to today's proceedings.

Question and Answer Session

Geoffrey Turner

My question is in regards to consultation fatigue and, in particular, the COB standards. You allowed the City one-month to reply to the paper, and you had cunningly chosen the holiday season to do this. I was going to ask for more time to reply, however I have learnt that it has been announced in Parliament that you have done this. So on behalf of the members of the Securities Institute I thank you.

With the current pace of change of the internet, it raises the question whether current legislation will be able to keep up with this pace. How do you feel about running an organisation that is rooted in today's practices, in the face of a world where practices are likely to be revolutionised? With the present regulation, will the FSA be able to cope with this new environment?

Chairman

At the outset the FSA has set a cautious balance between continuity and change. The FSA has tended to carry forward the core elements of the old regime, unless there is a particular reason not to. Then, over time, the FSA will assess the different elements. The FSA has recognised that the industry has to deal with

a great deal of change caused by a single regulator. Also, that elements of the Conduct of Business Sourcebook and the prudential arrangements should not be altered, unless there is good reason to do so. The FSA has announced that it will consult on further changes as it progresses.

However, will the regime be able to adapt to changes in technology and the structure of the industry? I think that it would be imprudent to answer yes. Although, I do think that in comparison with other international regimes the FSA has a more flexible system. In Parliament, there tended to be a great deal of debate over the accountability of the FSA. However, subject to the consultation requirements, the FSA has quite a lot of flexibility to make alterations if necessary. An area where this is crystallised is the comparison of the UK and German rules. When examining the possibility of aligning the securities rules between the two countries, it is typically found that the FSA is able to make changes through consultation and agreement, though the Germans' response is that, although they would like to make changes, they cannot as it is primary legislation. Hence, the FSA typically has a more flexible regime to change rules than most other countries. Consequently, the FSA is in a better position than most, after this major overhaul of the statutory framework, though it could not be said with absolute certainty that the flexibility will be adequate to cope with all possibilities.

John Collier, Secretary General of the Chartered Accountants of England and Wales

Within the Annual Report, there is a reference to some excellent work that the FSA has carried out with IOSCO and the International Accounting Standards Committee to initiate a new framework for international accounting standards, which I thank the Chairman for. However, there is a long way to go, as transnational issues are becoming more important. These issues can only be handled by genuine international standards. Currently, we are on the threshold of putting these standards in place. The UK Accounting profession is strongly in favour of international accounting standards. My concern is that the SEC and the European Commission will make endorsements that will be damaging. My plea to the FSA is for a global standard, without any local endorsement.

Chairman

Thank you for your comments on our progress so far.

A set of trustees have been appointed under the responsibility of Paul Volcker, who have appointed David Tweedie as the Chairman of the new International Accounting Standards organisation, so my hope is that there will be less need for international travel.

With regard to the USA endorsement mechanisms, the SEC has, in our view, progressed and were forthcoming with the IOSCO endorsement and have been more supportive of international accounting standards over the past two years.

In relation to Europe, the FSA does not view the endorsement mechanism as requiring a European committee to examine every standard and then propose amendments. The FSA primarily views it as a process of translating international standards into the appropriate Directives. Only in exceptional circumstances that concern other aspects of the European legal framework, may there need to be a reconciliation or adaptation of the standards. There are others in the EU who view this in terms of an EU standard setting body, as opposed to one of the translation of international standards. The FSA strongly believe in the latter and this is the approach we will take in discussions.

David Leighton, Association of British Insurers

My reaction to the appointment of the third managing director is welcoming, and we hope that it is in recognition of the insurance industry. Can you state how this appointment will combine with the consistent approach to risk-based supervision and issues such as complex groups?

Michael Foot

Until the third managing director is appointed, I will oversee this area. Within the new structure the FSA is committed to an increase in horizontal and co-operative workings. This is in regard to both teams that are dealing with themes and the problem that, no matter the organisation of the structure, there are a great many different sizes of firms in industries and there are firms within different industries competing with each other. Therefore, the relationship between the current insurance division and the current complex groups will evolve. It is likely that the priority risk assessment that we make will shift the boundaries between firms. However, there will still be the same objectives of consistency and ensuring a level playing field. Within the model that was outlined in January, which we will add to later in the year, there will also be a cross FSA challenge process, which Phillip is responsible for, to ensure that we are adopting a rational and consistent approach.

Phillip Thorpe

This issue was referred to in the new regulator document that was released in January. In the autumn, an update on this matter will be released with more detail. One of the key components of developing the model was to secure consistency across the organisation. Furthermore, the FSA recognises that risks will shift rapidly and unpredictably. Another element of the model that will be developed, is the ability to react to these risks and allow the FSA to apply its resources. This raises the question: how do you shift resources and maintain standards across a range of activities? In October, there will be further information released on this model to deal with this matter.

William Kemble, UK Invest.com

Given the proliferation of online financial news services that seek to develop services that were traditionally the realm of banking, will all online financial journalists have to be FSA registered? If so, in order to have a level playing field, do you foresee a time when all financial journalists will be regulated by the FSA?

Phillip Thorpe

The initial approach, that may have to be changed, is consistent with that which is applied to print-based journalism. Consequently, provided that the services are sold to the public in general and the advice is generic, the FSA is not concerned. However, the FSA will remain open-minded on the matter. Next week, the revised version of the Market Conduct code will be released, which covers the overall position of journalists. The FSA will look for an extended consultation period on this matter.

Sheila Nicoll, Association of Unit Trusts and Investment Funds

I understand your intention to base the allocation of resources upon risk assessment. Although I can see how this applies to the areas of supervision and authorisation, how does it apply to broader policy areas?

My thinking is that this is an industry that is willing to pay more in the interests of international competitiveness and innovation.

Phillip Thorpe

The motivation of the allocation process is tied to the FSA's statutory objectives. The FSA also recognises that there are several conditioning factors that will substantiate this, such as the seven principles of good regulation. I believe that you are referring to these, which I assure you will be factored in. However, this will be a conditioning factor in the pursuit of the objectives. As we proceed to identify the allocation of resources, we expect to approach our stakeholders for suggestions of where risks are perceived to be. However, the FSA will not be able to pursue every risk. Each risk will be ranked in accordance with the impact of the statutory objectives that the FSA is obliged to pursue.

Peter Haines, UBS Warburg; Representative of the Securities House's Compliance Officers Group

I believe that the industry would be prepared to pay more to ensure that experts staff the FSA. Also, since many staff are approached by firms, they should be morally obliged to find a solution to this.

Have you considered greater use of seconding staff from firms? I asked my chief executive about this matter, who agreed with me that the top firms should be willing to second a person every year to the regulator to ensure appropriate industry input.

Chairman

This is an issue that David has discussed with the Practitioner Forum, and has agreed a paper on last week.

David Challen

We agree that secondment would be in both the FSA's and the industry's interests. However, there are difficulties over how this would be organised, as there would be concerns such as the safeguarding of confidential information. A blueprint has been created for the basis of secondment from firms. In the near future, a communication will be released to encourage secondment.

Chairman

Currently, the FSA has approximately 50 people on secondment. However, only a few are from regulated firms. The majority are from accountancy firms, legal firms and overseas regulators. Therefore, we need to increase the flow of secondment from the major firms, as this has proved to be the most difficult.

Barry Epstein, Association of British Credit Unions Limited

My question is a memorial to little Sarah of West Sussex. Why was it that the consultation document on money laundering was so flaccid? Its content was less stringent than the guidance notes released by the Registry of Friendly Societies to all credit unions in 1994. Paedophilia and pornography are well-known

crimes and disgusting crimes, which are closely associated to money laundering. I would like to know what the FSA would do to address these disgusting problems?

Phillip Thorpe

We released the consultation document after a great deal of work with the Joint Steering Group that was established by the industry to examine money laundering. This Group has released guidance on laundering, which to a large degree the FSA has replicated. The point of consultation is to elicit a response. If there is a general feeling that the degree of strength has not been met on this or any other point, then we will listen and decide how best to accommodate views. This is the basis for our action, as we are obliged by statute to pursue financial crime. Dealing with financial crime as an objective is a relatively new area for the FSA, although we are familiar with money laundering, so we encourage suggestions on how to deal with this.

Barbara Saunders

All those within the consumer movement and on a wider basis sympathise with the objective of ensuring adequate arrangements for preventing money laundering, and other fraudulent activities, and subsequent prosecution. However, the Consumer Panel is concerned with the way that money laundering regulations have been used to impose unreasonable restraints on people with a low income. In particular, there must be regard to the fact that within the UK there is no obligation carry identification documentation. The Panel has witnessed a variety of occasions where money laundering obligations are used in an unacceptable way, that go beyond the intent of the rules. Consequently, there are civil liberty issues that the FSA must regard. An appropriate method needs to be found that does not impose burdensome obligations upon those people that operate at the margins of the economy, and prevents major fraud from taking place.

Michael Perry, Fund Managers Association

How practical is it for the FSA and other regulators to police websites that may be based in any jurisdiction in the world? Once the concept of home state regulation is approved, will the FSA, along with other bodies, agree on kite-marking sites from countries where regulatory standards are comparable, and warning against those sites that are not?

Chairman

We recognise that the challenges of dealing with internet based trade are substantial. There has been a debate over whether the internet was a form of phone or fax, which I do not think it is. However, this does raise challenges to any entity that is constrained by a jurisdiction, which the FSA is. Consequently, the FSA cannot expect to be able to protect people from offers or solicitations from other jurisdictions. The answer to this problem lies in educating consumers of the implications of these types of deals, which the FSA is pursuing

In relation to this, the FSA acknowledges that consumers must be able to identify who they are dealing with. In respect to this, there has been a considerable gain through the creation of the FSA by simplifying dealings in the UK. The challenge is to optimise the fact that there is a unique label that will indicate to people whether they are dealing with a regulated entity in the UK and the associated level of standards that can be expected. This presents a substantial educational challenge, though this is the route that the FSA believe will be the most productive. There is also a great deal of co-operation with other jurisdictions to

discover how efforts can be co-ordinated against fraudulent websites, although, this will only be a partial solution.

In relation to the Financial Fraud Network, the FSA does not entirely pay for this network. The network is funded through the contributions of agencies, of which the FSA is one.

David Myers, Chairman, Society of Pension Consultants

My question is in relation to the European Commission's proposal for creating a single market for financial services in Europe. The FSA has managed a balance between excessive regulation and excessive laissez faire, but the same cannot be said of other European authorities. How do you envisage preventing insufficiently regulated financial operators in a European country selling financial services in the UK, which are not under the scrutiny of the FSA, and opening up the markets in Europe for the UK to sell financial services throughout Europe?

Chairman

In general, the FSA believes that it should support the Financial Services Action Plan of the Commission. The Commission is, in this area, on the whole in favour of liberalisation. Although their process may be slow, the Commission does eventually produce useful directives. Therefore, on the whole we are comfortable with the general approach of the Commission, one of the reasons for this is that the current Commissioner has a liberal frame of mind.

Another concern is cross-border activity, which is a complex area. In Europe, the UK operates on the basis of mutual recognition, which is mainly an advantage as the UK is a net exporter of financial services to the European Union. Therefore, it would not be consistent to raise objections to imports of financial services. However, it must be ensured that those who sell to the UK are operating along broadly comparable rules and, if they are not, that people understand the nature of the differences. There is no alternative within a single market to explaining directly to the consumer what the procedures are and what protections they have. If parties are actively selling in the UK and have a natural presence in the UK, then they will have to seek authorisation in the UK. Therefore, this issue relates to remote access to the UK, such as through the internet on a cross-border authorisation or selling certain forms of investment products, although this is infrequent. There is no alternative within the overall architecture to accepting that passporting is acceptable and, on the whole the UK benefits from this.

Michael McKee, British Bankers Association

ECOFIN have announced that a committee will be set up to examine European regulatory issues. What issues do you think this committee should examine? How does the FSA believe European regulation should proceed?

Chairman

The terms of reference for that committee were agreed last Monday, and the final version has not yet been released; though it is certain that Mr. Lamfalussy will shortly release further details. The focus of this committee is the regulation of securities markets and exchanges. The last version of the terms of reference, that I am aware of, identified a link between the committee and the Financial Services Action Plan. The stimulus for this group was the merger of European exchanges, and where the regulation of merged

exchanges would take place. The view of the FSA, so far, is that the proposals for merged exchanges, particularly iX, are manageable within the existing framework, as long as there is enhanced collaboration between the regulatory authorities involved. There is no doubt that the FSA will have to intensify its collaboration with the German regulators to effectively regulate the iX family of exchanges. Accordingly, this committee will examine whether the existing mechanisms of collaboration are effective enough to cope where the stocks of one country are traded in another. On Monday, the Treasury released a paper of the British government's view of the priorities of European regulation.

Conclusion

I would like to thank David and Barbara for being here today.

Thank you all for coming and the interesting questions that you posed.