

Financial Services Authority

**Annual Public Meeting**

17 July 2003

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## Chairman's Keynote Address

**Howard Davies****Chairman, FSA****I. Introduction**

First of all, I should thank you all for attending and just explain the orchestration of the session before I introduce myself. I will speak first, giving my report on the year. Then Stewart Boyd, the Deputy Chairman of the Authority, will talk about the role of the Board, particularly its accountability functions. We will then hear from the Chairmen of our two statutory Panels: Colin Brown from the Consumer Panel and Donald Brydon from the Practitioner Panel. Then we will have questions to anyone on the Panel, some have been notified, but we will also take some from the floor. Then there will be a coffee break at around 11 o'clock and thereafter there are presentations for which many of you have signed up, both here and in Cabot Hall. We will give the details of that at the end.

As you know, today's annual meeting will be the last under my chairmanship. It is therefore a good opportunity to reflect on the way the Authority has developed since it was formally established in 1998. It is also a good opportunity to welcome my successor as chairman, Callum McCarthy, and his new chief executive John Tiner, whose appointment was announced on Monday of this week. I wish them both every success here. They take up their new roles on the 22 September. The transition, we hope, will be smooth; Callum is already attending Board meetings and John, of course, is in captivity at the FSA already.

**II. Development of the FSA****1. A single regulator**

It is entirely clear that the Government's decision to replace the previous patchwork quilt of financial regulators with a single entity was amply justified. The trend towards financial conglomerates has continued, both in the UK and elsewhere and the need to understand the interactions between different types of financial business has become more pressing as risk is more easily transferred between firms through the derivatives markets. And the reasonable demand of consumers to benefit from the protection of a regulatory system which they can easily understand has become even stronger.

Amongst financial firms, support for a single regulator has remained very strong. A recent survey of international firms shows that the very large majority believe that the London regulatory system is now the best able to cope with the demands of global markets. A survey conducted for the City Corporation by an independent think tank asked international firms if they agreed with the proposition that "a single regulator is a big advantage for London." 174 agreed while only 31 dissented. On more general questions about the attractiveness of the regulatory environment, London scored consistently highest, above New York and well ahead of Frankfurt and Paris, and London's regulation was seen as, indeed, the most significant competitive advantage for the City. The benefits of integrated regulation are now widely understood around the world and a number of countries, including Japan and, more recently, Germany, have now copied the FSA approach.

When the Authority was established there was some concern about the way in which it would interact with the Bank of England, which retains responsibility for the stability of the financial system as a whole. Those concerns have proved groundless. That is partly attributable to the structured relationship established under the Tripartite Standing Committee, which allows the Treasury, the Bank and the FSA to monitor trends in financial markets and potential threats to their stability. However, it owes just as much to the determination of the recently retired Governor, Eddie George, to make the new system work well. He was an enormous source of strength to the FSA and to me personally. His wise advice and sympathetic ear have been invaluable and his advocacy has greatly helped to establish the credibility of the new Authority at home and abroad. I am sure the relationship between Callum McCarthy and Mervyn King will be just as strong.

## **2. Financial Services and Markets Act (FSMA)**

The reform announced in 1997 was much more fundamental than a simple stitching together of the previous regulators. The FSMA reformed the entire legal basis of regulation. One unsought accolade is that it was the most amended piece of parliamentary legislation in history, but we benefited, in the end, from an intense degree of parliamentary scrutiny and the new Act is working well.

Of course there have been criticisms. While the legislation was under discussion, it was commonplace to argue that the FSA would be insufficiently accountable; that it would be a judge, jury, executioner and sexton. We hear much less of that rhetoric today, as the rigorous accountability procedures of the new Authority have become more widely understood. Indeed, we are now more frequently criticised for the steady pace of our disciplinary procedures, which is dictated by the Act.

We have also noticed that support for a non-zero failure regime, which was very evident during the debates on the approach the FSA should take to the markets in the future, has been much less evident when individual failures or near failures occur. I shall say more on that subject in a moment.

## **3. A difficult period**

We do have to acknowledge that some firms have indeed failed, creating losses for investors, not all of which have been compensated through the Financial Services Compensation Scheme, although many, of course, have. While market conditions in the first two years of the FSA's life were extremely benign, the last three years have been difficult, as you all know. Not since the 1930s has the UK experienced three consecutive years of falling share prices. That has put considerable pressure on a number of financial firms, notably life insurance companies with a large proportion of equities in their portfolios. Given the scale of the market fall, it is perhaps surprising that there have not been more failures, but that is no consolation for those investors who have experienced losses.

I am satisfied that the FSA has acted appropriately during this difficult period and that no actions we could reasonably have taken would have significantly altered the outcome in the most difficult cases we have encountered. On many occasions we have had to make difficult balancing decisions, bearing in mind our overall market confidence objective and our duty to protect consumers. In some regulatory regimes these objectives rest with different regulators who, in some respects, have an easier task in that they are able to pursue their aims single-mindedly with the inevitable reconciliation of conflicting objectives taking place in the political domain or in the courts. Some

of those decisions need to be taken within the FSA itself, putting considerable burdens on the staff and on the Board, but I am persuaded that the overall outcome is likely to be better balanced decisions.

In some specific cases where our judgment has been questioned, others have reviewed our work. On Equitable Life, the recent Parliamentary Ombudsman report reached the conclusion that the FSA had acted reasonably and could not be held responsible for the losses suffered by those who complained to the Ombudsman. As the earlier Baird report did for our Board, the Ombudsman pointed to things we could have done differently, but agreed that the die was cast, as far as Equitable was concerned, before the FSA took over its prudential regulation. The Ombudsman also drew attention to what she characterised as a mismatch between the expectations policyholders have of regulators, and what those regulators are empowered to achieve.

#### **4. The limits of regulation**

I am pleased that she opened up this debate. It is not possible, or even desirable, for regulators to seek to guarantee the survival or prosperity of all financial firms. Banks and insurers, in particular, are in the business of taking risk, that is their economic function and their social value, and risk brings with it the possibility of failure. A reasonable aim for the FSA is to reduce the incidence of firm failure and market disruption, through its prudential supervision in particular, to the minimum compatible with open and dynamic markets. There is, of course, a qualified safety net which provides compensation where failures occur.

My view is that we have calibrated the system appropriately in setting our requirements and the terms of the compensation arrangements. To try to do more and to seek to ensure that all firms are safe at all times would impose huge costs and rigid constraints on the system. It would be damaging to the financial system and to consumers' interests in the long run and indeed it would also be incompatible with the duties we were given in the legislation.

To return to Equitable for a moment, the Parliamentary Ombudsman review looked only at the last period of the life of the Society. We await the broader review by Lord Penrose, which will consider a longer period, including the actions of the Society itself and the previous regulators. I know that Equitable policyholders, for whom the last three years have been enormously stressful, are particularly anxious to see his report.

On split capital investment trusts, the Treasury Select Committee carried out an inquiry. Their final report acknowledged that in this area the FSA's powers were limited, but they enjoined us to be more vigilant in future, even in relation to financial products which do not, as investment trusts currently do not, come within our regulated regime. The Committee's most important recommendation was that we should regulate them in future. The Treasury are considering that proposal. But the problems of past sales and the predicament of those investors who were misled as to the risk characteristics of these products and who have incurred serious losses must also be addressed.

#### **5. Market surveillance**

We are carrying out a series of major enforcement investigations covering allegations of mis-selling, misleading marketing and of collusion leading to market manipulation. This is by far the largest enforcement project we have under way and it is moving forward well. It has been extended recently to cover a number of additional firms and individuals within them. The extensive

inquiries we have made so far, involving enormous volumes of documentation and the review of many hours of taped conversations, have not discouraged us in our view that there is a serious matter to be investigated.

Today we are publishing a paper which summarises progress on various strands of work related to [splits](#). At the same time, the Financial Ombudsman Service is releasing a further update on its own work on cases put forward by individual investors. We and the Ombudsman Service are determined to secure justice for those investors whose interests were damaged by this mis-selling or collusive behaviour.

The general point made by the Treasury Select Committee about our market surveillance is well taken. We fully acknowledge the need for vigilance on our part and our new operating arrangements do allow us to look beyond the confines of regulated product sales to seek to identify risks across the financial sector which could impose significant losses on groups of consumers. This is a point that has also been made to us by our Consumer Panel. We have developed a framework of risk-based supervision which involves both individual risk assessments of each firm we oversee and an overview of trends in financial markets as a whole. The [Financial Risk Outlook](#) we published earlier in the year shows that we are now seeking to identify potential risks across a broad front.

We are also now more active in reviewing financial promotions, again a point put to us strongly by the Consumer Panel. We recently published the first in a series of updates on our work to promote better and clearer advertisements and marketing material. We have also issued a number of consumer warnings, where particular products cause us concerns.

However, the regulator cannot be an all-purpose Cassandra. There are circumstances in which any investment may under-perform, or even fail, and little purpose would be served by our issuing serial warnings which would only be likely to damage market confidence – which, of course, it is one of our statutory objectives to maintain. We need to strike a balance once again.

Nonetheless, I would acknowledge that over time we ought to be able to do more to help consumers make good decisions for themselves and better to understand, in particular, the risks and benefits of diversification. We must do more to encourage firms themselves to think harder about the appropriate markets for their products and services. Many of the products which have caused difficulty in recent years and continue to cause problems (so-called precipice bonds are another example) are not inherently wicked constructions. The problem is that they have been sold to investors for whom they are unsuitable and sometimes in circumstances in which investors have been encouraged to put all their financial eggs in one particularly fragile basket. Split-capital investment trusts too had their place in the market for those who want leveraged stock market investments. Indeed, some have performed very well in normal times.

### **III. Challenges and changes ahead**

#### **1. Financial literacy**

A key challenge for the future, therefore, is to expand our work on financial literacy and consumer information. In particular, while we have prepared an enormous amount of material which could help consumers make better decisions, our readership is not yet wide enough. We must find ways of reaching more people. Similarly, while we have developed an imaginative suite of teaching materials for financial literacy in schools and colleges, the task now is to encourage more

institutions to incorporate it into their curriculum. The Authority will be bringing forward some proposals in that area in the autumn and our thinking on that is now quite well advanced

## **2. Wise and compliant marketing**

We must also do more to promote the benefits of wise and compliant marketing to firms themselves. The biggest disappointment of my time at the FSA has been the failure of firms, and particularly their senior management, to learn the lessons of past mis-selling. Sadly, the recent history of the British retail financial services industry is proof of the adage that those who fail to understand the mistakes of the past are condemned to repeat them. Though the pensions mis-selling debacle, which cost the industry over £11 billion in compensation, should have been a stark lesson of the dangers of uncontrolled and unsuitable selling, it is hard to see evidence that that lesson has been widely understood. Again and again we find examples of High Street firms disregarding the suitability requirements in our rulebook. Requirements which merely, in my view, describe what most service companies would regard as good customer service. Unfortunately, much of the industry remains focused on short-term gain from shifting product. Indeed many firms are happy to see themselves described as "product providers", terminology which in itself distances them from their customers, many of whom assume that they are being given advice which takes their personal circumstances into account and who see their relationship with their bank or life insurance company as one for the long term and not solely transaction-based. Some in the industry understand this problem well and the Association of British Insurers "Raising Standards" initiative is one worthy response, but there is still a long way to go.

## **3. Complaints, compensation and further regulation**

However, solving this retail market failure is not assisted by those who appear to believe that every loss to investors, whatever the cause, should be compensated. That way, madness lies. Some firms complaints systems are currently snowed under by indiscriminate claims for compensation by endowment mortgage policyholders. Many have little prospect of success and merely delay the resolution of other worthy claims.

There are those who conclude, on the basis of this experience, that a radically different approach to the retail market is required based on government designed low risk products and price controls. I understand the analysis which leads to that conclusion; however, as I have said before, I have personal doubts about whether product regulation and price controls are the right way to go. These are not primarily decisions for the FSA, they are for the Government. Our role, which I am sure the Authority will continue to perform, is to design an appropriate regulatory framework for whatever shape of retail market emerges and one which maintains strong standards of investor protection. I recognise the nervousness among both consumer representatives and indeed amongst some practitioners about Ron Sandler's ideas for cut back regulation.

## **4. Wholesale and professional markets**

There are challenges ahead too in the wholesale and professional markets. The experience of the last few years, especially in the United States, shows that companies and their directors too often ignore or forget their disclosure obligations, that auditors can be too easily distracted from their public interest responsibilities and that investment banks are not always good at managing the conflicts of interest which are inherent in their business models.

We have been spared some of the worst excesses in London, though we are not complacent. There are too many cases of poor compliance with our listing rules. Investment banks have operated management structures here, which, at the very least, leave them vulnerable to the charge that they do not handle conflicts of interest always in the way their customers would hope. We have proposed a series of reforms to address these deficiencies. Some firms argue that they would require inconvenient changes to their business models. That may be, but those firms need to ask themselves whether, in the long run, they do not need to work harder to restore investor confidence, which has been sadly dented in recent years. I therefore call upon the industry to take a more long-sighted view of the need for change.

## **5. European and global contexts**

In this area and many others we need to see our markets in a global context. Much of the work we do on the future of our regulatory environment has to be done in co-operation with regulators overseas and particularly in Europe. That is the third major challenge that I have faced and which, I am sure, will remain high on my successor's agenda. Heads of Government in Europe have committed themselves to the creation of a single financial market, which they see as an important contributor to the dynamism of the European economy in the future. I do not doubt that a single deep and flexible financial market will promote economic growth, but some of the routes we are required to take to get to that happy destination seem to involve changes to our regulatory environment which are not obviously beneficial to firms or to investors.

In part, that is because the markets in different European countries begin in very different places. In particular, Europe's wholesale markets are heavily concentrated in London and the regulatory needs of those wholesale markets are not always taken into account when directives are first drafted in Brussels.

I have spoken extensively, here and elsewhere in Europe, about the need for a proportionate approach to the development of European regulation and particularly for one which is sympathetic to the needs of wholesale markets, where the competition for London is in New York, rather than in Paris or Frankfurt. By comparison with the position I inherited in 1997, the UK is much better able to articulate its case in Brussels, but we do need to continue to make our voice heard. Fortunately, we now have a better-developed set of regulatory networks in the European Union and relationships between regulators themselves are generally constructive and harmonious. The Committee of European Securities Regulators, modestly known as CESR, is working particularly well and is a model for co-operation in other areas. At this point, we see no case for moving further to a single European regulator.

## **IV. Annual Report**

Our Annual Report for the year just gone shows how we have been pursuing our objectives over the last 12 months. I believe it demonstrates a record of which we can be proud. Inevitably much of what a regulator does is in the "good by stealth" category. We have headed off a good number of potential problems for consumers and for firms, and I believe our actions are one of the reasons why there have been relatively few failures during this very difficult time. We made timely changes to the insurance solvency regime, for example. But we recognise that we need to do more to explain our regime and to measure our effectiveness. There is more material in our report on service standards and outcomes this time, but gaps remain which we must work to fill.

In management terms, the FSA is in good shape. Staff turnover is low, skill and experience levels, which have concerned our Practitioner Panel in particular, are improving. Costs are under control, in spite of the pressures arising from a larger number of problem cases in difficult markets.

Our accounts do show that, like many other companies, we face a sizeable deficit on our pension fund, though one which would not crystallise for many years. The main reason is the decline in the value of the scheme's investments over the last three years. We took the most important step towards controlling that deficit in the future when we closed the final salary scheme to new members in 1998, but falling markets have obliged us, nonetheless, to increase our contribution rate and to adopt a new approach to pay which takes full account of pension costs in awarding increases.

Stewart Boyd, my Deputy Chairman, will say more shortly about the governance of the authority. He will, as I said, be followed by the Chairmen of the statutory Consumer and Practitioner Panels: Colin Brown and Donald Brydon. However, before they speak, I have an opportunity to get my retaliation in first.

As the two Panels' reports make clear (in fact, there are three reports since the Small Business Practitioner Panel also reports on its own account) we do not always see eye to eye with them. That is, perhaps, inevitable in view of the structure of accountability we have been given. However, over the last year each of the Panels has exerted significant influence over the policies of the FSA. My Board and I are in no doubt that the quality of our work has been better as a result. The members put in considerable effort on your and our behalves and we are grateful to them.

Our report also includes the Board's response to the report of the Complaints Commissioner. None of the complaints on which she reported during the year justifies, I think, particular comment at this meeting.

The reports of our two associated entities, the Financial Ombudsman Scheme and the Financial Services Compensation Scheme have also been published recently and I am grateful to the Boards and staff of those bodies for their hard work over the last 12 months.

## **V. Closing Remarks**

Overall, my conclusion is that the new regime is now functioning as Parliament intended, with this Public Meeting at the apex of a robust accountability structure. I am sure that the efficiency and effectiveness of the system can nonetheless be improved further. That, however, is a job for my successors. Thank you.

## **Role of the Board**

**Stewart Boyd QC**  
**Deputy Chairman, FSA**

### **I. Introduction**

Good morning, ladies and gentlemen. On most of these occasions Howard asks me to say something to you about corporate governance and accountability. Each year he says “Keep it a little bit shorter than last year”. This, I think, is nothing to do with the quality of what I say to you, but the fact that each year it becomes less necessary to explain to you things that are now becoming very much better understood. So I do not propose to do, as I have in the past, a complete picture of the elaborate checks and balances, which were put into place when we were first set up, to ensure that our formidable powers are used wisely and used well. I no longer, for example, need to explain the role of the Practitioner and Consumer Panels. All I would like to say is that the Board keeps abreast of their views in a variety of different ways which have, I think, improved over the years. There are formal and informal methods of keeping in touch with their thoughts, not least by means of an annual working dinner, one of which took place last night. We had a lively and, to my mind, enormously valuable debate about a number of matters.

### **II. Role of the Board**

I do not need to repeat either what I have said on earlier occasions about the role of the Regulatory Decisions Committee. As you know, although the Members of the Committee are appointed by the Board, they are required to exercise an independent judgment on enforcement decisions proposed by our staff and, in order to maintain this independence, relations between the Board and the Committee are overseen by the Non-Executive Directors rather than the Board as a whole.

What I would like to do is to concentrate on the Board’s own Committees and, more specifically, the role and work of the Non-Executive Committee and of the Risk Committee.

Our Annual Report contains summaries of the work which has been done during the past year by the other main Committees, the Audit and Remuneration Committee, and although that is of interest and sometimes of public concern, there is nothing particularly special about them that requires notice today.

During the year all the Board Committees have looked again at their terms of reference and working procedures. I should say that they are all composed entirely of Non-Executive Directors and chaired by me. As a result of looking at the terms of reference, there have been improvements made in the way in which the FSA Divisions report to the Committees, to the way in which the Committees themselves report to the Board, and I believe this has resulted in improvements, as it should do, in the way in which the Board, in turn, reports to its stakeholders on its corporate governance functions. I believe we may be able to do still better next year.

More importantly, the Board has a closer understanding of the activities of its Committees and thus better oversight of the work of the Authority.

### **III. Non-Executive Committee**

I said I wanted to mention the Non-Executive Committee and that is not because I need to add to what is said about its work in the Annual Report, but because, to my surprise, I still sometimes hear it said that the Non-Executive Directors in the FSA have no function beyond the statutory functions of a Non-Executive Committee. That, of course, is simply to monitor the efficiency and economy of the FSA and to keep its internal financial controls under review. I certainly do not need to stress to this audience that that is very far from being a true picture. The Non-Executive Directors are all full Board members in their own right. They participate on an equal footing with the Chairman and the three Managing Directors. The Non-Executives are in a substantial majority on the Board and they bring to its decisions a very wide range of skills and experience. When vacancies arise, as they have done at present and will do in larger numbers shortly, great efforts are made by us and by the Treasury, which has the formal power of appointment to the Board, to see that the breadth and the balance of the skills and background of Board members is maintained.

### **IV. Risk Committee**

I would now like to return very briefly to the work of the Risk Committee, which is where there have been rather more conspicuous changes during this year. The Risk Committee consists of Non-Executive Directors. It has been in existence only since September of 2001, but it is already clear that it is central to the Board's oversight of the FSA's risk based approach to regulation.

Probably the best known aspect of the risk based approach is the "ARROW Project" and I will not bother to explain that to this audience because most, if not all, of you will know very well, perhaps only too well, what it is. That aspect of risk is only a small part of what the Risk Committee undertakes and oversees.

The Risk Committee's terms of reference require it to review the adequacy of the FSA's risk management processes and systems with the aim of ensuring the effective identification, the monitoring and the control of risks from a variety of sources; from firms, from consumers, industry or market issues, from the external environment, from operational issues and so on. In doing that, the Committee aims to ensure that the setting of priorities and the allocation of budgetary resources is firmly based in a robust analysis of risks to our statutory objectives.

We are supported by the Regulatory Strategy and Risk Division led by Dan Walters under Carol Sergeant, who is the Managing Director with overall responsibility for the FSA's risk management. With their help the Committee has overseen the development of a number of management tools and processes for identifying and mitigating risk. We look for a clear allocation of responsibility for what is sometimes called "ownership of risk", effective co-ordination of risk processes across Divisions and a clear line of accountability which is embedded at all levels up to, and including, the Board. Our most recent meeting was yesterday and I think it is becoming clear that these management tools are bringing a sharper focus at all levels of management on the prioritisation of risk and, therefore, the prioritisation of strategic decisions and the allocation of budgetary resources.

Our work, of course, links in to the annual budget cycle, as it should, and it is no accident that the Financial Risk Outlook, which many of you will have seen, is published by us in January at the same time as the Annual Plan and Budget. The Financial Risk Outlook is an essential input to the policy and budget decisions proposed by the Board in its Plan and Budget.

At its early meetings the Risk Committee's work was mainly focused on setting up and monitoring the risk management processes. While this work will continue, it is, I think, largely complete and the emphasis will now shift more to looking at the risks identified by management and the mitigation strategies in place to manage and alleviate those risks.

## **V. Howard Davies**

So much for Board Committees and accountability. Before I sit down, I would like to come to a short, unscripted excursion which I have not told Howard about because I know he would put a stop to it if he knew I was going to do it.

This is Howard's last Annual Meeting. He has presided over the FSA since the very beginning and during a time not only of enormous organisational upheaval, but also of unprecedented economic strains in the financial services industry. As he comes to the end of his time here, it would be easy to underestimate the size of his achievement here, particularly as the main measure of success in this field is that nothing really bad has happened. I know how much Howard dislikes valedictory speeches, so I will be very brief indeed.

Howard has brought to the FSA huge intellectual skills, a unique ability to combine authority with charm and humour and an ability to deal with Government and overseas regulators which has given him an international reputation which will be very hard to match. On behalf of the Board, Howard, I would like to offer you our heartfelt thanks for what you have done here and our very best wishes for the future.

### **Howard Davies**

Thank you very much, Stewart, that is very much appreciated by me. We move on next to Colin Brown.

## **Chairman of Consumer Panel**

**Colin Brown**

**Chairman, Financial Services Consumer Panel**

## **I. Introduction**

Good morning. Howard Davies has already talked about the substantial amount of communication between the Panels and the FSA over the year. The Consumer Panel's own report gives plenty of detail, all 95 pages of it if you care to read it, on the many subjects on which we have given advice to the FSA.

We are pleased to say that on many important subjects the Regulator has listened to us and has acted on what we have said. In particular, we are encouraged by the FSA's commitment to the new and more vigorous approach to retail surveillance, which seems already to be showing some results. Once again, as last year, our judgment is that that, for the most part, the system of consultation is working well. I wish to record here, on behalf of the Panel, our thanks to Howard Davies. I believe that much of the openness that the FSA has demonstrated since day one (and I will remind you that consultation paper number 1 was called "Consulting Consumers") has been the result of his vision of how a Regulator should conduct itself.

At last year's Annual Meeting I made several points about problems that we, from the Consumer side, predicted would demand regulatory attention this year. Among them were, first, public understanding of the non-zero failure regime and I have to hand it to the Parliamentary Ombudsman for launching a public debate that I failed to launch last year. Secondly, the hazards of mis-selling in the depolarised stakeholder world that is to come. Those points are worth bearing in mind as we consider some of the events of the past year.

## **II. A tough year**

The past year, of course, has been a tough one for consumers. Falls in the value of investments and high profile problems of mis-selling have left many people with losses and, in many cases, losses from assets that they had no idea were exposed to the stock market.

Public confidence is understandably low. I think it has also been tough for those considering the appropriate regulatory response, not just because these are difficult issues with a lot of money and public confidence at stake, but also because some of the public discussion has glued together a set of problems that deserve separate consideration. Mis-selling has been stuck together with failures in occupational pensions, with predictions about the general viability of retirement provision, with the Equitable crisis, with much more and with the fall in share prices itself. The result is much confusion, as well as much concern, and it is not a good starting point for developing public understanding, so this is a call for a bit of clarity in public discussion.

Meanwhile, the FSA has found itself still mired in investigating mis-selling and other retail abuses, not just clearing up the past but also tackling new horrors. I listened to what the Chairman said earlier about the industry not learning from its mistakes and I have to agree. Parts of the industry have put everyone else back in the dock again.

## **III. Back to minimal regulation, or eliminate all risks?**

The reactions to all this among the public and the industry have been varied, but I would like to point out two strong currents within them which are very damaging and which are flowing in opposite directions. The first is the desire, in some parts of the industry, to go back to a so-called golden age of minimal regulation, the belief that we are now in a madhouse of over-regulation, retrospection and addiction to compensation and if only we would let firms get on with their business unimpeded, then all would be well. The second current is expectation among some consumers and among some commentators that the true job of the Regulator is to prevent all losses, to keep all firms afloat and to eliminate all risks. I believe that both of these crude views (and they are polar opposites) are caustic to genuine consumer protection and good business. They offer completely unattainable and unrealistic visions and while they vie for attention, the chance of getting a genuine public consensus on financial regulation is slim.

Looking ahead, there are several messages from the Panel to the FSA. The first is that the Panel continues to support the FSA's risk-based regime and we welcome much of the new approach. We are particularly keen on the disclosure plans and we hope to see that rolled out. The second is that problem of nobody understanding what the non-zero failure regime really means in practice. I know the FSA is working on a strategy for this and I hope it works. The nature of the public debate, following the Parliamentary Ombudsman's report shows how difficult that will be. The third message is one that the FSA have accepted, but we will be looking to see them deliver on it; faster, more joined up response to new retail problems is promised and, as I said at the start, there are good early signs. We will be monitoring this.

#### **IV. Mis-selling and stakeholder products**

I would like to return to the other message from last year. Our concern about the prospect of mis-selling in the changing retail market; specifically, when the Government's new stakeholder products are launched. I note that the misgivings about the stakeholder project are not exclusively on the consumer side and I know that the Chairman of the Practitioner Panel has some other problems which I leave to him.

Section 5 of the Act says that the FSA's consumer protection regime should take into account, first, the differing degrees of risk in different products and, secondly, (and I quote here): "the differing degrees of experience and expertise that different consumers may have". The Panel is deeply worried that the streamlined regime under discussion for stakeholder products is being driven by the first of these and paying precious little attention to the second. It is paying attention to adjustment to the product, but not adjustment to the target consumer. Our view is that the minor reductions in risk built into the new stakeholder design in respect of the unitised product are generally insufficient to warrant the removal of the suitability and know your customer rules.

However, when the target market is also taken into account, that is low to middle income households who have not yet invested, then the proposed removal of the conduct of business safeguards seems even more seriously at odds with that Section of the Act and in a situation where the industry still has to demonstrate that it will consistently act in good faith in selling to vulnerable consumers. The Panel thinks this is a very serious matter. We are saying to the FSA that; you are the independent regulator responsible for a risk based retail regime which should conform to that Section of the Act. If the sales regime that is eventually proposed does not do that, the Panel will do its utmost, within its powers, to challenge it. We take heart from the fact that the final decision has not yet been taken.

#### **V. Changes at the top of the FSA**

I would like to end on a different note. As I said, the Panel has appreciated Howard Davies's open approach to consumer consultation throughout the last five years. We have every reason to expect a similarly good relationship with the new Chairman. We look forward to working with Callum McCarthy and continuing to work with John Tiner. Thank you.

## **Chairman of Practitioner Panel**

**Donald Brydon**

**Chairman, Financial Services Practitioner Panel**

### **I. Introduction**

Good morning everyone and I am delighted to have the opportunity to address you again in my capacity as Chairman of the Financial Services Practitioner Panel after a somewhat turbulent year. The last 12 months can only be judged a success, however, for the FSA and I am delighted to place on the public record both the Panel's and my own admiration for the way in which Howard and his team have steered a fine path through the recent difficult years.

### **II. A state of effective regulation**

Of course, not everything is perfect, but if we judge by the need for there to be an atmosphere of broad confidence between regulator and regulated, then I believe it is fair to say that this condition for effective regulation is met. It is only a few years since perhaps most practitioners were fearful of the potential powers of the Authority. Today, with its emphasis on a proportionate and risk-based approach, broad confidence has been established. As a consequence, the UK remains a desirable place to do business, but the Panel has frequently expressed the view that there needs to be more analysis of the effects of new regulations on our international competitors and that care needs to be exercised to ensure that we neither damage our current advantage nor, in absolute terms, inhibit the willingness of our financial services industry to show the flexibility, innovation and risk-taking that has been its hallmark for most of the last century.

Relative comparisons with Continental Europe may give considerable cause for comfort amongst policymakers, but that is only appropriately judged if Europe itself is creating an environment that encourages that flexibility, innovation and risk taking. It is far from clear that the processes of developing European regulation, with all their necessary built in compromises, will continue to foster such enterprise.

For the wholesale markets, the competition is the United States, which even the positive CSFI study based ahead of the UK overall.

It is not the Panel's practice to comment on consultation papers while the consultation is in progress and therefore I will resist the temptation to comment on those controversial CPs in the 170s, save to say that international competitiveness, more than on most occasions, will need to be uppermost in the FSA's mind in considering subsequent action.

### **III. The Panel's survey of authorised firms**

Last year saw the publication of the Panel's second major survey of authorised firms. By repeating many of the questions from the first survey, we begin to see trends emerging. On two of the resulting issues, the FSA has made a strongly positive response. First, the need to find the effective mechanism for providing guidance to regulated firms without either becoming a free consultancy

service or, in the effort, making new rules *de facto*. Secondly, the anxieties of chief executives that the burden of regulatory costs in total has grown to a level that a substantial number now view as excessive.

On the first, internal action is being taken and with increasing familiarity with the new regime also assisting, I hope that the third survey scheduled for 2004 will reveal demonstrable progress in this area. The second – costs – will no doubt remain a concern for many. It is not a consolation that costs may be higher in other centres. The issue will lie around the willingness of practitioners to take risks to create wealth and here only absolute costs matter. That the Authority takes this issue seriously is helpful and my successors will, I am sure, continue to keep a close eye on this matter.

The survey also revealed unequivocal support for good and firm regulation and for the single regulator. I do not quite recognise in that Colin's characterisation of parts of our industry. It is in everyone's interests that the marketplace in which they participate, whether as producers or consumers, is fair. Saving is a particularly complex activity requiring an ability to understand risk from all involved. I have no doubt that the FSA fully understands this and the Panel welcomes the trend in FSA thinking which will focus regulation more clearly around customers' needs and around the sometime arcane structures of different products.

#### **IV. Financial Ombudsman Service (FOS)**

I was asked, in a different environment the other day, about who company boards feel most accountable to, a question born out of the current frenzy around corporate governance (of which more in a moment) and I answered "customers", for without customers whose needs are being satisfactorily met there will be no sustainable returns to shareholders or jobs for employees. It is curious then that the development of the Sandler world starts now with products and price, whilst the FSA endeavours to develop a regulated delivery system which will, in practice, determine who the products can be sold to, while asking the practitioners to take responsibility for defining the need and the relevant customers.

This process seems to me to be back to front and puts the FSA into an unenviable and difficult middle ground. I am glad I am not standing in Colin Brown's shoes, for I would be worried about mis-buying, probably deriving from either unsuitability or a failure to assess risk properly. I am concerned that from a practitioner's standpoint, however, no matter how brilliantly the FSA devises the distribution framework, practitioners will be left still with the risk that, even having followed the FSA's rules, they could fall foul of the FOS.

The consequence seems to me to be that vendors will still need to follow pre-Sandler suitability fact finding processes with all the associated costs or they will fall into the trap that Colin outlined so ably a moment ago, without the prospect of the associated economic benefit. Surely the Government does not want another failure in the savings area. I do hope it will listen to both the consumer and practitioner Panels.

In our Annual Report the Panel expressed concerns over the FOS and the possibility that it is in danger of defining risks or creating rules without the same rigour and public scrutiny to which the FSA is subjected. I must report an improving dialogue with the FOS and the positive willingness to discuss these issues. We see no conspiracy or malevolent intent, but the structure within which the FOS is established will probably ensure continuing tension in this area, no matter how well intentioned everyone may be.

This is an issue that the Panel is urging the Treasury to examine in the forthcoming so-called “N2 plus 2 Review”. The Panel recognises that finding Parliamentary time for primary legislation as a result of this Review may prove impossible, but it would be disappointing, to say the least, if anticipation of this difficulty causes the Review, by omission, to pre-judge such issues. The Panel, as we have made clear in our Annual Report, hopes that the review will examine the costs and complexity of the ever-increasing amount of regulation. Whilst the cost of each initiative taken by the FSA within FSMA, and many of those resulting from European legislation, can be assessed individually, the totality of the resulting complexity is generally inadequately analysed.

## **V. Reviews and proposals**

The Panel also hopes that the review will consider the effectiveness of the cost benefit analyses accompanying new proposals. We are conscious that CBA processes are not common in other countries, but we believe that Britain can be a leader in the analysis and justification of regulation, such that its regulation becomes consequently cost-effective and therefore supportive of our financial services sector. We have engaged in an increasingly detailed discussion with the FSA in this area during the year.

We have also considered the first non-rigorous evidence of the ARROW Project and urged the FSA to ensure that there is a well-developed feedback link established in order that firms gain added value through the ARROW visits. Rating the firms involved is not enough; there needs to be an understanding of the actions that can be taken by management to improve their rating.

For the Treasury Review, we have expressed an anxiety that when the FSA judges the level of co-operation by a firm, by affirming an investigation it again acts as judge and jury. It is welcome indeed that penalties reflect a degree of co-operation, but power in this sense continues to centralise.

The Panel has also expressed its anxiety at extending the remit of the FSA to the regulation of general insurance and mortgages. The FSA, correctly, is forced to undertake an increasing amount of what may be termed “industrial processes”. Such processes may prove to threaten the FSA’s welcome risk-based approach and before an even larger regulator is built on processes themselves at an early stage of evolution, great care and study should be undertaken lest the success of the FSA is unwittingly undermined.

## **VI. Extraordinary markets**

As has been said, we have witnessed extraordinary markets in the past 18 months and the way in which, in the end, the FSA navigated through these turbulent markets is to be commended. The approach of realism developed by John Tiner (and I would actually like to add my congratulations to him on his appointment) is both wise and balanced. In some areas of the evolving regulation of the insurance industry, the Panel made robust representations and has been pleased that these representations have been treated seriously in this evolution.

## **VII. The non-zero failure approach**

A clear statement by the FSA of its non-zero failure approach continues to be welcomed and understood by practitioners. It remains essential that politicians and others, when judging the actions of the Authority, really understand what this means. They must also consider the Authority’s actions in the light of analysis of risk at the time and without the benefit of hindsight.

There is only so much any regulator can do and those who shout about the failure of regulation when anything goes wrong serve neither the customer nor the practitioner well. Of course lessons may be learned, a subject likely to be of increasing interest to the Panel, but over-strident analysis will only drive those who work for the FSA to seek ever increasingly, and often unwittingly, to protect themselves. Such an environment will lead to increasingly intensive conduct of business rules and, as I said last year, to a sort of nationalised management consultancy.

The Panel also remains firmly of the view that the Regulator ought to have a continuous review process which asks, with respect to all its rules, if the market can do it better. This remains, I think, a significant piece of unfinished business.

## **VIII. Personal comments**

### **1. Regulation can promote a false sense of security**

So as I approach the end of my term as Chairman of the Panel, I would like to finish with two personal comments. First, everyone involved needs to be on guard against the risk that regulation promotes a false sense of security. This risk is clearly, as I have said, run in relation to the Sandler world and I am sure that the industry is keen to work with the FSA to improve consumer education. This has to be an increasing priority for all concerned. There is much that could be achieved by a joint effort.

### **2. Best practise is the enemy of judgement**

Secondly, I would like to leave you with a proposition that best practice is the enemy of judgment. Obeying rules is not substitute for good judgment. Following imposed codes is no substitute for good judgment and anodyne statements found in many areas, often with respect to proper governance, that we intend to follow best practice is no substitute for judgment. For those who assess the quality of those judgments, it is too easy to codify behaviour, to create check-lists and to tick boxes. Best practice is what is right for one firm, in one set of circumstances, at one moment. It may be different tomorrow, as circumstances changes. There is a dangerous downward path ahead in the “comply or explain” world. As one principal actor said in this field a few weeks ago “One should be mildly embarrassed to have to explain”. How wrong he was. The embarrassment should be in having to rely on rules, codes and lists to determine behaviour, instead of the robust and transparent exercise of judgment.

The same applies in the regulatory field and I hope when the FSA comes to its involvement in the post-Higgs environment, whatever that is to be, that it will resist strongly the otherwise inevitable journey towards replacing judgment with rules.

## **IX. Closing remarks**

Finally, I should like to thank publicly the FSA staff and the Board for their courtesy, willingness to engage and forbearance, even under criticism, which has enable the Panel to ensure that the practitioner’s voice is heard clearly in their deliberations. I would also like to thank, in front of you, both my Panel colleagues for the considerable time they spend on our affairs and our research and administrative support. We wish Howard success at the LSE and look forward to a continuing dialogue with Callum McCarthy. Thank you.

## Questions and Answers

### **Howard Davies**

Thank you very much, Donald. We have now reached the end of the formal presentations, so it is over to you for questions. Before I invite questions (and I hope you are thinking about them as I speak) I should just, for completeness, emphasise who we have on the Panel. In addition to John Tiner, who has been mentioned already but who is, at the moment, responsible for the consumer and insurance and investment parts of the FSA, we have: Carol Sergeant, who deals with authorisation, enforcement and risk; Michael Foot, who deals with banking, complex groups, the listing authority and prudential matters; and Paul Boyle, the Chief Operating Officer with responsibility for the finances and personnel and information technology of the Authority.

We have received some questions which people have kindly put in in advance. We will try to get to as many of those as we can. Those we do not get to, we will have a full answer put on the website and, indeed, anyone who we do not get to now who has a question which they would like to submit, they can give it to anybody with an FSA badge and they will also get an answer on the website.

Perhaps I could throw it open initially, to see if we have any questions from the floor.

### **Participant One**

Chairman, I would like to ask a question about illustrative rates. The FSA adopted certain rates for illustrative purposes some years ago; four, six and eight, five, seven and nine according to level of taxation. I wrote to you, sir, on the 27 January 2002, some 18 months ago, long before the stock market reached its lowest level, suggesting these were highly unrealistic and grossly misleading to the public, which is now all too obvious to those with pension pots, recently acquired annuities and most current endowment policies. During my period of correspondence, which is still ongoing, the FSA eventually decided to commission a study by PricewaterhouseCoopers, published last month. Although it contained conclusions, there were no recommendations and the FSA, in their infinite wisdom, apparently decided to continue with the same unrealistic rates. The report is highly technical and academic, running to 114 pages, with reviewers' comments, intended to look into the future rather than the past without any sort of practical content at all.

I made an initial six page analysed submission, on practical lines, which I was told would be taken note of, but this was completely ignored. I instigated a four page article in the Money Mail, published on the 19 February, and I raised an issue in an interview with Paul Lewis's *Money Box*, Radio 4, on the 15 March 2003, where everyone agreed with me but the FSA refused to appear or even provide a statement.

May I remind you that a 50% drop in a fund value, say over a realistic three year period, requires a 100% increase to get back to where you started at an unrealistic 7%, that is your middle figure, a sustained annual rate and who can see that being achieved? It takes 10 and a quarter years and you could arguably add the three years of fall, making over a 13-year period with no account of inflation just to get back to where you are. This could easily be half the lifetime of any savings plan or pension fund.

Could I ask the FSA to review these figures? They are totally misleading to the public.

**Howard Davies**

Thank you. I hope I will have the sympathy of the hall if I ask for succinct questions this morning.

**John Tiner, Managing Director, Consumer, Investments and Insurance Directorate, FSA**

Yes, thank you, sir, for your question. I should perhaps, first of all, point out that projection rates have been part of the regulatory apparatus for a very long time. I think, in fact, going back to pre-PIA days and the LAUTRO regime in the late 1980s.

When we set up this review (and it is a four year revolving review) of the projection rates, we did ask PricewaterhouseCoopers to look at the financial and economic environment and to advise us whether we should be changing the rates or not. Inevitably, I am afraid, this is a very, very technical and complex area and I can well understand, sir, that it does not lend itself easily to straightforward analysis. However, in some ways it is our job to convert the very academic and technically based information into something which is understandable to us all.

What we have decided to do is to leave the rates where they are, but not on another four year revolving cycle, but simply to extend them from effectively the time they came up for renewal a month or so ago, on the basis that that was the PwC's advice and indeed that was supported by the panel of academics that looked at that. That is on the assumption, and this is the important point I think, that the mix in the portfolio, which is then being projected forward, is 70% equities and 30% bonds and, of course, these are looked at as returns over the longer term, not over simply a two or three year period.

That decision is clearly supported by the economic and financial analysis in the PwC report. However, in response to your last point, we have decided to conduct a much more fundamental review of the way in which projection rates are used in illustrations, in investment illustrations of all kinds and we have a pretty open mind, sir, as to where that will come out and we will be progressing that as quickly as possible with a view to concluding on that over the next several months.

Of course, it is true that many funds, particularly with-profit funds, have changed their asset allocation from 70% equities 30% bonds to something like the other way round. We have issued a warning to life insurance companies and others that if they have asset allocation that is not consistent with the assumptions in the PwC report, that they should adjust their projection rates accordingly and indeed a number of them have already brought them down.

**Paul Austin**

My name is Paul Austin. I have actually flown in today from the Middle East, from Dubai. I am an expatriate. My question to you is basically this; I am representing about 2,000 international investors who invested in a product based out of the UK which unfortunately was not regulated, we have now learnt that the Imperial Consolidated Group are currently under investigation by the Serious Fraud Office (SFO). We are anticipating losses there to exceed US\$440 million. My biggest concern on this one is that (and I have actually got my own web page) I am on my own trying to fight this group. The SFO have been very helpful and we expect prosecution probably by the end of the year.

I did write to the FSA and you did point out to me unfortunately it was an unregulated product, so bad luck. I accept that, but what was confusing to most of us was the Japanese, which you said are hoping to follow the model of the FSA, lost nearly US\$150 million on their own through investing into the UK, through UK banks, UK insurance companies, UK lawyers, who all endorsed this product – not yourself and I am not here to criticise the FSA. My question to you is: how can banks, insurance companies (and I am talking High Street names) endorse a product that clearly was a scam on the go? It turns out now that Lazars, Neville and Russell have confirmed, along with PWC, that the fund was a scam. I did not even know these names before I started looking them up on your web page and other regulatory web pages around the world.

How can you protect foreign investors and the probity of the UK investment strategy and our banking and our finance, which is what we pride ourselves on around the world, when investors looked at this product, thought everything was okay? It was not a stock based product, Mr Davies. It was based on the micro-loans market, particularly for the small claims through legal practices, etc. How can you guarantee to them that you can provide some awareness (and I notice you have done that very recently) on the lines of perhaps what the Australian Securities and Investment Commission do? They are quite bold in their statements that this, in their opinion, is a bad scam, do not get involved with it, be aware and they have got good alerts pages. I think it is very effective what they do there.

Can I ask the FSA to try and do something as similar? Try and be bold, be confident in making statements that you do not consider a particular product to be worthy of investment, or that investors should really be aware. I hope that you have actually made contact with the SFO and we will start to find out how banks can take US\$200 million through the Giro Bank in Liverpool, Bootle, Merseyside and nobody actually noticed that this money was being stolen and we have very little opportunity of recovering it.

### **Howard Davies**

Thank you for your question and also for your correspondence. I do have a lot of sympathy with people who have been caught up in this particular affair. You were kind enough to acknowledge the limitations on the FSA. This was not within our regulatory environment.

On your general point, it is one we acknowledge and indeed we did recently publish a list of unauthorised firms offering investment opportunities from the UK who were not regulated by us. Some of them appear to be in the UK, but are somewhere else. Some of them appear to be somewhere else, but are in the UK. We certainly do accept that it is reasonable to expect that the regulator will look more broadly. Indeed, this is a similar point to one made by the Treasury Select Committee that we should not restrict ourselves - and indeed it is helpful to have Parliamentary support for this - to those things which are within our regime and we should be warning people.

Of course, you have to be careful because there are unregulated investment schemes run by honest people and some people choose, for a variety of reasons, to be outside the regulatory regime because of the type of business that they are doing and they are entitled to do that. So just the fact that people are not regulated does not mean they are crooks. Nor does the fact that they are regulated mean that they are necessarily not crooks, sadly. So we have to be slightly careful about this, but we do accept your general point and, as I say, we have already begun in that area. You are right to point to the Australians, who have been quite imaginative.

As for the specific case, we are in touch with SFO. We have given them what help we can with their inquiries.

**Participant Three**

Chairman, I am a simple consumer. I am unlike, I think, most people involved who are probably financial service professionals. Your relationship with the Financial Ombudsman Service (FOS) worries me. Incidentally, I cannot find any reference in your Annual Report about the FOS, except for two or three paragraphs. Is that correct or have I missed a page?

**Howard Davies**

The FOS produces its own Annual Report.

**Participant Three**

Indeed, but in many ways they are effectively a subsidiary of yours. You hire their directors –

**Howard Davies**

No, we do not.

**Participant Three**

Do you not appoint their directors?

**Howard Davies**

Do you want to ask your question and then I can explain the relationship?

**Participant Three**

I looked at the Memorandum of Understanding and it appeared to say that you appoint their directors.

**Howard Davies**

Yes, we appoint the Board members.

**Participant Three**

I am sorry if my terminology is not correct, I am not accustomed to public speaking. They are actually described, I think, in the Memorandum as a subsidiary of yours. I would have thought that if you have an oversight of the FOS activities, although that may be reported in their separate Annual Report, surely there would be something in your Annual Report about your activities overseeing the FOS.

That is not my point. As a simple consumer, I am concerned that you might be perceived by other consumers to have undue influence over the activities and ultimately the decisions of the FOS. Consider the case of somebody who feels that the FOS is considering his or her case reasonably but it is a case where, as far as the FSA is concerned, your other obligations in terms of regulation of markets may be engaged.

How can I, as a consumer, be confident that the FOS, which has a pretty close – one might even say incestuous – relationship with you in some regards is indeed entirely independent of you in terms of its judgements?

### **Howard Davies**

I believe that I can confidently assert that this is the case and I am sure that the Ombudsman would say the same. Let me briefly explain what the relationship is and I think there is nothing between us on this point. The legislation provides that the FSA is responsible for the rules of the ombudsman scheme, the coverage of the scheme and the way in which the scheme is operated. We consulted on the rules at an early stage and then the Board made those rules.

The FSA is responsible for appointing the Board members of the scheme and for recommending a chairman to the Treasury. The Treasury is responsible for appointing the chair of the scheme. It is currently Sue Slipman, who was appointed this year. However, the Ombudsman is entirely independent in respect of any of its cases and the ombudsmen themselves, who make the adjudications, are appointed by the Board of the FOS.

The purpose of the Memorandum of Understanding, which we agreed with them recently, was that points had been put to us strongly by the industry that there were cases that the Ombudsman was considering which might be ones of broader application. In such cases, perhaps the FSA ought to have the opportunity of considering the broader implications of these cases. In some cases, it may be that the Ombudsman identifies a case that is actually one of a category of cases that could perhaps better be dealt with under the FSA's powers to have an industry-wide review.

There needs to be an interface between these two but I can confidently tell you that the FSA Board is not involved in the process of adjudication on individual complaints, which is entirely a matter for the ombudsmen themselves, who have a quasi-judicial function in this regard.

### **Alan Smallbone**

This question is sparked by a report in the *Financial Times* on 18 June, which I am sure was brought to your attention, about the fact that on page 159 of the Report of Accounts you are shown as having a pension which accrues on a 1/30<sup>th</sup> basis. First, is there anybody else who is a member of the defined benefit scheme run on behalf of the FSA who has that?

Second, on page 160 your salary is given and it is not entirely clear where and how the £82,000 pension is calculated. You are listed on page 160 as having a salary of £327,500 and various other bits and pieces that comes to £385,000. Broadly, it is a very large sum that you get for a period that I suspect does not quite go back as far as 1989. That being the case, how does it come about that there is no reference to the Lawson Cap? Can you briefly say why?

**Stewart Boyd**

This is a matter for the Remuneration Committee, which I chair and which is manned entirely by non-executive directors. The specific question that you ask about pensions is one that we have spent some time addressing. The FSA inherited from its predecessor organisations a number of different pension obligations. The 1/30<sup>th</sup> rule is one of those anomalies. There is nobody else in the FSA whose pension is accruing on that basis. Michael Foot and Carol Sergeant are in theory entitled to 1/30<sup>th</sup> but in practice as a result of their personal circumstances, the accruals are in fact only at 1/60<sup>th</sup>.

These anomalies are undesirable but we have an obligation to live up to promises made by the predecessor organisations.\* The Remuneration Committee intends to get rid of these anomalies as part of the policy throughout the FSA of looking no longer simply at the base salary but looking at the total remuneration package. This will result in a rather different profile of remuneration for senior Board members in the future, which we will explain as and when they arise. This is an anomaly that will come to an end with Howard's departure. On the detailed figures, will you allow me to respond through the website rather than taking up the time of this meeting?

(\* The exact position is that the FSA decided to offer pension transfer arrangements that preserved the rights of predecessor schemes in respect of predecessor service, in order to smooth the path at start-up.)

**Alan Smallbone**

Thank you very much. Could you mention the Lawson Cap, which, as you may remember, limited the amount of pay that could be counted for purposes of calculation for those joining after a date in 1989?

**Stewart Boyd**

As far as I am aware, the Lawson Cap has been complied with in this case. Can I again respond to you on the website on that topic?

**Alan Smallbone**

That would be extremely kind. Being so very aged – old enough to be the Chairman's father – I do not have a website. I correspond by post.

**Stewart Boyd**

Speaking personally, I would much prefer to do that. May I do that as well?

**Alan Smallbone**

You may. I will give you my address before we part company.

**Stewart Boyd**

I will put the answer on the website for others as well.

**(Stewart Boyd's response to Mr Smallbone can be found [below](#).)**

**Rodney Allen**

In his opening remarks, the Chairman raised the issue of Equitable Life. I am an annuitant in Equitable Life and, like the other 60,000 members concerned, I do feel that we were very badly let down by the performance of the FSA in July 2000 at the time of the House of Lords decision and their subsequent behaviour afterwards. I will just mention very briefly that as far as the Parliamentary Ombudsman's decision is concerned, the research and the report was undoubtedly written by civil servants in the FSA and the Treasury and there was certainly no contribution from outsiders who might have argued differently.

We hardly need the Penrose Report because, in fact, the Baird Report, in which the FSA participated, has all the relevant facts here, which are pretty damning of how the regulatory authority has behaved towards Equitable Life. The IFSD, which is an internal department in the FSA concerned with the insurance industry, commented on Option 3, which was the option the House of Lords took that they ignored totally – the PREs of non-GAR policyholders – and they decided ring fencing was impermissible.

They said, "It should be noted that Option 3 is not something that had been considered previously. It would involve the court opining on the apportionment of bonuses between different classes of policyholders, GAR and non-GAR policyholders, rather than just on the bonus entitlements of GAR policyholders. Previous court hearings focused on the narrow issue of the rights of GAR policyholders. However, the hearing of the House of Lords suggests that they may consider the issue" – this was on the day before the decision – "in its broader context. Although Option 3 now appears to be a possibility, we still consider it much less likely than the other two potential outcomes". In other words, the House of Lords caught the FSA with their pants down.

I would quote similarly comments by Howard Davies himself on the 20<sup>th</sup>: "I cannot say there was a lengthy meeting on the subject" – he was talking about the actual decisions – "but there was a lot of corridor discussions at the time. It was a pretty chaotic day because it happened to be our annual meeting. I can remember asking if we were really confident that there were going to be lots of bidders and at the time we were so confident" etc. In any case, it looks as if there was no real consideration of the decision.

I will now quote finally his statement on 15<sup>th</sup> February before the Treasury Select Committee. The Chairman asked "Can I turn the question on its head? Are you really saying that in your view, or in the view of your legal advisors, the House of Lords appeal decision is a perverse one?" Howard Davies responded: "I would not wish to say that. I am only saying it was, Chairman, unexpected. Yes, it was unexpected and it overturned the quite fundamental principle on the way in which returns were allocated. Everybody now has to live with it and not just Equitable Life. Other companies too and it is having a redistribution consequence in other parts of the market and we will have to live with those. It is creating a different position from what we thought was the case".

The Chairman, unfortunately, did not ask precisely what this fundamental principle was but, of course, it is 300 years of insurance company practice by which those who are covered by a risk pay for it. There was obviously a fundamental flaw in the GAR policies because in certain circumstances everybody could benefit from it, which is obviously not sound insurance principle. The FSA should have taken advantage of Article 45 of the Insurance Industry Act of 1982 and should have used their exceptional powers under Article 45 to intervene and settle the issue, probably by having to go to the Government.

There were various things they could have done: if it was not possible to have differential bonuses then there could have been differential premium payments as a way out of the problem. What happened, in fact, was that the fundamental principles of the industry were ignored and we non-GAR policyholders lost our legal rights.

### **Howard Davies**

I would like to make a couple of observations that, I hope, go to the centre of the point that you made at the end. Firstly, however, I have to tell you that the Parliamentary Ombudsman's report was written by the Parliamentary Ombudsman and her staff, not by FSA staff or, as I understand it, by Treasury Staff. The Parliamentary Ombudsman would need to respond for herself on that point but I feel absolutely sure that she would very much resist any suggestion that her report was written by anybody else. It certainly was not.

The Baird Report, from which you quoted, was commissioned by the FSA Board because the Board took the view that it was good practice for a regulator to assess what it did and did not do in the event of a circumstance as serious as the closure of Equitable Life to new business. We published that in its unvarnished state and it did say that we had done things that, in retrospect, we would have liked to have done better. It also concluded, as the Parliamentary Ombudsman concluded, that there was nothing the FSA could have done that would have fundamentally affected the outcome for the society.

Of course, these two reports that have been published so far have only covered the period from 01 January 1999 to the date at which the Equitable was closed for new business in December 2000. As you are perfectly aware – I am sure that you will not resist this – there is a long history here to cover. I would say on behalf of the FSA and the Board that we do feel a little frustrated that we have had two intensive investigations of our own part of the story and so far no intensive investigation of any earlier part of the story.

When you specifically asked the question about the FSA's powers to intervene in the court case, I must remind you that the decision by Equitable Life to go to court was taken before the FSA took over any responsibility for the regulation of Equitable Life. The decision was taken by the society and by a number of individual policyholders; there was a representative action, as you will recall. We think that it would have been extremely difficult and very hard for us to justify intervening in that legal process, which had already begun when we took over and which then went through the High Court and the Court of Appeal and the House of Lords.

On your central point, we believe that it was not open for us to do that. Obviously, the question of whether there was a different resolution of this issue other than going to court, which might have been thought of earlier, is a different one that may well be addressed in another review. When we took over, the case was already under way and I think it would have been very difficult for the FSA to have intervened to prevent it proceeding.

### **Brian Brown**

Yesterday, it took me all of two minutes to find, using the FSA website, a mortgage, via its mortgage table, which had a mortgage company setting out a product that had in it an unfair term within the Unfair Terms Consumer Contracts regulations, which are now regulated by the FSA. I gave details of one of these to the FSA over six months ago and I question what the FSA is doing

about the unfair terms in relation to products, especially in relation to mortgage redemption penalties.

### **John Tiner**

Thank you for the question, Mr Brown. I do not know the specifics of your example but what I can say is that we have quite a number of referrals to us from consumers who are concerned about unfair terms in the contracts of all types of financial products. As you say, for a little while now we have had responsibility for following those up and pursuing them where we think that it is the appropriate course of action. In relation to this particular issue in terms of unfair redemption penalties, I think I would have to go and look at the detail and then write to you personally with the answer.

### **Brian Brown**

I want to make the specific point that it was a bank that had a fixed-rate mortgage during the whole of the fixed-rate mortgage period and the redemption penalty did not reduce by one penny. That was the very case I took against a bank in 1999 and they gave me all my money back. It seems to me that a mortgage redemption that does not reduce over a five or ten-year period has to be unfair and I think it is the duty of the FSA to do something about that. I do not think it is doing anything.

### **Joe Egerton**

I used to be the Director of Justice in Financial Services and caused a certain fuss about some aspects of the Financial Service and Markets Act. I do not repent what I said at the time but I do congratulate the FSA on what has been a colossal change in introducing fair procedures. I have seen a number of people, both in front of the RDC and other places, and not only have the staff been commendably and admirably fair but the entire hearing process has been very fair. I personally do not think any firm that wished to disagree with the FSA should whine about judge and jury. They should use the fair processes that are there and they will get a fair hearing if they want to argue. If they do not want to argue, I suggest they might shut up.

Could I suggest the way forward? It seems to me that quite a lot of people came through from the old regime without anything like the thorough vetting that is appropriate. I suggest that the FSA gives some thought in the future to a process whereby, at least for the more senior positions, approval does not last forever and there is some process for it having to be renewed. One possibility would be to require each firm to have a CF3 chief executive and to require that CF3 person to go through a full approval process.

Might I also suggest that the FSA make its processes more open? I appreciate that is going to require an amendment of the primary legislation but I think things are rather closed compared to the SEC. I know for a fact that the FSA is now getting criticism for things that it is investigating very thoroughly but it is unable to say so. It does seem to me that there is a very powerful case for looking at much more open disclosure. One of the other suggestions I would make is that the approval forms should become accessible on the website for people to look at.

Therefore, I firstly suggest more openness and secondly suggest looking closely at the possibility of doing something to review at least the more senior people, who may have got through from the old regime without necessarily being quite what people would want in the future.

**(Mr Egerton corresponded immediately after the event with the FSA to clarify his question. Our response to this can be found [below](#).)**

**Carol Sergeant, Managing Director, Regulatory Process and Risk Directorate**

Thank you very much for your remarks about our enforcement process. As far as approval is concerned, once an individual has been approved they are, of course, required to operate to the minimum standards throughout their tenure. That is obviously something that we monitor and people who are found not to meet those standards are invited to leave the system. As you may have observed, we have indeed prohibited a small number of people since we have been going and there are many more who have seen us coming and who have decided to leave the system. I hope I can assure you that the process, with all the fairness attached to it, which you have helpfully remarked upon, exists if people wish to object to our views. It does happen.

Re-approving very large numbers of people – we will take that away and think about it – would be quite an onerous process, I think. We do review the performance of people in various different ways throughout their tenure and obviously the more senior they are, the greater the scrutiny because of the greater influence they will have. You have also remarked upon the openness of our processes; this is something that we are considering very carefully.

In some ways, it might be helpful if we were able to be more open about progress in enforcement cases but that is intimately tied up with the whole principles of fairness. The fact is that actual public sanction of somebody is in itself, if you like, a discipline in the UK. We are looking extremely carefully at that but it is very finely balanced with the fairness aspect of the process that you remarked upon earlier. There are also certain legal constraints but we are certainly looking into that and seeing how much we can actually publish without infringing the rights of individuals and firms.

**Alex Henney**

First, I will make a comment linked to what the previous questioner said and it is one that disagrees with an earlier view that you and one of your colleagues was expressing. The FSA is not properly accountable. FSMA excludes it from review by the National Audit Office and although you sung the praises of the Parliamentary Ombudsman, you know that you are excluded from review by the Parliamentary Ombudsman after December 2001. Finally, Schedule 1 excludes the FSA from negligence. This is different from the state that pertains in Germany, France and Italy, where the supreme courts have ruled that the financial regulators are liable for negligence.

Moving to my question, the year 2000 highlighted a clear conflict between the FSA's attempt to avoid telling prospective policyholders the parlous financial state of the Equitable in order to allow it to continue in business. Its duty to fulfil the reasonable expectations of prospective policyholders was essentially ditched. Does the FSA agree that responsibility for conduct of business issues should be divested to an entirely separate statutory body over which it has not control at all and no MOUs? This would be similar to the split between Ofgen and Energy Watch, which I imagine your successor is very familiar with.

**(Mr Henney corresponded immediately after the event with the FSA to clarify one aspect of his question. Our response to this can be found [below](#).)**

**Howard Davies**

On your accountability points, I think there is little chance of us agreeing. A House of Lords Committee is looking at accountability regulators and they may have some observations to make but I believe our framework is extremely robust. As for the National Audit Office, the principle reason that they do not audit us is because we do not spend any public money. Fees from the industry raise all our money.

As for the statutory immunity point, this is a point about legislation and therefore it is primarily for the Treasury to answer. I would simply say that when our Act went through Parliament this issue was very heavily debated, as it had been in the Financial Services Act of 1986, where the Lords were strongly swayed by a powerful speech by Lord Denning. He argued that a regulator should not have to be looking over its shoulder when it is seeking to enforce.

This view was confirmed by the Burns Committee and by both Houses of Parliament, subject to the introduction of a new complaints commissioner, whose remit I have referred to and whose report is now published annually. There are different positions applying in different countries. You have quoted one or two where there are different arrangements. I could quote you a list where the arrangements are very similar to those here.

As for the issue of dividing the Authority into two, in a sense I addressed that question in my opening remarks, where I pointed to the fact that there is inevitably a need to reconcile the conduct of business responsibilities and the prudential responsibilities of financial regulation. Simply putting them into two different bodies does not remove the need to balance these aims and to balance consumer protection and maintaining confidence in the system. There would be occasions where you could pursue individual firms to the point of bringing them down, which would not be beneficial for consumers as a whole.

They are not, however, conflicting requirements on the regulator; they are ones that need to be balanced because pursuing either to the limit could damage consumers' interests. Thus I have to say that my own experience – and I believe this reflects the views of all those in the FSA – is that putting the two responsibilities together in one organisation is indeed extremely sensible. If you look at some cases in the past, you can argue that it would have been much better had the prudential implications of selling practices and of the terms of contracts been considered more explicitly by the prudential regulators. This might have produced a better outcome in past cases. Frankly, I do not agree that that would be a sensible division of responsibilities and I would not recommend that the Government go in that direction.

I think that we probably ought to end at that point. All of those people who have put in questions that we have not had time to answer will get an answer on the website. That will all be completed by next week unless there are a lot more questions submitted either this morning or immediately afterwards that will take time to answer. If you have any further questions, give them to an FSA member of staff. Otherwise, let me thank you all for attending and for the spirit in which this meeting has been conducted.

We do believe this is an important part of the accountability process. We hope that it is not an isolated event because we have presented quite a lot of material in the form of the four presentations this morning on which we would be happy to have comments and further questions if necessary. Thank you all for your attendance, questions and attention. I am sure Callum McCarthy will want to see you all next year.

## **Other questions asked before the Meeting, but not answered on the day**

A number of people notified in advance that they would like to ask a question at the Annual Public Meeting. Because we did not have time to respond to these on the day, the questions and our responses are provided in full below.

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### **Alex Henney (Chairman, Equitable Members' Action Group)**

#### **What is the significance of misfeasance in public office, governmental liability, and European influences by Mads Andenras and Duncan Fairgreve, International Comparative Law Quarterly (October 2002) for the liability of the FSA for life insurance misregulation?**

The question presupposes that there has been misregulation by the FSA. We would strongly reject such suggestions. Immediately after Equitable Life closed to new business, the FSA board commissioned a review by the then Head of Internal Audit, Ronnie Baird, to see what lessons could be learned. The Baird Report identified that, with the benefit of hindsight, things that might have been done differently, but the review did not suggest any fundamental failings by the FSA. As he put it, "the die was cast" when the FSA took over responsibility. The Parliamentary Ombudsman's report which was published more recently reached similar conclusions.

The FSA is aware of the academic article in question. It explores the circumstances in which a regulator should be liable when a regulated firm is unable to meet its liabilities to consumers. In particular, it considers where the threshold should be set, before a regulator should be liable for acting in bad faith or misfeasance. The discussion has been triggered by the case against the Bank of England following the collapse of BCCI in 1991. The trial of that case is due to start in January next year, and the judge will have to decide the point then.

The two reports published to date on our regulation of Equitable Life have not found a case of negligence, a less serious civil claim than bad faith/misfeasance, which is the subject matter of the study. This further supports our view that the study referred to is not relevant to us in the context of our regulation of Equitable Life.

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### **Simon Douglas (MD, Standard Life Assurance Company)**

#### **It is generally recognised that the cost of financial advice under the current regulatory regime is very high which means it is not economic for those with more modest savings to get advice, and very expensive for those who can and do pay (whether by fee or commission!). The proposed "Sandler" regime only addresses a small part of the problem, for a small part of the population. What measures do the FSA plan to take to help more people get access to cost effective financial advice?**

Our introduction of stakeholder pension decision trees and the work we are doing on a possible modified selling regime for simplified products show that the FSA is prepared to look at the scope to reduce firms' costs so long as it can still secure adequate protection for consumers. More generally, we are trying to introduce a more competitive market and one which provides a better service to lower income consumers through our depolarisation proposals.

In March 2003, we held a seminar with HM Treasury to demonstrate an interactive financial healthcheck in prototype form. We are now developing this tool further so consumers themselves can use it, with or without assistance from the voluntary or commercial sectors. This is part of our overall strategy for consumer education, information and generic advice. We shall consult widely on the strategy, and on the healthcheck in particular, in the coming months, aiming to launch the developed healthcheck product later in 2004.

We take very seriously firms' concerns over the costs of regulation, and recently commissioned independent research that did show some increase in costs as a proportion of firms' operating costs. These were, however, significantly lower figures than indicated by earlier industry surveys. The research also showed that many firms could reduce their cost burden through their own efforts, and that some are already able meet FSA requirements at low cost.

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**Richard Billington (Director, Richard Billington IFA Ltd)**

**Descriptions of financial products and key feature documents are not standardised, confuse the public, damage the reputation of our industry, may lead to complaints and are inadvertent breaches of tax law. Will the FSA enforce complete standardisation of font, text, size, text order and universal descriptions?**

We recently issued a consultation (CP170) proposing the replacement of Key Features with a new document called Key Facts. Our proposals for the Key Facts involve an element of standardisation, both in relation to the appearance of the document and to its content.

However, we do not see value in complete standardisation of items such as font, text, size, text order and universal descriptions. In general terms, our regulatory approach is to apply tools (of which prescriptive rules are one) in a proportionate way. In other words, we will be no more prescriptive than is necessary to achieve what we are trying to do in terms of consumer understanding and be able to compare financial products. We think we can achieve this with a more flexible approach.

Flexibility in our rules is valuable in that it provides a framework which is capable of being applied to a wide range of products, without stifling innovation. Prescription, by contrast, would carry the risk of causing misleading outcomes, for example if a firm shoehorned a product into one of our defined categories where it didn't quite fit. Very prescriptive regimes can also inhibit innovation.

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**John Donachie (Compliance Officer, Fairfield Greenwich (UK) Ltd)**

**Last year at the Open Meeting I asked Sir Howard about the electronic individual registration and we were promised Easter. I have now eaten my Easter Egg and still do not see any electronic IVA registration.**

In the long run, we would like to put our relationships with firms on an e-basis, with most of our returns submitted electronically and most of our responses going back the same way. Work on our

e-regulation programme is progressing well, and the electronic submission of Approved Persons forms is now available to all firms who register to use our E-Regulation service.

Electronic versions of six of our regulatory forms are currently available. We aim to expand the scope of electronic reporting on a continuous basis, offering further forms and more efficient flows of information between the industry and the FSA. The speed with which this develops, however, depends partly on the willingness and capability of firms to deal with us in this way.

Information on our current E-regulation services can be found on our website, under *Industry Help, E-Regulation*. This provides details of the minimum hardware requirements that firms will need to be able to operate the e-regulation system together with details of the e-regulation contact centre, where firms can register as users. The contact centre also provides guidance on how to use the system.

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**Alan Magnus (Director/ Co Secretary, Partnership Incorporations Ltd)**

**Can we adopt language and descriptions/ classifications which are more intelligible, e.g.: limited partnerships are classified as “unregulated schemes” but are subject to heavy regulation in many respects.**

We do not regulate limited partnerships as a form of investment vehicle. Were it an authorised unit trust or an investment company with variable capital, then it would be classified as a regulated collective investment scheme and would be required to meet the detailed provisions of CIS. Limited partnerships that carry out regulated activity are subject to our usual regulatory requirements.

Although limited partnerships must meet certain requirements – most notably those set out in the Limited Partnerships Act (1907) – it is inaccurate to suggest that this type of collective scheme is “regulated” in any meaningful sense. A limited partnership is not, for example, subject to the detailed provisions in CIS relating to constitution, charges and expenses, and dealing. Indeed, all that the Limited Partnerships Act requires is that limited partnerships be registered. It is therefore entirely legitimate for limited partnerships to be classified as “unregulated schemes”.

The term “unregulated scheme” has been used in SIB and FSA rulebooks for at least the last 11 years and is meant to contrast collective investment schemes that are subject to UK product regulation – “regulated schemes” – and can therefore be marketed freely to the public, with those that are not. The perception that limited partnerships are subject to heavy regulation may derive from the promotion of unregulated schemes. While we acknowledge that such promotions can be more onerous than for regulated ones, there is real justification for this since unregulated schemes are not suitable for every investor and consumers need to be protected.

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**Alan Macarthur (Director, CTC Financial Services Consulting Ltd)**

**Is the FSA taking any specific action to help the smaller IFA firm having problems gaining compliant PI cover? Whilst an application for a waiver is a possibility, substantially increased**

**capital adequacy might not be an equitable solution for a firm with a “non-contentious” business profile.**

The FSA recognises that a substantial number of smaller IFA firms have been unable to obtain Professional Indemnity Insurance (PII) or are only able to obtain non-compliant cover. We have already made a number of changes to our rules to help alleviate these problems, and we expect to publish a further consultation paper shortly setting out more radical changes to our policy in this area.

We take the view that the characteristics of a better PII market for IFAs are:

- the regulatory requirements set minimum standards in key areas, but allow flexibility in policy wording. This would encourage insurers and Lloyd’s syndicates to compete on policy terms;
- personal investment firms run their businesses in a way that minimises the number of claims on their PII policies;
- there is enough capacity in the market to provide PII cover for all those firms that are required to have it; and
- the insurance market has a better understanding of the risks of insuring IFAs. This will require regular and open dialogue between the insurance industry, the FSA, IFAs and trade bodies.

However, as regulator, we cannot provide PI or control prices, which is why it is important that the industry and insurers work with us to respond to the present challenge.

Whilst we recognise that firms purchase PI cover to protect themselves against claims we as regulator also use it as an important part of our consumer protection framework. A requirement on personal investment firms to hold PI has historically been the quid pro quo for comparatively low capital requirements. The presence of PI ensures that a firm has a certain level of resource available to meet a variety of types of claim from customers. If PI is not present, or is not comprehensive, then we need to ensure that there is an alternative source of compensation available to meet claims, whether these are routine claims of average size, or single, one-off claims, perhaps of significant size. This is why we have been requiring additional capital as a substitute for PI. Our forthcoming CP explores the relationship between regulatory capital and PI in more depth and we would encourage all those affected to let us have their comments.

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**V R Brindley, (LM&S Railway Running Department Insurance Society)**

**Mr Brindley noted the difficulty that some firms regulated by the FSA are having in securing Professional Indemnity Insurance (PII) and the increased cost of such insurance. He suggested that the FSA could bring to the attention of brokers and underwriters the possibility of providing block insurance to a number of firms engaged in similar types of business.**

We are grateful for all suggestions that may contribute to improving the situation in the PII market. The feasibility of providing block cover for those personal investment firms required by the FSA to have PII is really a commercial matter for the insurers. It is not something which the FSA can prescribe. However, we are very keen to promote discussion on all aspects of the PII situation

among participants in the market and we have therefore organised a PI forum for 29 July 2003. This is expected to be the first in a series of such meetings. We hope that insurers, brokers and the trade associations who represent regulated firms will attend and that it will provide an opportunity for ideas such as this one to be explored.

We will also be publishing very shortly a further consultation paper on proposals to amend significantly our requirements relating to PII. Any comments or further suggestions from interested parties will be most welcome.

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**George Crook (Financial Consultant, George Delana Consultancy Services)**

**How best can the small business prepare for the future regulatory process? What cost factor should the small to medium size organisation build into their budget to avoid financial crisis?**

Mortgage and general insurance firms will be regulated by us from October 2004 and January 2005 respectively. Many of these firms are small businesses and we are doing a variety of things to help them prepare for regulation. These include:

- publishing consultation papers setting out our proposed regulatory approach and plan to finalise our rules at least a year ahead of regulation commencing so that firms have sufficient notice to prepare. Each of our CPs is also accompanied by a short guide summarising the main proposals for firms that do not have time to read the whole CP. And we encourage small firms to read these so they understand what regulation will involve;
- running a number of seminars to help firms understand our proposals. These include free seminars on our mortgage and general insurance CPs. And later this year we will be holding a series of workshops to explain to firms how they can prepare for authorisation and to provide details of the application process. (There will be a small charge for these.);
- publishing a series of Factsheets over the summer explaining what is happening, including a Factsheet to help firms understand the links between the policies set out in our CPs; and
- help for firms is also available from trade associations and the existing voluntary regulators – in GISC and the MCCB.

The cost factor that small to medium organisations should build into their budgets depends on what business they are doing. Our CPs set out estimates of the costs of our proposals. In particular, our proposed fees for authorisation are set out in CP 180 and we plan to finalise these later this year. We would encourage the industry to let us have their comments on our consultation proposals.

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**Yemi Johnson (Compliance Officer, Law Debenture Corp. plc)**

**What is the FSA's approach to monitoring compliance with operational risk?**

We assess firms' compliance with operational risk using our risk-based approach. We have also created a specialist risk review team to assist our line supervision.

In our risk assessment framework, operational risk is a specific risk element but it is also a factor in most of the control risk groups. Depending on the type and nature of operational risk identified, our supervisors decide on the appropriate tool, for example:

- requiring a firm to provide information about material outsourcing contracts;
- carrying out a visit to a firm on internal audit; or
- commissioning a skilled persons report on information security

Using the risk assessment framework, we have carried out a review of the progress firms are making in developing risk management systems and controls for operational risk. We will publish the results shortly in the form of a policy statement on Consultation Paper 142: *Operational risk systems and controls*. The new requirements are due to be implemented next year.

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**Roland A Baker**

**Can the Chairman of the FSA or the Insurance Managing Director (John Tiner) explain how demeaning the standing of the Appointed Actuary in an insurance company conducting large volumes of business with the general public can reduce compliance costs and increase public protection?**

We are replacing the Appointed Actuary role with two new actuarial roles - the Actuarial Function and the With-profits Actuary. These roles underline the responsibility of directors and senior management of life insurers for all decisions taken on actuarial advice and emphasise that such advice is an integral and essential component in exercising their responsibility to treat policyholders fairly and establish adequate provisions for policyholder liabilities.

The With-profits Actuary will take over the Appointed Actuary's current duty to advise on the use of discretion in with-profits business but with additional responsibilities, including reporting directly to with-profits policyholders. The Actuarial Function holder will be responsible for valuing policyholder benefits. Furthermore, provisions for policyholder benefits will for the first time become subject to audit and to review by an independent actuary, who will advise the auditor and publish a public opinion on the results of his review alongside the audit opinion.

These changes should deliver substantial benefits for consumer protection and confidence, which will, in our view, outweigh any additional compliance costs.

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**Joanna Asm (Executive Director, British Bankers Association)**

**Given the increasing focus on financial education from Government and elsewhere, how does the FSA intend to ensure it fulfils its responsibilities in this area?**

We recognise that one of the key challenges for the future is to expand our work on financial literacy and consumer information. While we have prepared an enormous amount of material which could help consumers make better decisions, our readership is nowhere near wide enough, and we are currently looking at different ways of reaching more people.

To target younger people, we have also developed an imaginative suite of teaching materials for financial literacy in schools and colleges, and the task now is to encourage more institutions to incorporate it into their curriculum.

The FSA are only one of the many organisations contributing to work on financial literacy and we think it falls to us to try to ensure that all the elements are joined up and that any gaps are filled. We will therefore be launching an initiative to develop a UK strategy for financial capability in the autumn. In achieving this goal we will have to work closely with many partners. Our aim will be to ensure that the whole makes more than the sum of the parts.

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### Sheila Spicer

**The annual report mentions the potential adverse effects of regulation on competition. What are the three key regulatory challenges that you believe the FSA faces, if possible, one each for the short, medium and longer term?**

As the Chairman noted in his remarks to the Annual Public Meeting, key challenges for the future include:

- the need for firms themselves to learn the lessons of past mis-selling and to appreciate the benefits of wise and compliant marketing;
- the wider provision of financial education; and
- the continuing need for the UK financial services market and the UK authorities to prepare effectively for the establishment of a single financial market in Europe.

The FSA will set out its key priorities in January 2004 in the Plan and Budget for 2004/05.

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### Peter Beales (London Investment Banking Association)

**At last year's meeting, LIBA asked FSA to publish service standards for a number of operations and to consider introducing them for others. Progress is being made on some of this, but serious concerns remain about consultation overload, not least given the frequent combination of FSA consultation and European negotiations. Indeed if anything the problems for members and their associations has become more acute, particularly over proposals for sensitive policy changes. Therefore, we must now ask that, where sensitive policy proposals are contemplated, every reasonable effort is made to start with a proper "pre-consultation"; and that such pre-consultation should normally explore what will be a realistic and responsible timetable for the whole consultation process, for the market as much as for the Authorities.**

We welcome LIBA's recognition of the progress we have made on service standards.

We acknowledge the continuing weight of consultation. As we explained in our response to the Practitioner Panel report in our own Annual Report, change is driven from three sources - UK Government policy decisions; legislation by the EU and standard setting by other international

bodies; and our own decisions that aspects of our regime merit review in the light of experience and market developments.

We have taken some steps over the past year to help our stakeholders plan ahead - for example, we now publish an outline plan showing forthcoming publications and expected consultation periods.

On the pre-consultation point: we are committed (in "The Open Approach to consultation", July 1998) to having "informal discussions with those most likely to be affected" and that is our normal practice.

In deciding the timetable for reform on individual issues, we are sensitive to stakeholders' views - see our recent decision to extend from 29 August to 10 October the close of consultation on CP176 – unbundling/soft commissions. However, in deciding at what pace to proceed on individual issues the FSA Board needs to take into account a number of factors, including the need to implement international standards and our assessment of the risks to consumer protection and market confidence. So we do look to keep our stakeholders informed as our thinking on individual issues develops. What we cannot promise is that our decisions on timetabling will always be welcome to our stakeholders.

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### **Mike Chilton (Group Head, Operational Risk, Standard Chartered Bank)**

**In the context of BCP, can the FSA please clarify their role in relation to the various stakeholders involved in London wide BCP activity, such as London First, the London Resilience Team, the Corporation of London and the City of London Police?**

We have contributed a good deal ourselves to the debate on business continuity. Further information on this is available on the website maintained jointly by the FSA, HM Treasury and the Bank of England at [www.financialsectorcontinuity.gov.uk](http://www.financialsectorcontinuity.gov.uk)

The London Resilience Forum is the umbrella organisation through which the public and private sectors in London work together to ensure that London is prepared for major incidents or catastrophes. The Forum has several sub-committees including the Business sub-committee, representing the general business community. The Business Sub Committee is a group dedicated to discussing London-wide resilience issues in the business sector. Membership of the committee includes representatives from Corporation of London, Metropolitan Police, London First, Canary Wharf Management, Local Government, the Business Continuity Institute and the FSA. Our remit is to provide a central pool of expertise on BCM and to provide feedback and advice on key BCM issues.

Additional information on the work of the London Resilience Forum, its structure and membership, can be found at: [www.londonprepared.gov.uk](http://www.londonprepared.gov.uk)

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### **Roger Rowland**

**The statement of principles issued by FSA (then called SIB) on 15 March 1990 formed a universal statement of the standards expected of persons (firms), self-regulating organisations and professional bodies. It appears that Equitable Life breached several of those principles for some years, but FSA did not intervene with the relevant SRO. Why not please?**

The question does not specify the nature of the alleged breaches of the principles and when these breaches should have been apparent to the relevant regulator(s). The principles were supplemented by the rules of the SROs and it was for those bodies to enforce the principles and the relevant rules among their member firms and to take such disciplinary measures as they considered appropriate. The question does not provide any evidence that the Personal Investment Authority, as the relevant SRO, failed to act in response to any such breaches that it could have known about at the time.

**FSA's balance sheet suggests that the company is insolvent. May I assume there is an unlimited guarantor that allows the directors to trade legally? If that is so, upon whom does the final responsibility fall – the investors or the taxpayers?**

As explained in the Financial Review in our Annual Report 2002/03, we do not consider the FSA to be insolvent, as our pensions liabilities will not crystallise for many years and in the meantime we remain able to meet our liabilities as they fall due.

In considering our ability to meet liabilities, we place considerable reliance on our statutory powers under FSMA to raise fees. Further, the funds we need to meet our costs are met by regulated firms and listed companies, and as such we receive no public money and are therefore not a burden on taxpayers. There is therefore no need for any guarantor.

**What is the contingent liability for Gavrelle House?**

The figures relating to Gavrelle House can be calculated from the disclosures in our Accounts. If there was to be no increase in market rents between July 2000 and July 2010, then the FSA would have a maximum liability of £1.5m payable between 2005 and 2015. We think it unlikely that this liability will crystallise.

**Page 199 of the Annual Report refers to the FSA's responsibilities concerning mistakes, lack of care, unreasonable behaviour, bias and lack of integrity. I have suffered from all of these! Yet, the chairman refuses to reply to my letter of 17 February 2003. Why please?**

The question refers to Appendix 6 of the Annual Report: Complaints Against FSA. We take complaints very seriously. Where matters complained of fall within the scope of our formal complaints scheme (which forms part of our Rulebook), they are investigated in accordance with the rules of the scheme and in compliance with the four service standards that relate to this area, as published in the Plan and Budget 2003/04.

In this particular instance Mr Rowland has not received a response to his letter of 17 February since the background to which concerned a complaint that had previously exhausted the complaints procedures under previous legislation. We informed Mr Rowland in 22 May 2000 that his case was now closed, and that we would not continue to correspond with him on this matter although the complainant continued to correspond with the then Complaints Commissioner.

New complaints arrangements were established at N2. The complainant referred this matter to the FSA's new Complaints Commissioner under these arrangements, citing new information. (The Complaints Commissioner does not investigate complaints that have already been investigated by previous Commissioners under previous legislation). Following a review, the Commissioner took that view that no new information had come to light since the investigations by the old Complaints Commissioners under the old arrangements and therefore did not believe that the matter should be

reinvestigated. We therefore continue to place all letters on file without acknowledgement where we are of the view that they relate to the matters that have previously been concluded.

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### **Paul Braithwaite (Equitable Members' Action Group)**

**As a long-standing Equitable Life policyholder activist with the Equitable Members' Action Group (EMAG), I am concerned that the apparent level of involvement of the FSA into strategic decisions, seeming to exceed what is reasonable for a regulator.**

**By way of examples I would cite:**

- **the counsel's opinion of Glick and Snowden Sept 2001 - which must have been commissioned weeks before members were given Nicholas Warren's opinion that it addresses**
- **The FSA received the so-called independent actuarial review by Bacon and Woodrow months before the Moss and Carr opinion on what would be fair to late-joiners who left 3. The FSA has permitted Equitable to freeze unilaterally the GAR rectification scheme required by the House of Lords. Is this even legal?**
- **The FSA has granted a waiver to Equitable to delay addressing the 50,000 cases of possible drawdown mis-selling until the end of next year.**
- **For more than two years the administrative service standards of the Equitable Life have fell far below acceptable standards and the FSA did nothing.**

**In summary, EMAG suggests that the FSA may be acting as a shadow director of Equitable Life, well beyond its formal remit.**

Section 741(2) of the Companies Act 1985 defines a shadow director as “a person in accordance with whose directions or instructions the directors of the company are accustomed to act”. The examples cited in the question (which we do not necessarily accept to be true) do not appear to suggest the behaviour of a person who is acting as a shadow director. In any event, the FSA denies that it or any of its employees have given any such directions or instructions.

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### **Ann Berry**

**I am a WP annuitant of Equitable Life. There are around 50,000 of us in the UK. Since once an annuity has been purchased it is irreversible, all of us are trapped in Equitable Life. I purchased my annuity in the spring of 1998, after the FSA became responsible for regulation of Equitable. At that time I understood the risks inherent in a With Profits policy and took responsibility for those risks, but there was no way I or any other ordinary member of the public could know of the 1.2 billion pounds black hole in Equitable's Finances. I refer to the gap by that time existing between their assets and their liabilities. It is my contention that in view of this black hole, I was mis-sold a With Profits annuity, as indeed were many thousands of other people. When the House of Lords ruling went against Equitable Life, resulting in the closing of doors to further business and the subsequent Compromise Agreement, Equitable policy holders were told by the FSA in their Assessment of the Compromise Scheme - and I quote - “we ((FSA) firmly believe that a successful compromise would, in principle, offer the**

best prospect of bringing stability to the with profits fund and improving the outlook for concerned policyholders” (section 7) and “we have concluded that the Compromise does not give these groups.... (with profits annuitants) disproportionately greater benefits or disbenefits.” (section 28) Elsewhere in the document the FSA makes reference to the enhanced stability to the with profits fund that would derive from the compromise scheme.

On the basis of the FSA’s endorsement of this Scheme I and many thousands more Equitable policyholders voted in favour, thus surrendering our right to sue for compensation for mis-selling. Subsequent to its implementation all with profits annuitants have suffered a reduction in income of up to 30% per annum, with further reductions to come. It is evident that the With Profits fund is unstable in the extreme.

I should like to know how the Panel squares the present predicament of Equitable’s trapped with profits annuitants with their statements made in the Assessment of the Compromise Scheme, from which I have just quoted. I should also like to ask the Panel how, in view of what has happened to Equitable Life’s WP annuitants, any member of the public can be asked to put any trust at all in the FSA’s regulation of the personal pensions industry.

The sorry state of the with profits fund cannot be blamed upon falling equity values, since during the months since the compromise scheme was implemented only around 5% of the fund has been in equities. It would appear in fact that the demise of Equitable Life and the present predicament of with profits annuitants should be laid at the door of the "black hole" which the FSA either identified and failed to act upon, or failed to identify despite its regulatory remit.

Please refer to the reply to question on with-profits [below](#).

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Leslie Seymour

I have complained to the Belgian regulator and the EC about mis-selling of UK financial products in Belgium and I have claimed compensation for my consequential severe losses.

The Belgian regulator, "Office de controle des assurance", and an EU commissioner, Frits Bolkenstein, have both written to state that the UK regulator is the relevant "national supervisory body".

I have complained to this "national supervisory body", the FSA, and. I wish to take my complaint to the national courts.

However I find that, contrary to the European third life directive, this "national supervisory body", against which I should be able to make a claim, has crown immunity. This is scandalous.

I also find that even the UK PO refuses to investigate the relevant periods of the mis-selling, while in other European countries, such as France and Germany, the financial regulators are taken to task by the courts for negligence.

The UK situation is a travesty of the European insurance directives. Far from creating the necessary confidence in European insurance, it clearly identifies that UK Member State’s

**insurance regulation avoids accountability via the courts and other judicial bodies.**

**Can you please explain EXACTLY who the FSA IS accountable to, as I believe that neither the PO nor the National Audits Bureau nor the courts have any jurisdiction?**

**Futher, what steps are in hand to harmonise regulatory framework within the EC to restore the disastrous loss of confidence in the insurance sector?"**

There is an explanation about the FSA's accountability in reply to a question [below](#).

However, the underlying point in this question appears to be an allegation of mis-selling for which redress is sought. If consumers consider that they were mis-sold a policy, they should complain to the company or person who advised them or sold them the policy, since it is the company rather than the regulatory authority that would be responsible for any redress that may be due and in default can be held to account through the courts. There is further information about complaints procedures in the Consumer Help section of our website.

The European Union has introduced a range of measures over the last 30 years which seek to ensure that financial firms, including insurance companies, within the European Economic Area meet certain minimum standards. Under those arrangements, EEA authorised insurance firms are regulated for solvency purposes by the regulator in the State where they have their head office. However, the regulation of the sale of financial products and advice given to consumers as part of the sale process is the responsibility of the State where the product is sold. Firms must, therefore, comply with the local regulatory requirements in the place where the sale takes place and enforcement of those requirements is reserved to the local authorities of that State. The FSA does not therefore supervise sales of life insurance in Belgium (or any other part of the EEA, apart from the UK).

A fundamental review of the EU insurance solvency regime – known as Solvency II – is currently under way. In addition to leading discussions between Member States, the European Commission published a report in May 2002 which sought to analyse existing solvency systems, the key risks facing insurers and the models used in the financial services sector. We anticipate that the proposals the Commission will produce will introduce a coherent risk-based approach to insurance supervision. Our expectation is that the future EU solvency regime will be much better geared to the risks that insurance companies face, that companies will be encouraged to develop improved internal risk management practices, and that convergence of supervisory practices will be promoted. The Commission will start outlining its specific proposals for a new directive this autumn.

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**Chris Carnagan**

**Most members of the public probably think, as I did, that the Financial Ombudsman Service is an independent organisation whose sole role is to protect consumers. When I read the Memorandum of Understanding between the FOS and the FSA I realised that this is not the case.**

**The MOU gives the FSA substantial control over the FOS (e.g. by appointment of directors,**

**approval of budgets, early disclosure of information by the FOS, etc), which seems uncomfortably incestuous.**

**While this may be convenient for the FSA, surely this degree of control militates against the independence of the FOS when adjudicating on consumers' complaints that might, on occasions, be in conflict with the FSA's other interests and commitments?**

**In order to fulfil its consumer protection role without prejudice the FOS should be entirely independent of the FSA.**

The FSA has established the FOS under the Financial Services and Market Act 2000 (FSMA), which provides for “a scheme under which certain disputes may be resolved quickly and with the minimum formality by an independent person.”

It is FSMA which governs the relationship between the FSA and the FOS, rather than the Memorandum of Understanding. FSMA does provide for the FSA to appoint the Board of the FOS but also provides that this must be on terms which secure the operational independence of the FOS Board.

Similarly, FSMA requires the FSA to approve the FOS's budget. There is also a specific duty on the FSA to ensure that the FOS is at all time capable of exercising its functions conferred by or under FSMA.

In terms of its individual decision making, the FOS is independent of the FSA. The Memorandum of Understanding was negotiated with the FOS in order that both sides may share information and co-operate with each other, where this is possible and where it can help either or both of us to carry out our statutory functions set out in FSMA. The Memorandum of Understanding is based on the structure established by FSMA under which both the FSA and the FOS must operate.

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### **Response to Mr Smallbone's request for additional information on the Lawson Cap.**

The impact of the Lawson Earnings Cap is to restrict the benefits that can be received from an approved Pension Plan for those who joined that Plan after 31 May 1989. Howard Davies' pensionable service started on 11th September 1995 and the Earnings Cap therefore needs to be taken into consideration in calculating the benefits that he may receive from the FSA Pension Plan.

However, all members of the FSA Pension Plan are offered, for the period of their FSA service, pension benefits on the full value of their salary, irrespective of when their pensionable service commenced. Benefits due will be paid by a combination of the FSA Plan paying the maximum approvable pension, with the FSA meeting any excess. Each individual's circumstances will vary in relation to their earnings, their retained benefits and, where relevant, their length of service with the FSA. All of these factors will influence the proportion of members' benefits that will be payable from the FSA Plan and the proportion (if any) that will be payable by the FSA. In practice, very few staff are affected by these arrangements.

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We also received a number of questions from the Equitable Members' Action Group after the Annual Public Meeting. We publish these questions in full, along with our answers below.

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**Alex Henney**

**If you are going to put the first part of my question on the website, I suggest you get it right. I did not ask why the NAO did not audit your accounts, I asked why the C&AG/NAO were not empowered to undertake efficiency reviews. The NAO does not audit Ofgem's accounts; but it is empowered to review its efficiency. I have no doubt that the exclusion of the NAO and PO were designed to limit the accountability of the FSA along with the immunity. To claim the thinking of a decade ago, and to dismiss the relevance of Germany, France and Italy, is "not me gov" stuff yet again.**

The Financial Services and Markets Act 2000 does not specifically deal with the powers or jurisdiction of the National Audit Office or the Parliamentary Ombudsman, which are dealt with under separate legislation. FSMA does, however, authorise HM Treasury to order a value for money review of the FSA, and it may appoint the NAO for this purpose.

The Chairman responded to the point on statutory immunity during the meeting, but we further emphasise that we do not believe it limits the FSA's accountability. There is plenty of scope under FSMA for independent scrutiny of the FSA's decisions – the power of HM Treasury to order an inquiry or review, the availability of judicial review, the complaints scheme, the role of the non-executive directors, the obligation to consult the panels and report publicly on the discharge of its functions, and the Financial Services and Markets Tribunal.

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**Joe Egerton**

**I am not sure who has ownership of the operation to bring GISC regulated animals into the FSA fold, but following Carol Sergeant's comment about people leaving by the backdoor as the FSA arrived at the front, it strikes me that:**

- 1. a number of the less attractive goats that left your herd went into the GISC herd**
- 2. the understandable and laudable objective of minimising the difficulties of the expansion of the herd to include GISC animals may let them back in.**

**May I suggest that the FSA:**

- 1. requires all firms applying for authorisation to provide:**
  - a form listing the names of ALL employees with details adequate to identify in FSA/PIA/SFA/IMRO registers – e.g. previous names, dates of birth, NI numbers**
  - names and details of all persons who were at any time approved by the FSA or registered with an SRO regardless of whether the firm they now work for is applying for them to be authorised**

- **in respect of those in b at least, (if not a as well), a declaration that the firm is satisfied, on the basis of due and diligent inquiry, that the persons on the list are honest. (It is tempting to add competent, but I think the FSA will need to address the problem of competence more widely. If the crooks move on, that will be a worthwhile achievement not to be put in jeopardy.) (If you extend the honesty requirement to a, may I suggest that separate individual declarations are also required for those in b?)**

**(b and c would, I think, ensure that the least attractive goats would move on.)**

2. **requires all persons with the CF10 and CF11 controlled functions to provide a list of those persons to whom they report and provides a guidance note that:**
  - a) **makes it clear even for those compliance officers who have suffered a frontal lobotomy at the hands of a CEO that they personally have to provide a proper list – and will be personally liable to discipline if there are errors**
  - b) **expressly states that the FSA requires the list to include anybody who has told a compliance officer not to pursue an investigation or that funds will not be available for a project or investigation.**

**On the basis of this, I would have thought that the FSA could send out Form As for completion for the identified shadow directors and ask for their prompt return. This will focus minds wonderfully.**

**Please forgive me if I am suggesting things that you have already considered, but I can see a number of very objectionable goats back in the herd if you do not put something in place.**

Many of your concerns are addressed by questions contained within the new firm and individuals application form, which we will publish in the autumn for this constituency.

The first part of the form that addresses some of your concerns is the section on fitness and propriety. For example, the firm application form requires the firm to disclose whether they have ever been refused, or had revoked, any licence, membership, authorisation, registration or any other permission granted by a financial services regulator in the UK or overseas. The individuals form requires the applicant to provide similar regulatory information and declare whether they are aware of any business interests, employment obligations, or any other situations that may conflict with the performance of the control functions for which approval is sought.

In addition to the questions on fitness and propriety the application asks a specific question relating to IMD requirements for firms to establish on reasonable grounds that:

All persons in its management structure and any staff directly involved in their insurance activity are of good repute.

A reasonable proportion of persons within their management structure who are responsible for, and all other persons directly involved in, its insurance activity, demonstrate the knowledge and ability necessary to perform their duties.

We are also required to understand who owns the firm applying for authorisation and what relationship the firm has with other individuals and entities. To understand the ownership of the

firm we ask the firm to declare who the ultimate beneficial owners of the firm are, i.e. who controls the firm. To understand what relationships the firm has with other individuals and entities, its 'close links', the firm has to declare the name and relationship of each close link and for firms with a significant number of close links a structure chart will need to be supplied.

To further reinforce the importance of the firm's close links the firm has to declare whether they are aware of any information to suggest that the close links are likely to prevent our effective supervision of the firm.

In addition to the information supplied on the application form we have access to current and previous regulatory information via a shared intelligence service. Subscribers to this service include self-regulatory organisations and statutory bodies.

Once approved an approved person must abide by the Code of Practice for Approved Persons which sets out the Statements of Principle. The code sets out descriptions of conduct which, in the FSA's opinion, do not comply with the relevant Statements of Principle. The code also sets out certain factors which, in the opinion of the FSA, are to be taken into account in determining whether an approved person's conduct complies with a particular Statement of Principle.

For example Statement of Principle 4 states that an *approved person* must deal with the FSA and with other regulators in an open and co-operative way and must disclose appropriately any information of which the FSA would reasonably expect notice.

Our authorisation process aims to prevent those individuals and firms who are not fit and proper from carrying on regulated business. However, we have to balance the costs of providing and analysing information against the occurrence of the risks that you highlight in your question. If the FSA were to be inefficient or excessive in its data collection, the cost of authorisation would be driven upwards – so restricting competition by discouraging smaller firms from applying. We believe that our disclosure requirements and intelligence checks strike an appropriate balance.

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### **No name supplied**

**One of the FSA's statutory objectives is the protection of consumers by the provision of accurate information.**

**On 16th July 2001 Equitable Life announced that, following a financial review, policy values had been cut by 16%. The directors' explanation of this cut was confusing and Equitable Members' Action Group asked Equitable Life to publish the financial review or a summary of it. The Directors refused. EMAG asked the FSA to require publication. The FSA took no action.**

**Over the last 2 years EMAG has discovered various matters, which we have no doubt were included in the financial review. For example:**

- **The fact that the Equitable's non-profit business had absorbed almost all the Society's investment return for 2000 (and had made a big dent in the returns for previous years)**

- **The fact that more than three-quarters of the Society's policies contained the right to a Guaranteed Interest Rate, which means it could not operate properly as a with-profit fund.**
- **The fact that the Regulator was informed of Guaranteed Annuity Rate liabilities of £1.6 billion two years before that information was provided to policyholders.**
- **The fact that assets fell short of policy values at 31/12/00 by at least 10% and probably nearer 13%**
- **The fact that Equitable had repeatedly voted bonuses in excess of assets from 1994 to 1999 of the order of £1-2 billion pounds.**

**The FSA recommended the Directors' compromise proposals without the proper disclosure of these facts. Is this an example of how the FSA protects consumers?**

The FSA published a statement explaining that we had considered whether, for each relevant group of policyholders, the proposed Compromise offered a fair exchange for the rights and potential claims that policyholders were being asked to give up. The FSA was content that it did and that the Compromise did not give disproportionately greater benefits or disbenefits to some groups of policyholders. That statement was accompanied by a detailed explanation of the FSA's analysis which was published on our website. None of the issues mentioned in point 1 or points 3 to 5 (to the extent that the statements are true) was relevant to that analysis because policy values had been realigned with assets before the Compromise scheme. Such information would therefore have been out of date and unlikely to have been of assistance to policyholders. The financial position of Equitable Life was explained in the documents issued to policyholders. As for point 2, the fact that many policies included a guaranteed interest rate, this and all other information that we considered to be relevant to the Compromise, was disclosed in the Compromise documents.

More detail on the issue of availability of information to policyholders in general can be found in the response [below](#).

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### **No name supplied**

**I'm a locked in annuitant with Equitable Life and I want to take the FSA to task for not protecting me and 50,000 other with profits annuitants in the compromise that was voted on in January 2001.**

**We had been told that annuitants would have their cuts smoothed over many years and it was on that assurance I voted. The FSA now says it didn't endorse the compromise. RUBBISH!**

**Locked-in annuitants are unique: Unlike late-joiners (who have recently been judged by the FOS as deserving compensation) WE never had the opportunity to leave to preserve our rights.**

**What's more, the land of milk and honey held out to us, with the FSA's tacit endorsement, hasn't materialised. In fact I've recently suffered a 30% reduction in my pension because Equitable welched on their undertaking to smooth our cuts, again with the approval of the FSA.**

**The FSA were WRONG to endorse the compromise and were wrong, in my opinion, to conclude, that us annuitants were not unique. They led us into a trap. This is not my, or 50,000 other annuitants idea of protecting policyholders. The FSA has blood on its hands.**

In addition to the FSA's assessment of the Compromise, the proposals were scrutinised by an independent actuary and, after the vote by policyholders, the Compromise was endorsed by the court, which had the benefit of representations made at the sanction hearing by many policyholders, including a number of with-profits annuitants. The judge gave a detailed explanation of his reasons for approving the Compromise.

As for the cuts in annuity payments, with-profits policies normally have a guaranteed minimum amount that will be paid out, but the insurer may often add bonuses to increase the amount actually paid. The amount of these bonuses, which are not guaranteed, depends largely on investment performance. In common with many firms running with-profits funds, Equitable Life has reduced the amount of these non-guaranteed bonuses on all policies, including with-profits annuities, to keep policy values aligned to the value of the with-profits fund. Due to the way financial markets have performed, these cuts – the need for which could not have been reasonably anticipated at the time – would have been necessary whether or not the Compromise had gone ahead.

**No name supplied:**

**Does the FSA believe that the maintenance of confidence in the financial system relies on the public perception that investors are properly protected?**

**The Ombudsman's report on 'light touch' regulation exonerated the FSA, incidentally it was FAR less critical than the FSA's own internal Baird report, but must actually have been COUNTER-PRODUCTIVE to confidence. Dr Vincent Cable MP summed it up well when he described to Jeremy Paxman the effect of the PO's report:**

**"The wider issue you raise is this. Occupational schemes are falling all over the place. People are going to have to save for themselves. They now know that they cannot rely on the regulator either to ensure that companies are soundly managed or that they can be protected from mis-selling. This severely undermines confidence in future savings."**

**Was not, therefore, the report of the Parliamentary Ombudsman actually counter-productive to confidence?**

The FSA welcomes the debate that has been promoted by the Parliamentary Ombudsman's report on our regulation of Equitable Life. We consider that overall confidence will be improved if the public have a better understanding of the risks involved in financial markets and information about how to protect themselves against those risks.

It is not possible, or even desirable for regulators to seek to guarantee the survival or prosperity of all financial firms. Banks and insurers, in particular, are in the business of taking risk: that is their economic function and their social value. And risk brings with it the possibility of failure. A reasonable aim for the FSA is to reduce the incidence of firm failure and market disruption, through its prudential supervision in particular, to the minimum compatible with open and dynamic markets. It is because we accept that failures are not completely avoidable that we have the compensation scheme which provides a degree of protection to consumers where failures occur.

The question also comments on the lack of consumer confidence because of mis-selling problems. As the Chairman said in the remarks to the Public Meeting, though the [pensions mis-selling](#) debacle – costing the industry over £11 billion in compensation - should have been a stark lesson of the dangers of uncontrolled and unsuitable selling, it is hard to find evidence that that lesson has been learnt.

In addition to the ordinary protections that the consumer has under the law, FSA rules require firms to have arrangements for investigating complaints from consumers in a timely fashion. Consumers also have the right of recourse, at no cost to them, to the Financial Ombudsman Service if they are dissatisfied with a firm's response to a complaint.

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**No name supplied:**

**Standard Life and Equitable demonstrate the intrinsic weakness and unaccountability of mutuals. The FSA parrots a mantra that they are subject to democratic control. PIFFLE. In practise it is TOTALLY impossible for the member owners, however well they organise, to exercise any influence over self-serving, self-perpetuating boards of cronies. In the last three troubled years of Standard Life and Equitable, never more than 10% of votes have been exercised and the boards have gone their own way WITH DISASTROUS CONSEQUENCES. When will the FSA address the governance of mutuals instead of hiding behind the pretence that they are democratic?**

The legislation governing the constitution of mutual insurance companies is not within the FSA's remit. Companies legislation is a matter for the Department of Trade and Industry. The members of mutual firms also have an important role to play in holding their boards to account.

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**No name supplied:**

**Can we have a commitment from the FSA's new chairman that he will set about, as a matter of urgency, 'cleaning house' at the FSA on pensions and insurance? At present, policyholders seem to be reliant on chance questioning by the Treasury Select Committee to reveal cover-ups.**

**There appears to be NO accountability. Therefore, will the FSA volunteer in the November 2003 Treasury review to agree to formalise channels of accountability and the spinning off of responsibility for "conduct of business", which is in systemic conflict with policyholder protection as pointed out by the Consumers' Association.**

The report of the investigation commissioned by the FSA Board into its regulation of Equitable Life ("the Baird report") made recommendations about how the regulation of insurance could be improved. In the light of those recommendations, the FSA established the Tiner Review to take forward the issues raised. The FSA is now working on the implementation of its recommendations. We specifically reject the suggestion that our responsibilities should be split – the FSA firmly believes that the patchwork of regulators that existed before the FSA did not serve the interests of consumers well (as the Baird report indicated).

The basis on which the FSA's independence and accountability are secured in practice is set out in an exchange of letters between the Chancellor of the Exchequer and the Chairman of the FSA. These were published in December 2001 and set out what the Government is responsible for under FSMA, namely:

- the legal and institutional framework within which regulation is carried out, including the core corporate governance structure of the FSA;
- appointing the executive and non-executive members of the FSA Board, and judging their overall performance in relation to the FSA's statutory responsibilities;
- ensuring the boundaries of FSA regulation are correct – the Government and Parliament therefore decide the FSA's scope;
- directing the FSA on additional matters to be included in its public Annual Report;
- mounting investigations in cases of possible major regulatory failure, and also to assess value for money;
- directing implementation of international obligations.

The FSA's accountability to the Treasury is balanced by a legislative framework which ensures that it is open and responsive in its policies and reporting to other stakeholders, and that its procedures are seen to be fair and independent. Specifically, the FSA is accountable in the following ways:

**Statutory objectives.** The statutory objectives provide the FSA with a clear goal and describe the overall purpose of the regulatory system and the way in which Parliament expects it to operate in practice. The FSA has set out in "A new regulator for the new millennium" (January 2000) how it intends to meet these objectives in its work. This can be found elsewhere on our website at [www.fsa.gov.uk/pubs/policy/index-2000.html](http://www.fsa.gov.uk/pubs/policy/index-2000.html).

**Clear governance structures.** FSMA requires the FSA to have regard to applicable principles of good corporate governance, and a statement on these is included in the FSA's annual report under the Companies Acts. FSMA gives specific responsibilities to the FSA's non-executive directors – such as reviewing the economic and efficient use of the FSA's resources and setting the pay of executive Board members. The non-executive committee reports annually to the Treasury on the discharge of its functions. This is included in the FSA's published Annual Report.

**Public reporting mechanisms.** The FSA reports annually to the Treasury on the discharge of its functions and the extent to which it has met the statutory objectives and taken into account the principles of good regulation. The report is laid before Parliament. The FSA holds an annual open public meeting for its stakeholders to discuss the report and the FSA's performance. This is advertised in the national press and a wide range of stakeholders – firms, trade associations, consumers – attend.

**Service Standards.** FSMA sets out a number of explicit standards that the FSA must meet in carrying out its duties – for example, time periods within which it must take certain decisions. Now that FSMA has been in force for just over a year, the FSA has gained some experience of how the legislation works in practice. So it has published a framework of service standards in its recent Plan and Budget. In developing the framework the FSA has set itself a number of targets and will begin publishing performance against these at the time of its Annual Report later this year. The FSA

will also develop other standards to cover further aspects of its work. These will be published at the same time as our Annual Report.

**Direct input by the industry and consumers.** The FSA is required to consult publicly on proposed rules and regulatory guidance before issuing them. The consultation must explain how the proposed rules and guidance will meet the statutory objectives and will be consistent with the principles of good regulation and must include a cost benefit analysis. The FSA publishes feedback statements following consultation. FSMA requires the FSA to establish mechanisms for consulting practitioners and consumers directly on whether the FSA is meeting its objectives – including statutory Practitioner and Consumer Panels. We have also established, voluntarily, a Small Business Practitioner Panel. The statutory Panels make annual reports (to which we respond publicly in our Annual Report) and appear before the Treasury Select Committee of the House of Commons. The Panels also have the right to require us to respond in public to their views or requests.

**Public access to the FSA.** Members of the public have access to the FSA through its Consumer Helpline and Consumer Help website. The Helpline handles around 205,000 calls a year and the Consumer Help website attracts up to 8,000 users a week. In addition, consumers have access to the FSA through their MPs. The FSA receives on average 60 letters a month from MPs on behalf of their constituents.

**Independent review of the FSA's rules and decisions.** As well as the normal safeguard of judicial review, the FSA's rules and practices are subject to independent competition scrutiny by the OFT and the Competition Commission.

As required by FSMA, the FSA's internal procedures also ensure that a decision on a case is not taken by the FSA staff who conduct the investigation. The Regulatory Decisions Committee, which is made up of recently retired practitioners and individuals representing the public interest, is responsible for the FSA's more fundamental enforcement decisions (e.g. disciplinary cases and cancellation of a firm's authorisation).

Individual decisions on enforcement and authorisation cases can be considered afresh by the Financial Services and Markets Tribunal if the firm or individual involved chooses to refer the case to it. The Tribunal is set up under FSMA and run by the Lord Chancellor's Department.

**Independent investigation of complaints.** The FSA has made arrangements, as required by FSMA, for investigating complaints against it. Complaints may be made by anyone directly affected by the FSA's actions or inactions - that is, regulated firms, individual employees of firms, listed companies, consumers etc. As part of these arrangements, the FSA has appointed an independent Complaints Commissioner. The Commissioner's role is to investigate complaints and report to the complainant and the FSA. She can publish this and require the FSA to publish the whole or part of its response. She can also recommend that the FSA make a compensatory payment to a complainant. Our Board will decide whether to make any such payments. If the FSA disagrees with a recommendation it must publish its reasons for doing so. A report from the Commissioner is included in the FSA's Annual Report.

**Accountability to Parliament, including through the Treasury** – the Treasury Select Committee holds formal hearings with the FSA on the Report. The Committee will typically hold several sessions with FSA during the year across a range of issues. During last year, for example, the FSA appeared in front of the Committee or the sub-Committee on five occasions. We welcome these opportunities to explain our work and policies.

In order to explain our actions to Parliament more widely, we also hold regular meetings and briefings with: All Party Parliamentary Groups - in particular, the Insurance and Financial Services Group and the Building Societies and Mutuals Group; Backbench groups from the three main parties; and Opposition Spokesmen.

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**No name supplied:**

**The Ombudsman's report said that the FSA was 99.9% certain that Equitable Life would be sold in the autumn of 2000. The FSA had been very extensively briefed by the Treasury in 1998, had kept Equitable on watch from its own inception, had the full regulatory returns and private reports which gave it a comprehensive picture. How could the FSA reach that demonstrably wildly inept conclusion, when on the basis of only a limited puffed sales prospectus 16 competitors walked away within three months and wouldn't touch Equitable. This demonstrates the absurd naivety within the FSA on what is arguably a commercial judgement that the FSA should not have even been entertaining. Their job, under "conduct of business" was to protect new investors.**

The reports into our regulation of Equitable Life have made it plain that there was every indication that a sale of the business would be possible, and that serious negotiations between Equitable Life and potential purchasers continued until late in 2000. In the light of the facts, we do not consider our conclusion was "demonstrably, wildly inept". The Parliamentary Ombudsman appears to have agreed with our view.

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**No name supplied:**

**On page 14 of the FSA's annual report is written:**

**"Consumers need to have better and timely access to impartial and accurate information to help them in their financial decisions."**

**Hear, hear!**

**But when does it begin? For Equitable Life policyholders that is a hollow laugh. The FSA has never supported EMAG's pursuit of more comprehensive and timely information to be provided to IFAs and the member/owners.**

The FSA works hard to ensure that policyholders have the information that they need about their policies to be able take informed decisions. We are also pursuing a number of policy initiatives to improve the quality of information that is made available, see for example our Consultation Paper 170, *Informing Consumers: product disclosure at the point of sale*. In some cases consumers seek information, such as unaudited financial information, that may be commercially sensitive or that may not be reasonable for them to have.

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**No name supplied:**

**I have the misfortune to be an Equitable Life with-profits annuitant and I have been worried sick about my pension every day for the last two years. My income has just gone down, not by 20% but by 29% and I understand that there are definitely more cuts to come.**

**My question is:**

**EXACTLY what has the FSA EVER done to protect Equitable Life policyholders?**

**Because, frankly, I'm more and inclined to agree with what Broadcaster Libby Purves wrote in the Times two years ago about the FSA's regulation of Equitable Life, and I quote: "Am I alone in wondering whether it might not be more effective to replace Sir Howard Davies's Financial Services Authority with a lucky rabbit's foot and a bunch of white heather? Or perhaps a chocolate teapot?"**

**I repeat: What, exactly, has the FSA ever done to protect Equitable Life policyholders?"**

Much of the FSA's work to protect policyholders must, for legal reasons, remain confidential. However, the recently published Parliamentary Ombudsman's report and the FSA's own Baird report in 2001 into our regulation of Equitable Life give many examples of ways we work to protect policyholders. The FSA acts to ensure that Equitable Life has acted in accordance with relevant regulatory requirements. If it appeared to us that it was in danger of not doing so, we would take the steps that we consider appropriate to make them comply. We have tested the decisions that have been taken by the Equitable Life's board so that we can be satisfied that they are taken with due regard to consumer interests. We have also brought pressure on Equitable Life, where necessary, to make appropriate disclosures of information to policyholders and to ensure that they deliver acceptable standards of service, both for dealing with routine enquiries and for carrying out structured business reviews.

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