

Financial Services Consumer
Panel response to:
Consultation Paper 30:
*The FSA's regulation of
professional firms*

Regulation of professional firms

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Contents

Introduction	3
Summary of recommendations	3
General Comments	5
Detailed comments	6
Chapter 2: Basics of the regime	6
Chapter 3 Authorisation regime	9
Chapter 4 Approved Persons	10
Chapter 5 Financial Regulation	10
Chapter 6 Professional Indemnity Insurance	11
Chapter 7 Conduct of Business	11
Chapter 8 Training and competence	12
Chapter 9 Compensation arrangements	12
Chapter 11 Supervision and Enforcement	13
Chapter 12 Complaints	13
About the Financial Services Consumer Panel	14
Who is on the Panel?	14
How to contact the Panel	16

Introduction

This paper is the response of the Financial Services Consumer Panel ('the Panel') to the Financial Services Authority (FSA) Consultation Paper 30, '*The FSA's regulation of professional firms*'. The FSA established the Panel to advise the FSA Board on the interests and concerns of consumers and to report on the FSA's effectiveness in meeting its consumer protection and public awareness statutory objectives.

Summary of recommendations

- a. The Panel is concerned that the document will be impenetrable to consumers and their representatives. Little effort is made to explain to laymen the difficult concepts and issues it addresses.
- b. The FSA has not made clear the core principles which have guided it in the formulation of its policies. In particular, the paper does not give a strong sense that the FSA has sought to ensure a level playing field between professional firms and other financial advisers.
- c. The Panel strongly encourages the FSA to apply the same measures for investor protection (both Conduct of Business regulation and Prudential controls) to all authorised business conducted by professional firms. It is particularly undesirable for the FSA to take a different approach to 'non-mainstream' business conducted by authorised professional firms. The Panel looks to the FSA to establish as simple and consistent an approach as possible.
- d. The Panel welcomes the proposals to include 'non-mainstream' business in the scope of the Financial Ombudsman Service, but expresses some reservations about the proposal to accept some professional bodies' redress arrangements as an alternative to participation in the Financial Services and Markets Compensation Scheme.

- e. The FSA must take measures to clarify the boundary between business which requires authorisation and that which is excluded or exempt, for the benefit of both firms and consumers.

General Comments

1. We have two main comments to make in relation to the paper as a whole.
2. First, the impenetrability of the document for consumers and their representatives concerns us. It does not identify, and does not appear to be written for, its different audiences. For consumers in particular, the concepts contained within the paper are difficult and little effort appears to have been made to ensure that they are communicated in a way which is accessible to non-practitioners. The glossary, for example, gives only the expansion of each acronym, with no explanation of the entities or concepts they denote.
3. This is consistent with a general, and unwelcome, trend which we have noted in FSA consultation papers. The FSA should therefore consider setting up internal processes for reviewing public consultative documents to ensure clarity of drafting and accessibility for all FSA stakeholders.
4. Second, it is not clear to us what are the core principles which have guided the FSA in its formulation of these proposed policies. We acknowledge the difficulty faced by the FSA in that having to work on a rather provisional basis within an overall framework established by the Government; but the FSA has not articulated the guiding principles it has applied in planning its policies in the light of the Government's proposals. We would have expected these principles to be clearly explained from the outset, and to act as the benchmarks against which the FSA's proposals could be assessed.
5. The FSA's proposed statutory objectives and considerations are mentioned, but the text does not then explain how these are met through the proposals advanced. The FSA appears to have devised a set of administrative arrangements for handling the influx of an indeterminate number of professional firms in a vacuum, without a sense that its proposals are directed towards a common purpose.

6. In particular, we would have expected one guiding principle to be that the FSA would ensure a level playing field in terms of the investor protection measures established in respect of these firms. In contrast, however, we find that there is no strong sense in this document of what these proposals actually mean for consumers.
7. We would also have expected the paper generally to identify more clearly the various industry-focused and consumer-focused issues. Instead, the 'one purpose' explicitly identified in the paper is the need to indicate to firms how FSA intends to fulfil its responsibilities: there is no parallel 'purpose' recognised in relation to consumers.
8. Lastly, we acknowledge that it can be difficult to identify and cost consumer benefits, but it seems that no attempt has been made in this document to identify benefits and costs – particularly if things go wrong - to consumers. Our particular concern is that for those who deal with firms outside the perimeter, the costs will ultimately fall on those individuals rather than on the system as a whole. The FSA should make clear to customers and potential customers how they can ensure that the firm they are dealing with is authorised for the business it is conducting, or whether relevant exemptions apply.

Detailed comments

9. Our detailed comments and responses to questions asked in the Consultation Paper follow the format of the paper, although not all chapters or questions have given rise to comments.

Chapter 2: Basics of the regime

10. **Para 2.12(b):** how does the FSA propose to enforce rules directed at firms it does not regulate? How will compliance be monitored effectively?
11. **Question 2.1:** the secondary legislation to the Bill should make clear what is and what is not an activity requiring authorisation. If an activity does

require authorisation, this is presumably because it involves some risk to consumers and deserves regulatory control. We do not, therefore, understand the arguments in favour of designing a special regulatory regime for certain types of business only when transacted by professional firms.

12. Conduct of business regulation is designed to give necessary protections to individual customers of firms in the context of the risks associated with the business being done. The risk associated with a particular activity will surely be the same whether the business is conducted by a professional firm or an IFA. We have not seen any powerful arguments which could justify a dilution of regulatory protections for customers of professional firms simply because the investment business is transacted alongside or incidental to those firms' main activities. The FSA's existing risk-based regime should be capable of applying appropriate regulatory measures to any firms carrying on investment business falling within the FSA's category of 'non-mainstream'.
13. We think it particularly undesirable for the FSA to take a different regulatory approach to non-mainstream business conducted by an authorised firm. It is not reasonable, in our view, to suggest that an authorised person could conduct 'non-mainstream' activities without that part of their business being subject to the full range of regulatory measures. A consumer dealing with an authorised firm will expect the full range of regulatory protections to be provided in respect of all the investment business transacted through that firm.
14. From our point of view, therefore, the distinction the FSA proposes to draw between mainstream and non-mainstream business when conducted by authorised firms is not a helpful one, and not easily understood. This is not intended to be an comment on the overall framework for authorisation of professional firms proposed by the Government; but reflects our belief that the 'perimeter' of authorisation is already difficult enough to define clearly without the FSA's adding a further layer of complexity.

Notwithstanding the examples given, it remains extremely unclear from this paper how regulated 'non-mainstream' activities will be defined and delimited in practice, particularly in the context of a firm delivering 'mainstream' services as well; and as such we do not think that the FSA will be able to satisfy itself that it is delivering adequate consumer protection.

15. Consumers will not readily understand what level of protection they may expect to be delivered, particularly if the proposal to institute a 'light touch' regime is instituted. They want to know simply whether particular activities are regulated by the FSA, and will not expect, nor understand, that FSA's regulatory activity will be different if they are dealing with an authorised accountant as opposed to an IFA.
16. It is essential that both firms and consumers understand fully whether or not the business they are transacting falls within the regulatory regime. For example, where is it expected that alarm bells will ring as the perimeter is approached: at the firm? At FSA? Or is the consumer expected to understand when the service they receive benefits from regulatory protections and when it does not? The latter is unrealistic, especially if the firm itself has difficulty understanding the boundaries.
17. The FSA must therefore do more to clarify the boundary, for the sake of both firms and consumers, since the lack of certainty is, in our view, a significant problem. The FSA must also take steps to ensure that consumers can identify straightforwardly which firms and what activities are within and outside the statutory scope of regulation. FSA will need to give very clear guidance on where they consider the boundaries to lie.
18. This would, in our view, obviate the need for the FSA's proposed mainstream/non-mainstream distinction: if firms are confident about whether or not their business should be authorised, there will be no need for the FSA to create a non-mainstream 'ghetto' for firms which (it would appear) have sought authorisation without a real need for regulation. It

would also help consumers understand where the legal boundaries lie. This might be achieved by a variety of measures: for example, guidance to firms; consumer education; and/or information on the Public Register. The professional bodies may also have a role to play in this work.

19. It is also unclear to what extent the FSA expects firms to re-structure themselves to cope with the legal and administrative boundaries operating under the new regime. Firms structure themselves to respond to customers' business needs, and those needs can change through the duration of their relationship with a firm, weaving in and out of the scope of both statutory regulation and any administrative boundaries established by FSA. It is not difficult to imagine a scenario where a customer used to dealing with a firm on mainstream business finds that they have a need which would be considered 'non-mainstream'. How is the firm expected to make clear the implications of this to its customer and the consequences in terms of consumer protection?

Chapter 3 Authorisation regime

20. **Question 3.1:** the FSA needs to be more specific about the monitoring activities it plans to undertake during the initial post-grandfathering period.
21. It is particularly undesirable for any firm to be engaging even on an occasional basis in business which it is not fully competent to conduct. The FSA will need to look closely at the competence of firms which may have benefited from unusually broad authorisation status under the RPB regime (see paragraph **3.18**).
22. We realise that the framework which will establish which firms are to be 'grandfathered' into FSA authorisation will derive from the Financial Services and Markets Act itself, and as such is a matter for the Government and Parliament, rather than the FSA. We understand the difficulties faced by the FSA in having to devise a regulatory approach for these firms without full clarity as to the statutory framework within which they will eventually have to operate. But whatever regulatory measures

are introduced in the light of this consultation, they must deliver transparency and certainty for the consumer.

23. We repeat our call to the FSA that enforcement action it takes in respect of any firm should be published on the Public Register.

Chapter 4 Approved Persons

24. We have already commented extensively on the FSA's proposals in respect of the Approved Persons regime: we consider that our comments in that response are equally relevant to the proposals made here.

Chapter 5 Financial Regulation

25. Again, we consider that the guiding principle here is that there should be a level playing field between these and other comparable authorised firms. We do not believe that adequate arguments have been made to justify any special treatment for former RPB authorised firms. We would expect the FSA to apply comparable requirements to these as to other non-ISD firms. In particular, any firm holding Client Money must have sufficient resources to meet its liabilities.

26. Consumers have, in the past, been extremely critical of the RPB regulatory regime. It would be most damaging to the FSA's credibility to be seen to be providing lower levels of consumer protection through their regulation of this group of firms.

27. We do not feel that there are adequate arguments made to support the proposal for a differentiated regime that appears to be made in paragraph **5.16**. We believe that there are compelling arguments in favour of applying the same requirements as will be applied to former PIA-authorised firms. This would, for example, help to address the question described in paragraph **5.19** – how does the PIA deal with the question of net personal assets?

28. We are puzzled by the proposals set out in paragraphs **5.21 – 5.23**. Article 2.2(c) of the ISD deals with, broadly speaking, business which will fall outside the scope of regulation by virtue of the exemption to regulatory activities. It is not clear to us what activities are capable of not being caught by the exemption, but still benefit from Article 2.2(c) ISD.

Chapter 6 Professional Indemnity Insurance

29. **Paragraphs 6.1-6.3** collapse into three compressed paragraphs what is evidently a difficult issue given that professional firms require PI cover for their non-investment business. But if the proposal is that FSA will ensure that PI cover for mainstream and non-mainstream business will be equivalent in all respects to that required of non-professional authorised persons, it is acceptable. Otherwise, a full discussion of the issues is required.

Chapter 7 Conduct of Business

30. If a firm is doing investment business, then (as we have observed above) the FSA's risk-based approach to monitoring the activities of that business should be capable of applying an appropriate level of regulation. The FSA appears to be arguing in favour of a differentiated regime simply because that is what the firms are used to. Surely the arguments should be centred on determining what requirements are needed to provide an appropriate level of investor protection: and within this principle, FSA should work to establish a level playing field in the interests of consumer certainty.
31. It is not possible for us to comment on whether or not the solicitors accounts rules would be an adequate substitute for those of the FSA. A much more detailed analysis would be required, which is lacking in this paper. We do not find the statement that 'the basic elements of accounts rules of the law societies are similar to those generally required by other investment business regulators' reassuring. The principle should be that

alternative rules provide at least the same levels of investor protection, if not more.

Chapter 8 Training and competence

32. **Question 8.1:** the Panel considers that while it may be inconvenient for former RPB-regulated practitioners to sit an examination, it should not be onerous for them to have to do so. If their levels of competence are genuinely on a par with those of other practitioners in the industry, then it should be a simple matter for them to certify that fact through examination. The FSA must do all that is necessary to satisfy itself that these practitioners are at least as well qualified as others in the industry to provide investment advice.
33. In the longer run, FSA should apply the same training and competence requirements to all firms, including professional firms; this is particularly important in relation to the sale of investment packaged products.

Chapter 9 Compensation arrangements

34. **Question 9.1:** the issue for consumers is that redress should be available; it is less significant to them how that is funded.
35. **Questions 9.2 and 9.3:** the FSA must satisfy itself on all the grounds mentioned that any alternative redress arrangements are provided on terms at least as generous as those provided through the FSA's own regime. As to whether firms of solicitors should be required to participate in the Financial Services and Markets Compensation Scheme (FSMCS) even though their own arrangements are deemed equivalent, this would seem onerous, given our comments in paragraph 30 above. However, it is hard for us to imagine circumstances when the solicitors' schemes will truly parallel the arrangements which are envisaged for the FSMCS. As far as we understand matters, the solicitors' schemes operate effectively as 'captive' indemnity insurers; as such, their responsibility is in part to ensure that claims are minimised, in the interests of all their contributors.

It may not be feasible for them to assess claims according to the same principles as those applied by the FSMCS.

Chapter 11 Supervision and Enforcement

36. The issue of professional misconduct may not be – or ought not to be – so casually dismissed as is the case in paragraph **11.14**. The borderline between misconduct and negligence (and between them and incompetence) is not crystal clear. The FSA potentially has a much greater interest in misdeeds involving investment business, including that business which may be part of a wider set of transactions, than is tentatively indicated in the paper.

Chapter 12 Complaints

37. We welcome the proposal to include non-mainstream business in the scope of the Financial Ombudsman Scheme. However, there will certainly need to be formalised agreements between the Financial Services Ombudsman (FSO) and the professional complaints bodies to ensure that complaints involving financial services are properly and speedily directed to the FSO. The public is accustomed to complaining to the professional body where a professional is involved: transparency of, and publicity for, the revised arrangements will be needed.

About the Financial Services Consumer Panel

The Financial Services Consumer Panel was established by the Financial Services Authority (FSA) to advise the FSA Board on the interests and concerns of consumers and to report on the FSA's effectiveness in meeting its consumer protection and public awareness statutory objectives. There are eleven members of the Panel representing a broad range of consumer interests. The Panel is independent of the FSA – it can raise its own concerns, initiate its own research and publish its own reports.

Who is on the Panel?

Barbara Saunders (Chairman)

Barbara is a public interest member of the PIA Board. She is an independent consumer consultant and past Chairman of the Council of the Insurance Ombudsman Bureau. Among other public and professional appointments she is a Non-Executive Director of the St Albans and Hemel Hempstead NHS Trust and a member of the Architects Registration Board.

Colin Brown (Vice Chairman)

Colin is an independent consultant specialising in consumer affairs. Previously Deputy Director of Research at Consumers' Association and Senior Fellow at the Policy Studies Institute, he has over 20 years' experience of social and consumer research.

Jean Gaffin

Jean is Chairman of the Advisory Committee on Telecommunications for Disabled and Elderly People that provides advice to the telecommunications regulator, OFTEL, and a Non-Executive Director of Harrow & Hillingdon Healthcare NHS Trust. She has extensive experience of working on behalf of vulnerable consumers. Previous positions include: the Executive Director of the National Council for Hospice and Palliative Care Services and Chief Executive of Arthritis Care.

Yvonne Gallacher

Yvonne is Chief Executive of Money Advice Scotland, which was set up by the Scottish Consumer Council. She has over 10 years experience of consumer credit/money advice issues and of working with vulnerable consumers in a variety of roles, including debt counsellor, trainer and manager. She is Co-Director and Secretary of the Government funded Lead Body for Advice, Guidance, Counselling & Psychotherapy (CAMPAG). Yvonne is a member of the Scottish Consumer Council.

Joan Harbison

Joan is Chief Commissioner of the Equality Commission for Northern Ireland. She has been Chair of the Commission for Racial Equality for Northern Ireland since its inception in 1997 and is a former Chairman and member of the Executive Committee of the Northern Ireland Association of Citizens' Advice Bureaux. She has held a number of public appointments including being Vice Chairman of the Eastern Health and Social Services Board and the Northern Ireland Standing Advisory Commission on Human Rights and former member of the Human Fertilisation and Embryology Authority.

Noel Hunter

Noel is County Trading Standards Officer for Warwickshire. A National Council member of the National Consumer Council, he also chairs the Management Board of the Institute of Trading Standards Administration and is an adviser to the Local Government Association.

Gerald Lanchin

Gerry is a Vice President of the National Federation of Consumer Groups. He is a former Under Secretary of the Consumer Affairs Division of the Department of Trade and Industry and author of "Government and the Consumer". His involvement in consumer protection includes being a former Council Member of Consumers' Association and of Consumer Congress Committee. He was the first chairman of the Direct Mail Services Standards Board and a member of the Data Protection Tribunal for 10 years.

Nick Pearson

Nick is the National Money Advice Co-ordinator for the Federation of Independent Advice Centres. A career spent in advice organisations including the National Association of Citizens' Advice Bureaux where he was manager of the Money Advice Support Unit, he has particular experience of credit, debt and personal finance issues and of working with vulnerable consumers.

Richard Smethurst

Richard is Provost of Worcester College, Oxford University; he chairs the Training Standards Panel of IMRO, of which he is a non-executive Director. He has served as an economic adviser in Whitehall, and the Monopolies and Mergers Commission, where he was Deputy Chairman. Richard lectures widely on financial and economic topics to businessmen and adult education groups. He is President of the National Institute of Adult Continuing Education.

Jane Vass

Jane is an independent consumer researcher specialising in financial services. She was previously Head of the Financial and Economic Research Group at Consumers' Association and is still author and editor of a number of Consumers' Association publications in addition to other research, including work for the National Consumer Council. Her current committee memberships include: Council of the Ombudsman for Estate Agents, the Inland Revenue Tax Law Rewrite Project Consultative Committee, the PIA Training Advisory Group and the FSA Training Advisory Panel.

Dave Watts

Dave is a partner in a media business which is involved in publishing, editing and journalism - personal finance plays a large part in this. He is a former editor of "Which?" and "Money Which?" and former Assistant Director of Consumers' Association. He was also a policyholder representative on the Insurance Brokers Registration Council for nine years.

How to contact the Panel

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