

# **Practitioner Panel**

**Fifth Survey of the FSA's regulatory performance**

**Executive summary**

**December 2008**

**Prepared for the Financial Services Practitioner Panel by BMRB**



# **Fifth Survey of the FSA's Regulatory Performance**

**Prepared for: The Financial Services Practitioner Panel**

**December 2008**

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## **Acknowledgements**

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## Chairman's Foreword

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### The Panel's perspective

Now, more than ever, the financial and regulatory environment is a fast moving one. Therefore, there was never a perfect moment to undertake our biennial survey. We began the survey in the Spring of 2008, shortly after the FSA published its 'lessons learned' review of Northern Rock. Most of the questionnaires were completed in the Summer, with some received just after the collapse of Lehman Brothers; however, the responses were received prior to the UK Government's bank stabilisation and recapitalisation plan in October.

The survey is only ever a snapshot that captures firms' views within a relatively narrow timeframe. It is, nonetheless, an important barometer of how firms are feeling and, in particular, how they rate the FSA's performance across its range of functions.

This year, 46% of firms surveyed took the time and trouble to complete and return the questionnaire to us; this represents an increase from a 40% response rate in 2006. This is a much better than the usual response to a survey of this type, for which I would like to express the Panel's sincere gratitude. I am conscious that these are testing times for the industry, making such a willingness to participate in this piece of work all the more appreciated. It gives the findings, and therefore the representations the Panel might make to the FSA as a result of it, a high degree of authority and credibility.

BMRB was appointed to conduct the research on the Panel's behalf. The Panel was committed to producing a report and conclusions that were objective, tangible and constructive – thus providing a meaningful and balanced basis for us to give credit where it is due and to make some specific recommendations, based on the views of the industry, for real improvement in the way the FSA goes about its business.

The Panel recognises that certain elements of the survey are based on firms' perceptions. But that does not, in itself, make those views invalid – in fact, perceptions are often just as important as any other form of measurement and should be regarded and addressed with similar seriousness. That said, we have sought this year to ensure that, wherever possible, the report is clear about those views which are perception-based, those which are formed out of personal experience, and those where frequency of contact or more recent contact with the FSA appears to have a demonstrable impact (whether positive or negative) on firms' satisfaction.

In doing so, we hope that this will enhance the veracity of the survey and, crucially, help produce genuinely actionable and influential outputs – which the

FSA can understand and engage with positively – for the benefit of regulated firms, their customers and the marketplace as a whole.

### **The areas we have identified from the survey for the FSA to address**

The Panel has already commenced discussions with the FSA about its response to the findings in the survey. Over the period following the survey's publication, the Panel will distil the data and findings in order to identify and prioritise those specific areas where the FSA is seen to be performing well (or better than in 2006), those where the FSA is already striving to make progress, and those where we feel that more could and should be done. In doing so, we shall also seek to distinguish clearly between the views of wholesale firms, retail firms, major groups and smaller firms and target our representations and proposals accordingly.

I shall, therefore, not use my introduction to cover these aspects in great detail at this stage. However, at the high level, the key messages that my fellow Panel members and I are taking from this study – the 'story' that it tells us, from a regulated firms' perspective – can be summarised as follows:

- It is imperative that the FSA learns the lessons arising from the market turbulence at the time of the survey and its handling of it (and is able to demonstrate that it has done so); regulated firms have responded quite positively to the FSA's willingness to learn the lessons from Northern Rock, but it is early days to see whether that learning (and other learning from similar events) is being put into practice.
- Firms have expressed the view, even more forcefully in this survey than previous ones, that strong regulation is a good thing. However, the burden that FSA regulation places on firms – of all types and sizes – remains a source of significant concern.
- Firms continue to want the FSA to improve its understanding of their business and the risks. There is a clear link between individual firms' satisfaction and continuity of supervisory staff. Firms that have experienced continuity in their relationship manager are far more positive in their views than those that have had frequent changes.
- Satisfaction with the FSA's Firm Contact Centre has improved, as has the quality of guidance it provides, especially with those (mainly smaller) firms which have used that facility in more recent times. In addition, firms that had experienced some contact with the FSA in the six months leading up to the survey were more satisfied than firms that had not had recent contact.

- The FSA's perceived performance in maintaining confidence in the financial system has declined significantly since 2006 – though this is not altogether unexpected and the ratings on the FSA's other objectives remain largely unchanged.
- Firms believe that the FSA has tended to focus on 'consumer protection' to the detriment of its other objectives.
- Wholesale firms are typically more satisfied than retail firms when asked about the FSA's performance and/or their regulatory relationship, but the gap has narrowed.
- Smaller firms remain less satisfied than larger relationship managed firms, but there are signs that the gap is closing and that concerns are converging around common themes.
- There is definite improvement in firms' views about the high costs of compliance, but small firms in particular still perceive the FSA to offer poor value for money.
- While continuing to support principles based regulation, firms believe that communication (especially at the point of launch) and implementation of major FSA initiatives could be handled more effectively.
- Firms are not yet convinced about the robustness of the FSA's cost benefit analyses prior to launching new initiatives.

I commend this survey report to you. If you are a regulated firm, I would particularly like to encourage you to review it and see what your contemporaries/peer groups are saying about the FSA – these are the issues that will frame the agenda of the Panel over the coming year.

Finally, my own and the Panel's thanks go to Russell Collins, Helena Morrissey, Iain Cornish from the Panel, and Gillian Cardy from the Smaller Businesses Practitioner Panel for their hard work in our sub-group which oversaw the day-to-day activities relating to the survey. I would also like to thank the team at BMRB who conducted this research on the Panel's behalf and authored the final report, and our own Secretariat staff for ensuring that all operational and communication aspects of this project ran smoothly.

In concluding, I would also like to put on record my thanks to the FSA for the constructive way in which it has engaged with the Panel on this survey.

Nick Prettejohn

Panel Chairman, December 2008



# 1 Executive Summary

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## Fifth survey of the FSA's regulatory performance

The 2008 survey is the fifth survey of regulated firms conducted on behalf of the Financial Services Practitioner Panel to measure the FSA's regulatory performance. This report is based on the responses of 4,459 regulated firms. An overall response rate of (46%) was achieved. The survey data have been weighted to ensure the survey results are representative of all regulated firms in the industry.

Fieldwork for the survey was conducted between 1<sup>st</sup> July and 22<sup>nd</sup> September 2008. The majority of firms completed a paper questionnaire with a small number (257) completing the survey by telephone. Two-thirds (65%) of questionnaires were completed by the chief executive, managing director, partner or principal in the firm.

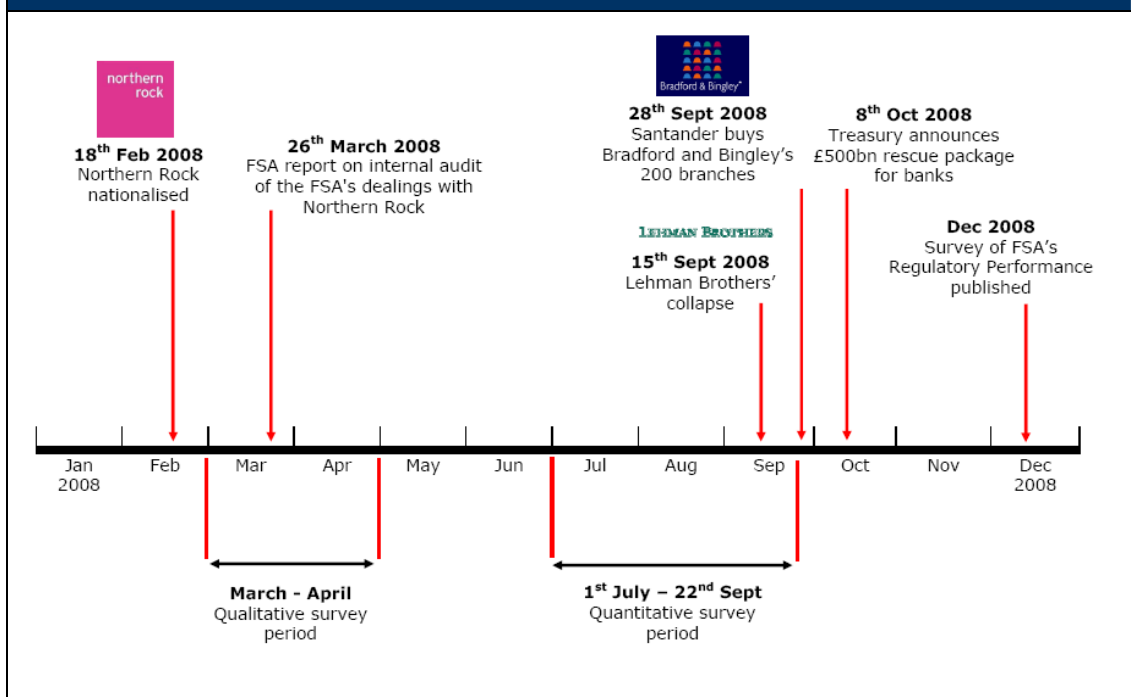
A census of all regulated firms was undertaken with the exception of home finance broker firms, general insurance intermediaries and financial advisers where a random sample was taken.

Prior to the quantitative research, a qualitative phase of research was conducted to identify the key areas of interest to firms. Forty two depth interviews were conducted with chief executives of regulated firms and focus groups were conducted with managing directors of small businesses.

### 1.1 Overview

A number of high profile events were affecting the financial services industry throughout the time the survey was being designed and undertaken, and it is likely that these events impacted on the views expressed by firms throughout the survey. Chart 2.1 shows a timeline placing the survey in the context of the events that were happening at the time.

**Chart 2.1 Timeline of survey development**



Firms' rating of the FSA's performance in meeting its four statutory objectives (see Section 2.2) has remained stable since 2006, with the exception of the rating of the FSA's performance in maintaining confidence in the UK financial system which has seen a sharp decline. This is not surprising considering the context in which the survey was conducted.

There is now an even greater acceptance among regulated firms in the financial services industry of the need for strong regulation. The proportion of firms believing that the regulatory system places too great a burden on firms remains high, but has fallen dramatically since 2006, and there has also been a fall in the proportion of firms which believe the costs of compliance to be excessive.

Among regulated firms there is widespread acceptance of the initiatives introduced by the FSA such as Treating Customers Fairly (TCF), More Principles Based Regulation (MPBR) and, to a lesser extent, the Retail Distribution Review (RDR). There are, however, strong concerns in the industry about how these initiatives are implemented and how they are communicated to the industry.

Regarding MPBR in particular there has been a deterioration rather than an improvement since the 2006 survey in the proportion of firms which agree that the FSA has made it clear how MPBR will work in practice.

Since the 2006 survey there has been little improvement in regulated firms' overall satisfaction with their relationship with the FSA. Although the proportion

of firms giving a high rating of satisfaction has increased slightly, the average satisfaction score across all firms has seen no change.

Firms with fewer than 20 full-time staff remain less satisfied overall with most aspects of their dealings with the FSA than firms with 20 or more full-time staff. This gap appears to be narrowing and the issues affecting firms with fewer than 20 full-time staff are much the same as those affecting firms with 20 or more full-time staff.

Relationship managed firms are more positive overall about the FSA. Satisfaction with the FSA among relationship managed firms is, however, associated with the turnover of relationship managers. Satisfaction decreases as the turnover of relationship managers increases.

Contact with the FSA is positively correlated with greater satisfaction among firms. Across almost all measures, firms that had had contact with the FSA in the last six months were more positive than those that had had no contact.

## **1.2 FSA performance**

Regulated firms were asked to rate the FSA's performance against its four statutory objectives:

- maintaining confidence in the UK financial system
- promoting public understanding of the financial system
- securing the appropriate degree of protection for consumers
- reducing the extent to which it is possible for a business to be used for a purpose connected with financial crime.

There was a sharp decline in the rating of the FSA for maintaining confidence in the UK financial system, with a fall from an average score of 5.5 to 4.3 out of 10. The proportion of firms giving a low rating (between 1 and 3) has more than doubled since the 2006 survey from 15% to 38%. This is likely to reflect the time at which the survey was conducted, around six to eight months after Northern Rock was nationalised, with reports of the 'credit crunch' becoming widespread and the beginning of the Government's intervention in the financial markets in the UK and internationally.

With the exception of the first objective – maintaining confidence in the UK financial system, there was little movement in firms' rating of the FSA's performance against these objectives since the 2006 survey. This indicates that firms' concern over the first objective has not prejudiced their views of the FSA's performance in general. However, 61% of firms agreed that the FSA has focused on consumer protection to the detriment of other objectives.

Of the remaining objectives, firms were least positive about the FSA's performance in promoting public understanding of the financial system with only 17% rating the FSA highly in this area. Around a third of firms rated the FSA highly for securing the appropriate degree of consumer protection (32%) and reducing financial crime (35%).

The 2008 survey included a question to gauge opinion about what had recently happened with Northern Rock. Four in ten firms (42%) believed that the FSA was committed to learning the lessons following Northern Rock to make it a better regulator.

### **1.3 Attitudes towards regulation**

There is a mixed response to regulation; while the industry as a whole sees the benefit of strong regulation, there is at the same time a real concern that it has a negative effect on firms.

The overwhelming majority of firms (85%) recognised the need for strong regulation, with almost half (46%) agreeing strongly that it is for the benefit of the industry as a whole. This is an increase from 2006 when eight in ten firms (79%) saw it as beneficial and 39% agreed strongly that this was the case.

While most firms see the benefit of strong regulation, at the same time there is a widespread belief across the industry that regulation also impacts negatively on businesses; eight out of ten firms (82%) agreed that the current regulatory system places too great a burden on firms. Although this is still high, it is slightly lower than in 2006, when 86% of firms felt this.

Firms with fewer than 20 full-time staff were more likely than firms with 20 or more full-time staff to see regulation as placing too great a burden on firms. Almost half of firms with fewer than 20 full-time staff (44%) agreed strongly that the current regulatory system places too great a burden on firms, compared with just over a quarter (27%) of firms with 20 or more full-time staff.

As in 2006, there was general support from the industry for MPBR, with three-quarters (75%) agreeing that it is a welcome approach. Most firms also felt that they would benefit from MPBR. Six out of ten firms (60%) agreed that they will benefit from the FSA's focus on principles.

However, although MPBR has been in operation since 2006, fewer than three in ten firms (29%) agreed that the FSA has made it clear how it will work in practice. This is a significant decrease from 2006 when 37% agreed.

There was also a real concern among firms that MPBR may leave them open to retrospective regulation, with six in ten firms (62%) feeling this might be the case. This was a particular concern for major group firms, 80% of which agreed that they may be left vulnerable to retrospective regulation.

There was an overwhelmingly positive attitude to the *principle* of TCF. Around nine in ten firms (89%) supported the TCF initiative, with 68% agreeing strongly that they supported TCF.

However, opinion is more divided on the FSA's implementation and communication of TCF to the industry. Just over half of firms (53%) believed that the FSA has provided a clear explanation of how firms should implement TCF; this is, however, a significant improvement from 2006 when only 39% felt this.

Despite this improvement, one in five firms (21%) still did not feel they understood what management information was required to demonstrate compliance with TCF – a significant number given that the deadline for having this information in place was in March 2008, several months before the survey took place.

#### **1.4 Attitudes towards enforcement**

Overall satisfaction with enforcement has remained largely similar to that seen in the 2006 survey, with the majority of firms essentially neutral on FSA performance in this area. There was a general consensus that enforcement is perceived by the industry to be a 'credible deterrent' with two-thirds of firms (67%) endorsing this statement. This was particularly true of major group firms, 77% of which agreed.

While many firms did not know whether a principles based approach was followed by the FSA in its enforcement, half of firms (51%) were inclined to agree that this was the case.

#### **1.5 Cost of compliance**

Since the 2006 survey, the proportion of firms believing the costs of compliance to be excessive has declined from 57% to 45%. Relationship managed firms were far less likely to view the costs of compliance as excessive compared with firms without a relationship manager (21% compared with 47%).

When the costs of compliance were estimated as less than 5% of total costs, around a third of firms (35%) felt these to be excessive, and this rises to half of firms (50%) when costs are estimated as 5 to <15% of total costs, two-thirds (64%) with costs of 15 to <20%, and up to three-quarters (73%) of firms believing the costs to be excessive where they account for 20% or more of total costs.

Just one in ten firms (11%) rated the FSA highly in terms of offering value for money.

Firms' views on the importance of strong regulation were correlated with their perception of the FSA offering value for money against the regulatory fees.

Those which believed strong regulation to be important were less likely than those which did not believe this to see the FSA as offering poor value for money. Eight in ten (80%) firms which disagreed strongly that strong regulation is for the benefit of the financial services industry as a whole rated the FSA poorly in terms of offering value for money, compared with 32% of firms which agreed strongly with this statement.

The proportion of firms feeling strongly that the costs of compliance were harmful to their business has fallen from a third of firms (34%) in 2006 to a quarter (23%) in 2008.

## **1.6 Satisfaction with the FSA**

Overall satisfaction among regulated firms with their relationship with the FSA has remained the same as in the 2006 survey, with an average score of 6 out of 10. There has, however, been an increase in the proportion of firms giving high ratings (from 7 to 10) and a decrease in the proportion giving the lowest rating (1 to 3) or a neutral rating (4 to 6).

Relationship managed wholesale firms and credit unions tended to be most satisfied while non-relationship managed retail firms reported the lowest levels of satisfaction. As seen in 2006, wholesale firms reported higher levels of satisfaction than retail firms.

However, satisfaction could be undermined by the perception that there is some lack of balance between the FSA satisfactorily addressing risks in prudential capital and liquidity and their continued process-driven approach to regulation.

Satisfaction among relationship managed firms also declined as the turnover of relationship managers increased. Firms that had seen no change in their designated relationship manager over the last two years were more highly satisfied with their relationship with the FSA than firms that had seen two or more changes in relationship manager over this time period (71% and 56% respectively).

The majority of firms (71%) reported that their relationship with the FSA had remained the same over the past two years, a fifth (19%) said it had improved and one in twenty (5%) said it had deteriorated. The proportion feeling their relationship has remained the same is higher than seen in 2006, suggesting a period of stability over the last two years. Of firms which reported no change, two-fifths (40%) gave a high satisfaction rating, indicating they were very satisfied and had been so over the last two years. Half (47%) gave a neutral rating and 11% were dissatisfied and had seen no improvement to ease this dissatisfaction over the last two years.

More than four in ten firms (43%) gave a high rating in terms of ease of dealing with the FSA. Firms which had had contact with the FSA in the last six months were more likely than firms which had not had contact to feel that their ease of dealing with the FSA had improved in the last two years.

### **1.7 Relationship with the FSA**

The majority of relationship managed firms (77%) were satisfied with their relationship manager, with 35% reporting high levels of satisfaction. One in ten (9%) were dissatisfied. Dissatisfaction was clearly related to the number of times the relationship manager had changed. Just 6% of firms that had kept the same relationship manager over the last two years reported dissatisfaction, compared with 14% of those that had seen two or more relationship managers over this time period.

There were high levels of satisfaction with the Firm Contact Centre among firms which had used it, with 68% being satisfied with the service provided.

Levels of satisfaction with the guidance given by the FSA were good, with 47% of firms rating the guidance highly. The majority of firms had mainly sought guidance from the Firm Contact Centre.

There was a degree of scepticism among firms about the cost benefit analysis carried out in consultation papers, with six in ten firms (59%) able to give an opinion disagreeing that cost benefit analyses were carried out robustly. Firms were, however, slightly more positive about the reliance placed on market-led opinion – half of firms (50%) agreed that the FSA places sensible reliance on market-led solutions.

### **1.8 Attitudes towards supervision**

Around half of all firms (48%) were satisfied with the FSA's performance in its supervisory role. However, six out of ten firms (59%) had never had a supervisory visit and, even when visits had taken place, these tended to be over three years ago.

Encouragingly, three-quarters of firms (74%) felt that the level of supervision they receive is 'reasonable' for a firm of their size and type, an increase from the 67% who agreed with this in 2006.

Relationship managed firms were much more likely to have had a supervisory visit compared with non-relationship managed firms (79% and 29% respectively). Relationship managed firms were also much more positive about all the aspects of supervision than those firms which are not relationship managed. They were more likely to see the FSA as a 'partner', with 89% agreeing that the FSA was willing to hold a dialogue with them about enforcement issues. This is compared with 80% of firms without a relationship manager.

## **1.9 Attitudes towards RDR**

Although the majority of firms giving an opinion welcomed the RDR initiative (60%), there was less support among firms for the RDR than was identified for TCF and MPBR. Wholesale firms were more likely than retail firms to welcome the RDR (75% and 59% respectively).

## **1.10 Attitudes towards EU and international issues**

Since the 2006 survey there has been a fall in the proportion of firms which agreed that the FSA was suitably coordinated with HM Treasury, from 49% in 2006 to 39% in 2008.

Almost six in ten (58%) firms believed that the FSA is alert to emerging EU issues and prepares its position in time. Seven in ten (70%) firms able to give an opinion agreed that the FSA had been consistent in its implementation of the Markets in Financial Instruments Directive (MiFID) and 69% agreed that the FSA had given them sufficient time to prepare for MiFID.

## **1.11 Attitudes towards the Panels**

Before being contacted to take part in this survey, just under half (45%) of regulated firms had heard of the Practitioner Panel. Three-quarters (74%) of major groups had heard of the Panel. Just under a third (31%) of firms had heard anything about the Smaller Businesses Practitioner Panel. Large firms with 20 or more full time staff were equally as likely to have heard of the Smaller Business Practitioner Panel as smaller firms (30% and 32% respectively).

Firms that were aware of the Panels expressed fairly positive attitudes towards them. Of those able to give an opinion, nine in ten (89%) agreed that the Panels had an important role to play on behalf of their type of business and the same proportion agreed that the Panels were helping the FSA to understand industry views. However, just two-thirds (67%) agreed that the Panels were able to influence FSA policies and decisions.

There was a strong belief by firms in the independence of the Panels, with 85% agreeing that the Panels were independent of the FSA. Three-quarters (76%) of firms felt it was easy to express their views to the Panels and the same proportion agreed that the Panels were able to represent the industry as a whole.

## **1.12 Key areas for improvement**

Firms' satisfaction in the FSA's performance against its four statutory objectives is driven by a belief that the FSA facilitates innovation and competitiveness within the UK, understands firms' business and listens to industry views in deciding policies and procedures.

The particular drivers of firms' satisfaction with maintaining confidence in the UK financial system mirror the drivers for all four objectives combined, with the exception that 'fostering a sense of partnership with firms' replaces 'understanding the firm's business'.

Firms' satisfaction with their relationship with the FSA was very closely correlated with the ease of dealing with the FSA. A number of themes were identified that drove firms' satisfaction with the FSA. These were:

- the role as a regulator
- supervision of firms
- the relationship with the FSA
- communication.

Two key areas were identified from the key driver analysis that were important drivers of firms' satisfaction with their relationship with the FSA but in which the FSA was currently not perceived to be performing well. These were:

- understanding firms' business
- satisfaction with the FSA's approach to enforcement.

Improvement in these two areas by the FSA would be expected to show a significant reward in terms of increasing firms' satisfaction with their relationship with the FSA.

The key factors influencing attitudes towards the FSA's understanding of a firm's business were creating a sense of partnership, specifically understanding the firm's risk profile, listening to industry views when developing policy and understanding small firms and the implications of regulatory change on these firms.

In terms of understanding business, it is reasonable to suppose that a relationship manager can play a key role in demonstrating this understanding to firms. Among relationship managed firms it is not surprising that satisfaction with the relationship manager is a key driver in overall satisfaction and the research has identified that numerous changes of relationship manager tend to result in lower satisfaction levels. Although firms that have seen two or more relationship managers in the last two years are still generally satisfied with their relationship manager, they are less likely to be satisfied than firms that have seen no change in their relationship manager.

Satisfaction with the FSA's approach to enforcement was driven by firms' perception of the FSA's enforcement procedure being seen by the industry as a

credible deterrent and being used in a way that better protects the public. In addition, improvement could be seen in firms' perception of the FSA's performance in this area if there is clarity of the rationale of enforcement and improvement in the communication and implementation of enforcement (such as ensuring enforcement follows a principles based approach, placing clear and reasonable responsibilities on senior management and demonstrating fairness in its dealings with the financial services industry).

Among major groups the key areas for improvement were in encouraging greater education of the public about financial products and services and redressing the balance between consumer protection and the FSA's other objectives.



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