

# Essential facts about the Financial Services Authority

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## ■ What is the FSA?

We are the main statutory regulator for the UK financial services industry. We were established by an Act of Parliament in 2000 and formally gained our powers on 1 December 2001.

We regulate some 29,000 firms, which includes EEA firms passporting into the UK, ranging from global investment banks to very small businesses, and around 165,000 individuals. This industry contributes 6.8% of UK GDP and employs 1.1 million people, providing products and services to millions of consumers.

## ■ What is the FSA's purpose?

We were given four specific, and equal, objectives by Parliament. These are: maintaining market confidence; promoting public understanding of the financial system; securing the appropriate degree of protection for consumers; and fighting financial crime.

In our day-to-day operations, we aim to promote efficient, orderly and fair markets, help retail consumers achieve a fair deal and improve our own business capability and effectiveness.

In practice, this means that we want to make markets work effectively to deliver benefits to firms and consumers. We operate a risk-based approach concentrating on the big risks and accepting that some failure neither can, nor should, be avoided. Potential risks are prioritised, using impact and probability analysis, and we then decide on an appropriate regulatory response – in other words, what approach we will take and how much resource we will allocate to mitigating the risk.

## ■ Who pays for the FSA?

Our budget is met from a levy on the firms we regulate. We receive no funding from the taxpayer. The amount each firm pays is determined according to its size and the types of business it undertakes. When financial penalties are imposed on firms or individuals, the proceeds are used to reduce fees in the following financial year.

Our budget for 2006/07 is £276m. In terms of indirect costs, research by European Economics in 2003 put compliance costs incurred by firms at 1.6% of their total operating costs. The FSA and the independent Practitioner Panel (a statutory body that represents the interests of regulated firms to the FSA) are undertaking further work this year on the indirect costs of the regulatory regime, with particular focus on the position of small firms.

## ■ How does the FSA decide what to regulate?

The scope of our authority was initially set out in the Financial Services and Markets Act 2000 (FSMA). Since then, Parliament has extended our responsibilities to include, for example, mortgage lending and insurance broking.



Some financial services, such as consumer credit and occupational pension schemes, are not regulated by us. In addition, some businesses that may appear to be offering financial services, such as buy-to-let property clubs or compensation claim handlers, fall outside our scope.

Only Parliament currently has the authority to add to the FSA's remit.

When deciding how to regulate, we aim to intervene only where there is a market failure and where the benefits of doing so are likely to outweigh the costs. This cost-benefit analysis helps us to achieve a proportionate response to the risks we identify – it is widely regarded as well ahead of practice in most other jurisdictions.

In policy-making, cost-benefit analysis ensures that initial ideas that do not deliver benefits in excess of potential costs are returned to the drawing board or dropped altogether. Our analysis is published, enabling interested parties to suggest policy changes, as in the recent work on 'soft commissions' and the introduction of mortgage and general insurance regulation.

## ■ Who regulates the FSA?

The FSA's powers derive, ultimately, from Parliament; in practice, we are accountable in a number of ways to the public, industry, government and Parliament.

- The independent Practitioner and Consumer Panels, whose status is set out in FSMA, exist to ensure we take the views of consumers and the industry into account. We are required to respond formally to their representations
- Complaints against the FSA may be investigated by an independent Complaints Commissioner, whose findings are published
- There is scope for judicial review of FSA decisions
- FSA rules are subject to scrutiny by competition authorities
- We make an annual report to Parliament, which is published, and our chairman and other senior directors make regular appearances before the Commons Treasury Select Committee.

## ■ What is the background and experience of the FSA's staff?

We employ around 2,800 people, almost all at our offices in Canary Wharf, London.

Staff are often drawn from (and, indeed, return to) regulated firms and the professional services firms that advise them. More than half our staff comes from the industry and at any one time around 100 people are seconded to or from the industry and other bodies. Annual staff turnover is well below the industry average, at around 9.2%.

The FSA's graduate development programme has produced 197 staff since 1999; we aim to recruit 60 graduates every year. More than 10% of staff are studying for professional qualifications; many others already hold these.

Staff are able to pursue broad-based careers, with the opportunity to move around the organisation or to specialise. We aim to pay staff around the market median for comparable roles in the industry, with high performers able to earn significantly more than this; in 2004/05, the average remuneration package, excluding pension contributions, was worth £56,000.

The FSA Board comprises the chairman, chief executive, three managing directors and ten non-executives, from industry, consumer and other backgrounds, all representing the public interest.

## ■ **What does the FSA do to prevent people buying the wrong products?**

Our philosophy is that consumers should be provided with the information that they need in order to make informed decisions about their financial arrangements; that this information should be fair, clear and not misleading; and that customers have the right to expect that any professional advice they receive is appropriate for their individual circumstances.

With these rights, however, come responsibilities – consumers need to ensure that the information they provide to their advisers is accurate and complete; give proper consideration to the products or services being offered to them; and make sure they fully understand any risks associated with the product before they buy.

In a competitive market, firms must not be prevented from offering innovative or high-risk products to those investors who are prepared, on the basis of an informed judgement, to accept the risks.

We can – and do – intervene where we see the risk or reality of products being mis-sold. We can issue consumer warnings, via our website and the media; recent examples have included warnings on high-income bonds, venture capital trusts and equity release schemes. We identify potential risks and take action to, in effect, nip potential problems in the bud. Finally, where individual instances of mis-selling have occurred, we can take enforcement action and secure redress for customers.

## ■ **Why doesn't the FSA investigate customers' complaints and pay them compensation?**

We are only one part of a regulatory framework that also provides a free complaint resolution service and a 'safety net' to provide compensation to individual customers when financial firms go out of business.

The Financial Ombudsman Service adjudicates on complaints that have not been resolved by the relevant firms. We do not duplicate this service by investigating individual complaints ourselves, but we will undertake investigations where it appears that a particular firm or product is attracting a disproportionate number of complaints.

The Financial Services Compensation Scheme (FSCS) steps in when financial firms go out of business owing money to their individual customers. It does not compensate customers for poor investment performance.

We do not provide compensation to consumers. In some enforcement cases, we are able to secure compensation from firms for customers who have lost out as a result of the firms' behaviour. This compensation is paid directly by the firm, not via the FSCS.

## ■ **What is the FSA's policy on enforcing its rules and fining firms that break them?**

Our powers enable us to censure or fine firms that fail to follow our rules, but we are not an 'enforcement-led' regulator and formal disciplinary action is only one of the tools available to us. Under our risk-based approach, we cannot attempt to pursue every rule breach and so minor problems are usually resolved through the day-to-day relationships we have with regulated firms, without the need for any formal regulatory action to be taken.

We select cases to investigate formally according to their seriousness and how they fit with our priorities – there are no targets for the number, size or type of cases our enforcement

division investigates. Similarly, there is no ‘table of penalties’ used when determining the level of financial penalties. Each case is considered individually and any penalty based solely on the seriousness of the breaches concerned.

In 2005 we undertook a thorough review of our enforcement processes and made a number of recommendations for the process of investigating cases and making decisions. The review team’s report was published in July 2005 and is available on our website ([www.fsa.gov.uk](http://www.fsa.gov.uk)).

## ■ **What is the FSA’s role in fighting financial crime?**

The reduction of financial crime is one of our four statutory objectives: FSMA requires us to aim to reduce the extent to which regulated persons and unauthorised businesses can be ‘used for a purpose connected with financial crime’. Financial crime includes any offence involving money laundering, fraud or dishonesty, or market abuse. The objective interacts with our three other objectives: protecting consumers; market confidence; and public awareness.

In pursuing our financial crime objective, our main focus is on firms’ risk management systems and controls. We also work closely with the range of other organisations involved in fighting financial crime – such as the government, law enforcement, trade associations, the Joint Money Laundering Steering Group – in developing and delivering effective defences against financial crime.

## ■ **What does the FSA do to stop scams like boiler rooms?**

By definition, scams such as so-called boiler rooms operate outside the regulatory regime, as well as, in many cases, outside the UK, so we rarely have any jurisdiction over them. Some unauthorised firms arrange for their promotional material to be approved by an FSA-regulated firm, in which case we can take action if the material is misleading (one firm was fined £20,000 in 2005 for doing this). We also encourage overseas regulators to take action against scams operating in their countries but targeting the UK.

Our website contains details of scams that have come to our attention, including lists of firms known to be targeting UK investors. But this is an area in which common sense and caution on the part of individual investors is the most effective form of protection.

## ■ **What is the FSA’s role in promoting the UK’s financial services industry?**

We do not have a formal objective to promote the industry we regulate, but in pursuing our objectives we have to take into account the UK’s competitive position internationally and ensure that our regulation is not disproportionate. Our approach is based on making the retail and wholesale markets work effectively. This means that (except where regulation is required by government or EU legislation) regulation is proposed only where there is market failure and where there is a realistic chance that regulation can correct that failure without imposing excessive costs.

Our day-to-day approach is also different from that adopted by regulators in many other countries and, comment suggests, contributes to the UK’s attractiveness to international financial firms. For example, one benefit of being an integrated regulator – covering both prudential and conduct of business regulation and combining banking, insurance and securities – is that a large firm that was previously regulated by several different regulators now has a single regulator at the FSA looking after all aspects of their business. This eliminates the need for compliance staff, and senior management, to develop duplicative relationships with each regulator individually. Our aim is that the FSA staff supervising each such firm should develop a thorough understanding of the

business, to ensure that regulation is proportionate and genuinely risk-based. However, we have not taken the step, as has happened in some countries, of requiring large firms to provide facilities so that our staff can be actually based on their premises at all times.

The outcome we seek is that the UK is regarded internationally as a good place in which to do business. Third-party analysis suggests that this aim is being achieved. For example, the Confederation of British Industry (CBI) (Oct 2004) and the Corporation of London (Nov 2005) rated the regulatory environment in the UK ahead of that in the US and materially ahead of the rest of Europe. The Centre for the Study of Financial Innovation (CSFI) (June 2003) also ranked the UK financial environment above France and Germany and equal with the US. The Association of British Insurers (ABI) (Feb 2005) stated that one of the most important reasons why London is the largest and most liquid market in Europe is the contribution made by the regulatory environment.

## ■ What is the FSA doing to help the smaller regulated firms?

Around 90% of the firms we regulate are categorised as ‘small’ and, as such, do not have a dedicated supervisor. One of our three aims is to make it easier for these firms to work with us and when implementing policies we consider carefully the likely effects specifically on small firms.

Recent initiatives to assist small firms include:

- a ‘Firms Online’ service enabling firms to handle most routine dealings with the FSA on the internet, at their own convenience;
- personal handbooks which allow firms to select only those parts of the FSA rulebook that apply to their business and produce their own reference guide;
- discounts on FSA fees for firms that operate in many areas but undertake only small amounts of business in each;
- working with a commercial credit provider to introduce a facility to enable firms to pay their fees by instalments; and
- a series of events such as roadshows, surgeries, dinners and visits to firms around the country to answer questions face-to-face and advise them about the implications of new developments.

## ■ What is the FSA doing about the pensions crisis?

Our scope covers firms advising on and selling personal pensions, stakeholder pensions and annuities. We have prudential oversight of the firms that provide such products, so can set requirements for them to set aside sufficient reserves to meet their future liabilities, but we have no authority over occupational (company) pension schemes and so cannot influence the way in which companies operate their staff pensions schemes. These are regulated by The Pensions Regulator.

Through our public awareness work, we are able to provide generic information about planning for retirement; we have recently, for example, re-published our basic guide to pensions, updated to explain the impact of forthcoming changes to pension law. We hold no view on whether pension law should be changed (to introduce compulsory schemes, for example); such matters are for government to decide.

## ■ What is the FSA's approach to implementing European Directives?

Around 70% of our policy work is driven by the requirement to implement European Directives to which the government has agreed. Although there is not yet an adequate EU equivalent to our own approach to policy development, including cost-benefit analysis and the requirement for proportionality, we have no latitude to refuse to implement any directive.

Our approach is not to impose obligations beyond what is required by directives (so-called super equivalence) unless this is necessary to achieve the statutory objectives and can be justified by cost-benefit analysis.

Senior FSA staff are actively engaged in influencing the European agenda, including seeking to ensure that the same disciplines that are applied to UK policy development are applied in the EU.

## ■ What does the FSA mean by 'principles-based regulation' rather than 'rules'?

Our approach is underpinned by the principle that it is neither possible nor desirable to write a rule to cover every specific situation or need for decision that a regulated firm might encounter. Instead, we focus on the Principles set out in FSMA. These set out in more general terms the types of behaviour that we expect of firms and individuals (for example – 'A firm must conduct its business with due skill, care and diligence').

Many in the financial services industry, particularly at senior level, support this approach. However, our experience is that many of those operating in compliance or legal departments within regulated firms have yet to become comfortable with this approach and consistently seek detailed guidance on how to interpret principles in specific situations. We expect that understanding of how to operate in a more flexible, principles-based regime will evolve over time. In the meantime, we accept that, as an inevitable result of amalgamating the rulebooks of all our predecessor regulators, the FSA Handbook is a large document. In practice, there are few (if any) firms to whom all of the Handbook applies, but we believe there is scope to reduce it and are looking at ways of achieving this.

**February 2006**