Association of British Insurers (ABI)
Association of Private Client Investment Management and Stockbrokers (APCIMS)
British Bankers' Association (BBA)
Building Societies Association (BSA)
Finance and Leasing Association (FLA)
International Capital Market Association (ICMA)
Investment Management Association (IMA)
London Investment Banking Association (LIBA)

Hector Sants
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10 November 2008

Sent by e-mail and copied to Verena Ross & Katharine Braddick

Dear Hector,

DP08/3 – Transparency as a Regulatory Tool
Joint additional submission by the associations to the FSA

The ABI, APCIMS, BBA, BSA, FLA, ICMA, IMA and LIBA (the 'associations') liaised closely to consider their Members' reactions to the FSA's proposals for the use of transparency as a regulatory tool, as outlined in Discussion Paper 08/3[1], and each association has submitted a response to the FSA.

The purpose of this letter is to highlight the extent of cross-sector consensus about the FSA's proposals and to set out our shared fundamental concerns.

We support the FSA's vision of competition stimulated by informed and financially capable and confident consumers. To work well, markets need good information in the hands of consumers and other market participants. The associations therefore support the use of transparency, where the information being communicated is clear, and contributes to greater understanding of important issues, either by firms or by consumers.

We note that the FSA already deploys transparency as part of its established regulatory practice. For example, it is right and proper that the FSA publicly discloses the identity of firms which have been subject to final FSA enforcement action.

[1] Transparency as a Regulatory Tool

However, we do not agree that a wide-ranging initiative of the kind the FSA has in mind is appropriate and we have strong reservations about whether the proposals would prove effective in achieving the FSA's objectives. Some of the proposals run significant risks of unintended and damaging consequences, not only for consumers, but also for the relationship between the FSA and regulated firms. The objectives have also not been backed up by a robust market failure and cost benefit analysis.

Our shared fundamental concerns are set out below.

1. Firm-specific Disclosures

More transparency does not automatically equate to better outcomes for consumers. We believe that the FSA's proposal to publish firm-specific complaints data risks misleading and confusing consumers. FSA-published research into behavioural economics underscores this risk.

The proposal assumes that the published complaints data is comparable. However, firms use different interpretations of what constitutes a complaint. Users of the information would therefore not be comparing like with like. The data is also unlikely to be meaningful to consumers because the level of complaints is dependent on the size of the business and the level of redress paid varies according to the complexity of the product provided. Firms taking longer to investigate complaints could be undertaking a thorough investigation or be selling more complex products.

We therefore believe that it will be very difficult for consumers to form a balanced view of what the data conveys between one institution and another. Even if this data is appropriately contextualised and explained, consumers are more likely to draw their views from media interpretation of the data. So there would be significant practical hurdles to overcome for the publication of firm-specific complaints data if this is to contribute to the delivery of FSA's objectives. This approach also has the potential for 'naming and shaming' by the media and consumer groups, causing reputational damage despite full regulatory compliance.

We believe that the provision by the FSA of generic good and poor practice for complaints handling and effective risk-based supervision provides a superior alternative solution without the downside risks expressed above.

2. Conflict with public policy aims to address the savings gap

We believe that the DP fails to consider how its proposals fit in with efforts to engage consumers with financial services and to create a savings culture. As the press coverage at the DP's launch demonstrated, the media coverage is likely to focus on league tables and on "naming and shaming". This would generate further negativity in the minds of consumers about saving and investing, especially given the recent market turmoil. This could negatively affect market confidence and exacerbate the savings and protection gaps. We therefore believe the FSA should defer further work on the transparency proposals until the implications of the present crisis on consumer confidence in the financial services sector have been properly assessed.

3. Supervisory relationship

We believe that the proposals have the potential to fundamentally undermine the FSA's supervisory approach. This approach is built on firms providing information voluntarily beyond the requirements of Principle 11 in a relationship of openness and trust. But greater

disclosure of firm-specific information could lead to a legalistic environment where firms will only provide the minimum information required.

We are also deeply concerned about the FSA's proposals on the extended use of own initiative variations of permission (OIVoPs) and their publication on the grounds of "improved flexibility, greater consumer awareness and effective deterrence". This would blur the line between supervision and enforcement, amount to public censure in all but name, and deprive firms of their right to due process.

We believe that the proposals conflict with more principles-based regulation (MPBR) which focuses on outcomes and senior management responsibility rather than detailed rules. A regime where the FSA could impose and publish a variation of permission even where the firm is prepared to address the FSA's concerns will make firms focus more on processes and their legal risks, rather than on achieving the desired outcomes.

4. **Application to Wholesale Business**

The proposals appear to impact primarily on retail firms although it is not clear at this stage how the proposals could impact wholesale firms and markets. There are also concerns on how the proposals apply to EEA passporting firms and the related implications on competitiveness. This creates uncertainty and we are concerned that the risks of disproportionate regulatory responses and unintended consequences could be replicated for wholesale business if the proposals are read across in due course.

5. Proportionate regulation - Transparency as a regulatory tool

The DP does not explain why the FSA's existing tools are unsuitable or insufficient to achieve the intended outcomes, and why increasing transparency will achieve these outcomes. The FSA is a powerful regulator with a considerable toolkit under FSMA. The FSA has made clear its intention to deploy transparency where it believes it can leverage a threat to a firm's reputation in order to incentivise change to sub-optimal firm behaviour. Firm specific disclosures are clearly designed with this approach in mind yet the FSA has not been able to explain, either in the DP or in recent discussions with the industry, how it can ensure that the outcome of firm specific disclosure will be a proportionate and effective regulatory response.

The FSA has strict control over how supervision and enforcement are utilised as proportionate regulatory tools. Under the proposed changes, reliance on the media to interpret and intermediate information, as proposed in the DP, runs the risk of serious unintended consequences, as the FSA is unable to control the reputational damage to both an individual firm and the broader financial sector.

6. Role of a Code of Practice and further Consultation

If a general initiative on transparency is to be taken forward, a Code of Practice is vital to underpinning an effective and properly governed framework to oversee the deployment of transparency as a regulatory tool. However, we consider the draft Code of Practice in the DP to be rather formative in nature and consideration should be given to the following aspects:

- The Code is too general in nature and does not clearly articulate the FSA's decision-making process, for example, who is responsible for determining that use of the disclosure tool is appropriate;
- The Code should contain a process to ensure that firms are not subject to inappropriate public censure, for example, in relation to the publication of non-fundamental OIVoPs;

- The Code does not offer sufficient clarity on how consistency of decision-making will be achieved;
- Further clarity should be provided on the application of the s. 348 FSMA gateway and how the legislation can be applied given EU requirements;
- Governance arrangements must be included to explain the terms on which the Code is to be reviewed and the frequency of these reviews.

An initiative on transparency cannot be implemented unless governance arrangements are agreed and we must emphasise the need for a full consultation exercise. We also believe that the proper application of any Code of Practice is key to its success. In the case of some of the proposals put forward in this discussion paper, we are not convinced they meet these high-level code requirements.

7. Market Failure / Cost Benefit Analysis

We note the lack of a market failure analysis accompanying the DP. The FSA has consistently indicated in the past that it would only consider regulatory intervention in light of a proven market failure and where there is the prospect that intervention will bring a net benefit. In addition, we consider the cost benefit analysis in the DP to be insufficient to justify the proposed step change in regulatory approach.

8. Interaction with other stakeholders

We are disappointed that the DP does not consider how the FSA's proposals interact with the FOS's proposals to publish firm-specific complaints data, and how they impact on other stakeholders. The associations urge the FSA to coordinate its approach to disclosure with the FOS and all other relevant stakeholders, including the Banking Code Standards Board, the OFT, other EU financial regulators and EU institutions.

9. Legal Basis for the proposals

We are concerned that the proposals are not based on a sound legal footing. The proposals appear to be incompatible with European Union Financial Services Directives on the confidentiality of information provided to regulators. For example, the Consolidated Life Directive 2002/83, and the Capital Requirements Directive 2006/48 expressly prohibit regulators from disclosing confidential information received from firms, except in aggregate form such that individual firms cannot be identified.

We also do not agree that MiFID Article 54 should be interpreted in the way suggested by FSA, an analysis which is inconsistent with the restricted approach taken in other Directives. In our view, Article 54(5) of MiFID does not remove the obligation of professional secrecy imposed under Article 54(1) of MiFID and certainly does not go so far as to provide that competent authorities may, subject to national law, divulge confidential information received from MiFID investment firms to the world at large, as the FSA appears to be contending. Has FSA discussed its interpretation with the Commission and with its opposite numbers in other Member states?

In addition, we believe that the FSA's intention to deploy OIVoPs as a broader public communication device runs contrary to the intention of the original legislation, as explained during the Bill stages, from which the powers for this tool are derived. We believe that FSMA intends that OIVoPs be used to protect the existing and potential customers of the firm and not the public at large. We do not think it is legitimate to interpret the legislation on the assumption that all members of the public are potential customers of the firm in question and certainly such an assumption is not proportionate.

10. Conclusion

In summary, we recognise that it is legitimate to debate how more regulatory transparency could assist the FSA in delivering its statutory objectives. However, the collective concerns of the associations demonstrate that the proposals in DP08/3, as they stand, should not be taken forward given the potential unintended consequences, the question about their vires and because they fall short in several areas given the FSA's principles of good regulation.

We recognise that the FSA is under increasing pressure from a number of stakeholders to increase transparency. But it should attach the greatest weight to real evidence on the benefits and costs of its proposals.

The associations believe that the discussion paper presented a starting point for dialogue. Building on the outcomes of this dialogue, the FSA should consider whether to examine increased transparency in targeted areas (such as firm-specific complaints data), with attendant further consultation papers, alongside a robust cost benefit analysis.

We would very much welcome the opportunity of a round table discussion with you to consider these issues before the FSA decides how best to take this work forward.

Yours sincerely,

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