Fees Response

Introductory Comments

This response is submitted by the Association of Independent Financial Advisers (AIFA). AIFA is the parent organisation of the AIFA family of trade bodies, which also includes the Association of Mortgage Intermediaries and the Association of Finance Brokers. Our three industries account for over 8,600 directly authorised and circa 14,000 appointed representative firms and this response has been developed following research with members in order to identify the key points to make. The views expressed herein are those of the membership of these three industries.

Recommendations

We have five main recommendations for FSA to consider:

- We cannot comment on the absolute total of the regulator's budget given the limited information presented in the consultation paper and business plan. No details are given about the internal prioritisation process that FSA undergoes in determining its work priorities, how these are costed (in terms of an internal cost / benefit system), and then the post-implementation review process that ensures an internal accountability process is maintained. Further, we assume a "best value" purchasing system is in place (or other costing model) which ensures transparency of purchasing. Finally, we would wish to be reassured that FSA operates a "fiduciary duty" system against which those with budgetary authority are assessed. We recommend that FSA publishes more information on these internal financial controls to reassure those who finance it that its financial systems and controls are in-line with good practice in larger firms. A public review of these matters would be appropriate, given the scale of increase proposed by FSA.

- The budget process within FSA is not subject to a formal cost / benefit analysis – as stated within the fees consultation. FSA conducts an apparently "top level" review in accordance with the Better Regulation Principles. However, this could be seen as insufficient for a budget now approaching half-a-billion pounds. In order to protect FSA from external criticism, reassure the firms who finance the regulator, and provide market confidence, we recommend that FSA voluntarily adopts a cost / benefit process in determining its budget.

- For five years AIFA has stated that FSA was in danger of missing key risks because it was trying to do too much with its resources. We have repeatedly suggested that FSA slims down the number of priorities and projects in order to look more deeply into the most important areas. We again repeat this advice. Given the market conditions, cultural changes required, and desire to recruit more supervisors, it would be folly to proceed with too many initiatives. The result of reviewing, and slimming

down, the initiatives FSA is seeking to do would be to reduce costs and improve the regulator's ability to deploy a strength-in-depth strategy that will be needed.

- FSA may need to allocate more resources to regulate high risk organisations (such as banks). The failure of the banking community to assess its own risks has failed not only all other financial services organisations but, more importantly the UK public as a whole. We agree with Hector Sants' comment that "principles based regulation cannot work in a market where the participants are not principled" and the behaviour of the banking community has exposed this truth. However, we believe it would be deeply unfair to allocate costs to be borne by the intermediary market on this basis. We share Lord Turner's view that intermediary firms have paid too much for regulation for too long. His comment that "IFAs… might be worried about the cost [of regulation]" was entirely accurate. We also support his assertion that "If you look at what [FSA] were charging the biggest banks in the world, and what [FSA] were charging some small regional IFA, the differential was nothing like as big as I think it logically should be, just given the scale of their economics and the scale of the threat to the system". Thus we recommend that FSA revisits its internal allocation model to refocus costs onto the sectors where more intrusive regulation is needed – and not ask the intermediary community to pay more. We can see no reason why intermediary firms are being asked to pay more than the rate of inflation.

  We note the proposals to spare the smallest firms from an increase in regulatory fees and welcome this move. We regard this aspect of the proposals as sealed as it would cause significant negative comment for the FSA to step back from this high profile pledge. Indeed, it was noticeable that this was the focus of the regulator's PR strategy at the time the fee proposals were announced.

- We recommend that FSA, in conjunction with colleagues at Treasury, invites the National Audit Office to review its budgetary process and conduct a value for money assessment on a regular, scheduled basis. This will provide FSA with confidence that its procedures are robust and also allow the regulator to answer any critics who worry about the closed-book nature of the budget process. Further, FSA should discuss with Treasury if the Treasury Select Committee or the Public Accounts Committee is the better body to review the financial management of FSA. We would expect a consultation process for this move.

In summary, we call for a lessening of the financial call proposed for intermediary firms, given their lower risk nature. This may mean charging other sectors more – but given the impact they have had on the wider economy we feel this is appropriate. We would welcome an opportunity to discuss our other recommendations, which are longer term, over the coming period.

Economic conditions and their impact on firms

We are currently finalising our latest economic analysis and refining our view of the year ahead. We would be delighted to provide copies of this paper to FSA if it would be helpful. However, the clear, uncontroversial, conclusion is that the economic situation has worsened considerably and the outlook is difficult for the remainder of 2009 and well into 2010.

The Government has launched a series of measures to help small firms continue to trade through these times, including allowing them to defer VAT payments, staggering the increase in business rates, providing loan schemes and certain export guarantees. The clear thrust of public policy is to protect firms, jobs, and provide a degree of impetus to the UK economy.

It is well known that smaller firms provide greatest levels of innovation, and also now employ more people in the UK than the largest organisations (ONS figures).

It would seem appropriate for FSA to support the political consensus on helping smaller firms continue to trade through these difficulties (whilst ensuring a visible level of supervision to encourage positive behaviour). Indeed, one of FSA's statutory objectives is around market confidence and actions that result in the premature closure of firms strike at this objective and also stymie consumer access to good advice – at a time when this is needed most.

Instalment scheme

We are pleased to note that FSA is again facilitating discussions for an instalment scheme for payment of regulatory fees. This will be appreciated – and needed by more firms.

It is our view that the instalment scheme is especially important this year, given the actions of the banking community. FSA will know that banks are removing the overdraft facilities of firms, withdrawing lines of credit, and instead offering small business loans at rates of 17% APR.

Financial impact on firms

We have modelled the impact of the proposed fee increases on firms and would welcome an opportunity to discuss our figures with those used by FSA in arriving at the figures quoted.

The proposed fee increases cannot be seen in isolation, given the other steps FSA is asking firms to take currently. The impact of the costs of the Retail Distribution Review must be factored into this equation – and set against an economic climate that shows deteriorating business conditions for the coming years.

We are pleased that FSA is now undertaking a cost / benefit analysis of the Retail Distribution Review. As will be known we have been encouraging firms to prepare for the proposed changes (and recently announced a new year-long programme designed to help firms make the necessary changes). The costs to firms of adopting the new proposals will be significant (for instance, it costs in excess of £1,200 for one adviser to move from Level 3 to Level 4 competence by sitting the CII's stated qualifications, before considering the cost of 470 hours' study).

Additionally, the proposed increases in capital that firms must hold has an economic cost. The sources of new capital are few and with banks removing credit lines to firms, even the FSA's proposals that firms may borrow the money to finance their capital requirements are blocked off. As highlighted in AIFA's response to CP08/20, the impact of additional capital requirements for PIFs will be significant, with 69% of AIFA members surveyed having to raise further capital to satisfy FSA's proposed requirements.

Specifically considering FSA's proposed fees for 2009/10, we acknowledge that there is no increase in FSA minimum fees for A13 advisers. However, a firm with just two APs will face an increase in excess of inflation of 4.7%. Indeed, any firm with six or more APs will face a double digit percentage increase in core FSA fees.

In CP08/08, FSA quoted Oxera research which identified the annual equivalent income of one AP in A13 at £20,000 for investment advisers, and £50,000 for life and pensions advisers. On these assumptions, an adviser with equal exposure to both life and pensions and investments would have a turnover of £35,000. For a one AP firm, core FSA fees equate to 5.3% of turnover, before considering FSCS and FOS levies.

In times of economic uncertainty, firms perhaps focus less on individual costs, and more on the bottom line. Whilst last year some firms benefited from the revised structure of the FSCS, receiving a refund for the clean-break transition, firms this year are facing substantial rises in total fees.

A one AP firm with an equal life and pensions and investment split would receive a bill of £2,500.84 in addition to their immediate interim FSCS levy of £282.50. This cumulative cost represents a 9% increase on last year's fee (excluding the interim levy). Firms also stand to receive a further bill of £118.50 for the additional interim levy (based on the SD02 sub class totalling £58m for 2009/10 compared to the consultative £44m).

To contextualise, the March 2009 interim levy in addition to the total regulatory fees for 2009/10, but excluding any further interim levies, would equate to 8% of a one AP firm's turnover based on Oxera data.

For a firm of five advisers, total regulatory fees for 2009/10, excluding interim levies, would rise by over 4%. When considering the impact of the March interim FOS levy this would equate to 19% increase, and with the potential additional interim levy of Q3/4 2009/10 this would increase to a 32% increase.

On the same terms, a firm of twenty-five advisers (who as identified in CP08/20 would be particularly hit by the revised prudential requirements) would face increases of 8.6%, 25% and 39% respectively.

The reality for firms in a challenging economic environment is that bottom-line cash flow will be severely impacted in some cases. Firms do not differentiate between March interim levies and June regulatory fees, or between fine rebates or FSCS sub-class levies. Fundamentally, they will consider the headline cost of regulation, which is increasing for all in deteriorating business conditions.

New funding model

We are very happy to work with FSA to design a new funding model for the regulator.

However, we believe FSA needs to ask some fundamental questions about its structure and reach before looking at funding. It is commonly regarded truism that funding follows function – not visa-versa.

Our initial suggestions for this model include:

- A review of the funding models and strategies used by other regulators – in different markets (e.g. food, telecommunications, and pharmaceuticals) and in different EU member states – though a global context may be helpful.
- A review of the objectives of the funding. For instance, it used to be said by the Food Standards Agency that their goal was to have a decreasing budget – because the better regulator they were, the more the regulated firms would know what was expected of them, the less they would need to do.
- A review of the scope of the regulator. Is the current workload of FSA appropriate? For instance, should financial capability and Money Guidance sit within FSA? If so, should the funding model that is applied for supervision be applied to these other, ancillary, activities?
- What is the right constitution for FSA to operate? For instance, would “divisional boards” focused at a market level be preferable? Thus we could see a focused business unit overseeing the mortgage market, general insurance industry etc. rather than the small firms, high street firms etc. current split.
- The FSA Board would need to be reviewed as part of the funding review as the simple principle of “no taxation without representation” should hold true at the highest levels of the regulator. Those who are asked to pay for regulation should be represented on its Board – but with a clear consumer advocate role also represented.

We would be happy to provide detailed comments (in addition to those set out in our main recommendations) about the budgetary regime and operating principles that should be best utilised (whether a zero based budgeting

regime, or task-based regime works best should also be fed into the review etc.).

Conclusion

We are keen to see a regulator that has the respect of the firms it supervises emerge from this process. A fundamental building block of that outcome, will be that firms understand the funding regime and can identify what they are asked to pay with what is delivered in the market – and feel the costs are fair and justified.

We believe the current system looks out of step with the transparent nature of good regulation and a budget process that allows the board of the regulator to sign-off against its own budget plan looks outdated and is an obvious weak-link in the regulatory chain. In many ways, FSA should absent itself from the financial process and have its budget either set or approved, and certainly scrutinised, by an external body.

Specific Questions

Q1: Do you have any comments on the proposed 2009/10 FSA fee rates for authorised firms?

AIFA does not support the proposed fee rates for firms as proposed in the CP for the reasons raised above. We believe any allocation of additional resources for regulating high-impact firms should be borne by those firms where more intrusive regulation is appropriate.

The economic climate remains very difficult for firms, and we fail to how a greater than inflationary increase can be justified.

Q6: Do you agree with our proposals for charging a General Special Project Fee (SPF) for financing transactions?

We have no objection that firms should pay for the process of refinancing.

6th April 2009