

Compliance Monitor

The monthly briefing service for compliance specialists

Journey to the centre of the new regulatory regime

*Explorers seeking reconnaissance of coming changes to UK financial services supervision will have been poring over such maps as currently exist – including the FSA’s recent Q&A document. **Julian Sampson** ventures boldly into the unknown, encountering dangers of costs and rule-making processes as well as the challenge of transforming the regulator’s own culture.*

It’s unlikely that FSA policy-makers have much time for reading science fiction, but the FSA’s recently released Q&A on preparations for transition from FSA to the FCA (title: ‘Journey to the FCA’) bears a striking resemblance to the nineteenth century Jules Verne classic ‘Journey to the Centre of the Earth’.

In the story, the irascible and impatient Professor Lindenbrock leads his intrepid (and some unwilling and afraid) explorers on a journey of discovery, with only a coded runic translation to guide them to their goal. Starting in Iceland, they have many adventures and face many dangers, including underground rivers and prehistoric monsters, to finally be ejected by a volcano in Italy, some 2,000 miles away from where they started.

The Q&A document does read like that runic translation, giving tantalising glimpses of what lies ahead, but requiring the reader to be patient, and wait until the full guide, the ‘Approach Document’, is issued in October, and for further consultation papers. However, in following the Q&A, one does find some clues along the way.

Firstly, the FSA re-states that firms will not need to make any application to the FCA in order to become regulated by it. All those currently regulated will be automatically transferred to one (or both) of the new regulators. So the only issue for firms should be for those likely to be regulated by both the FCA and PRA, and who have a case to argue that they need not be dual regulated. These firms should already be in discussion with the FSA.

There will be some relief that such printing costs as firms still, in this digital age, incur may be defrayed

for up to six months. There will, unsurprisingly, be a new regulatory disclosure (“authorised and regulated by...”) to be shown on letterhead, cards and updated on electronic media. The FSA reveals that they are planning a six-month transitional period for this – so firms can continue to print business cards bearing the current disclosure, safe in the knowledge that they will not be prohibited from using them as soon as the new bodies take power. (Explorers following the Q&A trail will have seen this confirmed by the more recently issued consultation paper 12/24).

Other news on costs is less sanguine. The FSA makes all the right noises. For example, they say “we want to be more efficient in the way we do things and try to keep costs down where possible...” They “aim to get value for money”. But there will be additional costs associated with the transition and it will be firms that pay these. And on the critical question of “Will fees go up?” the Q&A document can do no more than shrug its shoulders and say, “It is impossible to say at this stage.”

There’s some reassurance from what the Q&A says about the rule making process under the FCA/PRA. The current process of rule making by consultation is to be continued – indeed enhanced. This may generate a wry smile from compliance professionals who have got used, over the years, to the FSA making pronouncements which are as effective as rules, through newsletters, guidance and even speeches. The Q&A concedes that this process hasn’t been perfect: “We want to get better at explaining what we are doing and listening to the views from firms before we put things in our rulebook.” The document cites the example of a current consultation being held directly with a trade association and its members as a way in which the FCA would like to proceed in the future. It says: “We’re then going to use what we hear back when we develop our rules so they protect consumers and can be practically applied by firms.”

But that will be a hugely difficult task for the FCA to achieve. It will continue to come under sustained pressure from the ill-informed press and politicians to make rules at short notice where they are not required and which lead to unintended consequences. And the pace of change in financial services will not abate, requiring the FCA to continue to use informal methods of rule-making, with all their attendant aggravations.

Indeed, that is not the only difficult issue the Q&A questions, but does not in fact answer. Like Lindenbrock's translation, the Q&A is only a guide. Many answers are deferred to the Approach Document, promised in October, and later consultations. The Approach Document will address, among other things, the questions of supervisory approach ("we're working on this at the moment"), firm culture and product intervention. But it's hard to see what else can be said about some of these deferred answers, given the enormous volume of literature that has already been released on some of these topics by the FSA, and indeed already implemented. Thus it will come as no surprise to regulated firms to hear that as regards firm culture, and notwithstanding the awaited Approach Document, the FCA "will continue to [focus] on senior management as we believe they are crucial in setting their firms' culture. Boards need to understand our priorities as a regulator and need to challenge their executives to make sure they put customers at the heart of what they do."

But the really difficult thing to achieve is not change in firms, but change in the FCA itself. The Q&A recognises that this is a tough one. For example, the FCA knows that it needs to be forward looking. It knows that it is fair to say that the culture of the people who work in regulation might not be forward looking. It also recognises that the relationship that the FSA has with firms has ceased to be one described as a "partnership" and is now one characterised as "intrusive and teeth-bearing". And it knows that in order to make it all work, it needs the "right people" with the "right skills".

All these issues are currently being addressed in the FCA. New approaches are being developed and

tried. And the Q&A does give us an indication of where the Approach Document might go. On the relationship with firms, the Q&A concedes that "while regulation is going to be more intrusive overall, we also know that we want to work in partnership with firms. Part of this is about us setting out much more clearly what we expect from firms, and getting out and talking to firms more and understanding their businesses better."

Easy to say, harder to do. Similarly, on communication with firms and product knowledge more generally, it's "going to be about setting up better two-way information sharing with bodies that work with consumers and firms, as well as working more closely with firms to understand their businesses better". The trouble with this is that it assumes that the FCA will be in a much more frequent and intense dialogue with firms than has hitherto been the case. And it's already been announced that the FCA will focus resources on systemically important firms. Therefore the vast majority of firms, more than now, will be in a contact centre relationship. So when the Q&A says that FCA will work "more closely with firms to understand their businesses better", just which firms is it talking about?

In the end, there will be a heavy burden of expectation on the shoulders of rank-and-file FCA staff to deliver these enhanced outcomes. Thus "we will expect all of our people that talk to and work with firms to display the new FCA 'culture'." And "we think the majority of the change that we deliver as a regulator will come from our people doing things differently and behaving in ways that match up with what the FCA wants to do."

How they will achieve that, we don't know. Maybe all will be revealed in the Approach Document. Let's hope that these issues don't turn out to be the dinosaurs which Lindenbrock and his party encounter. And let's also hope that the FCA doesn't end up 2,000 miles off course. We wait to see.

Julian Sampson (julian@fulcrumcompliance.com) is director of Fulcrum Compliance (www.fulcrumcompliance.com) and chair of the Chartered Institute for Securities and Investment compliance professional forum.