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Shoot first, ask questions later

The incoming regulator's 'early intervention' policy has been expressed in some rather trigger-happy terms. ***Julian Sampson****, for one, is asking questions ahead of the Financial Conduct Authority's gunfire.*

"What's the difference between Tracey McDermott, top enforcer at the FSA, and Wyatt Earp, top enforcer in old-time USA?"

I first posed the question back in June last year. The answer I provided was that there was no difference – both would shoot first and ask questions later. And both thought they were operating in the Wild West.

At the time I thought this might be a controversial, uncomplimentary parallel. How could one compare a process driven UK-wide institution employing thousands, governed by law and subject to checks and balances, with the idiosyncratic individual lawman of Dodge City and Tombstone, Arizona?

But this is no idle analogy. One of the hallmarks of the new Financial Conduct Authority (FCA) regime is its capacity to intervene early – or, to use a vernacular expression – "to shoot first". So we should all be hoping that the FCA's aim is as good as Earp's.

Yet it turns out that the FCA – and in particular Martin Wheatley, its incoming chief executive – may have taken the analogy to heart, rather than be worried by it. Speaking later in 2012 at the September conference of the Association of British Insurers [1], he said: "The key difference between the future and now… is we are being given the power to shoot first and ask questions later…" So there you have it – it's actually policy. You can see the tin star glinting on his lapel.

And how will the FCA be "shooting first"? Well, the FCA's product intervention powers will allow it to enforce against firms before the product has reached the streets. The idea is that by the time customers have complained to the ombudsman, it's too late to protect consumers. They've already lost out. So the new conduct regulator will intervene early, reviewing the product development processes of manufacturer firms to ensure that they match up to what the FCA believes are the standards that will indeed protect consumers. Similarly in the enforcement arena, the FCA will take on "hard cases" and in supervision, will make "judgements" on a firm's business model that may be at variance to the firm's own view.

There's clearly a case for doing this. Some would say – certainly in the public prints – that the City is out of control, very much like the Wild West of Earp's day. LIBOR, PPI, unsustainable bonuses – need one go on? And the FSA has already taken aim and let off a few volleys. Take, for example, the initial decision to restrict the sales of Unregulated Collective Investment Schemes, revealed during August 2012 in CP12/19. As Gavin Stewart, then acting director of policy, risk and research at the FSA, said at the time, "we are acting now to prevent these products being marketed to ordinary retail investors…" On the enforcement side, the decision in May 2012 to ban Anthony Verrier "from performing any function in relation to any regulated activity" on the basis of findings of the High Court in the *Tullet v BGC* case was a very obvious smoking gun.

But if "shooting first" is to be policy, it had better be accurate. History doesn't reveal how many hours Earp spent honing his marksmanship, but however long it was, it allowed him to walk out of the OK Corral unscathed and die in bed at the age of 80. So, as the 1 April date for legal cut-over from the FSA to the FCA/PRA approaches, let's hope that the North Colonnade is in a ferment of preparation, and not just on the new training, cross-skilling and other processes. Let's also hope that one of the changes Martin Wheatley has introduced is a metaphorical pistol range, to enable FCA staff to improve their sharp-shooting skills. They certainly need one, as there are worrying signs that rather than the cold dead eye of a hot shot gun slinger, there's rather a scatter-gun approach in need of some target practice.

Take, for example, that same CP on UCIS. Having made its big pronouncements back in August 2012, the FSA was forced on 11 February to issue clarification that as good as conceded that its original marksmanship had erred. Thus David Geale, head of investments policy, confirmed that "having

reflected on responses to the consultation, we are considering how best to refine the scope of the marketing restriction." The FSA should of course be congratulated for listening to its respondents and taking advice on board, but it hardly inspires confidence in a "shoot first" policy.

It's all the more worrying because the initial UCIS proposals were based largely on the older model of FSA supervision. Field visits by supervisory staff to IFAs had revealed that there was a problem. This led to an aggregation of the data and a formal CP. If, in spite of this opportunity to get the targeting correct, they're still sufficiently off-target that such a letter has to be issued, how is the FCA going to do better under the "shoot first" policy? A "shoot first" approach is reliant not on the judgement of hindsight, but on an assessment – or, as the FCA would prefer to put it, a "judgement" – about the future. And, as the Danish physicist Niels Bohr said, "prediction is very difficult – especially about the future."

Indeed, the future can come back to bite you. The FSA's recent work on salaries and commission was designed with the laudable aim of protecting consumers from high-pressure sales tactics. These were used by salespeople remunerated through commission structures that caused them to put their own financial interest ahead of those of the customer. This supervisory work is right and proper – but again, it needs accurate targeting.

One of the most important financial transactions an individual can make is for a pension. The problem is that at the time when they would be best advised to make that transaction, when they're in their early years, they're least able or inclined to do so. It's arguable that the pension has to be *sold* to the 20-something individual. They won't just *buy* it. And that will require some incentivisation of the salesperson. If that advice is suitable, in a growing economy it will likely turn out to have been a very wise investment. But if the salesperson is not incentivised to overcome the 20-something's understandable reticence, there is a danger that pensions will not be sold to the people who need them most at the time when they had best invest. And that leads to us all working longer.

Perhaps it's understandable that the FSA is slightly off-target on these major issues. After all, judgement is required and the protection of consumers is so paramount that quick-draw action is needed. But the indications are that this lack of accuracy is permeating the whole organisation. Take, for example, the circular sent to retail advisory firms in January, requiring them to confirm to the FSA the names and qualifications of their newly RDR-compliant advisers. 6,000 of these were reportedly sent to the wrong firms. This, in spite of the now ironic rubric in the circular that, "it is important to make sure that you send your data to the correct email address." That's not just missing the target, that's shooting yourself in the foot. Trivial? Maybe. Let's just hope that the FCA will regard a similar data-handling error by a firm with equal equanimity and not as an excuse for some target practice.

And again, take the change of FSA tariff base for advisory firms from a headcount to an income basis. The FSA might be forgiven for thinking that it had adequately signposted this, via CP12/28 of October 2012 and a Policy Development Update in January. Yet, in spite of this, a sufficient number of firms had misunderstood the FSA's intention to require them to issue on 13 February a further note stating, "we have identified a number of reporting errors on forms submitted by firms to date and therefore thought it may be helpful to highlight these common errors and misunderstandings to ensure you report correctly."

The FSA may protest that it is unfair to blame them for inadequate targeting in this respect – a simple change, and what more could they have done? But this tells its own story – that if firms are so busy, with compliance and accounting staff under such pressure that they don't have time to read, absorb and brief management on such a change as this, what hope is there for other initiatives emanating from Canary Wharf or Brussels? Perhaps the lesson for us all from this is not one of targeting, but that firms are at policy overload.

And there is good reason to fear that the FCA's level of accuracy will not, in spite of all the public pronouncements, be an improvement. The key to an accurate 'shooting first' policy is good information. The best way for the regulator to gather this would be from its own supervisory staff, monitoring the firms they supervise. But the FCA is committed to reducing the number of field supervisors. Many firms, including those with direct contact with retail customers, have been taken out of a supervisory relationship and will henceforth only deal with the FCA through the call centre.

The FCA is aware that it needs good information, and in chapters 5 and 6 of the October 2012 document 'Journey to the FCA' talked about how it would be "building [their] understanding of the markets" and "maintaining effective relationships".

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A new division – Policy, Risk and Research – has been established to act as the FCA's "radar". This will "gather and use a wide range of data, information and intelligence from across our organisation, firms and elsewhere to help [the FCA] identify and assess risks in financial markets. This will include economic and market analysis, consumer complaints and enquiries, media analysis, and intelligence from consumer organisations and professional firms."

This new department is to be the FCA's shooting gallery, where they will practice before loading for real. There is much said in the 'Journey' about how this will work, their risk-based approach, the link between "high-severity incidents and regulatory performance" and "using behavioural insights to deliver better outcomes for consumers". One hopes that this will be an effective substitute for the lack of feet-on-the-ground post legal cut-over.

One thing Wyatt Earp knew – he only had one shot. It had to be good. While the FCA may not be in such a dramatic position, a misplaced shot for Earp or the FCA could be equally damaging. For both the target – and the shooter.

[1] 18 September 2012, reported by *Money Marketing*.

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