SCOPE AND METHODOLOGY

1 The National Audit Office was invited by HM Treasury on 21 June 2006 to review the economy, efficiency and effectiveness with which the Financial Services Authority (FSA) has used its resources in discharging its statutory functions. The review was carried out under Section 12 of the Financial Services and Markets Act 2000. Under the terms of reference of the invitation (full terms of reference are included on page 67), HM Treasury asked the NAO to look at five broad areas of the FSA's work:

- internal performance management;
- external joint-working in the UK;
- influencing and representation internationally;
- financial crime; and
- financial capability.

2 The key elements of our study methodology are outlined below:

31 Review methodologies

Section	Methodology
1	Document review and case study analysis
2	Process mapping
3	Data analysis
4	Work observation
5	Staff interviews
6	NAO survey of FSA supervisors
7	Other surveys
8	International interviews
9	Industry interviews and discussion groups
10	Stakeholder and partner consultation and interviews
11	Correspondence and web log monitoring

Source: National Audit Office

1. Document review and case study analysis

3 We examined a wide range of documents published by the FSA, and those generated internally. For each of the five terms of reference areas, we identified the main strategic documents in which the FSA sets out the outcomes it aims to achieve and the work programme to deliver these aims. We then sought to identify where and how far the outcomes and work programmes are reported publicly; and how they are recorded in internal performance management information reported to senior executives, the main FSA Board, and non-executive directors. In this way, we integrated our audit approach, with the performance management strand of the terms of reference forming the central element, focusing on how far performance management information focuses on appropriate outputs and outcomes. For the other four strands, we sought to identify how far the FSA had integrated them into the overall performance management approach via a clear identification of intended outputs and desired outcomes.

4 In addition, we identified a series of case studies that illustrated how the FSA approaches its work in each of the five terms of reference areas. These case studies served two purposes: firstly, they enabled us to understand the practical challenges and solutions that the FSA faces in a wide range of areas; and secondly, they provided evidence that we have used throughout our report to illustrate important points. The main case studies we reviewed were:

Part 2: Working with other UK regulators

- Payment Protection Insurance (Figure 9)

Part 3: Influencing and representation internationally

- Markets in Financial Instruments Directive: assessment of costs and benefits (Figure 10) and directive timeline (Figure 11)
- Credit rating agencies (Figure 12)
- Credit derivatives and bi-lateral working (Figure 13)

Part 4: Financial crime

- High profile anti-money laundering fines issued by FSA (Figure 19)

Part 5: Financial capability

- FSA's baseline survey of Financial Capability in the UK (Figure 25)
- FSA's Evaluation of work-place seminars (Figure 28)
- Innovation fund (Figure 30)

2. Process mapping

5 We mapped the FSA's performance management process. We did this by tracing how performance information is generated, reviewed and reported, and we interviewed FSA staff responsible for producing performance management information to ascertain how they used the information. This work involved mapping two separate processes: firstly, that involved in the generation of the FSA's existing internal performance management information; and secondly, that involved in the FSA's new Outcomes Performance Report, which identifies 9 high-level outcomes from the FSA's work.

6 We carried out an informal high-level benchmarking exercise of the FSA's performance management system against the performance management maturity model set out in the National Audit Office's Efficiency Toolkit published in 2006. More information on this exercise is detailed in Appendix 1a).

3. Data analysis

7 To carry out its work under our five terms of reference the FSA produces a large and varied amount of data such as cost estimates, consumer and industry research, web trends, enforcement statistics and project evaluations. Such data is integral to the FSA's internal thinking, stakeholder relationships and the conclusions and decisions it reaches. Based on a review of documents and interviews with FSA staff we identified the key data for each terms of reference area. We then conducted further analysis of the data to assess its robustness and draw out key trends and patterns. The main data sets and documents we analysed were:

Performance management

- Correlations between time recording and risk assessments for individual firms
- Executive Committee Management Information Packs
- Business Unit Management Information Packs
- Economy and efficiency reports

Working with other regulators

- Memorandums of Understanding (FSA & TPR; FSA & FRRP); Joint Action Plan (FSA & OFT)
- Minutes of joint meetings
- Relationship structure charts
- Case summaries illustrating joined-up working

International representation

- FSA's EU and Global Strategy
- FSA briefing papers for EU and international committees
- Financial Services Practitioner Panel and Consumer Panel surveys
- Case summaries evaluating FSA influencing in EU and internationally
- Estimates of staff time booked to EU and international activities

Financial crime

- Financial crime budgets
- Training statistics
- Communications releases
- Staff time booked to combating financial crime activities
- Enforcement case volumes, penalty decisions and ratio of opened cases to enforcement actions

Financial capability

- Overall financial capability expenditure and budget figures
- Financial capability project budgets
- Baseline survey on Financial Capability

4. Work observation

8 The FSA's work under our five terms of reference areas involves the use of a variety of internal and external meetings and similar to make decisions; develop thinking; and communicate with industry and consumers. To enhance our understanding of how the FSA operates, we attended relevant meetings in an observer capacity, as follows:

Performance management

- ARROW 2 training course
- ARROW pre-visit meeting and post-visit validation panel meeting
- Firm Contact Centre
- Small Firms Division roadshow

Financial Crime

- Risk Committee (Fin Crime)

Financial capability

- Joint HMT/FSA Financial Capability Conference
- Financial Capability Steering Group
- Financial Capability workplace seminars
- Higher Education Early Developers meeting

5. Staff interviews

9 We conducted interviews with a broad range of FSA officials from across the organisation. For each terms of reference area there was a lead member of staff who provided information about the FSA's work in that area, and facilitated meetings with relevant contacts within the FSA who were best-placed to answer our detailed questions. In total, we held over 70 interviews with FSA staff members.

10 In addition, the NAO held meetings with each member of the FSA's executive committee, principally to ascertain the use made of performance management information; and a majority of the FSA's Board members, where we sought views in particular on the information provided to Board members on the FSA's performance, and also Board members' views against each of the terms of reference questions.

6. NAO survey of FSA supervisors

11 Based on the findings from our early fieldwork, the NAO decided there was a need for further evidence from the FSA supervisory staff on certain key areas: the nature of their work, the FSA's work on combating financial crime, the FSA's work on improving the public's financial capability and the overall performance of the FSA. We therefore developed an on-line questionnaire which was designed to obtain the views of FSA supervisory staff on the relevant issues, rather than sent to all FSA staff. We were also conscious of avoiding duplicating the FSA's own staff survey. Our survey was sent to 580 FSA staff and 391 staff completed it (a response rate of 67 per cent). The results have been drawn on in this report as appropriate to give an additional layer of evidence.

7. Other surveys

12 With assistance from NAO experts in survey design, we reviewed and analysed the results from several other relevant surveys outlined in **Figure 32**.

32 Other relevant surveys

Survey	Organisation
Staff Survey 2006 (November 06)	Financial Services Authority
Fourth Survey of the FSA's Regulatory Performance (November 06)	Financial Services Practitioner Panel
BBA member survey of the FSA Regulatory Framework 2005 (December 05)	British Bankers' Association
Banking Banana Skins 2006 (June 06)	Centre for Study of Financial Innovation
Financial Capability Baseline Survey (March 06)	Financial Services Authority
The Competitive Position of London as a Global Financial Centre (November 05) and The Global Financial Centre Competitiveness Index (February 06)	The Corporation of London

Source: National Audit Office, FSA, FSPP, BBA, CSFI

13 We reviewed each survey to determine it was a robust source of evidence. We then conducted secondary analysis to draw out key findings which were relevant to our terms of reference. The results of these analyses informed our other strands of fieldwork, particularly our interviews with FSA staff, industry and other stakeholders. We also triangulated the results of these surveys with our own audit findings to provide an extra layer of evidence.

8. International interviews

14 As the regulator of a major financial market, there is an important international dimension to all the strands of the FSA's work which are covered by the terms of reference. In order to understand the international context in which the FSA works we conducted a number of in-person and telephone interviews with representatives from EU and international bodies and with international comparators.

15 We placed the most weight on this strand of our methodology in examining the FSA's work influencing and representing internationally. In this area we met:

33 International consultees

Area	Meetings conducted
EU consultees	
Committee of European Banking Supervisors	Chair, Secretary General, FSA secondee
Committee of European Securities Regulators	Chair, Secretary General, FSA secondee
Committee of European Insurance and Occupational Pension Supervisors	FSA secondee
European Commission	Director, Financial Services Policy and Financial Markets;
	Head of Department – Insurance and Pensions;
	FSA secondee
European Parliament	John Purvis MEP; Wolf Klinz MEP
	FSA secondee (Designated National Expert to the Economic and Monetary Affairs Committee)
UK Representation in Brussels	First Secretary, Financial Services
City EU Advisory Group	Chairman
City of London Office in Brussels	Director
European Banking Federation	Head of Department, Banking Supervision and Financial Markets
International consultees	
United States Securities and Exchange Commission	Chairman
Autorité des Marchés Financiers (the French Securities Regulator)	Chairman
Australian Securities and Investments Commission	Chairman
Hong Kong Securities and Futures Commission	Chief Executive Officer

Source: National Audit Office

NOTE

We also spoke to the international security regulators above about financial crime.

16 On financial capability, we interviewed five international comparator organisations by telephone. These were:

- Financial Consumer Agency of Canada
- Australian Financial Literacy Foundation
- New Zealand Retirement Commission
- Financial Regulator in Ireland
- Malta Financial Services Authority

17 We developed a topic guide for the interviews which was designed to gather views on the problem of financial capability, the work of the organisation on financial capability, the resources allocated by each organisation, how its impact was measured and impressions of the FSA's work in this field.

9. Industry interviews and discussion groups

18 As the FSA is funded through a levy on the financial services industry, a vital strand of our methodology was to canvass a wide range of views from businesses. We held a number of discussion groups structured around the terms of reference with trade associations, groups of interested parties and a wide range of businesses. For each discussion, we used the terms of reference questions as a topic guide.

19 We held semi-structured interviews with representatives from a number of trade associations across the financial services sector including:

- Association of British Insurers
- Association of Independent Financial Advisers

- Association of Private Client Investment Managers and Stockbrokers
- British Bankers' Association
- British Insurance Brokers Association
- Council of Mortgage Lenders
- Investment Management Association
- London Investment Banking Association
- National Association of Pension Funds

20 We also interviewed individual firms on specific issues of interest within the terms of reference. These firms were selected due to their particular relevance to the terms of reference areas. For example, we met with the Royal Bank of Scotland on Financial Capability because of their own programme providing financial education in schools. Overall, we held 24 interviews.

21 In the course of these discussions, interviewees frequently made observations and points that went beyond the terms of reference. Where appropriate, we recorded these observations and shared them with the FSA in an anonymised, summarised format, even though they fell outside our detailed terms of reference.

22 We also attended the following discussion groups with interested parties:

- FSA Practitioner Panel: (the Panel provides input to the FSA from the industry in order to help it meet its statutory objectives and comply with the seven principles of good regulation, and represent the interests of practitioners). We met the Panel on three occasions.
- FSA Smaller Businesses Practitioner Panel: (the Panel provides advice on policy initiatives, focusing in particular on the impact of those initiatives on small regulated businesses, and more generally its remit allows the Panel to comment on any specific FSA output as it wishes, and to set its own agenda). We met the Panel once, and also obtained written reponses to a detailed set of questions we shared with the Panel.
- FSA Consumer Panel: (The Panel advises and monitors the FSA on all its policies and activities from an independent consumer point of view. They also review and comment on wider developments in financial services if they feel that consumers are losing out). We met the Panel twice.
- Lloyds of London: (firms represented – **Figure 34**)
- British Bankers' Association: (firms represented – Figure 34)
- London Investment Banking Association: (firms represented – Figure 34)
- Beachcroft consultancy industry panels: (firms represented – Figure 34)

34 Attendees at industry discussion groups

Panels

Financial Services Practitioner Panel

Smaller Businesses Practitioner Panel

Financial Services Consumer Panel

Roundtables organised by:	Firms attending
Lloyds of London	Ace Underwriting Agency Ltd, Advent Underwriting Ltd, Atrium Underwriting Ltd, Beaufort Underwriting Agency Ltd, Beazley Furlonge Ltd, S A Meacock, Wellington Underwriting Agencies Ltd, Whittington Capital Management Ltd
British Bankers' Association	ABN Amro, Abbey National, Credit Agricole, Credit Suisse, HBOS, JP Morgan, Royal Bank of Scotland
London Investment Banking Association	Citigroup, Credit Suisse, Deutsche Bank, Morgan Stanley, UBS
Beachcroft Regulatory Consulting	AEGON, AXA, AIG Europe (UK) Ltd, Amlin plc, Aviva plc, Catlin Insurance Company (UK) Ltd, Chubb, Groupama Insurances, HCC International Insurance Co plc, HSBC, Legal & General Group, Prudential, Royal & Sun Alliance, St Paul Travelers Insurance Co Ltd, Wesleyan Assurance Society, Zurich Financial Services (UKISA) Ltd

Source: National Audit Office

NOTE

We also attended a meeting of the Centre for the Study of Financial Innovation Regulatory Working Group.

- We also convened our own Panel of Experts to advise on our methodology and emerging findings.
  - George Alford – banking and FSA expert (former CEO of Kleinwort Benson and ex-Bank of England, now with Beachcroft Regulatory Consulting)
  - Colette Bowe – consumer and regulation expert (Chair of Ofcom Consumer Panel, non executive director of Morgan Stanley International; Axa Framlington; Yorkshire Building Society)
  - Phil Evans – consumer and regulation expert (ex of WHICH?, now an independent consultant)
  - Rob Falkner – financial services legal expert (partner with Morgan Lewis)
  - John Howell - financial services expert with focus on financial crime issues (independent consultant)
  - Graham Mather – legal and regulatory expert (President of European Financial Forum)
  - Dr. Mark Thatcher – expert in public administration and policy, London School of Economics

10. Stakeholder and partner consultation and interviews

23 The FSA has a number of other stakeholders aside from industry including government, consumers, other regulators, other public bodies and the voluntary sector. Across most of the areas in the terms of reference, it was necessary to speak to organisations with a common interest in particular aspects of the work of the FSA.

24 We held an on-going dialogue with HMT officials who had commissioned the review not only to keep them informed of progress on the review but also to gain their views on the FSA's performance against the areas in the terms of reference.

25 On joint working with other UK regulators, we met the chief executive of each of the three bodies named in the terms of reference (FRC, OFT, TPR) and held follow up meetings with relevant staff at the three bodies. For these meetings we developed a structured questionnaire based on the themes in the Hampton Report to ensure we covered similar areas with each. Questions were asked under the following headings: collaborative working; liaison with the FSA; information sharing with the FSA; reducing the administrative burden on jointly regulated firms; joint training and development; communicating with the public; and general issues of joint working.

26 On combating financial crime, we held meetings with key UK public bodies involved in combating financial crime. At these interviews we discussed their level of cooperation with the FSA on financial crime, as well as issues that effect the effectiveness of joint working between the agencies:

- City of London Police (Economic Crime Department);
- Metropolitan Police Service (Economic & Specialist Crime Command);
- Serious and Organised Crime Agency (Proceeds of Crime Division);
- Serious Fraud Office;
- HM Treasury (Financial Crime team within Financial Services Division);
- Home Office (Organised & Financial Crime Department); and
- HM Revenue & Customs (Anti-Money Laundering Unit & Criminal Investigations).

27 On financial capability, we interviewed key stakeholders including delivery partners under the Financial Capability Action Plan, members and former members of the FSA's financial capability working groups, consumer bodies, and relevant government departments. For these meetings we developed a topic guide based on our desk research and FSA interviews. Topics covered included the scale of the problem, the role of the FSA, the appropriateness of resources applied, the challenges faced, the successes and gaps in the FSA's work, the FSA's relationship with its delivery partners and how the impact of the FSA's work can be measured. In order to reach the widest number of stakeholders possible, we also sent a qualitative questionnaire covering the same topics to members and former members of the FSA's working groups.

35 Consumer consultees

Consultees

- Which?
- National Consumer Council
- Resolution Foundation
- Personal Finance Education Group
- BBC
- Roehampton University
- Citizens Advice
- Omagh Independent Advisors
- Fairbridge West
- L&Q Housing Trust

11. Correspondence and monitoring of Adam Smith web log

28 We received 115 pieces of correspondence in relation to our review of the FSA. Many of these communications referred to matters which were outside our terms of reference. Where the information related to our terms of reference areas we treated the submissions as evidence to be investigated and considered alongside our other streams of evidence gathering.

29 The Adam Smith Institute set up a web log for people to post comments on our review. We monitored this web log and where comments were relevant to our terms of reference areas we treated them as evidence to be investigated and considered alongside our other streams of evidence gathering.

TERMS OF REFERENCE

1. Internal performance management

The FSA's economy and efficiency is kept under review, and reported on in the annual report, by its Non-Executive Directors. They are informed by, among other things, the FSA executive's quarterly management information and in particular the "Economy and Efficiency" reporting. The FSA is seeking continuously to enhance this economy and efficiency reporting and is implementing a complementary strategic performance management framework focused on effectiveness. In this context:

- how effective are the FSA's Non-Executive Directors in carrying out their responsibility to prepare an annual report on economy and efficiency, and are there any suggestions for improving their effectiveness?
- how useful to the Non-Executive Directors are the FSA's new "Economy and Efficiency Report" procedures, and are there any suggestions for improvement?
- how well is the FSA matching its resource allocation to its identification of risks to its objectives?
- are there any suggestions about the design of the FSA's new strategic performance framework?[149]
- are there any suggestions for improving the processes?

2. External joint-working within the UK

In the context of the Hampton Report and the benefits of risk-based regulation for efficient use of resources by regulators and the business sector:

- how strong are the links and working relationships between the FSA and other relevant regulatory bodies in the UK – notably The Pensions Regulator, the Financial Reporting Council and the Office of Fair Trading – and is the sharing of regulatory techniques and expertise between them effective?
- looking ahead, what are most likely to be the future priorities and challenges for joint-working with UK regulatory bodies, and are there any suggestions?

3. Influencing and representation internationally

A large proportion of financial regulation in the UK is based on international and/or EU standards or rules. The ability to supervise effectively and efficiently depends in part on these rules and standards. The FSA has, since its establishment, been given an important role in international fora. Its role in EU bodies has increased since the establishment of the so-called "level 3" committees of European supervisors. In that context:

- does the FSA's performance in influencing the development of international and EU financial supervision – in particular through its participation in international and EU bodies – reflect fully the UK's prominent role as a global financial market, and are there any suggestions for improving the FSA's performance in future?

4. Financial crime

The FSA has an objective relating to financial crime. It works with the Treasury, SOCA, the police and other bodies. In this context:

- is the FSA's work on combating financial crime effectively – including counter-terrorist finance – integrated with its other supervisory work and with other agencies in this field?
- is the FSA communicating effectively with business about issues on the financial crime agenda, and sharing information with them about risks?
- does the FSA make appropriate use of its enforcement powers and penalties?
- in light of the above, and the FSA's risk based allocation of its finite resources, does the level of resources allocated to combating financial crime – including counter-terrorist finance – appear appropriate, given its size and importance?

5. Financial capability

The FSA has an objective relating to public awareness. It has recently published an updated strategy on financial capability, having surveyed the extent of consumers' abilities. Lack of ability and understanding on the part of consumers remains one of the key underlying market failures in retail financial services, and as such one of the reasons for financial regulation. In this context:

- is the FSA's allocation of resources to work on financial capability appropriate (i.e. when looked at in the context of other demands on the FSA's finite resources and considering the cost/benefit of investment of resources in seeking to impact on this large scale social issue), bearing in mind the regulatory consequences and costs of low financial capability among consumers?
- how effective is the FSA's working with other organisations, in the public and private sectors, to improve financial capability – and are there any opportunities to increase value-for-money through partnership?

HM Treasury
June 2006

APPENDIX ONE

Performance management

This appendix contains information relating to key aspects of our review of the FSA's performance management, specifically:

a our benchmarking of the FSA's performance management framework against the NAO Efficiency Toolkit; and

b information relating to the FSA's Outcomes Performance Report showing an example of its lower levels.

1a. Benchmarking the FSA's performance management framework against NAO Efficiency Toolkit

1 The National Audit Office developed its Efficiency Toolkit in 2006. It provides practical guidance on assessing an organisation's current approach to achieving efficiency. It helps identify opportunities for improvements and develop actionable recommendations.

2 The National Audit Office applied the Performance Management assessment to the FSA's performance management system. It is essentially a performance management maturity model which describes how well an organisation's performance management capabilities link behaviour with business strategies.

3 The model describes five interlocking elements key to effective performance management:

- Strategic measures – Managing the business through financial and non-financial measures linked to strategy
- Cascaded measures – Strategic measures cascaded consistently down the organisation
- Aligned processes – Planning, budgeting, capital investment and appraisal and reward processes aligned consistently with business strategy
- Management Information – Reliable management information is available that supports the measures
- Action – Using the information to act appropriately to ensure the required target performance is met.

4 The toolkit divides each element into a spectrum of potential capabilities against which an organisation can be benchmarked. An informal high-level benchmarking exercise of the FSA's performance management system against these capabilities has been carried out with the following results:

- Strategic measures – The FSA scores highly in managing the business through strategic measures, largely due to the design of the Outcomes Performance Report (the Outcomes report) linking the Outcomes report to the strategic objectives. A possible area for improvement is understanding the inter-relationship between different measures (i.e. risk and resource).

- Cascaded Measures – The FSA scores medium-high for cascaded measures. The structure of the Outcomes report targets performance management at all levels onto the strategic aims. However, the culture embodied in the Outcomes report is not yet embedded and links with individuals/teams need to be strengthened (currently some teams may still use their own measures internally leading to inconsistencies). A particular area of weakness is that the FSA has a high number measures in use at different levels (many unrelated to the Outcomes report). This could lead to links with overall business requirements remaining unclear.
- Aligned processes – The FSA scores medium-high in aligning processes consistently with business strategy. Strengths include the alignment of planning and budgeting with strategic direction and the use of milestones. Areas for possible improvement include on-going assessments of the performance management system and strengthening the link with the reward framework.
- Management Information – The FSA scores medium-high in delivering reliable management information to support the measures. A particular strength is the governance arrangements surrounding data, including the "ownership" of the Outcomes report's indicators by directors. Areas for possible improvement include the co-ordination of data from different sources to allow more cross-reporting (e.g. between risks and resources) and more regular reporting of key measures to Executive Committee (i.e. monthly rather than quarterly).
- Action – The FSA scores medium in acting on management information. Given the volume of management information, there is a risk that the process of measurement could displace time from acting on the information. It is important to ensure that the focus of management remains on action rather than process.

5 Overall, the FSA scores highly indicating that it has a mature performance management framework linked to business strategies. This reflects the high profile of performance management at the FSA resulting from its statutory obligation to measure performance.

1b. The FSA's new Outcomes Performance Report

This section contains two figures illustrating the operation of the Outcomes Performance Report in greater depth.

The FSA has translated its statutory objectives into three strategic aims:

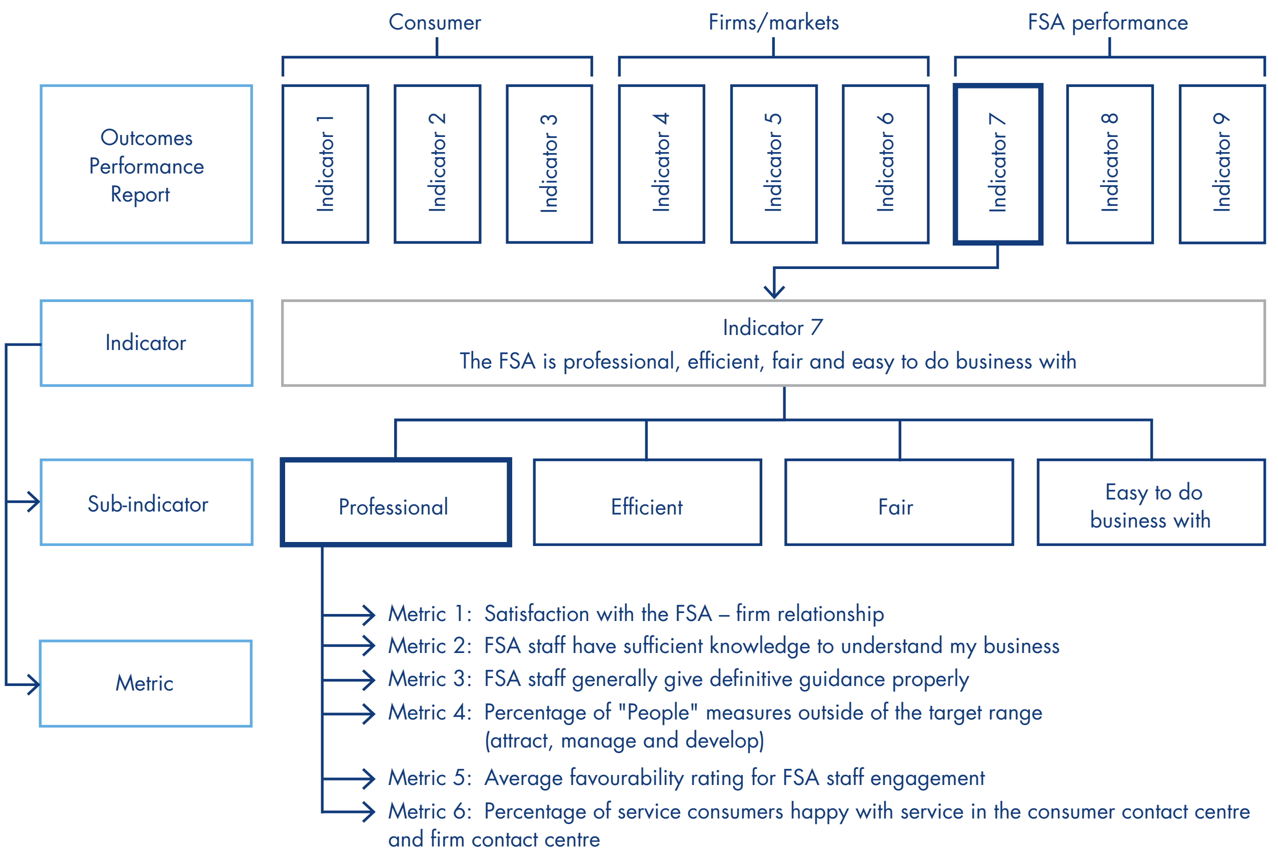
- Helping retail consumers achieve a fair deal
- Promoting efficient, orderly and fair markets
- Improving the FSA's business capability and effectiveness.

The Outcomes report has nine high level indicators by which to assess performance in achieving its strategic aims. These nine indicators are:

1. Consumers receive and use clear, simple and relevant information from the industry and from the FSA;
2. Consumers are capable of exercising responsibility when dealing with the financial services industry;
3. Financial services firms treat their customers fairly and thereby help them to meet their targets;
4. Firms are financially sound, well managed and compliant with their regulatory obligations;
5. Firms and other stakeholders understand their respective responsibilities and mitigate risks relating to financial crime and arising from market conduct;
6. Financial markets are efficient, resilient and internationally attractive;
7. The FSA is professional, fair and easy to do business with;
8. The FSA is effective in identifying and managing risks to its statutory objectives;
9. The costs and benefits of regulation are proportionate.

Each indicator is broken down into a number of sub-indicators which are in turn supported by a series of metrics. **Figure 36 overleaf** demonstrates this for indicator 7.

36 The lower levels of the Outcomes Performance Report



Source: FSA

APPENDIX TWO

Working with other regulators

This appendix includes information which further illustrates the working relationship between the FSA and the OFT, specifically:

a The FSA/OFT Joint Action Plan which sets out the key areas of collaboration between the two organisations.

2a. FSA/OFT Joint Action Plan

The key points from the FSA/OFT Joint Action Plan are set out below:

Working more closely together:

- The FSA and the OFT published studies in October 2006 on Payment Protection Insurance (PPI), and intend to collaborate on future regulation of this market.
- They updated a Concordat formalising their working arrangements on unfair contract terms.[150]

  This commits the FSA and the OFT to take necessary and proportionate action where there is evidence of a potential breach of the regulations causing consumer harm. It should ensure that there is no duplication of effort and that action is taken by the body best placed to lead on any given issue.
- Implications of the new Consumer Credit Act 2006 for the Financial Ombudsman Service.

  The OFT is responsible for regulating consumer credit. The new Consumer Credit Act creates the Consumer Credit Jurisdiction (CCJ), which allows consumers to access the Financial Ombudsman Service (FOS) for consumer credit complaints concerning firms that are licensed by the OFT but not authorised by the FSA. The FSA and FOS worked with the OFT to align the CCJ with the existing FOS Compulsory Jurisdiction (CJ), resulting in changes to the relevant FSA Handbooks. The FSA will be responsible for the way FSA-authorised firms handle all complaints, including those concerning consumer credit business, so jointly regulated firms' complaint handling procedures will be overseen by one regulator only. This also means that FSA-authorised firms will only pay a single levy to fund the FOS rather than two separate levies. These changes will be brought into effect in April 2007.

Reducing the administrative burden on jointly regulated firms:

- Consolidated guidance and revised rules on jointly regulated advertisements.
- Completed feasibility studies into ways to reduce the burden on jointly regulated firms in respect of the FSA and OFT's authorisation and licensing processes. Studies concluded that few changes were justified on cost-benefit grounds at this time but agreed to revisit these results once new on-line systems are in place. These findings were endorsed by the industry user group for the Joint Action Plan.
- New joint communications strategy agreed.

Communicating with consumers

- Re-launch of the FSA and the OFT's consumer websites and improved coordination of consumer communications

  Collaboration continuing between the FSA and the OFT on a revamp of their respective websites and consumer communications strategy. The FSA and OFT will share lessons from the respective work and campaigns and feed them in to future campaign planning and evaluation. This will include using regional data from the FSA's Financial Capability Baseline Survey.
- Consumer contact centres

  Collaboration continuing on the feasibility of integrating their consumer contact centres.
- Public registers

  Collaboration continuing on the feasibility of integrating the FSA's and the OFT's public registers. The study is due to be completed by the end of March 2007.

APPENDIX THREE

Influencing and representation internationally

This appendix sets out further information on the European context in which the FSA operates, specifically:

a **The relationship between key EU institutions and the Lamfalussy committees.**

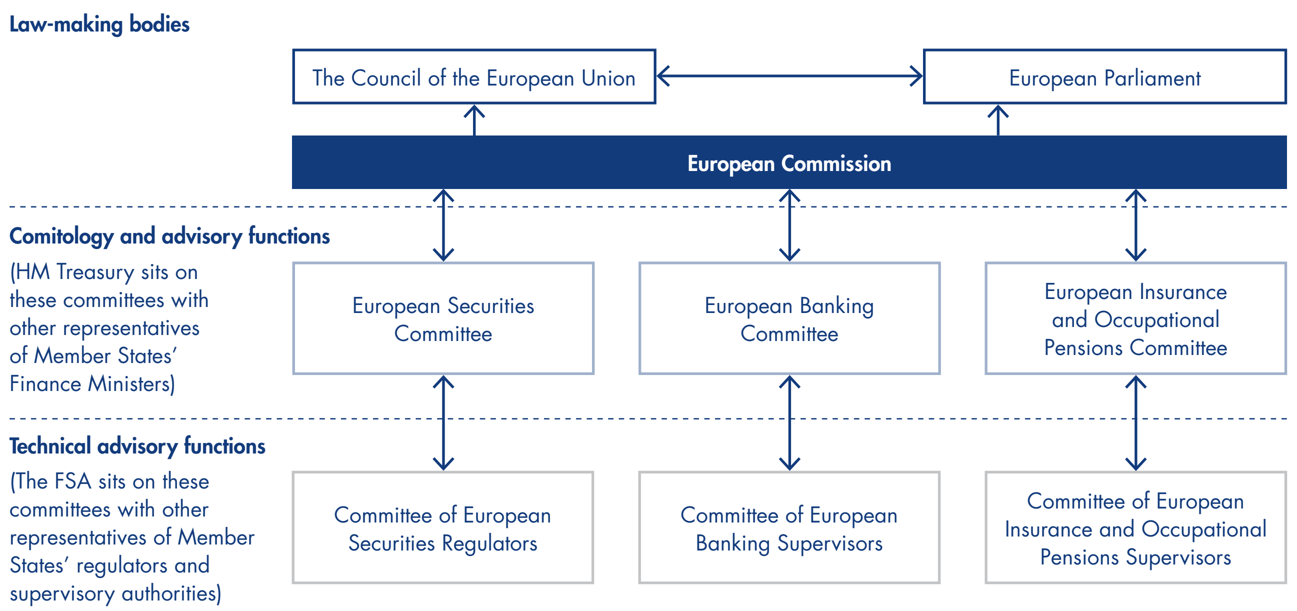
b **The respective roles of the FSA and HM Treasury in influencing EU policy development.**

c **The most significant EU legislative measures currently being implemented or under development.**

3a. EU institutions and the Lamfalussy committees

The financial architecture of regulation in Europe is characterised by de-centralisation with separate national regulators rather than a centralised single European regulator; segmentation with specialist committees that cover distinct financial activities (banking; securities; insurance and occupational pensions); and co-operation between national regulators who sit on these committees.

37 The relationship between the Lamfalussy committees and other key EU institutions



Source: National Audit Office

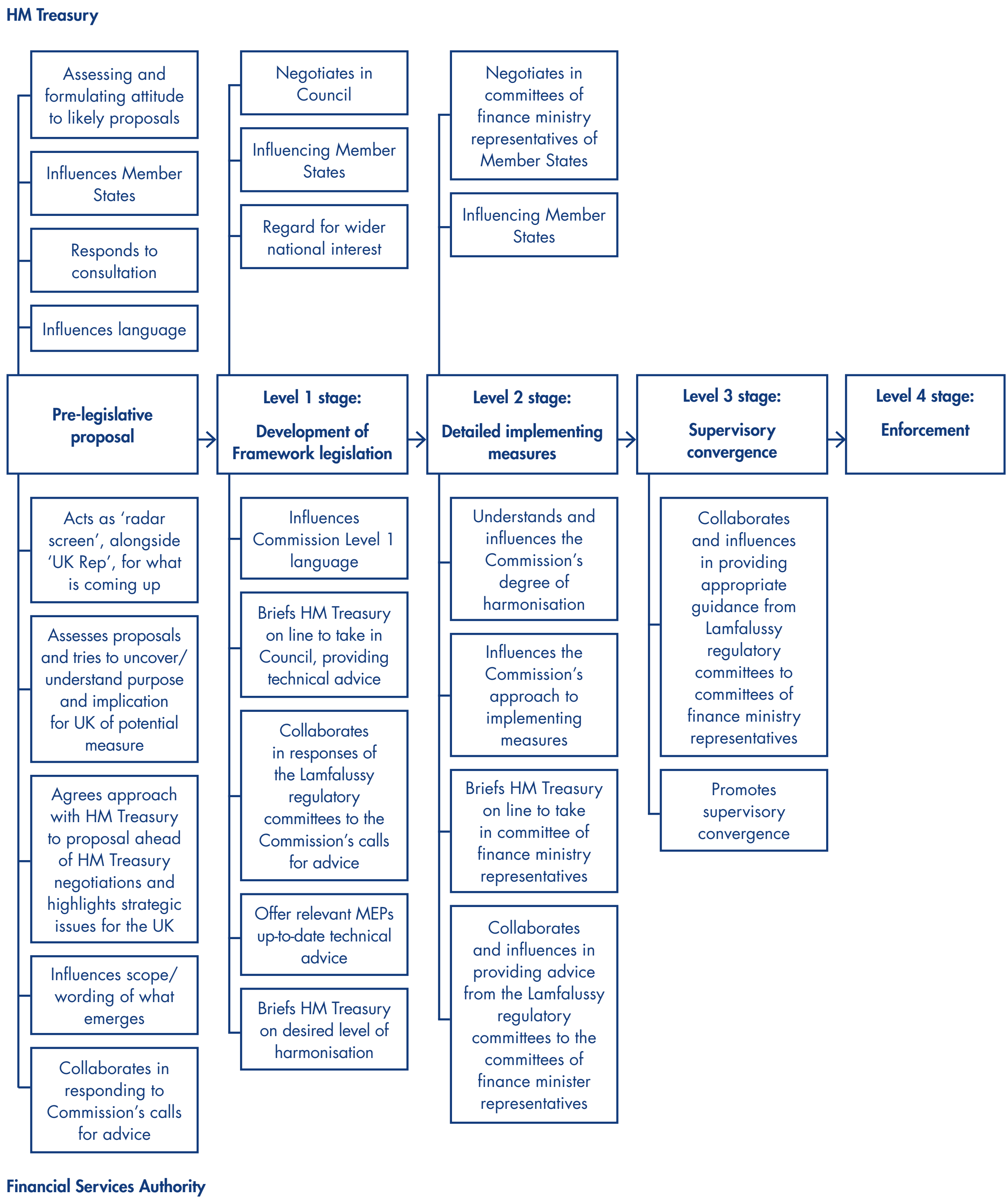
NOTE

This is a simplified schematic to show where the committees of regulators (including the FSA) and the committees of finance ministers' representatives (including HM Treasury) sit in relation to other key legislative bodies in Europe. The committees are known as the Lamfalussy committees.

3b. The FSA/Treasury in EU policy development

As explained in part 3 the FSA and HM Treasury both have roles to influence and represent at European Union level. **Figure 38** sets out their respective roles in influencing EU policy development.

38 The respective roles of the FSA and HM Treasury in influencing EU policy development



Source: FSA

3c. The most significant EU legislative measures currently being implemented or under development

- **Capital Requirements Directive:**

  This Directive introduces a risk-sensitive prudential framework for credit institutions and investment firms across the EU. It applies to all investment firms, banks and building societies. It is closely linked to the Revised Basel Framework, agreed in June 2004, which applies to internationally-active banks.

- **Markets in Financial Instruments Directive:**

  MIFID is a wide-ranging Directive, constituting a major element in the EU's Financial Services Action Plan. The Directive substantially revises the current Investment Services Directive and is intended to promote a single market for wholesale and retail transactions in financial instruments. MIFID widens both the scope of investment services requiring authorisation by Member States and the range of investments falling within the range of regulation. In relation to these and other investment services and activities, MIFID significantly improves the 'passport' for investment firms. This enables them to conduct cross-border activities across Europe on the basis of their Home State authorisation.

- **Reinsurance Directive:**

  The Reinsurance Directive (RID) aims to introduce harmonised supervision of reinsurance across the EU. It is intended to create a single market in reinsurance (similar to that which already exists for direct insurance) and to remove remaining barriers to trade within the EU.

- **Third Money Laundering Directive:**

  The main purpose of the Directive is to provide a common EU basis for implementing the revised Financial Action Task Force (FATF) recommendations (issued in June 2003). It will replace the First and Second Money Laundering Directives.

- **Transparency Directive:**

  The Transparency Directive (TD) establishes periodic reporting requirements on an ongoing basis for issuers who have securities admitted to trading on a regulated market situated or operated within the EU. Investors in shares of issuers listed on regulated or prescribed markets will need to comply with major shareholding disclosure rules.

- **Unfair Commercial Practices Directive:**

  The Unfair Commercial Practices Directive (UCPD) seeks to protect consumer interests from unfair business-to-consumer commercial practices. In particular, commercial practices will be unfair if they are misleading (this includes both acts and omissions) or aggressive. The Directive contains a list of 31 practices which will always be considered unfair.

- **Regulation on information accompanying wire transfers:**

  The Regulation seeks to adopt into EU legislation FATF Special Recommendation VII on information accompanying wire transfers. The requirement is for transfers of funds to be accompanied by accurate and meaningful originator information. Financial institutions will be required to monitor incoming transfers and to detect those without full originator information.

- **Solvency 2:**

  Solvency 2 is a fundamental and wide-ranging review of the current EU Life and Non-Life, Reinsurance and Insurance Groups Directives (Solvency 1) in the light of developments in insurance, risk management and finance techniques.

- **Credit for Consumers Directive:**

  The purpose of the Credit for Consumers Directive is to promote the development of a Single Market for consumer credit. It will apply to all providers of unsecured credit to consumers (such as banks and building societies), and all unsecured credit intermediaries.

- **Payment Services Directive:**

  The aim of the Directive is for users to be able to make cross-border payments as quickly, efficiently and securely as they can. The proposed Directive introduces conduct of business regulation for all payment service providers and an authorisation regime for providers that are neither currently authorised as credit institutions nor e-money issuers – creating a new class of 'payment institutions' (e.g. money remitters).

APPENDIX FOUR Financial Crime

This section provides further information on the FSA's work on the complex area of financial crime and the NAO's work to assess the FSA's performance in this area, specifically:

- a **An explanation of the Money Laundering Offence;**
- b **How the FSA will measure its performance on financial crime through its Outcomes Performance Report; and**
- c **Summary results from the NAO survey of FSA supervisors on the questions relating to financial crime.**

4a. Money Laundering

This section provides an explanation of the Money Laundering Offence, including a definition, the relevant legislation, the controls required for firms and the differences between Money Laundering and Counter-Terrorist Financing **(see Figure 39 overleaf)**.

4b. Performance measurement in financial crime work

This section demonstrates how the Outcomes Performance Report measures the FSA's performance on financial crime, from the high level indicator down to the 18 metrics **(see Figure 40 on page 79)**.

4c. National Audit Office survey of FSA supervisors

This section contains summary results from the NAO survey of FSA supervisors on questions relating to financial crime. We have set out both quantitative results and qualitative comments by the supervisors **(see Figures 41 and 42 on page 80)**.

39 Explaining the Money Laundering Offence

Change	Issue
Definition	The ways in which criminals process illegal or "dirty" money derived from the proceeds of illegal activity (e.g. drug-dealing, human trafficking, fraud, tax evasion) through a succession of transfers/deals until the source of illegally acquired funds is obscured and the money takes on the appearance of legitimate or "clean" funds
Relevant legislation	Terrorism Act 2000 Proceeds of Crime Act 2002 Money Laundering Regulations 2003 Serious Organised Crime and Police Act 2005 The Proceeds of Crime Act 2002 and Money Laundering Regulations 2003 (Amendment) Order 2006 EU 3rd Money Laundering Directive 2005 (implemented in UK by 15 December 2007)
Money Laundering Offence	■ trying to turn money raised through criminal activity into 'clean' money; ■ handling the benefit of acquisitive crimes such as theft, fraud and tax evasion; ■ handling stolen goods; ■ being directly involved in, or entering into arrangements to facilitate laundering; and ■ criminals investing the proceeds of their crimes in the range of financial products.
Controls required for firms	There are three broad groups of offences that firms need to avoid committing: ■ knowingly assisting in concealing, or entering into arrangements for the acquisition, use, and/or possession of, criminal property; ■ failing to report knowledge, suspicion, or where there are reasonable grounds for knowing or suspecting, that another person is engaged in money laundering; and ■ tipping off, or prejudicing an investigation. It is also a separate offence under the ML Regulations not to have systems and procedures in place to combat money laundering (regardless of whether or not money laundering actually takes place).
Sectors involved	■ Financial services ■ Money Service Businesses ■ High Value Dealers (e.g. jewellers) ■ Real estate agents ■ Accountants, Trust and Company Services ■ Lawyers
Differences with counter terrorist financing	■ often only small amounts are required to commit individual terrorist acts, thus increasing the difficulty of tracking the terrorist property; ■ terrorists can be funded from legitimately obtained income, including charitable donations, and it is extremely difficult to identify the stage at which legitimate funds become terrorist property.

Source: HM Treasury[1] and Joint Money Laundering Steering Group[2]

NOTES

1 HM Treasury (2004), "Anti-Money Laundering Strategy", October 2004 (http://www.hm-treasury.gov.uk/media/D57/97/D579755E-BCDC-D4B3-19632628BD485787.pdf). 3rd Money Laundering Directive brings in further requirements for supervision with these sectors coming under the Money Laundering regime.

2 Joint Money Laundering Steering Group (2006), "Prevention of money laundering/combating the financing of terrorism" (http://www.jmlsg.org.uk/content/1/c4/68/86/Final_Part_I_030306.pdf).

40 Monitoring financial crime in the Outcomes Performance Report

Consumers			Firms/Markets			FSA performance		
1	2	3	4	5	6	7	8	9

Indicator 5: Firms and other stakeholders understand their respective responsibilities and mitigate risks relating to financial crime and arising from market conduct.

Firms understand and mitigate risks relating to financial crime

1. Survey of firms[1] (level of resources and understanding)
2. Survey of firms (verification of staff criminal disclosures)
3. Number of Suspicious Activity Reports submitted to Serious and Organised Crime Agency by regulated firms
4. Number of small firm alerts for financial crime

The FSA acts to mitigate risks relating to financial crime

5. Survey of firms about FSA as an effective partner and its communications
6. Survey of firms about its communications
7. Authorisations/ permissions rejected ('gatekeeper' role)
8. Staff having passed financial crime training
9. Number of reports on financial crime to internal committee
10. Number of financial crime cases referred to Enforcement

Other stakeholders understand their respective responsibilities and mitigate risks relating to financial crime

11. Survey of firms about stakeholder capabilities
12. Number of cases of information exchange
13. Number of significant fraud trials

Recorded levels of financial crime and market abuse

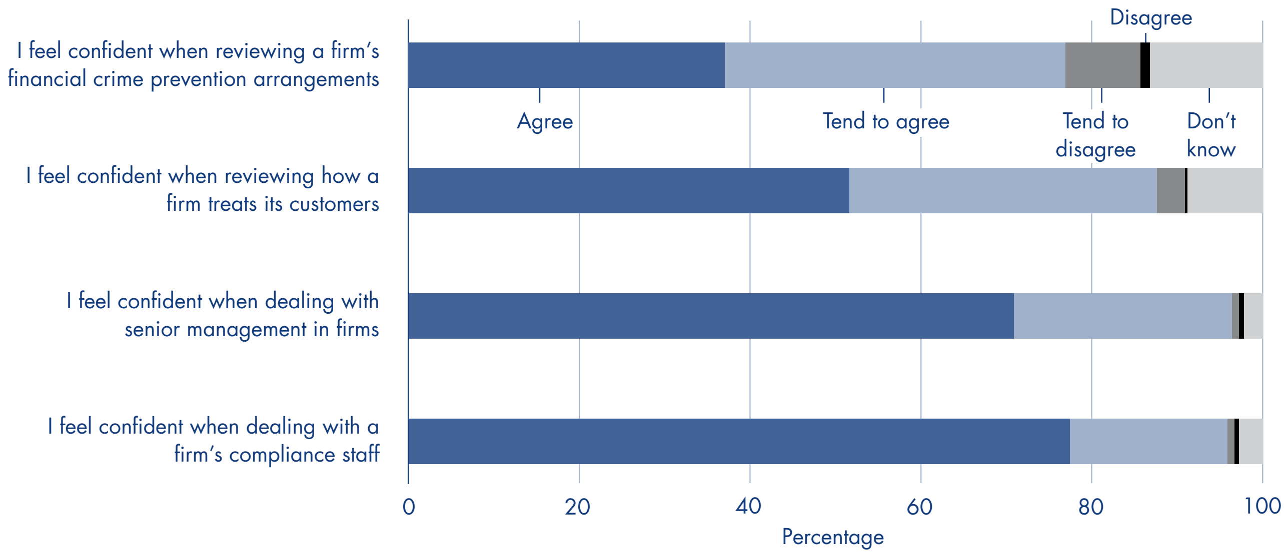
14. Survey of Money Laundering Reporting Officers' views
15. Number of fraud trials
16. Measures of market cleanliness
17. Related consumer enquiries to FSA
18. Press coverage (is it positive towards financial crime work?)

Source: FSA

NOTE

1 The FSA is planning to undertake an annual Financial Crime Survey of firms. It will ask senior management and Money Laundering Reporting Officers about their perceptions of crime and the firm's approach to countering financial crime, including level of resourcing.

41 Supervisors interacting with firms



Source: National Audit Office survey of Financial Services Authority supervisors

42 Selection of comments from supervisors on approach to financial crime

Issue	Responses
Strategic approach	"The financial crime sector team come across as being very pro-active"
	"The interplay between the financial crime [sector] team's work and that in the Markets Division on tackling market abuse is not clear"
Profile of financial crime	"Financial crime training has only been developed very recently. Previously the area was largely invisible to most people"
	"Financial crime seems to have taken a back seat to ARROW 2 development and it's unclear to most staff how financial crime work fits with ARROW 2"
	"I note a lack of understanding of financial crime… needs more attention"
	"… focused on firms [with] compliance resources and could do more for the sole trader"
Weight accorded to financial crime in supervision	"My impression is that, as supervisors, financial crime is secondary to our role of protecting customers"
	"I always felt financial crime could be better represented in supervision as many supervisors are unsure what to ask with regards to… their firm"
	"[The] overwhelming focus is TCF not financial crime"
	"Where there is more than 1 supervisor working on a firm it may not be necessary for all supervisors to be equally expert on all issues"
Training and development	"It needs to be more practical… haven't had any proper training on the new guidance"
	"Training has to be tailored to the different types of firms being supervised"
	"more practical training in how to put the information into practice with small firms"
	"…. relating to JMLSG's revised risk based approach, in-house guidance has been at a "high level" and not very detailed"

Source: National Audit Office survey of FSA supervisors

APPENDIX FIVE

Financial Capability

This section provides further information on the FSA's work on financial capability and the NAO's review of its performance in this area, specifically:

- **a** **The FSA's intended outcomes for its National Strategy for Financial Capability.**
- **b** **The range of intermediate and final targets which the FSA has set out for each of its financial capability projects.**
- **c** **An outline of how financial capability relates to the FSA's retail strategy and wider strategic aims.**
- **d** **Treating Customers Fairly.**

5a. Intended outcomes for the National Strategy for Financial Capability

This section sets out the FSA's planned overall outcomes for its work on Financial Capability, first set out in *Building Financial Capability in the UK* in March 2005. The outcomes are set out in four themes – working together; reaching people; influencing people and making a difference.

43 Planned outcomes for the National Strategy on Financial Capability

Working Together	Support for the strategy is established among key partners (consumer groups, voluntary groups, Government and the financial services industry) Funding and other resources are put in place Resources spent on financial capability projects are better coordinated and spent more efficiently Financial capability projects are given significantly greater priority
Reaching people	There is a step change in the number of people who are reached by financial capability initiatives People are reached in ways which are more suited to their needs People actively looking for help are offered simpler access to it, appropriate to their needs
Influencing people	Skills: People have more of the skills needed to address personal finance issues Knowledge and understanding: People have greater knowledge and understanding of financial issues, can better identify their needs and the products that might help meet those needs, and know when and where to seek further advice Awareness: People are more aware of the need to take control of their personal finances Confidence: People have greater confidence in their ability to take an active role in managing their financial needs Engagement: People are engaged and motivated to take action
Making a difference	More people review their financial situation regularly People are more discriminating when shopping for financial services Fewer people buy unsuitable financial services and products The FSA is able to take a less interventionist approach to the regulation of the retail financial services industry The financial services industry designs products that more closely meet people's needs Products are promoted and sold in a fashion that is more suited to people's needs

Source: FSA

5b. Targets for Financial Capability Projects

Figure 44 sets out the FSA's intermediate and overall targets for its financial capability projects between 2006 and 2011, set out in the FSA's annual report 2005-06.

44 Intermediate and overall targets for the FSA's Financial Capability projects

Key outcome/indicator: To provide a step change in the financial capability of the UK population	Intermediate Targets 2006-07	Overall Targets for 2006-11
Schools (Learning Money Matters) ■ To create effective partnerships in a coherent and funded strategy to deliver Learning Money Matters in schools. ■ Support made available through this project is used by teachers of children in the 11–19 age range. ■ The profile, status and quality of personal finance education (pfe) is raised and maintained. ■ Young people agree that the pfe they receive at school has made them more capable and confident in dealing with financial issues.	■ Establish UK co-coordinating group to oversee implementation of Learning Money Matters across UK. ■ Develop and implement longer-term funding strategy. ■ 500 secondary schools request support through Learning Money Matters. ■ 75,000 new pupils in the 11–19 age reached by project. ■ Planned changes to the curriculum in England and N. Ireland already provide the opportunities to mainstream pfe in these countries. The FSA will contribute to the curriculum reviews currently taking place in Wales and Scotland to assist in mainstreaming pfe in these countries too. ■ Deliver a toolkit that will enable schools to evaluate the impact of pfe on the confidence of young people to deal with financial issues.	■ Key stakeholders such as Department for Education and Skills and Qualifications and Curriculum Authority remain fully engaged with schools project. ■ Project is fully funded. ■ 4,000 secondary schools in England have accessed and used support through Learning Money Matters. ■ 1.8 million pupils in 11–19 age range reached by project. ■ Most schools recognize the importance of pfe and include it within their curriculum development plans. ■ Evaluation demonstrates that young people are more confident and better equipped to deal with financial issues.
Young Adults: Helping Young Adults Make Sense of Money (Higher Education, Further Education & those Not in Education, Employment or Training) ■ To create effective partnerships in a coherent and funded delivery strategy to young adults in Higher Education, Further Education and NEET (those Not in Education, Employment or Training). ■ Delivery organisations commit sufficient resources to the programme. ■ The products and support promoted through the Young Adults programme (toolkits and training) are used by delivery organisations in order to reach the target audiences. ■ Young adults in target sectors engage with the need to take control of their money and agree that the programme has helped them to be more capable and confident in dealing with financial issues.	Higher Education Institutions ■ 10–20 representative HE Institutions across the UK become "Early Adopters". ■ Early Adopters refine and add to the model developed in partnership with Roehampton University ("Money Doctors" scheme) and provide appropriate evaluation and feedback (Q3 2007). ■ Refined and enlarged toolkit is completed in two stages and available for national roll-out in academic year 2007-08. Further Education Institutions ■ Work with FE Institutions, Learning and Skills Councils and their umbrella bodies to use personal finance as a context for delivering key skills. This will be based on successful pilots in London colleges. ■ Adapted Roehampton University (Money Doctors) pilot package taken up and used for pastoral support by five FE Institutions (during academic year 2006-07).	■ All 168 UK HE Institutions are aware of, and use, the toolkits and training available and proactively provide their students (currently 2.3 million) with information, education and guidance about their personal finances. ■ Evaluation demonstrates that students are more confident and better equipped to deal with financial issues. ■ All UK FE institutions – serving an estimated five million students – will be aware that personal finance can be used as a context for delivering key skills. 25 per cent of colleges do so. ■ Evaluation demonstrates that students are more confident and better equipped to deal with financial issues.

44 Intermediate and overall targets for the FSA's Financial Capability projects *continued*

Key outcome/indicator: To provide a step change in the financial capability of the UK population	**Intermediate Targets 2006-07**	**Overall Targets for 2006-11**
Young Adults: Helping Young Adults Make Sense of Money (Higher Education, Further Education & those Not in Education, Employment or Training) *continued*	NEET Sector ■ First tranche (10-12) of organizations to act as Early Adopters identified and programme agreed. ■ Second tranche (50) early Adopters confirmed. ■ Training and evaluation of second tranche on track to complete at end May '07. ■ On track for Early Adopter showcase event and report publication in Q4 2007.	■ Major government and charitable/voluntary sector organizations providing services to 1.1 million young people across the UK in the NEET sector are aware of the toolkits, training and quality materials available on financial capability, and the majority routinely provide such training to their staff. ■ Policy-making bodies support the programme and participate in its development. ■ Evaluation demonstrates that young people in the NEET sector are more confident and better equipped to deal with financial issues.
	Infrastructure ■ Establish whether there is a business case for providing support to organisations in the form of a national 'phone line and web-based information service and/or local partnership networks. ■ Fully costed business case for 'phone line and web-based information service prepared. ■ Explore further funding and operational possibilities for 'phone line and web-based information service. ■ Decide whether to proceed with 'phone line.	■ Dependent on business case investigation and result of continuing pilot at Young Scot. Possibly a national 'phone information service for young adults.
Workplace: Make the Most of your Money ■ Win commitment of adequate resource from partner organizations in the financial services industry and elsewhere. ■ Employers in the public and private sectors agree to participate in the programme, are convinced of the value of the programme and want to remain involved. ■ Employees make effective use of materials. ■ Employees attend seminars and adapt behaviour as a result. ■ Improved financial capability of employees reached.	■ 200,000 employees receive the 'Make the most of your money' information booklet. ■ 15,000 employees attend a one-hour generic advice seminar.	■ 4 million people receive financial information. ■ 500,000 attend a seminar. ■ Evaluation demonstrates that employees are more confident and better equipped to deal with financial issues, and that employers and seminar presenters derive anticipated benefits.

44 Intermediate and overall targets for the FSA's Financial Capability projects *continued*

Key outcome/indicator: To provide a step change in the financial capability of the UK population	Intermediate Targets 2006-07	Overall Targets for 2006-11
Workplace: Make the Most of your Money *continued* ■ Methods of delivering financial education in the workplace, and the materials provided, evolve to reflect the differing needs of employers. ■ The programme adapts to new initiatives, such as the introduction of a National Pension Savings Scheme.		
Consumer Communications ■ Effective partnerships with third parties who will help deliver financial capability products/services to the right people at the right time. ■ Clarity about target audiences FSA is trying to reach (influenced by the Financial Capability survey). ■ Information is engaging, accessible and appealing. ■ Significantly increased awareness and understanding among target audiences of FSA as a provider of free, impartial information. ■ Close collaboration with the Office of Fair Trading (OFT) on debt issues.	■ Increase the number of third parties who link to the FSA website. ■ Target audiences (for overhaul of website and publications) agreed using results of the Financial Capability Survey and other relevant inputs. ■ Core consumer messages are consumer tested, revised and agreed. ■ Consumer website overhauled by end Q4 2006, in collaboration with the OFT's revamp of its website. ■ New visual identity for consumer-facing material developed and tested. Rolled out on website in Q4. ■ Forward plan for consumer campaigns is developed. ■ Partnerships with key organizations are built to support campaigns. ■ Consumer testing of online material and selected publications, with recommendations fed into redevelopment project.	■ Traffic to new consumer website doubles over next three years – from 2 to 4 million per annum. ■ Deeper and more effective partnerships with third parties which enable us to reach our target audiences on key issues. ■ The majority of target audiences regard the FSA as a valuable source of impartial information on financial products and services (specific targets will be set for individual campaigns). ■ Evaluation demonstrates that consumers using the FSA's information demonstrate improved financially capable skills/behaviours. ■ Publications overhauled by Q2 2007.
Online Tools ■ FSA is working with and has the support of stakeholders to make its online tools more widely available. ■ FSA online tools are increasingly used by others. ■ Consumers using FSA online tools have more confidence and feel more capable about managing their affairs. ■ Consumers using FSA online tools behave differently when managing their financial affairs (e.g. plan better and make informed choices).	■ *(This phase will test the syndication model with a variety of partner types.)* ■ Increase the number of websites making available FSA online tools. 100 per cent increase in number of monthly visitors to FSA online tools, in particular the Healthcheck and Debt Test. ■ Use results to set suitable targets going forward for partner websites and visitor levels to online tools.	■ A significant increase in the number of websites making available FSA online tools. The long-term aim is to engage as many appropriate and high traffic partners as possible. ■ A significant increase in the number of visitors to FSA online tools.

44 Intermediate and overall targets for the FSA's Financial Capability projects *continued*

Key outcome/indicator: To provide a step change in the financial capability of the UK population	Intermediate Targets 2006-07	Overall Targets for 2006-11
New Parents (Money Box) ■ Establish whether or not a business case is made for proceeding with full rollout of Money Box. ■ Potential partners and distributors are identified. ■ If a business case is made, the product reaches target audience and parents are more aware of the financial implications of parenthood and more confident in managing their personal finances.	■ Develop and trial the concept through a number of large employers. ■ Obtain a full evaluation of the trial. ■ Assess the feasibility of using other distribution channels. ■ Develop the business case for full roll-out in 2007-08. ■ Involve key stakeholders and delivery channels.	■ If evaluation shows concept works, then by 2010-11 the product will have reached over 1.5 million parents. ■ A research and evaluation programme will show that new parents are more confident and better equipped to deal with financial issues.
Money Advice ■ Consumers become increasingly engaged with their own personal finances. ■ Preventative general money advice (recognisably distinct from the regulated sales process) is perceived as worthwhile and valuable. ■ Preventative general money advice is more widely available through a variety of channels appropriate to the target consumer audience. ■ There is a focus on groups with lower financial capability who could benefit most from access to preventative general money advice.	■ Positive engagement with prospective partner organizations (including governmental organisations and not-for-profit agencies) who have suitable infrastructure and relationships with people and are already providing advice and guidance in complementary subject areas. ■ Establish whether capacity exists for such organizations to provide preventative general money advice. ■ Completion of the assessment of whether it is in the interest of commercial organisations to offer non-regulated money advice.	■ The FSA is not yet in a position to formulate overall longer term targets, but will do so as soon is this initiative is sufficiently developed.

Source: FSA

5c. Financial capability work within the FSA and Retail Themes context

Figure 45 shows how the National Strategy for Financial Capability fits into the FSA's retail strategy, strategic aims and statutory objectives.

45 Financial Capability within the FSA

Statutory objectives

- Market confidence
- **Public awareness: promoting public understanding of the financial system**
- The protection of consumers
- The reduction of financial crime

Strategic aims

- Promoting efficient, orderly and fair markets
- **Helping retail consumers get a fair deal**
- Improving our business capability and effectiveness

Retail strategy

- **Capable and confident consumers**
- Clear, simple and understandable information from the industry and the FSA, available for, and used by, consumers
- Responsible firms who treat their customers fairly and are soundly managed and adequately capitalised
- Risk-based regulation, through firm-specific and thematic supervision and policy

National Strategy for Financial Capability (for planned outcomes see appendix 5a)

- Schools
- Young Adults
- Workplace
- Consumer Communications
- Online tools
- New parents
- Money Advice
- Innovation Fund

For project targets see Appendix 5b

Outcomes Performance Report Indicators

- Consumers receive and use clear, simple and relevant information from the industry and from the FSA
- **Consumers are capable in exercising responsibility when dealing with the financial services industry**
- Financial services firms treat their customers fairly and thereby help them to meet their needs

Sub indicators for Indicator 2	Metrics for sub-indicators
Consumers are capable regarding money management	Percentage of consumers deemed capable at money management in analysis of Financial Capability Survey
	Percentage of consumers deemed able to 'exercise responsibility' for money management in analysis of Financial Capability Survey
Consumers are capable when planning ahead	Percentage of consumers who are deemed capable of planning ahead in analysis of Financial Capability Survey
Consumers are capable at using financial products	Percentage of consumers who are deemed capable at using financial products in analysis of Financial Capability Survey
Consumers are capable when seeking and using advice	Percentage of consumers deemed capable when seeking and using advice and information in analysis of Financial Capability Survey
	If possible, the percentage of sample transactions in which there was an element of mis-buying of finanical products by the consumer from the Consumer Purchasing Outcomes Survey

Source: FSA

43 Planned outcomes for the National Strategy on Financial Capability

Working Together	Support for the strategy is established among key partners (consumer groups, voluntary groups, Government and the financial services industry) Funding and other resources are put in place Resources spent on financial capability projects are better coordinated and spent more efficiently Financial capability projects are given significantly greater priority
Reaching people	There is a step change in the number of people who are reached by financial capability initiatives People are reached in ways which are more suited to their needs People actively looking for help are offered simpler access to it, appropriate to their needs
Influencing people	Skills: People have more of the skills needed to address personal finance issues Knowledge and understanding: People have greater knowledge and understanding of financial issues, can better identify their needs and the products that might help meet those needs, and know when and where to seek further advice Awareness: People are more aware of the need to take control of their personal finances Confidence: People have greater confidence in their ability to take an active role in managing their financial needs Engagement: People are engaged and motivated to take action
Making a difference	More people review their financial situation regularly People are more discriminating when shopping for financial services Fewer people buy unsuitable financial services and products The FSA is able to take a less interventionist approach to the regulation of the retail financial services industry The financial services industry designs products that more closely meet people's needs Products are promoted and sold in a fashion that is more suited to people's needs

Source: FSA

5b. Targets for Financial Capability Projects

Figure 44 sets out the FSA's intermediate and overall targets for its financial capability projects between 2006 and 2011, set out in the FSA's annual report 2005-06.

44 Intermediate and overall targets for the FSA's Financial Capability projects

Key outcome/indicator: To provide a step change in the financial capability of the UK population	Intermediate Targets 2006-07	Overall Targets for 2006-11
Schools (Learning Money Matters) ■ To create effective partnerships in a coherent and funded strategy to deliver Learning Money Matters in schools. ■ Support made available through this project is used by teachers of children in the 11–19 age range. ■ The profile, status and quality of personal finance education (pfe) is raised and maintained. ■ Young people agree that the pfe they receive at school has made them more capable and confident in dealing with financial issues.	■ Establish UK co-coordinating group to oversee implementation of Learning Money Matters across UK. ■ Develop and implement longer-term funding strategy. ■ 500 secondary schools request support through Learning Money Matters. ■ 75,000 new pupils in the 11–19 age reached by project. ■ Planned changes to the curriculum in England and N. Ireland already provide the opportunities to mainstream pfe in these countries. The FSA will contribute to the curriculum reviews currently taking place in Wales and Scotland to assist in mainstreaming pfe in these countries too. ■ Deliver a toolkit that will enable schools to evaluate the impact of pfe on the confidence of young people to deal with financial issues.	■ Key stakeholders such as Department for Education and Skills and Qualifications and Curriculum Authority remain fully engaged with schools project. ■ Project is fully funded. ■ 4,000 secondary schools in England have accessed and used support through Learning Money Matters. ■ 1.8 million pupils in 11–19 age range reached by project. ■ Most schools recognize the importance of pfe and include it within their curriculum development plans. ■ Evaluation demonstrates that young people are more confident and better equipped to deal with financial issues.
Young Adults: Helping Young Adults Make Sense of Money (Higher Education, Further Education & those Not in Education, Employment or Training) ■ To create effective partnerships in a coherent and funded delivery strategy to young adults in Higher Education, Further Education and NEET (those Not in Education, Employment or Training). ■ Delivery organisations commit sufficient resources to the programme. ■ The products and support promoted through the Young Adults programme (toolkits and training) are used by delivery organisations in order to reach the target audiences. ■ Young adults in target sectors engage with the need to take control of their money and agree that the programme has helped them to be more capable and confident in dealing with financial issues.	Higher Education Institutions ■ 10–20 representative HE Institutions across the UK become "Early Adopters". ■ Early Adopters refine and add to the model developed in partnership with Roehampton University ("Money Doctors" scheme) and provide appropriate evaluation and feedback (Q3 2007). ■ Refined and enlarged toolkit is completed in two stages and available for national roll-out in academic year 2007-08. Further Education Institutions ■ Work with FE Institutions, Learning and Skills Councils and their umbrella bodies to use personal finance as a context for delivering key skills. This will be based on successful pilots in London colleges. ■ Adapted Roehampton University (Money Doctors) pilot package taken up and used for pastoral support by five FE Institutions (during academic year 2006-07).	■ All 168 UK HE Institutions are aware of, and use, the toolkits and training available and proactively provide their students (currently 2.3 million) with information, education and guidance about their personal finances. ■ Evaluation demonstrates that students are more confident and better equipped to deal with financial issues. ■ All UK FE institutions – serving an estimated five million students – will be aware that personal finance can be used as a context for delivering key skills. 25 per cent of colleges do so. ■ Evaluation demonstrates that students are more confident and better equipped to deal with financial issues.

44 Intermediate and overall targets for the FSA's Financial Capability projects *continued*

Key outcome/indicator: To provide a step change in the financial capability of the UK population	Intermediate Targets 2006-07	Overall Targets for 2006-11
Young Adults: Helping Young Adults Make Sense of Money (Higher Education, Further Education & those Not in Education, Employment or Training) *continued*	NEET Sector ■ First tranche (10-12) of organizations to act as Early Adopters identified and programme agreed. ■ Second tranche (50) early Adopters confirmed. ■ Training and evaluation of second tranche on track to complete at end May '07. ■ On track for Early Adopter showcase event and report publication in Q4 2007.	■ Major government and charitable/ voluntary sector organizations providing services to 1.1 million young people across the UK in the NEET sector are aware of the toolkits, training and quality materials available on financial capability, and the majority routinely provide such training to their staff. ■ Policy-making bodies support the programme and participate in its development. ■ Evaluation demonstrates that young people in the NEET sector are more confident and better equipped to deal with financial issues.
	Infrastructure ■ Establish whether there is a business case for providing support to organisations in the form of a national 'phone line and web-based information service and/or local partnership networks. ■ Fully costed business case for 'phone line and web-based information service prepared. ■ Explore further funding and operational possibilities for 'phone line and web-based information service. ■ Decide whether to proceed with 'phone line.	■ Dependent on business case investigation and result of continuing pilot at Young Scot. Possibly a national 'phone information service for young adults.
Workplace: Make the Most of your Money ■ Win commitment of adequate resource from partner organizations in the financial services industry and elsewhere. ■ Employers in the public and private sectors agree to participate in the programme, are convinced of the value of the programme and want to remain involved. ■ Employees make effective use of materials. ■ Employees attend seminars and adapt behaviour as a result. ■ Improved financial capability of employees reached.	■ 200,000 employees receive the 'Make the most of your money' information booklet. ■ 15,000 employees attend a one-hour generic advice seminar.	■ 4 million people receive financial information. ■ 500,000 attend a seminar. ■ Evaluation demonstrates that employees are more confident and better equipped to deal with financial issues, and that employers and seminar presenters derive anticipated benefits.

44 Intermediate and overall targets for the FSA's Financial Capability projects *continued*

Key outcome/indicator: To provide a step change in the financial capability of the UK population	**Intermediate Targets 2006-07**	**Overall Targets for 2006-11**
Workplace: Make the Most of your Money *continued* ■ Methods of delivering financial education in the workplace, and the materials provided, evolve to reflect the differing needs of employers. ■ The programme adapts to new initiatives, such as the introduction of a National Pension Savings Scheme.		
Consumer Communications ■ Effective partnerships with third parties who will help deliver financial capability products/services to the right people at the right time. ■ Clarity about target audiences FSA is trying to reach (influenced by the Financial Capability survey). ■ Information is engaging, accessible and appealing. ■ Significantly increased awareness and understanding among target audiences of FSA as a provider of free, impartial information. ■ Close collaboration with the Office of Fair Trading (OFT) on debt issues.	■ Increase the number of third parties who link to the FSA website. ■ Target audiences (for overhaul of website and publications) agreed using results of the Financial Capability Survey and other relevant inputs. ■ Core consumer messages are consumer tested, revised and agreed. ■ Consumer website overhauled by end Q4 2006, in collaboration with the OFT's revamp of its website. ■ New visual identity for consumer-facing material developed and tested. Rolled out on website in Q4. ■ Forward plan for consumer campaigns is developed. ■ Partnerships with key organizations are built to support campaigns. ■ Consumer testing of online material and selected publications, with recommendations fed into redevelopment project.	■ Traffic to new consumer website doubles over next three years – from 2 to 4 million per annum. ■ Deeper and more effective partnerships with third parties which enable us to reach our target audiences on key issues. ■ The majority of target audiences regard the FSA as a valuable source of impartial information on financial products and services (specific targets will be set for individual campaigns). ■ Evaluation demonstrates that consumers using the FSA's information demonstrate improved financially capable skills/behaviours. ■ Publications overhauled by Q2 2007.
Online Tools ■ FSA is working with and has the support of stakeholders to make its online tools more widely available. ■ FSA online tools are increasingly used by others. ■ Consumers using FSA online tools have more confidence and feel more capable about managing their affairs. ■ Consumers using FSA online tools behave differently when managing their financial affairs (e.g. plan better and make informed choices).	■ *(This phase will test the syndication model with a variety of partner types.)* ■ Increase the number of websites making available FSA online tools. 100 per cent increase in number of monthly visitors to FSA online tools, in particular the Healthcheck and Debt Test. ■ Use results to set suitable targets going forward for partner websites and visitor levels to online tools.	■ A significant increase in the number of websites making available FSA online tools. The long-term aim is to engage as many appropriate and high traffic partners as possible. ■ A significant increase in the number of visitors to FSA online tools.

44 Intermediate and overall targets for the FSA's Financial Capability projects *continued*

Key outcome/indicator: To provide a step change in the financial capability of the UK population	**Intermediate Targets 2006-07**	**Overall Targets for 2006-11**
New Parents (Money Box) ■ Establish whether or not a business case is made for proceeding with full rollout of Money Box. ■ Potential partners and distributors are identified. ■ If a business case is made, the product reaches target audience and parents are more aware of the financial implications of parenthood and more confident in managing their personal finances.	■ Develop and trial the concept through a number of large employers. ■ Obtain a full evaluation of the trial. ■ Assess the feasibility of using other distribution channels. ■ Develop the business case for full roll-out in 2007-08. ■ Involve key stakeholders and delivery channels.	■ If evaluation shows concept works, then by 2010-11 the product will have reached over 1.5 million parents. ■ A research and evaluation programme will show that new parents are more confident and better equipped to deal with financial issues.
Money Advice ■ Consumers become increasingly engaged with their own personal finances. ■ Preventative general money advice (recognisably distinct from the regulated sales process) is perceived as worthwhile and valuable. ■ Preventative general money advice is more widely available through a variety of channels appropriate to the target consumer audience. ■ There is a focus on groups with lower financial capability who could benefit most from access to preventative general money advice.	■ Positive engagement with prospective partner organizations (including governmental organisations and not-for-profit agencies) who have suitable infrastructure and relationships with people and are already providing advice and guidance in complementary subject areas. ■ Establish whether capacity exists for such organizations to provide preventative general money advice. ■ Completion of the assessment of whether it is in the interest of commercial organisations to offer non-regulated money advice.	■ The FSA is not yet in a position to formulate overall longer term targets, but will do so as soon is this initiative is sufficiently developed.

Source: FSA

5c. Financial capability work within the FSA and Retail Themes context

Figure 45 shows how the National Strategy for Financial Capability fits into the FSA's retail strategy, strategic aims and statutory objectives.

45 Financial Capability within the FSA

Statutory objectives

- Market confidence
- **Public awareness: promoting public understanding of the financial system**
- The protection of consumers
- The reduction of financial crime

Strategic aims

- Promoting efficient, orderly and fair markets
- **Helping retail consumers get a fair deal**
- Improving our business capability and effectiveness

Retail strategy

- **Capable and confident consumers**
- Clear, simple and understandable information from the industry and the FSA, available for, and used by, consumers
- Responsible firms who treat their customers fairly and are soundly managed and adequately capitalised
- Risk-based regulation, through firm-specific and thematic supervision and policy

National Strategy for Financial Capability (for planned outcomes see appendix 5a)

- Schools
- Young Adults
- Workplace
- Consumer Communications
- Online tools
- New parents
- Money Advice
- Innovation Fund

For project targets see Appendix 5b

Outcomes Performance Report Indicators

- Consumers receive and use clear, simple and relevant information from the industry and from the FSA
- **Consumers are capable in exercising responsibility when dealing with the financial services industry**
- Financial services firms treat their customers fairly and thereby help them to meet their needs

Sub indicators for Indicator 2	Metrics for sub-indicators
Consumers are capable regarding money management	Percentage of consumers deemed capable at money management in analysis of Financial Capability Survey
	Percentage of consumers deemed able to 'exercise responsibility' for money management in analysis of Financial Capability Survey
Consumers are capable when planning ahead	Percentage of consumers who are deemed capable of planning ahead in analysis of Financial Capability Survey
Consumers are capable at using financial products	Percentage of consumers who are deemed capable at using financial products in analysis of Financial Capability Survey
Consumers are capable when seeking and using advice	Percentage of consumers deemed capable when seeking and using advice and information in analysis of Financial Capability Survey
	If possible, the percentage of sample transactions in which there was an element of mis-buying of finanical products by the consumer from the Consumer Purchasing Outcomes Survey

Source: FSA

5d. Treating Customers Fairly

One of the FSA's 11 Principles for Business requires a financial services firm to pay due regard to the interests of its customers and treat them fairly. However, the FSA's supervisory work repeatedly uncovers problems in the way in which consumers are treated on a scale that it feels warrants serious thought and a determination to deliver change. The Treating Customers Fairly initiative, designed to encourage firms' senior management to direct their attention to ensuring the fair treatment of consumers, is an early example of the FSA's attempt to move to a more principles based approach to regulation.

Based on the FSA's 'product life-cycle' Treating Customers Fairly aims to achieve six outcomes for consumers. These outcomes are not FSA rules in themselves but designed as a description of the characteristics the FSA thinks a retail market will have if customers are to be treated fairly. They are:

- Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture.
- Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly.
- Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale.
- Where consumers receive advice, the advice is suitable and reflect their needs, priorities and circumstances.
- Consumers are provided with products that perform as firms have led them to expect and the associated service is both of an acceptable standard and as they have been led to expect.
- Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

The FSA has said it expects to see that:

- a firm has considered the implications of TCF for its business;
- senior management have played the role we expect of them in relation to TCF – e.g. identifying risks, having appropriate systems and controls in place to mitigate these risks, and ensuring these are effective;
- a firm has made a genuine attempt to deliver on what TCF means for it; and
- there has not been significant actual – or risk of – consumer detriment.

APPENDIX SIX

Suggestions for implementing NAO recommendations on financial crime and financial capability

Financial Crime and Financial Capability are the two areas in our terms of reference that link most closely to a specific statutory objective of the FSA (reducing financial crime and improving public understanding of the financial system respectively). We have made a number of recommendations to the FSA on these areas. During our review, through our stakeholder interviews, data analysis and wider research we also developed a number of suggestions which could help the FSA to implement our recommendations. These suggestions are set out in the table below.

Terms of Reference Area	NAO recommendation	Supporting suggestions and ideas for implementation
Financial Crime	The FSA's new Financial Crime Directorate should keep supervisory staff fully informed of, and help them develop their expertise in financial crime issues.	■ Within its new directorate the FSA could place particular emphasis on ensuring better linkages between the two arms of intelligence gathering and analysis: the Intelligence Team and the Market Monitoring Department. ■ The increased profile of the new directorate can be used to assist staff in developing their expertise of financial crime issues – for example by providing training for supervisors which is more practical and better tailored to sector or firm size. ■ The FSA needs to ensure that its training – for example its presentations on how staff should use the Joint Money Laundering Steering Group Guidance – reaches as wide a population as possible. ■ The new directorate could push the FSA to consider whether it is possible for research to benchmark the FSA's financial crime enforcement work against international peers to allow it to better understand what suitable enforcement goals they could establish in terms of case types, throughput, timescales and even staffing of the enforcement function. ■ The Directorate could work with others at the FSA to encourage other regulators to publish outcome-focused market measurements so that it can determine suitable comparators.
	The FSA should examine the basis of its risk assessments to determine if it is appropriate to use size as a proxy for impact in financial crime and if greater weight should be given to smaller firms than at present.	■ The FSA could look at the approach of HM Revenue & Customs to money laundering supervision of Money Service Businesses and High Value Dealers to see if there are any lessons it can learn from HMRC's specialised risk assessment and program of visits for its own financial crime work. ■ The FSA could begin to include a number of financial crime related checks within its computerised checking of firms' self assessment reports. ■ The FSA could increase its financial crime education efforts with small firms – particularly providing more practical feedback on what a risk-based regime means in practice for example through peer benchmarking or worked examples.

Terms of Reference Area	NAO recommendation	Supporting suggestions and ideas for implementation
Financial Capability	The FSA should aim to quantify the costs to society and the financial services market of low levels of financial capability to help determine long term plans for its role and resource allocation for this problem. It should also set measurable goals for improvements in consumer behaviour and outcomes against which success can be judged.	■ Objectives could be developed jointly with HM Treasury. ■ Overall objectives could be set against the baseline survey or against national statistics measures such as savings rates or household debt. ■ Project targets could be set against the baseline survey, against other national measures, against organisational statistics – for example the number of students dropping out of university due to debt – or against the circumstances of participants. ■ The FSA may want to consult with marketing and social marketing professionals on developing measurable objectives. ■ Longitudinal research is particularly important for tracking impact on behaviour. ■ The FSA will need to ensure the information it is collecting at the start of its projects is suitable for evaluation – for example it could ask workplace seminar participants questions about current spending, saving and purchasing habits and ask the same questions at a later date to judge if behaviour has changed, although achieving meaningful response rates will be difficult. Employers will also hold data such as pension contributions which can be compared before and after workplace seminars. ■ The FSA could select control groups for its research – for example it could gather statistics on debt, saving etc from universities at which Money Doctors is being carried out and those at which it is not and compare changes over time. ■ Qualitative research to determine impact is also valuable, particularly in determining which elements of the projects had most impact on behaviour. ■ The FSA could consider developing its audience segmentation to include more behavioural and attitudinal characteristics as well as demographic and socio-economic. ■ The methodologies of the FSA's impressive work on the Financial Capability survey, the Consumer Purchasing Outcomes Survey and its other consumer research should be complementary and linkages between the findings, analysis and conclusions fully exploited.
	The FSA should identify the responsibilities it wants consumers to take on when interacting with the financial services markets and how its financial capability programme, alongside other regulatory action, will help to equip consumers for these responsibilities. It is also important that the FSA, in consultation with its stakeholders, begins in good time to develop its strategic priorities and approach to financial capability beyond 2011.	■ Although financial capability is different depending on the circumstances, the FSA may want to set out scenarios of the actions a capable consumer might take e.g. the savings rates of a consumer with certain demographic, socio-economic characteristics. ■ The next phase of the strategy could include how the FSA will use its regulatory powers, for example under Treating Customers Fairly, to encourage industry to take on greater responsibility for responding to consumer levels of financial capability. It could also use its knowledge of firm activity, for example in financial promotions, to point to examples of good practice in influencing consumers to make sensible financial plans and decisions. ■ The FSA may want to set out its views on the development of its strategy in conjunction with the government's long-term approach to financial capability. ■ The FSA could include details of how it will link its activity in with other financial capability initiatives including media campaigns. ■ The FSA could develop thinking on how it could link its work to improve the financial capability of segments of the population with behaviour change activity in other areas such as health improvements and sustainability.

Terms of Reference Area	NAO recommendation	Supporting suggestions and ideas for implementation
Financial Capability *continued*		■ There is a lot of activity which could contribute to improved levels of financial capability including media campaigns such as the Metro debt campaign, TV programmes such as How to pay off your mortgage in two years and websites such as uswitch and money supermarket. The FSA could further explore how it can develop closer links with these organisations and campaigns, for example building on the relationship developed with the BBC on the financial healthcheck to explore other areas for collaboration. ■ Many private sector firms employ creative marketing strategies for example sponsorship, using new web developments such as My Space or targeting 'key' customers who are likely to have large networks which they can influence. The FSA could recruit from, second to or consult with such firms to learn lessons for its own work. ■ The FSA could improve the linkages between its products – as it is by distributing the New Parents Money Box through the HR departments of workplace seminars. The workplace seminars could provide pointers to other projects and, for example, links between the young adults and new parents projects could be increased. ■ With the Government now taking the lead on Money Advice the FSA could expand its innovation fund. The fund appears to offer the potential to support the development of projects which can reach target audiences segmented by life stage, key decision points, motivations etc and provide ongoing impact for relatively little investment by the FSA. ■ The FSA should begin stakeholder consultation on the development of its strategic thinking on financial capability post 2011 as early as possible to ensure stakeholders feel they have adequate input and influence.

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ENDNOTES

Executive Summary

1 The financial sector is the largest contributor to the UK balance of payments and contributed 8.5 per cent of UK GDP in 2005.

2 These activities include deposit taking (e.g. banks), insurance, mortgage lending, general insurance advice (e.g. motor, home), mortgage advice and investment business.

3 The Financial Services and Markets Act 2000, Part 1.

4 The FSA also regulates by reference to its own principles of good regulation.

5 It is common in financial services circles to refer to the 'twin peaks' of financial services regulation: market confidence and stability (known as prudential regulation) and consumer/investor protection (known as conduct of business regulation). These factors form a core part of the FSA's objectives, but are joined with a focus on financial crime and financial capability, so that in effect there are 'four peaks' of UK financial regulation.

6 This division is more than simply a difference between the wholesale and retail parts of markets. Rules are crucial in many elements of wholesale markets; principles are an important and growing factor in the regulation of retail financial services. For example, the FSA has developed an approach called Treating Customers Fairly for its regulation of retail financial services.

7 *Sustaining New York's and the US's Global Financial Services Leadership*, January 2007.

Introduction

8 Net exports of the financial sector totalled £19 billion in 2005.

9 The Chancellor announced the merger of investment services regulation and banking supervision into the Securities and Investments Board in 1997, which then changed its name to the Financial Services Authority.
In June 1998 responsibility for banking supervision was transferred to the FSA from the Bank of England.
In 2000, the FSA took over the role of UK Listing Authority from the London Stock Exchange. The Act transferred the responsibilities of several other organisations to the FSA: Building Societies Commission, Friendly Societies Commission, Investment Management Regulatory Organisation, Personal Investment Authority, Register of Friendly Societies and Securities and Futures Authority.
The FSA took on responsibility for mortgage regulation in 2004 and general insurance in 2005.

10 Under Section 19 of FSMA, any person who carries on a regulated activity in the UK must be authorised by the FSA.

11 For example, fitness and propriety issues/threshold conditions, market protection, systems and controls, Listing rule breaches, selling (mis-), pensions and endowments, retail mediation activities return, non-compliance with the Financial Ombudsman Service, Money Laundering Controls and financial fraud.

12 The National Audit Office's terms of reference refer to this as the Strategic Performance Framework, the FSA has subsequently renamed this as the Outcomes Performance Report, which is the term used throughout this report.

Part 1: Performance Management

13 For example, whether the firm is holding sufficient capital, the amount of client money held, if it holds professional indemnity insurance, and levels of staff training. The FSA will implement a new system in mid 2007, allowing up to 180 checks to be carried out.

14 Risk appetite refers to the level of harm or failure in financial services it is prepared to accept or tolerate – in this case the level of risk to its statutory objectives that the FSA is prepared to bear.

15 FSMA Schedule 1(10) (1) (b) requires the FSA to report on "the extent to which, in its opinion, the regulatory objectives have been met".

16 HM Treasury, Cabinet Office, National Audit Office, Audit Commission & Office For National Statistics, *Choosing the Right Fabric: A Framework for Performance Information*, 2000.

17 Financial Services Practitioner Panel (2006), *Fourth survey of the FSA's Regulatory Performance* (p.78) – for example, when asked about FSA supervisors, 55 per cent of respondents did not agree that supervisors have a good understanding of their firm's business.

18 In the FSA staff survey (question 54): In the 2005 results, two in every five respondents did not agree that staff performance reviews in their department were held regularly and on time.

19 The three indicators were (1) percentage of firms on amber watchlist for more than one year; (2) rookie ratio (proportion of staff with less than two years employment at the FSA, driven higher by the inclusion of Mortgage and General Insurance regulation within the FSA's scope in 2004-05); and (3) projects with performance measurement data collected and reported within three months of scheduled completion.

20 Financial Services and Markets Act 2000, Schedule 1(4)(3)(a).

21 *Annual Report 2002-03*, p.148–150 (Directors' report) and p.155 (non-executive directors' report).

22 FSA Annual Report 2005-06, p.58 (non-executive directors' report): "During the year, NedCo kept under review whether the FSA is using its resources efficiently and economically. NedCo challenged information provided to it, sought further explanation where appropriate and encouraged enhancements to the reporting framework on a continuous improvement basis."

Part 2: Working with other UK Regulators

23 The FSA and the OFT conducted a data matching exercise of their regulated populations that confirmed there were some 22,100 firms regulated in some capacity by both organisations. These are firms which conduct regulated activities under FSMA and also hold consumer credit licences from the OFT.

24 *Delivering better regulatory outcomes – an update: A joint FSA and OFT Action Plan*, November 2006.

25 The review of the retail distribution system is aimed at identifying and addressing the root causes of problems that continue to emerge in the retail investment market. The review's priority areas include: sustainability of the distribution sector; impact of incentives; professionalism and reputation; consumer access to financial products and services; and regulatory barriers and enablers.

26 Under the depolarisation regime which came fully into effect in June 2005, advisers must provide two 'key facts' documents, entitled 'about our services' and 'about the cost of our services'. These give consumers much clearer information earlier in the sales process about the type of advice and level of service being provided by the adviser. The post-implementation review will comprise several stages to assess how the market changes over time. As a first stage, the FSA has carried out a compliance review to assess how well firms are applying the rules.

27 The FSMA 2000 does require the FSA to have regard to the need to minimise the adverse effects on competition that may arise from their activities and the desirability of facilitating competition between the firms regulated by the FSA.

28 Under sections 302–304, the OFT has a similar duty to keep the provisions and practices of investment exchanges and clearing houses under review.

29 The OFT must make a report to the Competition Commission if it considers that regulating provisions or practices of the FSA result in a significant adverse effect on competition. The Competition Commission must then investigate the matter and if appropriate make a report to HM Treasury, which may make directions to the FSA to remedy the situation.

30 *Competition Review of the Financial Services and Markets Act 2000*, A report prepared for the OFT by Oxera. This review formed part of a broader two-year review of the FSMA, announced by HM Treasury in November 2003.

31 The seven markets identified were: the provision of current accounts to SMEs and individual consumers; trading exchanges; clearing and settlement infrastructure; credit rating agencies; pension fund consultants; investment banking, specifically initial public offerings and mergers and acquisitions; and custody services.

32 *Reducing Administrative Burdens: effective inspection and enforcement*, Philip Hampton, March 2005.

33 The application processes operated by the FSA and the OFT require the firms applying to provide certain types of information. Some of this information is required by both the FSA and the OFT and so firms have to submit duplicate information.

34 Only approximately 300 firms apply simultaneously to the FSA and OFT each year, and a further 600–700 firms that are already regulated by the FSA or OFT apply to become regulated by the other each year.

35 The industry user group comprises the Council of Mortgage Lenders, the Finance and Leasing Association, the Association of British Insurers, the British Bankers' Association, the FSA Smaller Businesses Practitioner Panel, the Consumer Credit Association UK, the British Cheque Cashers Association, the Consumer Credit Trade Association, and the Association of Payment and Clearing Systems.

36 In late March 2007 the OFT announced an in-depth study of retail bank pricing. The OFT expects the study to be completed by the end of 2007.

37 The FSMA Disclosure of Confidential Information Regulations 2001.

38 As at 26 February 2007, the FSA announced it had fined five firms over poor PPI selling practices, and had imposed public censure on two firms. Two other cases had also been concluded where problems relating to PPI also featured. Other PPI enforcement investigations were also underway at that time.

39 The Banking Codes Review is an independently led triennial review into the self-regulatory codes of practice governing British personal and small business banking. (See paragraph 2.32).

40 Between April to November 2005 however the FSA was not able to pass confidential information to TPR because the relevant changes to statutory instruments had not been made. HMT were responsible for ensuring this legal obstacle was removed.

41 Contract-based arrangements consist of individual personal pension policies owned by the individual members. They are schemes provided by insurance companies, friendly societies etc.

42 TPR's statutory responsibilities for work-based pensions extend to contract-based pensions where there is a direct payment arrangement from the employer to the provider.

43 Advice would be subject to the FSA's existing rules if it involved opting out of an occupational pension scheme into a personal pension for example.

44 TPR have recently issued a consultation on inducements. TPR *Inducement Offers*, January 2007.

45 The FRRP's functions were extended under both Companies (Audit, Investigations, and Community Enterprise) Act 2004, and the Supervision of Accounts and Reports (Prescribed Body) Order 2005.

46 FSMA (Disclosure of Confidential Information) (Amendment) Regulations 2006 (SI 3413).

47 Similar single invoicing arrangements exist between the FSA, the FOS and the FSCS.

48 The FSA first set out its 11 high level principles that set overarching requirements for all financial services firms in 2001.

49 In addition to the bodies listed below, the FSA also has relations with other bodies such as the Takeover Panel, Her Majesty's Revenue & Customs etc.

50 The FOS is responsible for the operation of the scheme for resolving disputes between financial services firms and consumers. It appoints the ombudsmen and the Chief Ombudsman, and makes the rules of procedure for reference of complaints to the scheme and for their investigation, consideration and determination. In addition, it make rules relating to the award of costs, and the levying of case fees, recommend an annual budget for approval by the FSA, and report to the FSA on the discharge of their functions.

51 The FSA is responsible for appointing and removing of the directors of the FOS, and ensuring that the FOS is at all times capable of exercising the functions conferred on it under FSMA. The FSA approves the FOS's budget and makes and approves the rules of the FOS's complaints' jurisdiction.

52 These are where complaints that are handled by the FOS may have wider regulatory implications, including for firms and consumers. In March 2005, the FSA and the FOS published updated arrangements for the referral of issues that may involve wider implications. The new arrangements clarified the different roles and responsibilities of the two bodies when a wider implications referral is received, and enhanced the way the two organisations cooperate on these issues.

53 The FSCS responsibilities include the effective operation of a single compensation scheme and overseeing the orderly wind-down of work (to which the Rules of the old schemes apply); making and implementing procedures to enable the FSCS to operate its functions; making levies for management expenses, compensation costs and establishment costs as are required under the Rules to enable it to carry out its role; and reporting to the FSA on the discharge of their functions.

54 The FSA is responsible for ensuring that the FSCS is capable of exercising its functions by: ensuring that any rules made by the FSA can be administered effectively; ensuring that the rules do not unreasonably constrain the FSCS's ability to raise sufficient funds to meet the costs incurred in discharging its responsibilities under the Act and under the rules; notifying the FSCS of any circumstances which may impact on its ability to meet the objective of administering the rules in a fair and cost-effective manner; and appointing appropriate persons to the FSCS's Board.

Part 3: Influencing and representation internationally

55 *Sustaining New York's and the U.S.'s Global Financial Services Leadership*, Report by McKinsey & Company for New York Mayor Michael R. Bloomberg and Senator Charles E. Schumer, January 2007. "Many commentators have …..questioned whether several new EU directives sufficiently enhance investor protection and market efficiency to warrant the costs entailed." page 91.

56 *The overall impact of MIFID*, FSA November 2006. This commentary is in addition to the detailed cost-benefit analyses that the FSA is obliged to undertake on individual proposed rule changes for MIFID.

57 The Committee was set up in July 2000 and reported in February 2001. Its terms of reference included: assessing the current conditions for implementation of the regulation of the securities markets in the EU; identifying a critical path to achieving the Financial Services Action Plan; assessing how the mechanism for regulating securities markets in the EU can best respond to developments; and proposing scenarios for adapting current practices in order to ensure greater convergence and cooperation in day-to-day implementation.

58 A qualified majority refers to the number of votes required for a decision to be adopted, with votes weighted according to a country's population.

59 John Tiner speech 11 October 2006 to BBA Annual Conference, London refers to "the need to reach consensus can still compromise/undermine the quality of the final outcome".

60 John Tiner speech 11 October 2006 to BBA Annual Conference, London.

61 'The European Equities Post-Trading Industry: Assessing the Impact of Market and Regulatory Changes', The City of London Corporation, February 2007.

62 The FSA devotes some five person years to this role.

63 Committee of European Securities Regulators.

64 Committee of European Insurance and Occupational Pensions Supervisors.

65 Committee of European Banking Supervisors.

66 Whilst the majority of staff time on EU and International issues is provided by the FSA's Wholesale and Prudential Policy Division and Retail Policy Division, the FSA estimates that at least an additional 17 person years of resources are spent on EU and international issues across a range of other divisions in the FSA, including the central unit on International Strategy and Policy Co-ordination.

67 In particular to achieve a set of managed regulatory relationships for internationally active financial institutions.

68 Including promoting a more harmonised regulatory culture by developing pan-EU common training for regulatory staff, and adoption of impact assessment guidelines.

69 *White Paper on Financial Services 2005-2010*, European Commission, December 2005.

70 For example, the White Paper commits to setting up a permanent group of consumer representatives from across Europe – similar to the Financial Services Consumer Panel.

71 John Tiner speech to APCIMS, 13 October 2006.

72 *Sustaining New York's and the U.S.'s Global Financial Services Leadership,* Report by McKinsey & Company for New York Mayor Michael R. Bloomberg and Senator Charles E. Schumer, January 2007.

73 *The Competitive Position of London as a Global Financial Centre*, The City of London Corporation, November 2005. Updated by the Corporation's Report *The Global Financial Centres Index*, March 2007.

74 *The Financial Services Practitioner Panel, Annual Report 2005-06*.

75 The Financial Services Consumer Panel praised the FSA for having been a strong voice for the UK consumer in the discussions on European proposals, and for ensuring that as much as possible, the needs and position of UK consumers are taken into account. *Financial Services Consumer Panel Annual Report 2005-06*.

76 John Tiner speech 13 October 2006 to APCIMS Annual Conference, Barcelona.

77 Sir Callum McCarthy, Mansion House speech, 20 September 2005.

78 DG Market website: FAQs on EU financial services policy for the next five years.

79 *Davidson Review Implementation of EU legislation*, Final Report November 2006.

80 *The Governance Structure for Financial Regulation and Supervision in Europe*, Dr Rosa M. Lastra, Columbia Journal of European Law, 2003.

81 John Tiner speech to the French Chamber of Commerce, 25 Nov 2005.

82 *European Regulation and Supervision of Financial Services*; A paper for the City EU Advisory Group, April 2005. The report was produced by a working group in the City of London drawn from a broad range of international financial services interests.

83 The European Central Bank favours such an approach for banking services.

84 The European Financial Services Round Table has called for a lead supervisor for cross-border financial institutions: *Towards a lead supervisor for cross border financial institutions in the European Union*, June 2004. The purpose of the Round Table is to provide a strong industry voice on European policy issues relating to financial services, in particular the completion of the single market in financial services. The members of the Round Table include Chairmen and Chief Executives of leading European banks and insurance companies.

85 Ibid, Dr Rosa M. Lastra, Columbia Journal of European Law, 2003.

86 Institute of International Finance, *Proposal for a Strategic Dialogue on Effective Regulation*, December 2006.

87 *Sustaining New York's and the U.S.'s Global Financial Services Leadership,* Report by McKinsey & Company for New York Mayor Michael R. Bloomberg and Senator Charles E. Schumer, January 2007.

88 The US Committee on Capital Markets Regulation has called for the US to move to principles-based regulation. In addition there has been a high-profile call on the same theme by U.S. Treasury Secretary Henry M. Paulson: *Competitiveness of the US Capital Markets*, Economic Club of New York, November 20, 2006.

89 *The Competitive Position of London as a Global Financial Centre*, The City of London Corporation, November 2005.

Part 4: Financial Crime

90 Section 6 (1), FSMA.

91 Appendix 4a provides an outline of the Money Laundering Offence.

92 The FSA may be able to collaborate with HM Revenue & Customs, which develops and publishes a wide range of tax evasion estimates such as VAT fraud and excise diversion fraud or smuggling.

93 A joint HM Treasury, Home Office, Serious Organised Crime Agency and Foreign and Commonwealth Office Publication.

94 PriceWaterhouseCoopers (2005), *Global economic crime survey 2005: United Kingdom*. This focuses on crime volume/firms affected, crime type, cost to firms, means of detection, type of perpetrator, reporting/investigation, regularity of board level engagement (http://www.pwc.com/gx/eng/cfr/gecs/PwC_GECS05_United_Kingdom.pdf).

95 Levi et al, *Economic impact of Fraud in the UK*, February 2007.

96 Monteiro, Zaman, Leitterstorf for the FSA, *Updated Measurement of Market Cleanliness*, March 2007.

97 The measurement did show a decrease between 2004 and 2005. For FTSE350 trading the measure of informed trading was significantly lower than the period before FSMA was introduced.

98 For example, the FSA has placed the risk of organised criminal groups corrupting firms' employees on the dashboard.

99 As outlined in the new Joint Money Laundering Steering Group industry guidance.

100 This contrasts with the approach adopted by HM Revenue & Customs to money laundering supervision of Money Service Businesses and High Value Dealers. It carries out a specialised risk assessment on the population (4,500 traders & 35,000 branches) based on business type, compliance, intelligence and levels of money transmitted. This then determines its visit programme – in the past five years, every Money Service Business has been visited at least once.

101 These relate to areas such as capital held, client money held, levels of staff training.

102 FSA's Small Firms Division recently examined levels of awareness of new anti-Money Laundering provisions at 100 small investment firms. It is also working with trade associations of higher risk sectors to distribute training material.

103 Our calculation of the overall percentage of resources spent by the FSA on financial crime is similar whether worked out by staff time or by cost. However, the percentage of resources allocated to the various activities within financial crime such as intelligence or enforcement

vary depending on whether it is calculated by staff time or cost. Given the lack of cost information this is the best estimation which can be achieved.

104 The NAO's calculation of overall resource allocation is sensitive to the estimate we used of the proportion of time spent by the FSA's supervisors on financial crime (in this exercise, we used the FSA's estimate of 10 per cent). An increased proportion of time would have a significant effect on the calculation of total costs dedicated to financial crime: £32 million (using 15 per cent of time) and £38 million (using 20 per cent of time).

105 The FSA publicly announced this change at its Financial Crime conference on 22 January 2007.

106 Financial Services and Markets Act 2000, s.354(b) (http://www.opsi.gov.uk/acts/acts2000/00008-ah.htm#354).

107 Attorney General (2006), Fraud Review, 24 July 2006 (http://www.lslo.gov.uk/pdf/FraudReview.pdf).

108 Its annual Financial Risk Outlook highlights these issues.

109 There are currently 31 FATF member countries.

110 The mutual evaluation of the UK regime was carried out by FATF in December 2006, with the results due to be published in summer 2007. The 40 recommendations and 9 special recommendations can be viewed on the FATF site (http://www.fatf-gafi.org/document/28/0,2340,en_32250379_32236930_33658140_1_1_1_1,00.html#40recs).

111 Financial Services and Markets Act 2000, s.169 (http://www.opsi.gov.uk/acts/acts2000/00008--n.htm#169).

112 http://www.sec.gov/about/secpar/secpar2006.pdf#sec2.

113 FSA Handbook PRIN 2 (http://fsahandbook.info/FSA/html/handbook/PRIN/2/1).

114 Money Laundering Regulations 2003, Part 2, 3(1)(2a), "A person who contravenes this regulation is guilty of an offence and liable on conviction on indictment, to imprisonment for a term not exceeding 2 years, to a fine or both".

115 Market Watch newsletter 18 Dec 2006, (http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter18.pdf).

116 http://www.fsa.gov.uk/pubs/other/money_laundering/letter_310806.pdf (31 August 2006).

117 John Tiner, Speech at the FSA's Annual Financial Crime Conference, January 2007.

118 Section 118 and section 91, FSMA.

119 The FSA can prosecute the following criminal offences: carrying on a regulated activity without authorisation; breaching restrictions on financial promotions; advertising without approval; failing to cooperate or supply information to FSA investigations; making misleading statements and market manipulation; insider dealing; and breaching money laundering regulations.

120 The FSA first announced plans to tender for a platform to replace its existing system in June 2005. It signed a letter of intent in December 2006 with IT consultancy, Detica, to deliver the new system (to be in place by the end of 2007) over a seven year contract valued at £17 million. The new system will analyse market activity in real-time to detect potentially illegal patterns of trading (http://www.detica.com/indexed/NewsItem_FSA-LOI.htm).

121 FSA (2006), *Implementing MiFID for Firms and Markets*, Consultation 06/14, Annex 2, para 10.13, p.57.

122 The others are contract certainty, credit derivatives, payment protection insurance and Treating Customers Fairly.

123 Market protection includes insider dealing, market manipulation, market abuse and code of market conduct.

124 US Securities and Exchange Commission annual reports. In addition, the two main US self-regulatory organisations also undertake over 1,000 cases between them (New York Stock Exchange and National Association of Securities Dealers).

125 Like the SEC, the FSA measures and monitors referral of cases, proportion of enforcement cases filed within a time limit and then successfully resolved, penalties imposed, requests by foreign regulators for enforcement assistance, and the distribution of cases across core enforcement areas (e.g. insider dealing).

126 For example, some preliminary research from Harvard Law School investigates the linkages between the staffing and budget levels of securities regulators around the world and the effectiveness of their enforcement efforts by developing an index to compare resourcing levels across 28 countries, incorporating budget, staff numbers, GDP and population. Australia and Hong Kong were highest, UK mid-level, and Germany and Austria lowest. Jackson H & Roe M (2006), *Public Enforcement of Securities Laws: Preliminary Evidence*, Harvard Law School, October 2006.

Part 5: Financial Capability

127 FSA, *Building Financial Capability in the UK*, March 2005.

128 Government Communications Network Engage (http://engage.comms.gov.uk/). Other principles are: express policy in a way that makes sense to target audience; feeding the views of the public into all aspects of policy development and service delivery; and being open and accountable in all communication and marketing activities.

129 General Accounting Office, *Further Progress Needed to Ensure an Effective National Strategy*, GAO-07-100 (www.gao.gov). The New Zealand Retirement Commission also carries out schools and workplace financial education.

130 The Resolution Foundation recently published research modelling the potential impact on the financial services industry of a national generic advice service. (Resolution Foundation, *The Advice Gain: The impact of generic financial advice on the financial services industry*, March 2007).

131 FSA, *Delivering Change*, March 2006.

132 John Tiner, *Financial Capability: Making a difference*, FSA/HMT Financial Capability Conference, 18th October 2006.

133 For example, Government Communications Network Engage programme (www.engage.comms.gov.uk) and the National Centre for Social Marketing (www.nsms.org.uk).

134 Organisation for Economic Cooperation and Development, *Improving Financial Literacy*, 2005.

135 Bernheim and Garrett, *The effects of financial education in the workplace*, August 2003.

136 Bernheim & Garrett, *Education and Saving: the long-term effects of high school financial curriculum mandates*, June 2001.

137 Institute of Public Policy Research, *Rethinking financial capability*, 2006.

138 *Losing interest: How much can consumers save by shopping around for financial products?* FSA occasional paper series 19, October 2002.

139 *A National Dividend: the economic impact of financial advice*, Resolution Foundation, September 2006.

140 Financial Services Authority, *Towards a National Strategy for Financial Capability*, 2003; *Building Financial Capability in the UK*, 2004; *Results of the Baseline Survey*, 2006 and *Delivering Change*, 2006.

141 Originally schools, work, young adults, families, retirement, borrowing and advice.

142 COI Strategic Consultancy for the Office of Fair Trading, *Consumer Education: establishing an evidence base*, April 2006.

143 Generic advice is unregulated advice which takes account of the specific financial circumstances of an individual but does not result in a product recommendation. The Resolution Foundation estimates a national generic advice service could cost up to £110 million; the FSA would not have been able to provide this level of funding. (Resolution Foundation, *Closing the advice gap: Providing financial advice for people on low incomes*, May 2006).

144 *Financial Capability: the Government's long-term approach* mapped out at least 60 initiatives by the financial services industry and third sector. OFT's *Consumer Education: establishing an evidence base* (April, 2006) found that the finance sector accounted for 40 per cent of consumer education initiatives examined.

145 The Enterprise Act 2002 gives the OFT powers to use consumer education to support its work in making markets work well for consumers.

146 HM Treasury, *Financial Capability: the Government's long term approach*, January 2007.

147 Better Regulation Commission, *Risk, Responsibility and Regulation*, October 2006.

148 FSA, *Treating Customers Fairly – towards fairer outcomes for consumers*, July 2006.

Terms of reference

149 The FSA has renamed this as the Outcomes Performance Report, which is the term used throughout the report.

Appendix 2: Working with other regulators

150 Both organisations have powers over unfair contract terms under the *Unfair Terms in Consumer Contracts Regulations 1999*.

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