

Reviewing the FSA Handbook Consultation paper 05/10

A response to

the Financial Services Authority

by

UK Society of Investment Professionals

About UKSIP

The UK Society of Investment Professionals (“UKSIP”) is a professional organisation whose main aim is to foster and maintain high standards of professional ability and practice in investment analysis, portfolio management and related disciplines. UKSIP currently has some 5,500 members who work or have an interest in the UK financial services industry. Most members hold the ASIP, CFA or IMC designation. The ASIP designation is held primarily by those who successfully completed UKSIP’s former Associate examination, which was similar to the CFA. UKSIP is the UK-based member society of the CFA Institute, the organisation that develops and administers the Chartered Financial Analyst (CFA®) Program.

UKSIP also develops and administers the Investment Management Certificate (IMC), the benchmark qualification for those working in investment management in the UK. Over 15,000 investment professionals have passed the IMC.

Introduction

UKSIP, the Society which represents investment professionals as individuals - rather than firms - operating in the area defined by the Financial Services Industry (FSA) as the “wholesale” industry, welcomes the opportunity to comment on the proposals for changes to the Approved Persons and the Training and Competence regime for the area of the wholesale investment industry. UKSIP is not commenting on the other aspects of this consultation paper.

UKSIP is on record as being supportive of regulation, based on the intelligent application of principles, in preference to compliance with detailed rules. In this way, managers at all levels in investment firms are encouraged to look for pragmatic solutions which are in the best interests of their clients and which, at the same time, meet the relevant regulatory principles. It follows that UKSIP supports the FSA in its aim to implement simpler and

cheaper regulation – too much detail being self-defeating, with the risk that firms will adopt a “box ticking” based approach to compliance rather than interpreting and applying the meaning behind a given regulatory principle.

It should be carefully noted that the current Approved Persons and Training and Competence regime was introduced following the McDonald Report of 1990 which highlighted the importance of standard examination requirements. Writing in the Financial Times of 23 September, Dr Oonagh McDonald stated her view that the current proposals to abandon mandatory examinations “would set the industry back by a decade” and “would be seen as endorsing lower professional standards than our main competitor the US ...” UKSIP also believes that some aspects of the proposals are inappropriate if the UK is to retain its reputation and position as a centre where both retail and professional investors can invest with confidence.

Securing the structure

Achieving and maintaining the highest possible standards of professionalism throughout the investment market place is an aim shared by both market practitioners and the FSA. It follows that both parties must play their full part in maintaining a robust structure within which all investment transactions can be undertaken with confidence. To withstand the pressures surrounding market practitioners and their firms – particularly in troubled times - such a structure needs secure foundations or benchmarks. The FSA’s proposal would place additional pressures on those responsible for maintaining standards of training and competence and would effectively be turning the clock back to a previous era by removing the secure foundations that help to sustain confidence in the market place.

Consistency between professions

There is not always a clear line between retail and wholesale investment. One of the largest areas of “wholesale” investment activities is the management of pension fund assets where the UK has a world class reputation. In the UK, pension fund trustees – the individuals with ultimate responsibility for the stewardship of millions of individuals’ pension investments – are heavily reliant on the professional abilities of their fund managers. As the FSA will be aware, another arm of government is seeking to introduce a knowledge and understanding requirement for trustees, including objective benchmark tests. If adopted in their present form, the FSA’s proposals would create a major inconsistency in this key area. Trustees could be more rigorously tested than some of those actually making the investment decisions.

Arguably, in a broader sense, there can be few more crucial areas of responsibility than the effective management of major investment funds which represent future pensions, underpin the mortgage and life insurance markets and generally provide savings for millions of individuals. Whilst the FSA is regarding these as wholesale market activities, any shortcomings impact directly upon individuals. In professions comparable with investment, there are requirements that practitioners pass specific qualifications in order to demonstrate competence and thus be allowed to pursue their business activities. Two of the most closely related areas are the actuarial and accounting professions, where success at examinations is all but a prerequisite. UKSIP believes it is illogical to move away from broadly accepted, objective practitioner based qualifications for all investment professionals.

In the case of UKSIP’s own interim approved IMC examination, the Society believes that – irrespective of whether it remains an FSA benchmark requirement test – there will be a strong measure of support amongst forward thinking industry professionals to achieve a suitable qualification. It may be that some investment firms have questioned the costs and other commitments inherent in the current Approved Persons regime. The view expressed to UKSIP by its members, the individual market practitioners, is that those in the industry

should succeed at a suitable qualification. As far as UKSIP is concerned, the IMC is designed to cover no more than one might reasonably expect someone managing money to know. As Dr Oonagh McDonald points out, “Professionals in the financial services industry are entrusted with managing our financial wealth and should be seen to be sufficiently qualified and knowledgeable so to do”. Given that the IMC examination is held very regularly – at present 10 times a year and, from early 2006 it will be available on demand through computer based assessment – the time needed to acquire a widely recognised qualification is kept to a minimum. Indeed, it could be argued that the requirement to pass an examination focuses the mind of both the employee and employer to ensure that adequate training is undertaken as soon as possible and so make the individual competent at the earliest opportunity.

Consistency of standards across the investment industry

One of the assets of the UK market place is the high professional standards expected of individuals within the industry, a situation that has been fostered by a constructive regulatory regime which has insisted upon comparable standards, particularly at the entry level, throughout. Clearly, individuals improve their expertise by gaining work experience within different firms and by ongoing professional development. However, finding individuals to fill vacancies is dependent upon the ability of firms to identify and recruit suitable candidates and this is where success at benchmark qualifications offers a strong, measurable indication of expertise. If adopted in their present form, the FSA’s proposals would be likely to undermine the ability of those responsible for training and competence to identify relevant individuals. In turn, this could impact upon job mobility within the sector.

Clearly, this would be an undesirable outcome for all concerned and a number of additional, in depth activities would need to be undertaken both within firms and by the FSA to ensure that, in the absence of generally recognised benchmarks, consistently high standards were maintained. For those responsible for training and competence within firms, much more time would need to be taken evaluating individuals where they have not succeeded at generally recognised benchmark tests. UKSIP does not believe that that these costs would be of “minimal significance”. For the FSA, particularly where firms have chosen to use the greater flexibility offered under the current proposals, much more time and effort would be required on prudential visits, due to the need to delve more deeply in to the training and competency arrangements within firms and to assess the differing standards of attainment by individuals. The firms themselves would also need to prove that the training provided met an unidentifiable standard.

Business pressures and benchmarks

UKSIP is generally supportive of reducing overheads and of simplifying regulatory requirements. The current high standards of staff within well run firms will, **in normal circumstances**, be maintained. Even in normal circumstances, less well run firms – particularly those experiencing financial difficulty – are under greater pressure to reduce costs wherever possible. Often the first cut is in the training budget. Such firms may, therefore, decide that it is not necessary for all relevant staff to attain generally recognised benchmark qualifications, opting instead for more affordable alternatives which may be less demanding. Furthermore, during an economic downturn – the time when expertise is most needed – the training budgets of even well run firms could be reduced. In such circumstances, the requirement to pass objective tests is all the more important. In such crucial circumstances the FSA’s current proposals could lead to a downward spiral of cost cutting amongst firms, which are aiming to maintain competitiveness. This would be very damaging.

If sufficient firms- were to follow such a route – and it need not be a high proportion overall – some of the benchmark qualifications, which have stood the test of time, may become

financially unviable to run. Such a development could be particularly detrimental to maintaining training and competency standards within smaller firms, where there might be an inability to undertake alternative training programmes of a comparable standard.

Response to selected questions

Q7 *Do you agree with our approach to senior management responsibility for ensuring fitness and propriety?*

No. Whilst UKSIP would agree that senior management should have responsibility for ensuring fitness and propriety, the absence of an objective benchmark - even at the entry level - will make it very difficult for senior management to judge competence in the wholesale industry. The loss of information regarding individuals currently available from the FSA will also make the task of distinguishing the good from the bad more difficult, increasing the moral hazard to the FSA and risk to the firm.

Q8 *Do you agree with our proposal to delete the sole trader function (CF7)?*

UKSIP has no comment to make.

Q9 *Do you agree with our proposal to delete the significant management function annual reporting requirement?*

UKSIP has no comment to make.

Q10 *Do you agree with our proposals to merge the significant management functions and the systems and controls functions?*

UKSIP has no comment to make.

Q11 *Do you agree with our proposals to change the scope of the customer functions, so that they do not apply to individuals that do not deal with private customers?*

UKSIP does not agree with the FSA's proposals in this area. UKSIP believes that this presents a reputational risk to both the FSA and the industry. Whilst UKSIP agrees that, whilst there is less likelihood of something going fundamentally wrong in the wholesale market, it would like to point out that, when it does, the impact is likely to be very significant. If the UK is to retain its reputation as a centre where both retail and professional investors can invest with confidence, there is a need to ensure that a high degree of professionalism is maintained in both the retail and so-called "wholesale" markets. Whilst wholesale customers are more likely to possess the necessary skills and information to judge the performance of a firm, for the reasons stated, above the absence of benchmark requirements in terms of training and competence would be likely to make it extremely difficult for senior management to assess whether a future employee in the wholesale industry is "fit and proper" for the task they are to undertake. In addition, it is likely to result in a "dumbing down" of expertise, an increase in inflexibility within the labour market and a consequent loss of job portability.

UKSIP has heard that some firms are concerned about the loss of information about individuals currently provided by the FSA, as this would make it extremely difficult for them to check thoroughly that an individual is fit and proper. Firms' risks and costs would, therefore, increase.

Q12 *Do you agree with our proposal to delete the Corporate Finance Adviser function (CF23)?*

UKSIP has no comment to make.

Q13 *Do you think that we should pursue option a), b) or c) above? Do you have any information on the practical implications, costs and benefits of each option?*

The primary concern of UKSIP's members relates to the FSA's proposals affecting the wholesale industry.

Q14 *Do you have any views on how we should implement any changes that we make to the controlled functions?*

Others, including investment firms, are probably better qualified than UKSIP to comment on this matter.

Q15 *Do you agree that firms should benefit from these changes and will not face costs of more than minimal significance as a result of them? Do you have any information on the likely costs and benefits involved?*

See response to Q18.

Q16 *Do you have any comments on our proposed changes to the Handbook (in Annex 3) to implement our proposals?*

UKSIP does not wish to comment on this.

Q17 *Do you have any comments on further changes that could be made to the Approved Persons regime in the future?*

Not at this time.

Chapter 4: Reviewing our Training & Competence regime

Q18 *Do you agree with our proposal to disapply the detailed training and competence requirements in TC2 in respect of activities carried on with or for non-private customers?*

The industry as a whole is likely to be adversely affected due to the absence of comprehensive, transferable benchmark qualifications. The proposals would also enable individuals from overseas who have no expertise or experience in the UK markets to operate without undertaking any training in UK regulatory requirements – even high level, global qualifications including the CFA do not cover local area regulations. Given the international nature of the financial services industry in the UK, this could pose a significant moral hazard to the FSA. The FSA is sending a very confused message. Only recently in DP 18 the FSA argued strongly for higher ethical standards. To achieve high standards of ethics and practice, it is necessary to maintain a well trained workforce. Those who are well trained are better able to challenge unethical practices and behaviour. If adopted, the current proposals would undermine high standards. It is also questionable whether the FSA's proposals, which do not specify a benchmark level, are enforceable as there would be no stick which could be used against errant firms. It is notable that the FSA has only ever levied a fine under TC2 and not TC1.

Q19 *Do you agree that firms would benefit from these changes and would not face costs of more than minimal significance as a result of them? Do you have any information on the likely costs and benefits involved?*

Whilst the costs for seeking regulatory approval for an individual employed in the wholesale sector will no longer be incurred, UKSIP believes that, in the absence of a benchmark laid down by the FSA, firms adopting a more flexible approach to training and competence are likely to incur significant extra costs in both recruitment and demonstrations to the FSA that their staff have met an appropriate standard. Those responsible for training will need to have recent technical expertise which could mean that expensive consultancy advice would have to be sought or a front office manager need to spend considerably more time advising the training/HR department.

Q20 *Do you have any comments on the draft amendments to the Training and Competence sourcebook which would give effect to our proposals (see Annex 3)?*

UKSIP does not wish to comment on this.

Q21 *Do you agree that we should review TC as a whole, and do you have any specific suggestions for further changes that could be made to the Training and Competence regime?*

On-going training is essential to maintain professional expertise in rapidly changing markets. UKSIP is, therefore, of the view that the FSA should verify that firms ensure that their staff continue to undertake relevant professional development.

14 October 2005