Peter Cardinali
Finance and Operations – Fees Policy
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

5th June 2013

Dear Mr Cardinali,

The Chartered Financial Analyst Society of the United Kingdom (CFA UK) is keen to share its views, ideas and observations about Financial Conduct Authority's (FCA) consultation 'Regulated fees and levies: Rates proposals 2013/14 CP 13/01. This response has been prepared by CFA UK's Professional Standards and Market Practices Committee (PSMPC). The PSMPC identifies and monitors key regulatory and best practice developments likely to affect CFA UK members.

Context and rationale for fees and levies

CFA UK appreciates that fees and levies imposed on regulated firms are required to resource the regulator. Hence, it becomes essential that these charges are set appropriately to bring about apt outcomes in terms of providing the regulator with adequate resources while being applied fairly across the industry. These features of an appropriate set of fees and levies become even more crucial when applied to a heterogeneous set of firms operating in the UK financial services industry. The focus of our response will relate mainly to section 7 of the CP which sets out the principles for the setting of fees.

Given the events of the last six years, more is expected from the regulator to ensure that, as a last line of defence, market integrity is not undermined, the quality of market participants' conduct does not deteriorate and that consumer detriment is minimised. On one level, more effective regulation may imply higher costs for the industry. However, at the same time, the regulator should be ready to demonstrate how it is delivering net benefits and what it will do if and when it fails.

Annual Funding Requirement (AFR)

CFA UK has stated that instead of changing the regulatory framework, more resources should have been diverted to improving the supervision and enforcement of existing requirements. The first round impact of the change in regulatory structure has resulted in a rise of 15% in the AFR (Table 3.1 in the consultation) or more than five times the rate of inflation. In addition, it appears that this increase in costs has affected all fee blocks bar one (Table 3.2 in the CP).

Table 3.1: Combined AFR across FCA and PRA

	FCA 2013/14 £m	PRA 2013/14 £m	FCA + PRA 2013/14 £m	FSA 2012/13 £m	Movement £m/%
Ongoing regulatory activity (ORA)					
FSA 12 months to 31 March 2013				535.5	
FCA 12 months to 31 March 2014	445.7		445.7		
PRA 12 months to 28 February 2014		217.6	217.6		
Total ORA	**445.7**	**217.6**	**663.3**	**535.5**	**127.8**
Year on year change in annual ORA					*24%*
PRA adjustment to 11 months		-18.2	-18.2		-18.2
Total ORA adjusted	**445.7**	**199.4**	**645.1**	**535.5**	**109.6**
Year on year change in adjusted ORA					*21%*
Additions:					
Recovery of scope change costs	3.3		3.3	2.4	0.9
FCA regulatory reform implementation	2.6		2.6	32.5	-29.9
Bank of England transition costs		14.8	14.8		14.8
Subtractions:					
Surplus in previous year*	-19.5		-19.5	-10.6	-8.9
AFR	**432.1**	**214.2**	**646.3**	**559.8**	**86.5**
Year on year change in AFR					*15%*
Financial Penalty Rebate	**-40.6**		**-40.6**	**-70.7**	**30.1**
% year on year change in chargeable fees taking account of financial penalties rebate					*24%*

* To be finalised on completion of the statutory audit.

Table 3.2

Fee blocks	FCA * 2013/14 £m	PRA # 2013/14 £m	FCA +PRA 2013/14 £m	FSA 2012/13 £m	Movement
A.0 Minimum fee	18.0	0.6	18.6	18.8	-1%
A.1 Deposit acceptors	59.9	146.1	206.0	171.2	20%
A.3 General insurers	22.1	24.3	46.4	38.9	20%
A.4 Life insurers	37.3	30.2	67.5	59.2	14%
A.5 Managing agents	0.2	1.3	1.5	1.3	13%
A.6 The Society of Lloyd's	0.3	1.5	1.8	1.6	14%
A.10 Firms dealing as principal	49.6	10.2	59.8	48.1	24%
FCA solo-regulated fee- blocks	244.7	-	244.7	220.7	11%
Total	**432.1**	**214.2**	**646.3**	**559.8**	**15%**

* including a share of the AP00 FCA Prudential fee-block where appropriate
# including a share of the PT01 PRA Transition Costs fee-block where appropriate

Though fees and levies have increased, it is unlcear whether or not a regulatory dividend is being provided. The financial penalties raised by the FSA of £382 Mln in 2012/2013 were equivalent to 59% of the AFR for 2013/2014. CFA UK appreciates that all but £40.6Mln of these penalties were remitted to the Exchequer, but it is still unclear why the rebate was almost 40% less than the one provided the previous year. Better disclosure on this year's rebate would have been helpful.

Headline information about rebates (Table 6.1 in the CP) is valuable, but no further detail is provided as to whether or not the firms that incurred these penalties shared in these rebates. Quality disclosures from the regulator would provide greater insight into the relationship between firms that were penalised for inappropriate activity and fee rebates. In addition, financial conglomerates that have multiple lines of regulated activity spread across all the fee blocks would also need to be shown to be appropriately affected by fee rebates.

In future, it may be reasonable for firms that are serial offenders or have undertaken significant levels of inappropriate activity to bear the majority of the costs to meet the AFR of the regulatory regime.

Table 6.1: Financial Penalties Scheme – Schedule of application of 2012/13 retained penalties in 2013/14

Fee-block	2012/13 Retained penalties to be applied to benenfit of fee-payers	Rebate applied to FCA 2013/14 fees
A.1 Deposit acceptors	5.1	8.4%
A.2 Home finance providers and administrators	0.5	3.5%
A.3 Insurers – general	1.1	4.8%
A.4 Insurers – life	1.9	5.1%
A.5 Managing Agents at Lloyd's	0.0	0.0%
A.6 The Society of Lloyd's	0.0	0.0%
A.7 Fund managers	8.2	21.0%
A.9 Operators, Trustees and Depositaries of collective investment schemes etc	1.3	12.0%
A.10 Firms dealing as principal	4.5	9.1%
A.12 Advisory arrangers, dealers or brokers (holding or controlling client money or assets, or both)	7.6	17.1%
A.13 Advisory arrangers, dealers or brokers (not holding or controlling client money or assets, or both)	4.0	10.2%
A.14 Corporate finance advisors	1.4	11.1%
A.18 Home finance providers, advisers and arrangers	2.1	13.6%
A.19 General insurance mediation	1.9	7.5%
B. Recognised Investment Exchanges and operators of Multilateral Trading Facilities (only)	0.0	0.0%
E. Issuers and Sponsors of securities	1.1	5.7%
G. Firms registered under the Money Laundering Regulations 2007. Firms subject to: – Regulated Covered Bonds Regulations 2008; – Payment Services Regulations 2009; and – Electronic Money Regulations 2011.	0.0	0.0%
Total	**40.6**	

The Principles for Fees

CFA UK welcomes the FCA's recognition that fee setting requires a set of governing principles (Table 7.1 in the CP). CFA UK welcomes the opportunity to discuss this with the regulator as we have made our views clear across a variety of responses to its predecessor. We believe it is an opportune time to go 'back to basics' as the CP states and we have several suggestions from a previous response[1] that may be helpful.

Table 7.1: FCA fees governing principles

1. Fair	Justify basis for any cross-subsidy.
2. Risk aligned	Risk taken into account where effective to do so.
3. Transparent	Link between cost allocation, application of risk and level of fees is clear.
4. Predictable	Firms can reasonably estimate their fees for the forthcoming year.
5. Flexible	Adaptable to changes in financial markets.
6. Proportionate	Costs of operating should be proportionate and consideration given to the impact on dual-regulated firms.
7. Legal	Allowable within Financial Services and Markets Act 2000 (FSMA) as amended by the Financial Services Act 2012 (2012 Act).

An over-riding principle for fees should be that they are set in a manner that contributes to the effective regulation of the profession. This in turn would help the regulator progress towards mitigating some of the risks to its statutory objectives.

The fees levied on regulated firms should be based on the following criteria:

1) Suitable – the level of fee should be suitable for the type and scale of regulated activity undertaken. For example, plain vanilla types of business should pay a lower fee than a more complex type of business or a firm that undertakes a variety of activities.

2) Cross-subsidy:. Firms that engage in a variety of regulated activities should have limited scope for the cross-subsidy of fees from these numerous sources of regulated income. This becomes more important when multi-activity firms are found to have acted inappropriately in one or more regulated areas. As recent history demonstrates, firms with multiple lines of regulated activities rarely pose lower risks. Hence, it is important to levy a fee on each type of activity and the risk associated with it, rather than aggregating the fee.

[1] CFA UK response Regulatory fees and levies: Policy Proposals for 2012/13 (CP11/21) https://secure.cfauk.org/about/advocacy.html

3) Risk based – Fees should take into account the regulatory and non-regulatory risks associated with each firm and the level of oversight required to ensure that the activity is undertaken appropriately. Firms that require more of the regulator's resources should pay fees and levies proportionate to this additional attention.

4) Memory – Fees should reflect firm's conduct over time. There should be higher fees for firms whose conduct has been inappropriate, ratcheting up for those that are either serial offenders or have undertaken conduct that results in severe breaches of the regulations. The more serious the offence, the greater the fee should be with it being calculated based on the activities of the firms concerned as well as the resources expended by the regulator plus some margin. These higher fees could be used to offset the fees of other firms that have not been involved with inappropriate conduct. In essence, firms would have a 'no claims discount' which would be lost if conduct was ever inappropriate.

5) Moral hazard – the current system suffers from an element of moral hazard. This arises when inappropriate conduct by a firm is insufficiently penalised, leaving them with a financial gain while other market participants pay the cost of diminished trust in the market. This situation is particularly serious where the offending firm goes out of business. Firms that knowingly take regulatory risks are usually only discovered after most of the damage has been done with the resultant 'clean up' costs being borne by the remaining participants in the market.

6) Transparency – The FCA should effectively disclose the mechanism and rationale for calculating fees and levies and should be similarly transparent about the process for determining any rebates or penalties.

7) Regulatory dividend - Fees and levies should be part of the strategy to enhance market integrity and raise trust and confidence in UK financial services. Firms that act in the best interests of their clients should benefit from a regulatory dividend (a 'no claims discount') via reduced fees and levies. These discounts would be sourced from the penalties, higher fees and levies imposed on firms that have not acted appropriately. The FSA was not averse to granting discounts on fines to firms that cooperated with investigations; maybe it is time to provide discounts to firms that continue to act appropriately and place client interests above their own.

We trust that these comments are useful and would be pleased to discuss them in person.

Yours,

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