

## **AFB response to Consultation Paper CP 10/5 Regulatory fees and levies 2010/11**

### **Introduction**

This response is submitted on behalf of the Association of Finance Brokers (AFB). The AFB is the trade association representing intermediaries operating in the secured loan (second charge mortgages over residential properties) industry. Our members hold OFT Consumer Credit Licenses, and most hold secondary insurance permissions with FSA.

The AFB represents brokers who are responsible for approximately 75% by volume and value of secured loans in the intermediary channel. Intermediaries active in this market act on behalf of the consumer in selecting an appropriate lender and product from within their panel of lenders to meet the individual consumer's loan requirements. Our members also provide access to associated protection products such as payment protection insurance.

We welcome the opportunity to respond to this consultation.

### **The need for change**

The cost burden incurred by smaller firms is disproportionate to the regulatory risk they present. They are paying too much for regulation. While general insurance providers are paying 5.3% of the regulator's costs, GI advisers are paying 8.6%. These firms do not present systemic risk and we question whether they cost more to regulate than GI provider firms.

FSA, in our view, must adjust its focus to where history tells us the risks are and apportion the cost of regulation accordingly. We are not persuaded that FSA is taking sufficient account of risk-alignment.

Firms holding solely GI permission are the main group who are paying more under the new proposals, experiencing a 122% increase. We do not see any evidence that the cost of regulating these firms has increased in proportion with the fee increase. FSA's Board stated that the modelling of fees should not 'provide unreasonable results in comparison to current fees'<sup>1</sup>. Further

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<sup>1</sup> Summary minutes of the FSA Board Meeting, 24<sup>th</sup> September 2009.

justification must therefore be put forward by the regulator for this considerable increase.

The move to a straight line recovery model for fees, which disregards economies of scale, ignores the true risk profile of firms and with the network model, will penalise severely a number of smaller firms who will suffer large increases due to the success of their parent organisation. There are many more appropriate risk indicators than firm size and we regret that a real opportunity to examine the true cost of regulating GI intermediaries has been lost. The fees being consulted on do not reflect the overall systemic risk that the sector poses to the economy. We would therefore urge FSA to revise their proposals.

### **Finance brokers as a social good**

If the intermediary sector did not exist, or was not regulated, 'costs' would still exist because the products AFB members recommend would still be there and would present risk. In our view, a prime role of finance brokers is to 'lubricate' the market. The market would not function as well without them and to this end, they are a social 'good'; consumers benefit from their advice and providers' distribution routes are kept clear, well maintained and cost effective. Consumers benefit from the advice they receive from a broker; not just the sale of a product.

We do share FSA's view that it is appropriate for Banks to subsidise the cost of regulating Credit Unions because of the social good they provide. Banks are happy to do this because they can see how the function of Credit Unions assists their own role on the high street. We would add, though, that FSA regulated finance brokers are also a force for good and that this should be reflected in the level of fees they are asked to pay.

### **Economies of scale**

The thrust of the modern financial services marketplace is towards cost-efficiency and economy of scale. Regulation and increasing levels of customer awareness have led to significant reductions in charges and profit margins on each product and this has been to the benefit of consumers. The inefficient practices and procedures of yesteryear were masked by higher charges on products and we welcome the fact that this situation is no longer tolerated.

These external pressures on the industry have also led to more focus on value for money and higher standards of customer service. Today's consumer has high expectations and is willing and able to complain if they do not receive what was promised or what they felt it was reasonable to expect. The industry is more flexible, innovative and customer-focused than ever before and this is good news for all concerned.

The reality of the increasingly efficient market that regulation has helped bring about should therefore be mirrored in the cost of its regulation. The move to straight line recovery we believe risks diminishing firms' potential to bring about ever-greater efficiencies and build on those that regulation and consumer pressure have helped bring about. Although this is a 2 and not a 3-star CP, consumers would inevitably suffer should some of the most efficient firms be forced to try to maintain current levels of service within more straitened circumstances.

We would urge FSA to consider risk metrics other than size. The evidence of economies of scale can be seen in the on-line library of historic data on firms and sectors that has been collected via electronic returns. FSA should focus on the areas where the risks actually are until the benefits of the enhanced supervision programme are embedded and tangible. The assumption that all firms of the same size within a fee-block take up the same level of resource and present an identical risk is misplaced and could impact adversely, albeit unwittingly, on consumer outcomes.

## **Budget Process**

The budget process within FSA is not subject to a formal cost / benefit analysis. Rather a "top level" review is conducted in accordance with the Better Regulation Principles. However, we do not believe this to be sufficient for a budget now approaching half-a-billion pounds. In order to protect FSA from external criticism, reassure the firms who finance the regulator, and provide market confidence, we would support moves by FSA to adopt voluntarily a cost / benefit process in determining its budget.

It is now time for FSA, in conjunction with colleagues from H M Treasury to invite the National Audit Office (NAO) to review its budgetary process and conduct a value for money assessment on a regular, scheduled basis. This will provide FSA with confidence that its procedures are robust and also allow the regulator to answer any critics who worry about the closed book nature of the budget process. Further, FSA should discuss with H M Treasury if the Treasury Select Committee or the Public Accounts Committee is the better body to review the financial management of FSA. We would expect a consultation process for this move.

## **Compatibility**

FSA rules relating to fees are excluded from the statutory requirement to conduct a Cost Benefit Analysis (CBA) Moreover, FSMA has nothing to say on the methodology that should be applied to calculate fees. We have previously stated

our concern that regulatory action is being considered without clear market failure having been identified and that the onus should not be on the industry to prove the *absence* of market failure. We cannot agree that size of firm is inevitably a more risky enterprise within the A19 fee-blocks which do not share the same capacity for systemic risk as the banks in the A1 fee-block. We would reiterate comments from our response to CP 09//26, that when setting a fees policy, FSA should not ignore the significance of sector, before firm size, as specific sectors and models within sectors have been the cause of real detriment in recent years.

AFB members and their clients are victims of the banking crisis, we would support whatever steps FSA deems it appropriate to take in order to mitigate the risk of reoccurrence. Our concern is the mapping across to other sectors, policy changes designed to fix problems with banks in the A1 sector.

## Questions

**Q1: Do you have any comments on the proposed 2010/11 FSA fee rates for authorised firms and the premium applied to the rates in A1 (deposit acceptors fee-block)?**

No

**Q2: Do you agree with the proposal to treat smaller non-directive friendly societies as an exception allowing them to pay a reduced minimum fee and the unrecovered minimum regulatory costs be applied to A.4 (insurers – life) fee-block**

No

**Q3: Do you have any comments on the proposed 2010/11 FSA fee rates for fee-payers other than authorised firms?**

Our concern is that fee-payers other than authorised firms meet the cost of their own regulation.

**Q4: Do you agree with the proposed change to FEES 3, Annex 5, Part 2, Category 2 to reduce the fee for vetting equity registration documents to £3,520?**

No comment

**Q5: Do you support our proposals for the new FEES 7 chapter?**

We fully support the principle of financial education and welcome the opportunity to discuss whether a new FEES chapter is the right way to meet the desired outcome of a better financially-educated populace. Until recently, unsustainably high levels of personal debt were being encouraged. The consequences of this for those who have been hit hard by the recession and have perhaps lost jobs, are threatened with repossession of their homes and so on, are widely known. The lesson that now needs to be learned is that people must be encouraged (shown how if necessary) to live within their means and this will require a complete cultural sea-change. Credit needs to be no longer considered a mark of confidence in the future but recognised as a debt which must be repaid at a future date regardless of personal circumstances at that time. We completely support efforts to bring this change about; regulation can help 'nudge' people towards the right behaviours – helping them to help themselves – but new regulation alone cannot 'force' people to act more responsibly.

Our answer assumes that the Financial Services Bill will be passed by Parliament before the end of the current session and a new Consumer Financial Education Body (CFEB) is established by FSA. Although this CP is concerned with that part of the CFEB's annual budget that is funded by 'fees raised from firms authorised under FSMA' it is important to consider proportionality; the proportion paid by authorised firms compared with

- "Public funds and dormant accounts, and
- Relevant consumer credit firms through the levies they pay to the OFT"

is a sensitive issue, particularly as the regulatory burden on firms is now higher than it has ever been and that firms are operating in economically difficult times. The CP refers to FSA contributing £32.9 million to the Financial Capability 2010/11 budget of £45.4 million but it is more correct to say that FSA *authorised firms* are making this contribution. 72% is a significant contribution by the industry. We therefore think it appropriate that CFEB's annual budget is subject to scrutiny discrete from the FSA approval that will be needed. We would like the scrutiny process to involve representatives of A-block fee-payers as the sign-off process as proposed is too remote from those who will actually have to pay the levies.

Consumers who use GI intermediaries do receive a measure of financial education via their relationships with them. GI intermediaries also contribute to financial education through a measure of pro bono work with the general public as well as with their own client banks. For these reasons, their contribution to the Financial Capability programme must be proportionate and bear in mind the role they are currently playing in improving consumer outcomes.

The success or otherwise of CFEB will be difficult to measure but, nevertheless, it must be an accountable body and demonstrate value-for-money. We would

like to know, therefore, how CFEB's objectives are to be measured and in particular the obligation in FEES 7.1.3 G to enhance

- “The understanding and knowledge of members of the public of financial matters (including the UK financial system); and
- The ability of members of the public to manage their own financial affairs.”  
(*i.e., live within their means*).

These are noble intentions which we do support, but if money is being levied, they must be more than this; there must be measurable objectives and this involves setting out clearly how CFEB's success will be identified and measured. CFEB must be accountable to those who fund it if it is to have credibility.

FEES 7 may be a step towards meeting CFEB's objectives, but it should be kept under review. Its application should be proportionate as should the contributions made by all its 'sponsors'.

**Q6: Do you agree with our proposed £10 minimum levy for financial capability work/Consumer Finance Education Body?**

Our concern is with the overall cost of regulation for our members rather than the allocation of levies to the various activity groups. The notional £10 minimum levy should be spread across a wider range of band widths until the CFEB is up and running and fee-payers know what *activities* are being funded and how these are being costed. The lack of tapering is unfair and punitive; we wish to see this revised.

**Q7: Do you agree with our proposed levies on periodic fees to recover the costs of financial capability work/Consumer Finance Education Body?**

No. The overall burden of regulation is increasing exponentially and FSA cannot expect industry to bear above inflation linked increases

**Q8: Do you agree that we should apply to CFEB the same discounts that we apply to FSA fees, apart from the discounts on financial penalties?**

Yes.

**Q9: Do you agree with the changes we are proposing to the way the IMAP SPF will be charged in 2010/11?**

No comment.

**Q10: Do you have any comments on the proposed non-IMAP SPF for the**

**period 2010/11?**

No comment.

**Q11: Do you agree that our proposed amendment to FEES4 Annex 2 Part 5 reflects the criteria set out in paragraph 9.23 of this CP and the requirements of the Solvency II Directive?**

No comment.

**Q12: Do you agree with our proposal to reduce the discount offered on the variable periodic fees charged to inward-passporting EEA and Treaty firms in fee-block A.1 from 80% to 50%?**

Our concern is that the cost of regulating these firms is met by them and reflects the full cost of FSA's work.

**Q13: Do you agree with our proposal to reduce the discount offered on the variable periodic fees charged to inward-passporting EEA and Treaty firms in fee-block A.3 from 100% to 90%?**

Our concern is that the cost of regulating these firms is met by them and reflects the full cost of FSA's work.

**Q14: Do you agree with our proposal to offer a discount of 40% on the variable periodic fees charged to inward-passporting EEA fee-paying payment institutions in fee-blocks G.2 and G.3?**

Our concern is that the full cost of regulating the COB of all passported-in payment institutions providing payment services in the UK is met by those firms in full.

**Q15: Do you agree that the amendments we propose to insert into FEES 4 Annex 9 make our definition of the tariff base clear and unambiguous?**

No comment.

**Q16: Do you agree with our proposed glossary definition of securities derivative?**

No comment.

**Q17: Do you agree with our proposals for recovering the costs of setting up the regulatory regime for reclaim funds?**

No comment.

**Q18: Do you have any comments on the proposed 2010/11 FSCS management expenses levy limit figure?**

Please see our earlier response to this question.

**Q19: Do you have any comments on the proposed 2010/11 FOS general levy rates?**

The proposed levy increase from £80 to £85 for Block 17 (GI intermediation) will result in GI intermediaries contributing c21% of the total levy in 2010/11. While FSA estimates that 14% of firms in block 17, which is subject to a tariff band, will pay more, the overall result will be a very uneven playing field between firms with <£340,000 annual income and larger firms whose contribution to FOS's costs will increase considerably.

The percentage of FOS's total funding raised via case fees is on the increase, thus reducing the amount raised by levy. The number of finance brokers in the industry has dropped dramatically throughout the difficult market conditions. Whilst we understand that PPI complaints have significantly added to FOS's workload, additional cost for firms at a time when the overall cost of regulation rises will increase the burden on firms that may already be under pressure.

Retaining the number of free cases at three will be of little benefit to those firms that have been active in the PPI market.

The issue we have specifically raised with FOS relates to the treatment of networks. Effectively network appointed representatives (ARs) are a group of small firms working under one umbrella. ARs hold the same range of legal statuses as other directly authorised firms; sole trader, limited company etc. They are however penalised as the network as a whole benefits from only three free cases a year, in the same way that the rules are applied to banking groups. As the number of complaints received by FOS against GI intermediary networks is still relatively low compared to other parts of financial services, it would be interesting to see how extending free cases to ARs would affect FOS's overall funding model. We have asked FOS to give consideration to this point.

Although we appreciate that complicated funding structures are difficult to implement, we would also like to see a "no wrong doing, no fee" applied to cases found in favour of the firm. The monetary and time resource cost of handling a complaint both in house and when presented to FOS, can be significant for small firms. Although only a small number of firms will be affected, in these circumstances reducing or even eliminating the case fee if a complaint is not upheld would be a welcome step.