

# Fees Response

## Introductory Comments

This response is submitted by the Association of Mortgage Intermediaries (AMI). AMI is part of the AIFA family of trade bodies, which also includes the parent organisation of the Association of Independent Financial Advisers, and the Association of Finance Brokers. Our three industries account for over 8,600 directly authorised and circa 14,000 appointed representative firms and this response has been developed following research with members in order to identify the key points to make. The views expressed herein are those of the membership of these three industries.

### Recommendations

We have five main recommendations for FSA to consider:

- We cannot comment on the absolute total of the regulator's budget given the limited information presented in the consultation paper and business plan. No details are given about the internal prioritisation process that FSA undergoes in determining its work priorities, how these are costed (in terms of an internal cost / benefit system), and then the post-implementation review process that ensures an internal accountability process is maintained. Further, we assume a "best value" purchasing system is in place (or other costing model) which ensures transparency of purchasing. Finally, we would wish to be reassured that FSA operates a "fiduciary duty" system against which those with budgetary authority are assessed. We recommend that FSA publishes more information on these internal financial controls to reassure those who finance it that its financial systems and controls are in-line with good practice in larger firms. A public review of these matters would be appropriate, given the scale of increase proposed by FSA.
- The budget process within FSA is not subject to a formal cost / benefit analysis – as stated within the fees consultation. FSA conducts an apparently "top level" review in accordance with the Better Regulation Principles. However, this could be seen as insufficient 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 recommend that FSA voluntarily adopts a cost / benefit process in determining its budget.
- Since inception AMI has stated that FSA was in danger of missing key risks because it was trying to do too much with its resources. We have repeatedly suggested that FSA slims down the number of priorities and projects in order to look more deeply into the most important areas. We again repeat this advice. Given the market conditions, cultural changes required, and desire to recruit more supervisors, it would be folly to proceed with too many initiatives. The result of reviewing, and slimming

down, the initiatives FSA is seeking to do would be to reduce costs and improve the regulator's ability to deploy a strength-in-depth strategy that will be needed.

- FSA may need to allocate more resources to regulate high risk organisations (such as banks). The failure of the banking community to assess its own risks has failed not only all other financial services organisations but, more importantly the UK public as a whole. We agree with Hector Sants' comment that "principles based regulation cannot work in a market where the participants are not principled" and the behaviour of the banking community has exposed this truth. However, we believe it would be deeply unfair to allocate costs to be borne by the intermediary market on this basis. We share Lord Turner's view that intermediary firms have paid too much for regulation for too long. His comment that firms "might be worried about the cost [of regulation]" was entirely accurate. We also support his assertion that "If you look at what [FSA] were charging the biggest banks in the world, and what [FSA] were charging some small regional IFA, the differential was nothing like as big as I think it logically should be, just given the scale of their economics and the scale of the threat to the system". Thus we recommend that FSA revisits its internal allocation model to refocus costs onto the sectors where more intrusive regulation is needed – and not ask the intermediary community to pay more. We can see no reason why intermediary firms are being asked to pay more than the rate of inflation.

We note the proposals to spare the smallest firms from an increase in regulatory fees and welcome this move. We regard this aspect of the proposals as sealed as it would cause significant negative comment for the FSA to step back from this high profile pledge. Indeed, it was noticeable that this was the focus of the regulator's PR strategy at the time the fee proposals were announced.

- We recommend that FSA, in conjunction with colleagues at Treasury, invites the National Audit Office 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 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.

In summary, we call for a lessening of the financial call proposed for intermediary firms, given their lower risk nature. This may mean charging other sectors more – but given the impact they have had on the wider economy we feel this is appropriate. We would welcome an opportunity to discuss our other recommendations, which are longer term, over the coming period.

## **Economic conditions and their impact on firms**

We are currently finalising our latest economic analysis and refining our view of the year ahead. We would be delighted to provide copies of this paper to FSA if it would be helpful. However, the clear, uncontroversial, conclusion is that the economic situation has worsened considerably and the outlook is difficult for the remainder of 2009 and well into 2010.

The Government has launched a series of measures to help small firms continue to trade through these times, including allowing them to defer VAT payments, staggering the increase in business rates, providing loan schemes and certain export guarantees. The clear thrust of public policy is to protect firms, jobs, and provide a degree of impetus to the UK economy.

It is well known that smaller firms provide greatest levels of innovation, and also now employ more people in the UK than the largest organisations (ONS figures).

It would seem appropriate for FSA to support the political consensus on helping smaller firms continue to trade through these difficulties (whilst ensuring a visible level of supervision to encourage positive behaviour). Indeed, one of FSA's statutory objectives is around market confidence and actions that result in the premature closure of firms strike at this objective and also stymie consumer access to good advice – at a time when this is needed most.

## **Instalment scheme**

We are pleased to note that FSA is again facilitating discussions for an instalment scheme for payment of regulatory fees. This will be appreciated – and needed by more firms.

It is our view that the instalment scheme is especially important this year, given the actions of the banking community. FSA will know that banks are removing the overdraft facilities of firms, withdrawing lines of credit, and instead offering small business loans at rates of 17% APR.

## **Financial impact on firms**

FSA will have noted the research into the authorisation intentions of Mortgage Strategy readers, with c40% stating they are considering withdrawing from the market and de-authorising. This confirms AMI statistics, published in 2008, suggesting a reduction of about half of all mortgage intermediaries. This has two immediate impacts: the regulatory burden increases on the firms left (as FSA budget does not fall in relation to firm numbers); and FSA must exercise due care in allowing de-authorisations so as not to facilitate phoenixing. The exit-audit that we have been pressing for is now a necessity if firms are not to leave complaints behind them.

We recommend that FSA reviews its authorisations procedure in light of these, and FSA's own statistics. In its Financial Risk Outlook (FRO) FSA suggested that the number of mortgage intermediary firms it allowed into regulation was "with hindsight, probably unsustainable". Part of the authorisation procedure is to examine a firm's business plan and stress test it according to market conditions. It is now obvious that this procedure was insufficient for the task – and also did not prevent fraudulent firms gaining authorised status (as FSA's investigations are now finding).

If Mortgage Strategy's research proves accurate, and 40% of firms exit the industry, the regulatory burden per firm would in theory increase by the reciprocal of this – thus an increase of 66%. This would directly counter the assumed 40% decrease in income FSA has factored into their calculations, and could result in firms paying fees equivalent to last years' pre-credit crunch income but at 2009/10 rates.

For FSA to now impose above the rate of inflation regulatory fee increases on mortgage intermediary firms would endanger even robust business models given the economic downturn. In particular prudent firms which have weathered the downturn better than most will face significant increases in their regulatory fees.

Our analysis shows that not all firms paying minimum fees will see their regulatory fees frozen, although we note that FSA has committed to holding the minimum fee for 2009/10. Firms with A18 regulated income of £180-240,000 would have paid minimum fees in 2008/9, but in 2009/10 will face a sliding scale of increases from 0-85% on their core-FSA fees. Any firm with A18 income in excess of £240,000 faces a minimum increase of 85% on a like-for-like basis (bearing in mind prospective withdrawals from the market).

Indeed, for firms with mortgage income in excess of £1.8m per annum fees will rise by 100%; firms with income in excess of £75m will see their fees triple under the current budget proposals. Given that these very large firms (networks primarily) are often simply a large number of small businesses under one shared principle authorisation this is counter to Government policy to assist small business and risks market distortion with potential negative consumer outcomes if pursued.

Many AMI members are also impacted by the increase in the General Insurance (GI) levy. Whilst FSCS costs are more complex to compare, due to A19 income including both Life and Pensions and General Insurance sub-classes, the core-FSA levy will still increase substantially for many firms.

Firms with GI income of less than £1m will see an increase of 8% - over twice the rate of inflation. Firms with income in excess of this will see increases of 24%, with firms with income in excess of £5m suffering from regulatory fees that at least double.

The cumulative impact on firms is notable. A firm with £250,000 eligible income in both A18 and A19, and with a 90% Life and Pensions bias to their

A19 business, would see an overall increase of approximately 20% in their total regulatory fees this year, against the backdrop of a challenging climate. This is a substantial increase for what is by any standards an SME.

AMI is aware that FSA has committed to review the regulation of the mortgage market in Q3 2009. This undoubtedly will cause disruption and costs for firms. In light of the underlying economic climate, AMI fears that substantial FSA regulatory fee increases could further unsettle firms, leaving a less robust industry in 2009/10. This in turn could jeopardise the success of any reforms.

### **New funding model**

We are very happy to work with FSA to design a new funding model for the regulator.

However, we believe FSA needs to ask some fundamental questions about its structure and reach before looking at funding. It is commonly regarded truism that funding follows function – not visa-versa.

Our initial suggestions for this model include:

- A review of the funding models and strategies used by other regulators – in different markets (e.g. food, telecommunications, and pharmaceuticals) and in different EU member states – though a global context may be helpful.
- A review of the objectives of the funding. For instance, it used to be said by the Food Standards Agency that their goal was to have a decreasing budget – because the better regulator they were, the more the regulated firms would know what was expected of them, the less they would need to do.
- A review of the scope of the regulator. Is the current workload of FSA appropriate? For instance, should financial capability and Money Guidance sit within FSA? If so, should the funding model that is applied for supervision be applied to these other, ancillary, activities?
- What is the right constitution for FSA to operate? For instance, would “divisional boards” focused at a market level be preferable? Thus we could see a focused business unit overseeing the mortgage market, general insurance industry etc. rather than the small firms, high street firms etc. current split.
- The FSA Board would need to be reviewed as part of the funding review as the simple principle of “no taxation without representation” should hold true at the highest levels of the regulator. Those who are asked to pay for regulation should be represented on its Board – but with a clear consumer advocate role also represented.

We would be happy to provide detailed comments (in addition to those set out in our main recommendations) about the budgetary regime and operating principles that should be best utilised (whether a zero based budgeting

regime, or task-based regime works best should also be fed into the review etc.).

## **Conclusion**

We are keen to see a regulator that has the respect of the firms it supervises emerge from this process. A fundamental building block of that outcome, will be that firms understand the funding regime and can identify what they are asked to pay with what is delivered in the market – and feel the costs are fair and justified.

We believe the current system looks out of step with the transparent nature of good regulation and a budget process that allows the board of the regulator to sign-off against its own budget plan looks outdated and is an obvious weak-link in the regulatory chain. In many ways, FSA should absent itself from the financial process and have its budget either set or approved, and certainly scrutinised, by an external body.

## **Specific Questions**

Q1: Do you have any comments on the proposed 2009/10 FSA fee rates for authorised firms?

AMI does not support the proposed fee rates for firms as proposed in the CP for the reasons raised above. We believe any allocation of additional resources for regulating high-impact firms should be borne by those firms where more intrusive regulation is appropriate.

The economic climate remains very difficult for firms, and we fail to how a greater than inflationary increase can be justified.

Q6: Do you agree with our proposals for charging a General Special Project Fee (SPF) for financing transactions?

We have no objection that firms should pay for the process of refinancing.

**6<sup>th</sup> April 2009**