Annex 6
Fees consultations

1. The table below lists the main Consultation Papers (CPs) and resulting Policy Statements and other documents that have been issued by us concerning the FSA's fees since 'N2' (when we were given our statutory powers on 1 December 2001). Not included in the table below are:
   - consultations primarily on other topics which incidentally discuss related fees issues;
   - fee consultations concerning the ombudsman service and the FSCS; and
   - consultations relating to fees before 1 December 2001.
2. All the documents listed below are available on our website at: www.fsa.gov.uk/Pages/Library/Policy/index.shtml.

Fees consultations

Date	Consultation Paper	Date	Feedback Statements/other documents
June 2000	CP56: The FSA's post-N2 fee-raising arrangements		(feedback in CP79)
December 2000	CP79: Feedback Statement to CP56 and second Consultation Paper on the FSA's post-N2 fee-raising arrangements		(feedback in CP95)
May 2001	CP95: Third Consultation Paper on the FSA's post-N2 fee-raising arrangements including feedback on CP79	July 2001	Handbook Notice 2 (feedback also in CP111)
September 2001	CP111: Fourth Consultation Paper on the FSA's post-N2 fee-raising arrangements including feedback on CP95	January 2002	PS111: Fee-raising arrangements (feedback on CP111)
January 2002	CP125: Fees 2002/03	April 2002 June 2002	Handbook Notice 9 PS125: Fees 2002/03 (feedback on CP125)
		January 2002	Consolidated Policy Statement on our fee-raising arrangements (version 1.0)
		June 2002	Consolidated Policy Statement on the FSA's general policy framework for raising fees (version 2.0)
July 2002	CP141: Miscellaneous amendments to the Handbook (No.3)	November 2002	Handbook Notice 16
		August 2002	Feedback Statement on fees review
September 2002	CP152: Fees – interim consultation on policy issues		(feedback in CP168)
November 2002	CP156: Miscellaneous amendments to the Handbook (No.5)	March 2003	Handbook Notice 20
January 2003	CP168: Fees 2003/4	March 2003 May 2003	Handbook Notice 20 FS168: Fees 2003/04 (feedback on CP168)
April 2003	CP180: Fees for mortgage firms and insurance intermediaries	October 2003	PS180: Fees for mortgage firms and insurance intermediaries (feedback and made text from CP180)
		May 2003	Consolidated Policy Statement on the FSA's general policy framework for raising fees (version 3.0)
July 2003	CP192: Further consultation on fees for mortgage firms and insurance intermediaries	December 2003	PS192: Further consultation on fees for mortgage firms and insurance intermediaries (feedback and made text from CP192)

Date	Consultation Paper	Date	Feedback Statements/other documents
		July 2003	Consolidated Policy Statement on our fee raising framework (version 3.1)
January 2004	CP04/2: Fees and fees policy 2004/05	March 2004	Handbook Notice 31 (feedback also in CP04/9)
May 2004	CP04/9: Fees issues arising from the regulation of mortgage business and general insurance broking - including feedback on CP04/2	May 2004 October 2004	Consolidated Policy Statement on our fee-raising arrangements (version 4.1) PS04/21: Regulatory fees relating to mortgage and insurance mediation regulation (feedback on CP04/4 and CP04/9 and made text)
January 2005	CP05/2: Regulatory fees and levies 2005/06	March 2005 May 2005	Handbook Notice 42 PS05/6: Regulatory fees and levies 2005/06 – including feedback on CP 05/2 and made rules
		June 2005	Consolidated Policy Statement on our fee-raising arrangements (version 5.0)
February 2006	CP06/2: Regulatory fees and levies 2006/07	March 2006 May 2006	Handbook Notice 53 PS06/2: Regulatory fees and levies 2006/07 – including feedback on CP 06/2 and made rules
		May 2006	Consolidated Policy Statement on our fee-raising arrangements (version 6.0)
July 2006	CP06/13: Quarterly Consultation (No. 9)	September 2007 September 2007 September 2007 October 2007	PS06/7: The regulation of personal pension schemes including SIPPS CP06/16: Prudential changes for insurers Handbook Notice 58 PS06/12: Regulation of Home Reversion and Home Purchase Plans (Volume 1)

Date	Consultation Paper	Date	Feedback Statements/other documents
February 2007 July 2007 July 2007 September 2007 November 2007 December 2007 February 2008	CP07/3: Regulatory fees and levies 2007/08 CP07/13: Quarterly Consultation (No.13) Proposals for a UK recognised covered bonds legislative framework HM Treasury FSA The FSA's new role under the Money Laundering Regulations 2007 – our approach CP07/19:Regulatory fees and levies: policy proposals for 2008/09 CP07/22:Regulating connected travel insurance CP08/2: Regulatory fees and levies: rates proposals 2008/09 and feedback on CP07/19	March 2007 May 2007 September 2007 March 2008 N/A March 2008/ May 2008 May 2008 March 2008 May 2008	Handbook Notice 64 PS07/7: Consolidated Policy Statement on our fee-raising arrangements and regulatory fees and levies 2007/08, including feedback on CP07/3 and 'made rules' Handbook Notice 69 PS08/2: Regulated Covered Bonds: feedback on proposals for a Recognised Covered Bonds legislative framework and final Handbook N/A Handbook Notice 75 PS08/5: Consolidated Policy Statement on our fee-raising arrangements and regulatory fees and levies 2008/09, including feedback on CP07/19, CP08/2, CP08/7 and 'made rules' PS08/4: Travel Insurance – feedback on CP07/22 and made rules Handbook Notice 75 PS08/5: Consolidated Policy Statement on our fee-raising arrangements and regulatory fees and levies 2008/09, including feedback on CP07/19, CP08/2, CP08/7 and 'made rules'
April 2008	CP08/7:Quarterly Consultation Paper (No.16)	May 2008	PS08/5: Consolidated Policy Statement on our fee-raising arrangements and regulatory fees and levies 2008/09, including feedback on CP07/19, CP08/2, CP08/7 and 'made rules'
July 2008	CP08/12:Quarterly Consultation Paper (No.17)	September 2008 October 2008	Handbook Notice 81 CP08/18: Regulatory fees and levies: policy proposals for 2009/10

Date	Consultation Paper	Date	Feedback Statements/other documents
October 2008	CP08/18: Regulatory fees and levies: policy proposals for 2009/10	February 2009 June 2009	PS09/5: Fees and levy policy and certain regulatory fee and levy rates 2009/10 – including feedback on CP08/18 and part of CP09/7 PS09/8: Consolidated Policy Statement on our fee-raising arrangements and regulatory fees and levies 2009/10, including feedback on CP08/18, CP09/7 and 'made rules'
December 2008	CP08/21: Consultation on amendments to the Listing Rules and feedback on DP08/1 (A review of the structure of the Listing Regime)	November 2009 February 2010	CP09/28: Listing Regime Review Consultation on changes to the listing categories consequences to CP09/24 PS10/2: Listing Regime review: Consultation on changes to the listing categories consequent to CP09/24 Note: Concerning change in terminology from 'Primary Listing' to 'Premium Listing 'only.
February 2009	CP09/6: Regulating sale and rent back – an interim regime	–	PS09/9: Regulating sale and rent back: an interim regime - Feedback on CP09/6 and near-final rules
February 2009	CP09/7: Regulatory fees and levies: rates proposals for 2009/10	March 2009 April 2009 June 2009	PS09/5: Fees and levy policy and certain regulatory fee and levy rates 2009/10 - including feedback on CP08/18 and part of CP09/7 Handbook Notice 87 PS09/8: Consolidated Policy Statement on our fee-raising arrangements and regulatory fees and levies 2009/10, including feedback on CP08/18, CP09/7 and 'made rules'
February 2009	CP09/8: Regulating reclaim funds	July 2009 July 2009	Handbook Notice 90 PS09/12: Policy Statement Regulating Reclaim Funds – Feedback on CP09/8 and final rules.
April 2009	CP09/12:Quarterly Consultation Paper (No.20)	July 2009	Handbook Notice 89
September 2009	CP09/22: Regulating sale and rent back - the full regime	January 2010	PS10/4: Sale and rent back (full regime) – Feedback on CP09/22, made rules and consultation on reporting
October 2009	CP09/25: Quarterly Consultation Paper (No.22)	December 2009	Handbook Notice 95

Date	Consultation Paper	Date	Feedback Statements/other documents
November 2009	CP09/26: Regulatory fees and levies: policy proposals for 2010/11	December 2009 March 2010 December 2010	Handbook Notice 95 Handbook Notice 98 Handbook Notice 105
February 2010	CP10/5: Regulatory fees and levies – Rates proposals 2010/11 and feedback statement on Part 1 of CP09/26	March 2010 May 2010	Handbook Notice 98 PS10/7: Consolidated Policy Statement on our fee-raising arrangements and regulatory fees and levies 2010/11
April 2010	CP10/10: Quarterly Consultation Paper (No.24)	June 2010	Handbook Notice 101
October 2010	CP10/22: Regulatory fees and levies: policy proposals for 2011/12	December 2010 January 2011 February 2011	Handbook Notice 105 PS11/2: Implementation of the 2nd Electronic Money Directive CP11/2: Regulatory fees and levies – Rates proposals 2011/12
February 2011	CP11/2: Regulatory fees and levies – Rates proposals 2011/12	March 2011 May 2011	Handbook Notice 108 PS11/07: Consolidated Policy Statement on our fee-raising arrangements and regulatory fees and levies 2011/12
April 2011	CP11/7: Quarterly Consultation Paper (No.28)	May 2011	PS11/07: Consolidated Policy Statement on our fee-raising arrangements and regulatory fees and levies 2011/12

Annex 7

Financial Ombudsman Service general levy – 2011/12 overview

Industry Block Name	Description	Tariff Base	Final 2011/12 tariff rate (£)	Actual 2010/11 tariff rate (£)	Final 2011/12 Minimum Levy per firm (£)	Actual 2010/11 Minimum Levy per firm (£)	Final 2011/12 gross total (£)	Actual 2010/11 gross total (£)	Final 2011/12 levy as % of total budget	Actual 2010/11 levy as % of total budget
1	Deposit acceptors, home finance providers and administrators (excluding firms in block 14)	Per relevant account	0.0643648	0.0278	100	100	16,701,075	7,207,700	39.1	40.7
2	Insurers – general (excluding firms in block 13 and 15)	Per £1,000 of relevant annual gross premium income	0.21626	0.108	100	100	5,237,172	2,480,000	12.3	14.0
3	The Society of Lloyds		0	0	48,116	20,000	48,116	20,000	0.1	0.1
4	Insurers – life (excluding firms in block 15)	Per £1,000 of relevant adjusted annual gross premium income	0.038445	0.033	100	100	1,785,187	1,594,300	4.2	9.0

5	Fund managers	Flat fee	0	0	485	200	440,380	177,000	1.0	1.0
6	Operators, Trustees and Depositaries of collective investment schemes	Flat fee	0	0	120	50	50,880	20,000	0.0	0.1
7	Dealers as principal	Flat fee	0	0	125	50	32,500	14,000	0.1	0.1
8	Advisory arrangers, dealers or brokers holding client money	Per relevant approved person	36.98	35	35	35	894,574	923,000	2.1	5.2
9	Advisory arrangers, dealers or brokers not holding client money	Per relevant approved person	30.02	35	35	35	895,985	923,000	2.1	5.2
10	Corporate finance advisors	Flat fee	0	0	130	50	33,540	14,000	0.1	0.1
11	Fee-paying payment service providers (but excluding firms in other industry blocks)	Authorised payment institutions per £1,000 of relevant income	0.040854	0.015	75	75	62,957	25,800	0.1	0.1
	For small payment institutions and Small money institutions	For small payment institutions and small e-money issuers a flat fee	0	0	150	75	81,300	29,500	0.2	0.2

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Industry Block Name	Description	Tariff Base	Final 2011/12 tariff rate (£)	Actual 2010/11 tariff rate (£)	Final 2011/12 Minimum Levy per firm (£)	Actual 2010/11 Minimum Levy per firm (£)	Final 2011/12 gross total (£)	Actual 2010/11 gross total (£)	Final 2011/12 levy as % of total budget	Actual 2010/11 levy as % of total budget
13	Cash plan health providers	Flat fee	0	0	125	50	1,500	600	0.0	0.0
14	Credit unions	Flat fee	0	0	125	50	56,875	24,000	0.1	0.1
15	Friendly societies whose tax exempt business represents 95% or more of their total relevant business	Flat fee	0	0	125	50	8,625	3,700	0.0	0.0
16	Home finance lenders, advisers and arrangers	Flat fee	0	0	110	90	650,100	531,000	1.5	3.0
17	General insurance mediation	Per £1,000 of relevant business annual income	1.649277	0.31	85	85	15,718,115	3,712,400	36.8	21.0
18	Fee paying electronic money issuers	Flat fee	0	NA	180	NA	6,300	NA	0.0	NA
	Small electronic money institutions	Flat fee	0	NA	180	NA	7,200	NA	0.0	NA
Total							**42,712,381**	**17,700,700**		

LME-003679

Annex 8

List of non-confidential respondents to CP11/2, CP 11/7 (Chapter 4) and CP10/24 (Chapter 7)

CP11/2 (Regulatory fees and levies, February 2011)

Association of British Insurers

Association of Financial Mutuals

Association of Independent Financial Advisers

Association of Mortgage Intermediaries

Association of Private Client Investment Managers and Stockbrokers

Aviva plc

AXA UK

Bluefin Insurance Services Limited

Brighton Energy Cooperative

Building Societies Association

Capita Group plc

Capital One (Europe) Limited

Channel Islands' Co-operative Society

Co-operatives UK

Institute of Insurance Brokers

Investment & Life Assurance Group

Investment Management Association

London Energy Brokers Association

Lloyd's

Rensburg Sheppards Investment Management Limited

Midcounties Co-operative Limited

OLMEC

Nationwide Building Society

Nottinghamshire County Council

Royal & Sun Alliance Insurance plc

Scottish Midland Co-operative Society

Software Co-op

Terry Clay

Wholesale Markets Brokers' Association

CP11/7 (Quarterly consultation paper, April 2011): Chapter 4 - 'Proposed amendments to the fees manual'

Prudential UK

CP10/24 (Regulatory fees and levies, October 2010): Chapter 7 – 'For discussion – new fee-block for funding client money and assets)

Aon Ltd

Association of Independent Financial Advisers

Bluefin Insurance Services Limited

British Insurance Brokers Association

Depositary and Trustee Association

LME-003682

Griffiths & Armour

Institute of Insurance Brokers

International Financial Data Services

Investment Management Association

Lockton Companies LLP

London and International Insurance Brokers' Association

Prudential

St James's Place Wealth Management Group

Society of Pension Consultants

Thompson Heath & Bond Limited

LME-003684

Appendix 1

Periodic fees (2011/12) and other fees instrument 2011

PERIODIC FEES (2011/2012) AND OTHER FEES INSTRUMENT 2011

A. The Financial Services Authority makes this instrument in the exercise of:

(1) the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(a) section 99 (Fees);
(b) section 101 (Part 6 rules: general provisions);
(c) section 156 (General supplementary powers);
(d) section 157(1) (Guidance);
(e) section 234 (Industry Funding);
(f) paragraph 17(1) (Fees) of Schedule 1 (The Financial Services Authority);
(g) paragraph 12 of Part 2 (Funding) of Schedule 1A (Further provision about the Consumer Financial Education Body); and
(h) paragraphs 1 (General), 4 (Rules), and 7 (Fees) of Schedule 7 (The Authority as Competent Authority for Part VI);

(2) the following provisions of the Payment Services Regulations 2009 (SI 2009/209):

(a) regulation 82 (Reporting requirements);
(b) regulation 92 (Costs of supervision); and
(c) regulation 93 (Guidance); and

(3) the following provisions of the Electronic Money Regulations 2011 (SI 2011/99):

(a) regulation 49 (Reporting requirements);
(b) regulation 59 (Costs of supervision); and
(c) regulation 60 (Guidance).

B. The rule-making powers listed above are specified for the purposes of section 153(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 1 June 2011.

Amendments to the Handbook

D. The Glossary of definitions is amended in accordance with Annex A to this instrument.

E. The Fees manual (FEES) is amended in accordance with Annex B to this instrument.

Citation

F. This instrument may be cited as the Periodic Fees (2011/2012) and Other Fees Instrument 2011.

By order of the Board
26 May 2011

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text.

fee-paying payment service provider	any of the following when they provide *payment services*: (a) a *payment institution*; (b) a *full credit institution*; (c) an ~~*e-money*~~ *electronic money issuer* (except where it is an *electronic money issuer* whose only *payment service* activities are those relating to the issuance of *electronic money* by itself or if it is a *credit union*, a municipal bank or the National Savings Bank); (d) the Post Office Limited; (e) the Bank of England, other than when acting in its capacity as a monetary authority or carrying out functions of a public nature; and (f) government departments and local authorities, other than when carrying out functions of a public nature. A *full credit institution* ~~or an *e-money issuer*~~ that is an *EEA firm* is only a *fee-paying payment service provider* if it is exercising an *EEA right* in accordance with Part 2 of Schedule 3 to the *Act* (exercise of passport rights) to provide *payment services* in the *United Kingdom*. An *EEA authorised payment institution* or an *EEA authorised electronic money institution* is only a *fee-paying payment service provider* if it is exercising a right under Article 25 of the *Payment Services Directive* or Article 3 of the *Electronic Money Directive* to provide *payment services* in the *United Kingdom*.
firm	… (5) (in *FEES* 3, *FEES* 4, ~~to~~ *FEES* 5 and *FEES* 7) includes a *fee-paying payment service provider* and a *fee-paying electronic money issuer* in accordance with *FEES* 3.1.1AR, *FEES* 4.1.1AR, ~~and~~ *FEES* 5.1.1AR and *FEES* 7.1.1R ~~and in *FEES* 3 also includes a *fee-paying electronic money issuer*~~.

Annex B

Amendments to the Fees manual (FEES)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Application

1.1.2 R This manual applies in the following way:

…

(2) *FEES* 1, 2 and 4 apply to:

…

(j) every *fee-paying payment service provider*;

(k) every *fee-paying electronic money issuer*.

(3) *FEES* 1, 2 and 5 apply to:

(a) every *firm*, ~~and~~ *fee-paying payment service provider* and *fee-paying electronic money issuer* which is subject to the *Compulsory Jurisdiction* of the *Financial Ombudsman Service*; and

…

…

(5) *FEES* 1, 2 and 7 apply to:

…

(d) the *Society*;

(e) every *fee-paying payment service provider* except the Bank of England, government departments and local authorities;

(f) every *fee-paying electronic money issuer* except the Bank of England, government departments, local authorities, municipal banks and the National Savings Bank.

…

…

3 Annex 1R Authorisation fees payable

Part 1 – Authorisation fees payable

…

Moderately Complex Cases

Activity grouping	Description
~~A.1~~ [deleted]	~~*E-money issuers* only~~ [deleted]
…	

…

4.1 Introduction

Application

…

4.1.1A R A reference to "*firm*" in this chapter includes a reference to a *fee-paying payment service provider* and a *fee-paying electronic money issuer*.

…

4.1.4 G …

(3) The periodic fees for *fee-paying payment service providers* and *fee-paying electronic money issuers* are set out in *FEES* 4 Annex 11R. This annex sets out the activity groups, tariff base, valuation dates and, where applicable, the flat fees due for these *firms*.

…

Modifications for persons becoming subject to periodic fees during the course of a financial year

…

4.2.7 R A *firm* (other than an *ICVC* or *UCITS qualifier*) which becomes authorised or registered, or whose *permission* and/or *payment service* activities are extended, during the course of the financial year must pay a fee which is calculated by:

(1) identifying each of the tariffs set out in Part 1 of *FEES* 4 Annex 2R and/or *FEES* 4 Annex 11R as appropriate for the relevant financial year that apply to the *firm* only after the *permission* is received or

extended or *payment service* activities are authorised or registered or extended or *electronic money* issuance activities are authorised or registered under the *Electronic Money Regulations*, but ignoring:

…

…

4.2.7A G Projected valuations for a *firm's* first year will be collected for the 12 month period beginning with the date a *firm* becomes authorised or registered, or the date its *permission* and/or *payment service* activities are extended. That information will be used to calculate the periodic fee for the remainder of the financial year in which the *firm* was authorised or registered or its *permission* and/or payment service activities were extended (adjusted in accordance with *FEES* 4.2.7R) and to calculate the periodic fee for the following financial year. Projected valuations are not relevant for those fee payers that are only required to pay fixed fees.

4.2.7B R (1) This *rule* deals with the calculation of:

(a) a *firm's* fees for its second financial year. This is the *FSA* financial year following the *FSA* financial year in which it was given *permission* and/or was authorised or registered under the *Payment Services Regulations* or the *Electronic Money Regulations* or had its *permission* and/or *payment services* activities extended ("the relevant permissions"); and

…

…

(5) The rest of this *rule* only applies to a *firm* that becomes authorised or registered, or extends its *permission* and/or *payment services* activities, on or after 1 April 2009.

…

…

4.2.8 R In relation to an *incoming EEA firm* or an *incoming Treaty firm* the modification provisions of *FEES* 4.2.7R apply only in relation to the relevant *regulated activities* of the *firm*, which are *passported activities* or *Treaty* activities and which are carried on in the *United Kingdom*, and which are not provided on a *cross border services* basis. For *payment services* and *electronic money* issuance, the adjustment only applies to the business to which the calculation made in *FEES* 4.3.12AR relates.

…

4.2.11 R Table of periodic fees

1 Fee payer	2 Fee payable	3 Due date	4 Events occurring during the period leading to modified periodic fee
Any *firm* (except an *ICVC* or a *UCITS qualifier*)	As specified in *FEES* 4.3.1R	(1) Unless (2) or (3) apply, on or before the relevant dates specified in *FEES* 4.3.6R. (2) Unless (3) applies, if an event specified in column 4 occurs during the course of a financial year, 30 *days* after the occurrence of that event, or if later the dates specified in *FEES* 4.3.6R. (3) Where the *permission* is for *operating a multilateral trading facility*, the date specified in *FEES* 4 Annex 10 (Periodic fees for MTF operators).	*Firm* receives *permission*, or becomes authorised or registered under the *Payment Services Regulations* <u>or the *Electronic Money Regulations*</u>; or *firm* extends *permission* or its *payment service* activities
...			
Sponsors	~~£ 12,500~~ <u>£20,000</u> per year for the period from 1 April to 31 March the following year (see Note)	...	...
...			

...

4.3.2 G (1) The amount payable by each *firm* will depend upon the category (or categories) of *regulated activities* or *payment services* it is engaged in (fee-blocks) <u>and whether it is issuing *electronic money*</u>, and on the amount of business it conducts in each category (tariff base). The fee-blocks and tariffs are identified in *FEES* 4 Annex 1R (and guidance on calculating certain of the tariffs is at *FEES* 4 Annex 12G), while *FEES* 4 Annex 2R sets out the tariff rates for the relevant financial year. In the case of *firms* that provide *payment services* <u>and/or issue *electronic money*</u>, the relevant fee blocks, tariffs and rates are set out in *FEES* 4 Annex 11R.

(2) *Incoming EEA firms, incoming Treaty firms*<u>,</u> ~~and~~ *EEA authorised payment institutions* <u>and *EEA authorised electronic money institutions*</u> receive a discount to reflect the reduced scope of the *FSA's* responsibilities in respect of them. The level of the discount varies from fee-block to fee-block, according to the division of responsibilities between the *FSA* and *Home state regulators* for *firms* in each fee-block (see *FEES* 4.3.11G, *FEES* 4.3.12R and *FEES* 4.3.12AR).

Calculation of periodic fee (excluding fee-paying payment service providers <u>and fee-paying electronic money issuers</u>)

4.3.3 R The periodic fee referred to in *FEES* 4.3.1R is (except in relation to the *Society*<u>,</u> ~~and~~ *fee-paying payment service providers* <u>and *fee-paying electronic money issuers*</u>) calculated as follows:

...

Calculation of periodic fee for fee-paying payment~~s~~ service providers <u>and fee-paying electronic money issuers</u>

4.3.3A R The periodic fee referred to in *FEES* 4.3.1R in relation to *fee-paying payment service providers* <u>and *fee-paying electronic money issuers*</u> is calculated in accordance with *FEES* 4 Annex 11R.

Modification for firms with new or extended permissions

4.3.4 G (1) A *firm* which becomes authorised or registered during the course of a financial year will be required to pay a proportion of the periodic fee which reflects the proportion of the year for which it will have a *permission* or the right to provide particular *payment services* <u>or the right to issue *electronic money*</u> - see *FEES* 4.2.5G and *FEES* 4.2.6R.

...

(3) These provisions apply (with some changes) to *incoming EEA firms*<u>,</u> ~~and~~ *incoming Treaty firms*<u>, *EEA authorised payment institutions*</u> and <u>*EEA authorised electronic money institutions*</u>.

...

...

Time of payment

4.3.6 R (1) If the *firm's* periodic fee for the previous financial year was at least £50,000, the *firm* must pay:

...

...

(3) If a *firm* has applied to cancel its *Part IV permission* in the way set out in *SUP* 6.4.5D (Cancellation of permission), or its status as a *payment institution* under regulation 10 of the *Payment Services Regulations* (Cancellation of authorisation) or as regulation 10 is applied by regulation 14 of the *Payment Services Regulations* (Supplementary provisions), or its status as an *electronic money issuer* under regulation 10 of the *Electronic Money Regulations* (Cancellation of authorisation) or as regulation 10 is applied by regulation 15 of the *Electronic Money Regulations* (Supplementary provisions), then (1) and (2) do not apply but it must pay the total amount due when the application is made.

...

(4A) If the *FSA* has cancelled a *firm's* authorisation or registration under regulation 10 of the *Payment Services Regulations* or regulation 10 of the *Electronic Money Regulations* or its registration under regulation 10 as applied by regulation 14 of the *Payment Services Regulations* or its registration under regulation 10 as applied by regulation 15 of the *Electronic Money Regulations*, then (1) and (2) do not apply but the *firm* must pay the total amount due immediately before the cancellation becomes effective.

...

...

Incoming EEA firms, incoming Treaty firms, ~~and~~ EEA authorised payment institutions and EEA authorised electronic money institutions

4.3.11 G The *FSA* recognises that its responsibilities in respect of an *incoming EEA firm*, an *incoming Treaty firm*, ~~or~~ an *EEA authorised payment institution* or an *EEA authorised electronic money institution* are reduced compared with a *firm* which is incorporated in the *United Kingdom*. Accordingly the periodic fees which would otherwise be applicable to *incoming EEA firms*, *incoming Treaty firms*, ~~and~~ *EEA authorised payment institutions* and *EEA authorised electronic money institutions* are reduced.

...

4.3.12A R For:

(-1)

(a) a *full credit institution* ~~or an *e-money issuer*~~ which is a *fee-paying payment service provider* and an *EEA firm*,; or ~~for an *EEA authorised payment institution*,~~

(b) a *full credit institution* which is a *fee-paying electronic money issuer* and an *EEA firm*; or

(c) an *EEA authorised payment institution*; or

(d) an *EEA authorised electronic money institution*;

the calculation required by *FEES* 4.3.3AR is modified as follows:

(1) the tariffs set out in Part 5 of *FEES* 4 Annex 11R are only applied to the *payment services* or *electronic money* issuance of the *firm* ~~which are~~ carried on from an establishment in the *United Kingdom*, including any *payment services* ~~provided~~ carried on through any of its *agents* established in the *United Kingdom*; and

…

Firms Applying to Cancel or Vary Permission Before Start of Period

4.3.13 R (1) If:

(a) a *firm* makes an application to vary its *permission* (by reducing its scope), or cancel it, in the way set out in *SUP* 6.3.15D(3) (Variation of permission) and *SUP* 6.4.5D (Cancellation of permission), or applies to vary (by reducing its scope) or cancel its authorisation or registration (regulation 8 and 10(1) of the *Payment Services Regulations* including as applied by regulation 14 of the *Payment Services Regulations*) or applies to cancel its authorisation or registration (regulation 10 and 12 of the *Electronic Money Regulations* including as applied by regulation 15 of the *Electronic Money Regulations*); an *issuer* makes an application for de-listing; or a *sponsor* notifies the *FSA* of its intention to be removed from the list of approved *sponsors*; and

…

FEES 4.2.1R applies to the *firm* as if the relevant variation or cancellation of the *firm's permission* or authorisation or registration under the *Payment Services Regulations* or the *Electronic Money Regulations*, de-listing or removal from the list of approved *sponsors*, took effect immediately before the start of the period to which the fee relates.

…

4.3.14	G	Where a *firm* has applied to cancel its *Part IV permission*, or its authorisation or registration under the *Payment Services Regulations* or the *Electronic Money Regulations*, or the *FSA* has exercised its *own-initiative powers* to cancel a *firm's Part IV permission* or the *FSA* has exercised its powers under regulation 10 (Cancellation of authorisation), including as applied by regulation 14 (Supplementary provisions) of the *Payment Services Regulations* to cancel a *firm's* authorisation or registration under the *Payment Services Regulations* or the *FSA* has exercised its powers under regulation 10 (Cancellation of authorisation), including as applied by regulation 15 (Supplementary provisions) of the *Electronic Money Regulations*, the due dates for payment of periodic fees are modified by *FEES* 4.3.6R(3), *FEES* 4.3.6R(4) and *FEES* 4.3.6R(4A) respectively.

...

Information relating to payment services and the issuance of electronic money

4.4.7	D	~~An *authorised payment institution*, the Post Office Limited, government departments and local authorities or an *EEA authorised payment institution*~~ A *fee-paying payment service provider* and a *fee-paying electronic money issuer* must notify to the *FSA* the value (as at the valuation date specified in Part 4 of *FEES* 4 Annex 11R) of each element of business on which the periodic fee (other than a flat fee) payable by the *firm* under *FEES* 4 Annex 11R is to be calculated, including any *payment services* carried on by its *agents* from an establishment in the *United Kingdom*.
4.4.8	D	~~An *authorised payment institution*, the Post Office Limited, government departments and local authorities or an *EEA authorised payment institution*~~ A *firm* must send to the *FSA* in writing the information required under *FEES* 4.4.7D as soon as reasonably practicable, and in any event within two *months*, after the date specified as the valuation date in Part 4 of *FEES* 4 Annex 11R.
4.4.9	D	To the extent that ~~an *authorised payment institution* or an *EEA authorised payment institution*~~ a *firm* has provided the information required by *FEES* 4.4.7D to the *FSA* as part of its compliance with another provision of the *Handbook*, it is deemed to have complied with the provisions of ~~this section~~ that direction.

...

4 Annex 1R Activity groups, tariff bases and valuation dates applicable

Part 1	...

Activity group	Fee payer falls in the activity group if

A.1 Deposit acceptors	its *permission* includes *accepting deposits*~~,~~ <u>or</u> *operating a dormant account fund* ~~or *issuing e-money*;~~ BUT DOES NOT include either of the following:
	…
…	

Part 2	…

Activity group	Tariff base
A.1	… ~~For *e-money issuers*:~~ ~~Outstanding balance of *e-money* liabilities~~ …

…

Part 3	This table indicates the valuation date for each fee-block. A *firm* can calculate its tariff data by applying the tariff bases set out in Part 2 with reference to the valuation dates shown in this table.

Activity group	Valuation date
…	
Where a *firm's* tariff data is in a currency other than sterling, it should be converted into sterling at the exchange rate prevailing on the relevant valuation date.	
A.1	For *banks*: … ~~For *e-money issuer*:~~ ~~MELs, valued at the end of the financial year ended in the calendar year ending 31 December.~~ …

…

4 Annex 2R Fee tariff rates, permitted deductions and EEA/Treaty firm modifications for the period from 1 April ~~2010~~ <u>2011</u> to 31 March ~~2011~~ <u>2012</u>

Part 1

<table>
<tr><td colspan="4">This table shows the tariff rates applicable to each fee block</td></tr>
<tr><td>…</td><td colspan="3"></td></tr>
<tr><td>Note 1</td><td colspan="3">~~In the case of activity group A.1 there are two tariff rates. The rate in column 1 is the general periodic fee. The rate in column 2 is the reclaim funds set-up fee and is payable by all firms except credit unions and e-money issuers. The total periodic fee for the A1 fee block is determined by adding the amounts obtained under both columns.~~

…</td></tr>
<tr><td>Activity group</td><td colspan="3">Fee payable</td></tr>
<tr><td rowspan="8">A.1</td><td>Band width (£ million of Modified Eligible Liabilities (MELs))</td><td colspan="2">Fee (£/£m or part £m of MELs)</td></tr>
<tr><td></td><td>Column 1

General Periodic fee</td><td>~~Column 2~~

~~Reclaim Fund Set-Up fee~~</td></tr>
<tr><td>>10 – 140</td><td>~~29.90~~ <u>33.44</u></td><td>~~0.12~~</td></tr>
<tr><td>>140 – 630</td><td>~~29.90~~ <u>33.44</u></td><td>~~0.12~~</td></tr>
<tr><td>>630 – 1,580</td><td>~~29.90~~ <u>33.44</u></td><td>~~0.12~~</td></tr>
<tr><td>>1,580 – 13,400</td><td>~~37.38~~ <u>41.80</u></td><td>~~0.12~~</td></tr>
<tr><td>>13,400</td><td>~~49.34~~ <u>55.18</u></td><td>~~0.12~~</td></tr>
<tr><td colspan="3">…

The tariff rates in A.1 are not relevant for the permissions relating to operating a dormant account fund. Instead a flat fee of ~~£6,018~~ <u>£6,000</u> is payable in respect of these permissions. ~~The flat fee of £6,018 is made up of a portion of the general periodic fee of £6,000 and a reclaim fund set-up fee of £18.~~</td></tr>
<tr><td rowspan="3">A.2</td><td>Band width (No. of mortgages and/or home finance transactions)</td><td colspan="2">Fee (£/mortgage)</td></tr>
<tr><td>>50 - 130</td><td colspan="2">~~1.26~~ <u>1.79</u></td></tr>
<tr><td>>130 – 320</td><td colspan="2">~~1.26~~ <u>1.79</u></td></tr>
</table>

	>320 – 4,570	~~1.26~~ 1.79		
	>4, 570 – 37,500	~~1.26~~ 1.79		
	>37,500	~~1.26~~ 1.79		
A.3	Gross premium income (GPI)	Column 1 General periodic fee	Column 2 Solvency 2 Implement-ation fee	Column 3 Solvency 2 Special Project fee
	Minimum fee (£)	Not applicable	~~50.00~~ 25.00	25.00
	Band Width (£ million of GPI)	Fee (£/£m or part £m of GPI)		
	>0.5 – 10.5	~~531.58~~ 505.51	~~110.45~~ 119.38	~~93.40~~ 127.57
	>10.5 – 30	~~531.58~~ 505.51	~~110.45~~ 119.38	~~93.40~~ 127.57
	>30 – 245	~~531.58~~ 505.51	~~110.45~~ 119.38	~~93.40~~ 127.57
	>245 – 1,900	~~531.58~~ 505.51	~~110.45~~ 119.38	~~93.40~~ 127.57
	>1,900	~~531.58~~ 505.51	~~110.45~~ 119.38	~~93.40~~ 127.57
	PLUS			
	Gross technical liabilities (GTL)	Column 1 General Periodic fee	Column 2 Solvency 2 Implementation fee	Column 3 Solvency 2 Special Project fee
	Band Width (£ million of GTL)	Fee (£/£m or part £m of GTL)		
	>1 – 12.5	~~28.39~~ 26.82	~~5.65~~ 6.42	~~5.55~~ 7.25
	>12.5 – 70	~~28.39~~ 26.82	~~5.65~~ 6.42	~~5.55~~ 7.25
	>70 – 384	~~28.39~~ 26.82	~~5.65~~ 6.42	~~5.55~~ 7.25
	>384 – 3,750	~~28.39~~ 26.82	~~5.65~~ 6.42	~~5.55~~ 7.25
	>3,750	~~28.39~~ 26.82	~~5.65~~ 6.42	~~5.55~~ 7.25

	…			
A.4	Adjusted annual gross premium income (AGPI)	Column 1 General Periodic fee	Column 2 Solvency 2 Implementation fee	Column 3 Solvency 2 Special Project fee
	Minimum fee (£)	Not applicable	25.00	25.00
	Band Width (£ million of AGPI)	Fee (£/£m or part £m of AGPI)		
	>1 – 5	~~706.46~~ 628.82	~~137.00~~ 147.39	~~114.60~~ 151.35
	>5 – 40	~~706.46~~ 628.82	~~137.00~~ 147.39	~~114.60~~ 151.35
	>40 – 260	~~706.46~~ 628.82	~~137.00~~ 147.39	~~114.60~~ 151.35
	>260 – 4,000	~~706.46~~ 628.82	~~137.00~~ 147.39	~~114.60~~ 151.35
	>4,000	~~706.46~~ 628.82	~~137.00~~ 147.39	~~114.60~~ 151.35
	PLUS			
	Mathe-matical reserves (MR)	Column 1 General Periodic fee	Column 2 Solvency 2 Implementation fee	Column 3 (Solvency 2 Special Project fee
	Minimum fee (£)	Not applicable	25.00	25.00
	Band Width (£ million of MR)	Fee (£/£m or part £m of MR)		
	>1 –20	~~15.32~~ 13.44	~~3.00~~ 3.10	~~2.95~~ 3.06
	>20 – 270	~~15.32~~ 13.44	~~3.00~~ 3.10	~~2.95~~ 3.06
	>270 – 7,000	~~15.32~~ 13.44	~~3.00~~ 3.10	~~2.95~~ 3.06

	>7,000 – 45,000	~~15.32~~ 13.44	~~3.00~~ 3.10	~~2.95~~ 3.06
	>45,000	~~15.32~~ 13.44	~~3.00~~ 3.10	~~2.95~~ 3.06
A.5	Band Width (£ million of Active Capacity (AC))	Fee (£/£m or part £m of AC)		
	>50 – 150	~~54.55~~ 56.34		
	>150 – 250	~~54.55~~ 56.34		
	>250 – 500	~~54.55~~ 56.34		
	>500 – 1,000	~~54.55~~ 56.34		
	>1,000	~~54.55~~ 56.34		
A.6	Flat fee	~~1,500,514~~ 1, 419,112.28		
	PLUS			
	Solvency 2 Special Project Flat fee (£)	~~249,603.72~~ 975,000		
	PLUS			
	Solvency 2 Implementation Flat fee (£)	~~300,100.80~~ 331, 238.49		
A.7	For class 1(C), (2) and (3) *firms*:			
	Band Width (£ million of Funds under Management (FuM))	Fee (£/£m or part £m of FuM)		
	>10 – 150	~~8.52~~ 6.80		
	>150 – 2,800	~~8.52~~ 6.80		
	>2,800 – 17,500	~~8.52~~ 6.80		
	>17,500 – 100,000	~~8.52~~ 6.80		
	>100,000	~~8.52~~ 6.80		
	…			
…	…			

A.9	Band Width (£ million of Gross Income (GI))	Fee (£/£m or part £m of GI)
	>1 – 4.5	~~1,052.62~~ 1,380.85
	>4.5 – 17	~~1,052.62~~ 1,380.85
	>17 – 145	~~1,052.62~~ 1,380.85
	> 145 – 750	~~1,052.62~~ 1,380.85
	>750	~~1,052.62~~ 1,380.85
A.10	Band Width (No. of traders)	Fee (£/trader)
	2 – 3	~~3,196.91~~ 3,565.73
	4 – 5	~~3,196.91~~ 3,565.73
	6 – 30	~~3,196.91~~ 3,565.73
	31 – 180	~~3,196.91~~ 3,565.73
	>180	~~3,196.91~~ 3,565.73
…		
A.12	Band Width (No. of persons)	Fee (£/person)
	2 – 5	~~426.35~~ 757.17
	6 – 35	~~426.35~~ 757.17
	36 – 175	~~426.35~~ 757.17
	176 – 1,600	~~426.35~~ 757.17
	>1,600	~~426.35~~ 757.17
	For a *professional firm* in A.12 the fee is calculated as above less 10%.	
A.13	For class (2) *firms*:	
	Band Width (No. of persons)	Fee (£/person)
	2 – 3	~~1,290.54~~ 1,290.54
	4 – 30	~~1,290.54~~ 1,290.54
	31 – 300	~~1,290.54~~ 1,290.54

	301 – 2,000	~~1,290.54~~ 1,290.54
	>2,000	~~1,290.54~~ 1,290.54
	…	
A.14	Band Width (No. of persons)	Fee (£/person)
	2 – 4	~~1,340.87~~ 2,809.83
	5 – 25	~~1,340.87~~ 2,809.83
	26 – 80	~~1,340.87~~ 2,809.83
	81 – 199	~~1,340.87~~ 2,809.83
	>199	~~1,340.87~~ 2,809.83
…		
A.18	Band Width (£ thousands of Annual Income (AI))	Fee (£/£ thousand or part £ thousand of AI)
	>100 –180	~~10.54~~ 13.12
	>180 – 1,000	~~10.54~~ 13.12
	>1,000 – 12,500	~~10.54~~ 13.12
	>12,500 – 50,000	~~10.54~~ 13.12
	>50,000	~~10.54~~ 13.12
A.19	Band Width (£ thousands of Annual Income (AI))	Fee (£/£ thousand or part £ thousand of AI)
	>100 –325	~~2.43~~ 1.94
	>325 – 10,000	~~2.43~~ 1.94
	>10,000 – 50,750	~~2.43~~ 1.94
	>50,750 – 250,000	~~2.43~~ 1.94
	>250,000	~~2.43~~ 1.94
B. Market operators	£35,000	

B. Service companies	Bloomberg LP	£45,000
	~~EMX Co Ltd~~	~~£35,000~~
	LIFFE Services Ltd	£35,000
	[row deleted]	
	OMGEO Ltd	£35,000
	Reuters Ltd	£45,000
	Swapswire Ltd	£35,000
...		
...		

Part 2

This table shows the permitted deductions that apply where financial penalties are received ~~under the *Act*~~ by the *FSA* under sections 66, 123 and 206 of the *Act* and regulation 42 of the *Money Laundering Regulations*:

Activity group	Amount of deduction
Part 1A (minimum fee)	~~7.5%~~ 16.8% of the fee payable by the *firm* for the activity group (see Part 1)
A.1	~~7.5%~~ 17.0% of the fee payable by the *firm* for the activity group (see Part 1)
A.2	~~7.5%~~ 20.8% of the fee payable by the *firm* for the activity group (see Part 1)
A.3	~~7.5%~~ 16.9% of the fee payable by the *firm* for the activity group (see Part 1). The deduction does not apply to any Solvency 2 Special Project fee (as defined in Part 1) or Solvency 2 Implementation fee as applicable under Part 5.
A.4	~~7.5%~~ 16.9% of the fee payable by the *firm* for the activity group (see Part 1). The deduction does not apply to any Solvency 2 Special Project fee (as defined in Part 1) or Solvency 2 Implementation fee as applicable under Part 5.
A.5	~~7.5%~~ 16.8% of the fee payable by the *firm* for the activity group (see Part 1)

A.6	~~7.5%~~ 16.8% of the fee payable by the *firm* for the activity group (see Part 1). The deduction does not apply to any Solvency 2 Special Project flat fee or Solvency 2 Implementation flat fee (as defined in Part 1).
A.7	~~7.5%~~ 18.1% of the fee payable by the *firm* for the activity group (see Part 1)
A.9	~~7.5%~~ 16.8% of the fee payable by the *firm* for the activity group (see Part 1)
A.10	~~7.5%~~ 18.6% of the fee payable by the *firm* for the activity group (see Part 1)
A.12	~~9.3%~~ 21.7% of the fee payable by the *firm* for the activity group (see Part 1)
A.13	~~7.8%~~ 17.7% of the fee payable by the *firm* for the activity group (see Part 1)
A.14	~~7.5%~~ 20.4% of the fee payable by the *firm* for the activity group (see Part 1)
A.18	~~7.5%~~ 18.2% of the fee payable by the *firm* for the activity group (see Part 1)
A.19	~~7.5%~~ 17.3% of the fee payable by the *firm* for the activity group (see Part 1)

...

Part 4

This table shows the calculation of the Solvency 2 Special Project fee for *firms* falling into fee block A3 or A4.

(1)	The Solvency 2 Special Project fee forms part of the periodic fee payable under fee ~~block~~ blocks A3 and A4 ~~(the "insurance fee blocks")~~.	
(2)	The Solvency 2 Special Project fee is only payable by a *firm* if it meets the conditions in Part ~~(5)~~ and the conditions set out in paragraph (3) of this Part. ~~In addition:~~	
	(a)	~~where the *firm* falls into fee block A.3, the Solvency 2 Special Project fee is only payable with respect to that insurance fee block if the amount of the periodic fees payable by it under *FEES* 4.3 in respect of the financial year 2009/10 with respect to that insurance fee block was at least £49,000~~; [deleted]
	(b)	~~where the *firm* falls into fee block A.4, the Solvency 2 Special~~

LME-003705

		~~Project fee is only payable with respect to that insurance fee block if the amount of the periodic fees payable by it under *FEES* 4.3 in respect of the financial year 2009/10 with respect to that insurance fee block was at least £55,000.~~ [deleted]
	(c)	[deleted]
	(d)	[deleted]
(3)	~~[deleted]~~ The conditions are that:	
	(a)	before 1 April 2011 the *firm*, or a member of the group of which the *firm* is also a member (in either case, 'the recipient'), received a written communication from the *FSA* that it has met the criteria for entry into pre-Internal Model Approval Process status ('pre-IMAP'); and
	(b)	the recipient remains in pre-IMAP status on 1 April 2011.
(4)	~~The prior year fee referred to in (2) for a particular insurance fee block does not take into account the Solvency 2 Special Project fee or the Solvency 2 Implementation fee.~~ For the purposes of (3)(b), the recipient will be deemed to be in pre-IMAP status unless, before 1 April 2011:	
	(a)	the recipient informs the *FSA* in writing that it wishes to withdraw from pre-IMAP status; or
	(b)	the recipient has been informed by the *FSA* in writing that it is no longer in pre-IMAP status.
(5)	~~[deleted]~~ For the purposes of this Part a reference to pre-IMAP means the status achieved by the recipient by joining the process established by the *FSA* whereby the *FSA* and the recipient engage with a view to the *FSA* establishing whether an internal model developed by the recipient is likely to meet the tests and standards specified in the *Solvency 2 Directive*.	
(6)	~~[deleted]~~ A reference to 'group' in this Part means a group determined by reference to the provisions contained in Title III, Chapter I of the *Solvency 2 Directive*.	
…		

…

Part 5

This Part sets out when a Solvency 2 Implementation fee is due for *firms* in the A.3 and A.4 fee-blocks.

…		
(2)	…	
	(a)	…
	(b)	the *firm* has not notified the *FSA* before the start of the financial year ~~2010/11~~ 2011/12 that it intends to migrate out of the *United Kingdom* for regulatory purposes before the *Solvency 2 Directive* is implemented;
	(c)	…
	(d)	it was in one or both of the insurance fee blocks at the start of the financial year ~~2010/11~~ 2011/12;
	…	
…		

…

4 Annex 4 R **Periodic fees in relation to collective investment schemes payable for the period 1 April ~~2010~~ 2011 to 31 March ~~2011~~ 2012**

Part 1 - Periodic fees payable

Scheme type	Basic fee (£)	Total funds/sub-funds aggregate	Fund factor	Fee (£)
ICVC, AUT, Section 264 of the *Act* Section 270 of the *Act*	~~560~~ 585	1-2 3-6 7-15 16-50 >50	1 2.5 5 11 22	~~560~~ 585 ~~1,400~~ 1,463 ~~2,800~~ 2,925 ~~6,160~~ 6,435 ~~12,320~~ 12,870
Section 272 of the *Act*	~~2,280~~ 2,380	1-2 3-6 7-15 16-50 >50	1 2.5 5 11 22	~~2,280~~ 2,380 ~~5,700~~ 5,950 ~~11,400~~ 11,900 ~~25,080~~ 26,180 ~~50,160~~ 52,360
Fees are charged according to the number of funds or *sub-funds* operated by a *firm* as at 31 March ~~2010~~ 2011. …				

4 Annex 5 R **Periodic fees for designated professional bodies payable in relation to the period 1 April 2011 to 31 March 2012**

Table of fees payable by Designated Professional Bodies

Name of Designated Professional Body	Amount payable	Due date
The Law Society of England & Wales	£41,530	30 April 2011
	~~£48,565~~ £31, 660	1 September ~~2010~~ 2011
The Law Society of Scotland	~~£14,620~~ £13,990	1 July ~~2010~~ 2011
The Law Society of Northern Ireland	~~£13,380~~ £12,920	1 July ~~2010~~ 2011
The Institute of Actuaries	~~£10,130~~ £10,110	1 July ~~2010~~ 2011
The Institute of Chartered Accountants in England and Wales	~~£27,350~~ £24,660	1 July ~~2010~~ 2011
The Institute of Chartered Accountants of Scotland	~~£11,450~~ £11,200	1 July ~~2010~~ 2011
The Institute of Chartered Accountants in Ireland	~~£10,700~~ £10,650	1 July ~~2010~~ 2011
The Association of Chartered Certified Accountants	~~£18,040~~ £16,980	1 July ~~2010~~ 2011
The Council for Licensed Conveyancers	~~£11,290~~ £11,230	1 July ~~2010~~ 2011
Royal Institution of Chartered Surveyors	~~£14,390~~ £13,800	1 July ~~2010~~ 2011
…		

4 Annex 6 R Periodic fees for recognised investment exchanges and recognised clearing houses payable in relation to the period 1 April 2011 to 31 March 2012

…

Part 1 - Periodic fees for UK recognised bodies

Name of UK recognised body	Amount payable	Due date
Euroclear UK & Ireland Limited	£325,000	30 April 2011

	~~£372,500~~ £275,000	1 September ~~2010~~ 2011
ICE Futures Europe Ltd	£255,000	30 April 2011
	~~£280,000~~ £245,000	1 September ~~2010~~ 2011
LIFFE Administration and Management	£400,000	30 April 2011
	~~£475,000~~ £350,000	1 September ~~2010~~ 2011
LCH Clearnet Limited	£375,000	30 April 2011
	~~£452,000~~ £325,000	1 September ~~2010~~ 2011
The London Metal Exchange Limited	£237,500	30 April 2011
	~~£277,000~~ £212,500	1 September ~~2010~~ 2011
London Stock Exchange plc	£335,000	30 April 2011
	~~£409,000~~ £280,000	1 September ~~2010~~ 2011
EDX London Ltd	£60,000	30 April 2011
	~~£77,500~~ £30,000	1 September ~~2010~~ 2011
PLUS Markets Plc	£110,000	30 April 2011
	~~£122,500~~ £85,000	1 September ~~2010~~ 2011
European Central Counterparty Limited	£187,500	30 April 2011
	~~£211,500~~ £167,500	1 September ~~2010~~ 2011
ICE Clear Europe Limited	£275,000	30 April 2011
	~~£366,000~~ £265,000	1 September ~~2010~~ 2011
Chicago Mercantile Exchange Clearing Europe	£125,000	30 April 2011
	£275,000	1 September

		2011
…		

Part 2 - Periodic fees for overseas recognised bodies

Name of overseas recognised body	Amount payable	Due date
The Chicago Mercantile Exchange (CME) (ROIE)	£40,000	1 July ~~2010~~ 2011
Chicago Board of Trade	£40,000	1 July ~~2010~~ 2011
EUREX (Zurich)	£40,000	1 July ~~2010~~ 2011
National Association of Securities and Dealers Automated Quotations (NASDAQ)	£40,000	1 July ~~2010~~ 2011
New York Mercantile Exchange Inc.	£40,000	1 July ~~2010~~ 2011
The Swiss Stock Exchange	£40,000	1 July ~~2010~~ 2011
Sydney Futures Exchange Limited	£40,000	1 July ~~2010~~ 2011
ICE Futures US Inc	£40,000	1 July ~~2010~~ 2011
NYSE Liffe US	£40,000	1 July ~~2010~~ 2011
SIS x-clear AG	£100,000	1 July ~~2010~~ 2011
Eurex Clearing AG	~~£200,000~~ £70,000	1 July ~~2010~~ 2011
ICE Clear US Inc	£70,000	1 July ~~2010~~ 2011
Chicago Mercantile Exchange (CME) (ROCH)	~~£200,000~~ £100,000	1 July ~~2010~~ 2011
European Multi-Lateral Clearing Facility	£100,000	1 July ~~2010~~ 2011
Cassa di Compensazione e Garanzia (CC&G)	£70,000	1 July ~~2010~~ 2011
LCH Clearnet SA	£100,000	1 July 2011
…		

4 Annex 7 R Periodic fees in relation to the Listing Rules for the period 1 April ~~2010~~ 2011 to 31 March ~~2011~~ 2012

Fee type	Fee amount
Annual fees for the period 1 April ~~2010~~ 2011 to 31 March ~~2011~~ 2012	
…	

…

There is deducted from the fee specified in this Annex ~~0.0%~~ 4.7% of the fee payable to take into account financial penalties received by the *FSA* under section 91 of the *Act* in the previous financial year.

…

4 Annex 8 R Periodic fees in relation to the disclosure rules and transparency rules for the period 1 April ~~2010~~ 2011 to 31 March ~~2011~~ 2012

Annual fees for the period 1 April ~~2010~~ 2011 to 31 March ~~2011~~ 2012
…

…

There is deducted from the fee specified in this Annex 4.7% of the fee payable to take into account financial penalties received by the *FSA* under section 91 of the *Act* in the previous financial year.

4 Annex 9 R Periodic fees in respect of securities derivatives for the period from 1 April ~~2010~~ 2011 to 31 March ~~2011~~ 2012

Part 1

…

For the purposes of this Annex, a "relevant contract" is any contract entered into or settled by *firms* on or through *LIFFE* or Eurex Clearing AG in *securities derivatives* and the "relevant period" is 1 January ~~2009~~ 2010 to 31 December ~~2009~~ 2010 inclusive.

The fee shown in the table below for *firms* (but not *market operators*) will be subject to a deduction of ~~7.5%~~ 16.7%, as if that fee were a periodic fee charged under *FEES* 4.3.3R, and the deduction were a deduction set out in Part 2 of *FEES* 4 Annex 2R.

…

Fee amount for *firms*	
Number of relevant contracts entered into by the *firm*	Fee amount

during the relevant period	
0 – 100	£0
101 - 1,000	~~£550~~ £585
1,001 - 100,000	~~£2,775~~ £2,950
100,001 - 1,000,000	~~£8,340~~ £8,875
1,000,001 - 5,000,000	~~£20,000~~ £21,300
5,000,001 - 20,000,000	~~£35,435~~ £37,750
>20,000,000	~~£54,000~~ £57,500
Fee amount for *market operators*	
Market operators providing facilities for trading in *securities derivatives* that do not identify those *securities derivatives* using an International Securities Identity Number	~~£10,300~~ £11,000

...

4 Annex 10 R Periodic fees for MTF operators payable in relation to the period 1 April ~~2010~~ 2011 to 31 March ~~2011~~ 2012

Name of MTF operator	Fee payable (£)	Due date 1 July ~~2010~~ 2011
~~Baikal Global Ltd~~	~~25,000~~	
Barclays Bank Plc	~~3,600~~ 4,000	
Baltic Derivatives Trading Ltd	20,000	
BATS Trading Ltd	80,000	
BGC Brokers L.P	~~3,600~~ 4,000	
Cantor Index Limited	~~7,750~~ 8,000	
~~CantorCO2e Limited~~	~~3,600~~	
Chi-X Europe Limited	~~125,000~~ 130,000	
EuroMTS Limited	30,000	

GFI Brokers Limited	~~3,600~~ 4,000	
GFI Securities Limited	~~3,600~~ 4,000	
ICAP Electronic Broking Limited	~~6,000~~ 6,250	
ICAP Energy Limited	~~3,600~~ 4,000	
ICAP Europe Limited	~~3,600~~ 4,000	
ICAP Shipping Tanker Derivatives Limited	~~3,600~~ 4,000	
ICAP Securities Limited	~~3,600~~ 4,000	
ICAP WCLK Limited	~~3,600~~ 4,000	
J.P.Morgan Cazenove Limited	4,000	
Liquidnet Europe Limited	70,000	
MF Global UK Limited	~~3,300~~ 4,000	
My Treasury Limited	~~3,600~~ 4,000	
~~NASDAQ OMX Europe Limited~~	~~70,000~~	
Nomura	4,000	
Sigma X MTF	4,000	
SmartPool Trading Limited	~~20,000~~ 22,500	
TFS-ICAP Limited	~~3,600~~ 4,000	
Tradeweb Europe Limited	~~12,500~~ 13,000	
Tradition (UK) Limited	~~3,600~~ 4,000	
Tradition Financial Services Limited	~~3,600~~ 4,000	

Tullett Prebon (Europe) Limited	~~3,600~~ 4,000	
Tullett Prebon (Securities) Limited	~~3,600~~ 4,000	
Turquoise Global Holdings Ltd	140,000	
~~Turquoise Services Limited~~	~~80,000~~	
UBS Ltd	4,000	
	… In any other case ~~£3,000~~ £3,500	… In any other case, 1 July ~~2010~~ 2011

There is deducted from the fee specified in this Annex ~~7.5%~~ 16.7% of the fee payable to take into account financial penalties received by the *FSA* under section 66, 123 and 206 of the *Act* in the previous financial year.

…

4 Annex 11 R **Periodic fees in respect of payment services carried on by fee-paying payment service providers under the Payment Services Regulations and electronic money issuance by fee-paying electronic money issuers under the Electronic Money Regulations in relation to the period 1 April ~~2010~~ 2011 to 31 March ~~2011~~ 2012**

Part 1 – Method for calculating the fee for fee-paying payment service providers	
(1)	The periodic fee for *fee-paying payment service providers* is calculated by identifying the relevant activity group under Part 2 and then adding the minimum fee to an additional fee calculated by multiplying the tariff base identified in Part 3 of *FEES* 4 Annex 11R by the appropriate rates applying to each tranche of the tariff base as indicated in the table at Part 5. For *small payment institutions* and *small ~~e-money issuers~~ electronic money institutions* the tariff rates are not relevant and a flat fee is payable.
	…

Part 1A – Method for calculating the fee for fee-paying electronic money issuers

(1)	The periodic fee for *fee-paying electronic money issuers* is calculated by identifying the relevant activity group under Part 2A and then multiplying the tariff base identified in Part 3 of *FEES* 4 Annex 11R by the appropriate rates applying to each tranche of the tariff base as indicated in the table at Part 5. For *small electronic money institutions*, the tariff rates are not relevant and a flat fee is payable.	
(2)	A *fee-paying electronic money issuer* may apply the relevant tariff bases and rates to non-*UK* business, as well as to its *UK* business, if:	
	(a)	it has reasonable grounds for believing that the costs of identifying the *firm's UK* business separately from its non-*UK* business in the way described in Part 3 of *FEES* 4 Annex 11R is disproportionate to the difference in fees payable; and
	(b)	it notifies the *FSA* in writing at the same time as it provides the information concerned under *FEES* 4.4 (Information on which fees are calculated), or, if earlier, at the time it pays the fees concerned.
(3)	For a *fee-paying electronic money issuer* which is required to comply with *FEES* 4.4 (Information on which fees are calculated) and has not done so for this period:	
	(a)	the fee is calculated using (where relevant) the valuation or valuations of business applicable to the previous period, multiplied by the factor of 1.10;
	(b)	an additional administrative fee of £250 is payable; and
	(c)	the minimum total fee (including the administrative fee in (b)) is £650.

Part 1B – Method for calculating the periodic fee where the firm is both a fee-paying payment service provider and a fee-paying electronic money issuer
Add the fee calculated under Part 1 to the fee calculated under Part 1A.

Part 2 – Activity groups relevant to fee-paying payment service providers
…

Activity group	Fee payer falls into this activity group if:
G.2 Certain deposit acceptors ~~and *e-money issuers*~~	it is a *fee-paying payment service provider* not falling within any of the other fee-blocks in this table
G.3 Large payment institutions	it is a *fee-paying payment service provider* that is an *authorised payment institution*, an *EEA authorised payment institution*, ~~or~~ the Post Office Limited or a *fee-paying electronic money issuer* (except if it is a *small*

	electronic money institution)
G.4 Small payment institutions	it is a *fee-paying payment service provider* that is a *small payment institution* or a *small* ~~*e-money issuer*~~ *electronic money institution*
…	

Part 2A – Activity groups relevant to fee-paying electronic money issuers
This table shows how the *electronic money* issuance by *fee-paying electronic money issuers* is linked to activity groups ('fee-blocks'). A *fee-paying electronic money issuer* can use the table to identify which fee-blocks it falls into based on its authorisation, registration or *permission*, as applicable.

Activity group	Fee payer falls into this activity group if:
G.10 *Large electronic money institutions*	it is a *fee-paying electronic money issuer* (except if it is a *small electronic money institution*)
G.11 *Small electronic money institutions*	it is a *small electronic money institution*

Part 3 This table indicates the tariff base for each fee-block. The tariff base is the means by which the *FSA* measures the 'amount of business' conducted by *fee-paying payment service providers* and *fee-paying electronic money issuers*.	
Activity Group	Tariff base
...	
G.10	Average outstanding electronic money as defined under regulation 2(1) of the *Electronic Money Regulations.* This is the average total amount of financial liabilities related to *electronic money* in issue at the end of each calendar day over the preceding six calendar months (which is the period ending on the date set out under Part 4), calculated on the first calendar day of each calendar month and applied for that calendar month (£million).
G.11	Not applicable.

Part 4 – Valuation period
This table indicates the valuation date for each fee-block. A *fee-paying payment service*

provider and a *fee-paying electronic money issuer* can calculate ~~its~~ tariff data by applying the tariff bases set out in Part ~~2~~ 3 with reference to the valuation dates shown in this table.	
Activity group	Valuation date
...	
Where ~~a *fee-paying payment service provider's*~~ the tariff data of a *fee-paying payment service provider* or a *fee-paying electronic money issuer* is in a currency other than sterling, it must be converted into sterling at the exchange rate prevailing on the relevant valuation date.	
G.2	For *banks*~~, *e-money issuers*~~ and *building societies* as in *FEES* 4 Annex 1R Part 3.
...	
G.10	31 December.
G.11	Not relevant.

Part 5 – Tariff rates		
Activity group	Fee payable in relation to ~~2010/11~~ 2011/12	
G2	Minimum fee (£)	400
	£ million or part £m of Modified Eligible Liabilities (MELS)	Fee (£/£m or part £m of MELS)
	> 0.1	~~0.42292~~ 0.45265
	> 0.25	~~0.42292~~ 0.45265
	> 1.0	~~0.42292~~ 0.45265
	> 10.0	~~0.42292~~ 0.45265
	> 50.0	~~0.42292~~ 0.45265
	> 500.0	~~0.42292~~ 0.45265
G.3	Minimum fee (£)	400
	£ thousands or part £ thousand of Relevant Income	Fee (£/£thousand or part £ thousand of Relevant Income)

	~~>0.1~~ > 100	~~0.48508~~ 0.29950
	~~>0.25~~ > 250	~~0.48508~~ 0.29950
	~~>1.0~~ > 1000	~~0.48508~~ 0.29950
	~~>10.0~~ > 10,000	~~0.48508~~ 0.29950
	~~>50.0~~ > 50,000	~~0.48508~~ 0.29950
	~~>500.0~~ > 500,000	~~0.48508~~ 0.29950
…		
G.10	Minimum fee (£)	1,500
	£million or part £m of average outstanding electronic money (AOEM)	Fee (£/£m or part £m of AOEM)
	>5.0	150.00
G.11	£1,000	

Part 6 – Permitted deductions for financial penalties pursuant to regulation 85 of the *Payment Services Regulations* and regulation 51 of the *Electronic Money Regulations*, as applicable *Fee-paying payment service providers* *and fee-paying electronic money issuers* may make deductions as provided in this Part.		
Activity group	Nature of deduction	Amount of deduction
G.2	Financial penalties received	~~0.0%~~ 0.1%
G.3	Financial penalties received	~~0.0%~~ 0.1%
G.4	Financial penalties received	~~0.0%~~ 0.1%
G.5	Financial penalties received	~~0.0%~~ 0.1%
G.10	Financial penalties received	0.1%
G.11	Financial penalties received	0.1%

Part 7 – This table shows the modifications to fee tariffs that apply to *EEA authorised payment institutions*, *EEA authorised electronic money institutions*, and *full credit institutions* ~~and *e-money issuers*~~ that are *EEA firms*.		
Activity group	Percentage deducted from the tariff	Minimum amount payable

	payable under Part 5 applicable to the firm	
G.2	40%	
G.3	40%	
G.10	40%	

…

5 Financial Ombudsman Service Funding

…

5.1.1A R A reference to "*firm*" in this chapter includes a reference to a *fee-paying payment service provider* and *fee-paying electronic money issuer* except in *FEES* 5.5 and where "*firm*" is used elsewhere in this chapter in connection with the obligation to pay case fees.

…

5.4.1A D The information requirement set out under *FEES* 5.4.1R is applied under this direction to a *fee-paying payment service provider* and a *fee-paying electronic money issuer.*

…

5.8.2 R (1) This *rule* deals with the calculation of:

(a) a *firm's general levy* in the 12 *months* ending on the 31 March in which it obtains *permission*, or was authorised under the *Payment Services Regulations* or the *Electronic Money Regulations* or had its *permission* and/or *payment services* activities extended ("relevant permissions") and the following 12 months ending on the 31 March; and

…

5 Annex 1 R Annual General Levy Payable in Relation to the Compulsory Jurisdiction for ~~2010/11~~ 2011/12

Introduction: annual budget

1. The *annual budget* for ~~2010/11~~ 2011/12 approved by the *FSA* is ~~£113.7m~~ £127.9m.

2. The total amount expected to be raised through the *general levy* in ~~2010/11~~ 2011/12 will be ~~£17.7m~~ £42.7m (net of £1.8m to be raised from consumer credit firms).

Compulsory jurisdiction – general levy

Industry block	Tariff base	General levy payable by firm
1 –Deposit acceptors, *home finance providers*, *home finance administrators* (excluding *firms* in block 14) and *dormant account fund operators*	… ~~For an *e-money firm*, the tariff base includes the number of e-money accounts multiplied by 0.15. (7)~~ …	~~£0.0278~~ £0.0643648 per relevant account subject to a minimum levy of £100
2-Insurers - general (excluding *firms* in blocks 13 and 15)	…	~~£0.108~~ £0.21626 per £1,000 of relevant gross premium income subject to a minimum levy of £100
3-The *Society* (of Lloyd's)	…	~~£20,000~~ £48,116 to be allocated by the *Society*
4-Insurers - life (excluding *firms* in block 15)	…	~~£0.033~~ £0.038445 per £1,000 of relevant adjusted gross premium income, subject to a minimum levy of £100
5 – Fund managers (including those holding *client money*/assets and not holding *client money*/assets)	…	Levy of ~~£200~~ £485
6 – *Operators*, *trustees* and *depositaries* of *collective investment schemes* and *operators* of *personal pension schemes* and *stakeholder pension schemes*	…	Levy of ~~£50~~ £120
7 – Dealers as principal	…	Levy of ~~£50~~ £125
8-Advisory *arrangers*, dealers or brokers holding and controlling	…	~~£35~~ £36.98 per relevant *approved person* subject to a minimum levy of

client money and/or assets		£35
9-Advisory *arrangers*, dealers or brokers not holding and controlling *client money* and/or assets	…	~~£35~~ £30.02 per relevant *approved person* subject to a minimum levy of £35
10 – Corporate finance advisers	…	Levy of ~~£50~~ £130
11-*fee-paying payment service providers* (but excluding *firms* in any other Industry block except Industry block 18)	For *authorised payment institutions*, *electronic money issuers* (except for *small electronic money institutions*), the Post Office Limited, the Bank of England, government departments and local authorities, and *EEA authorised payment institutions* relevant income as described in *FEES* 4 Annex 11R Part 3	~~£0.015~~ £0.040854 per £1,000 of relevant income subject to a minimum levy of £75
	For *small payment institutions* and *small electronic-money institutions* ~~*small e-money issuers*~~ a flat fee	Levy of ~~£75~~ £150
…		
13 – Cash plan health providers	…	Levy of ~~£50~~ £125
14 – *Credit unions*	…	Levy of ~~£50~~ £125
15 – *Friendly societies* whose tax-exempt business represents 95% or more of their total relevant business	…	Levy of ~~£50~~ £125
16-*Home finance providers*, *advisers* and	…	Levy of ~~£90~~ £110

arrangers (excluding *firms* in blocks 13, 14 & 15)		
17-General insurance mediation (excluding *firms* in blocks 13, 14 & 15)	*Annual income* (as defined in *MIPRU* 4.3) relating to *firm's relevant business*	~~£0.31~~ £1.649277 per £1,000 of *annual income* (as defined in *MIPRU* 4.3) relating to *firm's relevant business* subject to a minimum levy of £85
18 – *fee-paying electronic money issuers*	For all *fee-paying electronic money* issuers except for *small electronic money institutions*, a flat fee For *small electronic money institutions*, a flat fee	£180 £180

Notes	
…	
5	The *industry blocks* in the table are based on the equivalent activity groups set out in Part 1 of *FEES* 4 Annex 1R and Part 2 and Part 2A of *FEES* 4 Annex 11R.
6	Where the tariff base in the table is defined in similar terms as that for the equivalent activity group in Part 2 of *FEES* 4 Annex 1R or Part 3 of *FEES* 4 Annex 11R, it must be calculated in the same way as that tariff base - taking into account only the *firm's relevant business*.
7	~~(1) An *e-money* account is, subject to (2), *e-money* that has been issued by an *e-money firm* issuer and which can reasonably be regarded as being held by the owner of the as a single balance and under the same arrangements.~~ ~~(2) An account that would be an *electronic money* account under (1) will not be one where, as at 31 December, it carries a nil balance and/or has been inactive for a period of 12 months or more.~~ [deleted]
…	

…

7.1.4 G Paragraph 12(1) of Part 2 of Schedule 1A to the *Act* enables the *FSA* to make *rules* requiring ~~any~~ certain *authorised persons* or *payment service providers* or *electronic money issuers* ~~or class of *authorised persons* or class of *payment service providers*~~ to pay to the *FSA* specified amounts or amounts calculated in a specified way in order to meet a proportion of:

…

…

7.1.10 G This chapter sets out the method by which the *CFEB levy* will be calculated. Details of the actual levy payable will vary from year to year, depending on the *CFEB's* annual budget. These details are set out in *FEES* 7 Annex 1R. New details will be prepared and consulted on for each financial year.

Exemption

7.1.11 G A *firm* is not liable to pay a *CFEB levy* in relation to *payment services* or *electronic money* issuance if it is the Bank of England, a government department, a local authority, a municipal bank or the National Savings Bank.

…

7.2.1 R A *firm* must pay each *CFEB levy* applicable to it:

(1) …

(2) in accordance with the provisions of *FEES* 4.3.6R as modified by *FEES* 7.2.1AR.

7.2.1A R (1) For the purposes of *FEES* 7.2.1R(2), *FEES* 4.3.6R(1), as applied by *FEES* 7.2.8R, is modified so that if a *firm's* periodic fees for the previous financial year was at least £50,000, the *firm* must pay:

(a) an amount equal to 50% of the *CFEB levy* payable for the previous year, by 30 April in the financial year to which the sum due under *FEES* 7.2.1R relates; and

(b) the balance of the *CFEB levy* due for the current financial year by 1 September in the financial year to which that sum relates.

(2) For the purposes of *FEES* 7.2.1R(2), *FEES* 4.3.6R(2), as applied by *FEES* 7.2.8R, is modified so that if the *firm's* periodic fee for the previous financial year was less than £50,000, the *firm* must pay its *CFEB levy* in full by 1 July in the financial year to which that sum relates.

…

7.2.3 R The amount payable by a *firm* with respect to a particular activity group is calculated as follows:

(1) calculate the size of the *firm's* tariff base for that activity group using the tariff base calculations in Part 2 of *FEES* 4 Annex 1R and Part 3 of

FEES 4 Annex 11R and the valuation date requirements in Part 3 of *FEES* 4 Annex 1R and Part 4 of *FEES* 4 Annex 11R;

...

7.2.4 R For the purposes of *FEES* 7.2.3R:

(1) a *firm* may apply the relevant tariff bases and rates to its non-*UK* business, as well as to its *UK* business, if:

(a) it has reasonable grounds for believing that the costs of identifying the *firm's UK* business separately from its non-*UK* business in the way described in Part 2 of *FEES* 4 Annex 1R and Part 1 of *FEES* 4 Annex 11R are disproportionate to the difference in fees payable; and

...

(2) for a *firm* which has not complied with *FEES* 4.4.2R (Information on which fees are calculated) or *FEES* 4.4.8D (Information relating to payment services and the issuance of electronic money) for this period, the *CFEB levy* is calculated using (where relevant) the valuation or valuations of business applicable to the previous period, multiplied by the factor of 1.10.

7.2.5 R The modifications in Part 3 of *FEES* 4 Annex 2R and Part 7 of *FEES* 4 Annex 11R apply.

...

7.2.9A D *FEES* 4.4.7D to *FEES* 4.4.9D (Information relating to *payment services* and the issuance of *electronic money*) also apply to *FEES* 7.

7.2.10 G References in a *FEES* 4 *rule* incorporated into *FEES* 7 by cross-reference to a periodic fee should be read as being to the *CFEB levy*. References in a *FEES* 4 *rule* incorporated into *FEES* 7 to ~~*fee-paying payment service providers*,~~ *market operators*, *service companies*, *MTF* operators, *investment* exchanges, *clearing houses*, *designated professional bodies* or Solvency 2 Implementation fees, Solvency 2 Implementation Flat fees, Solvency 2 Special Project fees and Solvency 2 Special Project Flat fees should be disregarded.

...

7.2.12 R Table of FEES 4 rules that correspond to FEES 7 rules

FEES 4 rules	Corresponding FEES 7 rules
...	

FEES 4.3.3 R	*FEES* 7.2.2R
<u>*FEES* 4.3.3AR</u>	<u>*FEES* 7.2.2R</u>
FEES 4.3.12R	*FEES* 7.2.5R
<u>*FEES* 4.3.12AR</u>	<u>*FEES* 7.2.5R</u>
Part 1 of *FEES* 4 Annex 2R	Part 1 of *FEES* 7 Annex 1R
<u>Part 2 of *FEES* 4 Annex 11R</u>	<u>Part 1 of *FEES* 7 Annex 1R</u>
<u>Part 5 of *FEES* 4 Annex 11R</u>	<u>Part 1 of *FEES* 7 Annex 1R</u>

7 Annex 1 R **CFEB levies for the period from 1 April ~~2010~~ <u>2011</u> to 31 March ~~2011~~ <u>2012</u>**

Part 1

This table shows the *CFEB levies* applicable to each activity group (fee-block)

Activity Group	*CFEB levy* payable	
A.1	Band Width (£ million of Modified Eligible Liabilities (MELs))	Fixed sum (£/£m or part £m of MELs)
	> 10 - 140	~~3.67~~ <u>5.01</u>
	> 140 - 630	~~3.67~~ <u>5.01</u>
	>630 - 1,580	~~3.67~~ <u>5.01</u>
	>1,580 - 13,400	~~3.67~~ <u>5.01</u>
	>13,400	~~3.67~~ <u>5.01</u>
	Note 1 For a *firm* in A.1 which has a limitation on its *permission* to the effect that it may *accept deposits* from	

	wholesale depositors only, this levy is calculated as above less 30%.	
A.2	Band Width (no. of mortgages and/or *home finance transactions*)	Fixed sum (£/mortgage)
	>50 – 130	~~0.10~~ 0.142
	>130 – 320	~~0.10~~ 0.142
	>320 – 4,570	~~0.10~~ 0.142
	>4, 570 – 37,500	~~0.10~~ 0.142
	>37,500	~~0.10~~ 0.142
A.3	**Gross premium income (GPI)**	
	Band Width (£ million of GPI)	Fixed sum (£/£m or part £m of GPI)
	>0.5 – 10.5	~~45.21~~ 55.74
	>10.5 - 30	~~45.21~~ 55.74
	>30 - 245	~~45.21~~ 55.74
	>245 - 1, 900	~~45.21~~ 55.74
	>1,900	~~45.21~~ 55.74
	PLUS	
	Gross technical liabilities (GTL)	
	Band Width (£ million of GTL)	Fixed sum (£/£m of part £m of GTL)
	>1 – 12.5	~~2.29~~ 3.01
	>12.5 - 70	~~2.29~~ 3.01
	>70 - 384	~~2.29~~ 3.01
	>384 - 3,750	~~2.29~~ 3.01
	>3,750	~~2.29~~ 3.01

A.4	**Adjusted annual gross premium income (AGPI)**	
	Band Width (£ million of AGPI)	Fixed sum (£/£m or part £m of AGPI)
	>1 - 5	~~56.32~~ 72.65
	>5 - 40	~~56.32~~ 72.65
	>40 - 260	~~56.32~~ 72.65
	>260 - 4,000	~~56.32~~ 72.65
	>4,000	~~56.32~~ 72.65
	PLUS	
	Mathematical reserves (MR)	
	Band Width (£ million of MR)	Fixed sum (£/£m or part £m of MR)
	>1 – 20	~~1.23~~ 1.57
	>20 - 270	~~1.23~~ 1.57
	>270 - 7,000	~~1.23~~ 1.57
	>7,000 - 45,000	~~1.23~~ 1.57
	>45,000	~~1.23~~ 1.57
A.5	Band Width (£ million of Active Capacity (AC))	Fixed sum (£/£m or part £m of AC)
	>50 - 150	~~4.25~~ 5.63
	>150 - 250	~~4.25~~ 5.63
	>250 - 500	~~4.25~~ 5.63
	>500 - 1,000	~~4.25~~ 5.63
	>1,000	~~4.25~~ 5.63
A.6	Flat levy	~~£120,590~~ £159,941.90
A.7	For class 1(C), (2) and (3) *firms*:	

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	Band Width (£ million of Funds under Management (FuM))	Fixed sum (£/£m of part £m of FuM)
	>10 - 150	~~0.68~~ 0.79
	>150 - 2,800	~~0.68~~ 0.79
	>2,800 - 17,500	~~0.68~~ 0.79
	>17,500 - 100,000	~~0.68~~ 0.79
	>100,000	~~0.68~~ 0.79
	…	
A.9	Band Width (£ million of Gross Income (GI))	Fixed sum (£/£m of part £m of GI)
	>1 - 4.5	~~83.19~~ 83.73
	>4.5 - 17	~~83.19~~ 83.73
	>17 - 145	~~83.19~~ 83.73
	> 145 - 750	~~83.19~~ 83.73
	>750	~~83.19~~ 83.73
A.10	Band Width (no. of traders)	Fixed sum (£/trader)
	2 - 3	~~253.40~~ 318.75
	4 - 5	~~253.40~~ 318.75
	6 - 30	~~253.40~~ 318.75
	31 - 180	~~253.40~~ 318.75
	>180	~~253.40~~ 318.75
A.12	Band Width (no. of persons)	Fixed sum (£/person)
	2 - 5	~~33.90~~ 43.13
	6 - 35	~~33.90~~ 43.13
	36 - 175	~~33.90~~ 43.13
	176 - 1,600	~~33.90~~ 43.13

	>1,600	~~33.90~~ 43.13
	…	
A.13	For class (2) firms	
	Band Width (no. of persons)	Fixed sum (£/person)
	2 – 3	~~102.10~~ 160.79
	4 - 30	~~102.10~~ 160.79
	31 - 300	~~102.10~~ 160.79
	301 - 2,000	~~102.10~~ 160.79
	>2,000	~~102.10~~ 160.79
	…	
A.14	Band Width (no. of persons)	Fixed sum (£/person)
	2 – 4	~~106.11~~ 126.34
	5 - 25	~~106.11~~ 126.34
	26 - 80	~~106.11~~ 126.34
	81 - 199	~~106.11~~ 126.34
	>199	~~106.11~~ 126.34
A.18	Band Width (£ thousands of Annual Income (AI))	Fixed sum (£/£ thousand or part £ thousand of AI)
	>100 - 180	~~0.85~~ 1.36
	>180 - 1,000	~~0.85~~ 1.36
	>1,000 - 12,500	~~0.85~~ 1.36
	>12,500 - 50,000	~~0.85~~ 1.36
	>50,000	~~0.85~~ 1.36
A.19	Band Width (£ thousands of Annual Income (AI))	Fixed sum (£/£ thousand or part £ thousand of AI)
	>100 - 325	~~0.20~~ 0.256
	>325 - 10,000	~~0.20~~ 0.256

	>10,000 - 50,750	~~0.20~~ 0.256
	>50,750 - 250,000	~~0.20~~ 0.256
	>250,000	~~0.20~~ 0.256
G.3	£ thousands or part £ thousand of Relevant Income	Fee (£/£thousand or part £ thousand of Relevant Income)
	>100	0.04787
	>250	0.04787
	>1,000	0.04787
	>10,000	0.04787
	>50,000	0.04787
	>500,000	0.04787
G.4	A flat fee of £10	
G.10	£ million or part £m of average outstanding electronic money (AOEM)	Fee (£/£m or part £m of AOEM)
	> 5.0	12.00
G.11	A flat fee of £10	
Notes		
(1) The definitions of fee-blocks G5 and G10 under Part 2 and Part 2A of *FEES* 4 Annex 11R are modified, for the purposes of *FEES* 7, so that they exclude the Bank of England, government departments, local authorities, municipal banks and the National Savings Bank.		
(2) The definitions of those fee-blocks are further amended to exclude EEA *firms* and those *firms* which hold a *Part IV permission*.		

Part 2	
(1)	...
(2)	…
(3)	A *firm* is referred to in this paragraph if it falls within the

	following activity groups: A.1; A.2; A.3 (excluding *UK ISPVs*); A.4; A.5; A.7; A.9; A.10; A.12; A.13; A.14; A.18; ~~and~~ A.19; G.3 and G.10.

…

TP 6 Transitional arrangements in relation to the introduction of the Electronic Money Regulations

…

6.2.3 G …

6.3 Periodic fees

6.3.1 G A *person* subject to the transitional arrangements in regulation 74 of the *Electronic Money Regulations* will be deemed to be an *authorised electronic money institution* during the transitional period applicable to it. It will also retain its *Part IV permission* in relation to electronic money.

6.3.2 G A *person* subject to those transitional arrangements will be liable for the periodic fees payable by an *authorised electronic money institution.*

6.3.3 R (1) This *rule* deals with periodic fees payable under *FEES* 4.3 by a *person* subject to the transitional regime in regulation 74 of the *Electronic Money Regulations.*

(2) The fees are calculated as if the *person* had been an *authorised electronic money institution* from the beginning of the *FSA's* financial year 2011/12.

(3) The fees for the *FSA's* financial year 2011/12 are based on information supplied by the *person* before the periodic fee becomes payable.

(4) If the *person* has notified the *FSA* that it wishes to be registered as a *small electronic money institution* and it is registered as a *small electronic money institution* under regulation 74 during a financial year of the *FSA* then, for the purpose of the periodic fees for that financial year, it is treated as remaining as an *authorised electronic money institution.* Therefore no periodic fee is payable for that financial year in its capacity as a *small electronic money institution.*

6.3.4 R If the transitional period under the *Electronic Money Regulations* comes to an end during a financial year of the *FSA* without the *person* being included by the *FSA* in the register as an *authorised electronic money institution* or as a *small electronic money institution*, periodic fees due at the start of that financial year must be paid immediately after the end of that transitional period.

6.3.5 R (1) This *rule* deals with periodic fees payable under *FEES* 4.3 by a *person* subject to the transitional regime in regulation 76 of the *Electronic Money Regulations*.

(2) Such an issuer is treated as a *small electronic money institution*. However the periodic fee is the same as the periodic fee for fee block G4 not fee block G11.

(3) If the *person* has notified the *FSA* that it wishes to be registered as a *small electronic money institution* and it is so registered during a financial year of the *FSA*, then while the transitional period under regulation 76 is still current in any part of that financial year, for the purpose of the periodic fees for that financial year, it is treated as remaining as a *small electronic money institution*.

(4) If the *person* has notified the *FSA* that it wishes to be authorised as an *authorised electronic money institution* and it is so authorised during a financial year of the *FSA*, then while the transitional period under regulation 76 is still current in any part of that financial year then, for the purpose of the periodic fees for that financial year:

(a) it is treated in the same way as a newly authorised *authorised electronic money institution*; but

(b) any periodic fee paid or payable for that financial year under (2) is taken into account so that no additional periodic fee is paid under (2).

6.3.6 G The transitional arrangements in regulation 75 of the *Electronic Money Regulations* deal with a *person* other than a *credit institution* that issued *electronic money* in the *United Kingdom* under an *EEA* passport. It may continue until 30th October 2011 to carry on that activity.

6.3.7 R (1) This *rule* deals with periodic fees payable under *FEES* 4.3 by a *person* subject to the transitional regime in regulation 75 of the *Electronic Money Regulations*.

(2) During the transitional period under the *Electronic Money Regulations* the *person* is treated as an *EEA authorised electronic money institution*. It is treated as having held this status from the beginning of the *FSA's* financial year 2011/12.

(3) The fees for the financial year 2011/12 are based on information supplied by the *person* before the periodic fee becomes payable.

6.3.8 G If the *person* becomes an *EEA authorised electronic money institution* during the transitional period under the *Electronic Money Regulations* it is treated as remaining as an *EEA authorised electronic money institution* during the *FSA's* financial year 2011/12. Therefore no additional periodic fee is payable.

6.3.9 R If the transitional status of a *person* under the *Electronic Money Regulations* comes to an end before it gets its final status as an *electronic money issuer* under those regulations, any periodic fees that are due at the time its transitional status ends must be paid immediately thereafter.

6.4 FOS general levy

6.4.1 R *FEES* TP 6.3 applies to the general levy described in *FEES* 5.3 in the same way as it does to periodic fees under *FEES* 4.3.

6.5 CFEB levy

6.5.1 R *FEES* TP 6.3, except *FEES* TP 6.3.5, applies to the *CFEB levy* in the same way as it does to periodic fees under *FEES* 4.3.

Appendix 2

Periodic fees (unauthorised mutual societies registration) (2011/12) instrument 2011

PERIODIC FEES (UNAUTHORISED MUTUAL SOCIETIES REGISTRATION) (2011/2012) INSTRUMENT 2011

Powers exercised

A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 156 (General supplementary powers); and
(2) paragraph 17 (Fees) of Schedule 1 (The Financial Services Authority).

B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on 1 June 2011.

Amendments to the FSA's rules

D. The Unauthorised mutuals registration fees rules are amended in accordance with the Annex to this instrument.

Citation

E. This instrument may be cited as the Periodic Fees (Unauthorised Mutual Societies Registration) (2011/2012) Instrument 2011.

By order of the Board
26 May 2011

Annex

Amendments to the Unauthorised mutuals registration fees rules

In this Annex, underlining indicates new text and striking through indicates deleted text.

Amend Annex 1R as shown.

ANNEX 1R
PERIODIC FEES PAYABLE FOR THE PERIOD 1 APRIL ~~2010~~ 2011 TO 31 MARCH ~~2011~~ 2012

Part 1
Periodic fee payable by Registered Societies (on 30 June ~~2010~~ 2011)
This fee is not payable by a *credit union.*

Transaction	Total assets (£'000s)	Amount payable (£)
Periodic fee	0 - 50	55
	> 50 to 100	110
	> 100 to 250	180
	> 250 to 1,000	235
	> 1,000	425

Part 2
Methods of payment of periodic fees

A periodic fee must be paid using either direct debit, credit transfer (BACS/CHAPS), cheque, switch or by credit card (Visa/Mastercard only). Any payment by permitted credit card must include an additional 2% of the sum paid.

PUB REF: 002609

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Financial Services Authority

Annual Report 2010/11

Financial Services Authority
Annual Report
2010/11

Presented to Parliament pursuant to Paragraph 10 of Schedule 1 of the Financial Services and Markets Act 2000.

This report is made by the Financial Services Authority (FSA) under the Financial Services and Markets Act 2000 (FSMA). It is made to the Treasury and covers the period 1 April 2010 to 31 March 2011.

Pursuant to paragraph 10 of schedule 1 to FSMA, the report covers:

- The discharge of the FSA's functions under FSMA;
- The extent to which, in the FSA's opinion, the regulatory objectives under FSMA have been met; and
- The FSA's consideration of matters mentioned in section 2(3) of FSMA (principles of good regulation).

It also includes the report by the FSA's non-executive committee under paragraph 4(6) of schedule 1 to FSMA.

The FSA's audited accounts for the reporting year ending 31 March 2011 are included in Section 8.

Additional material on our performance in 2010/11 including high-level indicators, can be found on our website at **www.fsa.gov.uk/pages/Library/Corporate/Annual/**

The Annual Report will be discussed at our annual public meeting on 23 June 2011.

There are further details of our annual public meeting on our website at **www.fsa.gov.uk/pages/Doing/Events/apm_2011.shtml**

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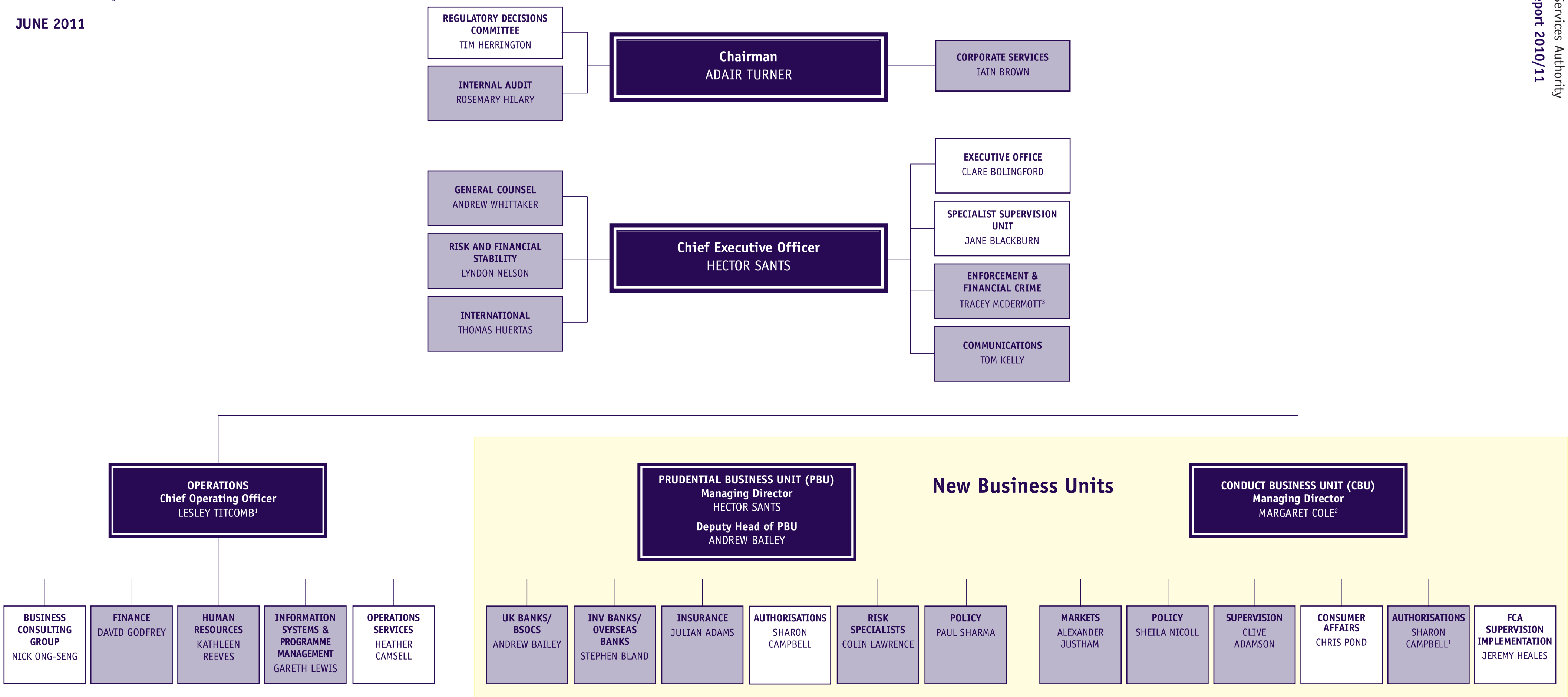
Contents

Appendices – available on our website:
www.fsa.gov.uk/Pages/Library/Corporate/Annual/ar10_11_appendices.shtml

Financial Services Authority

JUNE 2011



1 Acting
2 Interim from 4 April to 1 September, after which Martin Wheatley will take up this position
3 Acting from 4 April to 1 September and reporting directly to Margaret Cole

LME-003744

LME-003745

Chairman's statement

Adair, Lord Turner, FSA Chairman

This Annual Report describes the FSA's activities and performance during 2010/11. At the start of that year, before May 2010's general election, we did not know whether the FSA would have to implement major structural change. But we were already implementing or committed to major changes in the way that we regulate firms in pursuit of our statutory objectives.

The year has seen further major progress on initiatives already in hand, alongside preparations for structural change which will build on what the FSA has already achieved.

In particular I would like to highlight four key areas of focus:

- Further progress in executing our credible deterrence enforcement approach, building on the work begun in 2007, which has entailed a more aggressive approach to the prosecution of both criminal offences and breaches of FSA rules.

A radically new approach to the protection of retail customers

- The launch of a radically new approach to the protection of retail customers with a willingness to intervene earlier so that we can, in future, spot and offset problems such as the mis-selling of payment protection insurance, before rather than after they occur. Our first *Retail Conduct Risk Outlook*, published in February 2011, illustrates how we will seek to identify emerging market developments that could pose risks to consumers.

- The continued development of a more intensive approach to the prudential supervision of banks. This builds on our Supervisory Enhancement Programme, launched in the wake of Northern Rock's failure, but extends and deepens it. These programmes are putting in place supervisory processes and the supporting technical skills which amount to revolutionary change from the approaches under which The Royal Bank of Scotland (RBS) and HBOS failed.

- Continued progress in developing new global standards for the prudential regulation of banks, encompassing greatly enhanced requirements for capital and liquidity. Standards to ensure that all banks are resolvable and special prudential requirements for systemically important financial institutions, which in the past were seen as 'too big to fail'.

These four areas of particular focus – together with our continued work to ensure clean and efficient wholesale markets – would have shaped the FSA's work over the last year, even in the absence of major structural change. But the reforms announced by the Chancellor last June, which will be implemented by 2013 once the legislation has passed, will facilitate the further intensification of these changes.

The PRA will build on the FSA's already fundamental reforms to regulation and supervision

As the government's consultation paper[1] set out, the Financial Conduct Authority (FCA) will pursue a new, more interventionist approach to retail consumer protection, while maintaining continuity in our supervision of wholesale markets. The new Prudential Regulation Authority (PRA), within the Bank of England, will build on the FSA's already fundamental reforms to the regulation and supervision of prudential risks. And the Financial Policy Committee will address a key gap in the previous regulatory approach, being responsible for macro-prudential oversight to identify and offset emerging cross-system threats to financial stability.

Preparing these structural changes has required a huge amount of organisational design and implementation planning work over the last year. As Hector Sants describes in his CEO report, we have now taken the initial steps towards the internal division of the FSA into the successor organisations, and are well on target to move to the new structures as soon as the legislative process can be completed.

Planning and executing this transition in parallel with our ongoing work and in the context of still significant financial stability risks has imposed a large additional burden on the executive team and many staff across the FSA and I would like to thank them for their hard work and professionalism in a challenging year.

In particular I would like to thank Hector Sants for agreeing last June to stay on as CEO, to lead the transition to the new structures and become the first CEO of the PRA. I look forward to Martin Wheatley joining in September as CEO designate of the FCA, in which role he will lead the creation of the new organisation and the development of the new approach to retail consumer protection.

Finally, I should say thanks also to the non-executive directors of the Board, who have been closely involved in reviewing and challenging the executive's plans for the transition, and who have focused in particular on ensuring that we can build new approaches and structures for the future while maintaining focus on today's challenges to financial stability and customer protection.

Adair Turner

Adair, Lord Turner
June 2011

1 *A new approach to financial regulation: building a stronger system*, 17 February, 2011

Chief Executive's report

Hector Sants, FSA Chief Executive

Over the last 12 months, the FSA has continued to operate in a climate of economic fragility. Our principal focus has thus been on maintaining the high level of supervisory activity required to ensure the stability of firms in the system. We have also made considerable progress in advancing our new proactive approach to consumer protection.

We began work to reform our internal structure

In 2010, the government announced its intention to reform the structure of financial regulation in the UK, replacing the FSA with a Prudential Regulation Authority (PRA), which is a subsidiary of the Bank of England, and a Financial Conduct Authority (FCA). In 2010/11 we began work to reform our internal structure in anticipation of this 'twin peaks' approach. Alongside this structural change we have also continued refining and implementing the more intrusive approach to supervision we developed following the global financial crisis.

In our *Business Plan* for 2010/11, we set out our priorities:

- delivering effective on-the-ground supervision supported by our credible deterrence philosophy;
- continuing to embed and fully implement the required cultural and organisational change that underpins our intensive supervisory agenda;
- taking forward our policy reform agenda, driven largely by *The Turner Review* and other key initiatives that we began in response to the financial crisis;
- ensuring that we deliver our wider policy agenda, primarily mandated by the European Union, in particular Solvency II, which is the single largest project undertaken by the FSA; and
- playing our role in delivering financial stability, taking into account any changes to our scope of responsibilities arising from the Financial Services Bill, which was enacted in 2010.

The *Business Plan* also set out our ongoing commitment to meeting our objectives in a cost effective and efficient way.

A high-level assessment of whether we have delivered against our objectives can be measured by our performance against milestones in the *Business Plan*. In 2010/11, there were 41 in total. 90% of these have been delivered in full and four have been reprioritised.

However, ultimately we must be assessed against our statutory objectives and the outcomes. This *Annual Report* seeks to provide a comprehensive assessment of this performance. We review this under headings that link to our statutory objectives. We have also added a separate section on the regulatory reform agenda.

Regulatory reform

The government's regulatory reform agenda will see the prudential supervision of major banks and insurance firms transferred to a subsidiary of the Bank of England, the PRA. The remainder of the FSA will be renamed the FCA. A large amount of work has already been completed, both internally and with the Bank of England and the Treasury. In February 2011, the Treasury published its consultation document, *A new approach to financial regulation: building a stronger system,* which set out the rationale and key elements of the reform agenda. The FSA provided significant input to this document and continues to work closely with the Treasury as the Financial Services Bill is being drafted.

On 4 April 2011, the FSA changed its internal structure to reflect the forthcoming 'twin peaks' approach. We created two new business units: the Prudential Business Unit (PBU), which will become part of the PRA; and the Conduct Business Unit (CBU), which will become part of the FCA. During its remaining period as an integrated regulator, the FSA will maintain a unitary approach to its provision of central services. The FSA also announced on 2 February 2011 that Martin Wheatley would join the FSA on 1 September as CEO designate of the FCA, and before that appointment, as Head of the CBU.

The third element of the government's reform programme is the creation of the Financial Policy Committee (FPC), a committee of the Bank of England, with responsibility for maintaining and monitoring the stability of the financial system in the UK. Pending the enacting of the legislation, Adair Turner and I are members of the interim FPC; Martin Wheatley will join as an observer.

Managing the transition has been an organisational challenge this year

Managing the transition has been an organisational challenge this year and our internal restructure is only the beginning of the overall process. I am confident, however, that we have made good progress.

Delivering financial stability and supervision of firms

The FSA acquired its financial stability objective through the Financial Services Act 2010. We published *The FSA's financial stability strategy* in October 2010, outlining our key priorities and overall approach. Our main role in delivering this objective is as a micro-prudential regulator, and we have therefore focused on ensuring that firms have adequate capital and liquidity. In particular, we made sure that our major banks continued to comply with our interim capital regime, which ensures they hold a minimum of 4% core tier 1 capital on the basis of an individually tailored stress test.

We have further strengthened our capital regime by establishing a comprehensive stress-testing framework. The recent financial crisis highlighted the importance of firms being adequately capitalised to withstand a period of stress. In response, we introduced a key change whereby firms need to identify a specific capital planning buffer that they must now hold so that they are better able to withstand a severe, but plausible, stress event. Firms are also required to assess themselves against a 'reverse stress test'. This will oblige firms to consider the scenarios most likely to cause their business model to become unviable, so that we and firms are better able to take early action.

The protection of customers from the potential serious consequences of imprudent liquidity risk-management practices

Our objective on liquidity continues to be the improvement and strengthening of liquidity-risk-management practices. This enhances the protection of customers and other participants in the financial services markets from the potentially serious consequences of imprudent liquidity-risk-management practices. Throughout the year we have continued to implement our interim liquidity regime. We began to roll out the Supervisory Liquidity Review Process to firms, initially focusing on major firms. Over time we will expand the process to include a wider range of firms. We also continued to be actively engaged in the international debate to develop global liquidity requirements, and we made clear that once this global regime was finalised we will align our interim regime with these new standards.

For large insurers, we continued our work, both with the UK industry and through our contributions to the European Insurance and Occupational Pensions Authority (EIOPA), to ensure that the developing Solvency II measures are designed to achieve satisfactory outcomes. We encouraged firms to participate in the fifth quantitative impact study (QIS5) to provide evidence for ongoing negotiations, and received submissions from over 70% of the UK market. At the end of March 2011, we started the next phase of the internal model approval process (IMAP).We developed a two-tier approach to allocating our resources to firms in pre-application as we endeavour to give firms a decision for day one of the new regime.

Delivering market confidence – maintaining confidence in financial markets

Our objective, as set out in the *Business Plan* for 2010/11, remains to ensure that UK markets are efficient, orderly, fair, internationally attractive and sustainable. There is a clear inter-dependency between this and our other objectives of maintaining financial stability, consumer protection and reducing financial crime.

Accordingly, our priorities for 2010/11, described in the *Business Plan*, were to:

- continue to set standards that firms and other market participants must follow;
- challenge firms to be well governed, financially sound and to manage their risks effectively;
- monitor compliance with those standards and take action where we find shortcomings; and
- maintain our commitment to being an international leader in financial regulation.

We have pursued our agenda through a number of specific areas of focus, including the following:

- The implementation of new powers granted to us through the Financial Services Act 2010 on short selling. We are now able to require disclosure of significant short positions and we can take actions against firms that breach our short-selling requirements.

- In the wake of the financial crisis, the EU has undertaken a review of the Markets in Financial Instruments Directive (MiFID). We provided substantial technical input to the consultation process, which seeks to strengthen the regulatory framework, implement a new transparency regime and reduce the systemic risk posed by the over-the-counter (OTC) derivatives market.

- We have continued to pursue our credible deterrence agenda on insider dealing and market abuse. Over the last year we have secured five convictions for insider dealing and have prohibited nine individuals as a result of market abuse. Notably, last year we fined one person, banning him from working in financial services, following an investigation into deliberate market abuse. The fine (a penalty of £1.5m and a disgorgement of £1.3m) is the largest we have imposed against an individual to date.

- We published our Policy Statement on the structure of the UK listing regime in 2010, which set out our aims to make the regime clearer and more coherent.

We have continued to deliver our intensive supervisory approach in markets. We have increased the level of resource dedicated to larger firms and market infrastructure providers, and have undertaken both detailed firm-specific assessments and cross-firm work, including projects on high-frequency trading and co-location.[2]

Delivering consumer protection

We launched our consumer protection strategy in March 2010. It sets out our approach to a more proactive, outcomes-focused style of conduct supervision through:

- improving the long-term efficiency and fairness of the market;

- delivering intensive supervision of firms, including earlier interventions in the development of retail products; and

- where failure does occur, securing the appropriate level of redress, and achieving effective credible deterrence by taking action against firms who fail to meet our standards.

We began the debate on product intervention, setting out our initial thoughts

In January 2011, we published a Discussion Paper to begin the debate on product intervention, setting out our initial thoughts on intervening earlier in the product lifecycle. In early 2011, we also published the first *Retail Conduct Risk Outlook (RCRO)*, a forward-looking analytical document, identifying the key risks to consumers in the retail market. We have used the analysis underpinning the RCRO to inform our supervisory priorities.

As with all of our supervisory work, we recognise the need for the strategy to be underpinned by a robust policy framework. In the past year, we have continued to work on key initiatives, including the following:

- The new rules of the Retail Distribution Review (RDR) regime will come into force in 2013. They will ensure that consumers are offered a transparent and fair charging system for the advice they receive and that those people providing advice services are appropriately qualified.

2 Co-location allows traders to physically place their computer servers next to an exchange's matching engine to shave crucial milliseconds off the time it takes for trades to be done (see also page 57).

- We have also continued our work on the Mortgage Market Review (MMR), which aims to protect consumers from the poor lending practices that contributed to the financial crisis. Our key focus in the last year has been our consultation on arrears, responsible lending, and distribution and disclosure.

Over the last year, we made progress towards implementing intensive supervision of conduct issues, both on a firm-specific and sector-wide basis. We have developed an approach to test firms' business models and assess whether they pose any inherent risks to consumers and to assess the quality of the outcomes that consumers are receiving.

We used the lessons learned to develop a supervisory approach that is more proportionate

We have completed our assessment programme for smaller firms and used the lessons learned from it to develop a revised supervisory approach that is more proportionate and risk-based.

We recognise that there will always be instances where firms fail to treat their customers fairly and have therefore retained our focus on addressing these issues.
In particular, we have been implementing our new power under the Financial Services Act 2010, to secure redress for consumers where there is evidence of widespread failings.

Delivering a reduction of financial crime

In 2010/11, we increased our focus on financial crime, as part of the delivery of our credible deterrence agenda. We have delivered this through a combination of intelligence gathering, firm-specific supervision and cross-firm work – including anti-bribery and corruption (in commercial insurance broking[3]).

In the *Business Plan* for 2010/11 we said we would continue to take action where we found that firms were failing to meet our standards. In August 2010, we fined members of the Royal Bank of Scotland group £5.6m for failing to have adequate systems and controls in place to prevent breaches of financial sanctions.

Engaging with the international agenda

The last year has seen a very significant change to the European regulatory architecture with the creation on 1 January 2011 of the three new European Supervisory Authorities (ESAs). These will be the key policy-making forums in the EU, leaving the FSA and its successor bodies to act primarily in a policy-influencing and national supervisory role. The FSA is therefore actively committing increased resource, including senior management time, to the new ESAs and to this end we were successful in securing senior representation on all of the three ESAs.

A major focus of our work has been engaging with the Financial Stability Board (FSB) to continue to develop the new prudential regulatory framework, particularly capital, liquidity and resolution. Strong progress has been made in all three areas: during the year the FSB laid out a comprehensive programme for strengthening capital and liquidity and ensuring that there are effective resolution mechanisms in place for global firms.

We also engaged with the International Monetary Fund's (IMF) Financial Sector Assessment Program, which reviewed the health of the UK financial services sector,

3 Small firms' financial crime review, banks' management of high-risk customers and controls issues.

the effectiveness of supervision, and the effectiveness of our regulatory reform programme. This will be published in the summer of 2011.

Delivering the FSA's operational platform

In the *Business Plan* for 2010/11, we committed to continue to develop and enhance our operational effectiveness through our people strategy and technical infrastructure.

We continue to focus on recruitment and retention of high-quality staff

We continue to focus on recruitment and the retention of high-quality staff. Over the last year, we have met our headcount targets, which saw an increase in the FSA's permanent and contract full-time equivalent headcount of 478. For our permanent staff, turnover for the year was 10.4% which, in our view, was an acceptable figure in the context of the financial services industry. We successfully recruited the additional 1,019 people during the year, necessary to achieve our increased full-time equivalent headcount targets. In 2010 we introduced a new Training and Competence Scheme to improve the knowledge and skill sets across the FSA. This provides a consistent and comprehensive framework against which staff can be objectively and fairly assessed.

As in 2009/10, there was no general pay increase in 2010/11, in recognition of the continuing fragility of the economic climate, and the need to avoid placing undue financial burdens on firms. A small number of pay rises were given in order to correct significant pay anomalies.

We have significantly enhanced our work on equality and diversity in the last 12 months, with the publication of our *Single Equality Scheme* and *Action Plan* for 2010-2013. At senior management level, we have appointed leaders to champion and raise awareness within the FSA. They are supported in this by two diversity experts, recruited in 2010.

We continued to improve our operational platform in the last year by reforming our Information Systems (IS) and project management functions. We implemented a single delivery framework for projects and programmes both within IS and the wider business. This has allowed us to ensure that our project portfolio is more focused and balanced. We have also continued our programme of upgrading our internal technology platform. In particular, we enhanced our records management function and our ability to respond more effectively to enquiries from firms and individuals.

Conclusion

There is no doubt that the economic climate and the regulatory reform agenda have presented challenges for the FSA this year. However, our impact metrics demonstrate that we have nevertheless largely met our statutory objectives and did so within our budgeted resources. I conclude by expressing my gratitude to the staff of the FSA for this achievement.

Hector Sants

Section

1

LME-003754

Structural reform of financial regulation

Introduction

Last year, the UK financial services industry faced regulatory change on a sweeping scale.

At the national level the last UK government introduced the Financial Services Act 2010, which resulted in a number of changes to our objectives, powers and duties, in particular giving us a new financial stability objective and additional enforcement powers.

In June 2010, the current UK coalition government announced that the FSA will be split up. The prudential supervision of banks and insurers will be moved to a new operationally independent subsidiary of the Bank of England: the Prudential Regulation Authority (PRA). The FSA will be renamed the Financial Conduct Authority (FCA) and will focus on consumer protection and markets oversight. The government also established a new committee of the Bank of England with responsibility for delivering financial stability: the Financial Policy Committee (FPC).

The European Union (EU), meanwhile, created three pan-European agencies to address the risk of regulatory arbitrage and improve the quality of national supervision of banks, securities markets and the insurance industry. The EU also created a new advisory body, the European Systemic Risk Board (ESRB), to identify systemic risks and make recommendations for mitigating them. Europe's new regulatory architecture became operational in January 2011 and will fundamentally change the way in which national supervisory authorities operate. A significant majority of regulatory requirements will be determined solely at the EU level and national supervisors will play a key role in negotiating and agreeing these, but their role as decision makers will centre on their function as supervisors of firms and markets.

The Financial Services Act 2010

The Financial Services Act 2010 (the Act), which received royal assent on 8 April 2010, resulted in a number of changes:

Consumer protection

The Act removed the FSA's public awareness objective and required us to set up an independent body to take forward consumer education work. The Act also provides for more funding to be made available for consumer education work (see Section 4, page 79).

The Act gave us additional powers for the FSA to require consumer redress (see Section 4). This allows us to make sure that consumers receive redress in cases involving large-scale consumer mis-selling or other failures.

Financial stability

The Act gave us a new financial stability objective (see Section 2) to contribute to protecting and enhancing UK financial stability. We are required to cooperate appropriately with the Treasury, the Bank of England and other relevant bodies in pursuing this objective. The Act requires us to have and keep under review a financial stability strategy. It enables us to gather information from entities, including unregulated entities for financial stability purposes. It also requires us to consider the impact that international events and circumstances could have on financial stability in the UK.

Enhanced powers

We may use the powers in pursuit of any of our regulatory objectives

The Act extends the scope of our key regulatory powers to make rules and to alter authorised firms' regulatory permissions, so we may use the powers in pursuit of any of our regulatory objectives, including the new financial stability objective.

We have new rule-making powers for:

- remuneration (see Section 2): we now have the power to specify that remuneration agreements in breach of our rules are void;
- recovery and resolution plans (see Section 2);
- short selling (see Section 3); and
- consumer redress schemes (see Section 4).

We have new enforcement powers to:

- restrict or suspend the carrying on of regulated activities for up to 12 months;
- suspend or impose restrictions on an approved person for up to two years;
- impose a financial penalty at the same time as cancelling a firm's permission;
- penalise any person who performs a controlled function[4] without approval; and
- issue a warning notice against an individual three years from the time we first became aware of the misconduct (increased from two years).

Financial Services Compensation Scheme (FSCS)

The Act contains provisions that will enable the FSCS to act as a single point of contact and to pay redress to consumers where redress is due to them under other schemes, such as schemes established outside the UK.

4 A function, relating to the carrying on of a regulated activity by a firm, which is specified, under section 59 of the Act (Approval for particular arrangements), in the table of controlled functions.

UK regulatory reform

Over the past nine months, the FSA has begun the process of aligning the organisation to ensure it is ready to cut over to the new regulatory structure.

As a result, we incurred approximately £1m of direct costs last financial year:

- programme management support £0.33m;
- regulatory design £0.10m;
- IT design £0.33m; and
- other (e.g. HR and other central functions) £0.24m.

We are confident that our programme remains on track

Shortly after the end of our financial year in April 2011, we replaced our Risk and Supervision business units with two new ones: the Conduct Business Unit, which broadly aligns with the regulatory activities to be undertaken by the FCA, other than enforcement; and the Prudential Business Unit, which broadly aligns with the regulatory activities of the PRA, other than enforcement. Central services will continue for the lifetime of the FSA to be structured on an unitary basis. We are confident that our programme remains on track and further progress will be made during 2011/12.

A new European supervisory structure

European Supervisory Authorities (ESAs) and the European Systemic Risk Board (ESRB)

The creation of ESRB and the three new ESAs marks a significant change to the way in which financial services regulation will be developed and delivered across Europe. The ESRB will undertake macro-prudential analysis at EU level to identify risks to EU financial stability and will make recommendations to address these risks.

European Supervisory Authorities (ESAs)

The ESAs became operational in January 2011. They are:

- the European Banking Authority (EBA);
- the European Insurance and Occupational Pensions Authority (EIOPA); and
- the European Securities and Markets Authority (ESMA).

They replace:

- the Committee of European Banking Supervisors (CEBS);
- the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS); and
- the Committee of European Securities Regulators (CESR).

The ESAs are responsible for developing a large proportion of the rules that apply to the financial services sector in the UK. These will be issued as EU regulations, so will be directly applicable across the EU. As well as developing binding rules, the ESAs have powers to:

- impose a temporary ban on financial activities;
- investigate alleged breaches of EU rules;
- take binding decisions in emergencies;
- arbitrate in disputes between national supervisors;
- play a coordinating role within colleges of supervisors;
- undertake peer review;
- directly supervise credit rating agencies (ESMA only); and
- require information to be passed to them that is necessary for discharging their responsibilities.

We devoted significant resource to the negotiation of ESA legislation

In 2010/11, we devoted significant resource during the negotiation of the ESA legislation to ensure that the ESA package as a whole secured the key objectives of:

- protecting the single market;
- addressing the risks arising from regulatory arbitrage;
- raising standards of supervision among national supervisors; while
- retaining responsibility for day-to-day supervision at the national level.

Once the ESA legislative package was agreed in the Autumn of 2010, our focus shifted to preparing for the new European order. During 2010/11, we:

- influenced the ESAs regulatory framework and operating model;
- adapted our operating model to work effectively with the ESAs;
- enhanced our secondments strategy and identified training requirements; and
- developed systems to handle ESA data requests.

We published our views on the ESAs' operating models in December 2010 in our document *Working towards effective and confident European Supervisory Authorities: the FSA's views on policy considerations*.[5]

Outcomes during the past year, consistent with FSA objectives and achieved through close working with other bodies, such as the Treasury, included us:

- negotiating regulations establishing the ESAs, as set out above;
- agreeing, with other national supervisors, the rules of procedure with which ESAs must comply, so they operate as efficient member-led organisations;

Ensuring ESAs have access to senior expertise from the FSA

- ensuring the ESAs have access to senior expertise from the FSA: Thomas Huertas was elected Alternate Chair of EBA; and Hector Sants and Alexander Justham were elected to the management boards of EIOPA and ESMA respectively.

Additionally, Verena Ross, the FSA's former Director, International, was appointed as the Executive Director of ESMA.

We ensured the FSA was well prepared for the transition by:

- establishing procedures for engaging with the ESAs' rule-making functions;
- establishing procedures for the use of the ESAs' supervisory oversight powers to mitigate risk;
- resolving contractual issues to facilitate FSA staff joining the ESAs;
- training staff on how to deliver policy through the ESAs; and
- communicating information on the ESAs to all affected staff.

5 www.fsa.gov.uk/pages/About/What/International/pdf/esa_key.pdf

Section 2

LME-003760

Financial stability

Introduction

During 2010/11 the FSA's mandate was significantly extended. From April 2010, we were given a new statutory objective, which made more explicit the responsibilities for promoting financial stability that we had been exercising under the 'market confidence' objective mandated under FSMA (see Section 1).

At the same time, our supervisory approach continued to progress toward intensive supervision and proactive challenge, laying the groundwork for the preventative interaction framework that will guide the PRA.[6] We continued to embed the organisational and cultural change needed to implement intensive supervision, moving our regulatory approach from retrospective intervention to proactive challenge.

Our supervisors made judgements on firms' business models; intervening early if they anticipated any risks that might arise from firms' business strategies and approaches to funding and capital. This approach has demanded quality staff, industry knowledge and the will to challenge the industry robustly where potential threats were identified.

We contributed significantly to the development of a robust policy reform programme, driven by the initiatives and issues identified in *The Turner Review* and the wider policy agenda mandated by the EU.

And the FSA continued to play a leading role in influencing regulatory reform on the global stage, while ensuring that the UK arrangements on, for example, key issues of capital and liquidity were consistent with the direction of international standards.

This section describes the work we accomplished in these areas, under these headings:

- the Financial Services Act – our new financial stability objective;
- FSA supervision – a major intensification of approach;
- progress on reforming the international and European regulatory framework – policy and practice; and
- specific measures to strengthen firms' resilience.

We also include the principal metrics we use to assess our supervisory effectiveness in relation to our financial stability objective and to gauge financial stability generally.

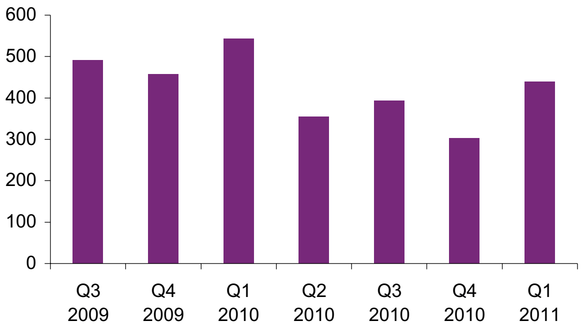
6 www.fsa.gov.uk/pubs/speeches/boe_pra.pdf

These are:

Supervisory effectiveness
Chart 1: Supervisory issues closed
Chart 2: Firm feedback on the quality of FSA supervisory risk assessments

Measures of financial stability
Chart 3: Cost of credit
Chart 4: FSA firm cancellations
Chart 5: Major UK banks – CDS spreads, five-year senior debt

Chart 1: Supervisory issues closed

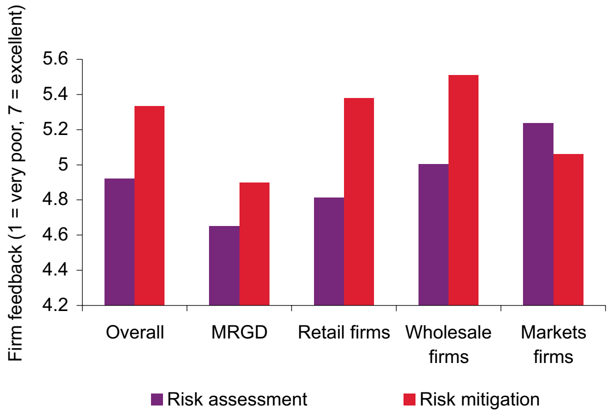


Source: FSA

A central tool in supervision is identifying the risk mitigation actions firms must take. Looking at the quantity identified and speed which with these are closed gives a perspective on the intensity and effectiveness of our supervision.

The number of issues closed in Q4 2010/11 is 439 (from 303 in Q3 2010/11); this represents 17% (12% in Q3 2010/11) of the population of open issues. This shows an absolute and proportional increase in the number of issues closed than previously reported. The proportion of high-risk issues closed was slightly higher than other issues at 18%, reflecting us prioritising issues with the most risk. Also, about 40% of the issues (recorded and closed) were in respect of high-impact firms, reflecting the enhanced focus of our risk assessment and mitigation work on these firms.

Chart 2: Firm feedback survey – quality of risk assessment and risk mitigation

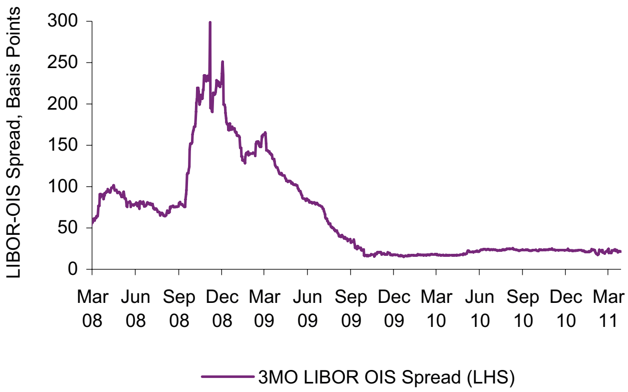


Source: FSA

From our regulated firms' perspective, the quality of our risk assessment in the last six months has reduced slightly from 5.2 down to 4.9, with the most significant reductions in our Major Retail Groups Division and Retail Division. Risk mitigation is scored more positively at 5.3, but again this represents a fall against the 5.6 recorded for the six months to June. However, scores remain positive in the context of a 1-7 scoring system, where 4 is neutral.

The deterioration may have been driven by the amount and pace of regulatory change, which has continued to put pressure on both sides of the firm-supervisory relationship.

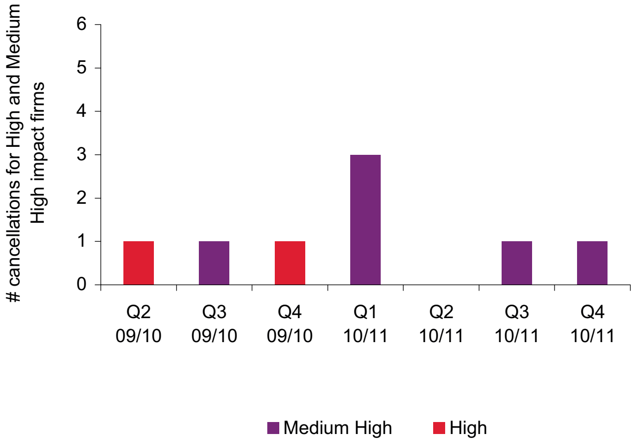
Chart 3: Libor-OIS spread



Source: Bloomberg

The current cost of interbank borrowing (measured by the Libor-OIS spread) – in a context and relative to the extremes of 2008 – is not excessive. However, spreads have recently entered a slightly more volatile period, driven by movement in the OIS swap rate. In part, this reflects uncertainty about the short-term outlook for the bank rate, amid persistent above target inflation and variable information about the performance of the economy.

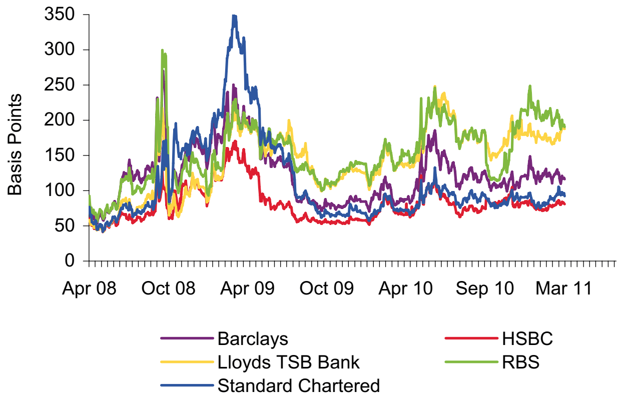
Chart 4: FSA firm cancellations



Source: FSA

This chart shows the number of authorised firms this year that have cancelled their authorisation with the FSA. Not all cancellations are necessarily failures and not all failures are regulatory failures. Nevertheless, this chart gives some indication of the level of distress in the system. During 2010/11, there was a significant reduction in the cancellation rate among significant impact firms.

Chart 5: Major UK banks – CDS spreads, five-year senior debt



Source: Bloomberg

UK banks' credit default swaps (CDS) spreads are a measure of how investors perceive the default risk posed by these firms.

UK banks' CDS spreads rose in November, as the Irish sovereign crisis pushed up CDS spreads for eurozone sovereigns. Spreads for some of the banks fell back after the EU and IMF bailout was announced.

HSBC and Standard Chartered have seen swap rates rise in early 2011 due to concerns in the aftermath of the Japanese earthquake. Nevertheless, using absolute CDS as an indicator, they remain the banks with the lowest perceived credit risk, driven in part by their strength in emerging market economies.

The Financial Services Act 2010 (the Act) – our new financial services objective

Our financial stability strategy

During 2010, in consultation with the Treasury, we determined our strategy in relation to our new financial stability objective and how we planned to deliver this in *The FSA's financial stability strategy*[7] published in October 2010.

Our principal channels for delivery during 2010/11 were to ensure that financial firms are well-supervised, that emerging threats and risks to financial stability were identified and acted on, and that our regulatory policy framework helped to facilitate stability. Our role supports the wider framework for macroeconomic, fiscal and financial stability in the UK determined by the government and the Bank of England's core purposes to achieve monetary and financial stability.

Our financial stability strategy takes account of the principles of good regulation[8] and how they relate to this work. The considerations are:

...the potentially very high costs of financial instability for the wider economy...

1. The economic and fiscal consequences for the UK of instability in its financial system.

   This emphasises the potentially very high costs of financial instability for the wider economy and the consequent fiscal costs of government action to protect the economy from financial instability. In 2010/11, we gave due weight to even relatively remote risks to financial stability, given the potentially very high costs if they crystallised. We retained discretion to decide what action to take, having considered the potential fiscal or economic effects.

2. The effects (if any) on the growth of the UK's economy of anything done for the purpose of meeting that objective.

   We considered the impact of regulatory actions on economic growth when deciding what action to take to meet the financial stability objective. The need to be aware of the possible impact of our actions fits with our existing approach to policy development, which requires us to undertake market failure analysis and cost-benefit analysis.

3. The impact (if any) on the stability of the UK financial system of events or circumstances outside the UK (as well as in the UK).

   We considered risks arising within or outside the UK through our intensive supervision, close cooperation with the Bank of England and Treasury, and by active participation in EU and international financial stability groups. The characteristics of the UK market are such that many firms operating here are headquartered outside the UK and operate through branches or subsidiaries. Also many of the major UK groups operate in and/or have significant exposures to other jurisdictions. We engaged with other regulators through formal colleges and informally on a day-to-day basis when supervising cross-border groups. And we supported initiatives such as cross-border stability groups.

7 www.fsa.gov.uk/pubs/other/finstab.pdf
8 www.fsa.gov.uk/Pages/about/aims/principles/index.shtml

We published our *Prudential Risk Outlook* (PRO) in March 2011, setting out our assessment of these risks and others to financial stability. This assessment was used as the context for our micro-prudential regulation and supervision of firms.

It described still-important risks to financial stability and highlighted, in particular:

- incomplete progress in deleveraging, required to create a less vulnerable system;
- progress towards improved global capital and liquidity standards and the need, as that progress is achieved, to understand possible risk transfers and migrations to other parts of the financial system;
- a number of important areas of credit risk, relating in particular to vulnerable eurozone countries, to commercial real estate and, potentially, in emerging markets facing rapid property price inflation; and
- the risks created by a sustained period of low interest rates, which could crystallise as and when interest rates return to more normal levels.

FSA supervision – major intensification of our approach

Continuing to strengthen our supervisory processes

The FSA has radically changed over the past three years

Last year, we continued with a major shift in our approach to supervision. We have made significant progress in improving supervisory effectiveness and continue to do so. The FSA has radically changed over the past three years and is now operating a more 'intensive' approach to supervision, which is designed to deliver a proactive, 'outcomes-based' system.

This involves our supervisors making judgements both about the robustness of the business models of firms and the suitability of the products they are selling. We then intervene promptly if we anticipate problems.

This rigorous approach demands quality staff, with in-depth industry knowledge and the will to challenge the industry robustly where potential threats to consumers or the stability of the financial system are identified.

High-impact/systemically important firms

For high-impact firms, given that – even with resolution tools[9] – the impact of failure is high, we have focused our resources (particularly senior management resources) on issues that really matter to the safety and soundness of these firms.

In 2010, we introduced a new outcomes-based approach for systemically important firms, centred on intervening in a proactive way and making forward-looking judgements about firms based on business modelling and other analysis, as well as comprehensive and rigorous stress-testing.

9 See section on recovery and resolution plans, page 34.

In particular, for major firms we introduced an enhanced approach to prudential oversight that ensures we make judgements on:

- capital, liquidity and asset quality, rigorously assessed through a comprehensive stress-testing regime;
- business model and risk analysis;
- systems and controls, senior management and culture; and
- recovery and resolution planning.

Capital – our interim regime

...to ensure that bank capital ratios were sufficiently high...

In October 2008, in response to the financial crisis, we introduced an interim capital framework to underpin the UK bank recapitalisation programme. The framework was introduced to ensure that bank capital ratios were sufficiently high to provide a buffer to allow them to withstand continued challenging economic conditions.

During 2010/11, we devoted significant supervisory effort to making sure that banks properly complied with this regime. We did this through regulatory stress testing of the adequacy of firms' capital and the consequent setting of capital buffers – an integral part of prudential oversight in the UK since the Capital Requirements Directive (CRD) was introduced in 2007.

Our integrated approach to stress testing comprises three interlinked and mutually reinforcing elements:

- firms' own stress testing;
- our stress testing of specific firms; and
- simultaneous system-wide stress testing undertaken by firms or supervisors using a common scenario for financial stability purposes.

Our Policy Statement, PS10/14: *Capital planning buffers (Feedback on CP09/30 and final rules)*, published in September 2010, focused on the first of these – firms' own stress testing (which may at times be informed by supervisory stress testing), specifically on the firm-wide stress under Pillar 2. Firms are required to stress test individual risks on a standalone basis. In a firm-wide stress test, these individual components are then stressed collectively to assess how the firm would fare in severe adverse conditions.

PS10/14 reassures firms, their boards and auditors that the capital planning buffers set under Pillar 2B are not part of the adequate financial resources, defined by Individual Capital Guidance, that firms must hold at all times. Rather, the capital planning buffer can be used in adverse circumstances outside of the firm's normal and direct control. We clarified this and our overall policy in PS10/14, including making some minor changes to our Handbook.

In respect of our firm-specific stress test, we ensured that firms continued to comply with our interim capital regime for their sector. This includes a firm-specific stress test designed to ensure firms' core tier 1 capital remains above 4%. The high level parameters of this test are published in the PRO.

Additionally, we participated in the EU-wide stress testing exercise designed to give investors a transparent view of the impact of a prenounced scenario. The first of these tests was published in June 2010 and a second one is due to be published in July 2011.

Liquidity – our interim regime

...we also overhauled our liquidity regulations...

Alongside our new interim capital regime, we also overhauled our liquidity regulations. In the past year, we finalised this work which was set out in our October 2009 Policy Statement, PS09/16. This set out:

- new systems and controls requirements;
- individual liquidity adequacy standards (ILAS);
- a process for undertaking quantitative and qualitative assessments of a firm's liquidity risk management;
- new reporting requirements; and
- a standardised liquidity buffer for less complex firms.

During 2010/11, we set 'backstop Individual Liquidity Guidance', for most major banks. For the weakest, supervisory action on a bilateral basis has led to some improvements. Some changes to aspects of business models have taken place.

In setting the path by which by which firms move to compliance, with new requirements, we recognise that all firms, at present, are experiencing a market-wide stress and some name-specific stress.

When we published the policy, we said that we intended to announce by the end of Q1 2010 our programme for making and applying judgements about the ultimate calibration of our quantitative requirements and the appropriate trajectory for achieving it. However, due to the prevailing economic conditions, we deferred that decision and in March 2011 announced that we would now wait until the Basel III liquidity framework was finalised and then revisit our current regime to ensure it aligns with the new standards.

Corporate governance and Significant Influence Functions (SIFs)

The safety and soundness of firms is ultimately the responsibility of firms' own management. Ensuring an effective standard of corporate governance and competency of senior management is thus a core responsibility of a prudential regulator. In 2010/11 we implemented significant further improvements in our oversight regime in respect of these key issues.

Of the 409 SIF interviews conducted during 2010/11, firms chose to withdraw their applications in 25 cases, 21 of which for competence-related reasons. This represents a

1% decrease in withdrawals against the previous year, which in part can be attributed to our more intrusive and competency based interviews. Firms are also recognising the need to submit adequate due diligence, as a result of which the quality and completeness of applications is improving.

The two main strands were:

- improving our corporate governance regime; and
- influencing reviews being conducted in this area, in Europe and internationally.

Improving our regime

...an enhanced, more detailed SIF regime...

In January 2010, we consulted, in CP10/3: *Effective corporate governance (significant influence controlled functions and the Walker review)*, on an enhanced, more detailed SIF regime to ensure individuals holding key positions within firms have the right level of competence and probity to carry out their role.

In September 2010, we published our Policy Statement, PS10/15, summarising the responses we received to CP10/3 and our proposals. We set out the following, which came into effect from 1 May 2011:

- new guidance on risk controls, particularly for FTSE 100 banks and insurers linked to recommendations from the Walker Review;
- clarification of our expectations of non-executive directors (NEDs) and the extent of their liability;
- applying the significant management function to the activity of accepting retail deposits by European Economic Area (EEA) branches;
- new guidance in the Fit and Proper test for Approved Persons (FIT) on having adequate time to perform a controlled function; and
- guidance that a 'compromise agreement' would not override a firm's obligations to disclose information.

Once the necessary systems are ready we shall implement the other changes, including new controlled functions, giving firms two months' notice.

Influencing governance reviews

During 2010/11, we carried out extensive work to influence the international agenda around governance. The Basel Committee on Banking Supervision (BCBS) consulted on revisions to its principles for enhancing corporate governance in March 2010 and we played an active part in this process. These principles were published in final form in October 2010 and were designed to enhance sound corporate governance practices within banking organisations.

At a European level, we responded to the European Commission's green paper on Corporate Governance in Financial Institutions, which was published in June 2010. We will continue to work closely with the government and other interested UK authorities to secure the best outcome we can for the UK, ensuring that we involve representatives from the industry in this process.

...drew attention to the importance of a firm's culture...

Additionally, our CEO, Hector Sants, drew attention to the importance of a firm's culture in developing good regulatory outcomes and the vital role governance plays in this in his speeches on 17 June 2010 to the Chartered Institute of Securities and Investments conference and on 4 October 2010, to the Mansion House Conference on Values and Trust.[10]

Core regulatory transactions

Consistent with our increasingly intensive supervisory approach, we have continued to carry out increased scrutiny of applications for all core regulatory transactions. Concerns around the suitability of applicants and/or the viability of proposed business models has resulted in a slight increase from last year in the number of withdrawals before we make a formal decision.

There was a slight reduction in the number of firms applying for permission in 2010/11, compared to the previous year. However, the number of applications withdrawn has remained at a similar level as reported last year. 261 applications were withdrawn before a formal decision in 2010/11, representing 18% of the cases closed during the year. This compares with 19% of applications withdrawn in 2009/10 and 14% in 2008/09. Three applications were rejected by the FSA for this year. There was an increase in the number of applications completed, with 1,490 cases in 2010/11 compared to 1,173 cases completed in 2009/10.

For variations of permission, there has been a steady decline in applications over the last three years. In previous years, volumes were inflated by a number of applications to reduce regulated activities, apparently to minimise regulatory costs and reporting requirements. Although this levelled off in 2009/10, this trend has continued in 2010/11. Only one variation of permission application was rejected in 2010/11.

This year showed 50% fewer firms seeking to cancel authorisation permissions when compared with 2008/09. This is the lowest number of cancellations received since the start of the financial crisis. It is also interesting to note that there were slightly more cancellations than authorisation applications received during the year resulting in a small reduction in regulated population.

For change in control applications, the two main themes reported previously continued during this year. The trend for applications to be of greater complexity with ongoing concerns being identified about the suitability of prospective controllers has continued since last year's *Annual Report*. The 2010/11 rate of withdrawals of applications received before a formal decision is consistent with the previous two years and only two applications were rejected.

For 2010/11 there was a 7% decrease in the number of individual approval applications received, in comparison to the previous two years. This could be an indicator of a reduction in the movement of individuals between firms as a consequence of the economic situation. This is supported by the fact the number of bulk transfers e.g. where firms merge and require approvals to be transferred, are far lower than in previous years. There were 1,022 applications withdrawn before approval in 2010/11, a decrease from 1,602 in the previous year. This can be linked in part to automation of these applications via the FSA's Online Notification and Authorisations (ONA) system, which prevents firms from submitting incomplete or duplicate applications.

10 www.fsa.gov.uk/pages/Library/Communication/Speeches/2010/0617_hs.shtml and www.fsa.gov.uk/pages/Library/Communication/Speeches/2010/1004_hs.shtml

Under The Payment Service Regulations (PSR) (2009), we are now responsible for the registration[11] and authorisation[12] of payment institutions. The increase in the total number of applications compared with last year is largely due to respective transitional periods expiring. 66 applications were withdrawn before a formal decision and one application was rejected.

The number of applications grouped under collective investment schemes has remained fairly stable over the last three years. The split between new schemes and alterations to existing is approximately 20:80 with EEA Undertakings for Collective Investments in Transferable Securities funds accounting for around 44% of the new schemes approved.

There has been a significant increase in the number of applications received for waivers due to the implementation of the new BIPRU 12 liquidity rules. 13 applications were rejected during 2010/11 and there has been a high volume of applications not progressing to decision stage, with 184 withdrawals. In some cases this has been due to uncertainties relating to the requirements of the specific rules and in others this is due to the more complex nature of applications received and our more intrusive approach to ensuring that the statutory tests are met. There has also been a significant increase in the number of waiver applications completed in 2010/11 when compared to the previous year, with 799 cases completed in 2010/11 and 504 in 2009/10.

Core regulatory transactions	2010/11	2009/10	2008/09
Corporate authorisations	1,313	1,520	1,375
Cancellations	1,577	2,226	2,995
Individual approvals[13]	38,288	41,141	40,997
Variations of permission	1,413	1,809	2,068
Changes of controller	1,887	1,825	1,837
Passporting[14]	2,715	2,632	2,828
Payment Services Directive: Authorisation/ Registration	111/639	97/566	N/A
Collective investment schemes (authorisations)	1,043	1,103	1,027
Waivers	724 (inc. 320 liquidity waivers)	583 (inc. 128 liquidity waivers)	527

Enhancing the contribution of auditors

…they are critical to achieving our objectives…

High-quality corporate reporting, audit and assurance support effective governance and underpin market confidence and market discipline. Together with effective communication between the FSA, regulated firms and their auditors, they are critical to achieving our objectives relating to market confidence, financial stability and consumer protection.

During the last financial year, we published three documents and one memorandum of understanding, all aimed at enhancing the effectiveness of external audit for regulated

11 Registered firms have to meet certain conditions as a payment institution such as the monthly average of the total amount of payment transactions carried out by the firm (including by agents on their behalf) over the preceding 12 months must not exceed €3m. There are lower FSA application and periodic fees when compared to authorised firms.
12 Firms who do not meet the conditions to be 'registered' or who want to take advantage of passport provisions under the PSR will require authorisation to be able to undertake payment services.
13 Excludes individual applications linked to corporate applications (2010/11: 4,412, 2009/10: 4,450; 2008/09: 3,993).
14 In 2009/10, excludes passports linked to PSD Authorisations (60).

firms and strengthening the communications between auditors and the FSA. We are already speaking to auditors on a bilateral basis more frequently than in the past and expect that this will continue to evolve in the coming year.

We are also increasing the number of section 166 skilled person reports as a supervisory tool. In addition, we are committed to making greater use of section 166 to provide greater assurance that regulatory returns submitted to the FSA have been completed in line with the relevant rules.

...designed to stimulate debate...

Our Discussion Paper, DP10/3: *Enhancing the auditor's contribution to prudential regulation*, published jointly with the Financial Reporting Council (FRC) in June 2010, was designed to stimulate debate on how we can best use audit and auditors to meet our statutory objectives. In particular, this paper examined how the FSA, the FRC and auditors can best work together to enhance auditors' contribution to prudential regulation in the future.

The paper:

- questions aspects of the quality of audit work relevant to prudential regulation – in particular, whether the auditor has always been sufficiently sceptical and has paid sufficient attention to indicators of management bias when examining key areas of financial accounting and disclosure which depend critically on management judgement;
- outlines the FSA's concerns about auditors' work on client assets and how auditors fulfil their legal obligation to report to the FSA;
- explores a variety of ways in which changes are being made and further changes could be made by the FSA, the FRC and auditors to increase the effectiveness with which auditors undertake their work; and
- examines the regulatory environment in which auditors operate more widely and suggests measures to enhance how auditors contribute to prudential supervision.

On 10 March, we published FS11/1: *Enhancing the auditor's contribution to prudential regulation: Feedback on DP10/3*. This joint FSA/FRC publication summarised the feedback received to DP10/3 and our responses. It also provided an overview of possible next steps from us and the FRC, including our intention to continue enhancing our interaction with external auditors, making use of the guidance and frameworks we have developed (such as those related to section 166 and the auditor code of practice described below) and the need for close monitoring of our success in these efforts.

Also in this area, following joint work with the Bank of England, in May 2011, we published a finalised code of practice designed to enhance the dialogue between auditors and supervisors. The code of practice establishes a framework for auditors and supervisors to work together in an open and collaborative way. This increased coordination will enhance the FSA's regulatory processes. Equally, auditors are expected to gain valuable insights from their dialogue with the FSA when gathering evidence to support their audit opinions.

Principles are set out in the code for auditors and supervisors to follow when they deal with regulated firms. These cover the nature of the relationship between the supervisor of a regulated firm and the firm's external auditor, how often and in what form they should be communicating with each other and the way that information should be shared between them.

For certain firms, the code specifies a minimum level of formal meetings between the supervisor, the external auditor and the firm. It also encourages discussions through informal channels to help both supervisors and auditors fulfil their responsibilities towards regulated firms and enhance the effectiveness of the supervisory and audit process.

On 17 January 2011, we signed a memorandum of understanding (MoU) with the FRC to enable a greater degree of cooperation and information exchange between us on audit issues and thus enable both the FSA and the FRC to improve the oversight of the audits of authorised firms. The formalised information-sharing arrangements between the FSA and the FRC should assist in our enforcement activities.

As well as additional and enhanced bilateral meetings between auditors and FSA supervisors, trilateral meetings, involving the firm's audit committee, will be a key initiative that we will implement and monitor.

We will actively monitor the success of our increased engagement with auditors and audit committees and use of section 166 reporting (see also Section 3, page 55).

Success in our efforts to enhance the role of auditors in prudential regulation will enhance the quality of debate and interaction between a firm's supervisors and its auditors to achieve more effective supervision. This will improve the quality of audit work undertaken by auditors on areas of key importance to us, including financial instrument valuations, financial statement disclosures and client assets.

Remuneration

...ensure that they do not provide incentives for excessive risk taking.

In our *Annual Report* last year, we described the introduction of our Remuneration Code (the code) for the largest banks and broker dealers, with effect from January 2010. Our aim was to ensure that the remuneration policies and practices of firms are aligned with effective risk management, and to ensure that they do not provide incentives for excessive risk taking.

We emphasised, in taking this initiative, that it is not our job to determine or regulate the amount of remuneration paid to individual employees. Levels of individual pay are primarily for the shareholders of a company to determine or, ultimately, by society as a whole via the democratic process. However, the rules of the code required a bonus pool to be significantly reduced in the event of poor financial performance: and the rules also required a firm to ensure that its bonus payouts do not limit its ability to strengthen its capital base, taking into account the results of forward-looking capital planning.

We revised our code during 2010, with the changes coming into effect from January 2011. This was to reflect the amendments to the EU's Capital Requirements Directive (CRD3): which included provisions on remuneration. These were finally agreed in July 2010, and we published a Consultation Paper that month.

CRD3 aims to align remuneration principles across the EU and, with this in mind, guidelines on how to implement the remuneration provisions were discussed in a working group of the Committee of European Banking Supervisors (CEBS – now called the European Banking Authority (EBA)). These were agreed and published in December. We published our Policy Statement with the final rules (PS10/20) immediately after the CEBS guidelines.

...the revised code covers some 2,700 firms...

The revised code continues to have as its core requirement that firms should have in place policies and practices that are consistent with – and promote – effective risk management, and most of the Principles are unchanged. However, there was a significant change to the scope of the code. Our earlier code covered around 26 of the largest banks and broker dealers, but in line with CRD3, the revised code covers some 2,700 firms, including all banks, building societies and Capital Adequacy Directive (CAD) investment firms. The latter group includes investment banks, most asset management firms and many other brokers and dealers.

The CRD3 amendments also required us to make changes to the rules on remuneration structures. There is now a requirement for senior employees and material risk takers ('Code Staff') to receive 50% of their variable remuneration in the form of shares, share-linked instruments or other defined capital instruments. The 50% requirement must apply equally to the amount paid upfront and to amounts subject to deferral, and all such amounts must be subject to an appropriate retention policy. These rules are more prescriptive than those in other major financial centres outside the EU.

Given the range of firms within scope, we have implemented the revised code using a proportionate approach which ensures that its application is consistent with the nature, scale and complexity of firms' business activities. Firms have been placed into a four-tier structure, and some of the Principles of the code – for example, the rules on variable remuneration described above – can be disapplied by firms in the lower tiers.

Within the FSA, we aim to ensure that the implementation of the revised code to this enlarged group of firms is fully embedded into our existing supervisory framework, including ARROW, our risk-based assessment framework, and thematic reviews.

Differences remain in remuneration practices in the major financial centres, and in the approaches taken to them by supervisory authorities. CRD3 has aligned remuneration principles across the EU, but hardened the distinction between the EU and other major jurisdictions regarding the implementation of the Financial Stability Board (FSB) Principles and Standards on remuneration. A number of major G20 countries have implemented these Principles and Standards on the basis of guidance rather than enforceable rules. This is causing difficulties for EU banks competing to recruit and retain staff in non-EU markets.

We continue to monitor development in overseas markets closely, and consider ways in which we can mitigate adverse competitive implications for firms within the limitations imposed by CRD3.

Recovery and resolution plans

The Financial Services Act 2010 (see Section 1) required us to make rules requiring certain firms to prepare recovery and resolution plans.

In addition, the recent financial crisis highlighted the need for:

- firms to be better prepared to deal with, and ideally have plans in place to recover from, situations of severe stress; and
- firms to supply the regulatory authorities with detailed information on their businesses, organisations and structures.

Recovery plans are designed to set out the actions the firm would consider taking to restore its financial health and avoid triggering the Special Resolution Regime (SRR) conditions in the Banking Act 2009, i.e. a breach or potential breach of threshold conditions.

A **resolution plan** is invoked if a bank fails to meet threshold conditions – an SRR is triggered and the authorities put into place their resolution strategy for the firm.

...we are committed to working towards effective cross-border resolution arrangements...

Our rules will require banks and other major financial firms to have plans in place to demonstrate what they would do to deal with a major stress. If they cannot recover, the plan will show how the authorities could deal with the firm.

The wider implementation of these plans, which will follow work on a set of sample firms, will identify whether the impact of a failure can be managed and what action needs to be taken if it cannot. This is consistent with the work undertaken by the FSB and we are committed to working towards effective cross-border resolution arrangements with other authorities through cross-border crisis management groups. We expect to publish our first consultation in 2011.

Hedge funds

While hedge funds did not play a major role in the crisis, they have the potential to pose systemic risks if they are individually very large or have similar leveraged positions. So through our twice-yearly hedge fund survey, we seek to monitor the risks to financial stability emanating from the hedge fund sector.

In 2010/11, we published the results of two surveys with analysis of potential systemic risks. We also improved the surveys to collect better information and we gave that information to our supervisors of alternative asset management firms and some banks, to help in their reviews.

We carried out our latest survey in March 2011 and passed the analysed results to our senior management and supervisors in late May.

Our hedge fund survey is one of the key tools we have to gather information required to analyse risks from this sector and is highly respected by other regulators. Analysing risks to financial stability from all sources, including from outside the boundary of prudential regulation, is a core requirement of which hedge funds are an important component.

Looking ahead, we are planning further improvements to future surveys. In particular we will look to harmonise the FSA survey with proposed surveys by the US Securities and Exchange Commission (SEC), under the Dodd-Frank Act and the International Organization of Securities Commissions (IOSCO) wherever possible. This is so that a global comparison of results is easier and the burden on industry in completing multiple surveys is reduced. We hope this will improve both timeliness and accuracy.

Our work here has taken into account the principles of good regulation by focusing on the type of data collected, clear definitions, and proportionate coverage.

Progress on reforming the international and European regulatory framework

In December 2010, the Basel Committee of Banking Supervision (BCBS) agreed on the details of the Basel III framework, which includes global regulatory standards on capital adequacy and liquidity for banks.

...an ambitious agenda of change...

During 2010/11 we were engaged in BCBS's work. Throughout the year, we played an active part in shaping the direction of banking regulatory reform. We supported the delivery of an ambitious agenda of change to the regulatory framework, both domestically and internationally, and we maintained the momentum on international reform, carrying forward work from global bodies and through European Directives.

In particular, we worked on the following initiatives:

- specific measures to strengthen the resilience of firms;
- systemically important firms – the scope of regulation and cross-border issues; and
- recovery arrangements.

International policy framework for systemically important financial institutions

During 2010/11 we contributed to the work of the Financial Stability Board (FSB) and BCBS to develop recommendations to the G20 regarding how to reduce the moral hazard posed by globally systemically important banks (SIBs). These recommendations include:

- improving the authorities' ability to resolve such institutions in an orderly manner, without exposing taxpayers to loss;
- requiring that such institutions should have greater loss absorbency capacity than required under the Basel III framework to reflect the greater risks posed by their distress or failure; and
- subjecting these institutions to more intensive coordinated supervision and resolution planning to reduce the probability and impact of their failure.

Following the acceptance of these recommendations by the G20 in November we have worked with the FSB and BCBS to develop the policy framework for SIB. This work has yet to be completed, but we would hope it will be concluded over the next 12 months. On a longer time frame, the FSB is considering how to address other potentially systemically important financial institutions, including work with the International Association of Insurance Supervisors (IAIS) on insurance companies.

Greater loss absorbency capacity

We worked with the FSB and BCBS to agree a methodology for determining the banks that are systemically important at global level to which the FSB recommendations will initially apply. The next stage is to agree the amount of additional loss absorbency that these banks should hold and the extent to which other instruments, such as going concern contingent capital, can be used alongside common equity. A public consultation is planned for the middle of the year, before the finalised recommendations go to G20 leaders in November.

Improving resolvability

The FSA has contributed to the FSB work programme towards ensuring all systemically important financial institutions can be resolved safely, quickly and without destabilising the financial system. We have participated in the steering group responsible for delivering this work, and also a number of the supporting technical workstreams. The FSB will discuss the set of draft proposals in July.

At a firm-specific level, we have progressed our international recovery and resolution planning work (see page 34) in the context of the FSB's initiative on Crisis Management Groups (CMGs). We have held further CMG meetings with overseas authorities in relation to the UK banks with significant global activities. This has enabled us to take account of how overseas resolution and insolvency laws and other international developments would affect the resolution of UK banking groups and also work with other regulators in CMGs for non-UK firms.

Improving supervision of cross-border firms

During 2010/11, we have played a key role internationally in shaping and delivering initiatives to improve the supervision of cross-border firms. In particular, we have focused on how to ensure that the different national supervisors of cross-border firms work together effectively through supervisory 'colleges' to share information, exchange views on the risks facing the group and how well they are being managed, undertake joint supervisory work where appropriate, and to ensure that plans are developed for how to work together in times of crisis.

Running and participating in these colleges has helped improve the supervision of these firms...

For example, in terms of developing an effective supervisory framework for cross-border firms, the FSA chaired a Basel Task Force on colleges that produced *Good Practice Principles on Supervisory Colleges* in October 2010 and contributed towards the development of European guidelines on the operation of banking colleges. The FSA has now established supervisory colleges for the major UK firms that are active internationally and participates in colleges for dozens of firms for whom we are a host supervisor. Running and participating in these colleges has helped improve the supervision of these firms, and enabled us to work much more closely with foreign supervisors in understanding and assessing these firms' risks including, for example, through more joint visits to firms with other supervisors. From January 2011, we have also been implementing the new European requirement to seek to agree a joint risk and capital adequacy assessment among all the European supervisors of each European bank that operates across Europe and this will help provide valuable insights and input into the supervision of these banks.

Specific measures to strengthen the resilience of firms

As we said above, higher capital and liquidity standards across the global banking system are essential. Before the crisis, the system was running with inadequate buffers of capital and liquidity to absorb shocks – and, as a result, acted as a shock amplifier rather than a shock absorber. Capital against trading books was particularly deficient: the accumulation of large, illiquid, trading portfolios, often with material exposure to complex credit securities, was not backed by sufficient capital.

In 2010/11, the key areas of our work included the following:

Capital adequacy

Reverse stress-testing

In 2008, we proposed the introduction of a 'reverse-stress testing' requirement, which would apply to banks, building societies, CRD investment firms and insurers, and would require firms to consider the scenarios most likely to cause their business model to become unviable.

This year we implemented the requirement for all banks and building societies and eligible insurers (14 December 2010) and the requirement came into force for eligible BIPRU investment firms on 28 March 2011. The requirement is to be undertaken on a proportionate basis by firms according to their size, nature and complexity.

The primary purpose of this requirement is to serve as a risk-management tool…

The primary purpose of this requirement is to serve as a risk-management tool to improve firms' risk management and business planning, including improving focus on contingency planning.

We will now start to assess the efficacy of firms' reverse stress-testing exercises as part of our normal supervisory cycle over the next year or so. In light of this and other lessons learned, we shall review the submissions and feed back our observations and expectations to the industry.

As a result of this work, we expect firms to be more resilient in light of adverse circumstances that would have originally caused their business model to fail via the strengthening of existing management actions and development of new ones.

Capital buffers (counter-cyclical tools)

BCBS's publication of new standards on banks' capital adequacy included introducing a capital conservation buffer to ensure that banks build up capital buffers outside periods of stress, which can be drawn down as losses are incurred. This buffer will be increased counter-cyclically where banks have exposures in countries where the authorities judge that excessive credit growth is giving rise to system-wide risks.

The conservation buffer will be an additional 2.5% of risk weighed assets (RWAs), held in Common Equity Tier 1 (CET1) above the regulatory minimum requirement with constraints on a bank's ability to make distributions if it falls into the buffer range.

The additional countercyclical buffer will be an additional amount of CET1 between zero and 2.5% of RWAs to be determined by the relevant national authorities depending on how they judge the extent of the build up of system-wide risk.

We actively participated in the international negotiations at both the level of the BCBS and the FSB. The new rules come into force on a phased basis from 1 January 2013.

The capital conservation buffer will be phased in between 1 January 2016 and the end of 2018, becoming fully effective on 1 January 2019. It will begin at 0.625% of RWAs on 1 January 2016 and increase each subsequent year by an additional 0.625% to reach its final level of 2.5% of RWAs on 1 January 2019.

The countercyclical buffer regime will be introduced in parallel with the capital conservation buffer, between 1 January 2016 and year end 2018, becoming fully effective on 1 January 2019. This means that the maximum countercyclical buffer requirement will begin at 0.625% of RWAs on 1 January 2016 and increase each subsequent year by an additional 0.625%, to reach its final maximum of 2.5% of RWAs on 1 January 2019.

The main next step is for the Basel agreement to be fully implemented into European law and the FSA Handbook. This will take place during 2011 and 2012.

Leverage ratios

The BCBS has agreed that a leverage ratio should be implemented for banks to mitigate the build-up of excessive on and off-balance-sheet leverage and avoid its potentially destabilising effects.

When Basel published its new standards on banks' capital adequacy, this included the introduction of a leverage ratio to constrain the build-up of leverage in the banking sector, helping avoid destabilising deleveraging processes, which can damage the broader financial system and the economy and reinforce the risk-based requirements with a simple, non-risk based 'backstop' measure.

Basel will undertake further work from 2011 onwards to monitor and evaluate the impact of the leverage ratio. This will be followed by a parallel run period and disclosure by firms, before migration to Pillar 1 from 1 January 2018.

Pension risk

Our basic philosophy towards pension obligation risk capital (P2PRC) is that it exists to enable a firm to meet its pension obligations throughout a period of stress and beyond order to support the continued viability of financial institutions. We do not have a remit to protect members of defined benefit pension plans against the failure of those plans.

Last year we made our approach to Pillar 2 pension obligation risk capital assessments clearer. The consultation period ended on 15 March 2011, and we are now finalising the guidance, having considered the comments we received. After clarifying our current approach, we plan to review it in the medium term.

Trading book amendments

…these changes will increase the pillar one capital held against trading activities…

In July 2009, the BCBS agreed a range of amendments to the Basel II market risk framework, targeting specific weaknesses highlighted by the financial crisis. On average, in large banks, these changes will increase the pillar one capital held against trading activities by between two and three times current levels.

In *The Turner Review* we expressed our view that these reforms needed to be complemented by a fundamental review of the prudential regime that makes a full reappraisal of the prudential requirements for trading activities. This fundamental review is now being conducted by the BCBS and we are actively involved in that process.

The increasing level and complexity of trading among banks and investment firms – and the significant losses suffered on those activities during the financial crisis – mean it is vital for us to review the prudential regime for these activities to ensure that, in future, the level of capital is appropriate, given the risk taken by firms' trading operations. Opportunities for regulatory arbitrage, which can undermine regulatory objectives, also need to be addressed to contribute to a more robust regime.

In August we published a Discussion Paper (DP): DP10/4 *The Prudential regime for trading activities – a fundamental review*, to stimulate debate. The feedback we received is being fed into the international discussions on the fundamental review at the BCBS through our involvement in that forum. We plan to issue a Feedback Statement on the DP in the summer of 2011.

Asset encumbrance

In *The Turner Review* we set out our concerns on shortcomings in the current capital framework in banking, e.g. that the current Pillar 1 capital requirements do not capture the risks of asset encumbrance due to secured funding, and such risks are only partially mitigated by our Pillar 2 policies.

We are carrying out ongoing internal work to develop policy in this area and we are also preparing a survey of a sample of UK firms to collect more comprehensive data on the extent and sources of asset encumbrance, to improve our understanding of the issues and contribute to policy development.

Liquidity – long-term regime

...we will revisit our current regime to ensure it aligns with new standards...

As we say above, the Basel Committee has moved further towards introducing minimum global liquidity requirements that would be implemented through EU law. However, how this will happen is still not clear. So we will revisit our current regime to ensure it aligns with new standards when this happens.

Solvency II

As we said in our *Business Plan* for 2010/11, Solvency II is a fundamental change of the prudential regime for the European insurance industry. It aims to establish a revised set of EU-wide risk management standards and capital requirements that will replace and harmonise the current arrangements.

Policy in this area continues to be developed in Europe. There have been delays to the timeline that have affected our own consultation and shortened the window for implementation. As a result, we are looking for ways to manage this uncertainty.

At the same time, we have continued to contribute to the development of the Directive, such as through our involvement in the work of European Insurance and Occupational Pensions Authority (EIOPA). We continue to lead some of the working groups, and Hector Sants was appointed to the EIOPA Management Board in January 2011.

Our work with the UK industry

We have maintained close contact with the UK insurance industry on both policy and implementation issues. We continued in 2010 to engage with firms to understand how the developing requirements affect them and inform our contributions to EIOPA. We also had ongoing discussions with firms about how prepared they are for the new regime.

The fifth quantitative impact study (QIS5) helped us increase our dialogue with firms on both fronts. We gave briefings and ran workshops to educate firms about the importance of taking part in QIS5. We encouraged firms of all sizes and types to participate in the exercise to provide a robust evidence base to inform the ongoing development of the Solvency II landscape. During the exercise, we answered over 600 queries, and the UK report to EIOPA was compiled with submissions from 267 solo firms and 35 groups, representing over 70% of the market. We also had discussions with firms about the practical implications for them and we will continue to do so in the run up to implementation.

We have continued to make progress with the internal model approval process (IMAP). We published an update in April 2010 setting out the pre-application process for firms, and the findings of the thematic review in February 2011. At the end of March 2011, started the next phase of IMAP as we endeavour to give as many firms as possible a decision on their model for day one. We further detailed our approach at our Solvency II Conference in April 2011 – more information about this is available on the dedicated Solvency II pages of the FSA website.[15]

As stated above, we had started to prepare our consultations; however, the publication of the Omnibus II proposals to amend the Solvency II Directive to bring it in line with the new European regulatory structure and allow for transitional provisions has meant that our consultation timetable has been affected. Our consultation process will relate to the transposition of the level 1 text of the Directive and consequential changes to the Handbook. We expect to publish the first Consultation Paper later this year. We will review the European policy timelines regularly, and publish our own consultation timeline on our website in due course.

To deliver Solvency II we have increased our resources significantly...

Internally, we developed and delivered technical training for supervisors and other specialists working on Solvency II. At the end of March, we had trained over 450 people. To deliver Solvency II we have increased our resources significantly, with recruitment ongoing to provide the skills and processes to support and deliver the implementation of the Directive.

Most recently, we shared our current thinking on the policy issues and implementation approach, with approximately 550 people from the UK insurance industry at our Solvency II Conference on 18 April 2011.

- We outlined our two-tier approach to the way we would allocate resources to firms in the pre-application phase of IMAP.
- We discussed the main policy uncertainties, which we also set out in the accompanying conference document *Delivering Solvency II*, April 2011.[16]
- We outlined the key dates, including our assumptions that full implementation will be on 1 January 2013, and that we would be open to receive applications on the provisions of the Directive that require our approval.

15 see www.fsa.gov.uk/Solvency2
16 see www.fsa.gov.uk/pubs/international/conference_document_solvency.pdf

- We underlined the importance of the UK industry's continued involvement in developing the approach to implementation in Europe and the UK. We will do this through a number of different fora, including the existing Insurance Standing Group and its sub-groups, which has over 100 people registered to receive information. We will also create new ones as needed.

We published an overall update on Solvency II in June 2010 on all pillars of the Directive to inform and motivate firms to take action as needed. We have tailored our information for smaller insurers through our events and our website, including things for firms to consider when creating their implementation plans. We also gave briefings to market analysts and ratings agencies (February 2011), and to non-executive directors of insurance and reinsurance firms (January and April 2011) as part of our educational programme.

2011/12 is critical in our preparations for implementing Solvency II, in Europe and the UK. We are confident that our implementation approach will help us deliver our Solvency II programme and carry out our obligations fully.

Operational risk

An important part of our prudential regime is to require particular firms to put in place a robust operational risk-management framework, and to hold appropriate levels of capital against this risk.

In January 2011, we issued a guidance note, *Enhancing Frameworks*, that examined, reviewed and assessed the implementation of the standardised approach for operational risk, and set out the elements in operational risk management frameworks that could be improved on.

In particular, it is important that firms focus on improving the qualitative aspects of their operational risk management frameworks, seeking to reach the standard for risk management as set out in The Standard Approach (TSA). We will be expanding the guidance to cover areas like firms' policies and documentation.

In addition, we worked on other initiatives to further focus on appropriate management of operational risk, including:

- the Basel Committee paper, *Recognising the risk-mitigating impact of insurance in operational risk modelling*, published in October 2010;
- several lectures on operational risk appetite; and
- the CEBS work leading to the finalisation of CP35, *Guidelines on the management of operational risk in market related activities*, June 2010.

Looking forward, we will contribute to the BCBS review on assessing the adequacy of current operational risk capital requirements.

Additionally, although they are not subject to the same prudential regime as banks, many of the enhancements to operational risk practices will be required ahead of insurance firms' implementation of Solvency II (see above).

Building societies

Last year our *Financial Risk Outlook* highlighted the challenging economic conditions for building societies. We said we would continue to work with individual societies to ensure their risk-management systems and their capabilities were appropriate for their chosen risk model.

Our recent experience has shown that some building societies diversified without having the necessary skills and systems to manage the risks they were undertaking. So, in March 2010 we published PS10/5: *A specialist sourcebook for building societies: enhanced supervisory guidance on financial credit and risk management*. This was designed to ensure that building societies that chose to diversify from traditional lending and treasury activities have appropriate management expertise, risk management and systems in place. The guidance sets out clearly the skills, systems and controls a building society needs to manage more complex business models.

In essence, building societies were required to re-examine their risk management and business models in the areas of treasury and lending to identify any possible mismatches and agree with us what actions, if any, were needed to address these. Societies that demonstrate appropriate risk management and skills have the flexibility to run their business within the statutory limits set out in the Building Societies Act 1986. Those that cannot will be steered towards to either introducing more appropriate risk management or to moving to a simpler business model so that they only carry out activities they can safely undertake.

This guidance will help reduce the probability of a building society carrying out treasury or lending activities where the risks are not appropriately controlled and managed and therefore reduce the risk of a building society failure – this will have a positive outcome for both consumer protection and financial stability.

The guidance does not limit a building society's freedom to diversify but the more risky the diversification the higher the levels of required management skills and controls expected from the society.

Credit unions

In 2009, in CP09/27: *A Review of the Credit Union sourcebook*, we consulted on proposals to strengthen prudential standards for credit unions, focusing particularly on capital, liquidity and financial reporting. In line with our financial stability and market confidence objectives, the aim was to improve credit unions' financial soundness and help mitigate the risk of firm failures. We provided feedback on the responses to this consultation in PS10/11: *A Review of the Credit Union sourcebook (CRED)*, published in July 2010. This included 'near final rules', set out in a new, more user-friendly, Credit Union sourcebook (CREDS).

CREDS also contains provisions that are dependent on reforms to the legislative framework for credit unions, which the government plans to introduce through a Legislative Reform Order (LRO). CREDS is designed to complement the LRO changes, and will come into effect at the same time as the LRO. We now expect this to occur later this year, subject to Parliamentary approval.

We have also, during the year, consulted informally on: drafts of a new regulatory guide for credit unions (CURG), explaining key aspects of the LRO; and a direction that specifies conditions to be satisfied by a credit union that issues interest-bearing shares – one of the reforms to be introduced by the LRO. We have also revised our application forms to reflect the LRO changes. These measures will be finalised and take effect at the same time as the LRO.

In our *Business Plan* for 2010/11, we said we would work closely with the Treasury, the Northern Ireland (NI) Executive and the NI credit union sector to facilitate the transfer of the 180 Northern Ireland credit unions to our remit. We continue to do so and we estimate that the date of transfer will now be early 2012.

Impact studies

As we said in our *Business Plan* for 2010/11, one of our challenges last year was to ensure that the proposals and timings of the implementation of the Basel banking reforms were carefully determined and phased over the right period. Members of the BCBS committed to carrying out a Quantitative Impact Study (QIS) on the proposed changes.

During the year, we continued developing the macroeconomic model and contributed to the Basel Committee macroeconomic group (MAG) and long-term economic impact (LEI) working groups on calculating the macroeconomic impacts of higher capital standards.

We developed estimates for the tripartite authorities of the macroeconomic impact of all significant policy measures and we hope to publish a paper in 2011 on this.

In the Basel Committee's MAG, our original research was used in the analysis and contributed to the conclusion that faster implementation of higher capital standards would increase the costs to the economy.

In the Basel Committee's LEI group, we contributed to the estimates of the benefits of higher capital standards by introducing our crisis model.

Both of these inputs helped to ensure that the Basel III outcomes took proper account of the full range of impacts on the UK economy.

This work helped achieve two objectives:

- market confidence, by demonstrating that the calibration of the Basel III package is likely to generate net benefits and not net costs overall; and
- financial stability, by undertaking research that shows that higher prudential standards contribute to lowering the likelihood that financial crises will occur in future.

UK systemic testing – market-wide exercise (MWE)

The UK financial authorities are committed to promoting and running cross-sector business continuity exercises designed to test and improve the resilience of the sector. One of the most significant of these is the market-wide exercise (MWE) programme, which is organised by the authorities and led by the FSA. The exercise is held every two years.

Following the last MWE in 2009, the authorities conducted a series of meetings with sector representatives – including retail and investment banks, insurers, infrastructure providers and trade bodies – to take their views on the future of the programme.

Those meetings confirmed the sector's view that the MWE programme continues to play a vital role in promoting resilience across the financial sector and that the authorities' leadership remains fundamental to achieving successful delivery and senior management buy-in.

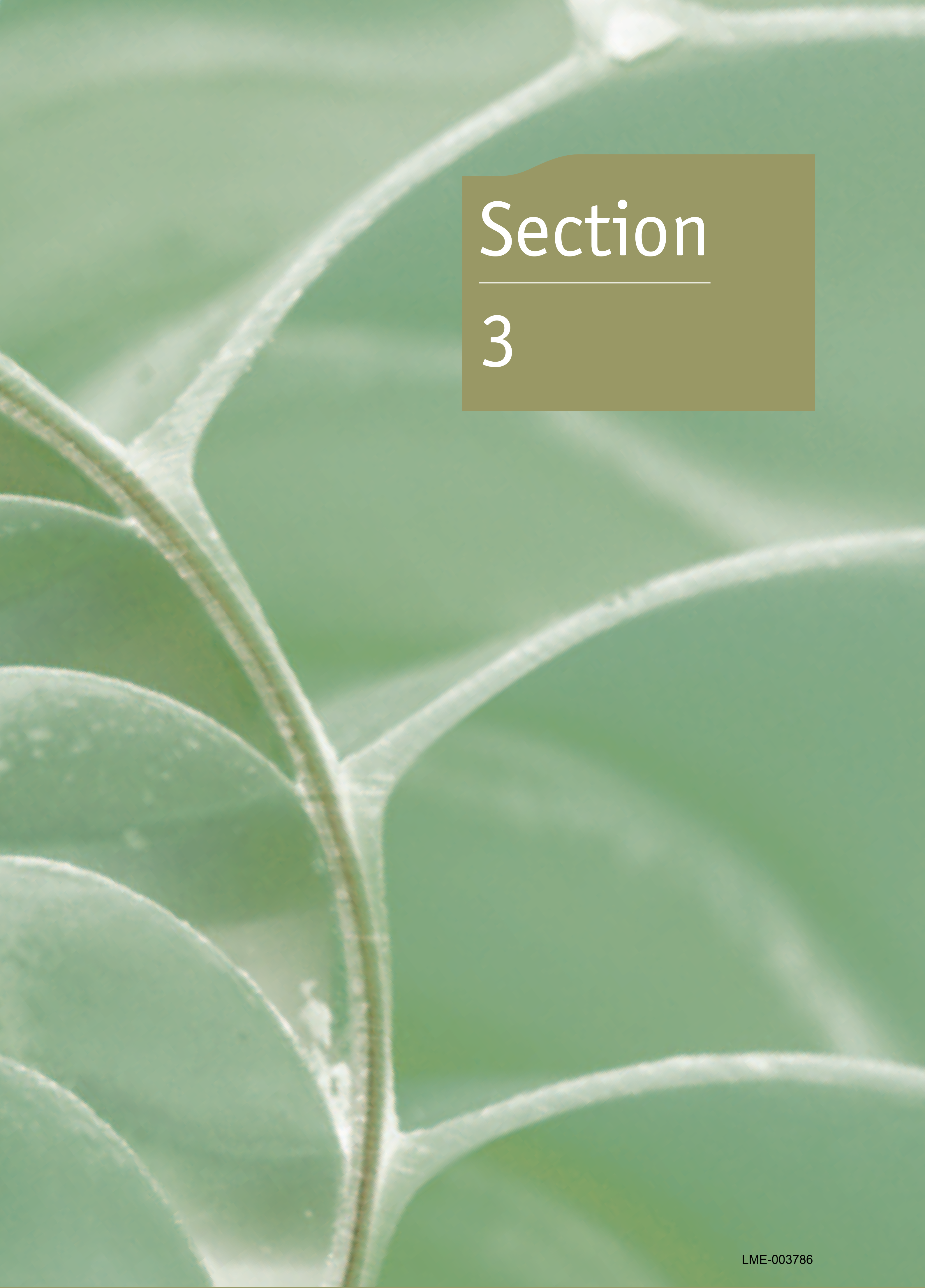
As a result, the MWE will continue to be held every other year (preparations have begun for the sixth exercise in November 2011) but efforts will be made to constrain the resource requirement to make room for other initiatives. For example, the authorities will seek to promote and support more industry-led exercise initiatives, such as the Payments Council Exercise in November 2010, in which the authorities took part. As resources allow, the authorities will organise desk-top discussions in response to specific industry risks or issues. For example, we facilitated a desktop discussion was facilitated in September 2010, involving a high-level walkthrough of some 'cyber scenarios' with a few sector representatives. The output from this discussion led to a more detailed cyber desktop exercise for the financial sector, which was organised in conjunction with sector representatives in March 2011.

Reviewing Financial Services Compensation Scheme (FSCS) funding

We remain committed to this and to delivering a fair and proportionate funding model

In our *Business Plan* for 2010/11 we said we intended to publish a CP in Q4 2010 on our proposals to review how the FSCS is funded. We remain committed to this and to delivering a fair and proportionate funding model. However, the government is consulting on the future structure of the FSCS and changes to the depositor protection regime, as part of its reform of the UK's financial regulatory framework. In addition, the European Commission is reviewing pan-European proposals on guarantee scheme reforms, including the possibility of introducing mandatory pre-funding for the deposits, investment and insurance sectors and risk-based levies for deposit takers and insurers.

In light of these initiatives, we have decided to postpone our review. However, we still believe we should conduct a review of the model when we know what the future structure of the FSCS will be.



Section

3

Delivering market confidence

Introduction

The regulatory landscape for financial markets is undergoing a period of significant change. Various factors, particularly in Europe, are posing new challenges to markets regulators – some generated by the ongoing dynamics of the markets themselves, such as new technology and new market participants, some from the continuous improvements being made to the regulatory framework, and some from the need to deal with deficiencies highlighted by the financial crisis. It is also clear that these challenges cannot be addressed at the national level, but need an international response.

Despite this change in context, our overriding objective in regulating and supervising financial markets during 2010/11 – derived from the Financial Services and Markets Act's (FSMA) statutory obligations – remained to ensure that UK markets are efficient, orderly, fair, internationally attractive and sustainable.

As the markets regime is refashioned, we will continue to pursue the appropriate regulatory standards and resist regulatory arbitrage. It is important to maintain market confidence. However, our markets-related work also significantly contributes to our objectives of financial stability, consumer protection and reducing financial crime.

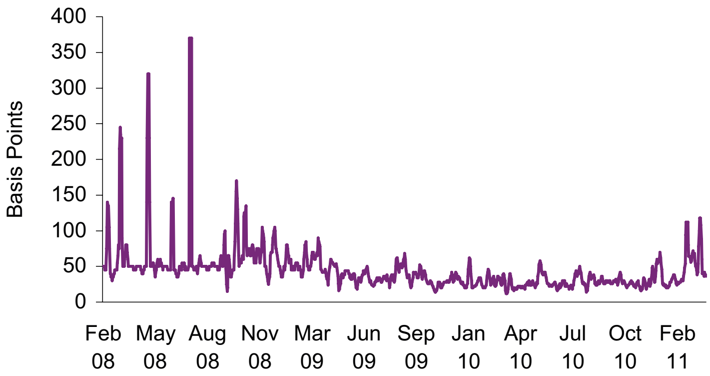
In this context, during 2010/11 our market-confidence work focused on:

- continuing to set standards that firms, issuers and other market participants must follow;
- challenging firms and market infrastructures to be well governed, financially sound and to manage their risks effectively;
- monitoring compliance with those standards and taking action where we find shortcomings;
- maintaining our commitment to being an international leader in financial regulation; and
- market regulation at an EU level.

We outline some of the ways we assess the quality of UK markets in:

- Measures of market confidence using market indicators (see page 62 and 63)
- Chart 6: FTSE 100 time-weighted spreads
- Chart 7: FTSE volatility measures

Chart 6: FTSE 100 time-weighted spreads (Bps)

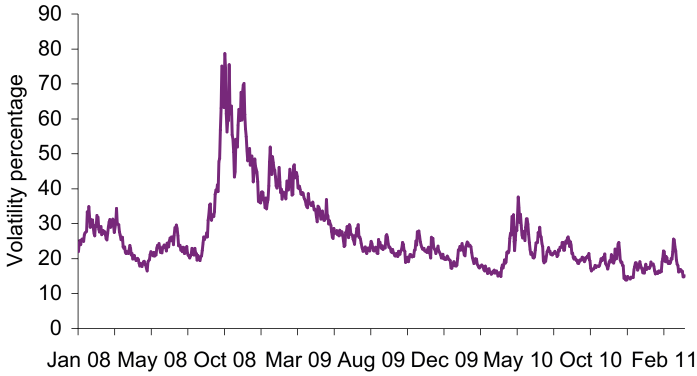


Source: LSE

iShares FTSE 100 is an exchange traded fund (ETF) that aims to track the performance of the FTSE 100 Index as closely as possible.

The spread is determined by the difference in the buy and sell price. Generally, the smaller the bid-ask spread, the better as it indicates that the FTSE 100 is more liquid and pricing is more efficient. As a rule, when ETF's see little trading activity, bid-ask spreads become wider. We can see that market conditions have had a large impact on the bid ask spread throughout Q4 2010/11 where there are large variations between the bid ask price.

Chart 7: Volatility index of the FTSE



Source: Bloomberg

VFTSE measures the market's expectation of 30-day share volatility through options prices. The higher the figure, the more volatile the stocks included in the FTSE 100. This measure of dispersion indicates the risk levels of FTSE 100 shares.

A VFTSE below 20% has historically been associated with periods of market stability. The VFTSE as at end March stood at 16.42. Although the VFTSE was impacted by adverse market events throughout Q4 2010/11, the VFTSE is now at a moderate level in comparison to recent trends.

Efficiency and fair operation of markets

As we said in our *Business Plan* for 2010/11, we remain strongly committed to promoting more outcomes-focused and risk-based approaches in developing international financial regulation. Throughout the year we were heavily engaged in domestic, EU and global forums to deliver regulatory change to improve the efficiency and fair operation of markets. This work is outlined here.

Short selling

In July 2010, we implemented new powers granted to the FSA by the Financial Services Act 2010. These powers enable us to:

- require the disclosure of significant net short positions as previously contained in the Code of Market Conduct (MAR) (the relevant parts of MAR were replaced by rules and guidance in the new FINMAR module of the Handbook);
- take appropriate action in relation to short selling in emergencies; and
- impose financial penalties on or publicly censure those who breach short-selling rules.

During 2010, therefore, we put our regime for disclosure of short selling and emergency rule-making on a firmer statutory footing. This contributed to our objective of reducing the potential for abusive behaviour and disorderly markets.

We coordinated the Committee of European Securities Regulators (CESR[17]) taskforce on short selling, whose output included the short-selling report of 26 May 2010, *Technical details of pan-European short selling disclosure regime*. This served as advice to the European Commission, which published its proposals for a new short-selling regime in September 2010 and we have continued to work alongside the Treasury in negotiations in the European Parliament and in the Council.

Over-the-counter (OTC) derivative markets

one of our key priorities in Europe has been the reform of the OTC derivatives market

Following the financial crisis, one of our key priorities in Europe has been the reform of the OTC derivatives market, with the aim of reducing systemic risk.

This is in line with the G20 commitment of September 2009 that: 'all standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements. We ask the FSB and its relevant members to assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse.'

In September 2010, the European Commission published its final proposal for a regulation (widely known as European Market Infrastructure Regulation (EMIR)) which sets out to increase stability within OTC derivative markets. It is aimed at establishing a regime across the EU for central counterparty clearing houses and trade repositories, and stronger risk management of non-centrally cleared trades. At the same time, the US authorities agreed similar proposals as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act. We worked intensively alongside the UK Treasury in the subsequent negotiation of EMIR.

This was followed by an EC consultation on its review of the Markets in Financial Instruments Directive (MiFID), which aims to implement the G20 commitment for trading standardised OTC derivatives on exchanges or electronic trading platforms 'where appropriate'.

We worked in CESR to provide technical advice in October 2010 to the EC as part of its review of MiFID, including on the standardisation and organised platform trading of OTC derivatives.

In addition, in the context of the Committee on Payment and Settlement Systems and International Organisation of Securities Commissions (CPSS-IOSCO work on Financial Market Infrastructures) we contributed to the March 2011 consultation on CPSS-IOSCO *Principles for Financial Market Infrastructures (FMIs)*. This sets out enhanced regulatory standards for central counterparties (CCPs), central securities depositories (CSDs), systemically important payment systems and trade repositories.

We also played a leading role in the global OTC Derivatives Regulators Forum (ODRF), which we currently chair. The ODRF seeks to enhance information cooperation between global regulatory authorities. This includes fostering the development of

17 CESR was replaced by the European Securities and Markets Authority (ESMA) in January 2011.

cooperative frameworks for information sharing and cooperation among relevant authorities concerning individual OTC derivatives market infrastructures.

Last year, therefore, we were – and remain – at the forefront of reform in this area. And we will continue to drive reform across the areas identified, consistent with the goals of:

- reducing systemic counterparty risk;
- ensuring greater transparency of OTC markets for regulators and the public;
- implementing strong and globally harmonised standards for clearing houses;
- effective risk management for non-centrally cleared trades; and
- proportionate implementation of reform to cater for the needs of the broad range of OTC derivative market participants.

We will continue to work on this in the Financial Stability Board (FSB), the International Organisation of Securities Commissions (IOSCO) (CPSS-IOSCO work on Financial Market Infrastructures), the OTC Derivatives Supervisors Group (ODSG), the OTC Derivatives Regulators Forum, the European Securities and Markets Authority (ESMA) and other global legislators and regulators.

Credit ratings agencies (CRAs)

CRAs have been recognised as playing a material role in the financial crisis. And since the crisis began, there has been a consensus that there is a need for appropriate and consistent regulation of these agencies – particularly reflecting their role in rating structured finance products in the run up to the financial crisis.

it will reduce the systemic importance of ratings and improve market confidence

The further development of regulations on the use of credit ratings and credit rating agencies is important because it will reduce the systemic importance of ratings and improve market confidence.

Our work in this area this year included the following.

- We assessed and authorised applications from CRAs under the new regulation, working collegiately with counterpart EU regulators. The supervision of CRAs will become a direct responsibility of the newly formed European Supervisory Markets Authority (ESMA), but we are likely to undertake delegated tasks on its behalf. The supervision of CRAs and the UK's active involvement in the registration process will help maintain market confidence and protect and enhance the stability of the UK financial system.
- We participated in ESMA work related to equivalence assessments of non-EU jurisdictions and the development of memoranda of understanding (MOUs).
- We worked with ESMA to develop proposals on decision making for ESMA's CRA supervision and a supervisory operating model. We will continue to interact with ESMA as it develops its supervisory capacity.

- ESMA will now develop advice for the Commission on the appropriate cooperation between ESMA and national authorities. We will contribute to this work so that the cooperation guidance provides a clearly defined process for delegating tasks to national authorities and the process for reimbursing the FSA is efficient and fully covers our costs.

- We contributed to the IOSCO report, *Regulatory Implementation of the Statement of Principles Regarding the Activities of Credit Rating Agencies*, which was published in February 2010. We will continue to be an active member of the IOSCO Standing Committee on CRAs. This will enhance international supervisory cooperation in implementing regulatory frameworks for CRAs.

- A joint response with the Treasury to the Commission's consultation on possible further measures to reduce reliance on credit rating agencies. We will help the Treasury negotiate the third wave of EU CRA regulations.

Markets in Financial Instruments Directive (MiFID)

The MiFID review is a key priority for us

The MiFID review – which among a number of issues – aims to implement the G20 commitment for trading standardised OTC derivatives on exchanges or electronic trading platforms 'where appropriate', is a key priority for us. Our work in this area has continued during 2010/11 with ESMA.

During 2010/11, we participated in a number of CESR taskforces to shape Consultation Papers and, ultimately, technical advice to the European Commission, with an overall view to making balanced, evidence-based amendments to the MiFID framework.

Most of the advice covering markets areas was developed by the ESMA Secondary Markets Standing Committee, which the FSA chairs. We are also represented on specific taskforces, for example, equity markets, non-equity transparency and OTC derivatives trading reported.

In July and October 2010, CESR sent the Commission substantive advice on how MiFID might be adapted to ensure it remains appropriate for current and future market developments. In our view, the package of recommendations was proportionate, consistent with our principles of good regulation and represented sensible improvements to the European regulatory framework.

The key recommendations included the following:

- the organisational requirements for multilateral trading facilities should be aligned with those for regulated markets, and broker crossing systems should be regulated as a new and separate category of trading venue;

- there should be mandatory consolidation of post-trade equity market transparency data, and new publication arrangements to ensure better quality and more easy-to-consolidate data;

- a mandatory trade transparency regime for corporate bonds, structured finance products and liquid/standardised derivatives markets should be set up, carefully calibrated so as not to damage market liquidity;

- regulators should have appropriate tools to ensure effective management of positions in commodity derivative markets;

- a new category of trading venue should be identified for the trading of standardised OTC derivatives, along with the aims of the G20 to promote transparency, reduce systemic risk and combat market abuse; and

- to improve market supervision and detection of market abuse by introducing additional transaction reporting requirements such as the mandatory collection of client identifiers.

In February 2011, the Commission's consultation on the review of MiFID closed. We submitted a joint response with the Treasury.

We continue to work with the Treasury and ESMA to influence the final form of Commission proposals to amend MiFID, including Level 2 measures, and will implement the resulting regulatory framework.

Commodities

Commodities continue to have great significance both macroeconomically and to consumers. This has been recognised by the G20, with specific directions given to the IOSCO Commodities Task Force, which we co-chair with the US CFTC, at both the Pittsburgh and Seoul G20 meetings. IOSCO's Commodities Task Force has produced two key reports during the period, in November 2010[18] and April 2011.[19] These reports included:

- results of a survey – conducted in cooperation with the ISDA Commodity Products Steering Group – on the composition of the OTC financial oil derivatives market;

- progress towards a statement of best practice recommendations for the supervision of commodity derivatives markets, updating the 1997 Tokyo Communiqué[20];

- work on the impact of price reporting agencies on oil markets; and

- assistance given to industry for its progress towards a repository for financial oil transactions.

Commodities have also formed an important part of other significant workstreams

In conjunction with the Oxford Institute of Energy Studies[21] we helped produce a paper analysing the trends in the oil markets between 2003 and 2010 and discussing possible policy responses.

Commodities have also formed an important part of other significant workstreams already noted, including the MiFID review, particularly the advice given by CESR to the European Commission in this regard.[22]

18 www.iosco.org/library/pubdocs/pdf/IOSCOPD340.pdf
19 www.iosco.org/library/pubdocs/pdf/IOSCOPD352.pdf
20 www.meti.go.jp/policy/commerce/intl/tkyc.pdf
21 www.oxfordenergy.org
22 www.esma.europa.eu/index.php?page=document_details&from_title=Documents&id=7279

Our objectives for commodities markets are to ensure that the policy initiatives advanced will yield real benefit and that the associated costs are not disproportionate to those benefits.

We have also stepped up enforcement activity to deter misconduct and market abuse in the commodities markets

We have also stepped up enforcement activity to deter misconduct and market abuse in the commodities markets. Two cases were completed with public outcomes during the year. In June 2010 the FSA fined Andrew Kerr, a commodity broker at Sucden Limited, £100,000 for market abuse and banned him from working in the financial services industry. The action related to Kerr's conduct on 15 May 2007, when he executed trades during a key one-minute period to artificially increase the price of coffee futures, in implementation of a plan developed with his client for the purpose of benefiting that client. Mr Kerr also provided false and misleading information while being investigated by the FSA.

Also in June 2010, the FSA banned Steven Perkins, a former oil futures trader with PVM Oil Futures Limited and fined him £72,000 for market abuse. Perkins had traded contracts on ICE without client authorisation and had built a very large position, which significantly affected the price on the exchange.

The Prospectus and Transparency and Market Abuse Directives

The Prospectus Directive aims to ensure that investors are provided with clear and comprehensive information when making investment decisions. An Amending Directive, which updates the Prospectus Directive, came into effect on 31 December 2010. It must be implemented in member states by 1 July 2012.

As part of this review, we have worked closely with the Treasury to negotiate on the amended Directive – this year we helped the Treasury put forward the UK position.

The Transparency Directive review began in June 2010 and in Q3 2010 we sent a joint response with the Treasury to the Commission.

Also, last year the EU Commission launched a public consultation on the review of the Market Abuse Directive (MAD).

As part of this review, we worked closely with the Treasury, helping it develop and put forward the UK position.

Alternative Investment Fund Managers (AIFM) Directive

The AIFM Directive seeks to regulate the managers of 'alternative' investment funds (including hedge funds, private equity funds, retail funds that are not undertakings for collective investment in transferable securities (UCITS) and closed-ended funds such as investment trusts). European negotiations on the text of the Directive, in which we supported the Treasury to achieve UK objectives, concluded during the year. The Directive contains a large number of implementing measures, on which the European Commission has asked ESMA to provide advice. The FSA is chairing one of the ESMA taskforces that will provide this advice, as part of the work of the Investment Management Standing Committee. This advice will be the subject of a public consultation later in 2011.

Client assets

Protecting client money and custody assets (client assets) is a regulatory priority. Confidence in the protection of client assets was damaged significantly in the worst days of the financial crisis, and both the regulator and the industry needed to repair this damage.

As we noted in our March 2010 *Financial Risk Outlook* (FRO), the standard of CASS (our client asset sourcebook) compliance at many firms is too low. With UK firms responsible for trillions of pounds of client assets, this poses an unacceptable risk to UK users of financial services. Our response to the financial crisis and the issues it uncovered was to change part of our operating model and increase the level of resource devoted to the protection of client assets.

In 2010, we established a client asset unit (the unit) to drive our specialist and intensive supervision of client assets

In 2010, we established a client asset unit (the unit) to drive our specialist and intensive supervision of client assets. The unit was specifically created to promote confidence in the regulatory regime and ensure that client assets were protected. The Treasury announced its full support for the unit and our enhanced approach to regulating client money and assets.

In our *Business Plan* for 2010/11 we set out numerous proposals which are now already in force or in the process of being implemented. The unit has led our increased regulatory focus on client assets, increasing the number of visits to firms and reviewing the rules around the protection of client assets. The past year has seen over £17bn worth of client money subject to our regulatory intervention. We have:

- pooled valuable and scarce client asset expertise into the unit;
- published 14 final enforcement notices, imposing over £34m in fines (40% of the total fines we issued this year) and a range of non-financial penalties including varying of firms' permissions and prohibiting individuals from performing certain controlled functions; and
- required firms to commission 28 section 166 skilled person reports.

Credible deterrence in the client asset sector

As part of our focus on the protection of client assets, we have taken robust disciplinary action against a range of firms found to be deficient in this area. These actions have included the following.

- In March 2011 we fined ActivTrades Plc, a foreign exchange broker, £85,750 for failing to protect clients' assets adequately. Under our client money rules, firms are required to keep client money separate from the firm's money in segregated accounts with trust status. This helps to safeguard and ring-fence the client money in the event of the firm's insolvency. Between 14 April 2009 and 2 September 2010, the amount of client money held by ActivTrades ranged between £3.4m and £23.6m and averaged £12.2m. ActivTrades failed to ensure that this money was fully segregated; failed to ensure that it did not hold client money in its own bank accounts; failed to perform client money calculations or reconciliations accurately; and failed to pay interest on client money. ActivTrades was also unable to monitor and assess the adequacy of its client money arrangements due to weaknesses in the information provided to senior management.

- Subsequently, on 17 May 2011, the FSA fined David McGrath, the former compliance officer at ActivTrades Plc, £3,000 and banned him from holding a compliance oversight function for failing to make sure ActivTrades met the FSA's rules. Mr McGrath fell short of the standards we would expect in this area and accordingly we took action to stop him from holding a compliance oversight function in the future. We originally imposed a fine of £20,000 but this was reduced to £14,000 as a result of a 30% discount in accordance with our settlement discount scheme. This was subsequently reduced to £3,000 as a result of Mr McGrath's hardship.
- In January 2011 we fined Barclays Capital Securities Limited £1.12m for failing to protect and segregate on an intra-day basis client money held in sterling money market deposits. The failing remained undetected for over eight years. The highest amount held in the account and at risk at any one time was £752m.
- In June 2010 we fined Close Investments Limited £98,000 for failing to properly protect and segregate client money. The firm also failed to maintain adequate controls over its client money (as required by FSA rules) in that for two years it failed to verify that certain accounts had been appropriately set up as client money accounts.
- In June 2010 we fined a stockbroking firm, Rowan Dartington & Co Ltd, £511,000 for its failure to maintain adequate processes to reconcile its clients' monies between its own systems. These deficiencies were to such an extent that it could not rely on the accuracy of its own books and records or that it could be confident that it was segregating the right amount of its clients' monies.
- In June 2010 we fined JPMorgan Securities Limited (JPMSL) £33.32m for failing to protect billions of dollars of client money by segregating it appropriately. Due to an error following the merger of JPMorgan and Chase banks, the client money held by JPMSL's futures and options business was not held overnight in a segregated money market account as it should have been, but was held in an unsegregated account. This error remained undetected for nearly seven years.

we have consulted and published rules and guidance to enhance the protection of client assets for firms doing investment business

To address issues we uncovered from our visits to firms and from the failure of Lehman Brothers, we have consulted and published rules and guidance to enhance the protection of client assets for firms doing investment business. The changes include:

- increasing our knowledge and oversight of the UK market through enhanced reporting and notification obligations on firms holding client assets;
- classifying these firms into three groups dependent on the highest amount of assets they held: CASS large, medium and small (this helps our risk-based approach to supervision and reflects the reality that the distinction drawn for wider supervisory purposes does not necessarily reflect the extent to which the firm's client asset holdings pose risks to our statutory objectives);
- increasing a firm's senior management CASS oversight through introducing a CASS operational oversight controlled function (CF10a);
- taking action to improve transparency in the prime brokerage market by requiring enhanced disclosure of re-hypothecation; and
- restricting placing client money with group banks, and prohibiting using general liens in custodial agreements.

we referred nine auditors to their relevant auditing bodies and brought in ten new requirements to improve the quality and consistency of auditors' client assets reports

After finding serious failings in relation to auditors' client assets reports, we referred nine auditors to their relevant auditing bodies and brought in ten new requirements to improve the quality and consistency of auditors' client assets reports. These new requirements will also enable us to better use the auditor's client asset reports to undertake firm and thematic reviews.

With the enhanced regulatory focus on client assets, we proposed a new fee block dedicated to recovering the costs we incurred in relation to client asset regulation. These draft proposals are at an early stage and we will be publishing a Consultation Paper in due course.

We have worked with EU institutions and with global initiatives looking at the protection of client assets. In particular, we participated with:

- CESR to consider the practice of re-hypothecation across EU member states;
- IOSCO to develop client assets principles and publish a paper on the treatment of client assets in line with domestic insolvency regimes including the UK; and
- the European Commission in its review of the Markets in Financial Instruments Directive (MiFID).

These actions and policy changes show our commitment to increasing standards of compliance with our rules. Our *Business Plan* for 2011/12 shows that the protection of client assets will remain a regulatory priority.

Delivering our intensive supervisory approach in markets

Just as supervision is critical to our financial stability objective, it is also an intrinsic element of our aim to ensure UK markets remain efficient, orderly, fair, internationally attractive and sustainable. Despite the change in our regulatory landscape, supervision is, and remains, a national, rather than a European competence.

Last year, we increased our resources and scale of contact for high-impact authorised firms. We also continued to align our supervision of market infrastructure providers with this enhanced approach where appropriate, increasing our resources and the scale of contact devoted to the most significant entities.

Last year our supervisors focused on:

- thematic issues arising from the changing nature of the trading process, including high frequency trading and co-location[23];
- representing our interests in European and international fora and ensuring that the infrastructure provider environment remains appropriately regulated in the context of ongoing commercial developments;

23 Co-location allows traders to physically place their computer servers next to an exchange's matching engine to shave crucial milliseconds off the time it takes for trades to be done.

- carrying out ARROW (our risk-assessment programme for firms) visits, close and continuous supervision, and surveillance of market risks and developments; and

- assessing new commercial developments for regulatory approval and risk with a particular focus on new technology in market infrastructures and risk-management processes in central counterparties (CCPs).

UK Listing Authority (UKLA)

we identified financial reporting as a key risk to market confidence

In our 2010 *Financial Risk Outlook* (FRO), we identified financial reporting as a key risk to market confidence, so this was a key area of focus for us in 2010/11.

In the primary markets, we perform the UK Listing Authority (UKLA) functions, responsible for reviewing and approving prospectuses and circulars, determining eligibility for listing and maintaining the Official List. We police the ongoing compliance of issuers and major shareholders with the ad hoc and periodic disclosures required under the Disclosure and Transparency and Listing Rules. We also authorise sponsors and monitor their performance.

These are the specialist firms that help premium issuers draw up listing documents, are responsible for the content, and act as the key link between the UKLA and issuers.

We started reviewing the structure of the UK Listing Regime in 2007 with the Investment Entities Listing Review. After publishing our Policy Statement on the structure of the Listing Regime in February 2010, the new regime came into effect on 6 April 2010. Its aim is to make the regime's structure clearer and more coherent.

We continued with the strategic programme to replace the UKLA's key IT systems, and to deliver associated business change. We are on target to complete the programme in the 2012/13 financial year.

The programme will deliver an integrated and flexible IT solution on a modern infrastructure platform that meets the UKLA's strategic business requirements. This will enhance the efficiency and effectiveness of the UKLA's internal and external-facing processes, enabling us to provide a more accessible and improved service.

As part of our work in policing compliance with the Disclosure and Transparency and Listing Rules, in January 2011 we imposed a penalty of £455,000 (after settlement discount) on JJB Plc (JJB) for breaches of these Rules. The penalty related to JJB's failure to disclose information to the market about the true cost of the acquisitions of two retail chains, the Original Shoe Company (OSC) and Qubefootwear Ltd (Qube). JJB announced in December 2007 that it had purchased OSC for £5m in cash, but failed to disclose that, in addition to the cash price, it had to pay for the in-store stock. The cost of the in-store stock was £10.038m. In May 2008 JJB announced that it had purchased Qube for £1 in cash, but failed to disclose that JJB had agreed to settle Qube's overdraft before completion. The cost to JJB of settling the overdraft was £6.47m. In both cases the true cost of the acquisition was inside information and should have been disclosed to the market as soon as possible. The true cost of the acquisitions was only disclosed in September 2008 when JJB published its 2008 interim results. The failure to announce the true costs of the acquisitions therefore resulted in a false market in JJB shares for a total of over nine months.

Insider dealing and market abuse

Our market abuse regime applies to anyone whose activity relates to the UK exchange-based markets, including those overseas. It is based on the Market Abuse Directive that aims to fight cross-border market abuse by establishing a common approach among EU member states. Seven types of behaviour can amount to market abuse. These are insider dealing, improper disclosure, misuse of information, manipulating transactions, manipulating devices, dissemination and distortion and misleading behaviour.

Over the last 12 months, we have continued to pursue our credible deterrence policy of increasingly effective action against insider dealing and market manipulation. This includes surveillance of market activity; following up suspicious transactions with timely and thorough investigation; ensuring firms have effective market abuse systems and controls; and actively using our civil and criminal market abuse powers.

Market abuse is difficult to detect, investigate and prosecute. Tackling it is one of the FSA's top priorities and we are confident that we have a robust strategy to achieve a credible deterrence. We note, as described below, the key market cleanliness statistical measure in respect of takeover/share price movements shows a positive change in the last year, from which we take considerable encouragement.

New penalties policy

In March last year, we published our new penalties policy, which establishes a consistent and more transparent framework for calculating financial penalties. Under this policy, the starting point for a penalty on an individual who commits market abuse will be the greater of:

- where the market abuse is referable to the individual's employment, up to 40% of the individual's salary and benefits (including bonuses) from their job over the 12 months preceding the final market abuse or, if longer, the period of the market abuse;
- up to four times the financial benefit made by the individual as a direct result of the market abuse; and
- in serious cases of market abuse, £100,000.

A minimum starting point of £100,000 for serious cases of market abuse supports our intention to be bolder and more resolute

The individual will also be required to give up all the financial benefit made as a direct result of the market abuse. A minimum starting point of £100,000 for serious cases of market abuse supports our intention to be bolder and more resolute in tackling market abuse so that we can bring about a change of culture.

The new penalty regime came into force on 6 March 2010.

Criminal and civil actions

Our enforcement actions in 2010/11 include:

- five criminal convictions for insider dealing, with sentences ranging from 12 months to three years and four months;
- five confiscation orders against individuals totalling £1,705,285.76;

- 13 defendants currently awaiting trial for insider-dealing offences, with trial dates fixed for November 2011, February 2012 and April 2012;
- four defendants due to stand trial in September 2011 for section 397 offences with respect to iSoft plc;
- 15 penalties levied in 2010/11 for market abuse, totalling £8,342,804;
- nine individuals prohibited as a result of market abuse;
- five market abuse cases (involving eight individuals) pending determination by the Tribunal; and
- an interim injunction obtained from the High Court in a case of ongoing market abuse.

Market abuse – Fundamental-E Investments Plc

In 2010, we fined Simon Eagle £2.8m and banned him from working in financial services for deliberate market abuse. This fine is the largest to date against an individual and consisted of the disgorgement of £1.3m profit and an additional penalty of £1.5m.

In 2003, Simon Eagle purchased an agency-only stockbroker, SP Bell Limited. He used the firm to carry out a share-ramping scheme in respect of Fundamental-E Investments Plc (FEI) shares. He did this by the firm selling shares to its clients and rolling over those trades to avoid the obligation to make payments. This generated demand for the stock and pushed up its price. Many of the clients were unaware that the shares were being bought and sold on their behalf. The scheme led to the share price rising from 2.5p in May 2003 to 11.75p in July 2004. The Tribunal also determined that Graham Betton, SP Bell Limited's director should be banned and a financial penalty imposed.

Many of the trades were placed through Winterflood, a market maker in FEI. We also imposed a penalty of £4m on Winterflood; and of £200,000 and £50,000 on two traders, Stephen Sortiriou and Jason Robins, respectively, for their role in the market abuse.

Insider dealing – Christian Littlewood, Angie Littlewood and Helmy Omar Sa'aid

Christian Littlewood was an investment banker who, over the course of nearly a decade, engaged in insider dealing by deliberately passing inside information to his wife so that she and a friend could trade on it profitably ahead of announcements. As a result of his position, Littlewood was entrusted with, or in a position to obtain, highly sensitive and valuable information. The trio made profits in excess of £590,000 on trading of over £2m. Mr Littlewood received a 40-month custodial sentence, the longest imposed in an FSA prosecution. His wife, Angie Littlewood, and family friend Helmy Omar Sa'aid (who was extradited from Mayotte in the Comoros Islands to face charges) were also sentenced to 12 months imprisonment (suspended for 24 months) and 24 months imprisonment respectively. Confiscation proceedings against the Littlewoods will be determined later in 2011 but Sa'aid has already paid £640,000 in satisfaction of his confiscation order.

Market education

Educating firms so they do not commit market abuse is more efficient and economic

Educating firms so they do not commit market abuse is more efficient and economic for us than firms lack of understanding leading to market abuse and then enforcement action.

So, last year we took steps to enhance market participants' awareness of their obligations and ensure they take all reasonable steps to mitigate the risk of market abuse. We continued to promote the need for effective anti-market abuse systems and controls, and conflicts management, with a particular focus on training and education. We visited firms to assess their systems and controls. We also advised some issuers on improving their handling of inside information.

In particular, we published several articles designed to educate firms on topical issues, with good practice points. These articles cover:

- broker disclosure of a sale of securities by a person discharging managerial responsibility within issuers;
- transaction reporting;
- trading venue outages;
- markets infrastructure providers' software resiliency; and
- leaks.

We also held several Transaction Reporting Forums, giving us the opportunity to make things clearer to the industry and give guidance on transaction reporting related issues and developments.

Market cleanliness statistics

we analyse the scale of share price movements in the two days ahead of regulatory announcements and identify movements that are abnormal

As part of our market monitoring activity, we analyse the scale of share price movements in the two days ahead of regulatory announcements and identify movements that are abnormal compared to a stock's normal movement. We publish the statistics annually and remain the only regulator that regularly publishes market cleanliness statistics.

It is important to realise that the level of abnormal pre-announcement price movements (APPMs) does not provide a precise measure of the level of suspected insider dealing.

Many factors, other than insider trading, could cause an abnormal price movement ahead of a takeover announcement; for example, financial analysts or the media correctly assessing which companies are likely takeover targets or non-abusive trades that just happen to fall before an announcement. In some circumstances there may also be a deliberate 'strategic' leak of information to help position an important deal in the marketplace. This is clearly improper. It is not possible to determine which of these factors are behind each abnormal price movement and therefore whether any insider dealing might have taken place.

It is also important to note that, due to the statistical thresholds used when computing APPMs, even if there is no insider or other abnormal trading, we would not expect the results to be zero but, on average, 10% for the takeovers data set and 3% for the set of other significant trading announcements made by FTSE 350 firms. For reasons of statistical significance, a movement of about 5% in either direction is needed before it is safe to conclude that the level of APPMs has changed from one period to the next. Finally, extreme volatility of share prices as we saw during 2008/9, may also affect the results. The full methodology and analysis is in our March 2007 *Occasional Paper* and April 2008 *Market Watch*, which you can find on the FSA website. For the reasons set out above, the statistics are only one of many factors that we consider when setting our anti-market abuse strategy.

After remaining stable for the past few years, the level of APPMs for the takeover data set declined to 21.2% in 2010. This is the lowest level for the takeover measure since 2003. As set out above, while this fall has taken place against the backdrop of increasing focus on market abuse, due to the nature of the statistic, the reason behind this decline cannot be determined with certainty. We cannot say whether improved market behaviour is a contributory factor, but the change in the outcome is nevertheless to be welcomed.

The level of APPMs for the FTSE 350 data set was at a historically low level in 2010. We did not identify any APPM within our set of price-sensitive announcements, giving a measure of 0% for 2010.

The measure of market cleanliness for the takeovers analysis

Year	Announcements	APPMs	Percentage % (APPMs/ announcements)
2000	183	44	24.0
2002	147	37	25.1
2003	160	22	13.8
2004	102	33	32.4
2005	177	42	23.7
2006	199	57	28.6
2007	167	48	28.7
2008	181	53	29.3
2009	144	44	30.6
2010	118	25	21.2

The measure of market cleanliness for the FTSE 350 analysis

Year	Announcements	Significant announcements	APPMs	Percentage % (APPMs/ announcements)
1998/1999/2000	487	51	10	19.6
2002/2003	734	54	6	11.1
2004/2005	927	49	1	2.0
2006/2007	1,085	78	6	7.7
2008	428	50	5*	10.0
2009	466	24	1	4.2
2010	469	31	0	0.0

* In calculating the number of APPMs for the FTSE 350 analysis, we cleansed the data by stripping-out two positive company announcements that were preceded by downward share price movements. This is because it is clear that both share price falls were attributable to wider market declines at that time and not to the announcements which were positive news stories.

The review of information sources we undertook to check the FTSE 350 figure has led to concern over the quality of the input data that we use to calculate this statistic. A number of announcement dates in the raw data did not match the dates of regulatory releases from other sources. As such, our confidence in the inputs, and therefore the statistic, is considerably reduced. In the absence of improved announcement data, we are concerned the statistic may not be robust and, from next year onwards, we will no longer be calculating this measure.

Transaction reporting

Firms must meet specified standards when reporting transactions to us in terms of submission of reports and their content

Transaction reports are an essential component of our toolkit for investigating instances of market abuse, including insider dealing. We have been working closely with firms to ensure they are aware of their obligation to put in place appropriate systems and procedures to ensure the submission of accurate transaction reports. Firms must meet specified standards when reporting transactions to us in terms of submission of reports and their content. To ensure accuracy and completeness, firms, under SYSC (Systems and Controls) and under Principle 3, must have appropriate systems and controls in place to enable them to comply with their regulatory obligations.

During 2010/11, we took enforcement action against firms where we considered the breaches to be serious.[24]

We fined the following firms for failure to report transactions and/or failure to report transactions accurately:

- Société Générale £1.575m for breaches of SUP 17 of our Handbook; and
- City Index Limited £490,000 for breaches of SUP17 of our Handbook and Principles 2 and 3 of our Principles for Business.

24 In 2009/10 we fined firms as follows: Barclays Capital Securities Limited and Barclays Capital Division of Barclays Bank were fined £2.45m for breaches of SUP17, Principles 2 and 3; Credit Suisse Securities (Europe) Limited, Credit Suisse (UK) Limited, Credit Suisse International and Credit Suisse AG were fined £1.75m for breaches of SUP17; Getco Europe Limited was fined £1.4m for breaches of SUP17; Instinet Europe Limited was fined £1.05m for breaches of SUP17, Principles 2 and 3; and Commerzbank was fined £595,000 for breaches of SUP17.

We also played an integral role in CESR's technical advice to the Commission on transaction reporting. We led the CESR Transaction Reporting Systems Joint Sub Group to finalise a harmonised approach on how to report transactions on OTC derivatives instruments.

SABRE/ZEN

The SABRE/ZEN system underpins our arrangements for monitoring authorised firms and investor activity

We have made significant progress in the redevelopment of our SABRE/ZEN system, including the design, development and the completion of the majority of testing, including user acceptance testing. The first major release of the new version of the system is due in Q3 2011. The SABRE/ZEN system underpins our arrangements for monitoring authorised firms and investor activity in reportable equity, debt and associated derivative trades (both on-exchange and OTC). SABRE/ZEN is being extended to:

- enhance regulatory capabilities, including a market abuse monitoring, alerting and reporting function;
- support increased transaction volumes from the industry (around ten million transactions per day) and to/from the ESMA TREM system;
- support the reporting of transactions identified using the Alternative Instrument Identifier (Aii); and
- collect instrument reference data from UK-regulated markets for exchange with ESMA.

Section

4

LME-003806

Delivering consumer protection

Introduction

In the past, we addressed our consumer protection objective by focusing principally on:

- ensuring clear, fair and not misleading disclosure and high standards of conduct in the sales process; and
- by taking enforcement action against firms (including seeking redress) when customers had been adversely affected.

In March 2010, we launched our enhanced consumer protection strategy, which seeks to make the retail market work better for consumers, avoid the crystallisation of conduct risks that exceed our risk tolerance and deliver credible deterrence and prompt and effective redress for consumers.

Our approach has three key strands:

1. seeking to improve the long-term efficiency and fairness of the market;
2. delivering intensive supervision of firms, including earlier interventions in the development of retail products; and
3. in the event that failure has occurred, securing the appropriate level of redress and compensation, and achieving effective credible deterrence by taking tough action against firms and individuals who have transgressed.

In 2010/11, we shifted to a more interventionist approach, with the aim of anticipating consumer detriment where possible and stopping it before it occurred. We started to look at how we could intervene earlier in the product cycle, before risks develop. On 25 January 2011, we published a comprehensive Discussion Paper (DP) to open the public debate about how we, and in future the Financial Conduct Authority (FCA), should pursue this (see Section 1).

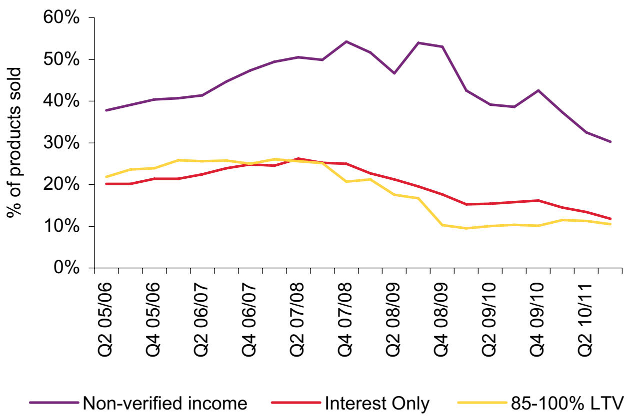
A successful consumer protection strategy must improve the reliance that consumers can place on financial institutions. So we have continued to focus on areas carrying the biggest risks to consumer trust and potential for significant consumer detriment – the retail investment market and the mortgage markets. The Retail Distribution Review (RDR), for example, is a key part of our consumer protection strategy, through which we aim to modernise the industry and establish a resilient, effective and attractive retail investment market in which consumers can have confidence and trust at a time when they need more help and advice than ever with their retirement and investment planning. The rule-making that has already taken place, and continues, will be supported by our intensive supervision of firms.

We also continued to take tough action when things went wrong. We delivered many good outcomes for consumers during 2010/11, seeking prompt redress and compensation for consumers who suffered detriment, and taking enforcement action against firms and individuals who transgressed.

Outlined below are some preliminary metrics we use to assess and measure our work.

- Analysis of mortgage indicators (Chart 8)
- Mortgage arrears (Chart 9)
- Non-conforming lending – serious arrears and repossessions (Chart 10)
- Redress paid by firms (Chart 11)
- FSA consumer awareness survey (Charts 12 and 13)
- Complaints made to the Financial Ombudsman Service (Chart 14)

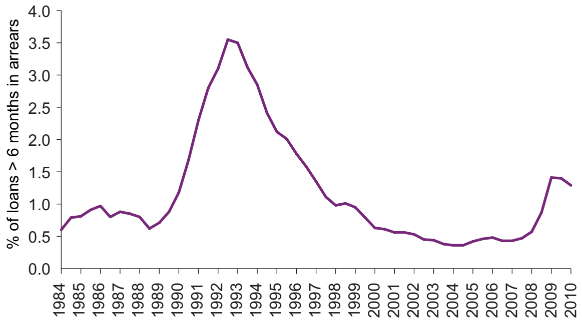
Chart 8: Analysis of mortgage indicators



Source: FSA

Lenders remain risk averse. Compared with only a few years ago, today's mortgage market is barely recognisable. Unprecedented market conditions, lack of mortgage funding and the move to lending based on quality rather than volume has resulted in lower lending volumes, fewer lenders and fewer intermediaries. Mortgages with 85-100% loan-to-value (LTV) fell from 11.3% to 10.5% of total mortgages sold in Q3 2010/11. Of those, 1.2% were over 90% LTV, the lowest recorded figure since we started collecting this data in 2005. Sales of interest-only mortgages and non-verified income mortgages also continued to fall.

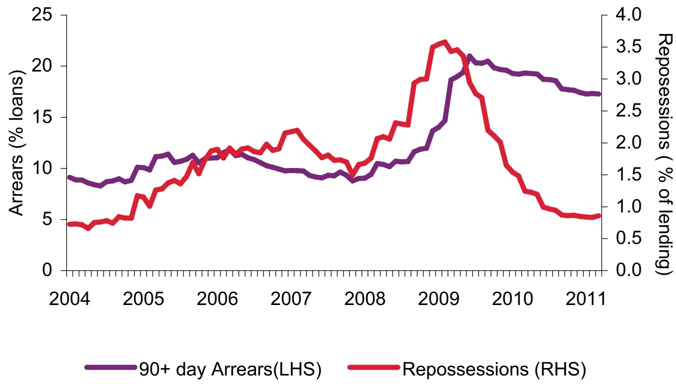
Chart 9: Mortgage arrears



Source: Council of Mortgage Lenders

Mortgage arrears increased between 2007 and 2009 to a high in mid-2009. At the end of 2010, accounts in arrears had decreased 7% from 2009. In the last quarter of 2010/11 the number of new possessions continued to decline to the lowest figure for three years. This is of course during a period of unprecedented low interest rates.

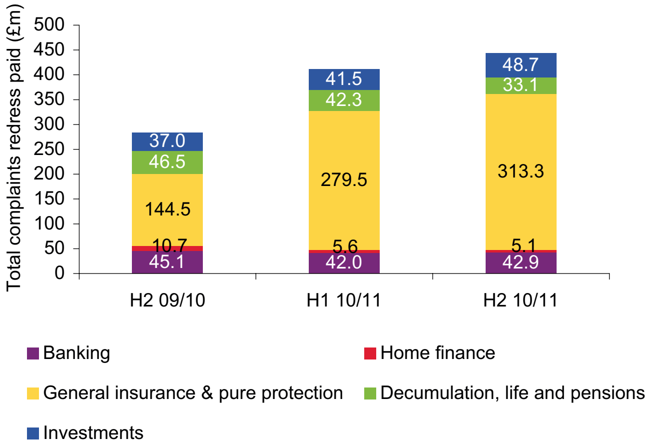
Chart 10: Non-conforming lending – serious arrears and repossessions (2004-2011)



Source: Ministry of Justice

The chart above shows falls in both mortgage repossessions and loans that have been in arrears for over 90 days since the middle of 2009. The improvement in the 90+ day arrears to an extent reflects low interest rates and the gradual recovery of the economy from recession. This will also feed through into fall in repossessions, but the sharper fall in repossessions than arrears reflects greater lender forbearance, likely driven by the FSA's letter to Chief Executives on this matter.

Chart 11: Redress paid by regulated firms in 2010/11



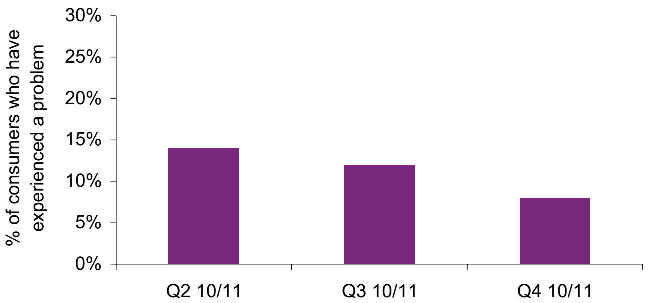
Source: FSA

Total redress paid as a result of complaints increased slightly from £443m in the six months to March 2011 compared to December 2010. As this chart shows, general insurance and pure protection insurance continue to dominate, driven significantly by previous payment protection insurance (PPI) mis-selling.

Over the last year, we have published redress data in more depth and are now looking at further ways of measuring redress data to give a fuller picture of our impact on redress payments from firms.

** Please note that quarters have been combined to reflect the fact that most of the redress data is reported in June or December data submissions, reflecting most corporations' reporting calendars.*

Chart 12: Respondents to FSA CAS who experienced problems with a financial firm in the last 12 months

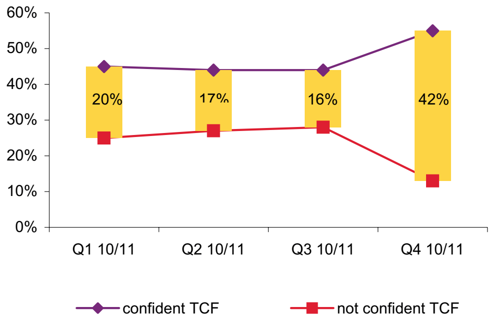


Source: FSA

According to our Consumer Awareness Survey (CAS)*, 8% of respondents experienced a problem with a financial firm in the past 12 months; a decrease from 12% in Q3 10/11. Problems include unsatisfactory handling of complaints, difficulty getting through to someone on the phone and staff being rude or unhelpful.

**The research presented in the CAS is based on results from an omnibus survey carried out by TNS.*

Chart 13: Respondents to FSA CAS who feel firms are treating them fairly

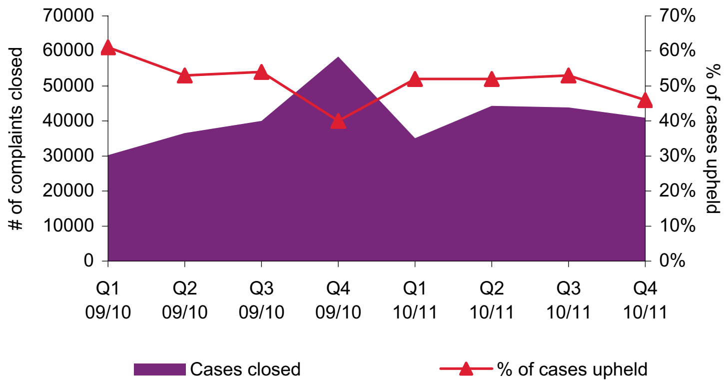


Source: FSA

Results from the FSA Consumer Awareness Survey suggest that consumers are confident that firms are treating them fairly with a net confidence level of 42%; an increase* from 16%.

**Please note that the methodology changed in March. The current figures are included as part of the annual FSA Consumer Awareness Survey as opposed to standalone trend questions.*

Chart 14: Financial Ombudsman Service's level of closed complaints and upheld rates



Source: the Financial Ombudsman Service

The changes to the number of and uphold rates for complaints over the past year highlight the impact of the judicial review on payment protection insurance (PPI). The proportion of complaints closed with a change in outcome in favour of the consumer (upheld) decreased from 53% in Q3 10/11 to 46% in Q4 10/11, reflecting the decline in the number of PPI cases resolved during this period as a result of the judicial review. The lower upheld rate – and increased volume – in Q4 09/10 reflects the bulk closure of bank-charge cases following the Supreme Court's ruling on unauthorised overdraft charges.

Consumer protection and product intervention

In January 2011, we published a Discussion Paper, DP11/1: *Product Intervention*, to open a public debate about how the FSA, and in future the Financial Conduct Authority (FCA), could achieve better consumer protection through focusing more on financial services products.

We have already begun to make a significant shift towards a more interventionist approach

The paper outlined how we have already begun to make a significant shift towards a more interventionist approach, with tighter supervision of the governance of product development. It also sets out a range of possible future interventions that could be introduced in areas where the potential for customer harm is greatest. These might include interventions such as banning products or prohibiting the sale of certain products to specific groups of customers.

Dealing with consumer detriment in particular market sectors

To make markets work better for consumers we continued to focus on two key areas during 2010/11 – the Mortgage Market Review (MMR) and the Retail Distribution Review (RDR).

Mortgage Market Review (MMR)

The MMR is designed to protect consumers from the type of poor and unsustainable lending that developed in the lead up to the financial crisis. Its aim is to bring about a sustainable market that works better for consumers. We want to prevent consumers taking on mortgages that are clearly unaffordable and/or where there is a high-risk of the mortgage becoming unaffordable as a result of reasonably foreseeable developments (such as an increase in interest rates). At the same time, we want to ensure that credit-worthy customers have access to mortgage finance.

We published a Discussion Paper in October 2009 setting out the reforms we thought might be necessary to address structural issues in the mortgage market. This was followed by a series of Consultation Papers throughout 2010, setting out the changes we believed necessary to achieve the MMR objectives.

The Consultation Papers took the MMR forward in two main phases.

- **Phase one** responded to the poor market practice identified in thematic reviews, by implementing reforms to ensure that firms treat consumers who fall into payment difficulties fairly. Phase one also outlined reforms to raise standards by extending our approved persons regime to all who advise on or sell mortgage contracts. For more information, see CP10/2: *Mortgage Market Review: Arrears and Approved Persons*.

- **Phase two** proposed reform aimed at constraining irresponsible lending in the next economic upswing and addressed distribution and disclosure issues. In 2010, we initiated consultation with industry and consumer stakeholders on these topics. Details are outlined in CP10/16: *Mortgage Market Review: Responsible Lending* and CP10/28: *Mortgage Market Review: Distribution and Disclosure*.

Arrears and approved persons

In CP10/2 we set out reforms to ensure that firms treat consumers who fall into payment difficulties fairly, including strengthening our arrears rules to make it clear that:

- firms must not apply a monthly arrears charge where an agreement is already in place to repay the arrears;
- payments by customers in financial difficulties must first be allocated to clearing the missed monthly payments, rather than to arrears charges, which can be repaid later; and
- firms must consider all options for borrowers – repossessions should always be the last resort.

We also confirmed plans to make all mortgage advisers and those who arrange non-advised sales personally accountable. They will be required to demonstrate they are 'fit and proper', helping to clamp down on mortgage fraud and enabling us to monitor individuals in the mortgage market. As we announced last December, as part of our ongoing reprioritisation of work, particularly around the regulatory reform agenda, we are deferring introduction of the changes to 2012/13. Once the rules are finalised, we will give firms enough time to put changes in place to comply with them.

Responsible lending

...the proposed changes aimed to ensure all lenders get back to the basics of responsible lending...

CP10/16, published in July 2010, signalled a significant shift in our approach to ensuring that consumers do not get loans that are unaffordable for them. Reflecting our enhanced consumer protection strategy and intensive supervisory approach, the proposed changes aimed to ensure all lenders get back to the basics of responsible lending and that problems are prevented before they can develop or get out of control.

Some of the key proposals included:

- ensuring affordability is considered in detail for all mortgages and making lenders ultimately responsible for assessing a consumer's ability to pay;
- requiring verification of borrowers' income in every case to prevent over inflation of income and to prevent mortgage fraud; and
- stress testing against future interest-rate changes.

These tough new proposals were based on detailed analysis of past lending decisions, looking at the causes of arrears and repossessions since 2005.

CP10/16 also included the key findings from our review into arrears charges, which indicated significant variation in the level of arrears fees across the market. We proposed strengthening our rules to ensure that arrears charges are fairly imposed and based on a reasonable estimate of the cost of the additional administration required as a result of the customer being in arrears.

Credible deterrence in the mortgage sector

- In January we announced the publication of the 101st mortgage broker prohibition (96 of the 101 were mortgage fraudsters). We have also taken tough action in mortgage arrears cases where firms have not treated customers in arrears fairly and failed to give consumers the protection they deserve. There will be further action in this area in the coming year. In each case we have fined the firm and also required that redress be paid to customers; for example, to pay them back any unfair or excessive administration charges.
- In April 2010 we fined Kensington Mortgage Company Ltd £1.225m in relation to its mortgage arrears handling processes and its dealings with customers in arrears during the period 1 January 2007 to 31 October 2008. Its management information focused on the performance of the firm's mortgage book and the profitability of the business, rather than on treating customers fairly. The firm also failed to take reasonable care to organise and control its affairs responsibly and effectively and to ensure adequate risk management systems were in place. Kensington agreed to pay redress, estimated at about £1.066m, to customers who were in arrears and charged specific unfair and/or excessive charges.
- In July 2010 we fined Redstone Mortgages £630,000 for failings in relation to its mortgage arrears handling processes and for poor treatment of some customers facing mortgage arrears. We also secured a redress package of about £500,000 for customers who were in arrears and were charged unfair and/or excessive charges in respect of their mortgage account. The failings occurred between 1 January 2007 and 5 August 2009.
- In October 2010, we fined a small mortgage lender, Bridging Loans Ltd, £42,000 and its director Joseph Cummings £70,000 for irresponsible lending practices and for failing to treat fairly customers in arrears. We took action to ensure that Bridging Loans could not repossess unfairly or sell the homes of any of its customers. Bridging Loans Ltd failings also included not treating customers' complaints fairly, providing inaccurate information to customers and imposing excessive charges. In addition to fining Joseph Cummings we banned him and three other directors of the firm. Mr Cummings was banned because he was involved in the firm's irresponsible lending practices and failure to treat customers fairly in arrears. Mr Cummings also used language in correspondence to customers that could have been interpreted by those customers as aggressive or threatening and failed to cooperate with the FSA. We banned Mr Cummings' colleagues because they had failed to inform themselves adequately about Bridging Loans Ltd's affairs.
- In February 2011 we announced that we had fined DB Mortgages £840,000 for irresponsible lending practices and unfair treatment of customers in arrears. The lending failings included DB Mortgages not being able to show that customers could afford mortgages where the term continued after their retirement. We also found that DB Mortgages did not consider the individual circumstances of customers in arrears or inform them of the range of options that were available to them and applied charges that were unfair because they were charged repeatedly or did not accurately reflect the cost of administering an account in arrears. We secured redress of approximately £1.5m and DB Mortgages will contact all customers affected by these failings, which may lead to further redress.

Distribution and disclosure

Our aim is to ensure that consumers are adequately protected against inappropriate product choice...

We then consulted in CP10/28 on proposed reform to the mortgage sales process. We proposed various changes that will affect mortgage sellers (intermediary, telephone and branch based). Our aim was to ensure, so far as is possible, that consumers are adequately protected against inappropriate product choice and that disclosure focuses on the key pieces of information that consumers need to know about mortgage products and services.

Key proposals included:

- replacing the obligation to issue an initial disclosure document to the customer, with requirements to clearly and prominently disclose key information about how the intermediary will be paid and the service they offer;
- changing the trigger points for providing the key facts illustration[25] to minimise information overload on consumers and reduce burdens on firms;
- a requirement for all individuals that sell mortgages to hold a relevant mortgage qualification ensuring appropriate professional standards across all sales;
- replacing the existing labels used to describe the firm's service with the RDR's 'independent' and 'restricted' labels; and
- requiring firms to disclose to customers whether they will consider deals that can only be obtained directly from a lender.

Our proposals were aimed at ensuring greater confidence in the mortgage market, protecting consumers from unsuitable advice and unfair treatment, combating financial crime, and raising public awareness about the risks and costs of mortgage borrowing. Our work in this area continues in 2011/12.

Sale and rent back agreements

In June 2010, we set out our rules to ensure there are proper protections in place for vulnerable customers entering sale and rent back (SRB) agreements. It defined the standards firms must follow to ensure that the often particularly vulnerable consumers who take out these products have greater protection.

From 30 June, SRB customers have been better protected from firms using aggressive or unfair methods. Some of the protections include:

- banning exploitative advertising and high-pressure sales techniques and prohibiting the use of emotive terms like 'fast sale', 'mortgage rescue' and 'cash quickly' in promotional literature;
- a 14-day cooling-off period to give consumers more time to make decisions on SRB;
- banning firms from cold calling and dropping promotional leaflets through letter boxes;

25 http://yourmoney.moneyadviceservice.org.uk/products/mortgages/help/getting_help_from_a_mortgage_broker.html

- security of tenure for customers for a minimum of five years; and
- measures to ensure all risks are clearly signposted to the customer, via FSA literature and during the sales process.

We are proactively monitoring the SRB market for unauthorised activity…

All firms active in the SRB market must be authorised. We are proactively monitoring that market for unauthorised activity, and will take action through the Courts to seek fines or other sanctions, if necessary. This would involve us taking action for a breach of general prohibition and then the Courts deciding to impose fines or other punishment.

Implementing the Retail Distribution Review (RDR)

We launched the RDR to deal with some long-standing issues in the market for retail investment advice. It aims to do this by bringing greater clarity to the customer about the nature of the advice they are receiving, raising the professional standards of investment advisers and reducing the potential for adviser remuneration to bias in the advice provided. The new rules will come into force in January 2013.

The key changes are as follows:

- **Consumers are offered a transparent and fair charging system for the advice they receive –** our rules require advisers to set their own charges in agreement with their clients (adviser charging) before they identify suitable products for the customer. This prevents product providers from offering pre-determined levels of commission and advisers from recommending products that automatically pay them commission. It also allows the cost of advice to be taken from the product.
- **Consumers are clear about the service they receive –** our rules introduce a distinction between 'independent advice' and 'restricted advice' (non-independent advice) services. Firms that describe their advice as 'independent' are required to consider all products and providers that could meet a customer's needs (so consider all relevant options), free from any restrictions or bias, when making their recommendation.
- **Consumers receive advice from qualified professionals –** our rules require all investment advisers to subscribe to a common code of ethics, modernising qualifications and enhancing standards for continuing professional development. We will require advisers to hold a Statement of Professional Standing to confirm they meet these standards.
- **Advisory firms become more stable and better able to meet their liabilities –** we require advisory firms to have adequate capital resources to minimise the financial impact of unsuitable advice. We are implementing an expenditure-based requirement and will require firms to hold at least a level of capital resources equivalent to a specified number of months of their fixed expenditure.
- **The FSA will be supervising individual advisers –** when the RDR comes into force in January 2013, we will start collecting information about individual advisers, such as the qualifications they hold and which accredited body they use. We will use this data to identify alerts and risk indicators about individual advisers, and emerging systemic issues in firms. Firms should already be notifying us of breaches to our rules. But to be clear on professionalism and in preparation for 2013, from

July 2011 firms will be obliged to notify us if any adviser falls below the required standard of competence, including ethical behaviour.

Group Personal Pensions (GPP)

The rules published in Policy Statement PS10/10, *Delivering the Retail Distribution Review: Corporate pensions – feedback to CP09/31 and final rules*, will remove the commission bias from the GPP market. Recommendations made by advisers will not be influenced by product providers' commission rates.

Our rules will make advisers' charges more transparent, as advisers will have to fully disclose how they will be remunerated and employers will negotiate and agree the cost of the adviser's services upfront. Advisers and employers will also agree how these charges are paid – either by direct fees from the employer or recouped from employees' GPP accounts. We believe that employers will be more engaged with the level of adviser remuneration when they are given transparent information on the overall amount an adviser will receive on the GPP as a whole.

Pure protection

We do not believe that applying the adviser charging regime to pure protection advice will enable us to target the problems we currently see in that market. We have published final rules in CP10/13: *Pure protection sales by retail investment firms: remuneration transparency and the COBS/ICOBS election*, which mean:

- Where pure protection sales and advice are associated with investment advice, firms will have to explain how they are remunerated and disclose the amount of commission or commission equivalent received.
- Firms will be required to make a judgement about whether the pure protection transaction is 'associated' with investment advice. We have added guidance to help firms make this judgement.
- Firms that sell pure protection products under the Conduct of Business sourcebook (COBS), rather than the Insurance Conduct of Business sourcebook (ICOBS), can continue to do so after the RDR is implemented.

Platforms

…this will support the RDR objective of reducing bias in the advised sales process.

In November 2010, we published CP10/29: *Platforms: Delivering the RDR and other issues for platforms and nominee-related services*, which consults on proposed changes to our regulation of platform services. Among other things, this will support the RDR objective of reducing bias in the advised sales process.

The key proposals were:

- improved disclosure of the income platforms receive from fund managers and other product providers;
- a ban on product charges being rebated in cash to consumers;
- new rules to guide advisers on the use of platform services;

- compulsory re-registration of investments from platforms and other nominees;
- new rules to require platforms and other nominees to pass on fund information and voting rights to the end investor (they will also be required to facilitate the exercise of voting rights); and
- further guidance on the use of platform services by independent advisers.

Intensive supervision of retail firms

In the past, our supervisory focus in the conduct area has tended to be reactive. During 2010/11, we have sought to rebalance this by providing a more consistent supervisory framework for conduct risk supervision, which identifies emerging issues much earlier.

During March to June 2010, we designed the approach for intensive and intrusive retail conduct supervision for very high-impact firms. From July to October 2010, we piloted this approach and in November we incorporated the lessons learned. In November, the revised approach was approved by our senior management as a possible basis for the FCA's retail conduct supervisory approach.

During 2011 we began our more intensive and intrusive supervisory approach in relation to the risks posed to consumers by the highest impact retail firms – this will include:

- a greater focus on understanding the risks to consumers posed by firms' business models, consumer strategy and products;
- intensive assessment of how firms manage their retail conduct risks (including testing outcomes experienced by consumers); and
- intervention to address the underlying root causes of problems we identify before they crystallise as consumer detriment.

Banking conduct

Banking customers have benefited from new rules and standards...

We began regulating retail banking conduct and payment services in November 2009 and during the last year, banking customers have benefited from the new rules and standards imposed through our banking conduct regime.

We are taking steps to raise consumers' awareness of their rights in relation to banking services. In November 2010, we launched a *Know Your Rights* booklet for bank and building society customers, to clarify the service standards customers can expect. The booklet offers straightforward material that a customer can use when dealing with their bank and is split into useful sections – for example: opening accounts, moving accounts and solving problems.

Other work during 2010/11 included testing deposit-takers' conduct when refunding unauthorised transactions, including the time taken to refund customers.

The Money Advice Service

Following the Financial Services Act 2010, we established a consumer financial education body (then called the Consumer Financial Education Body (CFEB)) to continue the work we previously undertook to enhance public understanding and knowledge of financial matters.

The body, which was renamed the Money Advice Service on 4 April 2011, is responsible for helping consumers:

- understand financial services in the UK; and
- manage their own finances better.

The Money Advice Service became operationally independent from the FSA on 26 April 2010 and we continue to work closely with it, underpinned by a memorandum of understanding. It provides consumers with information and generic advice on a range of money matters such as budgeting, saving and borrowing, mortgages, insurance, pensions and planning for retirement, and tax and benefits. The service plans to launch a health check in mid-2011, which will provide consumers with a personal action plan to help them with their money and longer-term goals.

We announced the appointment of Tony Hobman as the chief executive of CFEB (and now the Money Advice Service) in April 2010, and Gerard Lemos as its chairman in September 2010.

There have been significant improvements in a number of firms' procedures for refunding customers...

There have been significant improvements in a number of firms' procedures for refunding customers reporting unauthorised transactions on their bank account. We noted that firms were generally providing refunds on the day the claim was made and where firms were conducting investigations, they were generally conducting them within a reasonable timeframe.

In CP11/1[26], we consulted on updating our Handbook guidance to refer to the new industry guidelines on Cash ISA transfers and on including interest rates on bank statements.

The new industry guidelines on Cash ISA transfer times, implemented on 1 January 2011, have reduced the maximum time that should be taken for a typical Cash ISA to Cash ISA transfer, from 23 to 15 business days. We are monitoring performance with these standards.

We are aware that some technology providers have systems that can look ahead at the payments queue to process bank account payments in a way that maximises account fees. This would not provide a fair service to the consumer and we have included guidance to the effect in the Banking Conduct of Business Sourcebook.[27]

Our new guidance on the use of set-off by firms is intended to achieve fairer outcomes for consumers and came into effect on 6 March 2011 (although there is a transitional period until 7 September 2011 for some of the guidance).

Supervising small firms

Throughout 2010/11, we continued to deliver our assessment programme for small firms. During the year we had contact with over 2,700 firms through roadshows and assessments, allowing us to continue to meet our key aims of:

26 www.fsa.gov.uk/pubs/cp/cp11_01.pdf
27 www.fsa.gov.uk/pubs/handbook/hb_notice107.pdf

- increasing our contact and communication with small firms;
- helping firms trying to adhere to the regulatory rules; and
- identifying and taking action against those not engaging with us.

This programme is now complete and we will publish final communications on our work in this area in June 2011.

Follow-up work included a Regional Education Programme, which has ensured that small firms are keeping up the momentum towards delivering high standards for consumers.

We have developed a revised small firms supervision approach

We also developed a revised small firms supervisory approach, which builds on the successes of the assessment programme, but is more proportionate and risk-based. The next stage here is to implement this new approach across small firm supervision.

Our contact with small firms through our three-year assessment programme has significantly raised their understanding of their regulatory obligations to deliver consistently fair outcomes to their customers.

Following regional visits, 18 firms were referred to enforcement, leading to six prohibitions, five fines, two cancellations and a public censure to date.

Securing redress and compensation

Even with greater focus on pre-emptive action, some customers have been unfairly treated. Throughout 2010/11, we remained strongly focused on taking the necessary steps and dealing with the issues.

Payment protection insurance (PPI)

Since we began regulating PPI in 2005 we have taken enforcement action against 24 firms for sales failings. We have completed three thematic reviews, issued warnings, stopped the selling of single premium PPI with unsecured personal loans and visited over 200 firms to improve the market.

In August 2010, we published a Policy Statement confirming our package of measures to protect consumers in the PPI market.

The package was designed to ensure customers are treated fairly when complaining about PPI; it included:

- new Handbook guidance to ensure complaints are handled properly, and redressed fairly where appropriate;
- an explanation of when and why firms should analyse their past complaints to identify if there are serious flaws in sales practices that may have affected complainants and even non-complainants; and

- an open letter setting out common sales failings to help firms identify bad practice.

The measures came into force on 1 December 2010.

The High Court dismissed this challenge to our PPI measures.

In October 2010, the British Bankers' Association (BBA), supported by interested party Nemo Personal Finance Ltd (Nemo), launched a judicial review of our PPI complaint-handling measures, also challenging material published by the Financial Ombudsman Service (the ombudsman service).

However, on 20 April 2011, the High Court dismissed this challenge to our PPI measures. The challenge against the ombudsman service was also dismissed.

The BBA had argued that firms could not be made to pay redress in relation to breaches of the Principles and that the Principles could have no effect where the FSA had written detailed rules. The judgment fully supported the way we had used the Principles in this case. The judgment also supported our decision to use a complaints-led approach to tackling the problems in the PPI market rather than the use of an industry-wide review of past business.

On 9 May 2011 the BBA and Nemo confirmed they did not intend to appeal the judge's decision. This brought to an end the legal proceedings. We believe this decision will trigger a dramatic improvement in the way customers are treated when making complaints about PPI.

Keydata Investment Services Ltd

In 2009, the Court put Keydata Investment Services Ltd into administration on the application of the FSA. Since then we have worked with the administrators to ensure an orderly wind down of the firm, and with the FSCS to assist with the payment of compensation to investors. We continue to review the sales of Keydata products by IFAs and to seek redress for consumers and in this context we fined Norwich and Peterborough building society £1.4m in April 2011. Norwich and Peterborough will pay £51m to investors who bought Keydata products on the advice of their advisers, and to the FSCS.

Delivering consumer redress

In October 2010, as part of the Financial Services Act 2010, Section 404 of FSMA was amended to give the FSA a new supervisory power to deliver prompt and effective redress for consumers. The new section 404 power provides the FSA with authority to make rules requiring firms to establish and operate consumer redress schemes, without the approval of the Treasury.

It is an important new tool for us, which increases our ability to get redress for consumers when firms have not followed our rules.

The new power will be used in instances when there is evidence of widespread or regular failings that have caused consumer detriment. It is a rule-making power, so we must undertake cost-benefit analysis and consult each time we want to establish a redress scheme.

We have used this power twice in the last year…

Under the new section 404F(7) of FSMA, we can also impose on a single firm, a scheme that 'corresponds to or is similar to a consumer redress scheme'. We have used this power twice in the last year: once to secure a package of measures for approximately 600,000 Lloyds Banking Group customers who had taken out Halifax mortgages with unclear terms, including £500m redress for approximately 300,000 of those customers; and once to secure £90m redress for consumers who had been mis-sold PPI by Welcome Financial Services. The purpose of this power is to deliver redress quickly and efficiently for consumers in the case of a mass claim, allowing the ombudsman service to deal with its usual workload of individual customer complaints instead of being overwhelmed by large numbers of identical complaints. As a part of the governance process for using this power, the FSA will ensure that an appropriate outcome for customers is at the centre of any remedy it puts in place.

We continue to take tough action to secure redress for consumers where they have lost out financially as a result of poor treatment by firms. In December 2010, we fined Scottish Equitable £2.8m for causing consumer detriment through poor administrative procedures. Scottish Equitable also agreed to a comprehensive consumer redress package expected to total £60m, about half of which was paid by the end of 2010. In January 2011, we fined Barclays Bank plc £7.7m for failures relating to the sale of two funds. We also put in place a past business review, requiring Barclays to contact customers and pay redress where appropriate. By December 2010, approximately £17m had already been paid to investors. We expect further redress up to £42m to be paid (see also page 85 – assessing suitability).

Complaints handling

In April 2010, we published our findings from our review of banks' complaints handling. As a result of this review, five banks undertook major changes to the way they deal with complaints and Bank of Scotland (BOS), RBS and Natwest were referred to enforcement and subsequently fined £3.5m (with an expected £17m in compensation to customers) and £2.8m respectively.

In September 2010, we proposed changes to our complaints-handling rules as part of a package of measures to drive up standards of complaints handling within the industry.

Our Consultation Paper, CP10/21: *Consumer complaints – The ombudsman award limit and changes to complaints-handling rules,* is key to our consumer protection agenda and aimed at ensuring that more firms resolve complaints promptly and fairly.

Our proposals included:

- requiring firms to identify a senior individual responsible for complaints handling;
- abolishing the 'two-stage' complaints-handling rule to incentivise firms to resolve complaints fairly the first time;
- underlining the requirement for firms to carry out root cause analysis, by identifying and remedying any recurrent or systemic problems with complaints, and taking action where appropriate; and

- additional guidance in relation to taking account of ombudsman decisions and previous customer complaints and learning from the outcome.

We also proposed to increase the limit on awards made by the ombudsman service from £100,000 to £150,000.

At the same time as proposing changes to the complaints-handling rules, we began publishing firm-specific complaints data to encourage firms to improve their own performance, particularly in response to pressure from consumers. The second of these six monthly updates was published on 30 March 2011.

We published our latest set of aggregate complaints statistics for the second half of 2010, which we began publishing in 2009, to enable customers to see the total volume of complaints being received across the industry, as well as how these complaints are being handled.

We will follow up our previous review of complaints handling in banking groups and will test whether firms are providing fair customer outcomes and challenging areas of poor practice.

New deposit compensation limit

...we confirmed that the new deposit compensation limit for the UK would increase...

In December 2010, we confirmed that the new deposit compensation limit for the UK would increase from £50,000 to £85,000 per person, per authorised firm, from 31 December 2010.

This is the pound sterling equivalent of the €100,000 deposit compensation limit, which came into force in all European Economic Area (EEA) member states at the end of 2010.

Further changes that came into effect on 31 December 2010 were:

- fast payout rules, with a target of a seven-day payout for most claimants and the remainder within the required 20 days; and

- gross payout, which means customers will receive compensation on their deposits up to the deposit limit even if they have loans with the same firm.

The UK's Financial Services Compensation Scheme (FSCS) raised awareness of the scheme with a publicity campaign in early 2011 to inform customers of the compensation limits and of the importance of ensuring that they are covered, and by which national scheme.

Pension switching

In April 2010 we published the findings of our follow-up work to improve the quality of pension switching advice. This work included:

- writing to over 4,500 firms (a 'Dear Compliance Officer' letter) setting out the standards we expect of firms;

- publishing a pension switching suitability assessment template as a resource for firms;

- hosting regional roadshows providing further guidance and support for over 1,500 small firms; and

- carrying out further assessments in 22 firms posing the highest risk of poor advice.

Our work has seen significant change in the market. A number of firms are carrying out past-business reviews that will deliver more than £150m in redress to customers and many firms have changed the way they give advice to deliver improved outcomes for customers. However, there still remains some room for improvement in the quality of pension switching advice overall.

In addition to failings previously identified, our follow-up work highlighted additional concerns. Some advisers were found to be recommending 'portfolio advice services', with insufficient justification that the additional costs genuinely added value for customers. We also saw examples of firms operating tied advice models that prevented their advisers from considering a customer's existing pension arrangements.

We are committed to improving outcomes for consumers and will continue to focus on firms who have not demonstrated improvements. We will also continue to focus on firms posing the greatest risk of providing poor pension switching advice as part of our programme of intensive supervision.

We have taken disciplinary action against four firms and two individuals for poor conduct relating to pensions switching advice.

...a number of firms are carrying out past-business reviews that will deliver more than £150m...

- On 29 March 2010, in the previous reporting period, we fined Robin Bradford (Life and Pensions) Limited, based in London, £24,500 for failing to ensure the suitability of advice given to customers in relation to advice to transfer their pension. While the FSA found no evidence of actual detriment to Robin Bradford's customers, the firm voluntarily conducted a review of 100% of its pension switching business with a view to providing redress to customers where necessary.

- In July 2010, we fined N-Hanced LLP, a Gateshead-based IFA firm, £21,000 for exposing their customers to the risk of receiving poor advice about switching their pension. The firm is also reviewing the pension switching advice conducted during the period in question to see whether any redress is required.

- In February 2011, we levied fines totalling £143,500 on two firms that failed to check the suitability of the pension switching advice they gave their customers. Perspective Financial Management, based in Milton Keynes, was fined £49,000, and Cricket Hill Financial Planning Ltd, in Barnsley, was fined £70,000, along with the firm's director, Jeremy Sheard, who will pay £24,500. His colleague Mark Kelsey, responsible for compliance, was issued with a public censure. In addition to the fines, we appointed a 'skilled person' to carry out past-business reviews of relevant pension switching cases at both firms.

Assessing suitability

In March 2011 we published our guidance *Assessing suitability: establishing the risk a customer is willing and able to take and making a suitable investment selection*. This guidance highlights some important drivers of unsuitable investment selections, which are common across different firms and product areas. It highlights problems in the way firms are making investment selections to reflect the needs and circumstances of their customers, and in particular how investment recommendations can fail to reflect the risk their customers are able and willing to take.

We have taken enforcement action against a number of firms in this area. These resulted in substantial fines and redress packages.

- In January 2011, we fined Barclays Bank plc £7.7m for failures relating to the sale of two funds (See also page 81, Delivering consumer redress).

- In April 2011 we fined Norwich and Peterborough Building Society £1.4m for failing to give its customers suitable advice (see Keydata, page 81).

- Also in April 2011, we fined The Matrix Group for failing to take reasonable care to ensure the suitability of its advice in recommending Geared Traded Endowment Policy (GTEP) products; specifically, the firm failed to account for customers' attitudes to risk and did not communicate the risks involved with the GTEP product to customers.

Small firm intermediary market

...we published 71 enforcement final notices in this financial year

To deliver credible deterrence in the small firm intermediary market we published 71 enforcement final notices in this financial year. These 71 final notices included 22 investment, 36 mortgage and 13 insurance outcomes. Significant Influence Function (SIF) holders were the subjects of 40 of these notices.

- **The first FSA Unregulated Collective Investment Scheme (UCIS) case:** In January we fined and banned the two partners of the investment firm Clark Rees LLP for failing to ensure the firm made suitable recommendations to its customers regarding UCIS. Paul Clark was fined £10,500 and Ceri Rees was fined £17,500. They have been banned from performing senior roles and also from selling UCIS to customers for two years.

- **The first FSA platform case**: In September 2010, we fined Moneywise IFA Ltd £19,600 for failing to have sufficiently robust compliance arrangements for the investment advice it gave customers using platforms and discretionary portfolios.

We have taken disciplinary action against one small firm and two individuals for poor conduct relating to the sales of structured products.

- In September 2010, we fined Thorntons Law LLP (Thorntons), based in Dundee, £35,000 with a separate fine of £10,000 for one of its partners, Michael Royden. We found that, in relation to sales of Lehman-backed structured products, Thorntons did not give suitable advice. In addition, Michael Royden failed to inform himself adequately about Lehman-backed structured products before Lehmans' insolvency and failed to put in place adequate systems and controls to collate management information about Lehman-backed structured products.

- Also in September 2010, we fined Robert Peter Yarr of McCelland Yarr Financial Services Limited, based in Belfast, £28,000. Robert Yarr did not understand fully and then warn customers of the counterparty risk associated with structured products, he also failed to keep adequate records, conduct product research and ensure sufficient compliance oversight and management at the firm.

Safeguarding consumers from unauthorised businesses

We receive approximately 5,000 to 6,000 reports of unauthorised business activity each year. Our highest priority areas are share fraud, landbanking, deposit taking and insurance warranties. Quantifying these activities is difficult, but our best estimate is that they are likely to result in the region of £300m to £500m in victims' losses.

We carried out enquiries, conducted detailed investigations and took court proceedings in each of our priority areas. Court proceedings taken in 2010 related to schemes which together amounted to at least £220m in consumer losses.

We also carried out consumer education campaigns designed to help people avoid becoming victims of unauthorised businesses.

Landbanking and crop schemes

'Landbanking' fraud is where investors are led to believe they are investing in land that will significantly increase in value because the plots are, for example, in areas with high house prices or close to land that has been allocated for development. In reality, investors are sold land which often has no or very little development potential, is unlikely to be granted planning permission, or does not exist.

Like many investment scams – such as boiler room fraud – the sale often takes place through high-pressure telephone calls, although it can also be through mail shot, brochure distribution or websites.

We successfully applied to the court to wind up one landbanking scheme which had taken nearly £4m in victims' funds. We began court proceedings to stop the activities of a further four firms whose landbanking businesses appear to have taken approximately £40m.

Where court proceedings have been started, we intend to complete those proceedings, recover funds where available, and return any recovered funds to the victims of unauthorised schemes. As with all unauthorised business, however, we rarely recover the full amount invested by victims.

These priority areas will continue to be the focus of our activities in the coming year.

Authorised firms and unauthorised business activity

We have taken action against authorised firms and approved individuals whose actions have assisted unauthorised businesses in conducting their activities.

In May 2010, we fined Atlantic Law LLP £200,000 and fined and banned its senior partner, Andrew Greystoke, in connection with the approval of financial promotions issued by unregulated stockbroking firms.

In December 2010, we fined accountants Sedley Richards Laurence Voulters £163,140 and fined and banned two of its partners, Paolo Maranzana and Laurence Finger, for the firm's involvement in receiving and dispersing monies which had been received from investors who had been contacted by overseas share fraudsters.

These cases act as a reminder to authorised firms and their employees of their responsibilities in helping to tackle financial crime in this area.

Other key workstreams

Competence and ethics

In December 2010 we published final rules, which strengthened and clarified our requirements relating to competence and standards of behaviour. We have been clear that competence is about skills and behaviour, as well as qualifications.

We expect firms to effectively manage their competence arrangements

We have also reminded the industry that, while we have more detailed training and competence requirements for firms carrying on retail activities, all firms are obliged to ensure their employees are competent. We expect firms to effectively manage their competence arrangements and believe that firms need to link their business strategies more effectively with their people strategies and ensure that, in doing so, they are identifying and managing the risks that arise.

The key changes are:

- clarity about the responsibility for competence in our approved persons' regime;
- additional descriptions of behaviour, which we do not believe comply with the statements of principle for approved persons;
- an overall time limit of 30 months, within which relevant individuals must successfully pass all modules of a qualification as prescribed by our rules;
- a list of appropriate qualifications that meet our regulatory requirements; and
- two separate activities for dealing on securities and derivatives (in Appendix 1 of our training and competence sourcebook).

With-profits

We published the findings of our With-Profits Regime Review into the operation of with-profits funds in June 2010. The review focused on whether firms were treating their with-profits policyholders fairly, looking specifically at how senior managers in firms have implemented FSA rules. We carried out detailed assessments on a representative sample of 17 firms, including mutual societies and large shareholder-owned firms, representing around 80% of the with-profits market by assets.

In February 2011, with input from that review, we published CP11/5: *Protecting with-profits policyholders*, which contained proposals to strengthen the existing rules on with-profits to improve protection for policyholders.

The following key proposals were aimed at improving protection for with-profits policyholders.

- Strengthening the requirement for boards and governing bodies to obtain independent advice on the management of funds by enhancing the role of the with-profits committee and the with-profits actuary.

Mutual insurers operating with-profits funds

In 2010 we carried out further work on issues raised by mutual insurers operating with-profits funds in response to our 13 October 2009 Dear CEO letter. This set out our position on the interests of with-profits policyholders in their with-profits funds. We gave careful consideration to those responses and are continuing discussions where necessary with individual firms.

We also issued a further Dear CEO letter to with-profits mutuals on 28 September 2010, in which we addressed some of the points that emerged from our consideration of firms' responses.

We have included material on this subject in our Consultation Paper CP11/5: *Protecting with-profits policyholders*, which we published in February 2011 and additionally in a note, *Rights and expectations of with-profits policyholders in mutuals: the FSA's legal position*, published on our website in March 2011.

These publications give the mutual insurance sector further clarity on how we expect firms to manage their businesses and protect the interests of with-profits policyholders and treat them fairly.

- Requiring all firms to have a plan to distribute any excess surplus fairly to policyholders, particularly where a firm experiences a significant fall in the amount of new business it is writing.

- Strengthening the requirement for any new business backed by the with-profits fund so that writing new business has no adverse effect on with-profits policyholders' interests.

- Improving the ways in which firms identify and manage conflicts of interest affecting with-profits policyholders.

- Clarifying how our rules on the fair treatment of with-profits policyholders apply to mutually-owned funds.

- Restricting the circumstances under which firms can impose a market value reduction.

- Improving the reattributions process.

This is not the end of our work on with-profits. We will publish further proposals before the end of 2011 to improve firms' communications with policyholders and address issues arising from Solvency II (see Section 2). We will also continue to supervise the sector in an intensive way.

Pension reform

In November 2010, we published CP10/26, a Consultation Paper outlining changes to our Handbook following the government's confirmation of the workplace pension reforms.

These reforms will significantly change the pension landscape, so we must ensure consumers remain adequately protected and that interactions between the FSA and the Department of Work and Pensions (DWP) rules do not create unnecessary barriers within the workplace pension market.

The policy proposals broadly fall into two categories:

- the use of group personal pensions (GPPs) for automatic enrolment; and
- protecting consumers in the changing pension landscape.

GPP schemes

The Consultation Paper proposes to make a number of additions and changes to Handbook text relating to GPPs, including:

- making it clear that automatic enrolment does not fall within the scope of the European Union's Directive on the Distance Marketing of Financial Services (the Directive), which came into force on 23 September 2002; and
- clarifying that FSA and DWP rules for cancellation rights and opting out of automatic enrolment are interchangeable in respect of a scheme used for automatic enrolment and that only one process needs to be followed where an individual is being automatically enrolled – so providing a single solution rather than two different, potentially confusing and costly procedures to follow.

...providing a single solution other than two...

Protecting consumers in the changing pension landscape

We already have additional rules in place to mitigate the risk of poor advice being given in relation to occupational pension opt-outs, but these do not currently apply to GPPs.

To ensure those automatically enrolled into a GPP receive the same protections as those who are part of an occupational pension, we propose to extend the scope of its rules to cover all workplace schemes – including GPPs.

Similarly, we propose to extend rules around additional contributions to encompass all workplace schemes. Currently the Handbook stipulates that advisers must consider arrangements within an existing workplace scheme before recommending alternatives, but this does not include GPPs.

Lastly, we set out a number of issues that firms should be considering in their preparations for automatic enrolment, including:

- the importance of charges and the default fund in product design; and
- ensuring adequate resource is in place to deal with a potentially high increase in business volume.

These proposals mainly affect those involved in providing, distributing and operating of group and individual personal pensions. But anybody who has a pension now, expects to make contributions in the future, or who will be automatically enrolled from 2012, will also be affected. We published our Policy Statement and final rules in the second quarter of 2011 and the rules will come into effect from October 2012.

Electronic money (e-money)

On 1 May 2011, the Electronic Money Regulations 2011 (EMRs) came into full force, implementing the second Electronic Money Directive in the UK. We worked closely with the Treasury to design the new e-money regime, which makes it less costly to become an e-money institution and increases consumer protection.

E-money has been regulated since 2002 under the Financial Services and Markets Act 2000 (FSMA). Existing authorised electronic money institutions and small e-money issuers have to move to the new regime if they wish to continue issuing e-money and they have until 30 October 2011 and 30 April 2012 respectively to do so.

The change from FSMA to the EMRs also meant we had to make minor changes to our Handbook. We consulted on these in October 2010 and published our Policy Statement and the changes to the rules in February 2011. We also consulted on an E-money Approach Document (modelled on our document for payment services) and published it in March 2011 to help existing and potential electronic money issuers understand the EMRs and our relevant rules, directions and guidance. The new application forms for authorisation and registration were made available in March.

Delivering consumer protection in the EU

…customer outcomes that we believe are effective, evidence-based and proportionate.

During 2010/11, we continued to focus on early and effective influencing on conduct issues at the EU level. As we outline in Section 1, European initiatives continue to influence the standards that we are required to apply in our retail markets (and the new ESAs each have a consumer protection mandate) and this gave us the opportunity to engage proactively in shaping the EU consumer protection agenda. Our aim continued to be to promote standards and consumer outcomes that we believe are effective, evidence-based and proportionate. We also argued that the choice of legislative approaches to the regulating EU retail financial services markets must continue to accommodate national market characteristics and differing behaviours of consumers in different member states.

During 2010/11, we engaged actively and effectively in the EU debate leading up to the publication of a proposed new directive on mortgage credit, seeking to use the evidence we had obtained for the purposes of our Mortgage Market Review (MMR). We have argued that any directive must be sensibly targeted (given the likelihood of mortgage markets remaining primarily local) and not run contrary to the initiatives that a number of member states have already taken to bolster national protection (such as MMR). Together with the government, we will continue to be involved in the negotiations of the proposals over the coming months.

We were also very involved in the work of EU regulators over the past year to inform the European Commission's thinking on a new EU regime for packaged retail investment products (PRIPs). This included participating in various working groups created by the former committees of European supervisors (CESR, CEIOPS and CEBS). We supported the overall aims of the initiative, to create more consistency in the EU disclosure and selling standards that apply to the range of retail products across the securities, insurance and banking sectors that are intended to provide investment opportunities for consumers. This is also something that our domestic regime has sought to deliver. With the Treasury, we submitted a joint response to the Commission's formal consultation on the PRIPs' initiative published at the end of 2010 and we await legislative proposals in mid-2011.

Part of this new PRIPs regime will be delivered through the review of the conduct of business aspects in the Markets in Financial Instruments Directive (MiFID) and through the revision of the Insurance Mediation Directive (IMD). Both of these are initiatives where we have input our views over the past year. Again, there are many aspects of the ideas so far aired in the reviews which we can support; though we have stressed the need for any approach involving several directives to avoid creating diverging standards. As with PRIPs, we submitted a joint response with the Treasury to the Commission's formal consultations on MiFID and the IMD published in late 2010 and we await new draft directives during 2011.

During the year, we also supported the Treasury in negotiating revisions to the Investor Compensation Schemes Directive and the Deposit Guarantee Schemes Directive. These negotiations continue. We support workable outcomes that do not require us to reduce our existing levels of consumer protection and deliver sensible and manageable funding models. We have also responded to the European Commission's White Paper proposing a new EU directive on insurance guarantee schemes, indicating our support for the aims of this initiative.

The range of additional EU consumer protection initiatives to which we have sought to contribute over the year includes the UK response to the Commission's 2010 Green Paper on Pensions, and input to the UK position in negotiations on the Consumer Rights Directive.

As well as being involved in work on these specific EU policy initiatives, we have also worked hard to ensure the new European Supervisory Authorities (ESAs) take an effective but proportionate and outcomes-focused approach to their explicit consumer protection objectives and roles. We have been active participants in various working groups engaged in developing this aspect of ESA's remit, putting in place a framework to carry this forward.

Undertakings for Collective Investment in Transferable Securities (UCITS)

One of the reforms is the introduction of a 'key investor information document'

The package of reforms to the UCITS Directive, which concerns investment funds that can be marketed to retail consumers across the EU, comes into force on 1 July 2011. In December we issued a joint Consultation Paper with the Treasury to implement the reforms. Following the close of the consultation in March, we will make the necessary changes to our Handbook and processes before 1 July. One of the reforms is the introduction of a 'key investor information document', a two-page document that aims to set out the essential information an investor needs to make a pre-sale decision on investment. This document will include a numerical risk rating, based on the historic volatility of the fund.

Section

5

Delivering a reduction of financial crime

Introduction

One of our statutory objectives is to reduce the extent to which it is possible for a regulated business to be used for a purpose connected with financial crime. We primarily achieve this through our regulatory supervision process, engagement with the regulated community and liaison with law enforcement.[28]

In 2010/11, we significantly increased our activities in enforcement and financial crime, underpinning our philosophy of delivering credible deterrence. This was based on a more robust use of our civil and criminal prosecution powers last year.

In support of these activities we continued to focus on gathering intelligence and developing innovative policies that enhanced our ability to reduce the extent to which businesses could be used to aid financial crime.

Encouraging operational risk controls

In our *Business Plan* for 2010/11 we set out our strategy to encourage firms to improve and maintain their operational risk controls. In particular, we said we would take action against those firms who failed to manage this risk.

In 2010/11 we fined a number of institutions due to failures to comply with rules and regulations relating to the prevention of financial crime.

- In May 2010, we imposed a financial penalty of £140,000 on Alpari (UK) Ltd, an online provider of foreign exchange services for speculative trading, for breaching Principle 3 of the Principles for Businesses. These breaches relate to failings in the adequacy of Alpari's anti-money laundering systems and controls. Alpari failed to carry out adequate risk assessments of the financial crime risks that it faced, failed to have in place satisfactory customer due diligence procedures at the account opening stage and failed to monitor accounts adequately. These failings were particularly serious as Alpari's customer base included those from higher risk jurisdictions and its customer relationships were not on a face-to-face basis. Alpari also failed to train its employees on an ongoing basis in relation to financial crime and to have in place adequate systems for screening customers against UK

28 Our financial crime objective is also delivered through our work on insider dealing and market abuse and unauthorised business which is discussed in further detail in Sections 2 and 3.

and global sanctions lists and for determining whether customers were politically exposed persons.

- Alpari's former money laundering reporting officer (MLRO), Sudipto Chattopadhyay, also received a financial penalty of £14,000 for failing to comply with the Statement of Principle 7 of the FSA's Statements of Principle and Code of Practice for Approved Persons. Chattopadhyay also gave an undertaking that he would not apply to the FSA to be approved for a compliance oversight or MLRO role for three years.

This is our biggest fine to date in pursuit of our financial crime objective

- In August 2010, we fined members of the Royal Bank of Scotland Group (RBSG) £5.6m for breaching regulation 20(1) of the Money Laundering Regulations 2007 for failing to have adequate systems and controls in place to prevent breaches of UK financial sanctions. During 2007, RBSG processed the largest volume of foreign payments of any UK financial institution. However, between 15 December 2007 and 31 December 2008, RBS Plc, NatWest, Ulster Bank and Coutts & Co, which are all members of RBSG, failed to adequately screen both their customers, and the payments they made and received, against the sanctions list. This resulted in an unacceptable risk that RBSG could have facilitated transactions involving sanctions targets, including terrorist financing. We consider that RBSG's failings in relation to its screening procedures were particularly serious because of the risk they posed to the integrity of the UK financial services sector. This is our biggest fine to date in pursuit of our financial crime objective. It is also the first fine imposed by the FSA under the Money Laundering Regulations 2007 (the Regulations).

Thematic work

We continued to address financial crime systems and controls issues through increasingly intensive and intrusive supervision of regulated firms with support from our intelligence and financial crime specialists. We published two papers in May 2010 as a result of our thematic reviews into anti-bribery and corruption in commercial insurance broking and financial crime in small firms.

This thematic work involved interviews with front-line staff and file reviews to help us assess how effectively anti-financial crime policies, procedures and controls were embedded – directly in line with our more intrusive approach to supervising firms. The reports give many examples of good and poor practices to help relevant firms improve their anti-financial crime systems and controls, in line with our objective to reduce financial crime.

Where firms fail to take account of our reports and we identify serious weaknesses in systems and controls, we will consider enforcement action to send a strong message to the industry on required standards.

Both reviews demonstrate the importance of senior management responsibility when it comes to crime prevention. The anti-bribery and corruption paper specifically identifies failings in this area. Both papers take into account international standards and recognise the international nature of the issues.

Anti-bribery and corruption in commercial insurance broking

We found that serious weaknesses identified in some firms' systems and controls, particularly relating to due diligence on third-party payments, led to a significant risk of illicit payments or inducements being made to, or on behalf of, third parties to obtain business.

Many firms are required to do more to ensure they minimise the risk of becoming involved in bribery and corruption

Our report[29] concluded that commercial insurance brokers approached higher risk business involving third parties far too informally, with many firms required to do more to ensure they minimise the risk of becoming involved in bribery or corruption, unwittingly or otherwise.

Small firms' financial crime review

Our review[30] looked at over 150 small firms and identified a number of financial crime weaknesses across the sector. In particular, most small firms:

- did not carry out adequate due diligence on higher risk customers or situations;
- relied on policies and procedures prepared by consultants, which were not always tailored to the risks they faced;
- did not have appropriate formal vetting for staff;
- did not adequately mitigate the risk of fraud; and
- had a weak knowledge and implementation of the UK financial sanctions regime.

Thematic work in progress

In addition, we have now completed the fieldwork related to two major pieces of work covering banks' management of high-risk customers and industries within an anti-money laundering context, specifically politically-exposed persons, correspondent banking and wire transfers. The second report also covers lenders' anti-mortgage fraud systems and controls. We will launch both reports at our Financial Crime Conference in June 2011.

Mortgage fraud

We continue to work closely with the private sector and other agencies to enhance the industry's defences against mortgage fraud and to make it harder to execute these crimes by:

- increasing the level of intelligence received from lenders by streamlining reporting processes and providing more clarity on the information needed;
- enhancing the way intelligence is used in supervising firms and bringing about enforcement actions;
- strengthening engagement with regulators and law enforcement partners including the National Fraud Authority (NFA); and
- encouraging improved information sharing and intelligence analysis in the industry.

29 www.fsa.gov.uk/pubs/anti_bribery.pdf
30 www.fsa.gov.uk/smallfirms/pdf/financial_crime_report.pdf

Between December 2006 and January 2011 we banned a total of 101 mortgage intermediaries from the industry, 96 of whom had been involved with mortgage fraud.

Insurance fraud

...the aim is to make it harder for insurance fraud to be committed

Following on from the success we have had with mortgage lenders to reduce mortgage fraud, we have begun to work with insurers to identify firms engaged in insurance fraud. Similar to the work with mortgage fraud, the aim is to make it harder for insurance fraud to be committed. We have done this by:

- encouraging insurers to provide intelligence to us;
- improving reporting processes and providing more clarity on the information needed; and
- enhancing the way intelligence is used in supervising firms and bringing about enforcement actions.

We have taken action against a number of insurance brokers that were engaged in insurance fraud.

- In January 2011, we fined Barry Williams £25,000 and banned him from working in financial services for his part in a scheme that defrauded leading London market insurers of more than £2m.
- In August 2010, we fined Paul Willment £50,000 and banned him from financial services. Paul Willment was a director of Orion Direct Limited (Orion) and a non-executive director of Peppercom Plc (Peppercom). Paul delegated his roles and duties to an unapproved employee who withdrew over £300,000 from Orion's client money account to fund Peppercom's development. Willment was aware of the transfers but did not challenge the employee about this conduct.

Business carried out without appropriate authorisation

Firm authorisation

It is far more efficient to stop firms/individuals who do not meet our standards from getting into the financial services industry rather than having to remove them.

During 2010 we conducted successful research and investigations in this area, resulting in a number of firms withdrawing permission applications and, in some cases, their refusal by our authorising division.

Boiler rooms

Financial crime investigations have aided enforcement cases, as well as producing valuable input into successful law enforcement operations.

Our highest priority area of activity will continue to be share fraud

Last year we received calls from approximately 4,500 people who had been contacted by boiler rooms, of whom approximately 800 had been victims. This figure represents a fraction of the number of people who fall victim and suffer loses due to these scams. We estimate that this activity leads to losses for UK consumers of approximately £220m a year. In 2010/11 we wrote to approximately 95,000 people, identified from our intelligence operations as likely to be contacted by share fraudsters, to warn them.

Working with others to combat financial crime

During 2010/11 we continued to liaise with law enforcement, regulators, governments and other institutions to enhance our ability to combat financial crime. Underpinning this work is our focus on domestic and international information-sharing so that we have the necessary intelligence to fulfil our objective to reduce financial crime. These partnerships have resulted in us using a variety of tools to identify, assess and where we or others can, ensure criminals are punished.

We continued to work with a range of international standard setters to ensure our risk-based approach is further embedded in our anti-money laundering regime. We also continue to engage and encourage intelligence and information-sharing with domestic institutions to influence the outcome of regulation and policy.

During 2010/11 we also continued to support the Treasury at the Financial Action Task Force (FATF), looking to influence and provide leadership in the FATF's consideration of current international standards on anti-money laundering and terrorist financing.

Section

6

LME-003838

Delivering the FSA's operational platform

Introduction

During 2010/11 we continued to enhance our operational effectiveness to enable us to meet our objectives as effectively and efficiently as possible so we can deliver value-for-money to the firms we regulate and the consumers we protect.

We did this in a number of ways, including by:

- continuing to develop our people strategy to ensure that we attract, retain and develop the right people with the right skills;
- further improving our information systems, in particular for our externally facing applications and services that we use to interface with firms;
- improving our project and portfolio delivery capability; and
- delivering a wide portfolio of information systems (IS) and business change projects and programmes.

We outline the work we have done in these areas in more detail in this section.

People

Our people strategy continues to focus on attracting, retaining and developing talented people to achieve our objectives.

Competence

We began a phased roll-out of our Training and Competence scheme

We originally developed our Training and Competence scheme to improve the knowledge and skills needed for all supervisors and managers who look after relationship-managed firms. The scheme initially focused on supervisors and managers of high-impact firms. Last year, we began a phased roll-out of the scheme across the FSA, which will be completed by the end of 2011/12, identifying the knowledge and skills needed for roles in areas other than supervision. We are continuing to work with all areas of the organisation to ensure the scheme is applied consistently and to develop our people's technical skills.

Last year we further embedded our Talent Management strategy and we have a clear process to identify, monitor and enhance the potential of all our employees. We use this information to make strategic decisions in managing resources and talent across the FSA, as well as supporting individual development.

From April 2010 to March 2011, we delivered 174 courses in liquidity regulation and Solvency II, training over 750 attendees.

Leadership capability

We continued to focus on developing leadership capabilities through our Executive Development Programme to deliver our strategic priorities and ensure that senior staff across the organisation have the appropriate support and guidance needed to carry out their role effectively. In January 2011 we set up a Management Development Programme which will create a stronger pipeline for staff aspiring to be our people managers of the future and will help to enhance our succession planning.

Recruitment

We focused on positioning the FSA as an employer of choice in the marketplace

Our recruitment strategy focused on positioning the FSA as an employer of choice in the marketplace, with the aim of attracting a wider range of potential candidates. Our initiatives included re-launching our careers microsite – www.careersatfsa.com – and engaging with niche recruitment suppliers to attract candidates for our specialist roles.

During 2010/11, we increased our staffing levels by a net 478 full-time equivalents, which included 55 full-time equivalents within the enforcement function, to help deliver our 'credible deterrence' approach. We also strengthened our supervisory capacity by increasing our staff by a net 246 full-time equivalents, who will focus mainly on the highest-impact and most systemically important firms of those we regulate.

We increased our graduate pipeline of talent into key areas of the FSA by 83% compared with 2009 (90 in 2009 to 165 in 2010). This includes those on our Graduate Development Programme and specialist schemes, interns, placements and MBA graduates.

Staff turnover

Annual voluntary turnover to the end of March 2011 was 10.4%, compared to 4.9% to the end of March 2010. Annual voluntary turnover is calculated as the total number of employee resignations over 12 months divided by the average headcount for the same period.

Over the past five years, FSA staff levels have increased in line with our more intrusive and intensive approach to supervision. During this period our staff turnover rate has varied, largely reflecting the external financial services job market.[31]

FSA staff levels and turnover, March 2007 to March 2011[31]

	March 2007	March 2008	March 2009	March 2010	March 2011
Total headcount~	2,807	2,665	2,949	3,431	3,909
Staff turnover (%)^	11.0%	13.0%	6.9%	4.9%	10.4%

~ full-time equivalent of FSA staff as at the last day of the period
^ annual turnover rate for permanent employed staff

31 Before March 2010, the Money Advice Service was part of the FSA.

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The attraction and retention of high-quality people is essential to the delivery of our objectives. We need people from a variety of backgrounds and specialisms and continue to be able to compete with financial and professional services sector firms for talent. Our turnover levels are manageable; while our turnover went down considerably during the financial crisis it is now starting to return to the level we would expect as recruitment picks up across the sector.

Reward strategy

Last year we implemented a revised reward strategy to ensure a more equitable distribution of total reward spend and provide increasingly transparent links for staff between skills, performance, contribution and reward. As part of implementing this strategy, in April 2010 we closed the final salary section of our pension scheme and ceased the accrual of future service benefits from 1 April 2010, which will in future generate savings at an expected rate of £4.8m a year and reduce the uncertainty of future pension costs.

The total amount paid out in staff annual incentive rewards in 2010/11 was £24.8m, which equates to 13.8% of our total salary bill. This was the same percentage spend as last year (although the actual spend in 2009/10 was £21.9m because our total headcount was less). There was no general pay increase awarded to FSA staff during 2010/11 – although there were selective increases to reflect specific market circumstances. As a result, 92% of our people did not receive a salary increase in the pay review process (excluding graduates who receive contractual pay increases subject to performance).

Equality and diversity

We value equality, diversity and inclusion in our roles as both an employer and regulator. Last year we consulted and published our *Single Equality Scheme* and *Action Plan*. We also ran our annual diversity survey for staff and will use the findings to prioritise our diversity work during 2011/12. This work will help us to fulfil our general and specific duties as an employer under the Equality Act 2010.

We appointed senior leaders to champion and raise awareness of the benefits of diversity and equality

We have recruited diversity experts to provide specialist advice and guidance on employment and regulatory related Equality, Diversity and Inclusion (EDI) matters. We appointed senior leaders to champion and raise awareness of the benefits of diversity and equality and have developed a range of training courses for all staff on a number of diversity topics.

Information systems (IS) and programme management

During 2010/11 we implemented and delivered several significant initiatives and programmes to improve the way in which we deliver technology and business change, both internally and to the firms we regulate.

We reorganised our IS Division, establishing centres of expertise to improve our internal capability and focus on the quality of deliverables from our third-party suppliers. We also launched a strategic outsourcing framework agreement to develop relationships with new and existing suppliers and enhance the scope of services we outsource. As a result, we have improved accountability, introduced more competition and provided access to a greater range of specialist providers.

To improve our project and portfolio management capability, in 2010/11 we restructured our programme management function and established a dedicated internal consulting function. We reviewed and revised our approach to project and programme delivery and implemented a single delivery framework for both IS and business change projects and programmes.

...a much improved ability to shape and scope new business strategies and initiatives

The outputs of this include an enhanced level of monitoring and reporting across the portfolio of change projects and programmes and a much improved ability to shape and scope new business strategies and initiatives, ensuring an appropriately balanced portfolio.

We also continued to support the delivery of our key IS programmes.

Surveillance Analysis of Business Reporting System (SABRE/ZEN)

For information about SABRE/ZEN see Section 3, page 64.

Knowledge Infrastructure

We have continued modernising our internal technology platform through our Knowledge Infrastructure (KI) programme. The KI programme has introduced new technology which gives us:

- the ability to answer call enquiries from firms and individuals more efficiently and accurately through an advanced web-based search function for internal users; and

- a document and records management system to replace our main repository of documents and records. This will allow the FSA's records and the information in them to be better managed and maintained.

We are continuing to roll out this system, including a new application for maintaining the content of our internal and external websites and enhanced search functionality for external users, into 2011/12.

Online Notification and Applications System (ONA)

The Online Notification and Applications System (ONA) is our web-based case management system that allows firms to submit regulatory applications and notifications online. Using this system for a range of transactions became mandatory for all regulated firms in October 2010 and has allowed us to automate several internal processes, providing greater consistency and efficiency.

Post-implementation reviews have identified ways in which the system can be enhanced for the benefit of internal and external users.

Liquidity

We have designed and implemented systems to help us monitor, report and address firms' liquidity risk within the context of the new liquidity regime.

Our 'dashboard' gives supervisors effective access to liquidity data, collected through frequent, detailed reporting requirements. Supervisors can identify early warning signals on deteriorating liquidity positions with sufficient notice to proactively address issues within firms. As mentioned above, to make it easier to implement these systems, we devised and delivered programmes of tailored training for both supervisors and firms.

Building on the significant accomplishments of the implementation, our priorities are now to embed the processes and skills into 'business as usual' and to refine the systems following feedback from supervisors and our risk-management specialists.

Our main policy focus now will be to monitor proposed international liquidity standards being developed by the Basel Committee and to analyse how these may be implemented in Europe through EU legislation.

Analytics and Risk Technologies (ART)

ART will give us the ability to analyse and manage large amounts of risk information

ART will give us the ability to analyse and manage large amounts of information relating to the risks taken on by regulated firms. It will help our supervisors to ensure that firms, especially high-impact firms, have sustainable business models, adequate capital and sufficient liquidity in place.

Over the last year the ART programme has awarded key software contracts, developed the initial infrastructure design for future needs and mobilised the team for a pilot phase which will run to September 2011.

Full Risk Manager (FRM)

In our *Business Plan* for 2010/11, we said that the development of a Full Risk Manager (FRM) would deliver a strategic risk management system that would replace our existing stand-alone interim risk manager (IRM) and risk dashboard applications.

In light of future requirements arising from the Regulatory Reform Programme, ongoing delays and issues with quality, last year we decided to close the FRM project. Although the project was cancelled, much of the work from the project will be useful for the future and we have already begun to secure the positive legacy of the work delivered. We are also looking at options to improve the performance and effectiveness of IRM in the short to medium term and will begin planning the creation of revised supervisory databases and risk management systems to support the 'twin peaks' approach to regulation in 2012/13.

Office accommodation

To accommodate increased staffing levels and in line with the accommodation strategy review carried out in 2009, last year we took on an additional three floors in 1 Canada Square, Canary Wharf.

We now have sufficient capacity to accommodate the headcount we estimate we will need until the FSA is divided and its activities are assumed by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

Section

7

Financial review

Basis of preparation

We use this... to help monitor and manage our resources

This financial review is based on our Financial Management Reporting framework as updated in our *Business Plan* for 2011/12, and set out on pages 111 to 113 of this report. We use this framework for internal management purposes to help monitor and manage our resources. The framework is also designed to reduce the impact on fees of short-term volatility in our costs, including those created by pensions accounting. Under this framework, our net costs are identified as those of our Ongoing Regulatory Activities (ORA).

In addition to our ORA expenditure of £450.8m, we also spent £1.4m for items that represented additional scope for the FSA. This expenditure included work on Retail Distribution Review Professionalism and Alternative Investment Fund Managers Directive. Costs are to be recovered in future years from entities specifically aligned to these initiatives once they have been implemented.

Table 7.1: Reconciliation of statutory accounts to the financial review

	£m
Net cost for the year per the statutory accounts	**433.9**
Add: Taxation	0.4
Net costs for the year (including taxation) per the statutory accounts	**434.3**
Add: difference between accounting charges for pension provisions in the statutory accounts and the related cash costs of pension contributions paid	14.1
Add: advanced funding in respect of Transactional Reporting System and UKLA	4.5
Less: scope change	(1.4)
Less: Money Advice Service (to 26 April 2010)	(0.7)
Net costs for the year of our Ongoing Regulatory Activities (ORA)	**450.8**

Net expenditure

Cost of our Ongoing Regulatory Activity

Our net costs for the year (excluding costs associated with scope changes) were £450.8m. This is £7.2m below the original budget of £458.0m.

The tables below analyse in more detail the actual and budgeted total costs for 2010/11, by cost type and function. The budget reflects the reallocation of funds between Business Units to ensure resources are available for priorities as they emerge throughout the year, to facilitate comparison.

Staff costs were £3.4m higher than budget, reflecting a higher proportion of contractor staff compared to budget. This is due to significant levels of project activity and challenges experienced in recruiting permanent specialist resources.

IT costs were £1.8m below budget due to the lower costs arising from our third party IT services suppliers.

Professional fees were under budget by £1.5m due to the timing of initiatives. Printing, publications and other were £2.4m below budget due to an unused corporate budget contingency, set up to fund new business requirements.

Table 7.2: Net expenditure by type

	2011 Actual £m	2011 Budget £m	2011 Variance £m
Staff costs (including travel, training, recruitment and pension scheme deficit reduction contributions)	329.3	325.9	(3.4)
Accommodation, office services and depreciation	60.3	60.6	0.3
IT costs (including IT delivery outsourcing)	52.0	53.8	1.8
Professional fees	24.9	26.4	1.5
Printing, publications and other	9.6	12.0	2.4
	476.1	478.7	2.6
Sundry income	(25.3)	(20.7)	4.6
Total ORA	450.8	458.0	7.2

Sundry income was above budget by £4.6m, reflecting cost recoveries from the Money Advice Service and the recovery of certain Enforcement case costs. Sundry income also includes bank interest income on deposits.

Expenditure by business unit

Overall, we have kept our costs below budget

Overall, we have kept our costs below budget and have reallocated resources to emerging priorities.

Supervision and Risk under spends mainly reflect their allocated share of unused corporate budget contingency.

Additionally, Supervision under-spent against budget because of delays in recruiting specialist resources.

Operations costs were higher than budget as a result of costs borne on behalf of the Money Advice Service (recovered within sundry income) and higher spend on certain projects, notably significant investment in upgrading our IT infrastructure.

Table 7.3: Expenditure by business unit

	2011 Actual £m	2011 Budget £m	2011 Variance £m
Supervision	146.3	151.7	5.4
Risk	138.4	139.7	1.3
Operations	73.9	68.7	(5.2)
Other Direct Reports	50.5	50.9	0.4
Enforcement and Financial Crime	67.0	67.7	0.7
	476.1	478.7	2.6
Sundry income	(25.3)	(20.7)	4.6
Total ORA	450.8	458.0	7.2

The costs of other Direct Reports were in line with budget. Included within this Business Unit are panel costs and the Complaints Commissioner.

Panel costs

Panel costs include the cost of the Consumer Panel (£0.9m) and the combined cost of the Practitioner and Smaller Businesses Practitioner Panels (£0.3m). These figures include the costs of staff that support the Panels' work, independent research, Consumer and Small Business Practitioner Panel members' fees and expenses, and costs associated with the preparation of the Panels' annual reports. The overall costs of both these panels were in line with budget.

Complaints Commissioner

The FSA provides funding for the Office of the Complaints Commissioner (OCC), which incur costs mainly comprising of the Commissioner and his staff, accommodation and ancillary services. The OCC's total costs for 2010/11 were £0.5m, in line with budget.

Our Enforcement costs were £57.9m for 2010/11 (£68.4m 2009/10), which include the cost of external accountants and lawyers of £8.8m for 2010/11 (£7.3m in 2009/10), brought in to assist with large or complex enforcement cases. Some of the costs of enforcement cases were recovered from the firms involved and are included separately within Sundry Income.

We neither budget for penalties arising from disciplinary cases nor use them to fund our activities

Overall, Sundry Income was £4.6m higher than budget mainly due to the inclusion of £3m for Money Advice Service cost recharges (such costs are included within Operations).

As in previous years, we neither budget for penalties arising from disciplinary cases nor use them to fund our activities. During 2010/11 we collected penalties of £91.2m (2009/10: £33.5m), which will be used to reduce the amounts payable to us, by relevant fee blocks in future years.

Funding

We are funded by fees payable by the organisations we authorise, recognise, register or list. During 2010/11, £464.2m in fees was raised directly from those fee-payers (2009/10: £435.5m).

Overall, surplus funds of £6.2m were raised, mainly comprising £8.2m of surplus fees income and £1.4m of Money Advice Service periodic fees collected, offset by net £3.3m Annual Funding Requirement movement in reserves including the ongoing recovery of Outcomes-focused regulation costs. This is in line with Consolidated Fees Policy Statement CP10/7.

Table 7.4: Funding the FSA's net expenditure

	2011 £m	2010 £m
Total net costs for the year per the financial review	450.8	391.7
Under spend against budget (see reserves movement – Table 7.5)	7.2	23.3
Surplus funds raised	6.2	20.5
Fees raised in the year	464.2	435.5

Balance sheet

Financial strength

The FSA had net liabilities of £93.7m at 31 March 2011, primarily as a result of pension liabilities of £114.5m, calculated under International Accounting Standard 19: Employee Benefits (IAS 19). Excluding the pensions deficit, we had a net reserve surplus of £20.8m.

The pension liabilities will not crystallise for many years and our proactive approach to managing them and to funding our pension deficit is explained on page 109.

The FSA's current borrowing facilities total £151m, comprising two Revolving Credit Facilities of £75m each with Lloyds Banking Group and HSBC respectively and a £1m overdraft facility with Lloyds Banking Group. These credit facilities provide short-term additional capacity to fund our projected requirements.

...predominantly these monies are returned to firms...

Additionally, as at 31 March 2011, the FSA had £100.1m of cash and cash equivalents (31 March 2010: £31.0m) and our average cash balance was £172.5m in 2010/11 (2009/10: £86.3m). The FSA raised £91.2m in fines during the year (2009/10: £33.5m) and predominantly these monies are returned to firms (excluding those fined) through the following year's fee-raising cycle. In the interim, from a working capital point of view, these funds are available to the FSA to meet its statutory obligations.

We continue to monitor our cash requirements and look for opportunities to reduce the credit facilities wherever possible.

The FSA also has strong fee covenants and a predictable cash flow/working capital profile. Furthermore, the invoicing of firms is undertaken in three main tranches across the year to ensure the FSA has appropriate working capital and liquid reserves available to it, to settle its liabilities as they fall due and meet its agreed liquid funds criteria. The minimum amount of immediate liquid funds for the FSA has been set at a period of six weeks' expenditure, being our Annual Funding Review expenditure (£58m for 2011/12).

Having regard to the above, it is the opinion of the Board that the FSA is well placed to manage any possible future funding requirements pertaining to its regulatory activity and has sufficient resources to continue its business for the foreseeable future. The 'going concern basis' thus remains appropriate in preparing our financial statements.

Financial management of the FSA's pension costs

Since 1 April 2010, the Final Salary scheme has been closed to future accruals...

Our pension plan has two sections – Final Salary and Money Purchase. The Final Salary section has been closed to new members since 1 June 1998, other than staff transferring from previous regulators whose activities we have taken on. Since 1 April 2010, the Final Salary section has been closed to future accruals as part of the FSA's move to a new reward platform. At 31 March 2011, there were no active members (31 March 2010: 466) in the Final Salary section, however at 31 March 2011 there were 1,665 (31 March 2010:1,244) deferred Final Salary members and 400 (31 March 2010: 362) in receipt of pension. The Final Salary section is relatively immature compared to many such schemes, in that just over 19% of members of the Final Salary section are pensioners. At 31 March 2011, there were 3,359 (31 March 2010: 2,932) staff in the Money Purchase section.

Overall the pension deficit has increased by £1.8m to £114.5m (2009/10 £112.7m).

Key factors impacting the change in value of our pension deficit are:

- the corporate bond discount rate decreased from 5.7% to 5.6% and increased the deficit by £9.7m;
- experience losses of £13.5m and interest costs of £24.1m that increased the deficit;
- a change in mortality assumptions that decreased the deficit by £9.4m;
- a gain arising from the change in pension increase assumptions linked to inflation that decreased the deficit by £3.3m;
- a £9.9m decrease in liabilities as a result of gross benefits paid; and
- an increase in the value of assets of £23.1m, arising from contributions and investment performance.

We continue to work with the Final Salary pension scheme Trustee to secure the pension benefits of our employees and mitigate the risks arising from our Final Salary pension scheme. We believe that our approach to the management of our pension costs strikes an appropriate balance between our obligations to our staff and fee-payers. We will keep our approach under review.

Movement in the FSA's reserves

Movements in our reserves/(deficit) can be summarised as follows:

Table 7.5: Reserves/(Deficits) movements

	ORA reserve £m	Scope change & IS deferred costs £m	Outcomes-focused regulation transition reserve £m	Advanced Funding £m	Additional pension payment £m	Total £m
At 1 April 2010	14.9	(4.8)	(19.7)	14.5	(2.5)	**2.4**
Annual Funding Requirement	(11.0)	2.7	5.0			**(3.3)**
Over collection of fees	8.2					**8.2**
Operations transferred (Money Advice Service)	0.7					**0.7**
ORA budget not spent	7.2					**7.2**
Pension adjustments					2.5	**2.5**
Movement in Advanced Funding				4.5		**4.5**
Costs relating to scope change		(1.4)				**(1.4)**
Additional MaRD reduction	(9.7)		9.7			**0.0**
Total management reserves at 31 March 2011	**10.3**	**(3.5)**	**(5.0)**	**19.0**	**0.0**	**20.8**
Net pension liability						**(114.5)**
Total statutory reserves at 31 March 2011						**93.7**

Excluding pensions, our reserves have increased from £2.4m to £20.8m over the year.

ORA reserves

Our final ORA reserves at 31 March 2011 were £10.3m (2009/10: £14.9m) after using £9.7m to reduce the outstanding balance on the Outcomes Focused Regulation transition reserve. This £10.3m reserve will be used to fund our commitment to reducing the fees we need to collect in 2010/11 by £9.0m. The remaining £1.3m is being carried forward as an ORA reserve.

...provide sufficient financial capacity to allow us to meet any likely unforeseen expenditure

We believe that our total revolving credit facilities (£150m) provide sufficient financial capacity to allow us to meet any likely unforeseen expenditure. Consequently, we target a level of ORA reserve (that is the cumulative excess of our fees over our costs) of +/- 2% of ORA.

Scope change

Scope changes of £1.4m in 2010/11 have been separately identified. The accumulated expenditure of £3.5m will be recovered in future years from appropriate fee blocks.

Outcomes-focused regulation transition

After the reduction in this reserve as mentioned above, we have an accumulated deficit relating to this programme of £5m at 31 March 2011 to be recovered next year.

Advanced funding

Our advanced funding reserve separately identifies funds collected for specific projects/activities, principally related to TRS and UKLA.

Additional pension payment

A £20m pension contribution was made in 2006/07 to reduce the deficit. In 2010/11 we have written off £2.5m as planned, thus clearing the balance to £nil (2009/10: £2.5m).

Financial management and reporting framework

The scope of activities falling within our remit is wide and varied. This includes some activities which are intended to be temporary in nature and/or which are subject to considerable variation from year to year. We cannot forecast these with the same reliability as regular recurring activities. We will continue to:

- exert sound financial management and budgetary control over all areas of our expenditure and income; and
- seek to manage any unavoidable volatility to minimise the impact on fee-payers from year to year.

Our Board believes that it is helpful to have a framework within which to manage and report on our costs and funding. The following ‘streams’ of activities, which have distinct cost and funding characteristics, have been identified.

Ongoing Regulatory Activity (ORA)

These are core operating activities that are subject to year-on-year management as part of our budget process. The cost of ORA is the key figure, along with explanations of any material movements, which shows how we have met our obligation to be economic and efficient in using our resources.

Changes in scope (increase or decrease)

Under certain circumstances, including legislation introduced by Parliament, there may be changes to the scope of activities that we regulate. Any scope changes, as with our other core operating activities, are subject to financial management as part of our budget process. However, in the first financial year affected by the change in scope, and until the new supervisory process is fully established, we believe material activities resulting from a scope change are best controlled separately so they are individually identifiable. In the longer term, when the ongoing supervisory requirements of the scope change have stabilised, typically after the new scope has been in place for at least a full year, we include these activities as part of the cost of our ORA.

Exceptional items

We will include the costs of exceptional items within the cost of our ORA and will report on any material movements from year to year.

Enforcement costs

Total enforcement costs depend on the number of cases and their complexity. We will continue to manage these costs and seek to optimise the mix of internal and external enforcement resources when we do this. We have included these costs within the cost of our ORA and we will report on any material movements from year to year.

While we will maintain strong financial management of these costs, the actual amounts may be materially higher or lower than the budgeted level set in advance of the financial year (for example because a very large or complex case arose during the year which was not foreseen at the time of the budget, and which could not be addressed with the resources assigned to other priority cases). If this happens, then we will review any excess or reduction in costs from budgeted level and may seek to smooth the impact on fee-payers over a three-year period, subject to us being able to maintain satisfactory reserves.

Panel costs

The Financial Services Consumer Panel and the Practitioner Panel have a status under the Financial Services and Markets Act (FSMA) that guarantees their independence from the FSA. These bodies and the Smaller Businesses Practitioner Panel control their own costs against budgets. They are, however, subject to our approval and are funded through our fees. These costs are included within the cost of our ORA.

Financial management and reporting framework

Complaints Commissioner

FSMA requires that an arrangement be in place for the investigation of complaints against the FSA. The Complaints Scheme was introduced in September 2001. FSMA requires us to ensure that the Complaints Commissioner has at his disposal the resources to conduct a full investigation of any complaints. The Complaints Commissioner controls his own costs against a budget, which is subject to our approval and is funded through our fees. These costs are included within the costs of our ORA.

Pension scheme deficit reduction contributions

The amounts required to reduce this deficit over time are inherently variable and depend on a number of factors including current investment values and projected investment returns. We have plans in place to reduce this deficit to nil over the ten-year period to 31 March 2021.

Every three years the Trustee carries out what is known as a scheme specific valuation (SSV), which is a detailed valuation using actual asset and liability details. We agree a recovery plan with the Trustees to close the current funding gap.

The next SSV will be carried out using data as at 31 March 2013.

Reserves

In line with our Treasury Management Policy, we maintain the equivalent value of six weeks of our ORA as a contingency fund. We now anticipate that we will have sufficient financial capacity within the revolving credit facility to meet any expenditure required to address unforeseen events. We plan to keep our ORA reserves at +/-2% of ORA.

Financial risk management

In the ordinary course of business, our operations expose us to a number of financial risks including credit risk, liquidity risk, inflation risk and the risk arising from the provision and management of our Final Salary pension scheme. We have in place a risk-management programme that seeks to limit the adverse effect on our financial performance by monitoring those risks and taking appropriate mitigating action where required. FSMA provides us with the power to make rules to levy fees to fund our operations. In doing so, we seek to ensure that we operate with due regard to our economy, efficiency and effectiveness as well as seeking to minimise any unnecessary volatility in those fees.

The Board has delegated the responsibility of monitoring financial risk management to the Audit Committee. The policies set by the Board of Directors are implemented by the finance function (concerning the manner in which transactions are accounted for and the overall management of financial risk) and by our Operations business unit (concerning the financial transaction processing cycles, for example fee invoicing and collection).

Credit risk on the collection of our periodic fees

We charge fees to the persons we authorise, the bodies we recognise, the companies we list and the entities we register. The consultation process we go through in order to set our fees is designed to help ensure that they are set at a level which both reflects the regulatory activity involved and is affordable to all fee-payers, large or small. In addition, many of our smaller fee-payers use facilities offered by Premium Credit Limited, an independent credit provider, to finance the payment of our fees. In such instances Premium Credit Limited bears the credit risk, rather than the FSA. The level of unpaid debts is monitored regularly.

Liquidity, price and cash flow risk

The Board has approved a policy for the management of any surplus cash balances that we may hold above the level needed to manage our short-term liquidity requirements. Such balances are invested by our agents, Lloyds Banking Group, in high-quality, liquid deposits (thus eliminating any price risk) with a range of counter-parties in such a way as to avoid an excessive concentration of our investment with any specific counter-party. The concentration and the return on those investments, and the identity of our counter-parties, are monitored daily.

Since January 2007, we have had a revolving credit facility contract with Lloyds Banking Group, which is run alongside and operates in conjunction with the agency treasury service, allowing us to manage our net finance costs. Following analysis of cash requirements for the coming year, we have reduced this facility from £100m to £75m. We have a similar revolving credit arrangement with HSBC for a further £75m.

Final Salary pension scheme

Our most significant financial management risk is that the benefits our Pension Plan offers to its Final Salary members will not be matched by the assets available to the Plan. In that case, the residual cost will be met by the FSA. What we are doing to manage those risks is set out on pages 109 to 111.

Financial management and reporting framework

Leases

The lease on 25 The North Colonnade, Canary Wharf, London, will expire in November 2018. Under the terms of the lease, the rent for the period 4 November 2008 until 3 November 2018 rent will increase in line with R.P.I. subject to a minimum annual increase of 2.5% p.a. and a maximum of 5% p.a. As mentioned in note 15, our current assumption for R.P.I. is 3.5% p.a.

The lease on 18th floor, Canary Wharf Tower, London, was taken out in March 2008 and contains provision for a rent review in March 2013. The lease will expire in November 2018.

A short-term lease for the 24th floor, Canary Wharf Tower, London, was taken out in December 2010. The lease will expire in November 2011.

The lease on 25th floor, Canary Wharf Tower, London, was taken out in March 2010 and contains provision for a rent review in November 2015. The lease will expire in November 2018.

The lease on 26th floor, Canary Wharf Tower, London, was taken out in December 2009 and contains provision for a rent review in May 2015. The lease will expire in November 2018.

The lease on 27th floor, Canary Wharf Tower, London, was taken out in December 2009 and contains provision for a rent review in July 2015. The lease will expire in November 2018.

The lease on Quayside, Edinburgh was taken out in September 2005 and contains provision for a rent review in September 2015. The lease will expire in August 2020.

Currency risk

We do not have any significant exposure to currency risk.

Section 8

LME-003854

Contents

The Board of the FSA

1 **Paul Tucker**
Non-executive Director

2 **Margaret Cole**
Executive Director

3 **James Strachan**
Non-executive Director

4 **Sandra Dawson**
Non-executive Director

5 **Iain Brown**
Company Secretary

6 **Amanda Davidson**
Non-executive Director

7 **Andrew Scott**
Non-executive Director

8 **Adair, Lord Turner**
Chairman

9 **Brian Flanagan**
Non-executive Director

10 **Hector Sants**
Chief Executive

11 **Karin Forseke**
Non-executive Director

12 **Brian Pomeroy**
Non-executive Director

13 **Mick McAteer**
Non-executive Director

14 **Peter Fisher**
Non-executive Director

15 **Carolyn Fairbairn**
Non-executive Director

Directors' Report

Throughout the Directors' Report, references are made to the FSA website. The full addresses are detailed below.

Table 8.1

Retail Conduct Risk Outlook 2011	www.fsa.gov.uk/pages/library/corporate/rcro/index.shtml
Prudential Risk Outlook 2011	www.fsa.gov.uk/pages/library/corporate/pro/index.shtml
Business Plan	www.fsa.gov.uk/pubs/plan/pb2011_12.pdf
Corporate Responsibility	www.fsa.gov.uk/Pages/About/What/cr/index.shtml
Health & Safety	www.fsa.gov.uk/pubs/staff/staff_handbook.pdf
Equal Opportunities	www.fsa.gov.uk/pubs/staff/staff_handbook.pdf

Table 8.2

Name	Board meetings	Additional Board meetings*	NedCo	RemCo	AuditCo	RiskCo	Original appointment date	Expiry of current term
Margaret Cole	5/6	0/0					7. 9.10	6. 9.13
Amanda Davidson[e]	9/9	1/2	6/7		2/3		1. 5.10	30. 4.13
Sandra Dawson[e]	9/9	2/2	6/7	12/12	3/3		1. 5.10	30. 4.13
Sally Dewar	6/7	2/2					9. 1.08	8. 1.11
Carolyn Fairbairn[c & e]	9/10	2/2	5/8			4/4	11.12.07	10.12.13
Peter Fisher[c & e]	7/10	1/2	7/8			3/4	19. 1.07	17. 1.13
Brian Flanagan[c & e]	8/10	1/2	6/8	13/14	3/4		19. 1.07	17. 1.13
Karin Forseke[d & e]	8/10	2/2	7/8	14/14	4/4		1.12.04	31. 8.12
Mick McAteer[e]	10/10	2/2	7/8			4/4	1.11.09	31.10.12
Jon Pain	7/8	1/2					8. 9.08	28. 1.11
Brian Pomeroy[b & e]	8/10	2/2	8/8		4/4		1.11.09	31.10.12
Hector Sants[d]	9/10	2/2					4. 5.04	19. 7.12
Andrew Scott[e]	10/10	2/2	8/8			4/4	1.11.09	31.10.12
Hugh Stevenson[a, c & e]	2/2	2/2	2/2	2/2		0/0	1. 6.04	31. 5.10
James Strachan[e]	9/10	1/2	7/8	10/14	3/4		1.11.09	31.10.12
Paul Tucker[e]	8/10	2/2	5/8			2/4	1. 3.09	29. 2.12
Adair Turner	10/10	2/2					20. 9.08	19. 9.13

Key
a Chair of the FSA Pension Plan Trustee Ltd (until 31 May 2010)
b Chair of the FSA Pension Plan Trustee Ltd (from 1 June 2010)
c Director serving second concurrent term
d Director serving third concurrent term
e Independent non-executive director
* Additional to those scheduled at the start of the year.

Committee membership during the year:

Audit Committee (AuditCo)
Amanda Davidson (member since 27 May 2010)
Sandra Dawson (member since 27 May 2010)
Brian Flanagan
Karin Forseke (Chair of AuditCo)
Brian Pomeroy
James Strachan

Remuneration Committee (RemCo)
Sandra Dawson (member since 1 June 2010)
Brian Flanagan
Karin Forseke (Chair of RemCo from 1 June 2010)
Hugh Stevenson (Chair of RemCo until 31 May 2010)
James Strachan

Risk Committee (RiskCo)
Carolyn Fairbairn (Chair of RiskCo from 1 June 2010)
Peter Fisher
Mick McAteer
Andrew Scott
Hugh Stevenson (Chair of RiskCo until 31 May 2010)
Paul Tucker

Committee of Non-executive directors (NedCo)
All non-executives are members of NedCo.
Hugh Stevenson was chair of NedCo until 31 May 2010.
Karin Forseke was chair of NedCo from 1 June 2010.

The only members of the FSA are the directors. Each current director has undertaken to guarantee the liability of the FSA up to an amount of £1.

The executive directors are not directors of any UK-listed companies and have no other paid positions.

The deputy governor (Financial Stability) at the Bank of England is a member of the Board of the FSA. In a reciprocal arrangement with the Bank of England, the FSA's chairman serves as a member of the Court of the Bank of England.

All the FSA's directors are appointed by the Treasury, with input on the selection panel from at least one incumbent member of the FSA Board. Although the FSA is not subject to the code of practice issued by the Commissioner for Public Appointments, appointments are made in line with the principles in the code.

The chairman of the FSA is appointed for a five-year term and all other directors are appointed for three-year terms. The executive directors have continuous employment contracts with the FSA, details of which are given in the Remuneration Report.

The directors present their report for the year ended 31 March 2011.

Principal activities

The FSA is the primary regulator of financial services in the UK and has statutory responsibilities set out in FSMA. Detailed information on the FSA's principal activities for the year can be found in Sections 2 to 5 of this Annual Report.

Business review

As a company, it is necessary for the FSA to provide a fair review of its business. This requirement is fulfilled by information provided in the first six sections of the Annual Report.

Principal risks and uncertainties

The principal risk for the FSA is the failure to meet its statutory objectives. The key external issues that pose risks to the FSA's ability to meet its statutory objectives are explained in the Prudential Risk Outlook.

In addition, following the government's announcements on regulatory reform, there are considerable risks relating to the execution of the transition of the FSA into the PRA, the FCA and the Bank of England, including the impact on the FSA's capacity to deliver against its current FSMA obligations. The Board has regularly reviewed the FSA executive's strategy to mitigate these risks, which is led by a high-level transition committee, and will continue to scrutinise and challenge the plan to ensure operational risks are minimised. All identified risks and uncertainties are kept under review throughout the organisation, including by the Executive Risk Committee and, at the highest level, by the Risk Committee and the Audit Committee. Further information on some of the key areas recently reviewed can be found in the committees' reports.

Development and performance of the FSA

Analysis of the FSA's performance during the year and the position at the end of the financial year are set out in the Financial Review and the financial statements for the year. Future developments of the FSA can be found in the Business Plan for 2011/12, which is available on the FSA website and provides information relating to the FSA's budget and priorities.

Qualifying indemnity provisions

Qualifying third-party indemnity provisions for the purposes of section 232 of the Companies Act 2006 were accordingly in force during the course of the financial year and remain in force at the date of this report.

Directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law, the directors have elected to prepare financial statements in accordance with international financial reporting standards as adopted by the European Union. The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable International Financial Reporting Standards as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records that disclose, with reasonable accuracy at any time, the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and for taking reasonable steps to detect and prevent fraud and other irregularities.

Insofar as the directors are aware:

- there is no relevant audit information of which the company's auditors are unaware; and
- the directors have taken all steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the FSA website. Legislation in the UK governing the preparation and distribution of financial statements may differ from legislation in other jurisdictions.

Financial position

The FSA's primary source of income is the fees charged to regulated firms. Specific information on the FSA's financial position is provided in the financial statements and in the Financial Review. The Financial Review explains how the

FSA manages its pensions liabilities. The directors agree with the analysis in the Financial Review and believe the FSA remains able to meet its liabilities as they fall due.

Going concern

The business activities of the FSA are summarised in the chief executive's report, with details of the factors likely to affect the future activities of the FSA being outlined in Sections 1 to 6 on pages 15 to 103.

The FSA's financial strength, liquidity position and borrowing facilities are described in the Financial Review on pages 105 to 113. The FSA's objectives, policies and processes for managing its capital, its financial risk management objectives, details of its financial instruments, and its exposures to credit risk and liquidity risk are included in the notes to the financial statements.

The FSA has statutory power granted to it under the Financial Services and Markets Act (2000) to raise fees to fund its regulatory activities. Having regard to this and to the FSA's credit facilities, the directors believe that the company is well placed to manage the future funding requirements of its regulatory activity.

Based on the above, the directors have a reasonable expectation that the FSA has sufficient resources to continue its business for the foreseeable future and therefore the 'going concern' basis continues to be appropriate in preparing the annual financial statements.

Corporate responsibility

With regard to corporate responsibility (CR), the FSA aims to be a good corporate citizen and develop projects that will both help the community and be of benefit to staff.

For the FSA to consider undertaking a CR activity it must pass one of three tests. The activity must:

- support the FSA's statutory objectives;
- make the FSA a better regulator, as defined in the FSA's principles of good regulation; or
- be considered best practice by the industry and be seen as appropriate for the FSA.

The FSA publishes a separate CR Report that focuses on the following key areas.

People

The FSA is committed to promoting equality and diversity and creating a positive culture in all areas of its work as an employer and a regulator, where differences are recognised, supported and celebrated. The FSA has policies that outline its approach to equality, diversity and inclusion, flexible working, career development, and wellbeing. Each of these emphasise the FSA's commitment to its people. The FSA has key performance indicators that focus on these areas. Performance, where possible, is measured and reported in the CR section of the website. The FSA continues to review and develop measures for those areas that are not currently assessed.

Environment

The FSA is conscious of the impact of its operations on the environment and the increasing expectation that organisations should manage this impact. The FSA aims to reduce CO_2 emissions, energy use, water and the waste it produces, as well as increase the amount of waste that is recycled. To achieve these aims, the FSA seeks to raise awareness of environmental issues among its staff. It sets targets in each of its key impact areas, and these are measured and reported on in the CR section of the FSA website.

Community

The FSA strives to have a positive impact on society. It encourages, supports and enables staff to play an active role in the local community near its headquarters. Key performance indicators assess the numbers of employees involved in volunteering and the number of community recipients of the FSA's various projects. Staff are encouraged to view volunteering as a part of their personal development, and, to facilitate that, all applications for volunteering are now put through the FSA's internal learning and development booking system.

Equality and diversity

The FSA is committed to the principles of equality, diversity and inclusion. The FSA continues to seek ways of further improving its performance in this area, ensuring that all members of staff, visitors and applicants are treated on the basis of their merits and abilities and that no one suffers discrimination or disadvantage regardless of gender, race, disability, sexual orientation, religion/belief or age. The FSA also takes into account its equality responsibility regarding its regulatory approach.

To ensure effective governance of this work, the FSA has in place an Executive Diversity Committee, which acts with the full authority of the Executive Committee. The Executive Diversity Committee is responsible for leading and directing the FSA's internal and external diversity agenda. This supports the FSA being an employer of choice and a more effective regulator, and includes Senior Leader Champions for each of the diversity strands.

During the last year, a mandatory training package for all staff was developed and delivered, in addition to specific training and awareness sessions for the Senior Leadership Team. There are a number of staff networks in place, a staff representative group and a regular programme of awareness talks and interactive sessions covering different aspects of diversity. A diversity-specific all staff survey was initiated to gauge perceptions of diversity within the FSA and highlight priority areas for the coming year.

With regard to the FSA's responsibilities within the regulatory sphere, the Equality Impact Assessment process for all new policies and processes has been enhanced and this has been used to revisit some of the key existing processes to ensure the FSA's obligations are fully met.

The FSA has begun to develop a portfolio of work looking at the issues of gender representation on boards and worked on the development of a supervisory toolkit in relation to equality, diversity and the industry's obligations. This will be delivered in the forthcoming year.

Over the course of the year, the FSA has been preparing to ensure that its obligations in relation to its Public Sector Equality Duty are met, and have opened discussions with key stakeholders, including representatives of the industry, to develop the best approach to take forward.

Employee involvement

A variety of media is used to communicate with employees, including the intranet, email, weekly floor briefings, forums and staff meetings. Employees are invited to give feedback on the FSA and its operations, both informally and formally, through a number of staff surveys.

The Staff Consultative Committee is the forum through which the FSA complies with the EU Information and Consultation Directive 2004. It also provides a clear channel of communication and consultation between the FSA and its staff. It gives staff the opportunity to contribute to and influence the development of the FSA, and to provide their views to the highest levels in the organisation. The FSA recognises the importance and value of ensuring this process happens effectively.

Employee training

Employees are given opportunities to undertake a variety of in-house and external training and, during the year, each employee spent an average of 6.5 days training (5.8 days in 2009/10).

Charitable donations

Following the termination of the lease agreement at 25 Bank Street, the FSA (in partnership with its service providers) made a voluntary gift of furniture which was no longer required by the FSA to a registered charity. This furniture, when purchased as new furniture four years ago, cost the FSA £70,000 and at the time of the donation had an estimated value of £42,000.

Health and safety

The FSA is committed to providing a healthy and safe environment. It pursues a policy to promote health and safety at work and seeks the cooperation of all employees and visitors in this endeavour.

Creditor payment policy

The FSA's policy is to aim to pay 90% of valid invoices with a correct purchase order within 30 days of receiving them. The average time taken to pay suppliers from receipt of invoice was 30 days (30 days in 2009/10).

Auditors

The National Audit Office were appointed as auditors of the company at a General Meeting on 1 July 2010.

By Order of the Board

K Iain Brown
Secretary
26 May 2011

Corporate governance statement and remuneration report

Corporate governance statement for the year ended 31 March 2011

Table 8.3

Accountability mechanisms	www.fsa.gov.uk/Pages/About/Who/Accountability/index.shtml
Role of Chairman	www.fsa.gov.uk/pages/About/Who/Management/Chairman.shtml
Role of Chief Executive	www.fsa.gov.uk/pages/About/Who/Management/CEO.shtml
Schedule of matters reserved to the Board	www.fsa.gov.uk/pubs/other/SoM.pdf
Board delegations including terms of reference of the committees	www.fsa.gov.uk/pubs/other/Gov_memo.pdf
Directors' biographies	www.fsa.gov.uk/Pages/About/Who/board/index.shtml
NedCo, RemCo, AuditCo and RiskCo membership	www.fsa.gov.uk/Pages/About/Who/board/committees/index.shtml
Regulatory Decisions Committee membership	www.fsa.gov.uk/Pages/About/Who/board/committees/RDC/index.shtml
Listing Authority Advisory Committee	www.fsa.gov.uk/Pages/About/Who/board/committees/laa/index.shtml

The FSA is a company limited by guarantee and, as such, is not obliged to comply with the UK Corporate Governance Code (the Code). However, the Board is committed to meeting high standards of corporate governance and has decided that the FSA should comply with the Code as far as appropriate. This report includes an explanation about where the FSA complies with the principles in the Code.

FSMA requires the FSA to have a number of accountability mechanisms, which include an Annual Public Meeting and the requirement to report on the extent to which its regulatory objectives have been met. The FSA, which is funded by the industry it regulates through its statutory fee-raising powers, operates independently of government, but is accountable to Parliament through Treasury ministers. The FSA is required to consult on its rules and general policy with consumers and practitioners and it does so through the Consumer, Practitioner and Smaller Businesses Practitioner Panels. More information about the accountability mechanisms can be found on the FSA website.

A unitary Board leads the FSA and approves the company's strategy and annual operating plan and budget. There is a schedule of matters reserved to the Board and a governance memorandum setting out the delegation of various functions, which can be found on the website. The majority of the Board is made up of non-executive directors who, in addition to their statutory responsibilities under the Companies Act 2006, have specific obligations under FSMA. The Board is of sufficient size to ensure the requirements of the business are met. Changes to the Board composition and any of its committees are managed without undue disruption. FSMA requires there to be a non-executive directors' committee (NedCo), which keeps certain functions under review. Information on its work is set out in the non-executive directors' report.

The Board meets regularly. Details of the number of Board and committee meetings held this year and attendance at those meetings are set out in Table 8.2. The membership of the various committees can also be found in Table 8.2 and on the FSA website.

The roles of the chairman and chief executive of the FSA are split, and responsibilities are set out on the website. The chairman, who was independent on appointment in September 2008, leads the Board and ensures its effectiveness, and the chief executive develops and delivers the strategic objectives agreed with the Board.

The non-executive directors of the Board have a variety of skills and experience that are appropriate for the requirements of the company. Further details of their backgrounds can be found on the website. Notwithstanding any contact they may have with the FSA as a result of being connected with a regulated firm, or as consumers of regulated products, the non-executive directors are judged to be independent of the FSA. Where any conflicts of interest arise relating to personal or business matters, procedures are in place to ensure that no director is exposed and that decisions are taken without undue influence. The Board members also adhere to a Code of Conduct.

The chairman ensures, with the company secretary, that the Board's agendas are set in line with the priorities of the company. The company secretary reviews papers before they are circulated to Board members to ensure that information is accurate and clear. Papers are usually circulated one week before meetings.

One of the non-executive directors acts as chair of the non-executive directors' committee and is viewed as the senior independent director.

Directors of the FSA are formally appointed by the Treasury following a rigorous selection process. The selection panel comprises representatives of both the FSA and the Treasury. Although the FSA is not subject to the code of practice issued by the Office of the Commissioner for Public Appointments the procedures followed are in line with the principles in the code.

When directors are appointed, the company secretary arranges an induction that is appropriate for their knowledge and experience. The Board receives ongoing professional development on issues that are relevant; during the year this included training for non-executive directors on product intervention, analytic and risk technology, Mortgage Market Review and European regulatory structures. Individual directors have also had the opportunity of personal briefings on other topics before Board meetings.

Each director has access to the advice and services of the company secretary who also advises the Board on all aspects of governance matters. The company secretary will provide access to external professional advice for directors, if required.

Due to its statutory nature, the FSA benefits from immunity under FSMA in respect of legal action, which it supplements with indemnities in favour of individual directors. The Board therefore regards insurance in respect of legal action against directors as unnecessary.

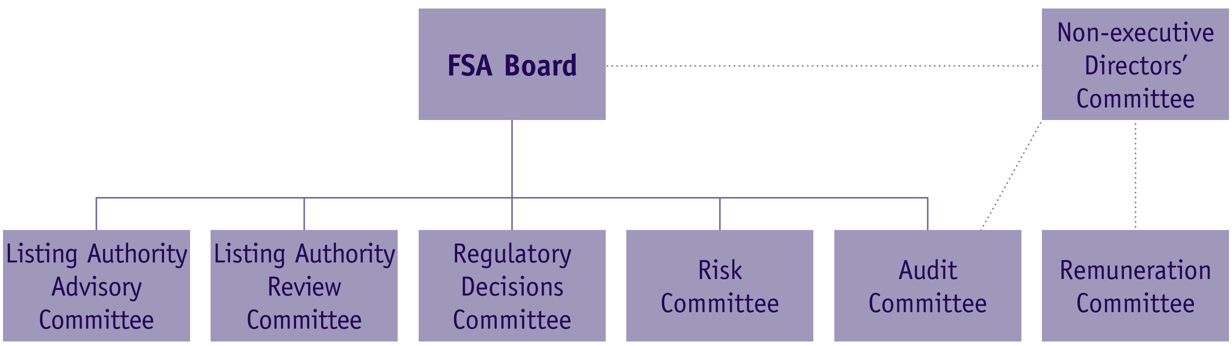
During the year, a number of evaluations relating to the Board, its members and committees were carried out.

The chair of NedCo led a review of the chairman's performance, taking input from key stakeholders and Board members and feedback was provided to the chairman. During the year, RiskCo reviewed its operation – focusing particularly on the planning and structure of its agenda – and appropriate changes were implemented.

In June 2010 the government announced its proposals for the reform of financial services regulation in the UK. The effect of those proposals, when implemented, would be to create a new Financial Policy Committee located within the Bank of England and for the FSA to be replaced by two new organisations – the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). Both of the new organisations will have Boards to oversee their operation, although the composition and responsibilities of them will only be confirmed once the current legislative process is complete.

During the year, the chairman held one-to-one discussions with the directors in relation to each individual's contribution to the Board and to obtain views on Board operation. The Board considered whether changes to its operation should be made to reflect the future structure, while allowing the Board to continue its oversight role for the current organisation.

Governance structure



The non-executive directors' committee (NedCo)

NedCo operates in line with the provisions of Schedule 1 to FSMA. During the year, NedCo ensured that its statutory functions were being satisfactorily discharged by:

- reviewing reports on the efficient and economic use of the FSA's resources;
- receiving reports on the Audit Committee's (AuditCo) work in keeping under review the question of whether the FSA's internal financial controls secured the proper conduct of its financial affairs (via reports made to the full FSA Board);
- receiving reports from RemCo on the remuneration awards to the executive directors and the chairman and the performance-related bonus payments made to the executive directors; and
- receiving reports from RemCo on its review of the priorities and focus of the executive directors' objectives and approving those objectives.

NedCo's composition is shown in Table 8.2. Further details on the statutory functions it discharges can be found on the FSA website.

Report of the non-executive directors

The unitary Board (which includes all non-executive directors) is the FSA's primary decision-making body. It also exercises a broad oversight of all the FSA's policy, strategic and operational activities. The extent of the Board's role and the provision of timely and relevant information to the Board, its committees and NedCo allows NedCo to rely largely on the Board's work while sharing other functions, including oversight of internal controls, with AuditCo. RemCo reports on its work to NedCo.

Efficiency and economy

During the year, NedCo kept under review whether the FSA was using its resources in the most efficient and economic way. Data relating to the measurement of efficiency and economy forms part of the management information presented to the Board quarterly and was reviewed specifically by NedCo. NedCo challenged information provided to it and sought further explanations when appropriate.

Internal financial controls

During the year, NedCo has kept under review the question of whether the FSA's internal financial controls secure the proper conduct of its financial affairs, in conjunction with AuditCo, which is a Board committee. The full statement on internal controls, which includes information on financial controls is on page 136.

Remuneration of the executive directors

NedCo has delegated to RemCo the function of determining the remuneration of the chairman, the chief executive, the executive directors and certain other senior staff.