HOUSE OF COMMONS

Treasury Committee

Oral evidence: Press Briefing of Information in the Financial Conduct Authority's 2014/15 Business Plan, HC 881

Wednesday 7 January 2015

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Watch the meeting

Members present: Mr Andrew Tyrie (Chair); Rushanara Ali, Steve Baker, Mark Garnier, Mike Kane, Mr Andrew Love, Jesse Norman, Teresa Pearce, Alok Sharma, John Thurso

Questions 272-411

Witnesses, Panel 1 [Q272-366]: **James Palmer**, Herbert Smith Freehills and Chairman, Listing Authority Advisory Panel, and **Otto Thoresen**, Director General, Association of British Insurers, gave evidence.

Witnesses, Panel 2 [Q367-411]: **Graham Beale**, Chairman, Practitioner Panel, FCA, **Andrew Turberville Smith**, Chairman, Smaller Business Practitioner Panel, FCA, and **Paul Swann**, Chairman, Markets Practitioner Panel, FCA, gave evidence

Q272 Chair: Thank you very much for coming before us this afternoon.

The regulated community spends a good deal of time complaining about the regulators, and one of our tasks is to try to distinguish moaning and lobbying from legitimate and sometimes serious concerns. It is with that in mind that we are holding this hearing this afternoon. Could I begin by asking you, Mr Thoresen, the general view of ABI members about how the FCA regulates the industry?

Otto Thoresen: A short answer to that question is that they have a very challenging task in front of them. We have worked constructively with them, fairly consistently, over the period that they have existed. We have learned a lot about how they work, and they are learning a lot more about the industry as time goes by. With the exception of one or two occasions, I would say that that learning is leading to a continuing, constructive engagement.

Q273 Chair: You are broadly happy with their performance.

Otto Thoresen: To represent a membership as broad as mine is a challenge, but I would say "broadly happy", yes. There are specifics—

Q274 Chair: Do you think that firms are scared of criticising the regulator?

Otto Thoresen: I think that they are very thoughtful about criticising the regulator. To a certain extent, that is entirely understandable. If you take the insurance industry, there are many aspects of how it operates and performs that we need to work hard on improving. Working with the regulator to achieve progress on those things is important. Individual firms choosing to engage publicly in debate about the performance of the regulator is unlikely to be particularly productive for them.

Q275 Chair: The question that I am asking is: does that lead them to not say what they really think?

Otto Thoresen: Privately they are very direct in engaging with the regulator on issues they feel uncomfortable about.

Q276 Chair: What about public criticism?

Otto Thoresen: Public criticism of the regulator? I am not convinced that that is a particularly constructive or optimal way of trying to move the agenda ahead, frankly. I would say that it is better, if you have issues, to engage privately on trying to get those addressed.

Q277 Chair: So in a nutshell, they are on a steep learning curve with respect to insurance, but are developing a constructive and good relationship with the industry. Would that be a fair summary?

Otto Thoresen: That is a reasonable summary, yes.

Q278 Chair: Mr Palmer, would you say that the FCA is as focused on its role as the listing authority as it is on other statutory obligations?

James Palmer: I think at the senior levels, the answer is no, but that is because it has not needed to be. The listing authority and the markets division have not been associated with any of the scandals of the crisis—they have been elsewhere in other parts of the FCA. The listing division, which is the part that my panel liaises with, has a good track record and has some able people in it. Yes, we have issues that we engage and disagree with them on from time to time, but it is a very good debate. The FCA's focus elsewhere has been understandable in recent years.

Q279 Chair: On the basis of what you have seen, do you basically agree with what Mr Thoresen said with respect to the relationship between the regulator and the regulated community?

James Palmer: I agree with him that it is a challenging task. I act for clients across all areas of financial regulation. I probably hear more criticism of elements of supervision—concern about misguided supervision, and a lot of concern about churn within the FCA and a lack of retention of capability—but, on the whole, I hear people believing that the FCA is trying to do a good job and trying to engage. It has removed itself from suggestions that it was captive to the industry, but is trying to avoid, in its private engagements at least, being too contrary.

Otto Thoresen: Perhaps I could add a little bit on some specifics. One of the standing issues that we, as an industry, have been uncomfortable about was the sheer volume of activity, and activity laid upon existing activity, and then more activity. We have pushed hard for prioritisation and for an attempt to try to sort out what things can achieve the best improvements in the environment most quickly, and trying to co-ordinate those so that you do not go in looking for data on more or less the same subject many times. There is plenty of that sort of pushback and debate but, frankly, that is pretty normal in an environment like this in which there is the breadth of coverage that they are trying to achieve. It is not that it is a perfect world but, to the spirit of your question, I would stand by the answer I gave.

Q280 Chair: Mr Palmer, do you think that the people you work with are sorry to see Mr Adamson go?

James Palmer: I do not know the answer to that. I suspect that they are, given his experience.

Q281 Chair: Mr Thoresen?

Otto Thoresen: In a trade association and in the role that I have, I do not regularly hear feedback on individuals within the regulator from the perspective of a member, but I hear a general comment about experience and knowledge of the sector. Somebody like Clive, who has a long track record of engagement in that role, will be a loss in terms of his expertise.

Q282 Chair: Do you think that the right people left the FCA in the wake of the Davis report?

Otto Thoresen: That is a question that I do not feel qualified to answer. As you might expect, I have read the Davis report many times and, factually, it covers the ground extremely well, but it still cannot really give you a sense of how that organisation is, for example, as an organisation to work in, and nor can it really give you a sense to make judgments about how—

Q283 Chair: Did it make those judgments or was it really a factual account, as you implied with the first part of your answer?

Otto Thoresen: What it pointed out to me were some very clear aspects of process that needed to be looked at and changed. The sense I got was that people within the organisation were carrying out their roles within the process that applied in a reasonably straightforward way. For me it was more the processes that applied that were the issue rather than the individuals but, as I say, that's based on—

Q284 Chair: Meaning?

Otto Thoresen: Well, I can give you a couple of examples to try to make that real. If you take a thematic review like the legacy thematic review, which is at the heart of this, you would expect a process that had some senior ownership of that piece of work, and somebody who was looking across all aspects of the way it was being developed and delivered, and who would be doing the scanning on how progress was being achieved to see if it was still on track and achieving what we want to achieve. The point there for me was the issue about this duality of purpose between the engagement publically, on the one hand, from the supervisory teams to clarify what the thematic was and what it wasn't and, on the other hand, from the media teams, to achieve coverage and make it clear that the conduct regulator was on the front foot and moving ahead.

For me, you would expect someone senior in the organisation to be looking at that in the round and saying, "Are we still on the track that we originally meant to be?" I did not see evidence in the report of that being present. That is just one example of a process point that I might expect to see done differently.

Q285 Chair: Do you have anything to add with respect to the reply we have just had on whether the right people left the FCA?

James Palmer: No.

Q286 Jesse Norman: Mr Palmer, what did you make of the Davis report?

James Palmer: I thought it was a very good and comprehensive piece of work.

Q287 Jesse Norman: And how happy or unhappy did practitioner members of the panel feel about the report?

James Palmer: We have not had a meeting of our panel since it came out, but I have certainly spoken to colleagues around the sector and the general view that I have picked up is that it was a thoughtful piece of work with some very constructive recommendations. If one looks at it, as the Chairman opened the discussion, with the principle of trying to ensure we have an effective regulator and an effective balance here, it seemed to me that the recommendations hit the nail.

Q288 Jesse Norman: So it got to the heart of the issue and it made some sensible recommendations.

James Palmer: Yes.

Q289 Jesse Norman: Presumably, practitioner members were pretty angry about the original set of events that had precipitated it?

James Palmer: The biggest level of frustration was in the industry that Mr Thoresen represents. I think there was a degree of frustration, and probably exasperation and regret, because anything that damages the reputation of the regulator, which this clearly did, is not helpful for the industry. It weakens the regulator, and we want a strong and effective regulator and this didn't help to instil confidence.

Q290 Jesse Norman: Part of the FCA's point is to build confidence in the quality of financial services and this significantly reduced confidence in the quality of financial services.

James Palmer: It was certainly very unhelpful.

Q291 Jesse Norman: Mr Thoresen, do you want to comment on any of those things?

Otto Thoresen: When I spoke to you last on this, it was very shortly after the event. The experience we have had in working with the regulator since the event is that on the particular aspect that we found the most concerning—the whole media engagement, communication and rhetoric piece—we have felt a change and a better balance even before the Davis report came through. What I was arguing for then, if you recall, was that the regulator should not feel an obligation somehow to expand or extend the impact of what it's doing. It has such power and import that it needs to be balanced, objective and fact-based in what it does, because that in itself has enormous potential for change.

Q292 Jesse Norman: Colleagues will come in on this, but it is true, isn't it, that the FCA is remarkably unaccountable, by design, in many of the ways that it operates?

Otto Thoresen: Governance and sustainability around the organisation—in a way, in the comment I just made about us feeling change, you almost already have a concern about how sustainable that is and whether it is the way things will continue. How the existing governance processes work, how the relationship with the panel works, how the engagement with the industry continues, and the very detailed issues around market-sensitive information, which are going to be far more focused on as a result of what happened a year ago, all need to continue to be taken on, but on a sustainable basis. That, for me, is about governance and oversight, and who regulates the regulator. Which is the organisation or organisations that can hold them to account?

Q293 Jesse Norman: Because the two things that came through most clearly were the lack of communication within that organisation on key issues and the lack of awareness of market behaviour. Is that something you picked up separately, Mr Palmer? On listings, do you feel you now have a degree of attention that you were not being paid before?

James Palmer: I think the community that is regulated by the Listing Authority has the right level of attention already. This was obviously an issue of a lack of awareness within other parts of the FCA of the listings sensitivity—of the market sensitivity. It is quite clear that this will have changed that, as Mr Thoresen says.

Q294 Jesse Norman: So you are comfortable that the FCA is fully competent to manage an industry of this size and complexity, Mr Thoresen, and hopefully with a degree of restraint appropriate to its lack of accountability.

Otto Thoresen: I think we may return to the accountability point. I don't think we should admit defeat on that or just accept that it cannot be improved. I think that is something we should discuss. On the first point, I go back to my opening remarks. The breadth of coverage that they have, the challenges of the markets to which they are trying to provide oversight and the importance of those markets mean that any organisation is going to find that it has to keep learning and developing its way of doing that. It has always got improvement in it.

Q295 Jesse Norman: Just to be clear, there is a difference, isn't there, between what you might call ultimate one-off accountability, which causes someone to be fired because something has gone badly wrong and there is a big public and industry reaction to it, and what I think of as rather more important in some aspects: the capacity of users and those around a regulator to ensure proper day-to-day accountability with the regulator? It is that that makes the most difference to your members, I think.

Otto Thoresen: Even as the events were happening at the end of March, there was much about the way we saw the FCA working with us that we saw as positive, and we continue to see as positive. Apart from volume of activity, priorities and all that stuff, which I have already talked about, the thing that we were consistently uncomfortable about was the tendency to extend into the territory of rhetoric away from the facts.

Q296 Jesse Norman: But you would agree with that distinction between one-off accountability and regular operating accountability, and you are seeing an improvement in both.

Otto Thoresen: Yes.

Q297 Alok Sharma: Mr Thoresen, you just made the point that, despite everything else that was going on at the end of March, the FCA was working positively together with the industry in certain aspects. Clearly, when it comes to the events at the end of March, that was not the view of the FCA Practitioner Panel. In fact, it stated in its report that "an unavoidable consequence of the direction of travel of the FCA's media policy" effectively resulted in those events. Do both of you share that view? Mr Thoresen first.

Otto Thoresen: Yes, essentially the points I have just made around the one aspect of their approach a year ago, which we had over a period of months been uncomfortable about, was what I described as rhetoric. It was the extension of talking about the facts and the analysis into making more broad-brush statements that took it beyond that. I think the Practitioner Panel is in the same space.

James Palmer: I agree. I sit to co-ordinate the two market-facing panels on Mr Swann's Markets Panel as well. At the December meeting we had a discussion with Zitah McMillan at which I and a number of others expressed strong concerns about the communications policy on exactly this issue.

Q298 Alok Sharma: As you said, things are now improving in the relationship between the FCA and the industry, but what happened at the end of March was fairly cataclysmic. Can you point at any other events over those preceding months where you thought there were incidents that perhaps were not quite as cataclysmic, but demonstrated that perhaps things were not working as well as you would have liked?

Otto Thoresen: There is one example that I can share. I remember it clearly. It is not a subject that is closed; it continues. The FCA had been working for some time in the area of the annuity market and how it operates. There was a preliminary piece of work completed in, I think, February 2014. It was the initial review of how the market operated and the issues that they wanted to focus on in their next phase of operation on the annuity market. There were some specifics around that which for me were informative about how things were working at that time. It is a mixture of the good and the bad.

The good was full engagement with—let us call them—the management team who were operating within the FCA on that particular piece of work, so the analysts who were working on that came and talked to us about some of their thoughts and findings as they were drafting the report. They listened to some of our feedback about some of the perspectives they perhaps should take that they had not taken. That felt very productive with good dialogue. Of course, it was for them to write the report, but we were in a position where we felt we were being listened to. Then there was the publication of the report itself. A particular headline that was being developed was that eight out of 10 people could get a better deal if they shopped around, but in fact—

Q299 Alok Sharma: Why do you think this was happening within the FCA? In the private sessions that you were having with them, you were satisfied, but what was coming out publicly was counter to what had been discussed.

Otto Thoresen: I am speculating, because of course I was not there and I was not involved in the discussions, but if you look at the equivalent case within the Davis report, which is public and which is discussed, you had then a supervisory focus on building a fact base—creating a basis on which to move the debate forward, identifying where the work needed to be done and identifying the issues—and you had a media perspective that was, "Where is the headline in this, and how can we get the coverage that we want?" I imagine that there was something similar there, because in fact the analysis said that eight out of 10 people who did not shop around could have got a better deal, and that would be the equivalent to three out of 10 of the population as a whole, which clearly does not have as big an impact, although it is still an important issue.

Q300 Alok Sharma: Mr Thoresen, when you came in April, you told us that the ABI had become used to the FCA's press releases being more extreme than the substance of its work. Mr Adamson's view was that some of the speeches being made by FCA staff "perhaps inflame the problem rather than solve the problem." That is consistent with what you are telling us that the approach was. Can you give us examples of how you have seen improvements over the last few months?

Otto Thoresen: I do not have examples. I can't say that it was this press release—

Alok Sharma: Can you talk about how the tone may have changed?

Otto Thoresen: The point is that I cannot remember over the last nine months experiences where I have felt that what I was reading in the press release did not fit with what I understood to be the substance of the report or the analysis on which it was based. It is as simple as that. The other factor that was clearly present in this example, which led to the Davis review in the first place, was that even where you had the rhetoric in the past that was extended from the facts, at least the facts were published at the same time, so you could take whoever was commenting and say, "Look at the facts. This does not fit with this rhetoric." On this occasion we did not have the facts, so until we saw how it was, we could not really comment.

Q301 Alok Sharma: A final question from me. How badly do you think the FCA's communications strategy has damaged its relationship with the industry? Secondly, how much recovery has there been over the last few months?

Otto Thoresen: Answering the second question first, through what has been happening and the actions that have been taken, I think there has been recovery. That has to be maintained, but I do think that the working-level trust between teams in the industry and the regulator continued pretty well through this period and are being maintained.

As to whether the communications strategy itself is in a more sensible place, other than the single points of evidence—or absence of the opposite, if you like—that I have experienced over the last nine months, I cannot really say. But the sense I get from talking to senior people in the FCA is that they completely acknowledge that this went further than was right and that they have learned from that experience.

James Palmer: I am not sure that I have anything specific to add. The sense that Mr Thoresen has described is consistent with my—probably less direct—impressions.

Q302 Mark Garnier: Martin Wheatley justified the use of the media as a way of contacting member firms; he said that the FCA cannot visit all the 72,000 firms that it regulates, “but if those firms see what it is we care about, they will respond to that.” Is that a viable proposition or complete nonsense—or something in the middle, perhaps?

Otto Thoresen: Well, I disagree with it. The FCA has responsibility for a broad and widely spread community. I am from a sector, of course, that is significantly relatively concentrated in that sense; we have 300 member firms, but that is not 300,000. There is something in the point that mass communication has to be part of setting the tone and expectation of regulated organisations, but in the 21st century, with the capabilities that technology brings us, targeted communication with those individuals and groups is possible to quite a high level of sophistication. The problem with a broadcast medium is exactly that—it is a broadcast medium, and the ability to control the nuancing of the messaging is quite limited.

Q303 Mark Garnier: Zitah McMillan said that using direct e-mails would be seen as less than transparent. Do you think that a viable comment?

Otto Thoresen: You should use all channels of communication appropriately. The point is that if you are communicating about the regulatory objectives of an organisation, the regulatory priorities that it is setting and the impact that will have on individual firms and their expectations, you have to be as clear and specific as you can and be confident that the message has been received as it was meant to be transmitted.

When you move to mass communication techniques, you are taken by definition right out to the edge of what can be achieved. Yes, send the broad signals and the big themes by all means, but do not get into trying to launch a specific part of your business plan.

Q304 Mark Garnier: Is it not fair to say, though, that if you are going to use the media it will be entirely unclear whether the message is directed at the regulated or those being protected by the regulators? You will probably agree that using the media is a perfectly valid way of demonstrating to the wider public what they should expect from a regulator working on their behalf, but it is not okay to try to use it as a communications tool. That is very clear.

Otto Thoresen *indicated assent.*

Q305 Mark Garnier: Mr Palmer, can I develop the issue a bit more when it comes to how it looks with the Listing Authority in particular? As we have seen, that is clearly a much more important area. Do you think the FCA has a particular, unique responsibility to make every communication absolutely crystal clear before it is made?

James Palmer: Let me put it differently. There are two points. First, the FCA have a particular responsibility to care about their reputation; they do try to do that and take it seriously, although their reputation was clearly dented in this case. Therefore they need to take an extra level of care over communication. I would not want to see them pushed to the ultimate extreme of over-prudence and over-self-regulation on every communication they make. I am strongly in favour of the FCA being able to communicate. I think it is part of what a regulator needs to do. The industry will communicate about the regulator; the regulator needs to be able to communicate back, and I agree with the point you made earlier.

Q306 Mark Garnier: That is very helpful. But in this case, they simply created a false market—forget the reputation—which is against the rules. That is clearly an example of when they got it horribly wrong.

James Palmer: Yes.

Q307 Mark Garnier: Following on from that, do you think that their strategy to selectively pre-brief the media, to secure press coverage, within the context of what we have just said, is a good idea or a bad idea?

James Palmer: I know Mr Davis expressed reservations about it but did not categorically say it should be rejected. I do not know enough about how easy the FCA finds it to get visibility on its positive consumer-protective actions, which clearly is its statutory role and clearly is something it does want to communicate, and I understand that. And I do understand, from working with clients, that if you give someone an exclusive, you may get an opportunity to get more coverage—more insightful, thoughtful coverage—than if you just put something out through a mass press release. So I do understand the idea of pre-briefing.

My reaction is not to damn all pre-briefing, because I think a lot of other pre-briefing has certainly has not done any harm, and it may have helped the FCA's communication of its policy goals around consumer regulation. I think the problem here was the absence of process, and review, and thought, about the particular pre-briefing that occurred, and indeed the absence of a process about pre-briefings, and review for this sort of information.

Q308 Mark Garnier: Mr Thoresen, do you want to come in on that?

Otto Thoresen: It depends what you are pre-briefing on.

Q309 Mark Garnier: I am interested in getting back to the first point we were discussing—whether you are communicating with the regulated or the people who are protected by them.

Otto Thoresen: I think people are interested—society is interested—in what the conduct regulator is thinking, and quite right too. There are ways of trying to make sure that you can communicate a message, explain the richness of what it is you are trying to do and why you are trying to do it and what your objectives are as a regulator. It is important for people to understand what that is about. And they should be able to use the tools that are available to them to do that kind of thing, just the same as any other organisation.

I remember, going back 10 years in my own life, if I ever found myself in a position where I was engaging on an exclusive basis with a journalist, as a regulated CFO and CEO, I was very, very clear in my own mind about the territory which was generic and of interest and strategic and valuable, but would not take me into territory that would be dangerous or create the risk of the kind of breach that we have been discussing. So it requires discipline and it requires clarity, and it requires responsibility of the individual who is being interviewed, because I am not actually totally convinced that there is such a thing as a pre-briefing. There is an interview. It is a dialogue between a journalist and someone who is being interviewed. And you are in a position where you are going to be asked things and you have to respond appropriately and you have to be clear on the boundaries which are acceptable.

James Palmer: The point about what is a pre-briefing is an important one, because there is a danger that we drag everything into one bucket and call it pre-briefing. If it is communication in advance of an announcement to the market, I think it is going to be very important that the FCA, when it is prospectively thinking about what it does in the future, does engage in discussions in advance of doing that, with the industry and with consumers and consumer groups, in order to make informed and insightful judgments about what it does in the future. I think that is entirely consistent with what Mr Thoresen said, which I agree with, which is that clearly, to do that, you have to have disciplines and processes and thought applied about what you are communicating in each case to ensure that you avoid exactly this kind of situation.

Q310 Mark Garnier: To be clear: you agree with the broad premise that if you are briefing the marketplace, including consumers, it is a good thing as long as it is done well, but you would also agree that if you are trying to talk directly to the regulated community, there are better ways of doing that, which include e-mails and direct letters. You would agree with that?

James Palmer: Yes.

Otto Thoresen: Yes.

Mark Garnier: That is fantastic. Thank you very much.

Q311 Mike Kane: Simon Davis concluded that those within the FCA had not considered within the content of the business plan and the life insurance pre-briefings that any of that information would be price sensitive. Were you surprised by that?

James Palmer: Yes.

Q312 Mike Kane: How surprised, on a scale of one to 10?

James Palmer: Disappointed. Very surprised.

Mike Kane: Mr Thoresen?

Otto Thoresen: Well, I have reflected a lot on this over the last nine months because we are in a challenging environment for the life sector. There have been a series of events which have been difficult for the life sector to respond to. If you look at the narrow definition of what the business plan was talking about doing, which was a discovery thematic on how legacy products were being administered and governed within the sector, it takes you quite a long way back from what might be described as market-sensitive or share price-moving information.

These kinds of discovery thematic are slow burn. They take a long time and only begin to get to a point where they start to generate real interventions some way down the path. It was the fact that the narrative bled into and spread into other territory which was way beyond the original scope of the piece which particularly changed that. I am not trying to say that it was not market sensitive, because it clearly was, but it is not quite as simple as—

James Palmer: My point was about the process. My point was that I would have expected all the communications people to have been trained to a level to have thought about price-sensitive information and to apply that generally to all external communication of any material initiative. That is the nub of my point. You have not asked, but I will make this point because it is relevant: I actually think there is a strong argument that, if you look at the specific words communicated by the FCA in Mr Davis's report to the journalist, the information shared was not price-sensitive information and was not inside information. It was the way that they lost control, as the report draws out, and the way that it was then communicated to the market which created a false impression of what was actually happening. When you review for price sensitivity, I would expect a listed company, for example, to think about the risk of miscommunication at the same time.

Q313 Mike Kane: Clive Adamson, in his evidence to us, did say that the FCA had not assumed that thematic reviews were price sensitive. Was he wrong to say that? Was that a wrong assumption?

James Palmer: He was clearly accurate in describing the fact that they had assumed they would not be, but that is a rash assumption that they are not going to make any further. I think that they will review it, going forward.

Q314 Mike Kane: What would your advice be?

Otto Thoresen: The fact that the supervisory teams involved were concerned that the communication of this had to be handled well and that their original objective, as described by Davis, was to try to make sure that this was properly communicated and that its scope was fully understood reflects that they themselves understood that this had the potential to become price-sensitive or market-moving, were it to be taken in a certain direction. Within the organisation, there was a recognition of what it could potentially be, but there was a desire to try to mitigate that risk as far as possible. The fact was that it did not turn out that way in practice.

Q315 Mike Kane: We have been focusing on this incident in particular, but have you had concerns at any other stage about the way that the FCA has dealt with price-sensitive information?

Otto Thoresen: Until I read the Davis report, probably not. I assumed certain things about the way that things would be reviewed internally. Subsequent to the event last year, I am sure that processes were strengthened dramatically and probably very effectively. I would be pretty hopeful and pretty optimistic that the approach being taken now is very thorough and solid. The concern I might have is that the pendulum may swing too far and that, in trying to make sure that work to be done can be done effectively and appropriately, the useful, constructive operational engagement that can happen between an industry and its regulator might begin to suffer as a result of that pendulum swinging.

Q316 Mike Kane: With respect, Mr Thoresen, that is an answer to one question but it was not an answer to mine. Have there been any other instances where you have had this concern?

Otto Thoresen: Not since March, no.

James Palmer: I am not aware of specifics, but I am aware of the concern and sensitivity around enforcement, which can be price-sensitive. There was a concern that that might not have been as disciplined as was appropriate, but I don't have specific examples.

Q317 Mike Kane: What are the communications procedures that a regulated firm needs to have in place so that it does not breach FCA rules?

James Palmer: Let me draw an analogy with a listed company, because this is about communication to the market, which is not just regulated firms but includes any listed company, and such a company may well be in an industry outside financial services. There are three sets of rules. I won't take you through the detail, but there are market abuse rules on the communication of information, as well as the avoidance of insider dealing, or the equivalent of insider dealing; there are listing rules and listing principles about how listed companies should be operated; and there are disclosure and transparency rules about the way in which information is communicated.

The market abuse rules do apply to the FCA in relation to its own communication, and it is only because this was—in my view—probably not inside information that there was not a market abuse breach by the FCA. It was close to the line, but on the right side of it. On the other issues that do not technically apply to the FCA, it is obviously not subject to the listing rules but is the regulator of them. If it had been a listed company, however, it would not have satisfied those requirements.

Q318 Mike Kane: First, thank you for outlining three key principles. Are you therefore surprised that the FCA had no such procedures in place?

James Palmer: I was surprised, yes.

Q319 Chair: How about on a scale of one to 10, which is how Mr Kane likes to hear it?

James Palmer: I think it is a serious defect.

Q320 Mr Love: How serious a defect is it on a scale of one to 10? I am just looking for clarification, that is all.

James Palmer: In terms of a breach of the rule, it was at the extreme end, because there were no procedures in those parts of the FCA. There were excellent procedures in other parts of the FCA, as was revealed in the report; the market monitoring, listing and enforcement division all had procedures around it. The absence of procedures in some parts was a serious defect. The dynamics of a regulator are not the same as those of a listed company, so I think it is not quite the same. It is not as important a set of rules as rules about capital being available or accounts being valid and not massively misleading, but it was a clear breach of the rules.

Q321 Mr Love: Can I come to the events of 28 March, Mr Thoresen? When did you first become aware of the share price movements in the market, and when did you become aware that these were related to the *Telegraph* article on the free market review?

Otto Thoresen: On the Friday morning, I awoke to the online version of the article. I had some discussions with my media team in Gresham street about it, but it was the online version; I was aware of the content but I did not study it in detail. I had an external meeting at 8 o'clock that morning, and it was when I emerged from the meeting at just after 9 that my BlackBerry was buzzing and I realised that things were happening to share prices.

Q322 Mr Love: Your members were buzzing you?

Otto Thoresen: Absolutely, because clearly we were quoted in the article. What did we know about what was going on here, was the question that I was being asked. In my responses to member firms—let's not exaggerate; it was a couple of calls—it was clear that we needed to engage with the FCA, and I fed that through to my colleague in the office, who got straight on to the FCA. It must have been about 10 o'clock that morning.

Q323 Mr Love: You met the FCA on that morning. It clarified the scope of the review. Did you pass that information on to your Members?

Otto Thoresen: There was a period of to-ing and fro-ing between the ABI and the FCA before that briefing was delivered to us, which I think was late morning—about 10.45 or 11 o'clock, if I remember rightly. We were telling our members that there would be clarity emerging as to what the scope of the work really was because at that point, until we received the briefing, although we had, as is documented in Davis, had early warning that the thematic was coming and that it would form part of the business plan, we did not have any specifics on what it would cover. We thought we knew what it would cover but we did not know. Until we got the briefing, we could not be sure what it would cover—the extent to which the *Telegraph* article was or was not accurate in terms of its suggestions about how far this might go and how quickly it might go there.

When we got the briefing in the late morning, we summarised that to give some clarity to members who would be affected. I do not have a specific time for you exactly but it would have been lunchtime or early afternoon before we could get our summary of the content of the briefing out to our members. By then, of course, in parallel, there was engagement with the FCA, which was signalling that it was going to publish some clarification, which followed at around 2.30 pm or so on the Friday.

Q324 Mr Love: But you released your summary to your members. Do you know whether your members released them to investors? How widely was that circulated?

Otto Thoresen: To be honest, it would have been—we were saying that it was what we thought it was. We were explaining in broad terms what the scope of the thematic was. We had been told to keep it confidential and we were continuing to keep it confidential but, to be honest, there was so much noise in the market, the media and elsewhere, that the only communication that could help to clarify and stabilise things was going to come from Canary Wharf, as it did.

Q325 Mr Love: But did the FCA say to you or your organisations at any time not to provide clarification because it was going to provide formal clarification?

Otto Thoresen: They did not. I do not think that those words were exchanged but the view we were taking was that we were expecting clarification, and that the clarification that would come from the FCA was the thing that mattered because it had the facts in their entirety. We were expecting that to happen quickly, or as quickly after it had been acknowledged that it was needed as they could get it out. Eventually, it emerged.

Q326 Mr Love: The reality is that the original FCA clarification did not include the question of exit fees. One of your members has been quoted as saying that if you had released that information, it would have "added fuel to the fire". Is that your view of what the FCA did?

Otto Thoresen: What they did in the end did the job in terms of defining what the thematic was not. It was mainly about what it wasn't: it wasn't this, it wasn't that, and it wasn't the next thing. The version that was being discussed mid-morning is covered or referenced in the Davis review. I must admit that I have never seen exactly what that version looked like. I have read and am aware of the comment that it did not go far enough. Actually, until you had an authoritative and clear statement of what the scope of the thematic was—that had to be as authoritative and as full as it could be—there was always going to be the risk that it was not enough.

Q327 Mr Love: But that authoritative statement came fairly late in the day. There was a lot of churn before that, which raises the question about whether the FCA truly understood the seriousness and the urgency of what was going on that day. What is your view?

Otto Thoresen: If you read Davis, I think it is clear that it took some time before the various pieces of the FCA's system connected up and it then understood what it was dealing with. There was a period when it was felt to be a question of media management, if I can put it that way. It then moved to a place where the combination of the scale of the difference between the factual behind the thematic and the perceived view that you could get by reading the press article was identified as so great, and the obvious evidence through the share price movements added up to something that needs to be addressed strongly, firmly and clearly so that we can move on. It clearly took far longer for that period to be reached than it should have done.

Q328 Mr Love: But why? We have this picture on that day of the leisurely consideration of what sort of formal response they are going to make. Meanwhile, there is total turmoil in the marketplace. What connection did the FCA have to the marketplace? Shouldn't they have been much more on the ball in recognising that? If they did not recognise the price-sensitive nature of it, they should at least have recognised the impact on the market.

Otto Thoresen: Clearly, yes is the answer to that. As to why that did not happen, maybe James would want to comment. From my perspective, I would go back to one of the comments that I made earlier, which was about having somebody senior overseeing and owning the project, the process or the delivery of this piece.

In my experience of operating in the commercial sector and in the past few years in the trade association, either I am or I know who is within my organisation, looking hard at every step of the journey, and then assessing how things are happening against what we expected. If there begins to become a divergence in that, a bell gets rung and you start to get involved. Nobody had the overall picture here until relatively late in the day. The minute that overall picture was clear, then you started to see action. That is perhaps, for me, what was behind what was going on.

Q329 Mr Love: One final question. You mentioned in response to an earlier question that you believed that working-level trust is reasonably well established, but what damage has this done to your individual members and to the insurance sector?

Otto Thoresen: The impact on individual firms can be seen through share prices and recovering share prices, but it is broader than that. However, it is recoverable, the extent to which we feel as an industry that we have re-established our terms of engagement and the basis of operation. The concern that has been present from the formation of the FCA through the early period of its existence and of it being active about its engagement publicly, using the media as a mechanism for telling its story, I do believe has been accepted and acknowledged as a mis-step, and that what we will see from here is a different way forward.

I genuinely believe that. I have heard that feedback consistently. The way they have responded to the Davis report is evidence of that. If we can achieve that sustainably, I do believe it is quite possible to re-establish the right kind of constructive but challenging relationship between regulator and regulated.

Q330 Mr Love: Mr Palmer, do you have anything to add to that?

James Palmer: No, there’s really only one point I would make. You asked about why this could have happened in the FCA with the confusion on the morning. I think the answer to that is that if you are used to not having problems when you communicate, it is easy to think you will always not have problems when you communicate. If you do not have procedures and training to prepare for what is not an inconceivable eventuality, to me that was the cause of it. If they had had training and a policy on it, which they should have done and have acknowledged that, the response on the morning—

Q331 Mr Love: So there was an element of hubris.

James Palmer: Yes. I would strongly agree about the response. I think there is an element of hubris, but the response has been positive. From an industry perspective, we have got a regulator who is more aware of those issues and has toned down some of the communications concerns.

Q332 Chair: So there has been a silver lining to the dark clouds. Is that what you are saying?

James Palmer: Bluntly, yes.

Q333 Rushanara Ali: Mr Palmer, how serious a breach of the FCA listing rules would this incident have constituted if the party at fault had been a regulated firm?

James Palmer: Or a listed company, yes. The answer is potentially serious. The breach would have been of two listing principles, one on systems and controls and one on effectively avoiding false markets in communication to the market. Having said that, I certainly think that the FCA, if this had been a listed company, would have launched an enforcement division investigation. I think they would have taken it seriously and this would have been investigated. What Mr Davis has revealed in the facts is that, actually, what the FCA said at no stage was untruthful. They communicated narrowly and, as has been discussed extensively, lost control of the way in which the public communication occurred and allowed a significant miscommunication of what was happening. Because it was not the FCA itself that did that significant external miscommunication—rather they allowed it to happen—at the minimum the FCA would have given a private rocket to a listed company, and they could have decided to take enforcement action.

Q334 Chair: And if they had taken enforcement action, what type of enforcement do you think would have followed? A censure? A fine? The withdrawal of the right to practise from someone?

James Palmer: No. Because the listing rules are for listed companies, there is no withdrawal of any rights as a remedy. It is a fine, and criticism is typically private only. I think that the natural remedy would have been a fine.

Q335 Chair: Of what size?

James Palmer: I do not feel qualified to answer that. That is a matter that the tribunals have a load of guidelines on.

Q336 Alok Sharma: I want to press on the size of the potential fine. If you cannot or are not willing to comment on this particular case, can you give another example where there may have been a similar breach by a corporate that then faced a fine, and what that level of fine was?

Q337 Chair: Rather than trying to come back now, why not think about it and come back to us with a piece of paper on the question that two of us have just asked?

James Palmer: Let me just say that I do not think that that is a precedent with comparable facts.

Chair: Well then, ask somebody, if you would, to take a look at the tribunal-related evidence in order to give us some sort of guidance on that.

James Palmer: I can certainly seek out what fines are applied in other cases.

Q338 Rushanara Ali: That is very helpful, and it would be helpful for us to know about the scale of the numbers, as our Chair has suggested.

Given that the FCA has statutory immunity to damages actions, do you feel that that creates a level of complacency that would otherwise not exist?

James Palmer: No, I do not. I think that the complacency arose through the absence of having to focus on the issue and a lack of thought about responsibilities in relation to all parts of the FCA for inside information. I personally am a strong supporter of the statutory immunity. The regulators that are susceptible to litigation get bogged down and paralysed by it, and it is of great benefit to my profession only.

Q339 Rushanara Ali: In terms of recourse regarding the money lost on account of the FCA's actions, there have been reports that investors have sought legal advice. Do you feel that investors might be wary of doing that, because you are the regulator against the situation that has occurred?

James Palmer: Yes. It is a matter for them what advice they get, but they will clearly be advised of the statutory immunity, which I would think means that claims face significant challenges.

Q340 Rushanara Ali: Has anyone got any estimates of what the actual costs are to the sector in the light of this particular incident?

James Palmer: No.

Otto Thoresen: No.

Q341 Rushanara Ali: Given the FCA's broad remit, which was mentioned earlier, do you feel confident that such mistakes will not recur, given how much responsibility the FCA has been given over the recent period?

Otto Thoresen: On the specific, around the market-sensitive issue, I would be surprised and disappointed if the response internally within the organisation has not been so strong that the risk of that has been reduced to a very low level. You can never make something a zero risk, but you can get a very low level. To the other point, around the broader aspects of how a regulator like the FCA can operate on as broad a waterfront of issues as it tries to cover, I think they acknowledge and recognise that.

On the recent restructuring that they have gone through, I have to say, I don't understand enough about that yet to even comment on the exact objectives it is trying to achieve. There are some interesting things there, though, around a shared view of markets, a better understanding of how markets are developing, consumer issues, an attempt to segment better the way they deal with the regulated in terms of smaller firms and larger firms, and so on. Some of those developments may well be helpful in terms of trying to improve the effectiveness of the organisation, but if you think about the variation in the nature of the role that they have, whether looking on to the debt advice sector, which is the new sector that they are taking responsibility for, or all the way through to wholesale regulation of large commercial organisations, that is an enormously challenging piece. It is about how you organise within your regulator to ensure that those things have been appropriately addressed and that you have the right kind of level of expertise in the different segments and the right kind of people involved to do it. There is nothing new there, but you have to do it very well. I think that is more about talent, management and governance and all those things than it is suggesting that there is a better way to deal with this. I think the FCA sets out to do the right thing and do it well, but there are big challenges in terms of operational delivery of that.

Q342 John Thurso: That leads me very neatly on to asking questions on governance. Mr Thoresen, do you think the FCA's response to the report has been adequate?

Otto Thoresen: There are different levels of the response. If you start from the market sensitive point then I believe yes, but James will have his own views. If you look at the communications and media management piece, which for me was a massive part of what Davis was talking about, so far the evidence suggests yes. There is an acknowledgement of the issue and a different attitude present, evidenced in some of the engagement I have with them. But the broader issue about sustainability, governance and oversight? That one is, for me, unproven and not yet demonstrated.

Q343 John Thurso: Basically, there was the "unrelated" departure of various people and there was a number of senior individuals who gave up—or had taken away—their bonuses. Was that a sufficient response?

Otto Thoresen: I go back to a comment I made earlier, which is that, for me, the Davis report tells you more about the processes that apply within the FCA than it necessarily tells you anything about any individual within the FCA. There are still areas where I would want to understand more about how they plan to manage the organisation under the new structure to see whether they have learned enough from what was a very difficult experience for them.

Q344 John Thurso: On a number of occasions, starting with your remarks to the Chair, you have talked about process not people. At one point you said there was a lack of ownership by senior people. Who should have had ownership? Who would you be looking to have owned that failed process?

Otto Thoresen: I will make a general comment about levels within the organisation. You have a chief executive and then an executive team; then you move below that to, if you like, sector specialists. That is a very broad term, but we have senior people within the FCA who are our point of contact on general insurance issues or on life and pensions issues; clearly, there will be the equivalent on the investment side, the wholesale side and right across the board.

Where I expect to see the ownership is at that level. What you expect to see from the executive team is oversight, challenge and co-ordination of all this stuff that is going on. You want someone who is closer to the action, dealing with it day to day, hopefully expert in the subject matter, aware of his teams and what they are trying to do, very much aware of the objective of the piece of work or the strategy being adopted in that area, and aware of the participants—my members and participants in the insurance sector, the investment sector or whatever. That individual can take that kind of view and understand the broader issues involved and how they are connected together. That is where I think the process should ask for ownership.

Q345 John Thurso: So what you are putting forward is that the person in charge at the team level of actually doing the work should have had sufficient ownership and understanding to not have got this wrong?

Otto Thoresen: It is clear to me that what you had were a number of silos of delivery, if you like, within the organisation. The connection did not seem to be present.

Q346 John Thurso: But that is the process that was defective.

Otto Thoresen: Yes. That is based on what I read in the report.

Q347 John Thurso: Who is responsible for the fact that that process was defective?

Otto Thoresen: From what I can see, it is one of those situations where that was the way the organisation was.

Q348 John Thurso: When I was chief executive of a company, it meant that I as chief executive was responsible if that was the way the company was. What I am getting at is that you seem to be saying to me that, somewhere down in the organisation, there is someone who has ownership and is responsible, and I am trying to find out at what level in the governance, the chief executive or the board should have had some oversight of this. Or is your feeling that they should not have had oversight of it?

Otto Thoresen: The way they did things was different. The fact that they had, for example, communications sitting as an executive team role separate from the supervisory people and from the markets and competition people—that was clearly the way that the organisation had been structured.

Q349 John Thurso: So if the chairman and the chief executive put the structure together, they are responsible.

James Palmer: I think that there is no perfect structure. You can rationalise how everything goes up to the top level, but I have to say that I think this was an issue that I would have expected to see addressed below the CEO and board level. It is a level of organisation that you would not naturally expect them to have to get into the weeds of. It seemed to me that both in advance, in terms of how communication worked, and in terms of the response on the day, the two primary divisions that had responsibility both for the communication in the first place and for then trying to deal with the response were the supervision and the communications divisions.

Q350 John Thurso: That, if I may say so, is the bankers' defence that was used all the time in the Banking Commission—"It wisnae me. It was the boys down there." Can I challenge you on that? I know that you are a corporate governance specialist. Ultimately, we have something where a massive dip in the market took place, where the industry was screaming blue murder and where the internal processes did not get to the chief executive in time—by the time he got hold of it and was able to change, we were at midday or 1 o'clock in the afternoon. You yourself have described the seriousness of this in terms of a breach of the rules. Are we seriously saying that, throughout this episode, there is no culpability or need for review of the actions of either the executive company or the board in what they did?

James Palmer: No, I do not think that we are saying that. Mr Davis has found that the collective responsibility—I am never quite sure what that means—and formal accountability of both the board and the executive committee were there. I am deeply aware of the PCBS's views on ultimate accountability. I think that there has to be a distinction between expecting your most senior people to be able to work out if your bank is at risk of going bust or not and understanding what procedures are in place for all of the compliance that you expect to see within the organisation. You cannot run a large, complex organisation of the size of the FCA with the board or even the CEO having an understanding and visibility of all those issues. You know, and I am sure that everyone knows, that you have to delegate. To me, delegation to the head of supervision and the head of communications is—

Q351 John Thurso: Can I just push you a little bit on that? This is the first and only time so far that the FCA have had an entire Treasury Committee hearing on one thing that they have undertaken. Otherwise, they come and see us every now and then for their six-monthly report and we cover a number of subjects. We are actually holding an inquiry into this. Why are we doing that? Because there was a major disruption in the market for six hours—you just have to look at the graph of the share prices to see that.

The FCA were required by the Chancellor and ourselves to get an outside report written. It is a very thorough report, which sets out in detail the defects. Those begin at the bottom with a PR person adding bells and whistles to an agreed policy release, but there are also quotes attributed to people who had not actually made them and that were not agreed. There is also the issue of whether this was the right thing to be doing. There is no risk analysis; Mr Davis, told me in evidence that he was aware of risks, but that he was not at all sure this was on the risk register.

These are all things that the chair of an audit committee or a risk committee might well look at and express concerns about. We will take evidence on that in due course, but if you were looking into this, would you not think that there was room for some criticism of the board processes?

James Palmer: All I can do is give you my view. It is easy with hindsight, as we all know, to always think that everything that gives rise to a problem ought to have been identified in advance. It seems to me that this should have been identified in advance as a risk. The expertise and the natural awareness of issues which were most likely to identify it was within those two divisions.

Q352 Chair: John is asking something slightly different—should somebody have been on point, responsible for trying to identify the problem in advance, at board level?

James Palmer: I am not in a position to answer that totally. It seems to me that, yes, a board needs to be identifying risks, but my understanding is that the board does have a risk-identification process, which will rely on inputs from around the organisation. I don't know enough about the board risk assessment in this case, but I would have expected the risk to be identified to the board, to internal audit, to risk—whoever was running this in the relevant business areas—although not necessarily by someone at the board level or the executive committee level.

Q353 John Thurso: The question I was going to ask you both was, do you consider that the board of the FCA has provided effective oversight, and what needs to be changed? I gather from your answers that you both broadly think that they give appropriate oversight already.

Otto Thoresen: This is on little evidence, of course, because it is hard to understand or have sight of how the board of the FCA operates and how it works with the executive team of the FCA. There are minutes published of meetings, but they are very brief. On many areas of the FCA's responsibility, I have no reason to suspect anything other than that the process works pretty effectively.

Q354 John Thurso: If I may—I do not want to prolong this—the point is that you have a regulator, who is probably the single most important regulator we have in this country, upon trust in whom depends most of the money that comes into the City of London from all around the world. We are talking about who regulates the regulator, and the first line of defence is the board. We have a problem, and we will ask the board what they have done, but my reading from the evidence in the report is that the board did not appear to have had sufficient regard to the risk or to have taken steps to mitigate it.

James Palmer: From my perspective, this issue, which was not a regular, obvious issue in practice for the FCA—it had not caused problems before—should have been identified. I don't think it is an obvious thing for somebody coming cold to this to see; I don't think anyone saw it. But just to follow through, I don't think the fact I am saying that in this particular case means I am in a position to answer your general question, although I do understand your general point.

Q355 John Thurso: I must remark that the fact that it had not happened before would have been great comfort to the captain of the Titanic.

James Palmer: But if you look at what happened, it was a miscommunication issue at heart, combined with a communication policy issue.

Otto Thoresen: And the issue, when it was a discovery thematic that had a timeline on it that would lead to consideration of further action, was different from the issue that it evolved into in the 24 hours, which was 30 million policies being reviewed over the next six months.

Q356 John Thurso: That is at the heart of this. The organisation agreed a simple communication. If what had been agreed had only been said and that simple communication had gone out, we would not be sitting here. It went horribly, horribly wrong and exposed a massive risk that nobody had thought about before—not us, not them, not anybody else. What we are trying to do, obviously, is help the FCA arrive at a point where that does not happen again. But to say that this was simply an issue of miscommunication is perhaps to understate its gravity.

Otto Thoresen: I totally agree; that was not the point I was trying to make. My point was that if a board is reviewing future activity and an action at the limited and more benign end of the spectrum of what the review was going to be to begin with, the view of the risk and potential for going wrong would be very different from the view of a board reviewing what the issue became—something far more specific and far more targeted and, in truth, not what the work was intended to do in the first place.

Q357 Teresa Pearce: Mr Thoresen, at the very beginning you were talking about building relationships and the industry interacting with the FCA. You said that churn was an issue. Are staff leaving, moving or what? Is staffing a real issue?

Otto Thoresen: I think it was James who talked about churn. Maybe you should respond, James, and then I will add my perspective.

James Palmer: There is an issue of people leaving. As the industry comes under a lot more focus and is significantly growing compliance, regulatory and risk functions, a lot of the capability is in the regulator. People bringing in senior people from the regulator is a way of mitigating the risks, so there has been a lot of movement out of the regulator and into the industry.

Q358 Teresa Pearce: So they are losing expertise?

James Palmer: They have been losing expertise. There are still lots of excellent people, but a lot of regulated firms feel that their supervisor has been changing very frequently and there is not a development of expertise to a sufficient degree. One of the things in my mind is making sure that there is a balance between holding and imposing accountability but not making everybody in the FCA so fearful that nobody ever wants to take a decision on anything.

Otto Thoresen: On churn and staff turnover, there is the supervisory point that James has just made but there is also the development of knowledge and understanding of how markets work. Those are very complex. A broad set of areas are being overseen, and they are not static. A combination of changes in the economic, legislative and legal environment around policy set within Government means that there is constant change. That requires some element of understanding and knowledge of how the markets work if the regulator is to be effective.

James Palmer: The point about regulatory change should not be underestimated. We run the risk of the regulators becoming change project managers rather than regulators. The combination of understandable response to the financial crisis—members of the Parliamentary Commission on Banking Standards were integral to that—and all the European initiatives mean that a huge amount of resource is dedicated to implementing new rules, rather than monitoring and implementing the effectiveness of the rules.

Q359 Teresa Pearce: Mr Thoresen, I was going to ask you whether the ABI had been consulted on the new strategy announced in December, but given that you said that you were still getting to grips with it, I imagine that it was not.

Otto Thoresen: That is correct.

Q360 Teresa Pearce: Okay. You are getting to grips with it, but have any of your members contacted you about it?

Otto Thoresen: As yet, we have had—

Teresa Pearce: They are still getting to grips?

Otto Thoresen: Yes, absolutely.

Q361 Teresa Pearce: I wonder whether your members would share concern about this. The FCA's "Our Strategy" document says that "the scale and scope of our new remit has put our supervisory model for small firms under strain". Have the ABI's smaller members raised concerns with you about the new model?

Otto Thoresen: I suspect even my smaller firms are still quite large firms in the context of the very broad community that the regulator has oversight over; but certainly I have not heard anything yet in that territory.

Q362 Teresa Pearce: One other thing—it mirrors what HMRC did, in a way—is that the FCA have announced changes in the way they supervise smaller firms, removing the distinction between C3 and C4 firms, and using a more risk-based model, removing their proactive supervision of those firms. That is something that HMRC did some years ago, and I am not sure it was a huge success. Do you think this would be welcomed—that you would only really get intervention if you were risky, rather than hand-holding along the way?

Otto Thoresen: Again, I suspect that the community that I am engaged with will be relatively unaffected by it, and certainly I have got no basis on which to give you a view, I am afraid.

Q363 Teresa Pearce: So no concerns have been raised.

Otto Thoresen: No, not yet.

James Palmer: I am not aware there was advance communication about the strategy review. I had not heard from anybody that they were consulted on it in advance, but you could ask the FCA that. I did raise some immediate concerns over the strategy review with the FCA, mainly because I did not feel they had fully articulated the reasons for some significant changes. Like Mr Thoresen I do want to understand better why they have done it.

Again, there is no perfect model, but it is another layer of change. I am sure there are good reasons, and I have had some response and some articulation of it, but there are some risks in the model they have gone to, because you are now going to have two supervision departments. You are going to have a smaller firms focus and a larger firms focus, as you describe. I think one of the important things will be for the FCA to make sure that they do not lose the expertise from one in monitoring the other, and that there is enough co-ordination between the two to make sure that you do not end up duplicating structure across, actually, the same kind of activity.

Q364 Teresa Pearce: Do you think the FCA is sufficiently transparent about which types of enforcement cases it chooses to pursue? Do you have any clarity around that?

James Palmer: I do not have an answer to that. I do not have a view, I am afraid.

Otto Thoresen: No, and again, because of the nature of the relationship we have with our member firms, this is a subject which does not find itself being discussed, particularly.

Q365 Teresa Pearce: Do you think they are predisposed to getting headline-grabbing enforcement cases, given that spin seems to be something they indulge in?

James Palmer: Irrespective of the spin issue, I think it is inevitable that in enforcement actions they pursue higher-profile ones. First of all, the big scandals like LIBOR and FX and so on: it is inevitable and right that they focus on those, and anybody who wants a strong market should want that. In terms of other areas of enforcement it is inevitable that they will pick cases which send a signal to the industry. I think that one of the challenges they have got with the scale of industry they are regulating is that actually enforcement does send very strong signals. I know there are all sorts of concerns about it, but my experience is that every time there is an enforcement action regulated firms and their boards are very focused on what it means for them. There is, however, an issue about the number of enforcement actions that they are able to bring against the size of industry they are regulating; so I think the signal is something they have to use.

Q366 Teresa Pearce: But they need to have the right balance between supervisory and enforcement. Do you think they have got that balance right, or is it too soon to tell?

James Palmer: I think that it is too soon to tell, but I think that the increased focus on the supervisory is very welcome. I absolutely believe that if you do not have enforcement you do not have compliance: you will have deteriorating behaviour. So I am strongly in favour of enforcement, but I do think you have to have supervisory, and as you have increased complexity you have to have engagement and dialogue. The rules are now so complicated in so many areas that we are creating barriers to entry for small firms, because you just cannot afford the resources to compete.

Chair: Thank you very much. Have you got anything you want to add, Mr Thoresen?

Otto Thoresen: No, I think we are done.

Chair: Okay, well thank you both very much for coming to give evidence to us this afternoon. We have what I think will be a somewhat briefer second panel, and I intend to go straight on to it now without delay. I am sorry for the delay we had in getting going.

Examination of Witnesses

Witnesses: **Graham Beale**, Chairman, Practitioner Panel, FCA, **Andrew Turberville Smith**, Chairman, Smaller Business Practitioner Panel, FCA, and **Paul Swann**, Chairman, Markets Practitioner Panel, FCA, gave evidence.

Q367 Chair: Thank you very much for coming to give evidence to us this afternoon. You will have heard the previous evidence as you were all here. I opened with some very general questions about the FCA's performance. It has been in operation for 21 months. Perhaps I can begin with you, Mr Swann, because you are in the middle. How do you rate its performance?

Paul Swann: Its performance has been well aligned with the objectives that were set out with the new regulatory regime that was implemented with the changes two years ago. It has developed a very productive dialogue with the industry. My role in that structure is chairing the Markets Practitioner Panel, which has had a structured, ongoing dialogue with the executive of the FCA. The early indications, from the market's perspective, are positive.

Q368 Chair: Mr Turberville Smith, do you agree with that?

Andrew Turberville Smith: Yes, I do. From the smaller firm's perspective, the first year of the FCA was well trailed and, from a supervisory perspective, in line with what seemed a sensible, risk-based approach. That has continued in the second year.

Q369 Chair: One of the conclusions of the Practitioner Panel was that the industry only ever gets bad press, wasn't it? You seem to be saying that you are happy with the way that the FCA is going about its business.

Paul Swann: I can respond to that from the Markets Practitioner Panel perspective. I will leave it to my colleague, Mr Beale, to respond to it from the Practitioner Panel—one of the three statutory panels. The dialogue that the Markets Practitioner Panel has been having with the executive around communication has been different from the core of the subject for this afternoon. The dialogue has really been around the broader engagement of the communications strategy in relation to markets rather than consumers, specifically the dialogue at an international level in relation to regulatory reform. The context, from the Markets Practitioner Panel's perspective, is very different from the context of the Davis review.

Q370 Chair: Let's go to Mr Beale. Thank you very much for coming to give evidence. In your report to the FCA's board meeting on 1 April, you wrote, "Concern has been growing within the Panel for some time over the degree of open interaction achieved with the FCA leadership". What did you mean by that?

Graham Beale: For a long time we have been talking about the communications strategy—the lack of balance in the messages and our concern that there will come a point where, instead of helping to rebuild confidence within the marketplace, overly negative reporting will start to undermine confidence and become part of the problem.

We have had some very constructive dialogue with certain members of the FCA executive team. You referenced Clive Adamson earlier; we have had a constructive dialogue with him and he is listening to us. We do not always agree, but he takes on board what we say and there is generally a sensible outcome. We have struggled to have the same impact in areas of enforcement and in some of the market study activity. The point that we were making is that the panel is there to give advice when called upon. We feel that there have been occasions where we could have added value and context to some of the thinking that sat behind some of the market reviews in particular that were going on. We do not sense that the resource that is there in the panel has been fully utilised by all parts of the FCA.

Q371 Chair: I wanted to come on to that. Your report also states that "a number of members openly questioned the role of the Panel and whether the efforts of members in trying to support a more effective conduct regime are being accepted and capitalised upon", which—only slightly translated—sounds like the Practitioner Panel is not worth the candle.

Graham Beale: There is frustration within the panel that comments that we have repeatedly made sometimes go into a black hole. After each meeting, we report to the FCA board. We have regular contact with the chairman and the chief executive; they listen and tell us that they take value from the board dialogue, but we do not get any feedback as a result of that, so it is difficult for us to determine whether we are having a beneficial impact or not. One of the consequences of the April board report is that Martin Wheatley volunteered that one of his executive team, Victoria Raffe, would work with me and the panel to see if we can find a better way or a more constructive level of engagement. Since that review, a member of the executive sits in on most but not all the panel meetings, so that we can have a dialogue and an exchange in real time, rather than writing a report that we then do not get feedback on. It is early days in terms of the changes, but it makes for a more productive session when we can engage directly with a member of the executive team.

Q372 Chair: Another line in your report is: "The Panel encounters varying levels of co-operation between members of the Executive Committee." In others words, you do not get co-operation from some. Which divisions did you not get co-operation from?

Graham Beale: Let me first of all expand on what we are saying there. We have never not had co-operation; it is more the extent to which certain members of the FCA see us as an opportunity to explore thinking and confirm their understanding of a situation—I go back to supervision as a good example where we felt that we had that level of engagement—whereas with others, there is a duty for them to consult with us. I guess that lip service is one way of conveying that, at times, we felt that they were going through the process rather than truly trying to engage.

The area where we have had the biggest debate on the level of engagement is within the market studies team. There has been some detailed debate on that point. Interestingly—this is sort of germane to the whole issue around market-sensitive data—the explanation we have received back is that there are elements of activity, such as the market studies, that are deemed to be market-sensitive so it would be inappropriate to discuss that with the panel. That is not a point that we agree with, because the panel members have all signed up to confidentiality undertakings. We sit there in private so we can have open debates, and there has never been an issue about any breach of confidence from the panel. For example, when the market study into the cash savings market was published, we gave quite extensive comment on the context and operation of the cash savings market, which we think could have influenced them and probably got them to a better place than they got to from their own resource.

Q373 Chair: Back to you, Mr Turberville Smith. Is it not the case that really small businesses feel that they get a raw deal from the regulator? They are pushed around a lot and they often feel that regulation freezes them out. We just heard about barriers to entry developing.

Andrew Turberville Smith: It is quite difficult to generalise across such a broad spectrum of financial services businesses. In many respects, smaller financial services firms work to regulation in a proportionate way. There are large numbers of firms operating in the sector—70,000, or 30,000 if the consumer credit firms are excluded. That would say to me that a number of firms are able to operate within the regulatory environment. Yes, there are certainly some differences around smaller firms' ability to compete in certain sectors, but that is not to say that smaller firms feel that the regulator freezes them out.

Q374 Mark Garnier: Mr Beale, could I come back on some answers you gave to Mr Tyrie about your engagement with senior people at the FCA? When Zitah McMillan came before the Committee she told us that the Practitioner Panel had not provided direct feedback to her or Martin Wheatley about the FCA's communications strategy. Do you want to comment on that?

Graham Beale: I am not clear why she made that comment.

Q375 Mark Garnier: You are aware she made it?

Graham Beale: I am aware she made it—I have seen the transcript of her evidence here—but I cannot comment on why she said that.

Q376 Mark Garnier: Can you give us evidence of why she is wrong?

Graham Beale: I went back to the reports that we produce at the end of each meeting. If I go back to commentary on the approach document, which was pre the establishment of the FCA, which was in September 2012, through to June of last year, there were 21 meetings and in 13 of those meetings there was some very clear commentary about the strategy to use the media, the tone and the content of the media briefings and the press releases that were made.

Q377 Mark Garnier: This would have required senior people at the FCA to read the minutes of the meetings.

Graham Beale: No, this is a report to the FCA board. It is not a minute. It is a full report, at times quite detailed.

Q378 Mark Garnier: I just want to be clear about this because sometimes people misunderstand: you may think you have done everything you need to by writing a report and presenting it to the right people, while she may be thinking that you have not grabbed her in the corridor and said, "I think you ought to read this because we have a serious problem." Do you think there is an element of that in this?

Graham Beale: No, no. If I go back to the meeting that we had last June, when Zitah presented to the panel a report that was on its way to the board, which is effectively a two-year review of the communication policy, it was put on the table, so we had not had a chance to digest the information in it, but as we turned the pages, there were a number of points we challenged her on. The first was that success in terms of the communications strategy was described in the report as the number of headlines and references made in the media.

Mark Garnier: There were quite a lot of headlines and references in the media in this debacle.

Graham Beale: They recorded that as good and we said, "No, you should look at the content of what is said in the media to determine whether it is good." The report went on to say that the level of media coverage was much influenced by enforcement activity, which was seen as good, and then there were a number of case studies that effectively described how certain events had been managed to generate publicity. It goes back to the comment in the paper about this being an accident waiting to happen: this extensive pre-briefing and a desire to generate at times sensational headlines are very unhelpful and high risk—I think that is how Simon Davis described it—and without appropriate control around it, it can go horribly wrong, which is what we saw in March.

Q379 Mark Garnier: In your 1 April report you said that the events of 28 March were "an unavoidable consequence of the direction of travel of the FCA's media policy". That is exactly what you are describing here.

Graham Beale: It is, and in February, the month before March, in our report to the board where we were commenting on the risk outlook, which is a sister document to the business plan, we specifically said that the FCA needed to be very careful about the way that the information was presented, because it could have a market consequence.

Q380 Mark Garnier: Mr Turberville Smith, you heard that Zitah McMillan and Martin Wheatley talked about this being an effective way to get the message across to the 72,000 members of the regulator, with the vast majority of those being smaller people. I will ask you the same question as I asked Mr Thoresen: do you think that is a valid, sensible and well thought-through communication strategy or is it just a load of old nonsense?

Andrew Turberville Smith: I don't think that very often the FCA is seeking to communicate to 72,000 firms in one go. A lot of the announcements that it is making are sector-specific. In that regard, if it is making an announcement to insurance brokers or financial advisors or any other sectors, such as asset managers and wealth managers, they are much smaller numbers than 72,000. We as a panel spend a lot of time talking to them about other methods of communication—simple things around e-mail, more direct communication, trade press, through trade bodies. That proves to be an effective communication channel for getting the message across to smaller firms.

Q381 Mark Garnier: Ultimately, each firm will have a compliance officer—someone responsible for compliance, who will be the point of contact for the regulator. Presumably the regulator can send e-mails to the compliance officer.

Andrew Turberville Smith: In the very smallest firms, the managing director is often the compliance director.

Q382 Mark Garnier: It is not a problem, is it?

Andrew Turberville Smith: It is not a problem if something is not in the national press, because things that are relevant to your specific sector are hopefully picked up, as I said, through a number of different channels that are perhaps more pertinent to you.

Q383 Mark Garnier: Having said that, if a firm was non-compliant and its plea was that the people there were not reading the right newspapers at the right time and did not know what was going on, do you think that that is something that FCA would agree with?

Andrew Turberville Smith: No, because it would come back to the handbook—the rubric on the website is where most of the relevant information is.

Q384 Mark Garnier: Fair enough. May I turn to speeches? Anyone may answer this. Clive Adamson was just about to get started on talking about how speeches were less than helpful in delivering the right message and that, in fact, some speeches by staff could perhaps inflame problems, rather than solving them. Can any of you think of an example when this might have happened? Don't all rush at once.

Graham Beale: I have read the transcript of what Clive said. I am not entirely sure where he was coming from, to be honest. If anything, I would say that speeches over the past 12 or 18 months have been very considered and very carefully put together. The difficulties in terms of sensational headlines occur when things happen off-script, either through interview or through engagement with the press. I cannot think of a speech that has generated a consequence of us having sensational headlines.

Q385 Mark Garnier: You did say in the foreword of the July 2014 FCA Practitioner Panel Survey of Regulated Firms that "messages conveyed in speeches by the FCA leadership are not always replicated in firm discussions with the FCA." Can you give us an example?

Graham Beale: That is a slightly different point. Something that we in the panel identified, and which I think the FCA acknowledges, is that when you talk to the senior team, you can have a very constructive and practical dialogue about some of the practical issues of conduct and compliance, but when you move down to the supervisory teams, they tend to be disinclined to exercise judgment or discretion and they are very rules-oriented. So that very constructive, practical dialogue that you can have with a Clive or a Martin Wheatley is not always translated into the way in which a team operates at the grass-roots level. That is what is behind that comment.

Q386 Mark Garnier: Fair enough. Mr Swann or Mr Turberville Smith, now you have had a few minutes to think about it, can you think of any speeches that have been unhelpful?

Paul Swann: I have done as Graham has and looked through the transcripts of all of the evidence that has been given prior to our sessions. The only example I can think of, Clive alluded to in his answer to the question, which was the comment about "shoot first, ask questions later". That really picks up the point that I think Mr Beale was making, in that that was an off-script addition to the original speech.

Mark Garnier: Mr Turberville Smith?

Andrew Turberville Smith: No.

Q387 Mark Garnier: One last question, if I may, just getting back to the overall strategy and the questions I was asking Mr Thoresen. The Consumer Panel seems to agree with this, but do you agree with them that this is actually quite a good way of making sure that consumers of financial services products know what they can expect from the regulator—that it is almost something that should be encouraged in terms of educating the consumer, if you like, but is something that should be discouraged in terms of getting messages across to the regulated, where there may be a far better way of doing that?

Graham Beale: Broad policy, strategy and direction of regulation can be communicated at a macro level. It is right that consumers understand what the regulator is doing, but the way in which you convey these messages is hugely important. Mr Davis concludes that an approach that is based on fact and evidence and that seeks to remove the likelihood of a sensational headline is a better way of communicating than trying to create a set of circumstances in which you are likely to generate a sensational headline. That will lead to an undermining of confidence in financial services from a consumer perspective. One of the big issues that we are dealing with now, post the crisis and all the other scandals, is rebuilding confidence. If we are not careful, this could eventually become part of the problem rather than part of the solution.

Mark Garnier: Do either of the other witnesses want to say anything?

Paul Swann: In the early stages of the evolution of the FCA, it was clear that the new authority needed to establish a dialogue with consumers. The media is clearly a significant part of doing that—ignoring the sensational headlines for a moment. As the regulator becomes more mature and consumers understand the concept of what the Financial Conduct Authority is responsible for, the strategy needs to evolve and develop with that change in recognition. As for understanding where the strategy came from and leading to, it needs to be an ongoing and evolving process of aligning the strategy with the regime as it becomes more mature.

Q388 John Thurso: I want to deal with the question of board regulation and governance. I know you all heard the interesting exchange in the last session. Perhaps I could come to you first, Mr Beale. You said earlier that you had made the comment that this was a high-risk strategy—I think you said you had been communicating with the board, and you commented that this was an accident waiting to happen. It would be fair to say, therefore, that the board should have been pretty alive to the scale of risk that might be involved in this communications strategy. Would that be an accurate presumption on my part?

Graham Beale: I think it is a logical conclusion. To build on the earlier questioning, I sat there listening and thinking from my perspective that I would expect any large organisation that has significant influence, whether it is a bank, a corporate body or whatever, to have a risk framework and understand where the sensitivities are in whatever it is doing. There should be a framework in place that seeks to minimise and mitigate any risk that you are dealing with. When we reflect on the events of the last several years, we see that there has been massive industry investment in risk management, putting in risk frameworks and operating the three lines of defence. The regulator should now be an exception to that; it should really have the same framework. That doesn't stop things happening, but it will minimise and mitigate that risk. What was disappointing for me when I read the Davis report was the absence of a framework and of a set of controls; there was no apparent understanding of where the risks reside within the FCA from its perspective as an operator. In this day and age, and given where we have come from, you would expect that to be in place.

Q389 John Thurso: For the clarity of the record, listed companies are required under the various codes—I can never remember which one we are at now; I haven't been on a board for a few years—to manage risk. They are required to have a risk register, and it is best practice and a requirement that every board go through that, usually in a committee, and that it features on the main board agenda. You have made it clear that you brought it to the board's attention, so it is unthinkable that the board would not have discussed it and come to some conclusions about the scale of the risk and any mitigation that would be necessary. You would concur?

Graham Beale: I do concur. The board has responded and argued that the use of the media in its communications strategy more generally was a regulatory tool and a way of communicating with the very large number of firms that it regulates. That is not a point that the panel agrees on. We wrote to the board and said it was a point that we would agree to disagree on, because we think it is high-risk. That is a specific point, but the bigger point is the absence of the governance and control framework that you would ordinarily expect to see.

Q390 John Thurso: You could easily disagree as to whether it is right to use the strategy, while you could both agree that the dangers need to be properly flushed out and mitigated. Mine is the second point. I think there is a valid argument on the former point, but I am really chasing the other one. I will go down the table and come to Mr Swann next, and then Mr Turberville Smith after that: on this point of governance, were you as surprised as I was by the evidence from the last panel and do you concur with Mr Beale that it is really something that the board should have been more alive to?

Paul Swann: It is a really complex question to answer. It is clear that the regulator itself is not directly exposed to the same strictures and norms as a listed company would be. Whether you would expect them to apply similar or identical processes within a regulator or not is in many ways a question for yourselves, about the way the regulator has been structured and organised, and a question to be asked back to the FCA board and its executive.

Q391 John Thurso: Even the House of Commons has, in its Audit Committee, a risk register, with identified risks, mitigating actions and residual risks. That may or may not protect us from some of the things that befall us, and I can tell you that it has not on all occasions, but it seeks to have one. Would you expect any organisation—public, private or whatever—that is competently run to have within it a risk register with that kind of statement?

Paul Swann: I would certainly accept that best practice is that you would have a governance structure that identifies risks to the organisation and seeks to mitigate those.

Q392 John Thurso: In all probability the FCA has one and this is a question of whether this risk was properly flushed out or not, rather than whether or not they have one.

Paul Swann: That is exactly the point I was trying to make, Mr Thurso. Whether they apply the same strictures as would be required under the listing code, for example, is a moot point. Whether or not they have a mechanism for identifying and mitigating risks, the best practice is that they should have one. I am not in a position to know what it is or whether there is one.

Q393 John Thurso: But without trying to put words in your mouth, you would be pretty surprised if it did not exist?

Paul Swann: I would be surprised if there is not a mechanism for identifying and mitigating risks. Whether it is in the same form or structure that the listing code would require—the way of implementing it—is something for the board and the executive to decide.

Q394 John Thurso: Let's turn to the banker—the man who manages risk.

Andrew Turberville Smith: I was going to say that even smaller firms are required, as regulated entities, to have good governance, controls and risk assessment. So I guess I would be slightly surprised if it proves to be the case that the FCA is lacking in that department, because that is the very least they expect of the smaller firms.

Graham Beale: The FCA does have a board risk committee, because for two successive years I have asked the panel to give views on the risks that the FCA faces. On the first occasion, which was a year ago, we covered a number of risks, internal and external, covering examples of internal risks like the lack of experience, the turnover of staff and the consequence of messaging in the way that we saw play out in March, as well as covering some external risks to the sector. On the second request, which was a year later and is work in progress now, we were asked to focus more specifically on risks to the sector rather than on risks to the FCA. It is clear that there is some dialogue within the FCA about risk management and risks that they need to be alert to.

Q395 John Thurso: My last question to you: do you think, following on from that, that the FCA and its board and management are very focused on what they perceive as risks in the areas they regulate and the operation of regulation, because that is what they are there for, and they do not give the same attention to the objective of this particular exercise, which was to say to the public, rather than to practitioners, "Look what good chaps we are"? There was a quote somewhere from the PR side saying something like, "This will get good headlines. We don't want that boring stuff about how much our plan costs every year. This will prevent that from going ahead." Do you think that, just because of who they are, they focus on their core purpose and do not see the other side for the risks that they are?

Graham Beale: It is difficult to comment directly because I am not privy to the information that would show that. From reading the Davis report—he had a much deeper insight—I think there is more focus on the external environment than the internal operation of the FCA.

Q396 Alok Sharma: You will have heard at the last session that Mr Palmer, in particular, was pressed on the issue of damage to the industry and what would be the result if a market player behaved in the way that the FCA did—effectively, it put market-sensitive information into the market. The FCA itself is statutorily immune to damage actions—it has immunity, at least. Do you think that creates a sense of complacency among senior regulators, because at the end of the day there is no comeback on them?

Graham Beale: I don't sense that there is complacency. I think some of their thinking, on the earlier question, suggests that it was not as mature as it should be, but I don't interpret that as complacency on their part. I think they are very aware of their responsibilities, and this was an unfortunate set of circumstances. It perhaps reflects some of the immaturity of the FCA—it is a recently created regulator—but I don't think they were complacent.

Paul Swann: I would concur with Mr Beale and with the answer that Mr Palmer gave in the previous session. I also concur with Mr Palmer's comments about the fact that for the regulator to be effective there has to be some degree of protection, otherwise it would become moribund from working out what the effects of its actions would be. The actions therefore would be either delayed or not taken.

Andrew Turberville Smith: I would only add, through the work of the panel that I chair, that they are nothing but conscientious and diligent in the way that they pursue their work. "Complacency" is not a word I would have used.

Q397 Alok Sharma: We had a discussion about risk registers and about whether the FCA has something such as that within its operations. In the previous session, Mr Thurso pressed on the issue of who regulates the regulator. The FCA has proposed as part of the senior manager regime for banks that there should be some sort of responsibilities map. They have talked about a governance map for insurers. Do you think that approach should be extended to the FCA itself? Mr Turberville Smith, you might want to take that first.

Andrew Turberville Smith: To some extent, there should be a different approach to the regulated firms, the accountability that they have to comply with and the regulation that they face, as opposed to the regulator. The same approach does not per se apply to the regulator as it does to the regulated firms.

Q398 Alok Sharma: I am surprised that you say that. At the end of the day, we had an incident that caused a big issue in the market, which is why we are sitting here having this discussion now. Why shouldn't individuals within senior regulators be responsible and be named to be responsible in the same way as is being proposed for the industry?

Andrew Turberville Smith: I am not sure what purpose that achieves, over and above—

Q399 Alok Sharma: It is about accountability, isn't it?

Andrew Turberville Smith: What sort of behaviour are you trying to drive by that? From my exposure to them, I feel that they feel that they are accountable for their actions, whether individual or collective. In this case, two senior ExCo members have moved on to different things—not necessarily directly, but they have—

Q400 Alok Sharma: To go back to that point, when they came to give evidence, one of them was pretty clear that their reason for going was given not as a result of what happened here but as a result of changes in the way that the FCA operated. It goes back to the heart of responsibility in the FCA. You are talking about two people who went, but were they the right people to have gone?

Andrew Turberville Smith: From my reading of the Davis report, they were two senior people responsible for supervision and communication, which were the two areas most closely related to it.

Q401 Alok Sharma: Mr Beale, do you think that there should be some sort of approach in the FCA itself to setting out this governance map and these responsibility areas?

Graham Beale: I do. It goes back to my earlier comment: it is a large, complicated organisation and it therefore needs a degree of governance and control that is consistent with its impact. We have seen the consequences of something going horribly wrong and you should have safeguards in place. I think it is entirely reasonable to expect that, and it should be parallel. You can't have an exact mirror of something that operates in a commercial environment, but the principles and the desire to understand where risk resides, to try to put mitigation in place and to have a framework whereby when things go wrong you can respond quickly, are just good business practice.

Q402 Alok Sharma: Do you think that the FCA currently has the framework? If something like this happened again—we all hope it doesn't—do you think that it has the framework in place to respond, and that we could look back and say, "This individual was ultimately responsible for the decisions that were taken"?

Graham Beale: I do not think we can answer that question. We have seen the FCA's response to the Davis report. It says that it will adopt all the recommendations, and we have seen some of that start to occur. One would therefore assume that that puts it in a more robust place. I don't think that the Davis report went so far as to suggest that there should be a full-blown risk framework and governance model that you would expect as a parallel to something in the corporate environment, but, to the extent that you can replicate that, you should have that framework in place.

Q403 Alok Sharma: To what extent do you consider it part of the role of statutory panels to hold the FCA to account for the way in which it conducts all its work?

Graham Beale: I do not think that we are there to hold it to account. The panels were established as a forum for consultation. In the strict sense, if you look at the scope and establishment of the panels, we are a passive panel—we receive requests for consultation, we have no power to do anything else, and the FCA is not obliged to listen to us. I do not think that we are a mechanism. The way that we operate in practice—and to recognise the FCA's attitude, it is comfortable that we create our own agenda and that we challenge it on points—there is a very good, constructive dialogue between the panel and the FCA. That is how the thing has evolved, but if you go back to the panel's scope and power per se, it is a passive panel.

Q404 Alok Sharma: Would you like it to be less of a passive panel?

Graham Beale: The way we operate now, and if we can continue with the improvements that we started late last year, is effective. It would be entirely inappropriate for regulated firms to be able effectively to challenge and hold the FCA to account. You would have regulatory capture, and that would be not be an appropriate outcome.

Q405 Chair: Do you think that, if a company had committed this breach of the listing rules, the regulator's response would have been similar to that we have seen by the regulator in response to a breach of its own rules?

Graham Beale: I agree with some of the earlier answers to the same question: I think there would have been an enforcement action and the firm would be required to correct and remedy the lack of control framework.

Q406 Chair: Do you think there would have been a fine?

Graham Beale: I think it would be highly likely, yes.

Q407 Chair: Picking up on something Alok Sharma said a moment ago, on which perhaps all three of you might like to reflect, the panels were inserted into the Financial Services and Markets Act at the request of the Opposition in 1999—I served on the Bill Committee—in the teeth of some opposition. They have generally been held to contribute something, which is why what I read of your paper—parts of which I read out at the beginning of this second hearing—was so concerning. Do you think that there are ways in which Parliament can and should try to build up panel work, to give firms greater confidence that they have a voice that can help counter what they perceive to be the judge, jury and executioner problem and the sense that they are up against an over-mighty regulator? Whether fair or unfair, that is the private feedback which so often comes back.

Andrew Turberville Smith: Perhaps I could start from the smaller firms' perspective. The panel certainly does not operate as a lobby group. It is very distinct from the sectors that all have their own individual trade bodies. It does engage well with the policy and supervision staff within the FCA on all the other areas that have come across our agenda to give good practitioner feedback, which is very helpful for some of the granularity that goes behind policy and supervision development. I would be nervous if the statutory panel was seen in any way as a lobby group for the industry. There are other bodies that can do that.

Q408 Chair: It is specifically because you are not a lobby group—you are in a position, by statute, to ignore what firms maintain and to just say the opposite, if that is what you think is appropriate—that I am raising this point.

Andrew Turberville Smith: I am not sure how far you can go with developing the statutory panels beyond the role that they play at the moment.

Paul Swann: There is a real conundrum around what the scope of the panels' involvement should be directly with the FCA. The conundrum is really around what the fundamental purpose is of having panels in the first place. I have always viewed the fundamental purpose as the FCA taking soundings from practitioners.

Q409 Chair: To act as a sounding board for their ideas. What I am saying is: should they now be developed into something that can also take the initiative?

Paul Swann: Why I wanted to establish what the panels were originally set up to do first was as a lead-in to—there is a very real risk, if the role was to expand, that continuing to get the level of commitment from practitioners at a very senior level in those panels would become increasingly hard. At the moment, the two panels either side of me meet monthly and the Markets Panel meets quarterly. There are a significant number of senior people from the industry who sit on those panels and give up a significant part of their diaries to achieve the input that the FCA needs as a sounding board. If you extend that further, I think that there would be a very real risk that those individuals would not be able to continue to participate and provide the time.

Q410 Chair: I will have one more go. The premise of my question was not what the FCA thinks it needs. My premise was what, taken as a whole, public policy might be better served by.

Paul Swann: The point I was trying to make is that I think you would potentially erode the benefits of the current structure if the role was extended.

Q411 Chair: So we are at a happy optimum.

Paul Swann: These things evolve and change and they do not ever cease evolving and changing. But beyond that, I think that they are broadly right.

Chair: Mr Beale has had the most time to think about this question.

Graham Beale: I am actually in the same place as my two colleagues. I think that the panel is what it is and we need to keep trying to make that work as best it can. In terms of public voice and having a response at a public level to the FCA, that should be undertaken by the trade bodies. It is what they are there to do. Again, the trade bodies within the UK are quite fragmented. There is a process going on to see if we cannot get some form of consolidation to make them more unified in their thinking. That will then give us a forum through which you can have that more public debate about the direction and the policies coming out of the FCA.

Chair: We do not often see the panels. We are particularly grateful to all three of you for coming in and being so patient in listening to a much longer first session. If there are further points on reflection that any of you want to make, both specifically with respect to the subject of this inquiry or using it more generally as an illustration, do come back to us in writing. We would be interested. We recognise the value of the work that you do, and we get feedback about it from the regulated community. Thank you very much for giving evidence to us this afternoon.