

Charles Stanley – Written evidence (SCG0034)

This submission is in response to the call for evidence that opened on 2nd May 2024.

Charles Stanley & Co. Limited is part of the Raymond James Group, which in the UK has over £40bn assets under management and administration on behalf of retail investors, to whom we provide discretionary investment management and financial advice services, along with an award-winning execution-only D2C trading platform Charles Stanley Direct. As a firm authorised and regulated by the FCA, our response focuses primarily on the new secondary objective as it applies to the FCA.

Incomplete data on the cost of regulation

Of the inquiry questions, this submission most closely relates to Questions 8 and 10 (metrics and accountability).

It is the contention of this response that the cost to authorised firms of regulation by the FCA is systematically undercounted, which can only lead to inaccurate assessments of regulator performance against the new secondary objective.

A proper assessment of regulator performance requires wider cost transparency than at present. Broadly speaking, an accurate assessment should include:

- a) The costs to firms of funding regulatory bodies through the levies they impose.
- b) The costs to firms of implementing policies and process aligned with regulation.
- c) The costs to firms incurred by the FCA's approach to regulatory supervision.

Of the above, only (a) is fully in the public domain. Item (b) is partly in the public domain, with the FCA estimating likely costs as part of its cost/benefit analysis on the introduction of new policies; although it should be noted that more accurate estimates, based on actual historic data, are not routinely calculated or published.

This response is primarily focused on (c). Only a very small amount of this data is currently collected or published. We believe the significant majority are effectively hidden from view. However, as a defect this data gap is readily rectified. This response suggests a way forwards.

The proposal

The Committee should gather data on the financial costs to industry of all reports produced by FSMA s166 Skilled Persons¹, of which there are approximately forty. This should include data on the numbers of reports and direct financial costs to firms of the following:

- 1) s166 reports requested by the FCA, on which data is already reported annually².
- 2) all reports on authorised firms produced by a Skilled Person and provided to the FCA, regardless of whether the report was formally requested under s166, and regardless of how they are received by the FCA, for example whether they are provided to the FCA by the Skilled Person or by the regulated firm that is the subject of the report.
- 3) all reports on authorised firms produced by a Skilled Person, where the reports are not provided to the FCA.

The latter two categories in (2) and (3) are referred to in this response as “non-s166 reports”, since although they are produced by Skilled Persons firms (and in the case of (2) viewed by the FCA), they are not formally requested by the FCA under s166 of FSMA.

Whilst there is some transparency around formal s166 reports – the FCA now publishes limited quarterly and annual statistics on numbers and costs of formal s166 reports - there is zero transparency on non-s166 reports, which are the main focus of this response.

In 2014, following concerns raised by industry via the trade associations, the FCA committed to publishing data on s166 reports (for a fuller explanation please refer to the Appendix). This response argues that this s166 data is the tip of the costs iceberg, and that to be able to assess properly FCA performance against its new secondary objective, the scope of published data should be expanded to include numbers and costs of “non-s166 reports”. As a first step, the Committee should at least request this data, as part of its enquiry, to be able to assess the scale of the issue.

How to obtain data on non-s166 reports

There are two potential sources of the data: from the FCA, or from Skilled Persons firms.

The FCA will be well aware already of all reports received by it that have

¹ A background note on Skilled Persons, s166 and non-s166 reports is included at the end of this response.

² <https://www.fca.org.uk/publication/annual-reports/annual-report-2023-24.pdf>

been produced by a firm on its Skilled Persons panel. It knows both numbers and costs of the reports in both (1) and (2) above. It will not know this information for those reports in (3), however.

Alternatively, the Committee can ask the Skilled Persons firms directly. There are approximately forty firms in all, so the exercise need not be lengthy or complex. As well as the information in (2), this would have the advantage of providing numbers and costs of reports in (3).

Either way, as with the FCA's current practice with reporting on s166 report numbers and costs, the information received and published can be aggregated and anonymised, so there would be no question of compromising data protection regulations or commercial confidentiality. Going forwards, it is worth considering including the provision and routine publication of this information as standard. This degree of transparency should be a condition of Skilled Person FCA panel membership.

Why this data is required

Not only s166 reports but also non-s166 reports are used extensively by the FCA to outsource its own supervisory work, the latter without transparency or accountability. Anecdotally, the volume of non-s166 reports is a multiple of formal s166 reports, yet currently side-step Parliamentary scrutiny by allowing the FCA to hide the cost of its supervisory activities "off-balance sheet". The proposal here is that Parliament be provided with a true picture of the costs of the FCA's activities.

Transparency is necessary because the FCA has the ability, anecdotally exercised often, under the threat of commencing a formal s166 process, to compel firms to commission non-s166 reports. Through these reports, the FCA extensively outsources its own supervisory activities. This comes at a considerable cost to firms. If used excessively, it may have an adverse impact on industry productivity. As such, a proper assessment of regulatory performance against the new secondary objective requires wider cost transparency than at present.

First, in order to be able to monitor the FCA's progress against its new secondary objective, Parliament must have a fuller picture of the total costs to industry of the FCA's activities. This must include not only the direct cost to industry of funding the FCA, as evidenced in its annual reports, but also other costs shouldered by industry where the FCA outsources (at industry's direct expense) its work to third parties. There is currently no public data on the latter.

The overall cost to regulated firms of the FCA is in effect a tax on firms and, insofar as it has the potential to impact industry productivity, is fundamental to the FCA's new secondary objective. It is an appropriate

public metric, vital for supporting scrutiny of the regulator's performance. Presently, Parliament and industry have an incomplete estimate of the costs of the FCA. Whilst some of the costs are transparent – for example, the FCA's fees and FSCS levy costs - others are potentially significant yet effectively invisible. Incomplete estimates of costs risk compromising Parliament's ability to monitor the FCA's performance, whether by setting a baseline or by monitoring trends thereafter. It would seem appropriate for the Committee to consider this as necessary information, given that it must be reasonably necessary for the purpose of reviewing and scrutinising the discharge of the FCA's functions.

Secondly, the current regime is open to abuse due to conflicts of interest. Significant corporate incentives exist for the FCA to request an excessive volume of reports. Since they provide significant benefit to the FCA, but at zero cost to the FCA, the incentive is to maximise their use. Without transparency and thus no oversight, there is no incentive for the FCA to keep the costs of such reports to a minimum.

Furthermore, arguably there is also the potential for personal conflicts of interest. For some FCA staff, Skilled Person firms may represent former or potential future employers. Generating excessive business for Skilled Person firms may benefit the careers of FCA staff.

Finally, this approach disadvantages the "good" firms. It creates an additional distortion, in that certain firms with higher risk appetites benefit from not investing in external consultancy and control recommendations via Skilled Persons, thereby gaining competitive advantage over more prudent firms. From speaking with other firms, our understanding is that firms proactively commission reports from Skilled Persons firms as a defensive measure. It is a rational response to jump before being pushed and commission a report proactively, on a firm's own terms.

Consequently, to allow for the fullest possible picture our response also argues for the inclusion of numbers and costs to firms of reports produced by a Skilled Person even where these are not provided to the FCA (category (3) above).

Conclusion

It is already broadly accepted that, to assess performance against the new secondary objective, Parliament should have a full picture of the costs to industry of FCA activities. The extensive use by the FCA of Skilled Persons reports – both formal s166 reports and non-s166 reports - has created an extensive cottage industry, characterised by a lack of transparency that promotes adverse incentives and the potential for rent-seeking.

No doubt much of the work of Skilled Persons firms is valuable. The argument of this response is rather that the lack of transparency and accountability around their use risks creating an incentive to overproduce them, at a cost to industry productivity, potentially in conflict with the new secondary objective.

The proposal here is simply that an incomplete picture can be avoided by including costs relating to reports produced by Skilled Persons, whether or not they are formal s166 reports, and ideally whether or not the FCA receives the report. This information should be readily obtainable and there are no obvious reasons not to obtain it. Our recommendation is that the Committee should request and review this information, as part of its enquiry, in order to establish whether these costs are indeed as significant as anecdotal evidence would suggest.

I hope that this response is useful to the Committee. Please do not hesitate to contact me should you have any questions.

Appendix: a background note on Skilled Persons, s166 and non-s166 reports

Under section 166 of FSMA, the FCA has a power to require a firm to provide a report by a Skilled Person, or itself to appoint a Skilled Person to produce such a report. There are approximately 40 Skilled Person firms on the FCA's panel³.

The FCA may use its s166 power to require reports by Skilled Persons to support its supervisory functions. These reports are requested by the FCA, but are paid for by the regulated firm, thereby providing a major incentive to the FCA to make extensive use of this power, since it requires no FCA resource despite incurring significant costs to the firms involved.

In 2014, following industry concerns about the mounting costs to industry of s166 reports and the lack of any accountability mechanism, the then Chair of the Treasury Select Committee wrote to the Chief Executive of the FCA asking for information on the costs and governance around s166 reports by Skilled Persons⁴. This generated a "nothing to see here" response from the FCA⁵.

³ <https://www.fca.org.uk/publication/documents/skilled-person-panel.pdf>

⁴ <https://www.parliament.uk/globalassets/documents/commons-committees/treasury/140623-Andrew-Tyrie-to-Martin-Wheatley-Skilled-Persons-Review.pdf>

⁵ https://www.parliament.uk/globalassets/documents/commons-committees/treasury/140707_Martin_Wheatley_Skilled_Persons_Reviews.pdf

The exchange of correspondence resulted however in a limited transparency commitment from the FCA to publish quarterly data on the number (but not the costs) of Skilled Persons reports. These are now published quarterly⁶. In addition, the FCA includes aggregate information on s166 report numbers and costs in its Annual Report⁷.

Most recently for 2023/24, the FCA reports: "In 2023/24, we used this s166 power in 83 cases. In 17 of those cases, we appointed the skilled person firm. In the remaining 66 cases the regulated firm appointed the skilled person. Across all 83 reviews, the work was undertaken by 20 different skilled persons firms. The aggregate cost incurred by regulated firms for s166 work undertaken in the 2023/24 financial year – including reviews that remain in progress from previous years – was £38.3m".

This small number significantly under-represents the true costs to industry by not including the extensive use the FCA makes of "non-s166 reports" by Skilled Persons, which were omitted from the 2014 correspondence. It is not clear whether their use has arisen as a way of avoiding the transparency now imposed on formal s166 reports, as outlined above. Either way, non-s166 reports are typically informally compelled by the FCA under the shadow of commencing s166 proceedings; they are undertaken by a Skilled Person and would be produced to s166 standards. In other words, they are s166 reports in all but name.

If the FCA is not satisfied with the conclusions of a non-s166 report, it would typically request a second, formal s166 report before a decision would be made on whether to commence enforcement proceedings. A firm may end up paying twice or more for multiple reviews of the same issue.

31 October 2024

⁶ <https://www.fca.org.uk/about/how-we-regulate/supervision/skilled-persons-reviews>

⁷ <https://www.fca.org.uk/publication/annual-reports/annual-report-2023-24.pdf>