



House of Commons
Treasury Committee

**Appointment of Lord Turner
of Ecchinswell as Chairman
of the Financial Services
Authority**

Fourteenth Report of Session 2007–08

Volume II

Oral and written evidence

*Ordered by the House of Commons
to be printed 2 July 2008*

The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of HM Treasury, HM Revenue & Customs and associated public bodies.

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Witnesses

Wednesday 2 July 2008

Lord Turner of Ecchinswell

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Oral evidence

Taken before the Treasury Committee

on Wednesday 2 July 2008

Members present

John McFall, in the Chair

Nick Ainger
Mr Graham Brady
Mr Colin Breed
Jim Cousins
Mr Philip Dunne

Mr Michael Fallon
Ms Sally Keeble
Mr Andrew Love
Mr Mark Todd

Witness: Lord Turner of Ecchinswell, a Member of the House of Lords, gave evidence.

Q1 Chairman: Lord Turner, welcome to this hearing on your chairmanship of the Financial Services Authority and congratulations from the Committee. For the sake of the shorthand writer, could you introduce yourself?

Lord Turner of Ecchinswell: Adair Turner, Designate Chairman of the Financial Services Authority.

Q2 Chairman: Could I start with your article *Just Capital*, which I have read, in which you discussed the concept of competitiveness. You refer to yourself at the CBI as the high priest of a cult whose beliefs you thought rather confused but which you could not reject without causing more confusion and offence. You end that article by saying that you adopted an attitude of cynical pragmatism. Can I therefore ask will cynical pragmatism be the hallmark of your time at the FSA?

Lord Turner of Ecchinswell: That is an unexpected first question since I wrote this book eight years ago but there it is. The background to that was a point of view that the use of the word “competitiveness”, as it relates to the threat to Western economies from lower income economies like China, is hugely overstated and does not take account of the way that exchange rates are adjusted and does not take account of the way that so much of our economy is actually non-traded sectors of the economy. That was the background to that. The answer is I think I will be pragmatic. I perhaps regret that you are using the word “cynical pragmatism” as it was said in a particular context.

Q3 Chairman: You used it.

Lord Turner of Ecchinswell: I did use it eight years ago. Having things quoted from eight years back may be difficult for several people. What I would accept is that sometimes you do have to pragmatically get on with things and not always express every theoretical complication that you could see with the situation that you are dealing with. What I was saying there was I had some doubts about the use of the word “competitiveness” but as long as what the CBI was arguing for was perfectly

sensible in any case it did not matter that the word you were using was not, in an absolutely intellectually rigorous sense, as precise as it could be.

Q4 Chairman: Good try! Is this consistent with someone going to lead and be straight and up front in all your dealings or will you go with the flow in the interests of an easy life?

Lord Turner of Ecchinswell: I do not think I have ever been someone who has gone with the flow in the interests of an easy life. If you look at my record in public policy, for instance on pensions’ policy, I do not think people would suggest that on that I went with the flow. I believe it is very important to set things out as they are. I believe it is very important, when there are crucial decisions to be made, that one clearly states one’s point of view. Of course in the FSA one is dealing with a situation where some of the most important decisions are made at the tripartite level between the three parties. It is very important that, whatever decisions are arrived at, there is collective responsibility but it is also important that you express your views clearly within it and accepting who is defined as the ultimate decision maker in different areas. The one thing I do not normally do is simply go with the flow because that is the easier thing to do as that is not my nature.

Q5 Chairman: You were quoted in the press at the end of May saying that high energy prices are a legitimate way to cut greenhouse gas emissions. Does that mean that as head of the FSA you would be less inclined to investigate the claim that high oil prices are in part the result of the FSA’s regulatory approach which has led to excessive speculation and market manipulation in the London oil market?

Lord Turner of Ecchinswell: No, I would not; they are two separate issues. The comment I was making that you quote, and I think it was slightly misquoted, was basically saying that high oil prices, and indeed high gas and coal prices because those have equally gone up over the last year, will usefully create incentives on our society to be more sensible about fuel efficiency and energy efficiency and therefore, in a sense, reduce the extent to which we have to use taxation levers since the market is doing it for us in

any case. If I then switch to the issue of speculation, it is clearly important for the FSA to consider whether there are any practices which amount to market manipulation or, in the extreme, market abuse. I have to say that so far there is no large accumulation of evidence, I would have thought, that speculation is playing a major role in what is happening to oil prices. Let me repeat again it is not just oil prices but gas and, most surprisingly, coal prices. It is the coal prices which are the really surprising feature of last year. There are a set of fundamental reasons of a balance of supply and demand which provide a reasonable explanation of why we have this significant spike in fossil fuel prices today. If you look at coal, it has a lot to do with shortages of shipping capacity which are difficult to move in the short term, there have been outages of Nigerian oil production and there is major demand increase in China. Although I think it is an issue that needs to be looked at, and is being looked at in the States by the CFTC, I do not think there is certainly overwhelming evidence and certainly it is not everything that is going on. There are some fundamentals of supply and demand which can help explain what is happening to fossil fuel prices.

Q6 Mr Fallon: You list 30 years of experience at Chase Manhattan, Standard Chartered, Merrill Lynch. You are City insider, are you not?

Lord Turner of Ecchinswell: I think I am both a City insider in the sense I have worked there but most of that life has not been literally working for City institutions. The biggest slice has actually been working for McKinsey as a consultant primarily to City institutions. I accept the point that can make me somebody who is closely involved in that. I think, however, what I have also done in my life, for instance in my public policy work recently on pensions, is to step back from City issues per se and consider the wider public good issues. For instance, some of what I came up with on the Pensions Commission was not what elements of the industry, particularly the retail financial services industry, would necessarily have wanted; it was not suggesting that we could solve all the problems by simply tinkering around in small measure with the rules that apply to them but was suggesting that there was a requirement for a more radical change which not all of them supported. I am enough of a City insider to understand the issues well but also somebody who approaches the issues in a very independent fashion.

Q7 Mr Fallon: We need to be convinced, as you have worked with three banks, you will be as tough as needed on banking supervision and enforcement and are ready to champion consumers of financial services.

Lord Turner of Ecchinswell: I am absolutely willing to champion consumers of financial services, both in respect of the importance of prudential regulation to make sure that we have a sound banking system and also in relation to issues relating to conduct of business and treating customers fairly. I will be absolutely robust in both those respects.

Q8 Mr Fallon: You would have seen Richard Northedge's article in *The Spectator* that made some rather harsh criticisms of you being not necessarily practical and reluctant to make decisions, which you may want to respond to. He also pointed out that you have never actually chaired an organisation. Is that the case?

Lord Turner of Ecchinswell: I have not read this article. I do not always read *The Spectator*. Having not had warning of that, I cannot respond in detail. I have chaired Commissions: I have chaired the Pensions Commission, I am chairing the Committee on Climate Change and I have chaired the Low Pay Commission. The role of Director General of the CBI also, although it is more like a CEO role than a chairman role because there is a president, also involved a significant element of chairing boards. The meeting of the trade associations and lots of different groups within it are chaired by the Director General. I do not think anybody who has actually seen me chairing an organisation or a meeting, which I have to say I do not think includes Mr Richard Northedge, would have any doubt about my ability to do so in an effective fashion.

Q9 Mr Dunne: You are a diligent sort of chap. What due diligence did you do before you decided to take up this appointment?

Lord Turner of Ecchinswell: Obviously before I was interviewed for the job I did a lot of reading about the background of it, which is both designed to prepare oneself to get through the interview but also to make sure that one really wants to do the job, and it was successful in both. I read very carefully, for instance, the internal audit report on Northern Rock to make sure I understood what had gone wrong and what measures were being taken to put that right. I read the business plan. I read the risk outlook which they produce each year. I also read very carefully the January tripartite paper in relation to the as then proposed relationship between the Treasury, the FSA and the Bank to make sure I was happy with what was being proposed in terms of the evolution of that relationship was something I felt I could work with. There were a number of other things but those were among those I read and thought about.

Q10 Mr Dunne: Did you discuss the role with either of your two predecessors?

Lord Turner of Ecchinswell: I did discuss the role with Howard Davies. I did not actually meet directly with Callum on this occasion. I did, however, have an hour meeting with Hector Sants because I think crucial to this job is a relationship with the chief executive. I had not previously met or known Hector so it would have been remiss to go into a set of interviews and put oneself forward without having spent time at least to begin to know the person with whom you would be working.

Q11 Mr Dunne: From those discussions did you form a view as to whether the advertisement to which you responded for a three day a week job was an appropriate period for this job?

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Lord Turner of Ecchinswell: The way you have to think about this is, first of all, it will be three days only in the sense that it is perhaps 60%, but often more, of one's time where one's time is not five days a week. I do not work five days a week. I doubt if you work five days a week, cabinet ministers do not work five days a week and, therefore, I do not think of the working week as being five days. At the very least I am thinking of this as being 60% of six lengthy days rather than five short days. What is absolutely clear is this is a job where if a crisis happens it has to be effectively full-time and that is one of the most important features of it. Therefore, I do not think it is combinable with any other role which is also capable of becoming a crisis. I do not think you can do this with any other role except those where, if necessary, you hand it over to another member of the committee to chair. I am absolutely clear this will take up the vast bulk of my time. I suspect that the distinction between Callum doing four and me doing three will, in practice, not really exist at all and I entirely accept that at some stage it is completely full time.

Q12 Mr Dunne: If you were to have discussed it with Callum he would have explained that he was working six days a week during the Northern Rock crisis. The question therefore arises we recognise you are stepping down from your other non-executive commitments but the Climate Change chairmanship you are retaining until the end of the year. Why do you think you can manage the two at this particular juncture?

Lord Turner of Ecchinswell: The challenge was that I had accepted the Climate Change job and that it is at a key point of developing a report but, having said that, by September 22 we will have made huge progress in writing a lot of the report. A report which has to be delivered on December 1. Fundamentally the heavy lifting work, in terms of putting together the outline and agreeing it, actually has to happen over the next two months. In fact, what I am effectively going to have is an extremely hard-working summer. During the autumn it will still be possible for me to continue to look after the fine tuning of that report, albeit we will have to have arrangements within the committee and in the secretariat that if anything approaching Northern Rock occurs we would have to have an acceptance that I will not be around for the week or whatever that occurs.

Q13 Ms Keeble: Would you like to explain the strategic priorities and objectives that you set out for yourself in your response to our questionnaire?

Lord Turner of Ecchinswell: You asked me what were the major objectives in the first six months of the chairmanship and the first one, familiarise myself with the full range of issues and develop a clear sense of priorities, is something which is not just for the first six months but something I am doing already. I attended last week the last meeting of the board and I will attend it again in July later this month and in September. I am meeting with the top 30 people, the managing directors and directors, in a

structured way over the summer. I will be spending more time with both Callum and Hector Sants and in a whole series of ways I will be trying to make sure that, ideally as much as possible before I start but then rapidly thereafter as well, I have a real sense of the full range of issues. I do think that one of the most important issues for the chairman is to think about the priorities. This is an organisation which has an enormous range of things to do and, therefore, really thinking are we focusing enough attention on the issues which are capable of having either serious systemic impact or serious customer detriment is very important. That is one of the roles of the chairman in challenging the CEO.

Q14 Ms Keeble: On the issue about the priorities, you have put as one of them playing a major role in the discussions on the key regulatory issues, and you have put down capital adequacy, pro-cyclicality and liquidity. How about the issues about the ratings agencies which have been much in the news recently? Do you see that as part of your role or not?

Lord Turner of Ecchinswell: I would not necessarily exclude those and I think those are part of the international discussions which would go on so those are there undoubtedly as well. Everything which is, for instance, in the Financial Stability Forums list of activities, which includes capital adequacy, pro-cyclicality and liquidity but also includes things to do with the credit rating agency, would be there. The key point is that capital adequacy and liquidity, and the treatment of liquidity as it relates to capital adequacy, are very specific things that the international regulators have to decide whether there are new approaches and which definitely have to be either reflected or not reflected in our rules and guidance. The credit rating agencies, there is a wider issue of how much regulators should get into that. There is a proposal within the European Union, which I believe will be discussed in the Committee of European Banking Supervisors, as to whether we should in Europe get into the process of registering and overlooking, in some sense, the credit rating agency and that would undoubtedly be on the list as well.

Q15 Ms Keeble: You have talked about the difference between rules based and you have put principles or outcome-based regulation. It can sound like semantics but underlying the three there are three quite different priorities for the form of regulation. Could you say a bit more about how you would want to see the regulation working?

Lord Turner of Ecchinswell: As I think Hector Sants said in a comment to this Committee about a month and a half ago, we can end up chasing ourselves round and round in discussion about all these different words. All of the words, rules, risks, principles and outcomes, certainly have a role to play in thinking about what we are doing here. First of all, there will definitely be rules. There is no regulatory system which does not have a formal rule book and sometimes those rules are important: rules on capital adequacy, possibly quantitative rules on liquidity, rules on conduct of business, et cetera.

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There are some rules but we know that effective regulation has to go beyond rules and then we get to those words: risks, principles and outcomes. The thing we are trying to achieve is good outcomes. Principles or risk based is only useful in so far as it makes sure that the outcomes are good for financial stability and good for good customer service and treating customers fairly. In order to get to those good outcomes we have to make it risk based. We have to be thinking where are the real dangers in this system and making sure that is where the greatest degree of supervisory focus is based. One of the lessons of Northern Rock was the FSA was not adequately focusing on the areas which had potential systemic disadvantage. Principles based comes in, in the sense, that in order to produce good outcomes, and whatever your rules, you have to try as best you can to make sure that management and boards of companies are following a set of principles about how they operate and have the competence to do that. It is not that those principles can simply be written down in the 11 principles, handed over and it will happen. You have to have a supervisory approach to make sure that management is aware of those principles and is really making them work. I hope that is clear. The end result is outcomes and in order to produce those outcomes you need a risk basis to work out where the worst outcomes could occur, and you need a combination of rules and principles, and people who are competent to pursue principles, to make sure we produce the outcomes we want.

Q16 Mr Todd: You read the internal audit report into Northern Rock. What was your initial reaction to reading it? You may have read it before being offered this post, I do not know.

Lord Turner of Ecchinswell: I did read it before I was offered the post. In relation to Mr Dunne's question, I read it before I was interviewed for the post. First, I think it is to the credit of the FSA that they were completely open about what had occurred. The chief executive said that what occurred was not acceptable to either him personally or the organisation. Not all regulators throughout the world, and not all organisations, would be as open about what went wrong. Secondly, what did surprise me is that what went wrong clearly had things going wrong months before last August/September. It was not just a problem of what occurred in the debates about whether to provide emergency liquidity, et cetera. What did surprise me is there were fundamental process things going wrong: points about too rapid turnover, not enough challenge from one layer of management to another, failure to document, and a lack of a number of visits and intensity. That surprised me because sometimes what you get is despite the formal processes looking good you produce a bad result, and yet here we had something where they quite openly said some of the formal processes were not right. That is why I do think the programme called the Supervisory Enhancement Programme is absolutely fundamental to get right.

Q17 Mr Todd: Can I highlight an area where potentially you would be engaged, which is the internal challenge dimension which I think was one of the most alarming parts of the report. What would you do, in concrete terms, to ensure that there is a framework of internal challenge to raise standards on matters of this kind?

Lord Turner of Ecchinswell: There are at least two aspects to it. Within the normal process of supervision we have to ensure that there is challenge between different levels of management to make sure that processes have been gone through, that the correct questions have been asked and that the processes of analysis have been correctly done. That is something which the Supervisory Enhancement Programme will aim to do. It is a lot to do with processes but also culture, just establishing a culture whereby between the immediate supervisor and the one level up there is challenge. Also there is a different aspect of challenge which is implicit within the internal audit report but also within the wider understanding, which is an intellectual challenge or an interchange between the Bank of England and the FSA. There is sometimes a distinction drawn, and there has to be a clear distinction, between responsibility for financial stability systemically and responsibility for the supervision of individual institutions. It is very important that those two are talking closely together and that the insights which are coming out of the Bank's financial stability analyst are being used to generate questions which are intellectually challenging the supervisors in the FSA.

Q18 Mr Todd: Particularly if there are unstated assumptions, which again appeared in the internal audit report, as to the behaviour of others which actually had not been tested in any robust environment. Let me check the division of responsibilities between you and Hector Sants in delivering this outcome. Where do you draw your line?

Lord Turner of Ecchinswell: Ultimately it is for the chief executive to propose what are the specific numbers of people who are going to work in different departments, how much we are going to increase our staff, what will be the procedures for measuring the performance and what will be the processes which need to be put in place, but it is for the Chairman to be continually saying have we done that and have you got ideas to do that, and when those proposals have been brought forward to keep challenging those and asking can I satisfy myself that these proposals you are making really are going to make sure that the problems we had previously will not occur again. There is a fairly classic role of a chairman to a chief executive which is one of suggesting priorities, thinking about priorities and challenging proposals on operational decisions but ultimately there has to be a clear proposal from a chief executive.

Q19 Mr Brady: You said in your response to us that you understand there has been an increased day-to-day co-operation between the tripartite authorities

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since the Northern Rock problems and you then go on to say that clearly it is essential that the improved co-operation since then continues. Do you think that improvement has been sufficient or do you propose further action to strengthen the tripartite co-operation?

Lord Turner of Ecchinswell: My comments reflect the fact that both from the FSA and indeed in the conversation I had with the Governor there is a perception that in the various situations over the last year, where there have been discussions as to whether problems were coming up again, because there have been various such discussions during the course of the last year and has been a continuation of turbulent times, that there is a feeling on both sides that the processes of data exchange and intellectual exchange have been far better than they were on Northern Rock. I have been told that both from the Bank side and the FSA side, and indeed I have seen a day-by-day account of what has occurred in some of these more recent cases which have been developed within the FSA to help us understand the ways that it would now work and whether they fit in with what is proposed within the tripartite agreement proposals that came out yesterday. That is why I have considerable confidence that they have got better, and even if one did not write it down then simply sensible working relations would work. It makes absolute sense that we have, in the proposals which came out yesterday, a codification of who does what and what the responsibilities are. I think those proposals are workable and sensible proposals. I would, however, just stress one thing about them. For instance, if we take the Special Resolution Regime there is a very interesting comment at point 1.45 in the first chapter. Essentially it says that in practice any problems to do with troubled banks will involve detailed intensive discussions between all three parties. Although it is very important that we have a clear definition of who pulls the trigger, who decides ultimately which form of special resolution to use, who decides whether to provide extra liquidity, who can decide and it has to be the Chancellor if it is public money, what it must not suggest is that these things happen in a nice easy sequential fashion where, as it were, the FSA sits there, presses the trigger on the Special Resolution Regime and hands it over to the Bank of England and says now think about what to do about it. Any such decision will involve, as that point 1.45 makes, intense discussions. What has been happening, as I understand it, over the last year in situations which did not get that far, but at some stages people thought they might have, those discussions have been very effective.

Q20 Mr Brady: For a Special Resolution procedure it does require everybody to work together and there will be intense discussion but somebody also has to take the lead. We have heard very different views on that. We have heard from Callum McCarthy and Hector Sants that it should be the FSA, we have

heard from Mervyn King that at a certain point it has to be the Bank that takes the lead. What do you think?

Lord Turner of Ecchinswell: The proposals that have come forward are perfectly sensible and workable in this respect. It is difficult for it to be other than the FSA that makes that trigger decision without the other party then coming back into the whole process of banking supervision. Again the decision to say we have reached the point where we have to trigger a special resolution is the end point of a set of heightened supervision before that. If you were to say another party such as the Bank has to pull the trigger, then they have to come back into the whole of heightened supervision as well in order to have the information. I think it is a workable way of doing it, it is a sensible way of doing it and a sensible resolution has been produced. I know that the concern of the Governor has been about what is called regulatory forbearance. I have to say that looking carefully at what happened with Northern Rock last year there were a whole load of problems, both early in the year about the failure of some of the processes of supervision that could have spotted the problems earlier and there were clearly then problems between the tripartite authorities in what to do about it when people had decided that something rather severe had to happen, but the one thing there was not was regulatory forbearance at the point of actually saying we have now got to the stage where we have to do something really serious and certainly not on the part of the FSA. The idea of regulatory forbearance is not one that worries me and I know that is a difference of opinion between the FSA (and myself), and the Governor.

Chairman: We will have you back on that.

Q21 Jim Cousins: Were you aware of the architecture of these arrangements you have just now been discussing before your appointment?

Lord Turner of Ecchinswell: The architecture of the tripartite arrangements?

Q22 Jim Cousins: When you were appointed were you then aware of the architecture of the arrangements you have just now been discussing?

Lord Turner of Ecchinswell: I had read the January tripartite arrangement which has not been radically changed in the new consultation paper. They have been changed in minor respects but broadly speaking the January paper put out by the tripartite authorities for consultation was, in most respects, where we have ended up today. It is not radically different and, therefore, I was aware that we were heading towards a clearer treatment of an insurance regime, that there was going to be a Special Resolution Regime and the roles of the Bank in respect of financial stability were likely to be more clearly defined. All of that, if I remember rightly, is in the January paper.

Q23 Jim Cousins: Were you aware when you were appointed of the fact that the trigger mechanism would be set in hand by the FSA and the operation of the regime would be by the Bank of England?

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Lord Turner of Ecchinswell: No, I was not. The January paper, if I remember rightly, does not get into that level of detail and in particular leaves it open as to whether the operation of the Special Resolution Regime should be the Treasury, FSA, the Bank or someone else. I do not think I could have been aware at that stage because I do not think it had got to that stage of definition. I was aware of the problems that people were trying to grapple with and those are clearly set out in the January paper. It was clear that decisions would have to be made as to what were the relative roles of different players in this respect.

Chairman: I will adjourn the Committee for 10 minutes.

The Committee suspended from 4.00 pm to 4.10 pm for a division in the House.

Q24 Jim Cousins: Lord Turner, you were setting out for us, in reply to my colleague Mr Brady's questions, your view that the formal process which launches the Special Resolution Regime, which is a bit of a pantomime horse with the front two legs being the FSA and the rear two legs being the Bank of England, would be less significant than the consensus processes of discussion between the tripartite authorities. You in turn then went on to emphasise the importance of the heightened supervision phase which would precede any consideration of a Special Resolution Regime. Do you think the fact that an institution is in that heightened supervision phase, or indeed naming that institution, should be a public process?

Lord Turner of Ecchinswell: I do not think it should. I am not sure that would be helpful. Obviously at one level one can have a sort of principle of absolute transparency in everything but in one crucial way the proposals which were issued yesterday and foreseen before go in exactly the opposite way, but probably in a way most of us would consider reasonable. For instance, they allow the Bank of England to provide emergency liquidity support while not being subject to the normal processes of disclosure that it would have and indeed while making it possible for the institution involved receiving that support not to disclose that effect. That reflects the fact that when you get to that position where there is an institution in some danger but still not passed the point of recovery, i.e. not past the point where you trigger the Special Resolution Regime, part of good prudential management has to be to do things which are not absolutely disclosed and transparent. That applies both in relation to the fact that one is subjecting them to heightened supervision and to the fact, if it is true, that one has provided them with emergency liquidity support, both features of which are likely at times to be closely correlated. The same principles that mean that some of what the Bank in England does is not fully and immediately exposed probably applies also to the FSA in that respect.

Q25 Jim Cousins: If the heightened supervision phase, and the fact that an institution is in the heightened supervision phase, is to be covert and not

to be made public, do you think that really fits with the way public life is now conducted? There is nothing to stop Mr Peston announcing on *Newsnight* that something is going to happen which is, of course, the run on Northern Rock.

Lord Turner of Ecchinswell: That may be true.

Chairman: We are going to come back to this issue at a later time so we will give you more time to do that.

Q26 Mr Love: Coincidentally a copy of the FSA's annual report thudded on my desk today. I do not know if you had anything to do with that.

Lord Turner of Ecchinswell: No, it thudded on my desk as well.

Q27 Mr Love: I have not had a chance to read it but I have read the letter that accompanies it from your predecessor or the current chairman. He states: "The three main themes which run through our work remain consistent with last year. One of those three main themes is helping retail consumers achieve a fair deal." When I look at your questionnaire there does not seem to be much comment on retail consumers. Can you tell us why and is this a priority for you?

Lord Turner of Ecchinswell: If that is true then that is unintentional. One of the points I certainly thought I had made is on page 6, at the bottom at point 9, where I say: "While focusing on ensuring that recent problems do not occur it is also essential to ensure that the FSA is identifying future potential risks and problems which may arise in quite different areas, for instance in relation to conduct of business in retail financial services." The point I am making there is, obviously given what went wrong last year, there has been an awful lot of focus on the issues which are essentially in the prudential management arena, the systemic risk and the financial stability because those, when they happen, are very severe. That is where there is a lot of discussion at international level and where a lot of the focus of the Tripartite Agreement Consultation Paper and the Supervisory Enhancement Programme are based. The point I am making, and maybe I should have expanded it a bit more, is if we had only rolled back two years ago and asked what were the major problems that the FSA should be dealing with we probably would have been talking about things which were to do with the conduct of business in retail financial services. We would have been worried about the whole issue of IFAs, commission-based sales, split capital trusts, et cetera, et cetera. I was trying to flag there, and maybe I should have made it at greater length, that one of the things that is the role of the chairman is to make sure that we are absolutely dealing with the problems that events have made clear are problems that we have to deal with while continuing to say what could be the future problems. It is entirely possible that in two or three years time we might, if we are lucky, not have had another major prudential systemic problem but we may be looking and saying our real problems are to do with conduct of business in retail financial

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services and some category of misselling or failure to treat customers fairly. That is also a priority and something which I will want to make sure does not get lost amid the completely understandable focus on making sure that issues like liquidity and prudential supervision of banks are better dealt with.

Q28 Mr Love: I want to focus on the Retail Distribution Review. Noting the comments that you made earlier on in reply to an earlier question about the balance between principles and rules in relation to regulation, do you think there is a need for a more robust attitude by the Financial Services Authority to protecting the consumer's interest? Let me give you some comments made by *Which?* magazine who looked at this. They are talking about the level of fines, whether or not you should employ naming and shaming where necessary and whether there is a need for mystery shopping which is something that they undertake. I am not asking you to answer in any of those specifics but is there a need for a more robust attitude by the FSA?

Lord Turner of Ecchinswell: The answer is I do not know and it is something I am going to look at in detail: the Retail Distribution Review is ongoing. There is the completion of a set of work on treating customers fairly which produced initial reports in March and more detail in December. I think there are debates within the retail industry about how effective that treating customers fairly initiative has been. That is something I will want to look at in detail and try and make sure that I am happy with the approach we are using to that segment of the market.

Q29 Nick Ainger: Past crises in the banking and financial sectors it is true to say have been the result of some sort of herd mentality. The Northern Rock business model, which then became incredibly heavily criticised after the problem, was accepted as a good model and seemed to work well. We had the dotcom bubble and we had the major issue which led to the credit crunch through sub-prime and the CDOs and all the risks that were not properly assessed by many financial institutions. Do you see it as your role to prick some of these bubbles?

Lord Turner of Ecchinswell: You have focused on a very important thing which is a herd mentality. There is a very good report out, as I understand it, from the Bank for International Settlements which is very well summarised and talked about by Martin Woolf in the *Financial Times* today on exactly this issue. What you can do about it falls within two categories, one of which is not the job of the FSA but the job of the monetary authorities. Indeed, there is a school of thought that monetary policy should do more to prick bubbles. The FSA does not have the instruments to prick overall asset price bubbles; those are either uninfluenceable or, to the extent they are influenceable, are influenceable by monetary policy rather than necessarily by supervisory policy. I am not saying that I believe that one should do that

but I am simply saying once we are into this arena of pricking bubbles there is a continuum of efforts from the monetary policy role of the Bank of England through their financial stability role to supervision. Where the supervisors and where the international debates come in is this important issue of pro-cyclicality as it is phrased. If you look at, for instance, the way we have in the past measured market risk within trading rooms, we do have quite a dangerous element of pro-cyclicality, by which I mean this is typically measured by value at risk over the last year, 250 days of trading activity. Clearly what was happening up until July or so last year is traders and their risk control departments were saying the observed variance of market movements over the last year has got less, therefore there is less volatility in markets, therefore I can price volatility, I can accept volatility, for a smaller return. There was, therefore, a herd mentality which was, in a sense, embedded within the way that we actually measure risk. It was not just a psychological herd mentality but there was a pro-cyclicality. This issue as to whether some of our measures of risk actually tell us that risk is lowest when it is highest is really problematic. Those value-at-risk measures in market risk were lowest in about July last year and yet on any reasonable basis that was probably the point of maximum danger for the world financial system. These are precisely the issues which the Bank for International Settlements and the Financial Stability Forum are trying to get to grips with within this heading of pro-cyclicality, i.e. that when times are good do the capital measures that we have encourage people to believe that they are even better than they really are and inversely the other way. On that area, which gets to how we supervise and how we measure capital, is crucially something that the FSA needs to look at in association with international bodies.

Q30 Nick Ainger: The report that we published on financial stability made a recommendation that there should be a new system of getting financial institutions to heed the warnings that are issued by the FSA or by the Bank. First of all, what are your views on that? Should there be something set out or some agreement reached and should we be considering naming and shaming particular financial institutions who are not following good advice and warnings that are issued by you or by the Bank?

Lord Turner of Ecchinswell: I do not know. I think that whole issue of naming and shaming, both in the retail and prudential area, is something I would rather not speak on at the moment but is an issue which I would certainly consider.

Nick Ainger: You talked about conventional wisdom and the herd mentality and I would ask you again to look at the oil futures market. Everyone keeps trotting out the conventional wisdom that it is supply and demand but there is ample evidence produced by the International Energy Agency that it is not supply and demand.

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Chairman: We will be looking at that.

Q31 Mr Breed: In 10 years the FSA has presided over the split capital debacle, the Equitable Life fiasco and the Northern Rock crisis. Do you think it is time it got ahead of the curve?

Lord Turner of Ecchinswell: I thought you were going to say why do I want the job? However hard one tries something will go wrong. When one takes a job like this for five years I will be amazed if there is not at least one thing which you and others will criticise me and the FSA for in five years' time. I do not think the regulatory tools are perfect enough to prevent something going wrong, but we have to make sure that as few things as possible go wrong and when they go wrong they are not really serious ones. The challenge is to try and keep ahead of the curve. I do think one of the key roles of the chairman is to be continually stepping back, continually listening to the organisation and the way that the organisation defines its risk and trying to help the executive see what is coming down the track rather than responding to it. I certainly see that as a major part of my role and I hope to do it very effectively but I doubt if I will do it perfectly.

Q32 Mr Breed: You no doubt looked at the list of your board members. Do you believe it provides the appropriate spread of interest, experience and knowledge in order to cover all the aspects of what is, by anybody's reckoning, a fairly broad brief of the FSA?

Lord Turner of Ecchinswell: I think it is a well constructed board with a wide set of appropriate skills on it. Obviously over time, as things rotate, I will want to look at that but I do not start with the proposition that is a key area for change.

Q33 Mr Breed: Is there a role for more consumer representation on the board?

Lord Turner of Ecchinswell: The issue of where we get consumer representation from is an important one. Obviously we have the Consumer Panel, as we have the Practitioner Panel, and I look forward to a close engagement with the Consumer Panel. Again, I think that is something on which I will have a better point of view in six months or a year as to whether there are any issues on the composition of the board. I doubt if the crucial issue on consumer representation is around the board table. I would have thought it is the way that we interface with the Consumer Panel and the way we interface with all the different consumer organisations, or indeed with yourselves as people who, through your constituents, are representatives of consumers.

Q34 Mr Breed: Some people would think that the consumer panel is not a substitute for proper representation on the board. Rather recently you have lost the deputy chairman who, in a sense, represented consumer interests so we are going backwards rather than forwards.

Lord Turner of Ecchinswell: I do not think that is true but I would be in a better position to either defend or agree with you in a year's time rather than today.

Q35 Chairman: The oil issue which was referred to, I noted in CBS News on 17 June it said very explicitly in terms of oil "British financial authorities are notoriously lax". How far are you willing to defend that and to counter that perception in the international markets?

Lord Turner of Ecchinswell: It is clearly important that the FSA is on the front foot on issues of market manipulation and market abuse but, having said that, there are some things which fall into the category of speculation which will be very difficult for any regulator to stop because speculation, in itself, as long as it is not market manipulative in its operation, is allowed in pretty much all financial markets. There are long only speculators but there are issues which need to be looked at. I know the FSA has been very keen that it gets more teeth in this area of market manipulation and market abuse and has been very thankful to your Committee for supporting the argument that we need some additional legal tools, in addition to the plea bargaining tools, in order to be effective if there are such problems.

Q36 Chairman: We are chasing government on that. I am not convinced personally that it is going to be in the Queen's Speech so we need to push on that from both us. From your experience and knowledge of the City of London how clean do you think our financial markets are?

Lord Turner of Ecchinswell: That is very difficult to say. The answer is they are not totally clean. Is there insider dealing?

Q37 Chairman: What will be your commitment to tackling market abuse?

Lord Turner of Ecchinswell: I have a very strong commitment to tackling market abuse but we all know that it is a damn difficult thing to prove. Quite a lot of market abuse and insider trading throughout the world goes undetected because it is simply inherently difficult to detect and also inherently difficult to get prosecutions in that area but I think it is something where we need to increase the aggressiveness of the way we look at that issue.

Q38 Chairman: You know that we published a report on inherited estates a couple of weeks ago. Since then Prudential has announced that they will not proceed with the reattribution of the inherited estate. From our perspective as a Committee, that underlies the importance of a new regulatory framework for inherited estates. What I am looking for from you is a commitment to give serious thought to the recommendations in our report which are designed to improve the overall framework for inherited estates.

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Lord Turner of Ecchinswell: I will have to look at that carefully. The FSA is due to come back with a response in the autumn some time to your report on inherited estates. There are some issues where there is increasing agreement, for instance the details of whether one can charge misselling costs against it so there is progress being made there. Whether or not it needs to be looked at in greater detail is something which I will think about and discuss. Obviously I would need to go through with the executive what is the appropriate response to the recommendations.

Q39 Chairman: I would say there is quite a lot of stuff in our report to reflect on.

Lord Turner of Ecchinswell: Certainly I will reflect on it.

Q40 Chairman: Can I thank you for your appearance here today. I wish you well in your new job and I do not look forward to you coming back to explain some big mistake.

Lord Turner of Ecchinswell: I hope it is just a very small mistake!

Treasury Committee Questionnaire: Response from Lord Turner of Ecchinswell

A. PERSONAL AND PROFESSIONAL BACKGROUND

1. *Do you have any business or financial connections or other commitments which might give rise to a conflict of interest in carrying out your duties as Chairman of the FSA? Are there any other relevant personal factors of which the Treasury Committee should be aware in considering your appointment?*

Prior to the date of my taking up office as Chairman I will have ceased to be a member of the board of any company, and will have sold any direct holdings of listed shares in FSMA-regulated companies. I own shares in Paternoster Ltd, an insurance company active in the bulk annuity buyout market of which I was a board member until 2 June 2008. Since these shares are unlisted, and there is no liquid market, it is not possible to sell these immediately, but I will sell them at the earliest opportunity (eg trade sale, a new equity injection, or an IPO). In the meantime, I am registering this interest, and will ensure that I do not have influence over any decisions which could have an impact on the potential value of these shares.

There are no other relevant personal factors of which I believe that the Treasury Committee needs to be made aware.

2. *Do you intend to serve out the full term for which you are appointed?*

Yes, I intend to serve a full term of five years.

3. *Please explain how your experience to date has equipped you to fulfil your responsibilities as Chairman of the FSA. In particular, in what areas of the FSA's work do you believe you will be able to make an immediate contribution and which areas will you have to undertake additional research when in post?*

My relevant experience includes:

- Extensive experience of commercial banking over 30 years at Chase Manhattan Bank, as a consultant at McKinsey & Co., and as a Director of Standard Chartered plc. This experience has covered all aspects of retail and wholesale banking, including retail distribution systems, credit assessment of retail and business customers, treasury and trading operations, asset and liability management, and payment systems. It has covered banks in the UK, Western Europe, the U.S.A., the transition economies of Eastern Europe and Asia.
- Extensive experience of investment banking as Vice-Chairman of Merrill Lynch Europe for six years, covering equity and debt markets, corporate finance, equities research and corporate broking.
- Detailed knowledge of the retail pension and investment market, arising from my chairmanship of the Pensions Commission.
- Understanding of life insurance risks and the prudential regime for life insurance companies arising from directorship at Paternoster Ltd.

I do not have detailed experience of the complexities involved in the detection of market abuse, nor in the legal issues relating to enforcement in market abuse cases or other financial crime. I aim to familiarise myself more with these issues before taking up the Chairmanship.

4. *To what extent will your Chairmanship of the FSA require a different approach from that required in your previous positions, with regard to the discharge of the duties and responsibilities involved?*

I would highlight the following differences:

- The role is quite different from that which I performed as Chair of the Pensions Commission. That role entailed sustained detailed focus on a particular issue of public policy, leading a small team to produce recommendations for a major change in policy and with the Chairman able to be deeply informed on every detail of the analysis. The role of FSA Chairman requires involvement in numerous different issues, on only a few of which the Chairman can himself be an expert, relying instead on the quality of the work of numerous experts and implementers. This in turn means that one of the key functions of the FSA Chair (working with and through the CEO) is to build the institutional capability of the FSA to deal effectively with a huge range of issues.
- The role of Chairman is more similar to my role as Director-General of the Confederation of British Industry which also required the ability to switch focus between a wide range of different public policy issues, relying on the quality of numerous policy experts, and which entailed building the Confederation's institutional capability via effective internal management. But with the crucial difference that the role of Director-General of the CBI is a CEO role, not a Chairman role.
- A key determinant of the FSA's success is therefore the effective working relationship and division of responsibilities between Chairman and CEO. I see the key tasks and challenges for the Chairman as being (i) providing support and advice to the CEO in the identification of the priorities which need to be reflected in effective internal management of the FSA; (ii) ensuring that the FSA is continually alert to developing risks in financial markets, and is taking appropriate actions to mitigate them; (iii) playing a major role in the external communication and stakeholder engagement of the FSA; (iv) playing a leading role in relationships with the other tripartite authorities; (v) playing a leading role in international discussions and decisions about appropriate financial regulation.

B. OTHER PROFESSIONAL ACTIVITIES

5. *You are contracted to work three days a week, one day fewer than Sir Callum McCarthy. How many hours do you expect to devote to the FSA each week:*

a) between September and December 2008?

b) from 2009?

The formal description of my role states a three day a week commitment. But any "three days a week" commitment at this level inevitably involves more than three normal working days of work, once reading and preparation for meetings and evening commitments are taken into account. Defining the number of "hours per week" involved in a senior job is somewhat arbitrary, but I am used to working at least 60 hours per week, and I would expect the FSA to take at least 60% of that time commitment. It is clear however that in the event of any financial crisis, the job of FSA Chair becomes effectively full time.

I will remain Chair of the Shadow Climate Change Committee until after the first report is launched in December. While the time commitment for this role was initially described as being "three or four days per month", it is clear that this is not adequate, and I have agreed that I will spend up to eight days per month on this role up to the end of 2008. From 22 September to the end of 2008 I will therefore have two roles which in total amount to a 100% time commitment. This will be hard work but manageable, especially given that the work of the Climate Committee, while very important, does not entail the need to respond rapidly to unexpected events.

After stepping down from the Chair of the Climate Committee in early 2009, it has been agreed (if the Secretary of State for DEFRA wishes) that I could continue to play a role on the Committee, but no longer as Chair. This would however be at a significantly reduced time commitment. I would therefore be able to continue to devote at least 60% of a more than normal working week to the FSA, with slightly less pressure on my own personal time than in the initial period.

6. *What professional activities, other than Chairman of the Shadow Climate Change Committee, do you expect to undertake in addition to your position on the FSA and how do you intend reconciling these activities with your position as Chairman?*

I have now resigned, or will have resigned by 19 September, from all positions other than Chair of the Shadow Climate Change Committee and Chair of the Overseas Development Institute, a research institute/think-tank. The latter role entails no more than about four days per year of formal commitments. It is not my current intention to take on other roles during my time as FSA Chairman. If I did take other roles, I would ensure that the maximum time commitment for all other roles combined (including any ongoing role as a member of the Climate Committee) would not exceed five days per month, which would be easily compatible with a more than 60% FSA commitment.

7. *What activities do you intend undertaking in order to add to the public's understanding of the role and decisions of the FSA?*

The FSA needs to communicate with a wide range of interested parties, in a variety of ways.

- In relation to the general public, as the Committee is aware, the FSA's responsibilities in this area have been greatly expanded following the Thoresen's recommendation that we lead a "Pathfinder" programme to set up a service offering free, impartial information and guidance on money matters. Clearly that will be an important development, building on the FSA's current consumer website, consumer contact centre and information campaigns relating to the current financial capability programme. Once I have taken up the Chairmanship, I will want to review in detail the range of our present and possible future consumer communication.
- The FSA also communicates via the speeches and press statements of its Chair and CEO, reaching both specialist industry audiences and to a degree the general public. I would expect to continue Sir Callum's significant commitment of time to such speeches. That will be particularly important as we explain the new approaches to enhanced supervision, to capital adequacy, and to liquidity, which will emerge from the deliberations of the FSA and international bodies on the lessons learnt from the last year's problems.
- The FSA also has a structured relationship management programme to ensure regular contact with the full range of stakeholders including relevant consumer groups, and I plan to participate in key meetings within that programme.
- And clearly one important form of communication is via the engagement with your Committee and with other Parliamentary groups.

C. STRENGTHENING THE FINANCIAL SERVICES AUTHORITY

8. *What advice have you received from Sir Callum McCarthy following your appointment?*

I have spent several hours with Sir Callum to benefit from his thoughts on the challenges facing the FSA, and on the role of the Chairman. I have also met for similar discussions with Hector Sants. I plan to attend this week's meeting of the FSA Board, and by 22 September will have had meetings with each of the Managing Directors and Directors (30 in total). At the end of July, Sir Callum and I will be travelling together to Washington DC and New York to introduce me to some of the key individuals involved in financial regulation in the US.

My discussions with Sir Callum and Hector Sants covered a wide range of different issues, but one particularly important topic has been the proposals for the development of the tripartite relationship to be set out in the forthcoming Consultation Document. I have also met with the Governor of the Bank of England to discuss effective working relationships between the FSA and the Bank.

9. *What steps will you take to enhance public confidence in the financial system and the City's confidence in the FSA as a regulator?*

A key challenge in enhancing and maintaining public confidence is to address the issues which have damaged confidence last year, while keeping continually alert to the danger that future problems may come from unexpected directions.

The key problems of the last year have related to banks and in particular to their liquidity. And the FSA has itself recognised, in its Internal Audit Report, that the failings of its supervision of Northern Rock have damaged confidence in the organisation, including in the minds of this Committee. The Supervisory Enhancement Programme is an important and wide-ranging response, relevant in particular to banks but also to other regulated firms. As the Committee is aware, the main features of the programme, as announced by the FSA on 26 March this year, are:

- "A new group of supervisory specialists will regularly review the supervision of all high impact firms to ensure procedures are being rigorously adhered to;
- The numbers of supervisory staff engaged with high-impact firms will be increased, with a mandated minimum level of staffing for each firm;
- The existing specialist prudential risk department of the FSA will be expanded following its upgrading to divisional status, as will the resource of the relevant sector teams;
- The current supervisory training and competency framework for FSA staff will be upgraded;
- The degree of FSA senior management involvement in direct supervision and contact with high impact firms will be increased;
- There will be more focus on liquidity, particularly in the supervision of high impact retail firms; and
- There will be raised emphasis on assessing the competence of firms' senior management."

One of my priorities for the next year will therefore be ensuring that the Executive deliver the changes promised in the Supervisory Enhancement Programme, and ensuring that the financial services industry and the wider public understand the scope of the actions being taken.

Alongside the FSA's Supervisory Enhancement Programme, improvements in the effectiveness of coordination by the tripartite authorities are clearly essential and will be described in the second consultation paper due shortly. I comment on this aspect of improved effectiveness in response to question 11 below.

Finally, in relation to the prudential supervision of banks and other systemically important institutions, there are complex and crucial issues which need to be addressed at an international level, for example liquidity supervision and possible pro-cyclicality in capital adequacy regimes. I intend to be significantly involved in these deliberations—for instance via the Financial Stability Forum—and in the communication to the financial services industry of the implications of these deliberations for financial supervision and financial stability.

While focussing on ensuring that recent problems do not recur, however, it is also essential to ensure that the FSA is identifying future potential risks and problems, which may arise in quite different areas, for instance in relation to conduct of business in retail financial services. I will therefore seek to satisfy myself that the FSA has rigorous processes for anticipating as best possible emerging potential problems.

10. *To what extent is it your ambition to support the move from rules-based regulation to outcome-based regulation?*

The distinction between rules-based regulation and principles or outcome-based regulation can sometimes be overstated. Any regulatory system will involve many specific rules, and it is possible that some of the major debates about prudential supervision now underway—for instance on capital adequacy and liquidity—may result in changes to specific rules. In some instances moreover the FSA is required by EU legislation to draft detailed rules in order to implement particular Directives. But the FSA philosophy that regulation should be risk-based, principles-based and as much as possible outcome-focussed is sound, and indeed is even more important in times of financial stress.

- It is vital for regulation to be risk based, ie for the FSA to ensure that its greatest focus is on those firms, markets, and activities which have the greatest potential to cause serious customer detriment or systemic risk.
- Regulation therefore also needs to be outcome-focussed. Rules may often be needed, but rules are only valuable in so far as they help achieve desirable outcomes. And desirable outcomes will in some cases not be achievable by rules, or by rules alone, but will be achieved by ensuring that key principles are followed.
- Close and continuous supervision of high impact firms, ensuring that they are operating to sound principles, and ensuring that the top management of those firms are committed to sound principles and are thinking carefully about possible outcomes, is therefore as essential as the rule book itself.

I therefore agree strongly with Hector Sants' comment that "the events of last year, including Northern Rock, support principles-based regulation; they highlight how important it is that firms' management and the FSA focus on delivery of outcomes rather than just focussing mechanically on compliance with the rules."

11. *How do you see the FSA's future relationship with the Treasury and the Bank of England?*

- Working effectively with the Treasury and the Bank of England is clearly crucial to effective financial supervision and to financial stability, and one of my priorities will be to ensure that those relationships work well, at all levels, including the most senior.
- The legal context for that cooperation will be set by the new Banking Bill, proposals for which will shortly be set out in the second Tripartite Consultation Paper. The overall approach has already been outlined by the Chancellor in his Mansion House speech on 18 June and in his letter of 19 June to the Chairman of this Committee. These proposals set out a workable division of responsibilities between FSA, Bank and Treasury in extreme conditions—and in particular in relation to the operation of the Special Resolution Regime. And they are based on a clear division of overall responsibilities—the FSA responsible for regulation and regulatory decisions for all regulated firms; the Bank responsible for overall issues of financial stability.
- But it is important to recognise that the legal definition of responsibilities can only go so far in ensuring effective decision-making and that success will depend crucially on close cooperation, data-sharing and joint working among the three parties, with whoever is responsible for a particular decision also taking into account the insights and judgements of the other parties. I understand that there has been increased day-to-day cooperation between the Tripartite Authorities since the Northern Rock problems, and that in dealing with recent market issues the three authorities have worked well together. Clearly it is essential that this close cooperation continues.

- And I believe it particularly important that this cooperation pertains not only in conditions where heightened supervision will apply and or where the use of the Special Regulation Regime may be under consideration, but at all times. The Bank, through its financial stability analysis, is well placed to identify emerging trends which may have implications for the appropriate focus of individual firm supervision and the FSA, through its supervision, may be aware of emerging patterns which the Bank's financial stability team should be investigating in more detail. Ensuring that there is not only formal exchange of information, but a continually interchange of views about the implications of available information is, I believe, a key priority.

12. *What are your major objectives in the first six months of your Chairmanship?*

- Familiarise myself with the full range of issues on the FSA's agenda and develop a clear sense of the priorities for the organisation, and for the Chairman personally.
- Ensure that the Executive drive through the priorities set out in this year's Business Plan, and in particular the Supervisory Enhancement Programme.
- Play a major role in international discussions of key regulatory issues, such as those on capital adequacy, pro-cyclicality and liquidity.
- Foster close and effective working relationships with the Bank of England to ensure both that any extreme circumstances are dealt with successfully, and that there is maximum synergy between the Bank's ongoing analysis and the FSA's supervisory activities.
- Meet a wide range of the FSA's external stakeholders and understand their perspectives on key challenges and risks in financial services, and on the FSA's effectiveness.

Memorandum from Which?

Which? is the leading consumer charity working on retail financial issues. As a result, we have worked closely with the Financial Services Authority (FSA) on numerous issues.

We welcome the appointment of Lord Turner as Chairman of the Financial Services Authority. His work as Chairman of the Pensions Commission indicates that he is focused on making the financial services market deliver for consumers.

However, he joins the FSA at a time when consumers feel badly let down by the financial services industry. Lord Turner and Chief Executive, Hector Sants have a huge task to turn the FSA into a truly effective, consumer-focused regulator. It is also important that given the increased focus on prudential regulation and wholesale markets that the FSA's retail agenda is not neglected.

We have highlighted a number of areas about which it would be useful to gain Lord Turner's views.

INHERITED ESTATES—WITH PROFITS FUNDS

We warmly welcome the contents of the Committee's report into inherited estate and fully support its conclusion that the regulatory framework and the FSA's current oversight are not sufficient to protect policyholders' interests.

The decision of the Prudential to not go ahead with its reattribution makes it all the more important that the FSA addresses its regulatory failures in this area. The FSA must urgently implement the recommendations of the Treasury Committee to ensure that inherited estates are used in the best interests of policyholders. This should be undertaken alongside a consultation on a redesign of the overall regulatory system for with-profits funds. We hope the Committee will press Lord Turner to ensure that the recommendations in the report are implemented.

THE FSA'S REGULATORY APPROACH

Which? is aware that the FSA's resources are limited, and that will impact on the level of supervision they can undertake. For example, some Independent Financial Advisors (IFAs) will never get a supervisory visit. As a result, the FSA cannot simply create regulations and hope that firms comply with them—it needs to put incentives in place to ensure compliance.

Ensuring the correct incentives are in place is becoming even more essential during the current move away from detailed rules towards a principle based approach. Which? does not object to high level principles, but we have reservations on how the FSA approaches enforcement. We do not think the FSA's current approach acts as a significant deterrent to corporate malpractice. Nor are the necessary market forces in place to provide incentives for good corporate behaviour.

If firms are to be expected to treat customers fairly, it is important that progress is capable of being measured. It is disappointing that only 13% of firms sampled by the FSA have met the March deadline to have appropriate management information in place to test whether they are treating their customers fairly.¹

Which? would argue that the FSA is taking a considerable risk removing rules without more robust enforcement in place to provide a deterrent against firms exploiting less intrusive regulation. Consumers need to be confident that they will be treated fairly. As a result, we would recommend that the FSA reviews the incentives it has in place, and in particular increases the level of fines and reconsiders its traditional opposition to “naming and shaming”.

Given the FSA’s move towards high level principles of regulation and devolving more responsibility for treating customers fairly to directors, a more robust approach is needed to investigate firms’ behaviour. Which? believes that one way to achieve this would be for the FSA to make greater use of mystery shopping to test firms’ behaviour and then publish the findings in a similar way to Which?.

Which? is not calling for more legislation or regulation, what consumers need is better regulation. The FSA must use its existing powers more flexibly and imaginatively to ensure proper enforcement and be an effective deterrent against the unfair treatment of consumers.

HIGHER LEVEL OF FINES

The level of fines imposed by the FSA seems inadequate when compared with those levied by the Office of Fair Trading for competition abuses. Which? believes that the revenue from FSA fines should be spent on financial capability and/or money guidance projects rather than being recycled into reduced regulatory fees for the financial services industry.

The Competition Act gives the OFT the power to impose penalties on companies of up to 10% of their worldwide turnover for price fixing and other forms of anti-competitive behaviour. The OFT has used these powers: For example, fining British Airways £121.5 million for price fixing and Argos and Littlewoods £22.65 million for price fixing of toys and games.²

Taking a specific example, in January 2008, the FSA imposed a fine of £1.085 million on HFC Bank Limited for failings in selling Payment Protection Insurance (PPI).³ The FSA said that HFC’s breaches of the regulation were “particularly serious” and that “the financial impact of customers of unsuitable advice was likely to be significant”. Over the 28 month period identified by the FSA, HFC sold 163,000 payment protection insurance policies (of which 124,000 were single premium). In a sample of sales reviewed by the FSA the average cost of a single premium PPI policy was £2,100. Therefore, it is reasonable to assume that revenue from these single premium policies was in the region of £260 million, with further revenue from the sale of other types of PPI policy. Given the level of fines, compared to the revenues at stake, it is unsurprising that the FSA’s regulatory activity in the market for Payment Protection Insurance has not had the desired outcome in ensuring that customers are treated fairly. Fines will need to be significantly higher. Also, to provide a stronger incentive to treat customers fairly firms found guilty of misselling should be made to re-examine all PPI policies sold and proactively provide redress to missold customers.

REGULATORY TRANSPARENCY—“NAMING AND SHAMING”

Which? believes that regulatory transparency could have a powerful effect towards incentivising firms to improve their practices. More detailed disclosure would inform consumers and send a strong message to the industry. The experience of Which? over its 50 years of existence is that the spotlight of publicity and the attendant changes in what people buy do more to improve standards in an industry than anything else.

We welcome the FSA’s discussion paper on increasing regulatory transparency, but believe that its proposals do not go far enough. In particular, Which? would like to see further details published about firms which issue misleading financial promotions.

CONSUMER REPRESENTATION—FSA BOARD

Which? is supportive of the work of the Financial Services Consumer Panel. However we strongly contend that the existence of the Consumer Panel in no way mitigates the need for proper consumer representation on the FSA Board.

The way the FSA is led has a significant impact in its ability to fulfil its two consumer focused objectives of securing the appropriate degree of protection for consumers and promoting public understanding of the financial system.

¹ Treating customers fairly: progress update, June 2008

² http://www.offt.gov.uk/news/press/2003/pn_18-03 ; <http://www.offt.gov.uk/news/press/2007/113-07>

³ http://www.fsa.gov.uk/pubs/final/hfc_bank.pdf

The consideration of consumer interests should be an integral part of FSA decision making, and must not be sidelined. Which? is concerned that the almost complete dominance of board members with a financial services industry background limits the regulator's ability or willingness to protect consumer interests against those of the industry.

A number of FSA non-executive board members retired in 2007. Which? called for a major increase in consumer representatives, or at least, non-industry representatives to balance out the Board. We were extremely disappointed this has not happened. Indeed, with the recent departure of Deputy Chair Deidre Hutton, consumer representation has actually decreased.

We believe an increase in consumer representation at the very top of the organisation would help to drive cultural change to ensure consumer interests are put at the heart of the FSA's decision making. We hope this will be a priority for Lord Turner in his role as Chairman of the Board.

30 June 2008
