ICAEW REPRESENTATION 112/15

Capital resources requirements for Personal Investment Firms (PIFs)

ICAEW welcomes the opportunity to comment on the paper CP15/17 *Capital resources requirements for Personal Investment Firms (PIFs*) published by Financial Conduct Authority on 28 May 2015, a copy of which is available from this link.

This response of 3 September 2015 has been prepared on behalf of ICAEW by the Financial Services Faculty. As a leading centre for thought leadership on financial services, the Faculty brings together different interests and is responsible for representations on behalf of ICAEW on governance, regulation, risk management, auditing and reporting issues facing the financial services sector. The Faculty draws on the expertise of its members and more than 25,000 ICAEW members involved in financial services.

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place London EC2R 6EA UK
icaew.com

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City

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GENERAL POINTS

Consumers need trust and confidence in the financial services sector and firms need sufficient capital resources to run a sustainable business. Personal Investment Firms (PIFs) should hold adequate capital resources to meet the everyday needs of running their business within the framework of a robust operational model structured to serve the long-term needs of customers.

ICAEW is broadly supportive of the objectives as outlined in this consultation paper and we agree that PIF's need to hold capital resources consistent with operating a sustainable business model. However, the intrinsic nature of professional services means the potential value of errors and mistakes that can arise from the provision of these services could be greater than the value a firm can generate from providing this type of service. Professional indemnity insurance (PII), not prudential capital, is the mechanism designed to address this potential imbalance.

The proposals to amend the capital resource requirements for PIFs as stated in the consultation, seems to generally strike a sensible balance. However, although we understand what you are trying to achieve, capital resources alone cannot ensure a safe and competitive marketplace that firms want to operate in and which consumers will feel safe to place investments. The implication of this line of reasoning, if carried to its logical conclusion, is that PIFs could be called to hold capital resources far in excess of the commercial value of its business, which clearly cannot make sense. Further, consumers should not be led to believe it is the capital reserves of a firm that serves as the ultimate backstop for meeting all claims and errors that could arise, although capital reserves do have an important role to play.

Anecdotal evidence from our members and advisory businesses suggest firms that operate in this market sector have difficulty obtaining cost-effective, comprehensive PII cover. The claims arising basis of PII, high policy excesses on a per claim basis, and tendency for insurers to exclude specific areas of regulated work, means there are a range of important issues that need to be addressed. It seems self-evident that difficulties in the PII market must be having a detrimental effect on the retail financial advice sector both in terms of inhibiting exit and entry to this sector, whilst also increasing the risks of creating a pool of potential uninsured losses. This situation cannot be in the interest of consumers or for the operation of an efficient and orderly market more generally. Given that professional indemnity insurers seem to be struggling to make a long term commercially viable return that allows them to remain in this market sector, it suggests there must still be some deep-rooted problems in the retail advice sector.

Whilst we are generally supportive of the proposals outlined in this consultation paper, the broader problems associated with the retail advice sector cannot be resolved simply by focussing on capital resources requirements. ICAEW note your comments in paragraphs 1.26 and 1.27 regarding the case for a time limit (or longstop) on complaints to the Financial Ombudsman Service and whether current arrangements are working in the best interest of consumers. These are important issues that need detailed consideration under the Financial Advice Market Review.

RESPONSES TO SPECIFIC QUESTIONS

Q1: Do you agree with our view that the use if an EBR can be viewed as inconsistent between firms and may provide adverse incentives? If not, how would you suggest an EBR could be deployed in a more consistent way?

Your analysis seems reasonable.

Q2: Do you agree with our proposal to set the capital resources requirements for PIFs on the basis of a firm's income? Do you also agree that a simple, single percentage calculation is the most appropriate? If not, what alternative approach will achieve the same objectives of consistency and simplify?

The approach seems generally sensible.

Q3: Is a minimum of £20,000 sufficient for firms to give their consumers' confidence of business sustainability? If not, what would be a more suitable level and why?

Q4: Is a variable requirement of 5% sufficient to give consumers of larger firms the same level of confidence? If not, what would be a more suitable level and why?

Factors that determine sustainability and consumer confidence are varied and complex. It would therefore be overly simplistic to correlate the potential sustainability of any particular business, and/or the relative level of consumer confidence, with the specific amount of capital resources PIFs are expected to hold. That said, from a practical perspective, the proposed £20,000 minimum seems to be a sensible figure and, similarly, we are not aware of any reason why setting a variable requirement of 5% is inappropriate.

Q5: Do you have any comments on our proposed approach to setting the capital resources requirements to reflect the additional risk for categories of PIF other than B3 that have permissions to deal as principal or manage portfolios ?

We have no reason to disagree with the proposals.

Q6: Do you have any comments on our proposed approach to setting the capital resources requirements for PIFs that are subject to MIFID?

The proposed approach seems generally sensible.

Q7: Do you have any comments on our proposed approach to setting the capital resources requirements for PIFs that are subject to MIPRU?

The proposals seem reasonable.

Q8: Do you have any comments on our proposed approach to setting the capital resources requirements for a PIF that has permission to conduct as a SIPP operator?

No.

Q9: Do you have any comments on our proposal to extend to all PIFs the restriction on the inclusion in the capital resources calculation of subordinated loans and preference shares redeemable within the next two years?

This seems generally sensible.

Q10: Do you have any comments on our proposal to remove the provision that allows a PIF to include a PASS Loan Agreement Scheme facility in the capital resources calculation?

No.

Q11: Do you have any comments on our proposed amendments to the financial returns?

No.