# Response to FSA Consultation Paper 12/28:
# Regulatory Fees and Levies: Proposals for 2013/14

## Introduction

WMBA welcomes the opportunity to respond to the issues raised in the FSA Consultation Paper 12/28: Regulatory Fees and Levies: Policy Proposals for 2013/14 and looks forward to further active engagement on this topic during the proposed Financial Conduct Authority's 2013 Fees Review.

WMBA comments are made from the viewpoint of its members who act as Limited Licence/Limited Activity firms in the wholesale markets and are currently designated within Fee Blocks A12 and A13. WMBA appreciates that by the time this response is considered by the FSA, the change from fees based on approved persons to an income basis will already have been implemented by the FSA and, hence, the WMBA have produced this position paper, based on the new FCA Fees Governing Principles, in respect of the current regime for consideration by the FSA and the FCA during their deliberations in 2013.

## Summary of Key Points

- **Fees in Fee Block A13 are now running at six times of those in Fee Block A12 whereas the risk profile of these firms is significantly less.**
- **WMBA member firms risk profile has not changed but for members in Fee Block A13 their fees under the new income based regime will increase by between 700-4,000%.**
- **The cross subsidy between the wholesale and retail sectors should be removed and new cost allocations and fee blocks based on the wholesale and retail nature of the *firm's* business should be introduced.**
- **FSA rational for moving to an income based allocation for Fee Blocks A12 and A13 is flawed and the resultant fees do not reflect the risks posed by different types of firms within these sectors**
- **Definition of Income in Fee Blocks A12 and A13 to be amended to allow the deduction of costs directly attributable to the generation of income**
- **The deficit on the FSA defined benefit pension fund should be underwritten by the Treasury or failing that allocated across all PRA and FCA firms.**
- **Transitional arrangements should be adopted which would cap the increase for a particular firm over a pre determined period.**
- **Financial penalties should remain within the financial services industry and be used to fund the Financial Services Compensation and Financial Omnibus Schemes.**

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## FCA Fees Governing Principles: Fee Blocks A12 and A13 for 2013/14

**Principle 1: Fair: Justify basis for any cross-subsidy**

Firms in Fee Blocks A12 and A13 are diverse in nature (ranging from large financial institutions to sole traders) and service different sectors of the financial services markets (wholesale and retail). WMBA believes that divergence of the FSA's priorities in this respect results in their members (who deal exclusively in the wholesale markets) providing a cross subsidy to the firms dealing in the retail sector. This is costly to its members and disproportionate to any perceived benefit they receive from the participation of end users in the financial markets.

It should be noted that WMBA members business model provide an execution only service with no reliance by its clients on any type of investment advice as opposed to the retail sector where there is reliance by customers on advice provided by intermediaries.

Unlike retail firms, who will pass the additional cost on to the consumers, the IDB Model is that of high volume and low margin and, consequently, any rises in FSA fees, be they direct or cross subsidies, cannot be passed on to their clients (who themselves are also facing higher regulatory fees plus additional capital requirements). The IDBs therefore incur any additional cost without any further regulatory protection to their eligible counterpart or professional client base.

Hence, to avoid cross subsidy between the wholesale and retail sectors, the WMBA would respectfully suggest that the FSA gives consideration to a new method of allocation whereby rather than fee blocks being split dependent of the holding of client money, they should be divided into wholesale and retail fee blocks with the costs being allocated accordingly. Firms would then be allocated to fee blocks based on their regulatory permissions.

**Principle 2: Risk aligned: Risk taken into account where effective to do so**

The proposed fees in Fee Block A12 and A13 are currently totally disproportionate to the risk profile of the firms within these blocks. Based on the figures, supplied in the FSA Consultation Paper CP12/28: Regulatory Fees and Levies: Proposals for 2013/14 Fees, the fees in Fee Block A13 (arrangers not providing client money) are now running at six times those of Fee Block A12 (arrangers providing client money) whereas the risk profile and consequently regulatory supervision of the former is significantly less. The WMBA find it difficult to understand why this is the case and would respectfully request that the FSA provides details of how the figures for 2012/13 (which have been quoted in the Consultation) have been calculated.

In the absence of a switch to a wholesale/retail fee structure(see above), WMBA would submit that given the recent cases of MF Global and similar, and the actual risk profiles of the Fee Blocks A12 and A13, there is a case for reviewing the allocation of fees and the population of firms within these fee

blocks. In lieu of any other logical assessment between holding and not holding client money, WMBA would suggest that it is better not to make the distinction and, hence, merge these two fee blocks.

As a result of the current market conditions, where the whole industry is suffering from a slowdown in trading activities, most firms are going through significant cost cutting across their entire businesses. This coupled with the increasing regulatory costs to meet with the forthcoming new European directives and regulations such as EMIR/REMIT/MiFID/MiFIR are placing significant calls on WMBA members' resources. Hence, WMBA considers that as neither the business model nor the risk profile of the IDBs have changed, requiring additional supervision by the FSA, any additional fees levied on its members cannot be justified in the current economic climate and will put undue burden upon its members without any benefits to the regulator or to the client.

The WMBA considers that the majority of the deficit on the FSA defined benefit pension fund is likely to be the result of ex-employees of the Bank of England, the insurance division of the Department for Trade and Industry and the Building Societies Commission and, hence, it is not equitable for this to remain with the FCA and allocated solely across FCA fee blocks (even though in the FSA words, the amount of £107m is liable to be small in relation to the overall costs of the FCA, a statement the WMBA would refute). The WMBA is of the opinion that because of the diverse origins of the deficit, it should be underwritten by the Treasury or if this is not deemed possible, Option 2 in the FSA Consultation Paper 12/28 should be adopted to ensure that at least the same proportion is collected from dual registered banks, building societies and insurers as was the case under the FSA in 2012/13.

**Principle 3: Transparent: Link between cost allocation, application of risk and levels of fees is clear**

Again, we would reiterate our comments above regarding Client Money holders and non-Client Money holders and the confusion over the riskiness of these 'permissions'.

Neither the risk profile nor the business models of the IDBs have changed over the years and hence no additional supervisory costs have been incurred (even in the recent financial crisis). As the regulatory fees should reflect the supervisory cost to monitor the activities of the sector WMBA members find it difficult to understand the significant increase in their regulatory fees for the year 2013/14 and as mentioned above would ask the FSA to substantiate the significant increase in the supervision costs for this and future years.

**Principle 4: Predictable: Firms can reasonably estimate their fees for the forthcoming year**

In the October 2012 Fees Policy CP 12/28, the FSA concluded that the impact assessment they undertook as a result of comments received in respect of the October 2011 Fees Consultation, in their opinion showed that income provides a fairer basis for the cost of regulation than headcount and hence have confirmed this basis for the fee year 2013/14. In the consultation paper, the FSA recognises 'that

some firms will undoubtedly see some sharp increases in fees but, while no doubt unwelcome, they should be affordable in relation to the income generated'.

In the current economic climate, the WMBA would refute the FSA assumption in the consultation paper that the increased fees (which for firms in Fee Block A12 and A13 will equate to 0.1 and 0.7 basis points) are "affordable in relation to the income generated".

The WMBA are concerned that due to the lack of information available, its members were unable to make a fully informed response to the original Consultation Paper in October 2011 and that the FSA failed to consult on this again once the impact analysis in CP12/28 showed that some regulated entities in their statistical sample would be facing increase fees of over 1,000% (WMBA has subsequently conducted a poll amongst its members and based on purely the change to income basis, the fee for its members in fees block A13 will increase by between 700-4,000%.)

The WMBA considers that given the current economic climate, any future proposal to change fee structures should be accompanied by an impact analysis which would accompany the initial consultation.

To mitigate the effect of the sudden increases in fees as a result of policy changes (ie, change of allocation of fees, change in the treatment penalties, reallocation of pension deficit, etc) the WMBA would advocate the use of transitional arrangements which caps the maximum increase for a particular firm over a pre-determined period. Any shortfall in funding resulting from these transitional arrangements should be funded by money market borrowing (as consulted on in the recent Financial Ombudsman Funding Consultation Paper). This policy would allow firms sufficient lead time to effectively consolidate them within their budgets and cash flows.

**Principle 5: Flexible: Adaptability to changes in the financial markets**

The FSA may be minded to look at the extra-territoriality regimes of overseas regulators and the impact of additional fees and costs on UK firms doing business either with overseas nationals from the UK or into the foreign jurisdiction. An example here would be the Dodd-Frank Act which has had (or may cause) big impacts on UK firms' costs given its reach overseas.

Another example is the recent change of swaps contracts into futures contracts by most US exchanges, to aid their US members to avoid the Dodd-Frank swaps regulations, has caused a massive impact on non-US firms, particularly the IDBs in the UK who are now required to register with the National Futures Authority to enable it to conduct these trades.

The FSA should be mindful to consider the extra regulatory costs on the IDBs in continuing to provide its services to its clients in other jurisdictions and include this, and that of similar issues, when being flexible to changes in the financial markets.

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**<u>Principle 6: Proportionate: Cost of operating should be proportionate and consideration given to the impact on dual-regulated firms</u>**

No comments.

**<u>Principle 7: Legal: allowable within FSMA as amended by the Financial Services Bill and other relevant legislation</u>**

No comments

**<u>Other Comments to Issues Raised in the Consultation</u>**

**Financial Penalties**

The WMBA considers that the payment of financial penalties by firms within the financial services industry to HMT is inconsistent with the concept of the financial services regulator being a self-funded organisation with statutory powers. WMBA would propose that the financial penalties levied on firms (above the enforcement costs) are used within the financial services industry by providing funding for the Financial Services Compensation and Financial Ombudsman Schemes. By adopting this policy, the funds raised would be used to directly compensate victims.

The payment of financial penalties to HMT seems to be a politicised move in line with the general climate against the financial services industry and does nothing to help these firms to keep their costs as low as possible and, in turn, generate economic activity for the benefit of the country.

**FSA Equality Assessment for Fee Blocks A12 and A13**

The FSA rationale for moving to an income based allocation within Fee Block A12 and A13 was based on their perception that the allocation based on approved persons was not equitable or fair for part-time employees.

However, WMBA considers that the proposed income based allocation for Fee Block 12 and 13 is also flawed in respect of a fair and equitable allocation for the following reasons:

- FSA supervision (and consequently costs) is based on the risks a firm poses to its four statutory objectives. The income method does not take into account the risk profile of the firm when allocating fees.
- The amount of risk posed by an employee is not dependent on the number of hours they work. Hence, a part-time employees can pose as much risk to the FSA's statutory objectives as full time employees . Thus the costs of supervising full-time or part-time employees should be the same.

- The same income can be earned from a small number of large sized deals in the wholesale markets as a large number of small sized tickets in the retail markets and does not reflect the cost of supervising that sector of the market.

Based on these points, the WMBA strongly disagrees that the move to an income based allocation was the correct approach. Rather, a combination of risk based and supervisory resource allocation approaches should be employed in the knowledge that exclusively wholesale market participants, without the requirement for recourse to resolution regimes, especially limited activity and limited license firms, are effectively far simpler and cheaper to supervise and to regulate.

## Definition of income for allocation of fees in Fee Blocks A12 and A13

For Block A13, based on the 2012/13 figures supplied in FSA consultation Paper 12-28, the fees would equate to approximately 0.7% of its income[1]. Whilst at first sight this appears to be a relevant small amount, it needs to be considered in the context of the low **net** margins currently obtained by WMBA members in the intermediation sector of the wholesale markets. Hence, the WMBA is concerned that in times of increased completion from exchanges and other participants in the financial markets, the effect of the increase on the bottom line for its members will be significant.

The WMBA would therefore respectfully request that the definition of income be amended to take into account any cost directly attributable to the generation of the income. FSA would provide guidance in respect of what, in their opinion, constitutes eligible costs (which the WMBA would suggest includes at least salary, contractual bonus, telephone, IT infrastructure costs).

[1] FSA currently defines income as ;

all brokerages, *commissions*, *fees*, and other related income (for example, administration *charges*, overrides, profit shares etc) due to the *firm* in respect of, or in relation to, the provision in the *UK* of the *regulated activities* specified in R, Part 1 as belonging to fee-blocks A.12, A.13 or A.14 and which the *firm* has not rebated to *clients* or passed on to other authorised firms (for example, where there is a commission chain).

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**The Wholesale Markets Brokers' Association and London Energy Brokers' Association**

The Wholesale Markets Brokers' Association (WMBA) and the London Energy Brokers' Association (LEBA) (jointly referred to in this document as WMBA) are the European industry associations for the wholesale intermediation of Over-the-Counter (OTC) markets and trading venues in financial, energy, commodity and emissions markets and their traded derivatives. Our members act solely as intermediaries in the said wholesale financial markets and are nearly entirely Limited Activity and Limited Licence firms (as defined by the UK Financial Services Authority) in respect of the EU Capital Requirements Directive.

As Interdealer Brokers (IDBs), the WMBA members' principal client base is made up of global banks, primary dealers, large energy companies and other wholesale market participants. (Please see www.wmba.org.uk and www.leba.org.uk for information about the associations, its members and products.)

WMBA members operate three models to facilitate trades: ***Name Give Up, Exchange Agency*** and ***Matched Principal***. These models are detailed on our website.