



FSA

Financial Services Authority

A new regulator
for the new millennium

January 2000

1 Statutory objectives and the principles of good regulation

The statutory objectives

- 1 The FSA's overall purpose is described in the four statutory objectives in the new legislation:
 - maintaining market confidence;
 - promoting public awareness;
 - protecting consumers; and
 - reducing financial crime.

The Bill applies these objectives and the principles of good regulation (see below) directly to specific FSA activities - making rules, preparing and issuing codes, giving advice and guidance and determining the general policy and principles by which we act. In addition they form a more general foundation for our public accountability.

Market confidence

- 2 Market confidence is fundamental to any successful financial system; only if it is maintained will participants and users be willing to trade in financial markets and use the services of financial institutions. Maintaining this confidence involves, in our view, preserving both actual stability in the financial system and the reasonable expectation that it will remain stable.

3 This is achieved through:

- preventing material damage to the soundness of the UK financial system caused by the conduct of, or collapse of, firms, markets or financial infrastructure; and
- explaining on what basis confidence in the UK financial system is justified: this includes stating explicitly what the regulator can and cannot achieve.

Market confidence does not imply zero failure

- 4 The FSA will aim to maintain a regime which ensures as low an incidence of failure of regulated firms and markets (especially failures which would have a material impact on public confidence and market soundness) as is consistent with the maintenance of competition and innovation in the markets. This in turn requires careful evaluation of the probability of any collapse, and its likely impact on the financial system.
- 5 There is a clear risk that the very existence of a regulatory regime may lead people to expect a higher degree of protection than is achievable or desirable. Under the public awareness objective, the FSA will therefore seek to explain what it aims to achieve within the financial system, so that when failures do occur, damage to market confidence is kept to a minimum.
- 6 Maintaining market confidence therefore does not, in the view of the FSA, imply aiming to prevent all collapses, or lapses in conduct, in the financial system. Given the nature of financial markets, which are inherently volatile, achieving a 'zero failure' regime is impossible and would in any case

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be undesirable. Any such regime would be excessively burdensome for regulated firms and would not accord with the statutory objectives and principles. It would be likely to damage the economy as a whole and would be uneconomic from a cost-benefit point of view; it would stifle innovation and competition; and it would be inconsistent with the respective responsibilities of firms' management and of consumers for their own actions. Considerable dangers would arise if consumers or market participants believed that no firm would ever be allowed to collapse; this would reduce the incentive for individuals or firms to take due care in assessing the risk attaching to their financial decisions.

- 7 The FSA will nonetheless seek ways of minimising the impact of failures on market confidence. We will co-operate with the Treasury and the Bank of England on financial stability issues, under the Memorandum of Understanding agreed in 1997. We will retain and improve the mechanisms currently in place to protect consumers when firms collapse or fail to meet expected standards of conduct. In particular, the Financial Services Compensation Scheme will be available when firms are unable to meet their liabilities, and the Financial Ombudsman Service will deal with complaints by consumers against regulated firms.

Public awareness

- 8 Many consumers do not understand the financial system, the products and services offered and how they relate to their financial needs. Such consumers may not secure suitable products at fair prices; they may misunderstand the terms on which products are offered or may not realise the pros and cons of different product offerings. The FSA will therefore pursue two main aims under this objective:
 - to improve general financial literacy; and
 - to improve the information and advice available to consumers.
- 9 General financial literacy will be improved through programmes to help individuals acquire the knowledge and skills they need to be better informed consumers of financial services. Under the second heading, the FSA will provide, or help others provide, generic information and advice to consumers (e.g. comparative information tables) and will encourage others to improve the availability and quality of their advice. We will develop the information and enquiry services which we already provide directly to consumers, including the statutory register of authorised firms and the Consumer Helpline.

- 10 The FSA will give priority to filling a number of existing gaps in public understanding of retail financial products, in particular on the part of vulnerable and inexperienced consumers. In addition, we will use public awareness as a means of achieving our consumer protection objective. Improving public awareness will also be addressed by promoting financial education as an integral part of the educational system.

Consumer protection

- 11 The FSA is also charged with "providing an appropriate degree of protection for consumers". The principal risks which consumers may face in their financial affairs are:
- *prudential risk*
the risk that a firm collapses, for example because of weak or incompetent management or lack of capital;
 - *bad faith risk*
the risk from fraud, misrepresentation, deliberate mis-selling or failure to disclose relevant information on the part of firms selling or advising on financial products;
 - *complexity/unsuitability risk*
the risk that consumers contract for a financial product or service they do not understand or which is unsuitable for their needs and circumstances;
 - *performance risk*
the risk that investments do not deliver hoped-for returns.
- 12 The FSA has a role to play in identifying and reducing prudential risk, bad faith risk and some aspects of complexity/unsuitability risk. It is not the FSA's responsibility to protect consumers from performance risk, which is inherent in investment markets - providing the firm recommending the product has explained to the consumer the risks involved and has not made excessive and unrealistic claims. Under the public awareness objective, the FSA will aim to ensure that consumers have a better understanding of the risks and opportunities involved in investment markets.
- 13 The level of protection provided will depend on the sophistication of the consumer; professional counterparties need (and want) much less

protection than retail consumers. It will also reflect the needs that consumers have for advice and information, and the general principle that consumers should take responsibility for their decisions.

Financial crime

- 14 Confidence in the financial system and consumer protection will be seriously undermined if the financial system and individual institutions are abused for criminal purposes. The FSA is therefore charged with reducing the extent to which it is possible for those organisations it regulates to be used in connection with financial crime.
- 15 The three main types of financial crime which the FSA will play a significant role in seeking to prevent are:
 - money laundering;
 - fraud or dishonesty, including financial e-crime and fraudulent marketing of investments; and
 - criminal market misconduct, including insider dealing. The Bill will give the FSA new powers in this area.
- 16 We will be doing more work across the whole financial sector to assess the effectiveness of firms' money-laundering controls and customer identification procedures.
- 17 There are many other forms of financial crime (e.g. credit card fraud) where we will play a secondary role. We will work with other organisations (e.g. the police, the Serious Fraud Office and the Department of Trade and Industry) to assist their efforts.

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