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Financial Regulation Strategy
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7 September 2011

Dear Sirs,

HM Treasury: A new approach to financial regulation: the blue print for reform (the "**Reform Proposal Document**")

1 Introduction

We refer to the Reform Proposal Document and to the draft financial services bill contained therein (the "**Bill**").

We welcome the opportunity to respond to the Reform Proposal Document. Our response is limited to the following consultation question as set out in Box A.1 of the Reform Proposal Document: *"Do you have any views on the proposals for markets regulation by the FCA described in paragraphs 2.120 to 2.123 and in Chapters 3 and 4?"*.

In particular we wish to set out our concerns in respect of the proposal outlined in paragraph 2.123, bullet 4 of the Reform Proposal Document and reflected in Part 2, Clause 18 of the Bill.

This response to the Reform Proposal Document is the joint response of Resolution Limited ("**RSL**") and Resolution Operations LLP ("**ROL**" and together with RSL, "**we**").

RSL is a Guernsey incorporated company with a premium listing on the Official List of the UK Listing Authority and which is admitted to trading on the main market of the London Stock Exchange. It is a member of the FTSE 100 and its business model is to acquire businesses and provide the public markets with a series of restructuring opportunities in the financial services industry in the UK and in Western Europe. As a non-regulated entity listed on the London Stock Exchange, RSL will be directly impacted by the proposed extension of the Section 166 powers (as defined below).

ROL is a privately owned FSA regulated advisory firm which provides investment advice and related services to RSL. ROL expects to undertake the formation of, and perform similar services for, other listed companies in the future. It therefore actively considers the merits of

being listed in the United Kingdom ("**UK**") as compared against the listing regimes of other jurisdictions.

2 Overview

Paragraph 2.123 of the Reform Proposal Document notes that in the response to the February 2011 paper "A new approach to financial regulation: building a stronger system" a number of respondents expressed concern about the inclusion of a proposal which would allow the FCA to require "skilled person" reports from listed issuers (the "**extension of the Section 166 powers**").

Whilst it was noted in paragraph 2.123 of the Reform Proposal Document that the government appreciated such concerns, the Reform Proposal Document states that it is of the view that the changes to be made to Part 6 (including the extension of the Section 166 powers) will strengthen the listing regime and maintain London's reputation as a leading centre for capital raising and primary markets without compromising the ability of UK businesses to obtain the financing that they need.

Notwithstanding the government's view, we remain concerned about the continued inclusion of the extension of the Section 166 powers in the Reform Proposal Document. We will address our concerns in more detail in Section 3 of this letter.

In addition to the general concerns that we will outline in Section 3 of this letter, we are particularly surprised and concerned by the proposal that the extension of the Section 166 powers be applied to individual directors (as evidenced by Clause 18(2) of the Bill - Section 97 (A) (3) (b)). Our views on the application of the extension of the Section 166 powers to directors are set out in Section 4 of this letter.

3 General concerns with the extension of Section 166 powers

There is a clear distinction between the FSA's role (i) as the UK Listing Authority for listed issuers admitted to a regulated market in the UK (the "**UKLA Role**") and (ii) its role as a supervisory and regulated body for authorised institutions under the Financial Services and Markets Act 2000 ("**FSMA**") (the "**Regulatory Role**"), the former role being more narrowly focussed on the sole statutory objective of maintaining confidence in the UK financial system.

The FSA's existing powers to appoint skilled persons under Section 166 of FSMA were introduced in the context of risk analysis of individual authorised firms (i.e. conferred on the FSA in its Regulatory Role). It is not clear what the rationale is for the extension of the Section 166 powers to the FCA's role of maintaining confidence in entities that are not authorised institutions when there appears to be little evidence that the existing rules and powers of the FSA do not adequately achieve this objective.

We assume that, if implemented, the extension of Section 166 powers would be used by the FCA in its UKLA Role in circumstances where the FCA was concerned that a non-regulated issuer was not maintaining the systems and controls required under the Listing Rules or the Disclosure and Transparency Rules. The premium listing regime already provides a solution to this concern on a reactive basis through the use of the sponsor regime (see, for example, Listing Rule 8.2.1(5) which requires a premium listed issuer to appoint a sponsor in circumstances where the FSA thinks that there is or may be a breach of the Listing Rules or the Disclosure and Transparency Rules). Those firms that only have a standard listing are not subject to the sponsor regime which is appropriate given the standard listing regime is premised on a "minimum standards" approach. If implemented, the extension of the Section 166 powers

could be seen in this context as equivalent to the sponsor regime, therefore representing a move away from this "minimum standards" approach- the result of which could be to make a standard listing less attractive, particularly to large multinationals who are considering London for their secondary listing. The FCA will also have (for both the standard and premium regimes) the benefit of the existing significant enforcement powers of the FSA.

Furthermore, conferring power on the FCA in its UKLA Role to commission Section 166 reports on a proactive basis is disproportionate bearing in mind:

- the resulting compromise to the competitiveness of the UK listing regime compared to those in other jurisdictions (in particular, other European jurisdictions);
- the likely material increase in costs and administration for issuers both as a result of issuers bearing the costs of these reports potentially at a point at which there may be no clear evidence of misconduct or failure by the issuer, and more generally because of the increased costs in the market (e.g. directors' fees (see Section 4 below));
- a lack of evidence that Section 166 reports commissioned in the context of the FSA's Regulatory Role have materially assisted in achieving the FSA's objectives, particularly given that the FSA has no ability (and it is similarly proposed that the FCA should have no ability) to supervise a skilled person commissioned to produce a skilled person report and that "skilled persons" will inevitably be less expert than the regulator itself in assessing potential or actual failures by issuers to maintain systems and controls to the standard required by the Listing Rules and Disclosure and Transparency Rules; and
- the results of the review of the effectiveness of the Combined Code undertaken by the Financial Reporting Council ("**FRC**") in 2009 (see further Section 4 below).

4 Application extension of Section 166 powers to directors

If the Bill was implemented in its current form, the FCA would also be given the power to commission skilled person reports in respect of directors of non-regulated issuers listed in the UK, directors of sponsors and directors of information providers (see Clause 18 (2) of the Bill, Section 97 (A) (3) (b)).

In addition to the general concerns raised in Section 3, we are particularly concerned with the application of the extension of the Section 166 powers to directors as it goes beyond equivalent powers under Section 166 of FSMA and beyond those that would be available to the FCA in its Regulatory Role.

Further, it is not clear to us what concern the extension of skilled person reports to directors is intended to address and hence the benefit it is intended to achieve either for the market as a whole or for the shareholders of a listed entity. We are of the view that the current level of protection for the market in respect of directors' responsibilities and obligations are sufficient (including, but not limited to, the codification of directors' duties in the Companies Act 2006 and the requirements of the Listing Rules and Disclosure and Transparency Rules).

It is also worth noting that board evaluation has been considered in some detail by market participants since the start of the economic crisis, as evidenced by the responses to the FRC's 2009 review of the effectiveness of the 2008 Combined Code. The outcome of the review was that the UK Corporate Governance Code (which replaced the Combined Code) introduced guidance that members of the FTSE 350 should have an independent external facilitator carry

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out a board review every three years. As was the case under the 2008 Combined Code, the UK Corporate Governance Code continues to require boards to undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. We are not aware of any new market concerns in respect of directors which have emerged since the FRC's comprehensive review in 2009 which merit the additional external input that the extension of the Section 166 powers might deliver.

Whilst it is unclear what market concern the application to directors of the extension of the Section 166 powers seeks to address, it is clear that such a proposal if implemented will result in costs in terms of increased premia for Directors and Officers Insurance.

Further, we think that the application of the extension of the Section 166 powers to directors is inappropriate because it undermines the concept, as set out in the UK Corporate Governance Code, that board members are collectively responsible for the success of a company.

The rules and regulations applicable to directors of UK listed companies have become progressively more demanding over the last decade and the imposition of further potential liabilities associated with being a director can, in our view, only further reduce the willingness of individuals to take on directorships of UK listed companies and hence risk compromising the ability of UK listed companies to hire the best talent for their boards and/or increase the fees which will need to be paid to those individuals to compensate them for the increased scrutiny.

5 Conclusion

The powers conferred on the FCA by the extension of the Section 166 powers are not appropriate in the context of the FCA's UKLA Role. The ability of the FCA to use such a risk analysis power proactively is disproportionate and out of step with the listing regimes of other jurisdictions; whilst its ability to use it reactively is unnecessary given the FSA's current enforcement powers and the sponsor regime. Our belief is that the FCA is better placed than a skilled person to assess and address any breaches of the Listing Rules or the Disclosure and Transparency Rules. Further, we think that the potential cost and administrative burden to issuers if the extension of the Section 166 powers is implemented is likely to act as a deterrent to listing in the UK. The government has not articulated any tangible benefit that would warrant the imposition of such costs.

The application of the extension of the Section 166 powers to individual directors is inappropriate. Given that no such power exists under FSMA in relation to regulated firms, and that there are no plans to introduce one in respect of the FCA's Regulatory Role, we are at a loss to see how such a measure could be considered proportionate in respect of listed companies.

We trust that these comments are helpful.

Please contact Kirstie Caneparo (email: kirstie.caneparo@resolution.co.uk and direct dial: 0203 372 2929) if you would like to discuss any of our comments further.

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Yours faithfully,

RESOLUTION OPERATIONS LLP

By:

For and on behalf of Resolution Operations LLP

HMT Consultation (Cm8083):
"A New Approach to Financial Regulation: The Blueprint for Reform"

Response by RBS Group plc

Executive Summary

Introduction

RBS Group plc ('RBS') welcomes the opportunity to provide views on the Government's latest consultation on reforming the UK's financial regulatory structure. As stated in our responses to the Government's earlier consultations, RBS supports the need for change, both in the banking sector and its regulation. The following comments are therefore aimed at helping achieve a framework that works well and one that, in addressing issues identified with the current "tripartite" framework, does not overlook potential challenges that the new structure may otherwise pose.

Our key comments on the consultation are reprised in this Executive Summary. More detailed points are made in the following sections, which reflect the consultation paper's chapter headings.

We would be happy to elaborate further on any of the points made in this response and look forward to engaging with, and supporting, the authorities as they take forward the extensive work that these reforms will require. In the first instance, any questions should be addressed to:

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Key Comments

- We continue to support the efforts being taken to strengthen the regulatory framework within the UK, and are keen to contribute to the ongoing consultation process and the review of the draft Financial Services Bill which is currently the subject of pre-legislative scrutiny.

- We welcome many of the changes to, and clarification of, the proposals following the previous consultations, although continue to have some reservations on specific issues that we have identified within the body of this response. There also remains a degree of vagueness/uncertainty in some of the detail provided.

- We remain of the opinion that competiveness and innovation should be worked into the objectives of the new regulatory bodies, for the reasons set out in responses to previous consultations issued, including the importance of these factors to restoring long-term, sustainable growth to the UK economy.

- The terms of the Memorandum of Understanding between the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA) have still to be provided and we would wish to have early sight of these to give us the opportunity to comment before the legislative process is too far advanced to enable us to comment on its content.

- We have particular concerns that the FCA's powers relating to product intervention and warning notices could have severe consequences, both financial and reputational, upon firms. We would wish to see further safeguards developed with respect to these powers.

- We believe that the capacity of the Court of Directors of the Bank of England (BoE) to provide oversight should be strengthened. The arrangements for the Financial Policy Committee (FPC) should mirror those of the Monetary Policy Committee (MPC) as much as possible – it should be a stand-alone committee rather than a sub-committee of the Court, and should have specific reporting obligations to the Government and Parliament.

- To strengthen governance and reduce the concentration of power represented in the proposed arrangements, the PRA in our view should have an independent Chairman.

Financial Policy Committee (FPC)

A. Key Comments

- We welcome the elaboration of the FPC's objective but as drafted the reference to growth is relatively weak and could be further strengthened.

- We believe that the capacity of the Court of Directors of the Bank of England (BoE) to provide oversight should be strengthened. The arrangements for the Financial Policy Committee (FPC) should mirror those of the Monetary Policy Committee (MPC) as much as possible – it should be a stand-alone committee rather than a sub-committee of the Court, and should have specific reporting obligations to the Government and Parliament.

- We believe that the crisis management arrangements should be strengthened – both in terms of the obligation on the BoE to notify the Treasury, and in setting up the operational structures for dealing with crises, as explained below.

B. Responses to Specific Consultation Questions

Question 1: Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?

The proposals relating to the Bank of England's financial stability strategy are, in our opinion, appropriate. We welcome the qualification of the FPC's objective such that it should not exercise its functions in a way that would have an adverse effect on the financial sector's contribution to growth in the medium or long term. However, as drafted the restraint remains subjective and therefore relatively weak. We would wish to see this strengthened through a more objective or independent restraint.

We consider the arrangements for setting the FPC's remit to be appropriately transparent.

We note that the Interim FPC is tasked with undertaking an analysis of potential macro-prudential tools and reporting to the Treasury. We assume that this report will be published but would welcome confirmation of this. We look forward to engaging with the Interim FPC's work in this regard

The FPC has been established as a sub-committee of the Court of Directors of the Bank of England but we believe that it should have the same status as the MPC. There should also be increased accountability to Government and Parliament which should be achieved by specific reporting requirements.

Question 2: Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems as described in paragraphs 2.32 to 2.40 and in Chapters 3 and 4?

We agree that it is appropriate for the Bank of England to regulate all systemically important infrastructures and support the proposals put forward.

Question 3: Do you have any comments on:

- ***the proposed crisis management arrangements; and***
- ***the proposals for minor and technical changes to the Special Resolution Regime***

as described in paragraphs 2.41 to 2.44 and in Chapters 3 and 4?

Crisis Management Arrangements
We support changes which will improve cooperation between UK authorities in the build up to, and during, a financial crisis. Whilst the legal underpinnings of such cooperation are important to improved handling of future crises, so are the practical arrangements that will be required to give them substance.

With respect to the proposals summarised in paragraphs 2.41 to 2.43, we believe that the proposed crisis management framework needs strengthening:

- We believe that the obligation on the BoE to notify the Treasury should not be limited solely to situations where there might be a call on public funds. With the likelihood of bail-in requirements for senior debt holders, and the changes already agreed by the Basel Committee and being implemented with respect to the loss absorbency of (non-common equity) Tier 1 and Tier 2 capital, the likelihood of future crises being dealt with through injections of public funds seems much more remote. Rather, we think that notification should be required in all situations where the BoE might reasonably expect to have to trigger the Special Resolution Regime.

- In addition to the requirement to agree a MOU, we believe the legislation should provide for the establishment of a small, financial equivalent of COBRA. By creating such a body, to include the Chancellor and Governor, supported by key HMT, BoE, PRA and FCA officials, a clear forum for escalation and management of crises can be established ex-ante. Such a body should also be responsible for overseeing "fire drills" to test cooperation between relevant parties. These preparations should extend to ensuring good and rapid communication between all parties – including, critically, external communication and how it is managed in the media. All of this requires detailed planning and preparation, at both operational and policy levels.

Technical Amendments to the SRR
We have no major comments on the proposed "minor and technical changes" to the Special Resolution Regime ("SRR"). We support the amendments contained in Clauses 60 to 62. With respect to Clause 59, we support the intent, but believe it needs reconsidering (e.g. in the drafting of Section 42A(4)), to address the situation where a property had subsequently been transferred and no longer was owned by the original transferee.

Prudential Regulation Authority (PRA)

A. Key Comments

- To strengthen governance and reduce the concentration of power represented in the proposed arrangements, the PRA in our view should have an independent Chairman.

- Further clarity is needed on the PRA's relationship with the Tribunal. We do not see why the Tribunal's powers should be weakened relative to the current status quo.

- The PRA needs to maintain its current level of consultation with practitioners; we do not agree with the proposal to disband the practitioner panel, which in our view potentially provides an important mechanism for facilitating that engagement.

B. Responses to Specific Consultation Questions

Question 4: Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?

We remain of the view that an explicit statement in support of competitiveness and innovation is needed, as other key elements that support longer-term, sustainable growth. We note that the BoE's current published Core Purposes include the statement that "The Bank will also play its part in promoting an open and internationally competitive financial centre in the United Kingdom" – and see no reason why something similar should not therefore be enshrined in legislation for the PRA.

We also believe that the Chairman of the PRA should be independent of the BoE, so as to strengthen governance and reduce the concentration of power and stretch that the proposed framework otherwise implies for the role of BoE Governor. As chair of both the FPC and the PRA, the Governor would find himself in the odd situation of issuing instructions to himself.

We acknowledge that draft provisions have now been made for the procedures for designating firms across PRA and FCA supervision. However, we wish to understand how the PRA will develop its own designation criteria to determine which firms will be within its remit. We also reiterate the need for all firms within a Group to be prudentially regulated by one regulator (the PRA) so as to avoid the potential for firms within the same group having to comply with different requirements depending on whether it is the PRA or the FCA that is responsible for their prudential regulation.

Question 5: Do you have any comments on the detailed arrangements for the PRA described in paragraphs 2.62 to 2.78 and in Chapters 3 and 4?

We are supportive of judgement-led regulation to the extent that it is suitably supported by objective evidence. We agree that decision-making must be executed by the highest calibre PRA staff and would further recommend that peer group analysis/comparison is included in the decision-making process as well.

With regard to the appeals process, we are concerned about the limited course of actions available to the Tribunal in the event it chooses not to uphold the PRA's (and the FCA's) decision. We understand that, barring a few exceptions, the Tribunal will not be able to substitute its opinion for that of regulator; instead, the former will be required to send its decision back to the latter with a direction to reconsider the matter and reach a decision in light of the Tribunal's findings. This significantly weakens the traditional role of the Tribunal, which in the current system is empowered to supersede FSA rulings. We remain unsatisfied that the regulator, in the proposed reform, will be incentivised to accept the Tribunal's findings given the Tribunal's lack of overruling power. We also remain unclear as to whether any fines or sanctions arising from a PRA/FCA ruling will take effect immediately following the regulator's ruling, or will only apply following escalation to the Tribunal – whose recommendations the PRA/FCA is ultimately empowered to overrule.

Furthermore, in the proposed reform, the PRA/FCA will be permitted to make public the outcome of its ruling prior to escalation to the Tribunal. This deviation from the current system – which only makes rulings public following the Tribunal's decision – further undermines the importance of the Tribunal, as firms will not be incentivised to escalate their case beyond the PRA/FCA ruling as the reputational damage will have already occurred. With the exception of cases where financial damage is significant, hence necessitating an appeal, the Tribunal will have a very limited role in the proposed system.

We are fully supportive of the legislative requirement for a non-executive majority on the Board although, as commented upon in our previous response, highlight the lack of "true" operational independence on the part of the PRA. This is evidenced by the Court of the BoE having approval rights over the budget and remuneration of the PRA.

We note the provisions set out in Clause 52 of the Draft Bill which outlines the two limbs to the statutory trigger through which the PRA and the FCA are under a duty to make a report on regulatory failures. We would recommend that the provisions include a further clause that the firm's position will be taken into account when the regulators determine whether it is appropriate to disclose confidential information.

We would appreciate confirmation that the accountability of the PRA will come from the defined starting point of the FSMA in that, as well as the annual PRA report, the Chief Executive will be subject to regular testimony sessions with the Treasury Select Committee.

We welcome the fact that the PRA will be placed under a statutory duty to engage with practitioners, but note that practitioner (and consumer) panels will not be retained. We would question this decision, and would wish to see current levels of consultation maintained.

Financial Conduct Authority (FCA)

A. Key Comments

- We welcome the establishment of the FCA and see it as an opportunity to improve customers' perception of, and confidence in, financial services regulation and, in turn, the industry itself. It is absolutely right that the regulator and firms themselves should have a low appetite for regulatory risk and this is very much RBS's approach.

- The objectives of the FCA should acknowledge competitiveness and innovation as relevant considerations.

- The guidance on the FCA's product intervention powers and the policy on publication of warning notices should be made available for consultation and discussion before the legislation is passed. We have particular concerns that the FCA's powers in these areas could have severe consequences, both financial and reputational, upon firms; and would wish to see further safeguards developed with respect to these.

- More needs to be done to ensure that the relationship between the FCA and the OFT/CMA operates effectively.

B. Responses to Specific Consultation Questions

Question 6: Do you have any views on the FCA's objectives – including its competition remit – as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?

The creation of the FCA provides an opportunity to include a more explicit consumer protection role. We broadly support the FCA's strategic and operational objectives although we mentioned in our response to the February consultation that the objectives need to be further defined and consideration needs to be given to how they will look in practice. We do not believe that this clarity has yet been achieved but recognise that the debate on the FCA approach will look to address this issue and we welcome the opportunity to contribute to that. We believe that there should be specific reference to the FCA having a role to encourage innovation and growth, which underpin confidence in the UK financial system, while promoting efficiency and choice in the market.

In relation to competition, please see our response to Question 10 below.

Question 7: Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?

We support the establishment of the FCA and of a more proactive and transparent regulatory approach which will provide an opportunity to improve customers' perception of, and confidence in, financial services regulation and, in turn, the industry itself.

We seek to comply with all relevant laws, regulations, FSA/FCA rules and guidance and will establish a strong and effective relationship with the regulator. We support a judgement-based approached based upon thorough cost/benefit analysis, risk assessment and impact assessment.

Product Intervention

The draft legislation would allow the FCA's proposed product intervention powers to be exercised without prior cost benefit analysis or consultation. We have great concern about this as the impact on both firms and consumers could be extremely severe if the power is not used appropriately. For example, the product intervention power could be used to cap prices but this could have an adverse impact on consumers by excluding certain consumers from the market and by reducing consumer choice (e.g. if some providers are forced from the market). The BIS Review of Consumer Credit and Personal Insolvency has established that applying interest rate caps on credit cards could have a detrimental effect on consumers. There is also nothing in the Bill to say that the product intervention power should only be used as a last resort i.e. if other initiatives have failed or in the extreme situation where no other alternative can be reasonably assumed to work. We would therefore propose, at the very least, amending the Bill to require a reasonable level of prior cost benefit analysis and that the power can only be used as a last resort or in extreme situations. There would also need to be some form of notice to affected firms as a certain amount of time would undoubtedly be needed in order to withdraw or amend a product. Not providing enough time to do this would create risks in itself and could be disadvantageous to customers, for example a customer who was in the process of obtaining a mortgage in order to buy a house at the time when a product intervention was put in place,

In having a "lower risk tolerance than the FSA" and applying a judgements-based approach, the FCA will inevitably be judging a product's value for money and making a trade-off, such as balancing intervention and innovation. We would welcome more clarity on how the FCA will make these judgements and trade-offs and how its approach might change over time. We will be asking the FSA for this in our response to the FCA Approach document.

Given such powers, and the resulting scope for significant regulatory uncertainty, some firms may seek some form of regulatory "comfort" when launching new or amended existing products. Some firms may decide simply not to innovate at all, instead offering a wholly "vanilla" product range. Hector Sants has commented that early intervention is "central to the proposed new model" but he has also acknowledged that "intervention itself runs the risk of creating more harm than good" in that it could be seen to reduce innovation, choice and competition, and raise the cost of regulation.

The FCA will be tasked with producing guidance on how it would use this power and the Government seems to be placing a lot of importance upon that guidance. We would like to see the guidance drafted and consulted upon as soon as possible so that it can inform the discussions on the legislation. Given its importance, producing it after the legislation would be too late.

Financial Promotions

We are pleased to see that the Government has decided to put further safeguards in place regarding this new power.

It is not clear if the FCA will be providing guidance on the use of the financial promotions power, for example, if it will use its general risk-based approach in this area rather than using it for minor rule breaches with little or no scope to cause consumer detriment. This might also cover the application of the proportionality and consumer responsibility principles in this area.

Due to the subjective nature of applying FSA financial promotion rules, it will also be important for the FCA to provide more guidance in advance about what compliance looks like, rather than defining it solely through enforcement i.e. what it does not look like. In this respect, it is important that any process for challenging an enforcement decision is swift, whether by the Financial Services & Markets Tribunal or an alternative process, both to provide guidance to the market and consumers but also to allow firms to manage promotional material and campaigns.

We welcome the recent FSA Guidance Consultation on Financial Promotions – Prominence and hope that the FCA takes a similar approach on other aspects of financial promotions (without gold-plating any applicable EU Directives).

Warning Notices
We welcome the safeguards surrounding the FCA's powers to publish warning notices and the obligation to consult the firm/individual. We remain concerned this new power will enable the FCA to take more successful enforcement actions that are not justified, as firms innocent of any wrongdoing will have less incentive to challenge, given the reputational damage incurred already at the warning notice stage. We wish to understand how this risk will be dealt with and whether there will be regular monitoring of the situation. Credible deterrence is important for a strong regulator but it needs to be balanced with fairness, proportionality and maintaining consumer and investor confidence in the industry.

The White Paper refers to the FCA setting its policy on publication of warning notices. We presume that this will be published and would like to have the opportunity of reviewing and commenting upon it. Again, it would be useful to see this sooner rather than later so that it can inform the debate on the draft Bill.

Consumer Responsibility
At the FCA Launch Conference on 28 June, the FSA talked about the need for the FCA to make clear to the public what its role and remit is (including the limits of them) and to also make clear to consumers what they can expect from the FCA and the FSA. We welcome that clarity as it will help to build trust in financial services regulation and build consumer responsibility. It is not clear, however, if this is the extent to which the FSA is intending to apply the regulatory principle of consumer responsibility. If so, we do not consider it to be in line with the intent of the proposed legislation, so we will be suggesting that the FCA gives further thought to this.

Question 8: What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

We agree that it makes sense for the "super-complaint" power that designated bodies currently have to refer issues to the OFT to be applied to the FCA.

We would expect that the implementation of this proposal should broadly follow the approach taken for super-complaints to the OFT under the Enterprise Act 2002 i.e. high-level legislation setting out: who are, or who can designate, the bodies that are able to make super-complaints (we would propose that this power is given to a relatively short list of appropriate bodies to make sure that it is effective); the time limit for the FCA publishing how it plans to deal with the complaint; when a super-complaint can be made - the drafting of which should be carefully and clearly defined so that it is used sensibly i.e. not too lightly (otherwise it will be open to potential abuse for headline-grabbing impact).

The legislation should also require the FCA to publish more substantive guidance on the super-complaints process. This guidance should cover the super-complaint process in detail; the factors the regulator will take into account when considering a super-complaint, including guidance on the kind of evidence that should be provided with a super-complaint; and how the regulator will deal with the super-complaint (including the process it follows when investigating a complaint). We would also expect that such guidance will be subject to consultation once drafted.

Question 9: What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

We agree it would be good to have a clear process in place to ensure that true mass detriment issues are dealt with quickly in a way that is fair to all parties. When determining "true" mass detriment, it will be important for the regulator to be careful to distinguish complaint volumes which highlight a genuine pattern of customer detriment from those inflated by the marketing practices of third party claims management companies who have their own commercial drivers for increasing complaints.

It would be sensible for the FCA to be required to set out its decision in full if there has been a super-complaint (referral from a nominated party). It is not clear how the Government proposes that this would work in the event that there had not been a super-complaint, nor how this links to the s404 consumer redress scheme powers that will be carried over from the FSA to the FCA. Presumably this would be an earlier stage in the process.

The Bill would not seem to prevent the FCA using its rule-making powers in mass detriment cases rather than its s404 powers. This seems inappropriate, would deprive firms of the safeguards which Parliament agreed to place on s404 and would also create potential problems with FOS cases as the rules would not be binding on the FOS (something which would not be possible under s404). This would not be aligned with the Government's intention to ensure that the roles of the regulator and the FOS are clearly defined and do not overlap. To prevent this situation occurring, we agree with the BBA proposals to strengthen the statutory regime by amending the Bill to reinforce the role of the FOS, whilst reducing the scope for protracted disputes.

Question 10: Do you have any comments on the competition proposals for the FCA set out in paragraphs 2.111 to 2.119 and in Chapters 3 and 4?

It is proposed that the FCA must, in so far as is compatible with its objectives, discharge its general functions in a way which promotes competition. We would welcome more detail on how the FCA will judge whether competition is adequate (e.g. the sort of criteria it will use) and how it will ensure an appropriate degree of consistency with the OFT/ Competition & Markets Authority (CMA).

For example, although the FCA will be able to refer matters to the OFT/CMA it may choose not to do so and this could result in inconsistent approaches. The FCA may not wish to cede authority to another body for issues it considers to be in its domain and may therefore rely on its general and specific objective around consumer protection to supersede any general "consideration of competition issues". This may result in entirely different approaches being adopted by the FCA and the OFT/CMA – if this approach is a stricter one then this could impact on the market's competitiveness internationally and ultimately on the UK economy. There is also potential scope for both the FCA and OFT/CMA to be involved in the same issue, such as the market for the provision of personal banking services. It is important that the FCA and the OFT/CMA put in place the necessary concordats and memorandum of understanding to ensure an orderly and efficient process for investigating and resolving relevant competition and regulatory issues.

Question 11: Do you have any views on the proposals for market regulation by the FCA, described in paragraphs 2.120 to 2.123 and in Chapters 3 and 4?

We support the proposal that the FCA be solely responsible for the prudential and conduct regulation of RIEs to provide a "birth through death" process and promote consistency of treatment. Similarly, we support its decision to retain the Part XVIII regime for recognised bodies pending the outcome of the European Commission's review of the Markets in Financial Instruments Directive. We are generally comfortable with the changes to the listing and primary markets legislation but seek confirmation on what notification, and timing, is required if the warning notice and decision notice process is not followed when the UKLA discontinues or suspends a listing at the request of the issuer.

We welcome the proposal for the FCA to have a new top-level Business and Market Analysis team that will provide the appropriate analysis on how markets work and their effect on consumer behaviour. This approach to financial services markets is significantly different to that of the FSA, both analytically and culturally. As such, the capabilities of the Business and Markets Analysis team will be important, given the key role which this team will have in analysing how markets work and their effect on consumer behaviour to inform FCA decisions, as will the capabilities of the FCA staff as a whole. It is important to ensure that the FCA can attract and retain the calibre of staff that it needs to be an effective judgement-based regulator.

Question 12: Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described in paragraphs 2.124 to 2.132 and in Chapters 3 and 4?

In relation to the representative Panels, the draft Bill only contains the following provision on the Consumer Panel: "1L (5) The FCA must secure that membership of the Consumer Panel is such as to give a fair degree of representation to those who are using, or are or may be contemplating using, services otherwise than in connection with businesses carried on by them."

However, no such provision appears in the sections on the Practitioner, Smaller Business Practitioner or Markets Practitioner Panels regarding the need for a fair degree of representation from the relevant firms. We would like to see a provision to this effect being added to the Bill as otherwise the membership of these important Panels is solely at the discretion of the FCA which is not appropriate or consistent with the creation of properly representative Panels which are a key part of the FCA's consultation and policy development process.

We agree that the FCA should investigate situations where market failure has occurred and attempt to use this to learn lessons and implement remedies. However, that part of the FCA investigating/drafting the report for HMT/Parliamentary review should be operationally independent from the area on which it is reporting. Unless a separate team is charged with conducting a review the independence of this report could be compromised. In the interests of transparency and objectivity, we believe that investigations of regulatory failure should be prepared by an independent body, such as the National Audit Office or HMT, although safeguards would be required to address concerns regarding the handling of commercially sensitive information about firms.

Coordination and Regulatory Processes

A. Key Comments

- We reiterate the suggestion that we have previously made that the BoE be a party to the Memorandum of Understanding between the PRA and the FCA.
- The PRA's power of veto over the FCA needs to be explicitly defined in the Memorandum of Understanding.
- There remains a need for further clarification of the proposals for the Approved Persons regime and reconsideration of the approach to be taken in respect of dual-regulated firms.

B. Responses to Specific Consultation Questions

Question 13: Do you have any comments on the general coordination arrangements for the PRA and FCA described in paragraphs 2.138 to 2.149 and in Chapters 3 and 4?

We welcome the new requirement that the PRA and the FCA must include in their annual reports an account of how they have coordinated during the year.

In response to the previous consultation we stressed, and now repeat, the need to involve the Bank of England as a primary stakeholder in the proposed Memorandum of Understanding between the PRA and the FCA. It is our belief that coordination at the "parent" level is equally crucial to the success of the new regulatory framework, particularly at the point where the BoE's resolution powers might need to be invoked.

In principle, we would accept the PRA's veto power over the FCA in situations of "disorderly failure" or "wider financial instability" so long as i) the veto power itself and ii) a guideline definition of these scenarios are made explicit in the Memorandum of Understanding between the two regulators.

We welcome the Government's commitment that the FCA will not be a "junior partner" to the PRA. It is essential that this commitment informs interaction between the two where the PRA proposes to use its power of veto.

Question 14: Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described in paragraphs 2.150 to 2.195 and in Chapters 3 and 4?

As mentioned previously, we wish to see a single prudential regulator (the PRA) for all firms within a Group although, subject to that, are supportive of the Government's decision on the alternative approach and appreciate the efforts that will be made to ensure that the additional burden of the dual regulatory system falls on the regulators rather than the firm in terms of the application process. For dual-regulated firms, having a single point of contact would be most useful.

With regards to the withdrawal of permissions because a firm has "failed to carry out the regulated activity over the preceding 12 months" we note the Draft Bill has now modified this to "once (the regulator) is satisfied that it is no longer necessary to keep the permission in force". We reiterate the points made in our response to the previous consultation i.e. we believe that there are circumstances where a firm may want to retain a permission for commercial reasons (e.g. to enable it to re-enter a market without having to apply to the regulator for an extension). As long as the firm is prepared to pay the fees and comply with the other regulatory requirements associated with that activity, it should be allowed to retain the permission. The new regulations should maintain the current requirement for the regulator to provide the firm with adequate warning of its intention to withdraw permissions and the firm's right to appeal.

We appreciate the acknowledgement that designating Significant Influence Functions as solely prudential functions would be exceedingly complex and, at times, arbitrary. This is particularly problematic in the case of NEDs, who we believe by nature should be generalists rather than specialists, empowered and equipped to handle all (prudential and conduct) aspects of the organisation. The consultation goes on to say that "the Government remains of the view that one authority should have a deciding say in the application process". However this seems to only pertain to the internal decision-making processes between the PRA and the FCA, and not the Approved Person's application process. Hence, more detail is required on the actual registration process. We would be concerned if dual-registered firms were expected to submit two separate application forms to the regulators. We are of the view that if the alternative approach" is adopted for Authorisations, this should be no different for the Approved Persons regime as the additional burden of the dual regulatory system should fall on the regulators rather than the firm in terms of the application process.

Whilst we welcome the commitment to a simplified process for the authorisation process whereby one regulator will take the lead in processing an application, we would wish to see a similar approach adopted for the approved persons application process and variations in permission.

It appears that the PRA and the FCA will both receive applications/notifications from dual-regulated UK firms wishing to establish overseas operations in an EEA state. More detail is required on the actual application process, including explicit guidelines on which regulator to approach on what kind of

overseas (EEA and non-EEA) operations. Again, the alternative approach and a single point of contact would be of benefit here.

Given the potential for conflict between the rules of the PRA and the FCA, we believe that in addition to the requirement that they consult each other to ensure consistency, the FSA's existing policy of "intelligent copy-out" should be replicated.

We note the addition of the new section in the Draft Bill which states that the PRA has a duty (rather than a mere option) to consult both the Bank of England and the Treasury, particularly in the formulation of recovery plans. We understand that the PRA remains vested with veto powers in situations of "disorderly failure" or "wider financial instability" and thus we reiterate the need for a guideline definition of these scenarios and how this will work.

In the previous consultation, we proposed that the process of consultation and engagement through stakeholder panels should continue so as to ensure that industry/practitioner experience is taken into account. We remain of that opinion.

Compensation, Dispute Resolution and Financial Education

A. Key Comments

- The FOS needs to recognise the need for confidentiality in certain situations when publishing determinations and specific provision should be contained within the legislation.

B. Responses to Specific Consultation Questions

Question 15: Do you have any comments on the proposals for the FSCS and FOS set out in paragraphs 2.196 to 2.204 and in Chapters 3 and 4?

Schedule 10 of the Bill refers to the intention to require the FOS to publish all Ombudsman determinations unless, in the Ombudsman's opinion, it is "inappropriate" to do so. To ensure transparency and clarity in this regard we would like to see the Bill's provision expanded to specifically state "inappropriate" would include confidentiality issues regarding the firm. Alternatively, it should state that legitimate business secrets should not be included in any publication and that there should be consultation with the firm to ensure that this is the case.

Section 203A (4) within Schedule 10 of the draft Bill states that the FOS may charge a reasonable fee for providing a person with a copy of a report. To ensure confidentiality of legitimate business secrets there is the need for explicit understanding of what the intended content of such a report would be. Will the report be a summary of the ombudsman's determination, is it correspondence used in support of the opinion, or is it the same as a Subject Access Request? Currently, information is provided on occasion to the FOS in case responses, but in confidence. With this in mind, there may be a risk that the FOS publishes inappropriate information which would currently be classed as Business Sensitive. Unless there is clarity here, there could be the potential for less substantive background detail being provided to the Ombudsman as some businesses attempt to manage this risk. Additionally, clarity is required around the definition of 'a person' within this section – does this mean the complainant, or would claims management companies or other third parties be able to obtain reports?

As indicated in our response to previous papers, we are supportive of the proposal to implement closer ties between the FOS and FCA and recognise that the proposed provisions within the draft go some way to achieve this. While we continue to be concerned as to what benefits can be achieved by making a voluntary MoU statutory, given that previous experience has not always been effective, we continue to recommend that as the details of the MoU will be crucial, input from all relevant stakeholders would be beneficial in ensuring its effectiveness.

---End---

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7 September 2011

Dear Sirs

A new approach to financial regulation: the blueprint for reform

Royal & Sun Alliance Insurance plc, is a member of the RSA Insurance Group (RSA), a multinational insurance group writing business in 130 countries with major operations worldwide. In the UK, RSA operate solely in the general insurance market.

We welcome the opportunity to respond to HMT's consultation paper *"A New Approach to Financial Regulation: the blueprint for reform"*. In our view the paper includes a number of positive changes and useful clarity on the roles, responsibilities, and objectives of the new regulatory bodies. In particular, we welcome the inclusion of an insurance specific objective for the PRA. More detail is required on how this will work in practice particularly to avoid any risk it will conflict with the existing financial stability objective, but it is a step in the right direction.

Overall, we still have some material concerns about certain aspects of the proposed framework and there are six principal points that we urge you to consider. We have suggested ways in which you may address these concerns in our detailed response attached. We would welcome an opportunity to discuss this further with you. The proposed changes to the regulatory framework are key to the future shape and success of the insurance sector and my colleagues and I believe we are well placed to support you with your work.

Proposed Timetable

The proposed plan to implement the new regulatory framework by the end of 2012 is ambitious. Since the Joint Committee will not complete its review of the draft Bill until 1st December 2011 Parliament is unlikely to begin its review of the final Bill until early 2012. This will leave less than a year to produce, consult and implement the detail needed, whether it's included in secondary legislation or new regulatory rule books, for each of the new regulatory bodies. Both firms and regulators are already stretched managing the current level of regulatory change within the market. We therefore ask HMT to reconsider the existing timetable to provide sufficient time to ensure the new legislation and associated requirements are fit for purpose and to allow the regulatory bodies ample time in which to implement the changes.

Supervision Staff

Our previous response, sent in April this year, stated that the FPC, PRA and FCA must ensure they recruit and retain staff with the necessary knowledge, experience, and expertise to understand the way that insurers and the wider insurance sector operate. The FSA has had a number of issues retaining quality staff in recent years and we believe that recruitment will remain one of the biggest challenges facing the new regulatory bodies. A failure to address this issue will undermine the introduction of a new regulatory framework and, in particular, the proposed move towards a more judgement-based supervisory approach.

On a related point the PRA has signalled a desire to make greater use of skilled persons and external auditors in its approach to supervision. While we recognise that these are seen as key regulatory tools and have an important role to play we would not want to see them deployed regularly or routinely as backfill for staff shortages. It is key that these tools are used proportionately, in line with Section 3B (1)(b) of the draft Financial Services Bill, and do not add materially to regulatory costs for those firms who are operating effectively and do not represent a significant risk to the PRA's objectives.

Coordination between the PRA and FCA

The proposed MOU for the PRA and FCA will be a key tool in ensuring that the regulatory bodies operate with appropriate levels of coordination and do not introduce unnecessary bureaucracy that will stifle timely commercial decisions. A failure to do so will result in an additional regulatory burden for all firms, especially for those that are dual-regulated. Given its importance, we agree that Parliament should have an opportunity to consider the overall framework for coordination. The steer given to the Bank of England and FSA to produce a draft version of the MOU in time for the introduction of the Bill to Parliament is helpful, but our strong preference would be for this to be produced in time for inclusion in the pre-legislative scrutiny phase.

We note that the draft legislation includes no requirement for the PRA and FCA to consult on any changes made to the content of the MOU. Since the MOU is a statutory requirement and given the significant reliance that will be placed upon it by all stakeholders, we strongly recommend that any changes should be subject to consultation.

European Representation

RSA welcomes the Government's comments on the importance of influencing future European and International reforms and the recognition that a number of challenges remain on this front. The ESAs, in particular, will drive more and more of the regulatory agenda in future and it is essential that the new authorities play an increasingly influential role during the early stages of development and throughout the process governing the agreement of new regulation.

The HMT paper comments on the different suggestions for ensuring the UK has a single, coherent and consistent strategy, but does not provide a clear view on the preferred solution. A report recently published by the House of Lords European Union Committee asks the Government to set out, in detail, what structures it plans to put in place to guarantee that the UK's supervisory bodies present a cohesive and unified face within the ESAs. We fully support this position and recommend that a number of mechanisms are established between the Treasury, Bank of England, PRA and FCA which outline how activity should be coordinated. We agree with the need for a specific MOU and believe this should be supported by the creation of an international coordination committee which would include representatives from each of the regulated bodies. Staff employed by the new regulatory bodies will also need to acquire new skills and expertise. This includes negotiating and influencing skills and a higher level of political awareness.

Excessive Powers

The proposal in its current form for the FCA to have wider powers than those available to the FSA causes some concern. The suggestion of additional powers relating to the early public disclosure of potential enforcement action, if executed inappropriately, will result in poor outcomes for firms and unwarranted damage to their reputation. There have, historically, been examples of FSA enforcement actions that have not been taken forward or have been challenged. Under these proposals significant reputational damage would have been caused.

If these changes are implemented they must be accompanied by appropriate and robust safeguards. In particular, there must be a firm requirement for the FCA to consider any potential negative impact,

including whether the disclosure is prejudicial to the safety and soundness of an authorised firm, before it takes any decision to publish details of enforcement action. The tool must only be used in circumstances where the FCA is confident it will bring about tangible benefits for customers and we would expect a commitment from the regulator that it will publicise, with equal prominence to the original announcement of potential enforcement action, the discontinuation of an enforcement investigation particularly in circumstances where the regulator's initial concerns have proved unfounded.

Lastly, if these powers are taken forward there must be an effective right of appeal process which is available to all firms and individuals in advance of any publication.

Costs

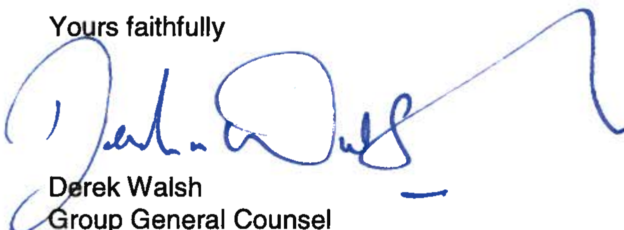
We continue to have very real concerns that the implementation of the new regulatory framework will result in yet further increases in regulatory costs. RSA has incurred a dramatic increase in regulatory fees in recent years from under £500,000 in 2007 to over £9 million in 2011. Further increases of this nature are likely to impose a disproportionate financial burden on regulated firms.

We stated in our response to HMT in April this year that the proposals do not address the pressing issue of how the authorities plan to ensure that future fee increases and overall regulatory costs are kept under control. There is insufficient evidence to suggest this issue has been considered adequately to date. The impact assessment included in the HMT paper confirms that the costs of establishing the new regulatory bodies, particularly the PRA, will be substantial. The assessment also confirms that the transition costs for dual-regulated firms, such as RSA, will be significant. HMT, together with the Bank of England and the FSA, need to provide further information on future costs in order to shed some much needed light on the future cost of regulation and, therefore, the extent to which the current proposals are proportionate.

Overall, we maintain our view that the authorities should be doing more and should take the opportunity presented by the change in the regulatory framework to actively consider, in conjunction with industry stakeholders, how to stop the spiralling costs of regulation from escalating any further. This will benefit both authorised firms and consumers, who ultimately bear the costs of regulation.

We would like to work with you and continue to provide positive support and input as the proposals develop to a further level of detail. To this end, both my Compliance Team and I would welcome an opportunity to come in and talk through our recommendations, to share experiences and discuss the practical implications for firms in order to develop solutions that meet the stated regulatory outcomes and also support your aims. If this is of interest to you do please contact me directly on 020 7111 7302.

Yours faithfully



Derek Walsh
Group General Counsel

Consultation Response - A new approach to financial regulation: the blueprint for reform

Consultation Questions

Q.1 Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?

RSA does not object to the proposals for the FPC as they stand. We agree that it is difficult to fully assess the effectiveness of the proposed tools given the limited information included in the consultation papers and await further detail on this subject. We repeat the comments made in our previous response that the development of any tools must recognise the characteristics of the different sectors within financial services market and, in particular, that a one size fits all approach is not appropriate.

We note that the Government and Bank of England are committed to ensuring an appropriate balance and breadth of expertise is in place for both the interim FPC and the permanent body. We welcome this commitment, but stress the need for the FPC to include insurance representation on its board. Without this the FPC will be disadvantaged when making recommendations and directions that impact on the insurance sector.

We also welcome the introduction of greater transparency for FPC activity particularly the publication of Financial Stability Reports and copies of the minutes from each meeting. We strongly agree that market sensitive or confidential information should be withheld from this material.

Q.2 Do you have any specific views on the proposals for the Bank of England's regulation of the RCH's, settlement and payment systems as described in paragraphs 2.32 to 2.40 and in Chapters 3 and 4?

We have no comments.

Q.3 Do you have any comment on:

i. **the proposed crisis management arrangements; and**
ii. **the proposals for minor and technical changes to the Special Resolution Regime as described in paragraphs 2.41 to 2.44 and in Chapters 3 and 4?**

We have no comments.

Q. 4 Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?

RSA welcomes the changes made to the PRA's objectives. In particular, the introduction of an objective for insurers will help ensure appropriate focus for this sector. Determining what an "appropriate degree of protection" represents for different customer groups will, however, not be straightforward and has the potential to conflict with other PRA priorities. It is positive to note, therefore, that the PRA must issue guidance setting out how it will interpret its objective in relation to different types of regulated activity.

This clarity is also needed in order to minimise the number of inconsistent judgments that could result from the new approach to supervision. This point is commented on further in our response to question no. 5.

Q.5 Do you have any comments on the detailed arrangements for the PRA described in paragraphs 2.62 to 2.78 and in Chapters 3 and 4?

It is positive to note HMT's comment that the quality of PRA staff is key to the successful implementation of a judgement led approach to supervision. RSA views this as one of the biggest challenges for the new regulatory bodies. It is widely recognised that the FSA has not been able to consistently recruit and retain high quality staff that are able to exercise sound judgments and it is not yet clear how both the PRA and FCA will overcome this challenge. RSA's preferred approach would be for the PRA to commit its budget to recruiting a smaller number of staff that are well placed to deliver the changes in regulatory approach.

On a related point the PRA has signalled a desire to make greater use of skilled persons and external auditors in its approach to supervision. While we recognise that these are important regulatory tools and have an important part to play we would not want to see them deployed regularly or routinely as backfill for staff shortages. It is key that these tools are used proportionately, in line with Section 3B (1)(b) of the draft Financial Services Bill, and do not add materially to regulatory costs for those firms that do not represent a significant risk to the PRA's objectives.

HMT has also commented that the future judgement-led approach to decision making must be rigorously evidence-based. We agree with this stance. One of the risks of moving to this model is that firm superviors will not act consistently. Ensuring their decisions are evidence-based will help ensure accurate decisions are made and provide source material for managerial and audit reviews.

Q6. Do you have any views on the FCA's objectives - including its competition remit- as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?

It is important that the FCA's proposed strategic and operational objectives are applied with appropriate regard to the proposed regulatory principles, in particular those relating to differences in product risks and the financial capability of consumers. Therefore, we welcome the inclusion of new section 1C(2) in relation to the consumer protection objective, in particular the requirements for the FCA to "have regards to" the differing degrees of risks in different kinds of investment and in the levels of consumer knowledge and experience.

We expect this to result in the FCA developing a regulatory approach to the general insurance market that reflects and is proportionate to the lower risks it poses in comparison to other products and markets, and in particular, to the varying degree of protection required by retail and commercial "consumers".

We continue to have reservations about proposals for the FCA to take an increasingly intrusive role as a product regulator, as stated in the FSA paper published earlier this year. We will continue to address these concerns with the FSA / FCA through the appropriate consultation process. Please also see Q10 below for further comments on the FCA's new competition powers.

Q7. Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?

The FCA's proposed proactive regulatory approach must be implemented in a manner that is proportionate, risk-based, and allows for product and / or market differentiation, where appropriate. The approach must also include appropriate and robust safeguards to protect both firms and consumers against inappropriate use of the new powers relating to product intervention, financial promotions, and early publication of disciplinary action.

Firms must be protected from unnecessary and unwarranted business disruption and/or reputational damage. While we agree that consumers must be protected from taking unnecessary and detrimental action based on the publication of inappropriate, inaccurate and untimely information these proposals are a departure from the FSA's current regulatory approach. We are therefore concerned that the FCA staff may not have the experience or training to effectively move to a more interventionist approach, and this could cause further detriment to firms and / or consumers.

Product Intervention

There is a risk that use of the product intervention power could cause consumers to steer away from a firm in respect of all of its products rather than just the product causing concern. Use of this power could therefore have a detrimental effect on the FCA's competition remit.

We strongly agree with the statement (in paragraph 2.99) that the product intervention power will only be used where it is appropriate and proportionate. In our view, it must only be used as a last resort when other, potentially less intrusive, regulatory intervention has been unsuccessful. We also agree that it should not be used in relation to the FCA's integrity objective.

We therefore believe that the draft provisions must be amended to ensure that the actions the FCA can take against firms that carry out any prohibited activities should only apply to any agreements made after the date on which the FCA make their ruling.

There will be some cases where prohibited products and / or product features will be suitable for some consumers who will not suffer detriment as a result of having purchased the contract in question. The existing provisions relating to dealing with complainants, non-complainants, and redress (including consumer redress schemes) are sufficient to address any consumer detriment that may have already been caused.

Financial Promotions
We have previously expressed concerns about the FCA's new financial promotion powers, especially the potential reputational damage that might be caused to a firm by the early and un-notified publication of a warning notice. Therefore the introduction of the new safeguards regarding the disclosure of enforcement action against a firm is important, as set out in the new section 137P. In particular, we strongly agree with the provisions requiring the FCA to notify any firm to whom a direction is to be issued and to allow the firm to make representations before the direction is published.

Publication
We are concerned about the inclusion of the new sub-section 137P (11), which allows the FCA to publish information about a direction given by them, even if the direction is revoked. If the firm in question has not breached any rules or guidance, then it is inappropriate to publicly name them as having been under investigation. This is very likely to cause reputational damage. However, if the purpose of any such disclosure is to inform other firms of the FCA's considerations and ruling in this matter, then it should be made without naming the firm.

Therefore, we believe that sub-section 137P (11) should contain similar provisions to those in the amended section 391 (Publication) requiring that the FCA should not publish information that may be unfair or prejudicial to a firm. This should include circumstances where the firm has been found to be in compliance with the relevant financial promotion rules.

Similarly, we support the introduction of safeguards regarding the general publication of enforcement notices, which will require the FCA to consult with the authorised firm in question before making any disclosure and to consider whether publication would be unfair to the firm, according to the prevailing circumstances. In addition, we recommend the following changes:

- There must be a firm requirement for the FCA to consider any potential negative impact, including whether the disclosure is prejudicial to the safety and soundness of an authorised firm, before it takes the decision to publish details of a potential enforcement action.
- In each case the FCA must be confident that early disclosure will result in tangible benefits for customers. In other words, the tool should not be used in circumstances where there is little likelihood of improving consumer outcomes. An early notification about internal fraud at a firm is one example of this.
- We would expect a commitment from the FCA that it will publicise, with equal prominence to the original announcement of potential enforcement action, the discontinuation of any enforcement action.

Q8. What are your views on the proposals to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

If introduced, this process should be subject to appropriate safeguards to protect authorised firms and the wider financial markets against inappropriate use of the referral process, and to ensure that the public is provided with accurate and timely information to avoid any potential consumer detriment caused by premature and uninformed publicity of the issues.

Examples of such safeguards would include:

- Guidance on the term "mass consumer detriment" to ensure these processes are used solely for the intended purpose;
- The selection of appropriate nominated parties and the development of a code of practice by which any referrals may be made;
- Controls over the publication of information, both before and after the FCA has made its ruling;

- Confirmation of the process by which the FCA will determine whether "mass consumer detriment" has occurred or may occur, including appropriate engagement with industry stakeholders; and
- Any statutory timescales for completion of the referral, assessment, and publication processes.

We agree that the FOS and the advisory Panels should be included in the process as nominated parties. Whilst we recognise that many consumer groups can provide important information about potential issues affecting consumers, we are concerned about any suggestion that they should be given a statutory role in the referral process. This would create an inappropriate imbalance in the roles of consumer and industry bodies, and would effectively give the consumer bodies the power to require the FCA to undertake potentially costly investigations, all of which are paid for by the industry through the fees framework.

Consumer groups should not become nominated parties, but should continue to provide information to the FCA on an informal basis. The FCA may still wish to consider this information but would not be under a statutory duty to do so, or to publish its decisions.

Q9. What are your views on the proposals to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

We believe any publication should only be made after:

- the FCA has completed at least an initial investigation into the scale and nature of the issue, the level of detriment caused, and the options and timescales for remediation; and
- the FCA has discussed the issue with appropriate stakeholders, including the industry, and
- the FCA has given due consideration to whether such publication is unfair to the person or persons that are the subject, directly or indirectly, of the investigations undertaken; whether it would be prejudicial to the interests of consumers; or detrimental to the stability of the UK financial system.

Q10. Do you have any comments on the competition proposals for the FCA set out in paragraphs 2.111 to 2.119 and in Chapters 3 and 4?

We agree that there is no need to provide the FCA with additional firm-specific rules and powers in order for it to fulfil its competition duties.

However, we continue to have reservations about how the FCA will seek to undertake an increasingly intrusive role as a product regulator, as set out in the recent FSA paper on the FCA's approach to regulation. We recognise that competition works more effectively in some markets than others, and that a lack of competition can lead to market failures. In those circumstances, we agree that the FCA may need to consider options for improving competition in order to help achieve its objectives and to ensure that customers are treated fairly.

We do not believe, however, that it is the regulator's responsibility to decide, for example, how much insurers should charge for cover, either in absolute terms or in comparison to their competitors. Therefore, in markets such as the general insurance market, where competition generally works effectively, we would not expect the FCA to intervene in matters relating to price / value for money, unless there are clear signs of consumer detriment.

Q11. Do you have any comments on the proposals for markets regulation by the FCA described in paragraphs 2.120 to 2.123 and in Chapters 3 and 4?

We have no objections to the FCA being given responsibility for the regulation of Recognised Investment Exchanges and other matters such as short-selling or market abuse. Nor do we object to the FCA performing as the UK Listing Authority. We do, however, believe that the regulatory focus and priorities of the UKLA are, and should remain, different from the rest of the FCA. Since listed issuers do not have to deal with customers for whom special protection measures are appropriate, the legislation relating to the UKLA should be tailored to ensure it is fit for purpose

Q12. Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described in paragraphs 2.124 to 2.132 and in Chapters 3 and 4?

We agree that the Government must ensure there is an effective and robust governance and accountability framework in place and we welcome the changes which have been made to the framework applicable to the FCA, following earlier consultation. We particularly welcome the provisions relating to the constitution of the FCA governing body, for audit by the National Audit Office, and for the production and publication of an annual report.

It is essential that the regulatory system is subject to regular and robust oversight. Regulatory failures are not necessarily the result of misconduct by participating firms. Therefore, we also welcome the decision to provide the Treasury with powers to direct the FCA to investigate and make a report where the Treasury believes that there has been an adverse affect on any of the FCA's objectives which may be the result of regulatory failure, either in the system itself or in the operation of the system.

Q13. Do you have any comments on the general coordination arrangements for the PRA and FCA described in paragraphs 2.138 to 2.149 and in Chapters 3 and 4?

As a general insurer subject to "dual-regulation" we strongly agree with the need to ensure there is effective coordination between the regulators. Not only is it essential for the regulators to be able to achieve their objectives, but also to minimise the regulatory burden on and costs to firms, which ultimately acts to the benefit of consumers.

The proposed MOU for the PRA and FCA will be a key tool in ensuring that the regulatory bodies operate with the appropriate levels of coordination. Given its importance we agree that Parliament should have an opportunity to consider the overall framework for coordination. The steer given to the Bank of England and FSA to produce a draft version of the MOU in time for the introduction of the Bill to Parliament is helpful, but our strong preference would be for this to be produced in time for inclusion in the pre-legislative scrutiny phase.

The draft legislation includes no requirement for the PRA and FCA to consult on future changes made to the content of the MOU. Since the MOU is a statutory requirement and given the reliance that will be placed upon it by all stakeholders, we believe that any changes should be subjected to consultation.

It is essential that the regulators coordinate in a way that uses the resources of each regulator effectively and economically and takes advantage of the scope in the legislation for sharing services. We agree with the requirements to review the MoU annually and for the regulators to include in their annual reports an account of how well they have coordinated during the year.

We welcome the specific provisions in new sub-section 3D(c) requiring the regulators to pay due consideration to their shared principles of proportionality in setting, supervising and enforcing regulation, both individually and collectively. In our view, the MoU should also include information on how the regulators will address issues of proportionality. Also, the annual reports of each regulator should include a specific assessment of how well the regulators have achieved "proportionality" in undertaking their coordinated activities. Appropriate provisions to this effect should be included in the draft Bill.

There still remains scope for overlap and gaps between the two regulators as well as increased bureaucracy for firms which could stifle quick commercial decisions. The Treasury must therefore consider the impact these changes will have on firms.

We agree that the PRA should have a power of veto over the FCA where there may be a threat to the stability of a PRA-authorised firm or to the wider financial system, subject to the provisions and procedures set out in section 3H of the draft Bill.

However, it is important that in deciding whether or not to publish details of any directions issued by the PRA to the FCA to not use its powers in certain cases, the regulator should not only consider if publication is in the public interest but also if it would be unfair or prejudicial to an authorised firm which may be the subject of the direction. This is particularly important if the direction is later revoked as publication in such

circumstances may cause unnecessary reputational damage. In our view, appropriate provisions should be included in section 3J.

Q14. Do you have any views on the detail of the specific regulatory processes involving the PRA and FCA, as described in paragraphs 2.150 to 2.195 and in Chapters 3 and 4?

We welcome the Government's decision to require the authority responsible for prudential regulation to manage the authorisation application process, to grant permission and, where applicable, to gain the consent of the other authority. This will significantly simplify the process for dual-regulated firms.

The approval and variation of permissions should follow similar processes and contain similar safeguards. However, it is essential that any procedures agreed between the PRA and FCA for the approval and variation of permissions ensure that the respective application processes address both the PRA's and FCA's information requirements from the outset, to minimise delays and to avoid unnecessary requests for additional information. We will expect these issues to be addressed in the MoU between the authorities and in the subsequent development of shared processes.

We welcome the proposal to align the process for granting Part 4A Permission and for approving the persons carrying out controlled functions so that they can work in parallel and therefore minimise delays for firms. However, as delays of this kind tend to be more of an issue on change of control applications, we would suggest that the approval process for Approved Persons on a change of control should also be aligned with the approval of the new controller, as this would be of significant benefit to firms.

RSA is comfortable with the proposed high level responsibilities for the appointment of Significant Influence Functions (SIFs) as outlined in 2.160 of the HMT publication. There is insufficient detail on the different SIFs at this stage, however, to fully understand how this will work in practice, but the regulatory bodies must implement a combined approach that requires only one application from dual regulated firms and one interview for new SIFs.

We disagree with the proposal to allow the FCA to withdraw approval for an individual carrying on a significant influence function within a PRA-authorised firm, where that function has been designated by the PRA as it may require the FCA to interpret the application of the PRA rules to the performance of a role that may be wholly (or for the most part) concerned with the prudential management of the firm in question.

In such cases, the PRA will be better placed to make an assessment of the individual's performance. Therefore, rather than obtaining the consent of the PRA, a more appropriate process would be for the FCA to advise the PRA of their concerns, who would then undertake the appropriate investigations and, if appropriate, withdraw approval following further discussion with the FCA as required.

In practice, a number of individuals within a firm may perform more than one function and, in a dual regulated firm, individuals may be designated as approved persons by both regulators. It is therefore essential that, in the development of the MoU setting out the coordination between them, the PRA and FCA agree procedures that ensure that they do not overburden individuals with any regulatory requirements e.g. inappropriate duplication of supervisory visits.

We agree with the proposals for inwards and outwards passporting, including the requirements for consultation between the PRA and FCA in the appropriate circumstances. Again, we will expect issues such as common processes, timescales, and documentation to be addressed within the MoU.

We are also in agreement with the proposals for the regulators to make, modify, and waive rules and to provide guidance. This includes the provisions for coordination between the regulators and for the wider consultation with key stakeholders (including the industry) on proposed rules or guidance.

However, please see our earlier comments in response to Question 7 on the specific rules relating to product intervention, financial promotions, and the early disclosure of disciplinary action.

We have no objections to the proposed provisions relating to the regulators' powers to direct the parent undertaking of an authorised firm. As stated in the White Paper, we would expect these powers to be used infrequently and only if alternative methods of regulation, supervision, or direction are ineffective.

However, we urgently require confirmation from the Treasury regarding which financial institutions will fall within the scope of these provisions. We also need to see the regulators' published statements of policy on the use of their powers to issue directions, which we assume will be subject to the new provisions regarding consultation.

We have no objections to the proposed changes to the provisions relating to discipline and enforcement, as set out in Schedule 8, which will allow the PRA and the FCA to continue with the FSA's current functions. However, please see our comments in response to Question 7 about the rules relating to the early disclosure of disciplinary action

We agree with reducing the minimum notification period to 14 days, **provided** the regulators give due consideration to extending the period where it is necessary to give firms adequate time in which to make suitable representations. Failure to do so may result in an unwanted and costly increase in the number of referrals to the Tribunal if firms feel they have been unable to fully respond to any notices issued.

We also agree that:

- the appropriate prudential regulator should be responsible for considering change of control applications, in consultation with the other regulator as required;
- the PRA should have primary responsibility for managing the Part VII Transfer process, in consultation with the FCA as appropriate;
- the PRA and FCA should both be given powers of investigation as set out Schedule 11 of the draft Bill, amended as proposed; and
- the proposed enhancements to the information sharing arrangements between the PRA, the Bank of England and the FCA should proceed, along with the widening of the information gateway from HMRC to the authorities.

Overall, there is an urgent need to set out the proposed transitional arrangements for firms when moving from the FSA to PRA and FCA. This should include, amongst others, a timetable for moving to the new permissions framework, grandfathering arrangements for approved persons and the like, timescales for reprinting literature etc.

Q15. Do you have any comments on the proposals for the FSCS and FOS set out in paragraphs 2.196 to 2.204 and in Chapters 3 and 4?

We require confirmation from the Treasury of the cases for which the FCA and the PRA will make rules relating to the operation of the FSCS. As a dual-regulated firm, we will also require assurance that there will be no significant changes to the liabilities and costs for firms under the new arrangements.

We agree that the responsibilities of the FCA and FOS should be set out clearly in a MoU. However, we are concerned that some of the provisions in the draft Bill regarding the sharing of information between the FOS and the FCA may diminish the FOS' independence. Consumers and authorised firms have an expectation that the FOS will treat each complaint on the evidence provided, acting independently in order to reach a decision based on the facts and merits of each case. We are concerned that this level of independent decision-making may be reduced if the FOS is required, or feels obligated, to take account of the FCA's operational objectives when considering individual complaints.

There should be appropriate segregation – if necessary by the introduction of "chinese walls" – between the FOS' decision making on individual cases and any subsequent decisions about whether the information should be shared. Greater transparency on the FOS' decision-making is also required.

We also have concerns about the potential impact on firms and the FOS that may result from any increased disclosure of determinations made by an ombudsman. We welcome the provisions in new sub-section 230A(2) which give the ombudsman discretion about whether a determination (or any part of it) should be published. However, we believe that in exercising this discretion the ombudsman should also consider whether publication is unfair or prejudicial to the respondent (or similar types of respondent) and / or whether publication might result in a precedent being set and / or an inappropriate and unwarranted increase in complaints.

For example, the FOS might uphold a complaint against one general insurer because of the specific nature of their product and / or their approach to underwriting or claims handling. Unless the specific circumstances are adequately explained, this may encourage consumers to make complaints to other insurers, even though the same circumstances do not apply. Firms will need to use resources to deal with these complaints, a number of which may be subsequently referred to the FOS, resulting in increased resource costs all-round. Therefore, there may be circumstances in which publication is inappropriate.

While these are operational issues and should be considered by the FCA and FOS when developing the MoU, it is important that provisions should be included in the draft Bill to ensure that the FOS retains its independence and uses its discretion about publication in an appropriate manner.

HM Treasury consultation: *A new approach to financial regulation*

Consultative response from SCM Private

8 September 2011

1. Introduction

1.1. SCM Private welcomes the opportunity to respond to the HM Treasury consultation "A new approach to financial regulation: the blueprint for reform" and looks forward to developing a constructive dialogue with HM Treasury during the legislative process and implementation of the regulatory reforms.

1.2. In this response, SCM Private does not propose to provide views on the entire range of proposals as set out in HM Treasury's consultation paper. Rather, it seeks to focus its response on specific issues relating to the future of financial conduct regulation and its potential impacts on the key markets in which SCM Private operates and consumer confidence in those markets.

1.3. As an asset manager which is committed to 100% transparency in regards to client holdings, fees and third party costs, we welcome the Government's proposals with regards to the remit and objectives of the new financial conduct regulator. In particular, SCM strongly supports the proposals for the Financial Conduct Authority (FCA) to have a duty to promote competition and efficiency and choice in the market for certain types of services. SCM believes that these operational objectives are essential for the restoration of consumer trust in financial services and, in particular, in the investment management industry, its products and performance.

2. About SCM Private

2.1 SCM Private is a wealth management company, founded by Alan Miller and Gina Miller in June 2009 which actively manages pure Exchange Traded Fund portfolios on a discretionary basis on behalf of individuals, companies and institutions. The Company has been one of the fastest growing wealth management companies in the UK with quarterly growth averaging over 40% per quarter since inception. Assets under management are on track for about £100m at the current year end, after only two and a half years of trading.

2.2 SCM Private has the ability to change the fund management model in the UK. Through focusing entirely on index funds and through a vigorous approach to both its overheads and all client related costs, SCM has been able to charge less than half the typical fund management average annual fee. Through the deployment of modern technology, SCM has enabled clients to invest in modern low-cost portfolios with on-line access revealing every single individual holding.

2.3 Alan Miller has one of the longest and most respected track records in fund management, having managed billions of pounds of investments on behalf of corporate and local authority pension funds, private individuals and hedge funds over 25 years. He helped grow the institutional business of Gartmore in the early 1990s and build the institutional and retail businesses within Jupiter and New Star Asset Management. Alan also launched the first UK equity hedge fund in 1997.

2.4 Gina Miller started the first specialist retail marketing financial services agency in 1994 at a time when Life Companies' strategy was to launch asset management businesses. She provided full

marketing services including copywriting for the clients such as AEGON, Legal & General Investment Management and undertook product launches for several asset management houses including Deutsche Bank Investment Management, Barings, Investec, Legg Mason, M&G and Schroders. Gina's agency provided all below the line marketing for the launch of New Star Asset Management and her agency's clients also included 12 large IFA firms such as Chase de Vere, Bradford & Bingley and Hornbuckle Mitchell. Gina was also the architect of an event called The Senate Programme that brought together the top 100 advisers in the UK with the top 20 asset management houses.

2.5 With this combined experience of 42 years, SCM Private's owners believe their experience and outstanding track record in the industry ensures that they are well placed to understand and comment on issues concerning the asset management industry, particularly in respect of its structure, performance, market competitiveness, transparency and regulation.

3. Concerns regarding the current regulation of the investment management industry

3.1. SCM Private has a number of concerns with regards to certain aspects of the investment management industry. In spite of the past best intentions of regulators and legislators, there remains a real lack of competition, choice and transparency available to consumers, who are, in turn, losing trust and confidence in financial services providers and products. Self-regulation alone is unlikely to achieve the sufficient levels competition and choice in the sector.

3.2. Currently SCM Private believes that retail investors within the UK are only "informed" as to where 40% of their savings are invested in an up-to-date manner and typically less than 50% of the real total costs are actually revealed. In addition, the industry is beset by systemic inefficiencies and wastage whilst prices and profitability remain exceptionally high – all these unnecessary costs and profits are extracted from individual's savings pots.

3.3. SCM has found that the fund management industry operates, despite its inefficiencies, on operating profit margins of 33%, this is over three times the average UK plc operating margin of less than 10%. There is no evidence that this extra profitability in any way helps the consumer – unlike the pharmaceutical industry, where extra profits fund new drug research. There are potentially significant long-term consequences of these negative practises and reputation as lack of trust and confidence in investment products are corrosive to building a savings culture and to everyone's disbenefit, including the nation as a whole.

3.4. SCM advocates the implementation of an industry-wide Best Practice, which would ensure that the industry provides 100% transparency to consumers as to where exactly their money is invested, together with 100% transparency as to the full underlying costs of investment

3.5. SCM urges the creation of an industry template for providing investment product information in a unified and consistent format enabling like-for-like investment product comparison. This has worked very successfully with school performance league tables, food labelling and credit card summary boxes: similar innovation in investment management would have immediate and beneficial effects for consumers.

3.6. SCM further welcomes the proposals with regards to the remit and objectives of the new financial conduct regulator - the FCA – particularly in respect of its emphasis on promoting competition and requiring greater transparency across markets.

3.7. This is a once in a generation opportunity to create a conduct regulatory model for investment products which properly and intuitively aligns with the needs and legitimate expectations of consumers. SCM believes that these developments present an ideal opportunity to reform the investment management industry; provide a greater level of transparency to enhance competition; reduce costs; and empower individuals to make fully informed decisions about where and how they invest their money.

4. Consultation Questions

4.1. Question 6: Do you have any views on the FCA's objectives – including its competition remit as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?

4.1.1. SCM Private supports the proposed strategic objectives and supporting operational objectives of the FCA. Securing an appropriate degree of protection for consumers; protecting and enhancing the integrity of the UK financial system; and promoting efficiency and choice in the market for certain types of services. At a product level, the first and third of these duties are of crucial importance to consumers.

4.1.2. SCM agrees strongly that the FCA should neither be, nor be thought to be the "junior partner" to the PRA.

4.1.3. SCM supports the duty of competition. SCM believes that such a duty is required for the regulation of the financial services industry and is particularly important in respect of the wealth management sector. There is currently very little evidence of genuine competition within the UK with a significant amount of savings channelled through a narrow number of fund managers and distributors. SCM has found that 73% of the total amount invested in the active funds within the largest retail sector has an identical annual management fee of exactly 1.5% pa. This shows there is no genuine price based competition within the UK retail fund management sector.

4.1.4. SCM agrees that consumer responsibility is a legitimate and important consideration. Nonetheless, there are, in the asset management industry, significant asymmetries of information between consumers and providers which are inequitable and lead to consumer purchasing disbenefits. We warmly welcome the fact that the Government intends to recognise this and reflect this in legislation.

4.2. Question 7: Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?

4.2.1. We applaud the Government's intention to pursue a more pro-active approach to conduct legislation which is both needed and overdue.

4.2.2. Accordingly, we welcome the Government's commitment to ensure the FCA has the necessary tools to take swift and decisive action in the interests of retail consumers, subject to normally understood conceptions of appropriateness and proportionality; and to take swift regulatory action to prevent consumers being misled and to publish the fact that it has done so.

4.2.3. SCM believes that the requirement on the FCA that it should have a duty to publish directions made under the new power, will drive a better appreciation among firms of the

clear difference between good and bad practice, and behaviourally stimulate a move toward better market practice.

4.2.4. SCM believes this power will also have the effect of enhancing awareness and confidence among consumers about what is good and, conversely, what is poor practice.

4.3. Question 8: What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

4.3.1. In view of recent examples of product-related "mass detriment", SCM welcomes the introduction of powers designed to facilitate early intervention. This is, in our view, a long overdue step, to promote consumer confidence and deliver swift and effective redress.

4.4. Question 9: What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

4.4.1. Any measure designed to demonstrate to consumers a proactive desire on the part of regulators to ensure that they and their interests are properly protected from vested market interests is to be applauded. Accordingly, we think the Government's proposals are sensible and likely to prove to be effective.

4.5. Question 10: Do you have any comments on the competition proposals for the FCA set out in paragraphs 2.111 to 2.119 and in Chapters 3 and 4?

4.5.1. SCM welcomes the Government's commitment to ensuring that an appropriate degree of importance attaches to achieving and sustaining competition in financial services.

4.5.2. Competition in financial services will, however, only be practically meaningful for consumers, their purchasing intentions and, therefore, wider market confidence, if this is matched by appropriate levels of product and service transparency.

4.5.3. SCM is agnostic about whether the FCA should have been granted limited concurrent powers to initiate a market investigation reference (MIR) to the Competition Commission, or to be able to trigger a super-complaint, however, it welcomes the proposals that the FCA should be capable of initiating a referral to the OFT on competition grounds.

5. Conclusion

5.1. SCM is delighted to have had the opportunity to respond to HM Treasury's consultation on financial regulatory reform. It believes that transparency and accountability, alongside competition, must be the key drivers in providing consumers with the confidence that they expect and need in order to make informed choices and decisions in the way in which they sources financial products and services.

5.2. SCM would be delighted to discuss its response in further detail with HM Treasury, if required.

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8 September 2011

Dear Sirs

A new approach to financial regulation: the blueprint for reform. Cm 8083

I am writing to comment on clause 35 of the draft Bill, in particular the amended s.315, relating to Lloyd's.

The effect of the proposed amendment is that the Society will lose the authorization and the permissions which it currently has by virtue of the primary legislation and will need to be authorised by PRA under the new Part 4A or receive the benefit of grandfathering provisions to the same effect.

I question the utility of this approach. I understand the Government's reluctance to anticipate in the Bill provisions as to the allocation of responsibilities between PRA and FCA which, as regards most regulated activities and the persons carrying them on, will be embodied in secondary legislation. However, it is implicit in s.318, as it is proposed to be amended, and indeed arguably all the sections of Part 19, that the Society will be authorized by the PRA and regulated by both the PRA and the FCA. The Government has already announced that the Society will be dual regulated.

The Society will need to be, and to remain, authorised with the unique permissions which it currently has under FSMA s. 315, subject always to s.315(3) or a successor provision. This would be so even in circumstances in which a Lloyd's market reorganization order under the Insurers (Reorganisation and Winding Up)(Lloyd's) Regulations 2005 was in force, given, for example, the Society's continuing functions in relation to the various trust funds.

The clarity in the current legislation as to the unique position and functions of the Society and its relationship to the members of Lloyd's for the purposes of FSMA will be lost if s.315 is amended as proposed. This would be unfortunate. It would be quite feasible to retain the present provisions in s.315, mutatis mutandis, subject (if considered necessary) to a Treasury power to make regulations for the purpose of specifying which of the ancillary regulated activities (referred to in s.315(2)(c)) carried on by the Society are to be treated as "PRA-regulated activities" in the particular context.

I make these comments particularly in the light of my experience, as Counsel to Lloyd's from 1995 to 2010, of having frequently to explain the relationships articulated in ss.315 and 316 to legislative draftsmen here and abroad, to foreign regulators, and to bankers to the Society and market participants.

Incidentally, it is not at all clear from the draft Bill how the powers to grandfather current authorizations are to be conferred. Perhaps I have missed something.

I am sending a copy of this letter to Lloyd's for their information.

Yours faithfully

Julian Burling

Response to "A new approach to financial regulation: The blueprint for reform"

by Tony Shearer (tony@tonyshearer.com), dated 15th August 2011.

financial.reform@hmtreasury.gsi.gov.uk

The Chancellor of the Exchequer is wrong when, in his foreword to the Blueprint, he says: "Over the past few years, a clear consensus has emerged that the shortcomings of the 'tripartite' model of financial regulation were a significant factor in the UK's failure to predict, or adequately respond to, the financial crisis that started in 2007... So the Government is committed to introducing a new approach to financial regulation – one which is based on clarity of focus and responsibility, and which places the judgement of expert supervisors at the heart of regulation........".

This Chancellor has probably been persuaded that he should blame the Tripartite Arrangement by officials at the Treasury and advisers who were themselves to blame for the failure of the Banks and the Regulatory system. The Treasury had responsibility for the Tripartite Arrangement (as it has for the new proposed structure, seemingly under the Bank of England), and so it is disappointing that these Treasury officials have succeed in passing the blame for their failure to others. The Blueprint contains a false analysis for the reasons that I gave in my responses to "A new approach to financial regulation: building a stronger system" (see Appendix 1) and "Interim Report of the Independent Commission on Banking" (see Appendix 2). Not one of my points has been addressed, and this I believe is because the Government has no answer.

In summary:

1. The Tripartite model failed because the people operating it failed to do their jobs, not because the model itself was deficient;
2. Those same people, more or less, are still at the heart of the new system, and so that is as likely to fail as was the the old model;
3. The Bank of England is culturally and organisationally incapable of performing the role that has been set out for it. Its past record shows that it has not the talent, experience, or ability to perform this role;
4. The Bank of England already has a major responsibility in setting interest rates, and to give it and its Governor more responsibility simply overloads them and him;
5. The Treasury is still at the head of the proposed system, just as it was for the Tripartite system, and shows no inclination to recognise its failings or learn from them;
6. The lessons from the "banking crisis" have not been identified publicly, let alone learned;
7. The Independent Banking Commission has not yet finally reported, but so long as the banks are allowed to include financial traders (aka Investment Banks) within proper banks, and allow these traders to use cheap finance obtained as a result of the "state guarantee" to fund their gambling activities, the new system is in grave danger;

8. None of the advisers and others who were very well remunerated to protect the system, but totally failed to do so, have been disciplined or reprimanded, even when they (such as auditors and ratings agencies) have been heavily criticised by Committees of Parliament;
9. The Government and Treasury are still being advised by those who are from backgrounds that created the banking crisis.

I have already made all the above points in my submissions in Appendices 1 and 2. Accordingly there is no point in commenting on the Government's more detailed proposals as they are based on flawed logic, and result from listening to very poor, and biased, advice.

The Chancellor should be aware that the process by which he is making decisions on future regulation is flawed, and this is an example of a flawed process.

Roger Bootle wrote an excellent article explaining this in an article in the Daily Telegraph on 28th November 2010 entitled "What holds Britain back is an ineffective government", and I have included this article in Appendix 3 below. His conclusion is: "I wonder what will happen when the British people wake up to how badly their leaders have governed them." The Chancellor should read it.

Prof. Drew Westen also wrote an article about President Obama's approach to the banking crisis in the New York Times on 6th August 2011 entitled "What Happened to Obama?", and I have included the full article in Appendix 4 below. In it Prof Westen said: "... This was a disaster, but it was not a natural disaster. It was made by Wall Street gamblers who speculated with your lives and futures. It was made by conservative extremists who told us that if we just eliminated regulations and rewarded greed and recklessness, it would all work out. But it didn't work out. And it didn't work out 80 years ago, when the same people sold our grandparents the same bill of goods, with the same results. ......

"In contrast, when faced with the greatest economic crisis, the greatest levels of economic inequality, and the greatest levels of corporate influence on politics since the Depression, Barack Obama stared into the eyes of history and chose to avert his gaze. Instead of indicting the people whose recklessness wrecked the economy, he put them in charge of it. He never explained that decision to the public — a failure in storytelling as extraordinary as the failure in judgment behind it. .... He would have had to stare down those who had wrecked the economy, and he would have had to tolerate their hatred if not welcome it. But the arc of his temperament just didn't bend that far. "

The Chancellor will also be aware of the publicity generated by the relationship between the Government and the Murdoch's and other media empires, and should learn the lessons from this in so far as they apply to the financial system. The UK has its own "corruption"; it is not as overly financially based as it is in some other countries, but it is there in a much more subtle way. Influence is obtained in different ways, often by contributions to political parties or by providing jobs, or through connections. The effect is the same, that the very people who wrecked the UK economy are for the most part still exercising influence. There have been some changes to the managements of some of the banks, but no prosecutions of the former managements, and on the whole no action taken

against the auditors, rating agencies, lawyers, investment bankers, analysts, brokers, ir/pr firms, civil servants, or regulators who were all involved. They are still in place, giving their advice and influencing events.

For example, I have asked the Financial Reporting Council ("FRC") why they are not investigating the auditors of the failed banks. The FRC has told me that they do "not comment on individual cases or on matters it is not investigating. In general, however, wherever a large corporation collapses or comes close to collapse, we will look in detail at the information available to see if there is information to suggest potential misconduct by the auditors. We do not start investigations without cause. There does need to be some concrete information to suggest potential misconduct by the auditors that relates directly and specifically to the individual matter concerned. A general view that the auditors were partly to blame for the financial crisis is not sufficient cause to start an investigation into a specific matter. " How can the FRC be credible when they hold the view that there is no "concrete information to suggest misconduct by the auditors". All they have to do is to look at the subsequent level of bad debt provisions and funding that were needed, or to look at the report of the House of Lords Economic Affairs Committee.

Another example is why was a former senior Director of RBS, Johnny Cameron, taken on by Spencer Stuart? How can anybody use such a firm that can make such a disastrous mistake in its own recruitment?

The Government must ensure that there is no room for its policies and actions to be influenced by those who failed in their jobs, thus allowing the banking crisis to occur, including those working inside the Treasury.

Tony Shearer,

15th August 2011

Appendix 1

"A new approach to financial regulation: building a stronger system"

Response to the Consultation Document by Tony Shearer (tony@tonyshearer.com), submitted as an individual, dated 31st March 2011.

Response e-mailed to: financial.reform@hmtreasury.gsi.gov.uk

Financial Regulation Strategy HM Treasury 1 Horse Guards Road London SW1A 2HQ

Summary

The Consultative Document addresses the wrong issues. This is not surprising as there has been no official attempt to assess and understand the causes of the banking crisis in the UK, and no attempt to identify publicly the lessons to be learned from it. Lord Turner's report in 2009 failed to do any of that as explained in my submission at the time; a copy of the introduction to my submission is included in the Appendix to this response.

There is no evidence that the past regulatory structure ("The Tripartite Arrangement") was the problem. The new structure is not a substantive change; the new proposal is to have three entities all under the Governor of the Bank of England but with the key appointments all within the control of the Treasury. The Tripartite Arrangement also has, and had, three different entities (Treasury, Bank of England, and FSA) and all under the overall arm of the Treasury. It is not as if these three bodies are three completely different businesses such as HSBC, Tesco and Vodafone with three different sets of owners; they are, and were, all Government entities falling under Government/Treasury supervision/control with responsibility to the taxpayer. It should not need a new structure for the Treasury and Government to co-ordinate between three of its own entities.

In reality very little practical change will be introduced by the new structure.

In fact regulation is about people, not structures. And it was the people that failed in the past; failed to do the job with which they were charged. The FSA had, and has, only two objectives, one of which was, and is, to prevent a systemic failure of the banking system. All that had to happen was the people running the FSA had to do their jobs, or the other members of the Tripartite Arrangement had to spot that they were not doing them.

This view is emphasised by the same people at the Treasury now arguing for the new structure and against the Tripartite Arrangement; the same people as argued a year ago, and over the previous dozen years, in favour of the Tripartite Arrangement.

The Bank of England as the regulator

If there is to be a new regulatory structure under one entity, then the Bank of England is an inappropriate choice for the following reasons:

1. It is probably amongst the least accountable and transparent organisations in the UK, probably even less so than the Treasury;
2. It is hierarchical, bureaucratic and composed of "Group think";
3. It has no obvious corporate governance structure. It is run by a Governor though it is not clear whether he is Chairman, Executive Chairman or Chief Executive, his executive colleagues such as the Finance Director do not fill the roles that their titles imply they should, and the roles of the non-executives are not clear;
4. Responsibility for the whole regulatory system (including both macro- and micro-regulation) is a massive job, when the Bank of England already has a very large job in setting interest rates and controlling inflation. The job seems to be too big for any one person or organisation;
5. The Bank of England has failed over the last couple of years to carry out its current main job of controlling inflation;
6. As I pointed out in 1997, the brief of controlling inflation is one that any student of GCSE Economics would know cannot be met only by setting interest rates, but the Bank of England has accepted the brief;
7. The Bank of England failed to do anything of substance to see, or address, the banking crisis before it hit, and even then was late to see the need to respond.

"Universal banks"

The paper does not address the issue of "Universal banks".

Large businesses (such as the big banks) will always be ahead of the regulators, employing lawyers and others to enable them to move faster than the regulators to find ways of avoiding, or minimising the impact of, rules and regulations (for example, capital requirements). Accordingly there need to be legal entities established that cannot be broken, as even Chinese walls will not always work securely. Separating the activities of the

"Universal Banks" will enable regulators to set different Capital requirements for financial traders and proper lending banks/deposit takers.

The Governor of the Bank of England has made his position clear on this matter, namely that for any regulatory structure to be effective, the casino operations of financial trading carried out by "investment banks" must be separated from the deposit taking and lending activities of proper banks; he is correct in that view, though that is not the point. If he is to be responsible for the regulatory system then he will need to make this separation happen, and that makes the report of the Independent Banking Commission as irrelevant as will be any decision by the Government on this matter. If the Governor accepts anything other than total legal and practical separation of these activities then he is forsaking what he has made clear he regards as probably the most important regulatory change.

Accordingly what is said in paragraph 1.7 is irrelevant, namely:

"Furthermore, the Government has also established the Independent Banking Commission, chaired by Sir John Vickers, to consider the structure of the UK banking market, including the question of whether to separate retail and investment banking, and questions of competition in banking. The Commission will report in September 2011, with an interim report due in April."

Relationship between the Regulator and the Regulated

The paper does not address adequately the issue of the relationships between the regulators and regulated.

What is said in paragraph 1.2 is:

"The crisis was caused by the failure of financial institutions to manage themselves prudently, and of regulators to spot the risks that were building up across the system as a whole. Most developed economies – including the UK's – are emerging from the deepest recession for generations"

And paragraph 1.5 states:

"The Government recognises that steps must also be taken to ensure that financial firms are never again allowed to take on risks that are so significant and so poorly understood, resulting in such severe economic consequences for businesses, households and individuals. That is why the Coalition Government made the reform of UK financial regulation, and the replacement of the flawed system introduced by the previous administration, one of its key priorities on taking office in May 2010."

These paragraphs give the impression that the Treasury believes that the issue is one between the management of banks and the regulators. To use a cricketing analogy, the bowler is the market and the batsman is the regulated entity, with the regulator as the long-stop. The other nine fielders can be equated to:

1. The executive management of the regulated entity;
2. Its chairman and non-executive directors;
3. Its shareholders;
4. Its auditors;
5. Its financial advisers
6. The rating agencies;
7. Financial analysts;
8. Its lawyers
9. Its Investor Relations and Public Relations firm.

The banking crisis occurred because none of these nine categories did their jobs properly. The FSA, the Bank of England and the Treasury did not, at the time, act on this

fact, and probably did not even appreciate it. The Consultation Document makes no mention of these nine groups, or of how the new structure will oversee their activities, even though:

a) on 30th March 2011 the Economic Affairs Committee of the House of Lords reported on the role of the auditors saying, inter alia, "There was no single cause of the banking meltdown of 2008-09. First and foremost, the banks have themselves to blame. As our predecessor Committee found in its report on *Banking Supervision and Regulation* in 2009, the supervisory system put in place in 1997 proved unfit for purpose. But we conclude that the complacency of bank auditors was a significant contributory factor. Either they were culpably unaware of the mounting dangers, or, if they were aware of them, they equally culpably failed to alert the supervisory authority of their concerns.", and
b) in March 2011 the Bank of England published a report that concluded, inter alia, that "Credit ratings are now heavily hardwired into financial contracts, investment processes, and the regulatory framework. Rating agency decisions therefore have potentially systemic consequences. Many policymakers and commentators have argued that the crisis was exacerbated by a combination of faulty ratings methodologies, conflicts of interest, and overreliance on ratings by banks, investors and regulators."

In a cricket match the long-stop needs to rely on the nine other fielders doing their job; he cannot do his job without their help. The fact that almost all of these fielders are paid by the batsman makes the job even harder. Similarly the regulator (long-stop) must get the others to help him. If they continue to fail to do their jobs, then it is inevitable that he will fail. Yet other than a few of the executives and non-executives and the two recent reports referred to above, it would seem as if none of the other players has been even admonished or identified for their failures. How will this now happen? How will these key and highly rewarded fielders be regulated within the new structure?

The people operating within the structures

The paper fails to identify that far more important than the structure are the people who are operating within it.

The Tripartite Arrangement could have prevented a systemic failure of the banking system, but didn't; and the Treasury did not act. I discussed and corresponded with Callum McCarthy (at that time Chairman of the FSA) on this very issue in 2005 and pointed out to him that the FSA focused on "minutiae and trivia" rather than the possibility of a systemic failure of the banking system. If he had listened or even understood, or if Mr Tiner or Mr Sants (respectively former Chief Executive of the FSA, and his successor) had done their jobs properly, none of these reforms would be necessary. I make this point now, because I was right in 2005, and if these proposals are not changed then there is every chance that I shall be right once again, and at a terrible cost to the UK economy.

The new structure includes many of the people whose failures in the past caused the banking crisis. It is true that Callum McCarthy and John Tiner as well as John Kingman (the former Chairman of the Tripartite Arrangement) are not in the new structure, though incredibly they are still in important positions in the financial services sector. But Mervyn King is, as is Hector Sants who was a key executive at the FSA as Managing Director of Wholesale and Institutional Markets from May 2004 to July 2007 when he was appointed CEO, and he is to be a Deputy-Governor of the Bank of England as Chief Executive of the Prudential Regulation Authority and a member of the Board of the Interim Financial Policy Committee in the new structure. Lord Turner, the Chairman of the FSA from September 2008, is to be a member of the Board of the Interim Financial Policy Committee, even though he has failed to make the necessary changes to the FSA, and as a result the Government is

now abolishing the FSA. The Governor of the Bank of England is to be Chair of both the Financial Policy Committee and the Prudential Regulation Authority, and will also have overall responsibility for the Financial Conduct Authority, as well as continuing as Chairman of the Monetary Policy Committee and holding his other responsibilities within the Bank of England.

Conclusion

The right solution is to keep the existing structure, not because it is brilliant or perfect but because the new one is not significantly better or even different as explained above. The cost and disruption of the changes are not worth the cost, the risks, the delay or the disruption. What needs to change are the people on the Board of, and within, the FSA, and as importantly within the Treasury and the Bank England. The new people should then get on and do their jobs properly.

Whatever structure is in place, circumstances will change to make it inappropriate. This may happen over a longish period such as over ten years, but it could happen over a period such as a year or two. Changes will happen in the way that banks operate either as a result of market forces, changes in other countries, or even as banks seek to create new products, structures or services to avoid what they see as costly or harmful restrictions or regulations. Accordingly the regulatory climate and structures cannot be set in stone. They need to be operated by people who understand the changing needs and priorities and adjust their objectives and actions accordingly.

The acid test will be how the structure operates in the short-term and also in the longer term. For each of the first 5 years, and thereafter every second year there should be an independent public review to see if the whole operation is working and meeting the changing needs and objectives.

Other comments

1. **Bonuses and lending**

Paragraph 1.3 states

"As they rebuild their balance sheets – often with direct or indirect support from the taxpayer – banks must continue to lend to the businesses that are the engine of economic growth, particularly small and medium enterprises."

Paragraph 1.4 states

"The Government welcomed, last week, the commitment by the UK's biggest banks on lending expectations and capacity, the size of the 2010 bonus pool, pay disclosure and support for regional growth and the Big Society. Barclays, HSBC, Lloyds Banking Group, RBS and, with respect to lending, Santander, have made specific commitments on these issues, following a period of discussion between the Government and the banks, known as Project Merlin."

These paragraphs show a lack of understanding, by thinking that bonuses paid to "financial traders" (also known as Investment Bankers) are somehow linked to the lending practices of proper banks.

2. Growth or Risk?

Paragraph 1.10 states:

The Government's reforms focus on three key institutional changes:

- first, a new Financial Policy Committee (FPC) will be established in the Bank of England, with responsibility for 'macro-prudential' regulation, or regulation of stability and resilience of the financial system as a whole;
- second, 'micro-prudential' (that is, firm-specific) regulation financial institutions that manage significant risks on their balance sheets will be carried out by an operationally independent subsidiary of the Bank of England, the Prudential Regulation Authority (PRA); and
- third, responsibility for conduct of business regulation will be transferred to a new specialist regulator, which has had the working title 'consumer protection and markets authority'. The Government has now finalised the name of this body as the Financial Conduct Authority (FCA); the FCA will have responsibility for conduct issues across the entire spectrum of financial services.

1.21 The Government recognises that the exercise of the FPC's macro-prudential functions to increase overall resilience and make the financial sector more sustainable may impact upon the capacity of the financial sector to support the economy. Many respondents to the July consultation called for this to be recognised through a specific reference to economic impact in the FPC's statutory objective. The Government proposes to build this factor into the FPC's objective through an additional statutory limb, as follows:

This does not require or authorise the Committee to exercise its functions in a way that would in its opinion be likely to have a significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy in the medium or long term.

The above is meaningless and open to many different interpretations. The reality is that there is a trade off between reducing risk to provide a secure banking system with a low chance of a systemic failure and taxpayer support, and a higher risk level to enable banks to lend for the benefit of the UK economy and to be very profitable, make taxable profits and enable the publicly held stakes in some of the banks to be sold for the maximum return. Government should indicate how they want these conflicting risk profiles to be balanced.

3. Accounting policies

There is no doubt that around 2004 and 2005 accounting practices changed, and this had a major impact on the financials statements of lending institutions. Particular areas affected were the way that bad debt provisions were calculated, and also in calculating the carrying value of liabilities as well as calculating "Mark to market" of assets when there was no market. The role of International Financial Reporting Standards in forcing banks to adopt these practices and the harmful role played by firms of auditors needs to be curtailed.

4. Independent inquiries

Paragraph 3.58 states:

"FSMA sections 14 to 18 provide the mechanism for the Treasury to appoint a person to hold an independent inquiry into the circumstances surrounding regulatory events which give rise to serious questions or public concern about the regulatory framework or the effectiveness of regulation in practice. The FSMA provisions established a statutory basis for launching the type of inquiry that had been conducted into the failures of the Bank of Credit & Commerce International (BCCI) in 1991 and Barings in 1995. The Bingham Inquiry into BCCI was conducted on a non-statutory basis and therefore had no powers to require witnesses to attend or give evidence. The Barings Inquiry was conducted by the Board of Banking Supervision (an advisory body within the Bank of England). The Government intends to retain an equivalent to the FSMA section 14 power in the new legislation, enabling the Treasury to order inquiries by an independent third party into any regulatory failure by the PRA and FCA."

No such inquiry has taken place into the collapse of the banking system and those who had a role in that failure, including the FSA. There has been no report published yet into the collapse of RBS, HBoS, or the Icelandic banks. What is the point in having such powers if you don't use them?

Tony Shearer

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31st March 2011

APPENDIX

From: Tony Shearer; tony@tonyshearer.com
15th June 2009

Section 1: Overview

Introduction

The Turner report is a missed opportunity.

In October 2008 The Chancellor of the Exchequer asked Lord Turner to review the causes of the current banking/financial crisis, and to make recommendations on the changes in regulation and supervisory approach needed to create a more robust banking system for the future. Lord Turner's review:

1. does not identify the causes of the crisis, and fails to deal with the related regulatory issues;
2. contains no analysis of what went wrong and the mistakes made by the FSA and others;
3. does not identify the lessons to be learned;
4. proposes solutions that are defective;
5. is deficient for these reasons and needs to contain sections covering:

a. the 100 or so people that brought down the UK economy and what lessons can be learned from them and their failures;

b. the consequences for depositors, and those who rely on the City of London and the other major financial centres, (such as pensioners, future pensioners, and private investors). It is this group who have not earned the returns that they should have, and needed, from the capital that they have saved and invested. Lord Turner wrote a previous report for the Government entitled The Pensions Crisis

published in October 2004. It is amazing he did not identify this as a major issue, and try to address it.

6. does not explain the lessons to be learned from overseas regulators. The UK regulator failed, and so did many, but not all, international regulators. The Turner review talks a lot about international co-operation amongst regulators. But there is no section explaining how regulatory bodies in other countries (such as the USA, Canada, Australia, South Africa, Germany, France, Saudi Arabia, etc) fared (some did a lot better than we in the UK because their regulators were more on the ball), and how their banks were impacted by the crisis, with the lessons to be learned.

7. does not contain a section that explains and admits the failures of the FSA, and the lessons that need to be learned. The Regulator failed, rather than the Regulations. It is important that the real lessons are learned so that remedies can be put in place. The FSA still seems not to recognise this, and is a clear indication that the FSA and the Board of the FSA are not fit to continue in their roles.

The review is seeking responses to the Turner review, but decisions on how to proceed should not be left to the Board of the FSA and the Treasury. They have both already failed spectacularly. If no better alternative exists, the Treasury Select Committee should, set up a Committee of knowledgeable people (who are not tainted by recent events) with a brief to look at the Turner Review, and to make recommendations to the Treasury Select Committee.

The causes of the crisis

It is clear that the Tripartite Regulatory System has failed, as has its constituent parts, the FSA, the Bank of England and the Treasury. But so have the rating agencies, the financial analysts (who were employed to analyse the strengths and weaknesses of financial service companies), the auditors (who signed off the banks' accounts when it is clear that those accounts did not give a "true and fair view"), the investment banks (who promoted and advised on corporate transactions, and packaged and distributed so much of the toxic debts), the lawyers (who advised on these transactions), the head-hunters (who helped companies recruit the wrong people as both executives and non-executives), the public/investor relations advisers and spokespeople (who have seen their jobs as to present their clients in the most favourable light rather than to get the truth and the facts out into the open), and also the remuneration consultants (often the same head-hunters, who advised on the creation of the remuneration packages of the executives): And of course the Executives and Non-Executives who were the directors of so many of the failed banks.

All of these have failed us; all of these have been very well remunerated, and all of these have left some depositors with substantial losses, and the taxpayer with the very considerable financial burden. Each of these groups needs to be embraced within the regulatory system, and the Police should open a few enquires.

The key points that Lord Turner's review does not deal with are:

1. The Turner review is based on a pseudo-academic analysis of what he says are the causes of the banking crisis. But what he actually does is to identify the conditions that enabled the City of London and the players in the other major financial centres to create the crisis.

It was the City of London (and the other major financial centres) that created the crisis by forgetting who their clients really were, and putting their own self-interests, greed and wealth before their duties to the providers of capital that were their clients. The culture of the City must change. These issues are really very difficult to resolve, and this is because the City has so lamentably failed its customers. The rewards for capital have been eaten into, if not obliterated, by the charges and fees of those who see themselves as having talents to advise and manage. Put another way, the City has been too expensive and taken too much reward for doing too little; actually it has destroyed, and not created, value.

This is what created the mess. Those working inside the City cannot be trusted to change this culture, and so the necessary change will have to be lead and enforced by the political and regulatory process.

2. Financial Markets are not efficient. They are driven by fear and greed: And those who benefit from and operate them often manipulate them to their advantage. The players in the City of London have a vested interest to keep financial markets buoyant and high. So booms go on long after they should have, crashes are far deeper and more intense, and recovery comes much too quickly. Few of the players have any vested interest in seeing bear markets. As a result, the City is not a safe place for pensioners, future pensioners, and private investors. Those who use the financial markets need protecting.
3. Institutional shareholders failed to behave like owners of the businesses and thus the banks were allowed to take on excessive risk for low returns, over-pay their staff, and over-stretch their own skills, their management and their resources. These shareholders have lamentably failed to deliver the service that they should have provided. Recent events have shown that the institutional shareholders and financial analysts have repeatedly missed what has been blindingly obvious to many of the rest of us. It is clear that many institutional shareholders have had over ambitious expectations of the returns that can be achieved from investment, and had little grasp of the issues facing the banks in which they had invested, or understanding of or influence over the boards of those banks. They have in many instances acted as if they were betting in a Casino using other people's money, and taking very large rewards for what has at best been some pretty average performance. The big issue here is how to get institutional shareholders to act responsibly and financial analysts to be independent!
4. The audiences that Lord Turner does not address is depositors, and also the needs of those who rely on the City of London and the other major financial centres; namely pensioners, future pensioners, and private investors. It is this group who have not earned the returns that they should have, and needed, from the capital that they have saved and introduced to the financial centres. The consequence for this on Government policy is massive; and compounded by the fact that there has been such a switch from final salary schemes (where the employer takes much of the investment risk) to money purchase pensions (where the investor takes all the investment risk). The consequences of this on the population of this country, Government policy and Government finances are massive. Lord Turner wrote a previous report for the Government entitled The Pensions Crisis published in October 2004. It is amazing he did not identify this as a major issue, and try to address it.
5. Politicians lost their objectivity in their approach to bankers and feted, honoured and praised them, participating and encouraging them in a process that made bankers believe that they were "Masters of the Universe".
6. The main regulatory issue is about the quality of the FSA's people. The FSA can put in place all sorts of things and procedures: But over time the requirements and issues will change. The FSA needs good honest people who can be flexible and adapt to changing circumstances: And not those who have failed to date. It has been reported that the FSA is often now using four times as many people as previously when it inspects a business; it does not need more people; it needs better people focused on the important issues. The regulators failed to understand what was going on in financial markets, and failed to use the regulations that they had available to them. The FSA's failure was that though it had the powers to curtail, and possibly to stop, the excesses it did not do so; it was a failure of the Regulators not of the Regulations. Until the FSA, its CEO (who was Managing Director, Wholesale and Institutional Markets from May 2004 until he became CEO in July 2007), the Board of the FSA and its management recognises that it has failed totally and lamentably, and that it is part of the problem, their recommendations and proposed actions have no credibility. Indeed the recent statement by the CEO that regulated businesses should be "frightened" of the FSA is crass, and is but one indication that he has no understanding of the situation. It is remarkable how many people have told me that they are sufficiently scared of the FSA that they do not see it as a body that they can

approach when they have concerns about a regulated business. Many of these are directors of companies and see the way that the FSA has responded to people such as me who have pointed out the shortcomings of the FSA, been whistle-blowers or otherwise been critical of the FSA and the regulatory environment. This attitude created by the FSA can only be harmful to the regulatory process. It is clear that there is so much that the FSA could have done, and did not do.
7. No organisation should be too big to fail. If it is that big then the state cannot afford to prop it up, and nor should it; and it will be too big to manage or to regulate.
8. The UK regulator failed, and so did many, but not all, international regulators. The Turner review talks a lot about international co-operation amongst regulators. This is pie in the sky. The UK regulator should get its own house in order and not rely on other regulatory bodies such as those in Iceland.
9. The "Protectors" (auditors, financial advisers, lawyers, rating agencies, and financial analysts) failed to do what they were paid to do, namely to protect investors, depositors and the taxpayers.
10. It is remarkable that the administration of the failed banks is costing so much. Ernst & Young and Freshfields have apparently billed about £30 million of fees from October 2008 to April 2009 in respect of the administration of Kaupthing Singer & Friedlander. This money will reduce the returns to depositors and other creditors. This is another example of the greed of the City of London, as by any measure fees such as these are excessive to a massive degree.

Appendix 2

Response to the "Interim Report of the Independent Commission on Banking"

by Tony Shearer (tony@tonyshearer.com), dated 30th May 2011.

Summary

The Interim Report:

-has covered a lot of useful ground, but has had to work against the background of the absence of any proper attempt to analyse the causes of the Banking Crisis, and to understand the reasons for the failure of the regulatory system; and

-is a welcome attempt to identify some solutions, but needs to address the issues raised below in its final report.

The key issues are to:

1. separate banks from financial traders;
2. reduce the size of banks so they are no longer too big to manage;
3. make all the "players on the cricket field" do their jobs properly;
4. create some fairness in the distribution of rewards between the clients on the one hand, and the employees and advisers on the other hand, of Banks and financial services businesses;
5. hold people within the regulatory structure to account (including and especially those in the Treasury), rather than to introduce a cosmetic change in the structure; and
6. increase the amount and quality of capital held by the Banks, whilst ensuring that lenders are at risk of credit losses.

Overview

The Interim Report is a helpful part of the process of reducing the risks from bank failures. However there are eight major issues that the Interim Report ignores, or fails to address adequately, and these should be addressed before the final report is produced.

1. Most of the credible definitions of "Bank" do not include the activities of financial traders (aka Investment Banks) any more than they would include different activities such as car manufactures, retail stores, or mining companies: There is no reason why proper banks should contain the activities of financial trading. There are many definitions of Bank and the following is reasonably representative of such a definition: "An establishment authorized by a government to accept deposits, pay interest, clear checks, make loans, act as an intermediary in financial transactions, and provide other financial services to its customers". The report should be clear on what activities the Commission believes that proper banks should be allowed to mix in with their activities. On this basis Financial Traders should be separated. If the Interim Report had defined what a Bank is (indeed the Glossary does not contain a definition of a Bank) then these issues would have to have been addressed by the Commission.

   The Report does not address adequately the issue of "Universal banks". Investment banks are a large part of the problem. Their issues need to be addressed.

   Large businesses (such as the big banks) will always be ahead of the regulators, employing lawyers and others to enable them to move faster than the regulators to find ways of avoiding, or minimising the impact of, rules and regulations (for example, capital requirements). Accordingly there need to be legal entities established that cannot be broken, as even Chinese walls will not always work securely. Separating the activities of the "Universal Banks" will enable regulators to set different Capital requirements for financial traders and proper lending banks/deposit takers.

   The Governor of the Bank of England has made his position clear on this matter, namely that for any regulatory structure to be effective, the casino operations of financial trading carried out by "investment banks" must be separated from the deposit taking and lending activities of proper banks; he is correct in that view, though that is not the point. If he is to be responsible for the regulatory system then he will need to make this separation happen, and that makes the report of the Independent Banking Commission on this matter as irrelevant as will be any decision by the Government. If the Governor accepts anything other than total legal and practical separation of these activities then he is forsaking what he has made clear he regards as probably the most important regulatory change.

   Accordingly what is said in paragraph 1.7 of the Interim Report is irrelevant, namely: "Furthermore, the Government has also established the Independent Banking Commission, chaired by Sir John Vickers, to consider the structure of the UK banking market, including the question of whether to separate retail and investment banking, and questions of competition in banking. The Commission will report in September 2011, with an interim report due in April."

2. The report contains no analysis of other countries whose banks did better or worse than the UK, or why some UK banks did better or worse than others. As a result it makes suggestions for reducing the risk of future banking crises without any understanding of the global lessons from the banking crisis. In October 2008 The then Chancellor of the Exchequer asked Lord Turner to review the causes of the banking/financial crisis, and to make recommendations on the changes in regulation and supervisory approach needed to create a more robust banking system for the future. Turner's report was a missed opportunity which now has a serious effect on the work of the Commission as there has been no attempt to:
   a. identify the causes of the crisis, or to deal with the related regulatory issues;
   b. analyse what went wrong and the mistakes made by the FSA and others;
   c. identify the lessons to be learned;
   d. identify the 100 or so people that brought down the UK economy and what lessons can be learned from them and their failures;
   e. explain the lessons to be learned from overseas regulators. The UK regulator failed, and so did many, but not all, international regulators. The Turner review talked a lot about international co-operation amongst regulators, but there was no section explaining how regulatory bodies in other countries (such as the USA, Canada, Australia, South Africa, Germany, France, Saudi Arabia, etc) fared (some did a lot better than we in the UK because their regulators were more on the ball), and how their banks were impacted by the crisis, with the lessons to be learned.
   f. explain and admit the failures of the FSA, and the lessons that need to be learned. The Regulator failed, rather than the Regulations. It is important that the real lessons are learned so that remedies can be put in place.

3. Whilst the Interim Report focuses on "Too big to fail", it ignores the much more important issue of "Too big to manage". Most of the major UK banks have extensive activities in other geographical areas (with their own different languages, legal and tax, systems, culture, economic cycle etc), as well as other activities such as asset management, life assurance, general insurance, commodity trading, provision of financial advice etc etc, and also financial trading. No one Chief Executive, Financial Director, Board, Chairman, Head of Risk, Chairman of the Audit Committee, etc can possibly be sufficiently familiar with these activities for them to be managed properly. To do so would be like asking Sir Alex Ferguson to manage Manchester United, Real Madrid, Inter-Milan, the Dallas Cowboys, the Auckland Blues, Lancashire Cricket Club, Wakefield Trinity Rugby League, sale Rugby Union, the New York Mets etc etc). No sane person would take on such a job, or be asked to.

   In a recent trip to New York I was surprised at how much agreement I found on this issue by people in senior positions within the "Universal Banks". However most people recognised that they could not express their views openly for fear of upsetting either their Boards or their shareholders.

4. Much has been made of the competitiveness and financial success of UK banks and other financial services businesses. However much of this success has been achieved at the expense of their UK clients. Most financial services organisations (including banks) have made good money for their employees, advisers and some of their

shareholders; clients have not enjoyed the same benefits. The Commission does not address the issue of the disparity between the returns of the clients as opposed to the employees, advisers, and sometimes shareholders. The consequences of this disparity will be an impoverished group of pensioners, and a lack of capital that will be held by UK residents who have not achieved a fair share of the benefits from these businesses. In other words, much of the success of UK banks has been achieved at the expense of their clients.

5. To remain as a leading financial centre enough British citizens need to be sufficiently wealthy that they can provide finance to those that seek it. The policies of successive British Governments are stopping the creation of sufficient wealthy British individuals to provide this finance. Whilst the Commission's comments seem to be based on wishing the UK to be a major financial centre, the Interim Report seems to be stating this as an objective without recognising that it is difficult to believe that the UK can remain a major financial centre when almost all external funding is sourced by non-UK residents and citizens.

6. The Interim Report does not seek to balance the contradictory positions of financial stability on the one hand and returns to the business on the other hand. Greater financial stability can be achieved at the expense of lower returns to the business. What balance between these two does the Commission consider that the public and tax-payers should accept?

7. The Interim Report assumes that Macro-prudential regulation can always be successful. Given that very few of the "official" commentators saw the financial crisis coming, it is difficult to believe that setting up a body to forecast it will be successful, even if all the pressures to ignore such forecasts can be overridden. So for this reason the Banks need to have in place structures to ensure that they cannot "over-trade".

8. The Interim Report fails to identify that far more important than the structures are the quality and philosophies of the people who are operating within them.

   The Tripartite Arrangement could have prevented a systemic failure of the banking system, but didn't; and the Treasury did not act. I discussed and corresponded with Callum McCarthy (at that time Chairman of the FSA) on this very issue in 2005 and pointed out to him that the FSA focused on "minutiae and trivia" rather than the possibility of a systemic failure of the banking system. If he had listened or even understood, or if Mr Tiner or Mr Sants (respectively former Chief Executive of the FSA, and his successor) had done their jobs properly, none of these

reforms would be necessary. I make this point now, because I was right in 2005, and if these proposals are not changed then there is every chance that I shall be right once again, and at a terrible cost to the UK economy.

The new structure includes many of the people whose failures in the past caused the banking crisis. It is true that Callum McCarthy and John Tiner as well as John Kingman (the former Chairman of the Tripartite Arrangement) are not in the new structure, though incredibly they are still in important positions in the financial services sector. But Mervyn King is, as is Hector Sants who was a key executive at the FSA as Managing Director of Wholesale and Institutional Markets from May 2004 to July 2007 when he was appointed CEO, and he is to be a Deputy-Governor of the Bank of England as Chief Executive of the Prudential Regulation Authority and a member of the Board of the Interim Financial Policy Committee in the new structure. Lord Turner, the Chairman of the FSA from September 2008, is to be a member of the Board of the Interim Financial Policy Committee, even though he has failed to make the necessary changes to the FSA, and as a result the Government is now abolishing the FSA.

The Governor of the Bank of England is to be Chair of both the Financial Policy Committee and the Prudential Regulation Authority, and will also have overall responsibility for the Financial Conduct Authority, as well as continuing as Chairman of the Monetary Policy Committee and holding his other responsibilities within the Bank of England. This sets an appalling example to the banks by placing far too much responsibility and burden on one person.

The number of instances where one person can retain such power in any organisation effectively will only be where an exceptionally able person is surrounded by a very able and stable management team, with really good tried and tested systems. It is unlikely that such an able person can be found either to run the Bank of England or any bank, and for there to be such stability in the markets and financial conditions for long enough for such management teams and systems to be proven. One of the lessons of the Banking Crisis in the UK and the USA was that the largest businesses were not being properly controlled or managed by their leaders. This is as true today as it was then.

<u>Comments on specific parts of the Interim Report</u>

<u>Regulation of the banking system</u>

The Interim Report says:

3.3 The financial crisis exposed gaps in regulation of the banking system both nationally and internationally.

This paragraph gives the impression that the Commission believes that the failures of the Banks is an issue between the management of banks and their regulators. To use a cricketing analogy, the bowler is the market and the batsman is the regulated entity, with the regulator as the long-stop. The other nine fielders can be equated to:

10. The executive management of the regulated entity;
11. Its chairman and non-executive directors;

12. Its shareholders;
13. Its auditors;
14. Its financial advisers
15. The rating agencies;
16. Financial analysts;
17. Its lawyers
18. Its Investor Relations and Public Relations firm.

The banking crisis occurred because none of these nine did their jobs properly. The FSA, the Bank of England and the Treasury did not, at the time, act on this fact, and probably did not even appreciate it. The Interim Report makes no mention of these nine groups, or of how the new structure will oversee their activities, even though:

c) on 30th March 2011 the Economic Affairs Committee of the House of Lords reported on the role of the auditors saying, inter alia, "There was no single cause of the banking meltdown of 2008-09. First and foremost, the banks have themselves to blame. As our predecessor Committee found in its report on *Banking Supervision and Regulation* in 2009, the supervisory system put in place in 1997 proved unfit for purpose. But we conclude that the complacency of bank auditors was a significant contributory factor. Either they were culpably unaware of the mounting dangers, or, if they were aware of them, they equally culpably failed to alert the supervisory authority of their concerns.", and
d) in March 2011 the Bank of England published a report that concluded, inter alia, that "Credit ratings are now heavily hardwired into financial contracts, investment processes, and the regulatory framework. Rating agency decisions therefore have potentially systemic consequences. Many policymakers and commentators have argued that the crisis was exacerbated by a combination of faulty ratings methodologies, conflicts of interest, and overreliance on ratings by banks, investors and regulators."

In a cricket match the long-stop needs to rely on the nine other fielders doing their job; he cannot do his job without their help. Indeed if the others do their jobs properly, there is no need for a long-stop! The fact that almost all of the fielders are paid by the batsman makes the job even harder. Similarly the regulator (long-stop) must get the others to help him. If they continue to fail to do their jobs, then it is inevitable that he will fail. Yet other than a few of the executives and non-executives and the two recent reports referred to above, it would seem as if none of the other players has been even admonished or identified for their failures. How will this now happen? How will these key and highly rewarded fielders be regulated within the new structure?

The proposed regulatory structure

The Interim Report says:

3.29 The UK is in the process of replacing the existing tripartite system (which currently consists of HM Treasury, the Bank of England and the FSA) and creating a number of new bodies to enhance the supervision of financial services and strengthen the stability of the financial system.12 The new regulatory architecture is to be fully in place by the end of 2012.

There is no evidence that the past regulatory structure ("The Tripartite Arrangement") was the problem. The new structure is not a substantive change; the new proposal is to have three entities all under the Governor of the Bank of England

but with the key appointments all within the control of the Treasury. The Tripartite Arrangement also has, and had, three different entities (Treasury, Bank of England, and FSA) and all under the overall arm of the Treasury. It is not as if these three bodies are three completely different businesses such as HSBC, Tesco and Vodafone with three different sets of owners; they are, and were, all Government entities falling under Government/Treasury supervision/control with responsibility to the taxpayer. It should not need a new structure for the Treasury and Government to co-ordinate between three of its "own" entities.

In reality very little practical change will be introduced by the new structure.

Regulation is about people, not structures. And it was the people that failed in the past; failed to do the job with which they were charged. The FSA had, and has, only two objectives, one of which was, and is, to prevent a systemic failure of the banking system. All that had to happen was the people running the FSA had to do their jobs, or the other members of the Tripartite Arrangement had to spot that they were not doing them; in other words that the members of the three Government Bodies should talk to each other!

This view is emphasised by the same people at the Treasury now arguing for the new structure and against the Tripartite Arrangement; the same people as argued a year or so ago, and over the previous dozen years, in favour of the Tripartite Arrangement.

The right solution is to keep the existing structure, not because it is brilliant or perfect but because the new one is not significantly better or even different as explained above. The cost and disruption of the changes are not worth the cost, the risks, the delay or the disruption. What needs to change are the people on the Board of, and within, the FSA, and as importantly within the Treasury and the Bank England. The new people should then get on and do their jobs properly.

Whatever structure is in place, circumstances will change to make it inappropriate. This may happen over a longish period such as over ten years, but it could happen over a period such as a year or two. Changes will happen in the way that banks operate either as a result of market forces, changes in other countries, or even as banks seek to create new products, structures or services to avoid what they see as costly or harmful restrictions or regulations. Accordingly the regulatory climate and structures cannot be set in stone. They need to be operated by people who understand the changing needs and priorities and adjust their objectives and actions accordingly.

The acid test will be how the structure operates in the short-term and also in the longer term. For each of the first 5 years, and thereafter every second year there should be an independent public review to see if the whole operation is working and meeting the changing needs and objectives.

Capital requirements and Creditors absorbing losses

The Interim Report says:

*"**4.1** This chapter examines ways to reduce the probability and impact of bank failures by increasing the loss-absorbing capacity of banks and by structural reform to create some degree of separation between retail banking and wholesale and investment banking. The aims of both sets of measures are making the banking system better able to absorb losses, making it easier and less costly to sort out banks*

that get into trouble, and curbing incentives for excessive risk taking." Need to talk about banks and not about traders.

And

***4.4** There are different ways of making banks safer. One approach would be to be sharply prescriptive about permitted structures, for example by requiring retail banking and wholesale and investment banking to be in separate non-affiliated firms.*[1] *Another would be to be laisser-faire about structure and to seek to achieve stability by very high capital requirements. As will be explained in this chapter, the Commission currently believes that the best way forward is a more moderate combination of these approaches by way of:*

- *internal ring-fencing within universal banks to isolate UK retail banking services; and*
- *higher – but not very high – capital requirements, together with measures to make bank debt effectively loss-absorbing.*

***4.34** In the Commission's view, for systemically important banks the minimum credible ratio of CET1 to RWAs on a Basel III basis is 10%. This would translate into a SIFI surcharge of at least 3%. It seems very doubtful that any figure below this can be robustly supported by the available evidence, and a case could quite easily be made for going higher Depositor preference*

***4.47** Bank deposits – including deposits from individuals and from (some) small and medium-sized enterprises (SMEs) that are guaranteed (up to a limit) by the Financial Services Compensation Scheme (FSCS) – currently rank pari passu with other senior unsecured creditors. This means that losses can only be imposed on senior unsecured creditors to the same extent they are imposed on retail depositors. But retail depositors are not as well-placed as other senior unsecured creditors to monitor and discipline banks' risk taking. Further, the FSCS guarantee transfers at least some of the risk associated with a bank's activities away from that bank and its creditors to the banking system as a whole (with an effective back-up from the taxpayer).*[21]

***4.48** Depositor preference would subordinate the claims of other senior unsecured creditors to those of depositors, better aligning the incentive to discipline banks with the ability to do so. It would also create a bigger buffer that would absorb losses prior to depositors, making banks easier to resolve, in particular where there is a political imperative to avoid losses for retail depositors. There may be a case for extending preference to a wider range of deposits than those that are FSCS-insured. (This is the approach that has been adopted in the US, where all domestic deposits are preferred.)*

The Commission is right to focus on these two related issues. Clearly the amount of capital held by the banks was too low, and in too many cases the capital was illusory too. What is required is greater amounts of quality capital. It is impossible to generalise as to the exact minimum amounts or as to what comprises quality capital.

Furthermore it is self-evident that the position of bank creditors needs to be clarified at least. It seems unfair that Lenders are usually not on the line to face credit losses.

Conclusions

The Interim Report:

-has covered a lot of useful ground, but has had to work against the background of the absence of any proper attempt to analyse the causes of the Banking Crisis, and to understand the reasons for the failure of the regulatory system; and

-is a welcome attempt to identify some solutions, but needs to address the issues raised below in its final report.

The key issues are to:

1. separate banks from financial traders;
2. reduce the size of banks so they are no longer too big to manage;
3. make all the "players on the cricket field" do their jobs properly;
4. create some fairness in the distribution of rewards between the clients on the one hand, and the employees and advisers on the other hand, of Banks and financial services businesses;
5. hold people within the regulatory structure to account (including and especially those in the Treasury), rather than to introduce a cosmetic change in the structure; and
6. increase the amount and quality of capital held by the Banks, whilst ensuring that lenders are at risk of credit losses.

Tony Shearer 30th May 2011

Appendix 3

"What holds Britain back is an ineffective government", 28th November 2010, Roger Bootle, Daily Telegraph

Hong Kong and Singapore have bounced back strongly from recession, unlike Britain, and what make the difference is they have leaders who deliver whether it is providing vital infrastructure, education, or law and order.

There is nothing like a foreign visit to put domestic issues into perspective. I have just returned from a business trip to Asia and I am all agog.

I will not bore you with the superlatives that are now commonplace about the growth of India and China. It is not these countries that set my mind racing. After all, both cover huge territories with enormous populations and their current high rates of economic growth are largely a reflection of their low starting point on the development ladder.

What's more, in both countries the average person is still extremely poor – especially in India. And, despite all the hype, both could yet falter in their path to full development and hence fail to achieve the superpower status that everyone now thinks is assured.

For me, the interesting questions are posed by the two city states of Hong Kong and Singapore. Both suffered in the world downturn, but both bounced back strongly. This year their growth should be 7pc and 15pc respectively. All the signs are that over the next few years they should grow by 4pc-5pc. By contrast, the UK will probably struggle to grow by even 2pc. And the difference is palpable.

Unlike the comparison with China and India, the contrast with the UK cannot be put down to these countries' low level of development. In Hong Kong, per capita GDP is almost as high as in the UK and in Singapore it is higher.

Nor can the UK's lack of space provide an answer. Both Hong Kong and Singapore are small territories. Indeed, Singapore is not much bigger than the Isle of Wight, but with a population of about 5m and an economy now almost as big as the whole of Malaysia.

So why the difference?

The first thing to strike you about these two city states is the people – hard-working, disciplined, committed, ambitious and law-abiding. But why?

You are drawn towards the conclusion that it is something to do with government – but that is not synonymous with either big government or no government. Hong Kong and Singapore are very different in style – Hong Kong free-wheeling and buccaneering, while in Singapore the government is interventionist and nannying, often to an annoying degree.

But in both cases government is effective. What it does, it does well – whether that is the provision of vital infrastructure, education, or law and order.

What strikes me about the UK is how many of the things which hold us back fall into government's sphere.

We have big government – but it is spectacularly ineffective government. Whether it is the egregious failure and gross waste of our social security system, or the degenerate state of our education standards, our transport infrastructure, or the travesty of the protection supposedly offered to the citizen against crime, it is the same story: huge amounts of money spent to little good effect.

We seem to have the worst of both worlds – big government, which makes a nuisance of itself and costs a fortune, but which achieves very little.

It is part of our tradition in the West, especially in Britain, that the state's power should be tightly circumscribed by law, and that law-abiding citizens should not fear the holders of government office. This is something we can be proud of. But we have gone much further. In the UK the state is now the subject of widespread contempt. When society needs the state's organising and protective power that is a disaster.

Can we take comfort from the fact that we in Britain have developed so far that further material success is unnecessary and unwanted? I do not think so. Many Asian countries are not stopping once they get to Western levels of income and development.

The loss of Western countries' relative position compared to Asia implies a huge loss of power – and that will have cultural and political as well as economic implications. It not as though everyone in our society lives life to a high standard, as a look around any British inner city will testify. The amounts spent weekly on buying lottery tickets give ample confirmation of people's financial aspirations.

Don't worry, I am not all starry-eyed about Asian values. I know that neither Hong Kong nor Singapore is a democracy in the British sense. And many Asian countries face problems of regime continuity.

Moreover, the British system has proved to be a promoter of individual freedom and a defence against tyranny – at least so far - but it has also proved to be ineffectual in fostering economic development.

I wonder what will happen when the British people wake up to how badly their leaders have governed them.

Appendix 4

"What Happened to Obama?", 6th August 2011, Drew Westen, New York Times

Drew Westen is a professor of psychology at Emory University and the author of "The Political Brain: The Role of Emotion in Deciding the Fate of the Nation."

Atlanta

IT was a blustery day in Washington on Jan. 20, 2009, as it often seems to be on the day of a presidential inauguration. As I stood with my 8-year-old daughter, watching the president deliver his inaugural address, I had a feeling of unease. It wasn't just that the man who could be so eloquent had seemingly chosen not to be on this auspicious occasion, although that turned out to be a troubling harbinger of things to come. It was that there was a story the American people were waiting to hear — and needed to hear — but he didn't tell it. And in the ensuing months he continued not to tell it, no matter how outrageous the slings and arrows his opponents threw at him.

The stories our leaders tell us matter, probably almost as much as the stories our parents tell us as children, because they orient us to what is, what could be, and what should be; to the worldviews they hold and to the values they hold sacred. Our brains evolved to "expect" stories with a particular structure, with protagonists and villains, a hill to be climbed or a battle to be fought. Our species existed for more than 100,000 years before

the earliest signs of literacy, and another 5,000 years would pass before the majority of humans would know how to read and write.

Stories were the primary way our ancestors transmitted knowledge and values. Today we seek movies, novels and “news stories” that put the events of the day in a form that our brains evolved to find compelling and memorable. Children crave bedtime stories; the holy books of the three great monotheistic religions are written in parables; and as research in cognitive science has shown, lawyers whose closing arguments tell a story win jury trials against their legal adversaries who just lay out “the facts of the case.”

When Barack Obama rose to the lectern on Inauguration Day, the nation was in tatters. Americans were scared and angry. The economy was spinning in reverse. Three-quarters of a million people lost their jobs that month. Many had lost their homes, and with them the only nest eggs they had. Even the usually impervious upper middle class had seen a decade of stagnant or declining investment, with the stock market dropping in value with no end in sight. Hope was as scarce as credit.

In that context, Americans needed their president to tell them a story that made sense of what they had just been through, what caused it, and how it was going to end. They needed to hear that he understood what they were feeling, that he would track down those responsible for their pain and suffering, and that he would restore order and safety. What they were waiting for, in broad strokes, was a story something like this:

“I know you’re scared and angry. Many of you have lost your jobs, your homes, your hope. This was a disaster, but it was not a natural disaster. It was made by Wall Street gamblers who speculated with your lives and futures. It was made by conservative extremists who told us that if we just eliminated regulations and rewarded greed and recklessness, it would all work out. But it didn’t work out. And it didn’t work out 80 years ago, when the same people sold our grandparents the same bill of goods, with the same results. But we learned something from our grandparents about how to fix it, and we will draw on their wisdom. We will restore business confidence the old-fashioned way: by putting money back in the pockets of working Americans by putting them back to work, and by restoring integrity to our financial markets and demanding it of those who want to run them. I can’t promise that we won’t make mistakes along the way. But I can promise you that they will be honest mistakes, and that your government has your back again.” A story isn’t a policy. But that simple narrative — and the policies that would naturally have flowed from it — would have inoculated against much of what was to come in the intervening two and a half years of failed government, idled factories and idled hands. That story would have made clear that the president understood that the American people had given Democrats the presidency and majorities in both houses of

Congress to fix the mess the Republicans and Wall Street had made of the country, and that this would not be a power-sharing arrangement. It would have made clear that the problem wasn't tax-and-spend liberalism or the deficit — a deficit that didn't exist until George W. Bush gave nearly $2 trillion in tax breaks largely to the wealthiest Americans and squandered $1 trillion in two wars.

And perhaps most important, it would have offered a clear, compelling alternative to the dominant narrative of the right, that our problem is not due to spending on things like the pensions of firefighters, but to the fact that those who can afford to buy influence are rewriting the rules so they can cut themselves progressively larger slices of the American pie while paying less of their fair share for it.

But there was no story — and there has been none since.

In similar circumstances, Franklin D. Roosevelt offered Americans a promise to use the power of his office to make their lives better and to keep trying until he got it right. Beginning in his first inaugural address, and in the fireside chats that followed, he explained how the crash had happened, and he minced no words about those who had caused it. He promised to do something no president had done before: to use the resources of the United States to put Americans directly to work, building the infrastructure we still rely on today. He swore to keep the people who had caused the crisis out of the halls of power, and he made good on that promise. In a 1936 speech at Madison Square Garden, he thundered, "Never before in all our history have these forces been so united against one candidate as they stand today. They are unanimous in their hate for me — and I welcome their hatred."

When Barack Obama stepped into the Oval Office, he stepped into a cycle of American history, best exemplified by F.D.R. and his distant cousin, Teddy. After a great technological revolution or a major economic transition, as when America changed from a nation of farmers to an urban industrial one, there is often a period of great concentration of wealth, and with it, a concentration of power in the wealthy. That's what we saw in 1928, and that's what we see today. At some point that power is exercised so injudiciously, and the lives of so many become so unbearable, that a period of reform ensues — and a charismatic reformer emerges to lead that renewal. In that sense, Teddy Roosevelt started the cycle of reform his cousin picked up 30 years later, as he began efforts to bust the trusts and regulate the railroads, exercise federal power over the banks and the nation's food supply, and protect America's land and wildlife, creating the modern environmental movement.

Those were the shoes — that was the historic role — that Americans elected Barack Obama to fill. The president is fond of referring to "the arc of history," paraphrasing the

Rev. Dr. Martin Luther King Jr.'s famous statement that "the arc of the moral universe is long, but it bends toward justice." But with his deep-seated aversion to conflict and his profound failure to understand bully dynamics — in which conciliation is always the wrong course of action, because bullies perceive it as weakness and just punch harder the next time — he has broken that arc and has likely bent it backward for at least a generation.

When Dr. King spoke of the great arc bending toward justice, he did not mean that we should wait for it to bend. He exhorted others to put their full weight behind it, and he gave his life speaking with a voice that cut through the blistering force of water cannons and the gnashing teeth of police dogs. He preached the gospel of nonviolence, but he knew that whether a bully hid behind a club or a poll tax, the only effective response was to face the bully down, and to make the bully show his true and repugnant face in public.

IN contrast, when faced with the greatest economic crisis, the greatest levels of economic inequality, and the greatest levels of corporate influence on politics since the Depression, Barack Obama stared into the eyes of history and chose to avert his gaze. Instead of indicting the people whose recklessness wrecked the economy, he put them in charge of it. He never explained that decision to the public — a failure in storytelling as extraordinary as the failure in judgment behind it. Had the president chosen to bend the arc of history, he would have told the public the story of the destruction wrought by the dismantling of the New Deal regulations that had protected them for more than half a century. He would have offered them a counternarrative of how to fix the problem other than the politics of appeasement, one that emphasized creating economic demand and consumer confidence by putting consumers back to work. He would have had to stare down those who had wrecked the economy, and he would have had to tolerate their hatred if not welcome it. But the arc of his temperament just didn't bend that far.

The truly decisive move that broke the arc of history was his handling of the stimulus. The public was desperate for a leader who would speak with confidence, and they were ready to follow wherever the president led. Yet instead of indicting the economic policies and principles that had just eliminated eight million jobs, in the most damaging of the tic-like gestures of compromise that have become the hallmark of his presidency — and against the advice of multiple Nobel-Prize-winning economists — he backed away from his advisers who proposed a big stimulus, and then diluted it with tax cuts that had already been shown to be inert. The result, as predicted in advance, was a half-stimulus that half-stimulated the economy. That, in turn, led the White House to feel rightly unappreciated for having saved the country from another Great Depression but in the unenviable position of having to argue a counterfactual — that something terrible might have happened had it not half-acted.

To the average American, who was still staring into the abyss, the half-stimulus did nothing but prove that Ronald Reagan was right, that government is the problem. In fact, the average American had no idea what Democrats were trying to accomplish by deficit spending because no one bothered to explain it to them with the repetition and evocative imagery that our brains require to make an idea, particularly a paradoxical one, "stick." Nor did anyone explain what health care reform was supposed to accomplish (other than the unbelievable and even more uninspiring claim that it would "bend the cost curve"), or why "credit card reform" had led to an increase in the interest rates they were already struggling to pay. Nor did anyone explain why saving the banks was such a priority, when saving the homes the banks were foreclosing didn't seem to be. All Americans knew, and all they know today, is that they're still unemployed, they're still worried about how they're going to pay their bills at the end of the month and their kids still can't get a job. And now the Republicans are chipping away at unemployment insurance, and the president is making his usual impotent verbal exhortations after bargaining it away.

What makes the "deficit debate" we just experienced seem so surreal is how divorced the conversation in Washington has been from conversations around the kitchen table everywhere else in America. Although I am a scientist by training, over the last several years, as a messaging consultant to nonprofit groups and Democratic leaders, I have studied the way voters think and feel, talking to them in plain language. At this point, I have interacted in person or virtually with more than 50,000 Americans on a range of issues, from taxes and deficits to abortion and immigration.

The average voter is far more worried about jobs than about the deficit, which few were talking about while Bush and the Republican Congress were running it up. The conventional wisdom is that Americans hate government, and if you ask the question in the abstract, people will certainly give you an earful about what government does wrong. But if you give them the choice between cutting the deficit and putting Americans back to work, it isn't even close. But it's not just jobs. Americans don't share the priorities of either party on taxes, budgets or any of the things Congress and the president have just agreed to slash — or failed to slash, like subsidies to oil companies. When it comes to tax cuts for the wealthy, Americans are united across the political spectrum, supporting a message that says, "In times like these, millionaires ought to be giving to charity, not getting it."

When pitted against a tough budget-cutting message straight from the mouth of its strongest advocates, swing voters vastly preferred a message that began, "The best way to reduce the deficit is to put Americans back to work." This statement is far more consistent with what many economists are saying publicly — and what investors

apparently believe, as evident in the nosedive the stock market took after the president and Congress "saved" the economy.

So where does that leave us?

Like most Americans, at this point, I have no idea what Barack Obama — and by extension the party he leads — believes on virtually any issue. The president tells us he prefers a "balanced" approach to deficit reduction, one that weds "revenue enhancements" (a weak way of describing popular taxes on the rich and big corporations that are evading them) with "entitlement cuts" (an equally poor choice of words that implies that people who've worked their whole lives are looking for handouts). But the law he just signed includes only the cuts. This pattern of presenting inconsistent positions with no apparent recognition of their incoherence is another hallmark of this president's storytelling. He announces in a speech on energy and climate change that we need to expand offshore oil drilling and coal production — two methods of obtaining fuels that contribute to the extreme weather Americans are now seeing. He supports a health care law that will use Medicaid to insure about 15 million more Americans and then endorses a budget plan that, through cuts to state budgets, will most likely decimate Medicaid and other essential programs for children, senior citizens and people who are vulnerable by virtue of disabilities or an economy that is getting weaker by the day. He gives a major speech on immigration reform after deporting around 800,000 immigrants in two years, a pace faster than nearly any other period in American history.

THE real conundrum is why the president seems so compelled to take both sides of every issue, encouraging voters to project whatever they want on him, and hoping they won't realize which hand is holding the rabbit. That a large section of the country views him as a socialist while many in his own party are concluding that he does not share their values speaks volumes — but not the volumes his advisers are selling: that if you make both the right and left mad, you must be doing something right.

As a practicing psychologist with more than 25 years of experience, I will resist the temptation to diagnose at a distance, but as a scientist and strategic consultant I will venture some hypotheses.

The most charitable explanation is that he and his advisers have succumbed to a view of electoral success to which many Democrats succumb — that "centrist" voters like "centrist" politicians. Unfortunately, reality is more complicated. Centrist voters prefer honest politicians who help them solve their problems. A second possibility is that he is simply not up to the task by virtue of his lack of experience and a character defect that might not have been so debilitating at some other time in history. Those of us who were bewitched by his eloquence on the campaign trail chose to ignore some disquieting

aspects of his biography: that he had accomplished very little before he ran for president, having never run a business or a state; that he had a singularly unremarkable career as a law professor, publishing nothing in 12 years at the University of Chicago other than an autobiography; and that, before joining the United States Senate, he had voted "present" (instead of "yea" or "nay") 130 times, sometimes dodging difficult issues.

A somewhat less charitable explanation is that we are a nation that is being held hostage not just by an extremist Republican Party but also by a president who either does not know what he believes or is willing to take whatever position he thinks will lead to his re-election. Perhaps those of us who were so enthralled with the magnificent story he told in “Dreams From My Father” appended a chapter at the end that wasn’t there — the chapter in which he resolves his identity and comes to know who he is and what he believes in.

Or perhaps, like so many politicians who come to Washington, he has already been consciously or unconsciously corrupted by a system that tests the souls even of people of tremendous integrity, by forcing them to dial for dollars — in the case of the modern presidency, for hundreds of millions of dollars. When he wants to be, the president is a brilliant and moving speaker, but his stories virtually always lack one element: the villain who caused the problem, who is always left out, described in impersonal terms, or described in passive voice, as if the cause of others’ misery has no agency and hence no culpability. Whether that reflects his aversion to conflict, an aversion to conflict with potential campaign donors that today cripples both parties’ ability to govern and threatens our democracy, or both, is unclear.

A final explanation is that he ran for president on two contradictory platforms: as a reformer who would clean up the system, and as a unity candidate who would transcend the lines of red and blue. He has pursued the one with which he is most comfortable given the constraints of his character, consistently choosing the message of bipartisanship over the message of confrontation.

But the arc of history does not bend toward justice through capitulation cast as compromise. It does not bend when 400 people control more of the wealth than 150 million of their fellow Americans. It does not bend when the average middle-class family has seen its income stagnate over the last 30 years while the richest 1 percent has seen its income rise astronomically. It does not bend when we cut the fixed incomes of our parents and grandparents so hedge fund managers can keep their 15 percent tax rates. It does not bend when only one side in negotiations between workers and their bosses is allowed representation. And it does not bend when, as political scientists have shown, it

is not public opinion but the opinions of the wealthy that predict the votes of the Senate. The arc of history can bend only so far before it breaks.

Consultation response

Shelter response to the HM Treasury consultation: A new approach to financial regulation: the blueprint for reform

September 2011

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Shelter

Shelter is a national campaigning charity that provides practical advice, support and innovative services to over 170,000 homeless or badly housed people a year. This work gives us direct experience of the various problems caused by the shortage of affordable housing across all tenures. Our services include:

- A national network of over 40 advice services
- Shelter's free housing advice helpline which runs from 8am–8pm
- Shelter's website (shelter.org.uk/getadvice) which provides advice online
- The Government-funded National Homelessness Advice Service, which provides specialist housing advice, training, consultancy, referral and information to other voluntary agencies, such as Citizens Advice Bureaux and members of Advice UK, who are approached by people seeking housing advice
- A number of specialist services promoting innovative solutions to particular homelessness and housing problems. These include Housing Support Services which work with formerly homeless families; the Shelter Inclusion Project, which works with families, couples and single people who are alleged to have been involved in antisocial behaviour; and, prison services providing housing advice and support to offenders which enable them to acquire and maintain suitable accommodation on release, which reduces re-offending. The aim of these services is to sustain tenancies and ensure people live successfully in the community.

We also campaign for new laws and policies – as well as more investment – to improve the lives of homeless and badly housed people, now and in the future.

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A new approach to financial regulation: the blueprint for reform

Shelter welcomes the opportunity to respond to the Treasury's consultation: A new approach to financial regulation: the blueprint for reform. We broadly welcome the government's proposals to improve financial regulation, which is of interest to Shelter because we know that poor financial regulation allowed risky mortgage lending and unfair treatment of mortgage borrowers by some lenders. This had negative consequences for individual borrowers, the housing market and the wider economy. As such, Shelter broadly welcomes the consumer protection proposals set out by the Treasury, which we believe could help to prevent the scale and the severity of the irresponsible practices we witnessed in the build up to the financial crisis.

Reckless mortgage lending saw many thousands of households lent mortgages that they had no hope of ever paying back, placing borrowers in dire financial straits. The practice of securitisation, where mortgage books were sometimes sold on to unregulated third parties who had no obligation to treat struggling borrowers fairly, led to macro-economic instability and also direct consumer detriment. We have also seen a sustained period of arrears and repossessions, partly dampened by low interest rates and increased regulatory scrutiny:

- Over 150,000 households have had their homes repossessed since 2007.[1]
- Meanwhile, new research by the Consumer Credit Counselling Service finds that 11% of all mortgage accounts are in some kind of financial distress.[2]
- Shelter commissioned YouGov polling found that 18% of homeowners are 'constantly struggling', an increase of 78% in the last year.[3]

Shelter is not directly concerned with the full range of financial services regulation; our interest lies in whether the proposed regulatory tools will prevent the conduct and prudential practice of lenders that causes direct detriment to borrowers and wider negative effects on the housing market. As such, our response to this consultation will focus on questions relating more directly to mortgage lending and consumer protector for borrowers.

Responses to individual questions

6) Do you have any views on the FCA's objectives – including its competition remit - as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?

Shelter believes that a sustainable financial system is one that starts with the best interests of consumers and the wider economy, and we are pleased that the Treasury has highlighted consumer protection as a key principle for the new regulatory framework. Consumer Focus research highlights that the overall culture of a regulator is central to the effectiveness of regulation.[4] We believe this should start with strong principles set out in legislation.

Shelter does not consider the wording of the consumer protection objectives as it stands to deliver on Ministers' ambitious vision. We believe a stronger objective, similar to Ofcom's consumer protection objective,[5] would send out a stronger message to the regulator about the necessary culture shift, and allow consumers and consumer groups to hold them to account against this objective, particularly around protection for vulnerable consumers.

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[1] Council of Mortgage Lenders, Quarterly repossession statistics
[2] Consumer Credit Counselling Service, Debt and household incomes report, 2011.
[3] Figures are from YouGov Plc. Total sample size was 2234 adults. Fieldwork was undertaken between 10-12 August 2010. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+).

[4] Fair enough? A report to Consumer Focus from the National Consumer Federation on the FSA's Treating Customers Fairly initiative. 2011.
[5] Section 3(4) of the Communications Act 2003

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7) Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?

Shelter welcomes the new powers proposed by the Treasury. In particular we support the powers to ban detrimental products and to publicise investigations into firms' practices. We believe these have the potential to be effective in stopping early detriment to consumers as well as sending out a clear message to lenders that they cannot get away with practices that causes serious detriment to consumers. If sufficiently robust, we know that naming and shaming can change culture across the financial services sector.[6]

For example, this could have prevented Sale and Rent Back products from causing significant detriment to consumers earlier, before they were brought within FSA regulation.[7] In this instance, Shelter advisers were seeing significant numbers of cases where vulnerable homeowners were facing eviction after taking out these often exploitative products, but it took two years for the FSA to bring them within their regulatory framework and a further year for sufficiently robust rules to come into play. This caused prolonged and unnecessary anguish for consumers.

We would urge the Treasury to consider whether the current proposals to only ban products within the FCA's existing regulatory framework are sufficient, and whether a fast-track process could be instigated to allow FCA to bring wholly unregulated products, such as 'Sale and Rent Back', within their regulatory framework. Shelter believes this additional power would further enshrine a more proactive approach for the regulator, and prevent similar problems occurring in the future.

8) What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

Shelter provides face-to-face and telephone housing advice to struggling homeowners, and in the last year we gave direct advice to over 4,000 households with mortgage problems. As such we consider that Shelter and other advice agencies are well-placed to identify early consumer detriment caused by risky products. Indeed, agencies such as Shelter and Citizens Advice Bureaux were quick to raise concerns about poor arrears management practice by lenders and press the FSA to clamp down. Research commissioned by Shelter has found that 44% of homeowners with housing problems sought formal advice,[8] so we believe that nominated parties should be defined widely to encapsulate all independent advice agencies in order to allow the FCA to be most effective in identifying issues early.

9) What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

It is vital this measure has teeth if it is going to act as a major disincentive to lenders to lend inappropriate products in the first place. We note that the Treasury has already made some concessions to lenders about the opportunity to appeal, and we would urge the Treasury to consider tight timescales for the FCA to come to a decision on a particular issue and agree a course of action. This would both create a disincentive for lenders and help protect consumers earlier, avoiding cases such as Sale and Rent Back products highlighted above.

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[6] Consumer Focus, 2009. Rating Regulators.

[7] 'Sale and rent back' or 'mortgage rescue' companies offer struggling homeowners the chance to stay in their homes when they can no longer afford their mortgage. The property is bought and rented back to them by the company. Before the FSA began regulation of the sector in July 2009, some companies took advantage of people's desperate circumstances by buying properties at much less than their market value, putting up rents to unreasonable levels or even evicting tenants from their own home for no reason.

[8] Shelter commissioned Professor Pascoe of University College London to investigate housing problems in England and Wales in 2011. These figures are based on interviews of 3.806 households, including 415 private renting households.

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15) Do you have any comments on the proposals for the FSCS and FOS set out in paragraphs 2.196 to 2.204 and in Chapters 3 and 4?

Shelter believes the Treasury should consider whether the valuable consumer advice on financial products provided by the Money Advice Service would be well-supported by a more sustainable framework for independent advice for borrowers who are encountering difficulties with existing products. With cuts to legal aid it will be harder for advice providers to meet the demand for independent legal advice in arrears and repossessions cases.

Early advice is the best way to save money in the long term, for lenders and the government, by agreeing early forbearance plans. We know that independent advice can prevent struggling borrowers from losing their home and that £1 of housing advice saves £2.34 for the state, while £2.98 can be saved for every £1 on debt advice.[9] Furthermore, we believe it can bolster a strong consumer protection approach by ensuring that borrowers have adequate opportunity to challenge poor practice by lenders. We therefore suggest the Treasury consider whether the levy raised by the Financial Ombudsman Service should also contribute to a national funding framework for independent advice.

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[9] Citizens Advice, Towards a business case for legal aid, 2010.

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Smaller Businesses Practitioner Panel
Financial Services Authority

September 2011

RESPONSE FROM THE SMALLER BUSINESSES PRACTITIONER PANEL OF THE FINANCIAL SERVICES AUTHORITY
TO
HM TREASURY CONSULTATION
'A NEW APPROACH TO FINANCIAL REGULATION: THE BLUEPRINT FOR REFORM' JUNE 2011

INTRODUCTION AND OVERVIEW

The Smaller Businesses Practitioner Panel represents the interests of smaller practitioners to the FSA, and is due to become a statutory body representing these interests to the FCA under the new regulatory structure. We have taken a close interest in the Government's plans for regulatory reform, as they will impact on smaller firms. The details of the Panel's remit, and its current membership is at Appendix 1.

As we have close links with the Financial Services Practitioner Panel, which is also responding to this consultation, this response focuses on those particular points which affect smaller firms. Overall, we would like to highlight the following as key issues for smaller firms:

Proportionality

We are particularly concerned to ensure that smaller firms are not overburdened with regulatory requirements which are targeted at larger firms, and yet apply to all. We have yet to see any detail of how the new regulators will adapt their requirements for smaller firms. For instance, the PRA Approach document refers to baseline supervisory monitoring for all firms. As yet there has been no recognition of the diversity of size of firms, and the needs of smaller firms in any of the Government's consultations. Smaller firms have significantly different resources and skills at their disposal than do larger firms, as well as posing a lesser systemic risk to the system, and they therefore have different regulatory needs.

Going forward, it is key to ensure that the burden/restriction of new regulations on small firms are proportionate to the benefits. This is especially important for small dual-regulated firms. We would like to see some specific reference to the regulators

adapting their requirements to firms of different sizes, and not just between mutuals and other types of firms.

We suggest that there should be a commitment to regular benchmarking of the regulatory burdens on firms in the UK compared to firms in other jurisdictions to ensure a proportionate approach. The regulator should be aware of the costs and benefits of regulation not just to firms and consumers, but also to the UK as a whole in terms of revenue generation and contribution to GDP.

Coordination
We remain unconvinced that enough has been done to ensure coordination at a day to day level between the regulators. This will be vital for the significant number of small deposit takers and insurance companies which are dual regulated, and where the burden of compliance will fall on a small number of staff.

We believe that a duty to coordinate should be in the regulatory principles, to ensure that coordination is fully incorporated into the day-to-day operations of both regulators.

Fairness and balance
It will be important that the FCA balances the views and responsibilities of both consumers and industry practitioners when framing its policies and supervising firms. Any regulator should be seen to take an unbiased approach, and not be inherently critical of the industry, as this will not enhance confidence overall.

Cost
In the Approach documents for the PRA and FCA, we have seen little reference to the cost of running these organisations and the ways in which the new regulators will be made cost-effective. In the Government's Impact Analysis in the first consultation in July 2010, it said there would be no significant additional ongoing costs for both of the new regulators after the transition costs. However, both organisations have referred to significant new initiatives in their Approach documents. There will also be additional internal costs on smaller firms who have to deal with two regulators, and we have not detected any real commitment and coordination to bear down on costs for dual regulated firms.

The Government's consultation in July 2010 also stated that firms who would remain with a single regulator were unlikely to suffer any significant transitional costs or any increase in ongoing costs as a result of these reforms. However, there are plans for the FCA to launch significant new initiatives such as new product intervention powers and development of new teams for business and market analysis and consumer engagement. These may require considerable resources, instead of building on the initiatives already launched by the FSA such as Treating Customers Fairly and the Retail Distribution Review.

We are concerned that this increase in regulation, along with other current changes in the regulatory landscape, will inevitably increase costs which could undermine the viability of many smaller financial services firms going forward. Both the Government and the regulators must guard against a situation where the drive towards financial stability puts so great a burden on firms that only the largest firms are able to survive,

as the smaller, sometimes more nimble and more attuned to specific consumers' needs, firms are unable to compete.

Practitioner representation
We are pleased that the Smaller Businesses Practitioner Panel will become a statutory Panel for the FCA as part of the proposed legislation. However, we continue to be concerned that there will not be a regular statutory forum for debate between practitioners and the PRA. We also believe that the FPC should have clear and regular dialogue with the industry, as its opinions will have a significant impact on the regulation of firms.

There are a number of key benefits for having such a Panel for the PRA:

a) A Panel of practitioners representing the wider industry would be able to recognise the *impact of regulation in one sector on another*. Specialist ad hoc groups drawn together for e.g. the purposes of giving input on regulation in the mortgage market would not appreciate the potential impact that same regulation could have in other sectors.
b) A Panel could comment on and therefore contribute to more *effective coordination between different regulatory bodies*. It could monitor how successfully they coordinate and provide feedback on an ongoing basis. This would work best with a Panel that has some overlapping membership or coordination requirements with the FCA practitioner panels.
c) A Panel would have *a 'corporate memory'* and so recognise links and repetitions over time that may not be obvious to ad hoc working groups.

We have set out our views on this in a separate briefing, jointly with the Financial Services Practitioner Panel, and this is attached at Appendix 2 to this document.

Our detailed responses to the questions posed in the White Paper published in June 2011 follow.

CONSULTATION QUESTIONS

FPC AND BANK OF ENGLAND

1. Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?

The Panel continues to believe that the FPC should have a remit to consider the health, diversity and competitiveness of the financial services sector as a whole, and not just to consider if its actions would have an adverse effect on the capacity of the financial sector to contribute to the UK economy. The proposed wording of the Bill would allow the FPC to take action which may harm niche sections of the industry, or smaller firms in general, because they might not have a significant effect on the whole UK economy. For example, if the FPC directed the PRA to take action which meant that it was no longer viable for credit unions to operate, this would not have an adverse effect on the UK economy as a whole, but would undermine a significant contributor to the diversity of the UK financial services industry.

We continue to be concerned about the accountability of the FPC and the breadth of responsibilities resting with the Governor of the Bank of England. We believe that the proposed power for HM Treasury to review the FPC's remit annually could be, at least a useful means of reviewing the workings of the FPC and how effectively it is working.

PRUDENTIAL REGULATION AUTHORITY (PRA)

4. Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?

We are pleased that the Government has introduced a more flexible approach to the objectives in allowing the PRA to focus on the specific needs of particular types of firms, and giving the authorities the tools to provide clarity to regulated firms on how they will implement their objectives. However, we are still awaiting any detail on how the PRA will deal with smaller firms within its remit. There will be more smaller firms by number than large firms who will be regulated by the PRA. So, although small firms pose much less risk to the system, it is important for there to be more clarity on how these firms will be regulated. This is particularly in light of the fact that small firms have significantly fewer skills and resources at their disposal than do large firms.

The Panel further supports the requirement for authorities to consider and consult on the impact of proposed rules on mutual societies, but believes this could go further in considering the impact of proposed rules on smaller firms overall. Recognition of diversity of ownership structure is not sufficient for the regulator – there must also be recognition of diversity in size of firm. As such, we recommend expanding this requirement to consider and consult on the impact of proposed rules on all smaller firms.

5. Do you have any comments on the detailed arrangements for the PRA described in paragraphs 2.62 to 2.78 and in Chapters 3 and 4?

Our concern about judgement-led supervision is based on the potential for it to be all encompassing, and particularly for small firms to have unlimited responsibilities towards the regulators unless there are clear guidelines in place. Smaller firms in particular need clarity on what is expected of them from the regulator. To ensure that the regulator is clear on its requirements, we suggest that should be an expectation that if there is not clarity, any decision should rule in the firm's favour.

We have been concerned that the PRA Approach document has talked about wide data sets, beyond what is normally submitted, being available for PRA supervisors to call upon at short notice. This is the kind of wide ranging requirement which is extremely difficult for smaller firms to be able to prepare for.

We are pleased that the Government has listened to the previous consultation responses and so is now proposing to leave the Tribunal's scope of review of supervisory decisions unchanged. However, we remain concerned about the limited power for the Tribunal to direct the PRA on what action to take as a result of its decision. If the PRA retains the power to re-consider in the light of the Tribunal's findings, there should still be some reference back to the Tribunal to ensure that they are satisfied with the PRA's actions.

We also believe that there should be an additional informal and confidential appeal process in the PRA. This should provide a mechanism for judgement-led supervision to be challenged, and help to provide consistency across regulatory judgements and cases.

We welcome the assurance that the NAO will be able to conduct Value for Money studies of the PRA. As firms will be funding the new regulators, it is important for us to be able to see robust and independent challenge of regulatory expenditure.

We continue to believe that there should be some kind of statutory Practitioner representation at the PRA, as well as for the FCA. We would be happy to provide some membership to a body representing all types of dual regulated practitioners, rather than a specific smaller businesses body. However we believe that the principle should be agreed that a statutory independent practitioner body, to provide regular and long term engagement with the PRA on its policy developments, its supervisory model and coordination with the other regulatory bodies, is crucial.

A detailed paper with our arguments for practitioner representation is at Appendix 2.

FINANCIAL CONDUCT AUTHORITY (FCA)

6. Do you have any views on the FCA's objectives – including its competition remit - as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?

The FCA's strategic objective of protecting and enhancing confidence in the UK financial system seems sensible. We believe it will be important that the FCA takes

an unbiased approach, and is not seen to be fostering a climate of criticism of the industry as this will not enhance confidence overall.

In addition, we believe that the FCA's operational objectives should be amended to incorporate the need to ensure or foster a diverse and competitive financial services industry in the UK. We believe that diversity in size of company stimulates a healthy market and benefits consumers. The regulator must not be allowed to introduce so many requirements that it makes it difficult for smaller firms to survive and compete. It is often smaller firms that are able to introduce the innovations that consumers want and then force the larger firms to follow suit. For instance, it was Nationwide Building Society who stood up to Barclays in 2000, to stop it charging for cash withdrawals from cashpoint machines.

We are not convinced that enough attention is being paid to consumer responsibility as a key principle of 'have regard' for the regulator. For instance, consumer responsibility was not discussed in the FCA Approach document published in July 2011. We believe there should be more consideration of how this principle will be applied in practice. Under the FSA, the role of consumer responsibility has been ambiguous: it has never been properly defined how the regulator should carry this out, beyond vague references to *caveat emptor*. The current legislation is an opportunity to set out clearly the balance between consumer protection and responsibility. If the FCA is not to be a zero-failure regime, then it must declare where the responsibilities of consumers, as well as firms, lie.

Further, the Panel would like to emphasise the importance of not losing valuable existing FSA initiatives (such as TCF) in the move to a new regulatory structure. The industry has spent a considerable amount of time and resources in implementing TCF, and so we do not wish to see the FCA developing and implementing a similar and yet different set of requirements on firms in the future.

We are also concerned that the single broad definition of consumers may encourage a "one size fits all" approach to regulation which we have fought hard to encourage the FSA to avoid unless clearly justified.

We continue to maintain that the regulators should each have the duty to coordinate set in their regulatory principles. Although there is an overall statutory duty, we believe it is the objectives and principles which will be used to guide the day to day operations of the regulators.

We believe that there are some merits in transferring responsibility for consumer credit regulation from the OFT to the FCA, and look forward to the Government's further consideration of this later in 2011.

7. Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?

The Panel recognises the benefits of the proactive regulatory approach but retains concerns around certain aspects of product intervention. Product intervention powers do not provide a simple solution: significant liabilities and pressure could build up on the FCA if the product intervention powers are not used appropriately. In cases

where either firms or consumers suffer detriment as a result of the regulator's actions, it is unclear what the regulator's liabilities and obligations would be. There should be a means to hold the regulator to account (and allow it to learn) from making the wrong decisions.

We are disappointed that there is little reference to how smaller firms will be regulated in both the Government's consultation and in the FCA Approach document. This will be all the more important as there have been indications that fewer firms will be relationship managed in the new system. Therefore, there must be an effective means both of monitoring the compliance of firms, and of providing guidance to firms on how best to comply with the regulatory requirements.

We will watch carefully to see how the FCA's new power to publicise enforcement action earlier on in the process is implemented. We appreciate that the Government has introduced more safeguards at this stage. Nevertheless, we remain concerned that this could have a negative impact on consumer confidence and may particularly damage smaller firms where their reputation can be key to their survival.

8. What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

We are interested in the proposals for nominated parties to refer to the FCA, issues that may be causing mass detriment. We believe that this may be a useful 'whistle-blowing' power for the FCA's practitioner panels, as well as for consumer bodies. It may well be that, as practitioners, we see products or practices which we do not believe are in the best interests of consumers. If such powers were put in place, the Panels could formally register concerns with the FCA, and ask the FCA to report back in public. This would enable practitioners to assist in targeting the resources of the FCA at areas of potential malpractice.

9. What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

It seems sensible to make the results of such investigations public, to enable there to be a proper and coherent debate on the issues.

However, there will need to be certain criteria given as to how mass detriment issues can be referred to the FCA. We would not like to see the FCA becoming distracted from its main task of regulating the industry overall due to its responsibility to respond to claims. Such claims must not became a way of organisations seeking publicity through unfounded claims, which then have an impact on the FCA and the relevant firms' ability to do business.

12. Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described in paragraphs 2.124 to 2.132 and in Chapters 3 and 4?

We welcome the proposed statutory roles of the four independent Panels for the FCA. However, we believe this should be balanced by some practitioner representation for the PRA, as set out in our joint briefing at Appendix 2.

PROCESSES

13. Do you have any comments on the general coordination arrangements for the PRA and FCA described in paragraphs 2.138 to 2.149 and in Chapters 3 and 4?

We are pleased that the Government agrees that a key purpose of the general duty to coordinate is to drive a culture that minimises unnecessary overlap, duplication and regulatory burden. We welcome the inclusion of a specific reference in the draft Bill of the need to use the resources of each regulator in the most efficient and economic way, and the principle that a burden or restriction which is imposed on a person, or on the carrying out of an activity should be proportionate to the benefits. This will be vital for firms, and particularly smaller regulated firms.

We would like to suggest two further enhancements to the Government's plans for ensuring coordination. Firstly, we believe that the requirement that the PRA and FCA must include an account of how they have coordinated during the year could be further enhanced by a requirement to include, or respond to, commentary from the Independent Panels (both Practitioner and Consumer) on their views as to whether coordination is effective, and any problems that have been identified.

Secondly, we continue to believe that the insertion of a duty to coordinate into the regulatory principles for each regulator would provide a reference point for coordination at a day to day level within the regulators. We are concerned that in 2.135, the Government expects that, over time, the regulators will develop their own regulatory culture and approach to engagement with firms. We believe that there must be a principle that they are constantly aware of the potential to coordinate and not to duplicate or cause confusion with potentially conflicting requests of firms.

14. Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described in paragraphs 2.150 to 2.195 and in Chapters 3 and 4?

We are pleased to see that further thought has been given to simplification and coordination of the processes for authorisation, permissions and approved persons. This is particularly important for smaller dual regulated firms, who will be able to deal with a single point of contact.

The proposals for the PRA to have some requirement to oversee firms passporting into the UK is welcomed. We are in favour of any scrutiny that is possible for those

firms who could potentially undermine overall confidence by undercutting the standards of business necessary for UK-based companies.

Although we welcome the additional requirement for impact assessment on mutuals, we are disappointed that the Government did not extend this additional requirement for all smaller firms as well.

COMPENSATION, DISPUTE RESOLUTION AND FINANCIAL EDUCATION

15. Do you have any comments on the proposals for the FSCS and FOS set out in paragraphs 2.196 to 2.204 and in Chapters 3 and 4?

We see the merits in continuing with the overall operating model for FSCS as proposed. However, we believe that the funding requirements for FSCS have the potential to cause severe problems for smaller firms who may be suddenly called on to fund significant requirements. We have been asking for further details from the FSA on the impact of the current funding requirements for the fallout out from KeyData and PPI defaults. We do not believe that the regulators can stand back and not consider the impact of FSCS levies on firms. We would like the FCA and PRA to be given a responsibility to undertake a full impact analysis when reviewing FSCS funding. In addition, it should have to consider the impact on the viability of firms of any major FSCS funding levies such as the recent levy to cover KeyData requirements.

We continue to be concerned about the lack of cost control on the set up of the Money Advice Service (MAS). We are pleased that there will be a requirement to publish its annual plan and that it will be subject to NAO audit. However, we believe there must be more public discussion of the costs and benefits of the Money Advice Service. For example, this year, the Practitioner Panels made it clear to the FSA Board that there was not enough detail and justification of the annual budget for MAS, and yet the programme has gone ahead, with funding nevertheless being demanded from industry through FSA administered levies.

APPENDIX 1

ROLE AND REMIT OF THE SMALLER BUSINESSES PRACTITIONER PANEL

1. The Smaller Businesses Practitioner Panel (SBPP) was set up by the Financial Services Authority (FSA) to represent the views and interests of smaller regulated firms and to provide advice to the FSA on its policies and strategic development of financial services regulation.

2. Our members are drawn from smaller firms operating across the main sectors of regulated business.

3. We consider several factors when deciding on the definition of “smaller” businesses and take a flexible approach to the application of criteria. A firm may have – in relative terms – a minor market share or small number of employees in the context of its industry sector. In addition, the firm’s financial position and whether the firm is owner-managed may be relevant.

4. We work to ensure that the interests of smaller financial services firms are taken into account and their importance to a healthy, successful and vibrant marketplace are properly reflected in the policies of the FSA.

5. The names of the members of the SBPP as at 1st September 2011 are as follows:

Panel Member	*Position*
Guy Matthews *Chairman*	Chief Executive, Sarasin Investment Funds
Clinton Askew	Director, Citywide Financial Partners
James Bawa	Chief Executive, Teachers' Building Society
Dick Carne	Director of Asset Management IFA Limited
Ian Dickinson	Director, The Brunsdon Group
Peter Evans	Chief Executive, Police Credit Union
Sally Laker	Managing Director, Mortgage Intelligence
Fiona McBain	Chief Executive, Scottish Friendly Assurance
Andy Smith	Risk, Governance and Compliance Director TD Wealth International
Ian Templeton	Managing Director, UIA (Insurance) Ltd
Andrew Turberville Smith	Chief Operating Officer and Finance Director, Weatherbys Bank Ltd

APPENDIX 2

Smaller Businesses Practitioner Panel

Financial Services Authority

JULY 2011

THE NEED FOR A STANDING BODY OF PRACTITIONER REPRESENTATIVES AT THE PRA

INTRODUCTION

This briefing is written on behalf of both the Practitioner Panel and Smaller Businesses Practitioner Panel, the current practitioner panels for the FSA. It is based on our knowledge and understanding of the contribution that the Panels make to regulatory policies, and we would like to contribute further to the ongoing debate concerning the need for statutory standing bodies for the proposed PRA. We recognise that these opinions might be viewed as being self serving; however, we do not believe that we have particular vested interests in the Panels continuing: members of the Practitioner Panel serve to make a personal contribution to the regulation of financial services and are unpaid (while the members of the SBPP receive only a small fee) and normally serve a maximum of two terms of three years each.

THE CURRENT PROPOSALS

The White Paper on regulatory reform published in June 2011 ("A new approach to financial regulation: the blueprint for reform") correctly distinguishes accountability (for example, to Boards/Court and Parliament) from engagement with stakeholders (for example, to Practitioners, Consumers). The White Paper is clear on the need for statutory Practitioner, Smaller Business Practitioner and Markets Panels for the FCA. However, whilst the White Paper proposes to give the PRA a statutory duty to put in place arrangements for engaging with practitioners, as drafted there will be no specification of what those arrangements might be. Therefore the arrangements would be at the discretion of the PRA and the Bank of England. The White Paper also indicated that the Government will continue to consider these arrangements in the light of further consultation and PLS.

As the current statutory practitioner panels of the FSA, we wanted to set out what our experiences indicate are the advantages of having a statutory standing body of practitioners with strong links to the FCA Practitioner Panels, possibly in the form of a statutory Panel, and also what we see as the disadvantages of not having such a forum for the PRA.

We believe that engagement with the industry at an early stage of policy development has significant benefits for regulators as well as firms. The Government has recognised this in the proposed structure for the FCA, but not in the PRA, although the reasons for the distinction are not articulated clearly and the distinction seems to us to be misguided , particularly as each body has the same policy-making functions. We believe that such a structure for industry consultation via a standing body is not relevant only to the FCA: it should also be incorporated into the set up of the PRA.

We do not accept that setting up a standing body for the PRA would increase the risk of "regulatory capture" given the powers and responsibilities of the regulators enshrined in the legislation. In this regard, we welcome the comments of Hector Sants in his speech to the PRA conference on 19 May 2011: "Avoiding regulatory capture does not mean, however, that the PRA will not engage with the firms it regulates. In particular in making its rules, the PRA should do so in full understanding of both their impact and the industry's perspective. It will accordingly set up the necessary consultation mechanisms to ensure the right people in industry are involved. Where necessary this could include standing advisory committees. Furthermore when it makes its rules it will set out their purpose in a clear and straightforward manner."

DISADVANTAGES OF NO STATUTORY STANDING BODY/PRACTITIONER PANEL

We believe that there are distinct disadvantages in not having a statutory Practitioner Panel with strong links to the FCA Panels at the PRA, even if there were to be either standing bodies or ad hoc groups gathered together for specific aspects of PRA regulation at the discretion of the PRA and the Bank. The main disadvantages of non statutory ad hoc groups or standing bodies are as follows:

- Groups drawn together for specific issues will only be focussed on that part of regulation and so may not recognise the impact that such an action may have on other aspects of the system, its interaction with other rules already in place or in prospect or the opportunities for coordination and economies of scale in implementing different changes at the same time. For example, there has recently been considerable debate about the fit between Basel III (and its requirement for banks to lengthen the maturity of their liabilities) and Solvency 2, which may make holdings of bank term debt more expensive, and hence less attractive, to insurance companies. These linkages could well be missed by two single sector groups.
- The division of regulatory issues into Conduct and Prudential at the FCA and PRA, whilst it may be a useful construct for supervisory purposes, is somewhat artificial: from the viewpoint of practitioners (and government), it is the cumulative impact of regulation that matters, especially in regard to maintaining financial stability, protecting consumers and ensuring the UK has an internationally competitive financial services industry.
- The 'corporate memory' of the Panel means that they may recognise links and repetitions that may not be obvious to ad hoc groups, and would be able to look at the impact of proposals when combined with FCA rules or proposals if there was strong linkage, or even some common membership with the FCA Panels. Although standing bodies might achieve this, we believe that a statutory basis

with a link to the FCA Panels would make the standing bodies much more effective.

- Deciding when an ad hoc body is needed or not could result in not having industry input precisely when it could be most beneficial, for example in making the case to the European Union regulatory bodies for regulations which can be properly applied in the UK, given its unique financial markets which is evidenced at the moment in the debate on maximum harmonisation of bank capital rules;
- Setting up various bodies will be time consuming and potentially inefficient. It also runs the risk of "missing the boat" insofar as engagement with EU policymaking is concerned.

REMIT OF A STATUTORY PRA STANDING BODY/PANEL IN THE NEW REGULATORY STRUCTURE

There are particular areas in the PRA's remit which would provide opportunities for engagement with a Practitioner Panel as follows:

- The PRA's future approach documents set out PRA responsibilities in regard to policy making. It says that the PRA will seek to ensure, wherever possible, that its policies and rules are straightforward, clear in intent, robust and support timely interventions. The PRA's policy documents will explain the underlying purpose of its policies and rules. And the PRA will, wherever possible, include clear statements of purpose when setting rules to ensure that firms and the market more generally understand the reasons behind the policy. All these commitments would benefit from a regular and informed dialogue with a specific group of practitioners who also have links to the FCA Panels.
- The PRA's (new) policyholder objective with regard to insurers gives the PRA a broader remit which needs to be considered and may require wider debate on the implications of proposed policy changes.
- The PRA's responsibility for designating Significant Influence Functions (SIFs) would benefit from debate with practitioners.
- The PRA will be the gateway to European and international regulation, and practitioner engagement on negotiating issues could be useful to the PRA.
- The PRA Panel could assist in providing feedback on the practitioner experience of coordination between the two regulators, particularly if it was set up with close links and some common membership with the FCA practitioner panels.

POTENTIAL REMIT REGARDING THE FPC AND BANK OF ENGLAND

The potential for engagement directly or indirectly with the FPC on financial stability issues as they impact on the PRA should also be considered. We believe this is particularly important in respect of the proposed macro-prudential policies. It can be illustrated by considering those in the interim FPC's first minutes of June 2011. The FPC made several recommendations including specific ones on banks' forbearance practices and on funding structures such as collateral swaps employed by exchange traded funds. In our view, the assessment of the impact of such policies in advance, but more importantly ensuring the implementation of such policies, would benefit from the expertise and knowledge of practitioners, especially understanding the transmission mechanisms and indirect effects, which will be crucial to their success.

In a speech at the British Bankers' Association's Annual Banking Conference on 29 June 2011, Paul Tucker (Deputy Governor for Financial Stability), talked of the broad approach of the PRA. He said that the supervisor will not "... treat firms as islands. They are part of a system. So, at the very least, supervisors will need to look laterally across peer groups of firms for oddities, and stress test firms' resilience against short-term and longer-fuse threats from the environment. They will, therefore, need to draw on market intelligence on industry trends from the Bank's Markets area; insights from the operators and overseers of the clearing, settlement and payment systems; and analysis from the finance and monetary researchers in the Bank. Conversely, the Financial Policy Committee will – and already has – drawn on briefings from the supervisors as well as the Bank's existing staff. In other words, this is going to be about making connections, pulling together a varied range of inputs. A measure of the Bank's success when prudential supervision transfers will be how well we knit them together".

We believe that "pulling together a varied range of inputs" is precisely what the FSA Panels have done over the years and that input from a standing body of senior practitioners linked also to the work of the FCA Panels, would contribute to this market intelligence and industry expertise.

ADVANTAGES TO A PRACTITIONER PANEL

We propose a single Practitioner Panel for the PRA – which would also incorporate the views of smaller firms who will be swept into regulation by the PRA. Such a Panel would have the following advantages:

1. Consideration of practical impact of policy changes

The Panel provides an overview from those who will have to implement any policy changes, and if it were also linked to the FCA Panels, would be able to give feedback in the light of FCA policy debates as well. The Panel would be able to review potential areas for misinterpretation of judgement-based regulation requirements on both sides. It would also be able to help the regulator to understand what is required to implement policy proposals successfully, whilst avoiding any unreasonably detrimental impact or unintended consequences on firms, and so assess costs versus benefits in accordance with regulatory principles. The Panel would also be able to look at how prudential requirements interact with conduct requirements from the firms' perspective and the impact on businesses and consumers more widely. We also feel that, adding smaller businesses representation into a PRA Panel would enable discussions about proportionality of application of rules and requirements across different sizes of firm.

2. Ability to review cumulative impact of PRA and FCA on firms

A vital area of concern in the new system is to see that there is effective coordination of regulatory requirements between the PRA and FCA. The PRA Panel should have a strong link to the FCA Panels to enable it to provide commentary and appropriate advice on the coordination of regulatory requirements between the two new regulators.

3. A forum with a remit to help the regulator to look ahead

With a regular forum, the members can look ahead to the impact of regulatory developments and initiate its own enquiries of the regulator if it sees a potentially

adverse impact or prudential risk. There is no wish to 'capture' regulators through this system, but to provide forward looking advice on issues to look out for. Decisions on how to use these insights are unambiguously for the regulator alone.

4. Well informed and quality membership

If the Panel is statutory, it is given an authority and credibility which enables CEO level people to be persuaded to give up valuable time to become members. Such individuals are more likely to be able to see the wood for the trees than specialists with a narrower focus. Cross sectoral membership provides a focus on effective regulation rather than the sectoral interests of trade associations, which have a separate and important place in discussions with the regulator (and incidentally seemed to support the role of a standing body of practitioners in some of their comments). The members can sign confidentiality requirements, allowing early debate on the pros and cons of new policy developments. They also build up a knowledge of regulatory policy developments through membership over a period of 3-6 years which helps them to bring regulatory perspective to the debates. In addition, individual and high level advice can be given to the regulator on specific subjects through ad hoc sub groups with Panel chairmen and members outside the formal meeting process.

5. Transparency and public accountability

Although we recognise that the Government has said that the PRA's arrangements for consulting practitioners should be transparent, it will be simpler and more practical for a regular Panel to achieve these transparency requirements: the Panel can be required to produce an annual report (as the FSA Panels do currently) and possibly report to the Treasury Select Committee on the PRA (and FCA) engagement with firms. In addition, the PRA Panel could join the FCA Panel in continuing a similar project to the Practitioner Panel's biennial survey of regulated firms which has proved a useful tool for the FSA and provides feedback on perceptions of the regulator's performance against its objectives.

6. Contribution to EU and international negotiations

Such a Panel could additionally contribute to effective EU and international representation for PRA, by providing a means of facilitating proactive and early involvement of the industry in EU developments. Panel members could provide advice on ensuring that EU rules deliver the desired objectives in as efficient and effective way as possible, such as the precise way in which stress tests are conducted, the different options to increase prudential capital or the interactions between the market structure and payment mechanisms and individual firms. Directives and regulations, even on capital and liquidity matters, include a wide range of specific measures on which industry input is extremely useful to ensure they achieve their intended effect and avoid adverse unintended consequence.

CONCLUSION

We believe that it will be crucial for the PRA to have a statutory standing panel of independent practitioners who regularly engage with the PRA in policy formulation and implementation. The group should have strong links to the FCA Panels. An alternative but less welcome structure would be for the FCA Practitioner Panels to have a remit and responsibility to look at certain prudential issues from the PRA.

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Financial Regulation Strategy
HM Treasury
1 Horse Guards Road
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Our Ref: JM/JB/4.17.2 August 22nd 2011

Dear Sir or Madam,

A NEW APPROACH TO FINANCIAL REGULATION: THE BLUEPRINT FOR REFORM

We have considered those questions in the Blueprint for Reform, which are broadly relevant to SPC Members, and set out our views below.

INTRODUCTION TO SPC

SPC is the representative body for a wide range of providers of advice and services to work-based pension schemes and to their sponsors. SPC's Members' profile is a key strength and includes accounting firms, solicitors, insurance companies, investment houses, investment performance measurers, consultants and actuaries, independent trustees and external pension administrators. SPC is the only body to focus on the whole range of pension related services across the private pensions sector, and through such a wide spread of providers of advice and services. We do not represent any particular type of provision or any one interest - body or group.

Many thousands of individuals and pension funds use the services of one or more of SPC's Members, including the overwhelming majority of the 500 largest UK pension funds. SPC's growing membership collectively employs some 15,000 people providing pension-related advice and services.

This consultation paper has been considered by SPC's Financial Services Regulation Sub-Committee which has representation from actuaries and consultants, insurance companies and lawyers

RESPONSES TO CONSULTATION QUESTIONS

Question 6: Do you have any views on the FCA's objectives – including its competition remit – as set out above and in paragraphs 2.80 to 2.90 and in chapters 3 and 4?

The objectives are broadly as we would have expected.

There is a potential conflict, which will need to be carefully managed, between the objective of promoting competition and the power to intervene in markets.

There is still no explicit reference to the prevention of financial crime, but we assume that this will be an important element in the promotion and enhancement of the integrity of the UK financial system.

Question 7: Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in chapters 3 and 4?

We welcome the recognition in paragraph 2.99 that product intervention is a complement to, and not a substitute for, regulation of the sales process.

Arguably, products are rarely intrinsically inappropriate. Problems arise when products are sold to inappropriate markets.

In principle, if there is to be product intervention, it is difficult to see how this cannot lead to pre-approval of products. Additionally, since price is a key constituent of a product, it is difficult to see how product intervention cannot lead to government involvement in difficult judgements on pricing.

In our view, the emphasis should remain on regulation of the sales and distribution process.

On disciplinary action, we maintain concerns, despite the assurances set out. In our view, there remains the risk of publicity, which needlessly damages the reputation of a firm or individual.

Question 8: What are your views on the proposal to allow nominated parties to refer to the FCA issues, which might be causing mass detriment?

We agree with the proposal.

Question 9: What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product might be causing mass detriment and its preferred course of action, and, in the case of referrals from nominated parties, to do so within a set period of time?

We agree with the proposal.

Question 10: Do you have any comments on the competition proposals for the FCA, set out in paragraphs 2.111 to 2.119 and in chapters 3 and 4?

Not at this stage. We will await the forthcoming strategy document.

Yours sincerely

John Mortimer
Secretary

Peter Sands
Group Chief Executive

Standard Chartered

8 September 2011

The Rt Hon George Osborne MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ

Dear George

Standard Chartered welcomes the latest HM Treasury consultation on the Government's financial regulatory reform (the 'Consultation'), and we continue to support your efforts to strengthen the resilience of the UK financial system and foster economic growth.

It is clear that strong, effective and independent supervision has a critical role to play in achieving and maintaining systemic stability. Successful supervision gives the management of financial institutions a valuable secondary perspective and bolsters the work of firms' risk management teams and structures. Intensive supervision also acts as an essential discipline on the industry as a whole by setting risk management standards and providing a source of challenge against any relaxation of controls or build up of risk in individual firms. In doing so, effective supervision can make a significant – and very cost effective - contribution to greater financial stability and reduce both the likelihood of individual institutions failing and the potential impact of such failures. We believe that good supervision is a shared interest and should be a shared priority for the future of the financial industry.

In this spirit, we are generally supportive of the Consultation's proposals for reinforcing supervision, including the shift towards a more judgement-led approach. However, we would emphasise that in order to be effective, a judgement-led supervisory approach must be overseen and implemented by sufficiently experienced, capable supervisors with a thorough understanding not just of the risk profiles of individual firms, but also of the industry in which they operate. This understanding should be informed by effective cross-sectoral and cross-border analysis, and needs to be premised on cooperation with other national supervisors given the international reach of many UK banks. Supervisors need to have the tools, techniques and expertise to analyse relevant information and it is critical that they have adequate staffing and resources to be able to challenge firms effectively.

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In the context of a move towards a judgement-led supervisory regime, proper appraisal of those judgements will require a robust, well resourced, independent and transparent accountability regime. To this end, we believe that the Bank of England's corporate governance regime should be aligned with the UK Code on Corporate Governance, including the provision for publicly reported external performance reviews to be conducted on a periodic basis.

It is also clear that firms will need to have proper recourse to an appeals procedure in respect of contested decisions. We therefore welcome the Government's decision to leave the Tribunal's scope of review of supervisory decisions unchanged, since we disagreed with the earlier assessment that appeals from judgement-based supervisory decisions should only be heard on the basis of a judicial review. However, we are concerned to note that the Tribunal will lose the power to overturn a decision by the Prudential Regulation Authority ("PRA") other than in the case of a disciplinary matter or one involving third-party rights. This represents a serious erosion of firms' rights to an independent review of contested decisions and we believe that it would be more appropriate for the Tribunal to retain the authority to overturn decisions with which it disagrees.

We are supportive of the principle that the PRA will not be operated on a "zero failure" basis. This sends out the correct message to the industry and removes the well-documented dangers of firms thinking they will not be allowed to fail. The same mindset should inform the approach towards supervision. Whilst effectively conducted intensive supervision is undoubtedly a good thing, it is vitally important not to dilute firms' own culture of management accountability.

We are very supportive of the move to establish a comprehensive framework for macro-prudential regulation and broadly welcome the establishment of the Financial Policy Committee ("FPC"). We would argue for a broad set of tools to be available to the FPC and a broad remit to consider all macro-prudential risks to financial stability, which should include the potential risks arising from public policy decisions. This mandate must be matched by equally comprehensive requirements for accountability, transparency and overall governance, especially given the inevitably political tradeoffs involved in decisions around balancing stability against growth. In this light, we welcome the greater oversight role that HM Treasury will have with regard to the FPC as a step in the right direction, in particular its ability to provide the FPC with specific guidance in the form of an annually reviewed and renewed remit.

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In general, we agree that a rigorous and effective regulatory framework provides a strong platform for the financial services industry's sustainable growth and success. However, in pursuing these objectives, it is vital to avoid parochialism to ensure that the cost effectiveness and cumulative impact of individual regulatory measures are carefully thought through. Given the UK's role as a leading financial centre, it is critical that the UK is aligned and engaged with the wider international agenda. In particular, it is important that the new regulatory authorities are able to influence the dialogue and policy formation within European and international circles.

We would also like to see an explicit requirement to identify and cost-justify "gold plating" of policy or implementation of European or international policy, since this has particular impact on the competitiveness of UK institutions and of the UK as a financial centre.

An important issue upon which we would welcome clarity is the territorial application of the Financial Conduct Authority's ("FCA") conduct of business rules in respect of the activities of UK banks' overseas operations. As you know, conduct rules are not subject to any global harmonizing force (such as operates, for example, in respect of macro-prudential rules via bodies such as the Basel Committee on Banking Supervision). This has meant that, save for instances such as MiFID, where EU Member States have agreed to share a common set of conduct rules, jurisdictions have tended to develop their own conduct rules more or less independently of one another. We strongly believe that each jurisdiction's conduct rules ought to be respected, and that it would be improper for the UK unilaterally to impose its own rules in another jurisdiction. The FCA's conduct remit should therefore generally be restricted to business that is conducted in or into the UK, or in compliance with relevant EU Directives such as MiFID.

I hope these comments, and the detailed responses in the attached Appendix, are helpful. I can assure you that Standard Chartered remains highly supportive of the efforts to strengthen the UK financial system. We look forward to continuing to assist this process and would be happy to expand on any of the matters raised in this response.

Yours sincerely,

Peter Sands

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Question No.	Question	SCB Response
1.	Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?	We support the proposals to give macro-prudential regulation an increased role within the UK supervisory regime, but retain some concerns about how this is to be achieved in practice. We are generally in agreement with the functions proposed for the FPC. However, we would stress the need to exercise those functions in a way that is proportionate and appropriate in the circumstances. Under the current proposals, the FPC must 'have regard' to the principle that "*a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction*". We would like to see this requirement strengthened such that the FPC has a positive general duty in the exercise of its functions to go no further than is necessary in the circumstances. There needs to be a robust governance and review process in respect of new regulations, accompanied by clear political accountability. We welcome the decision to undertake a more detailed analysis of the potential macro-prudential tools that could be used by the FPC. Our view is that many of the mechanisms that have been considered to date, such as leverage ratios, counter-cyclical capital buffers and changes to risk weighting of specific asset classes, are rather narrow in scope, operating as they do primarily through their effect on banks. Whilst such mechanisms may have a role to play, intelligence from Asia, where macro-prudential approaches have been deployed successfully for some time now, suggests there are significant advantages in more direct measures. These include Loan-To-Value ("LTV") or Loan-To–Income ("LTI") caps for specified asset classes, specific taxes, and even prohibitions of certain forms of lending. Such direct interventions can often have a greater impact, more quickly, for a lower cost than more indirect alternatives, not least because they send a more powerful message. Given the unpredictability of the challenges that the FPC will face, it would seem sensible to equip it with an appropriately broad range of potential tools, both direct and indirect. We support the decision to frame the FPC's toolkit in secondary legislation. The proposed authorisation process for the use of macro-prudential tools seems appropriate, though we would stress the need for adequate governmental oversight in respect of the FPC's recommendations and consideration of their effect. We welcome the recognition of the importance of ensuring that members of the FPC have appropriate experience and expertise, and look forward to seeing further detail of how this is to be achieved. We consider that there should be a careful review of the number of non-executive members of the FPC to ensure the correct mix of executive and non-executive members is present. Our view is that the number of external members should be higher than is envisaged under the current proposals. In addition, the skill set of the FPC, in particular the non-executive members, should be examined to ensure sufficient experience and knowledge in the relevant areas (including financial services and insurance) is available.

Question No.	Question	SCB Response
		We believe that the FPC's obligation to take proper account of the economic impact of proposed measures and of the inter-relation of monetary and fiscal policies should be strengthened. In addition, when deploying any macro-prudential tool, an impact analysis of the consequences should be undertaken in conjunction with other relevant regulatory bodies such as the PRA and FCA. In keeping with the UK's status as a global financial centre, the FPC must not only take into account constraints imposed by international law but also commit to reflect agreements reached within international and European fora. In particular, the FPC must ensure that its activities are coordinated with Financial Stability Board and the European Systemic Risk Board to ensure a level playing field and to avoid leakage.
2.	Do you have any specific views on the proposals for the Bank of England's regulation of Recognised Clearing Houses, settlement and payment systems as described in paragraphs 2.32 to 2.40 and in Chapters 3 and 4?	We do not have specific comments on this question.
3.	Do you have any comments on: • the proposed crisis management arrangements; and • the proposals for minor and technical changes to the Special Resolution Regime, as described in paragraphs 2.41 to 2.44 and in Chapters 3 and 4?	We generally welcome the arrangements for crisis management, particularly the assignment of a single lead regulator (the Bank of England) in such circumstances. Although we recognise the value of RRPs, we stress that their use is a last resort and as such has to be considered within the wider regulatory context. In particular, effective regulation, risk management, market discipline and corporate governance are the key to ensuring that they are rarely needed. An overriding principle should be that a privately owned financial institution should be able to conduct itself as a going concern (assuming it is so), in accordance with the legal obligations to its shareholders to hold capital and liquidity which should be appropriate to the risks inherent in the particular business. Well managed, international banks like Standard Chartered Bank provide a buffer for financial shocks. Our diversification across businesses and geographies provides significant strength. We are able to provide liquidity and capital into troubled markets for our customers in times of increased stress. Crisis management should be risk based recognising the "starting point" of an institution. RRPs should be high level and scenario based, setting out high level management actions. They should not be used as a vehicle for changing company structures or a move to subsidiarisation, which is an illusory benefit (as it creates other problems such as fragmentation of capital and liquidity strength, and will lead to replication of interdependencies through other means such as guarantees and indemnities). We welcome the thought leadership in this area, however it is essential there is international

Question No.	Question	SCB Response
		consistency on implementation, and the G20, FSB and Basel Committee should work towards harmonisation of relevant regulation on an international basis.
4.	Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?	Whilst we recognise and support the idea that the PRA should not attempt to operate a 'zero failure' regime, we believe that the PRA's stated objectives should be expanded to include appropriate and proportionate supervision designed to prevent firms' failure. The PRA should also have a specific duty to give due regard to the need for alignment and consistency with relevant international regulatory regimes. It is critical to ensure the principles of regulation reflect the need for efficiency, economy and effectiveness and for the PRA to utilise its resources in the most efficient and cost-effective manner. In particular, when making judgments the PRA should conduct Cost Benefit Analysis ("CBA") and only impose requirements where the evidence demonstrates that the benefits outweigh the costs. Whilst we recognise that the current approach towards CBA has become a cumbersome "box ticking" exercise, we think the right course of action is to streamline and improve the process rather than abandon it. We would also welcome the introduction of a formal review process for measuring the success of the CBA that the PRA has conducted. Outcomes should be measured at regular intervals in order to ensure that they are broadly in line with expectation. The assessment process should include the opportunity for input from consumers. In order to mitigate the threat of risks migrating outside the regulated sector, it is important that the regulatory scope of the PRA is as wide as possible. The PRA may choose to monitor firms rather than to apply detailed regulatory requirements, however it is important that the authorities have the ability to monitor activities across the financial sector to ensure risks are being effectively tracked. Such wide ranging powers are important because as new regulatory standards are applied there is a significant risk that some firms will seek to move to the other side of the regulatory perimeter and therefore it is essential that regulators are able to continue to understand the aggregate risks posed across the system, regardless of whether a firm is within or outside the perimeter. It will be important for the PRA to adopt a proportionate regime which uses market failure analysis ("MFA") and CBA to ensure that where it decides to intervene it is justified in doing so.
5.	Do you have any comments on the detailed arrangements for the PRA described in paragraphs 2.62 to 2.78 and in Chapters 3 and 4?	We are supportive of the proposed steps to reinforce supervision, including the shift to a more judgement-led approach. However, in order to be effective it is imperative that a judgement-led supervisory approach has experienced, capable supervisors who understand the business models of firms, market dynamics, the technical details of the issues, practical implementation constraints and the underlying nature of the risks involved. We remain concerned by the concentration of power within one institution overall (the Bank) and believe further thought should be given to ministerial oversight and in the Board composition to

Question No.	Question	SCB Response
		ensure effective checks and balances. In the context of a move towards a judgement-led supervisory regime, it is clear that proper appraisal of those judgements will require a robust, well resourced, independent and transparent accountability regime. We therefore believe that the Bank of England should be aligned with the UK Code on Corporate Governance, including the provision for publicly reported external performance reviews to be conducted on a periodic basis. We would also like to emphasise the importance and value of proportionality with regard to prudential oversight methods and practices. It is to be hoped that the shift to a more judgement-led approach will enhance the PRA's ability to align the form and content of its dealings with firms with the business models and risk profiles of those firms. In the past, a "one size fits all" approach to regulation has meant that firms have on occasion been subjected to unnecessarily onerous demands from the regulator. There remains a lack of clarity with regard to the precise nature of the "significant regulatory failures" that may be reported to HM Treasury and laid before Parliament. We would welcome a definition of what constitutes a "significant" regulatory failure. Further, it is essential that if firm-specific failures are to be reported, proper regard is given to the financial stability impact such disclosure might have. Indeed a convincing case can be made that firm-specific incidents should not be reported in this manner at all. The PRA should have discretion as to whether and when it chooses to report a failure, where such reporting may compromise financial stability or commercial confidentiality.
6.	Do you have any views on the FCA's objectives – including its competition remit - as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?	We welcome the Government's recognition of the role the FCA can and should play in promoting competition in the financial services sector. In view of the importance of this element, we suggest incorporating facilitating competition – between firms operating within the UK as well as between UK and non-UK firms operating in international markets - into the FCA's operational objectives explicitly rather than merely as a more general point. To facilitate full disclosure, it is crucial that firms and individuals have complete confidence that the regulators are able to safeguard the commercial and legal confidentiality of information provided by authorised persons. Consistent with this, the fifth regulatory principle should explicitly note the need to take into account commercial and legal confidentiality when making information available to public. Similarly in respect of the sixth regulatory principle, while we agree that regulators should exercise their functions transparently, such transparency should be subject to appropriate restrictions regarding commercial and legal confidentiality.
7.	Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and	The proposed product intervention power is very powerful one which should be used with appropriate caution. It is essential that a clear and consistent set of principles governing the territorial scope of the power and the circumstances under which it may be used be developed,

Question No.	Question	SCB Response
	4?	and this should be done in consultation with industry members. We would welcome further information in relation to the timing and the manner in which the FCA proposes to gather the information it requires in order to make its decisions regarding product intervention. We welcome the Government's recognition that this power could have a significant impact on firms, consumers and the market more generally, and must be appropriately safeguarded. In particular, new section 138, which requires the FCA to consult on and publish a statement of policy governing the circumstances in which it may make temporary product intervention rules and which provides that the FCA cannot immediately "renew" any temporary product intervention rules when they expire. Section 138 provides the industry with a valuable degree of certainty, and codifies the need for proportionality. As the Government has noted, the publication of warning notices may cause significant reputational damage to the firms and individuals concerned, even in cases where enforcement action is later discontinued. Such damage may not be fully remedied by the subsequent issuance of a "notice of discontinuance" and so the territorial scope of the power and the circumstances in which such notices may be issued must be absolutely clear. Fairness and proportionality will be key, and a consistent, public set of criteria should be established for use in assessing whether disclosure is appropriate. Another important issue upon which we would welcome clarity is the territorial application of the FCA's conduct of business rules in respect of the activities of UK banks' operations outside of the EEA. We strongly believe that each jurisdiction's conduct rules ought to be respected, and that it would generally be improper for the UK to import its own rules into another jurisdiction. The FCA's conduct remit should therefore be restricted to UK business (which in this context means business that is conducted in or into the UK, or in compliance with MiFID and other relevant EU Directives, where a UK branch operates in an EU Member State). The exception to this would be if a conduct issue arising outside the UK were to be regarded by the FCA as indicative of a systematic firm-wide failing with the potential to have a material negative impact on UK business. In those instances, careful consideration needs to be given to which of the new UK authorities should lead when dealing with offshore regulators so that the host regulators have clearly defined, and preferably a single point of contact in the UK regulatory framework. We believe the most appropriate point of contact in respect of large internationally active banks such as Standard Chartered to be the prudential regulator i.e. the Prudential Regulation Authority.
8.	What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?	We would welcome further clarity regarding the identity of the nominated parties prior to providing our views on this issue.
9.	What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to	If the FCA is going to publicly associate the phrase "mass detriment" with a particular product, the negative reputational consequences for its provider will be severe. This being so, a clear and consistent set of criteria must be established which set out not only exactly when the FCA would be justified in applying such a label to a product, but also when the reasons for its decision would be made public.

Question No.	Question	SCB Response
	do so within a set period of time?	We query the desirability of setting the FCA a time limit within which to respond to referrals from nominated parties. It is to be hoped that the FCA would respond to any such referrals as rapidly as was consistent with maintaining the appropriate standard. Imposing a time limit within which the process must be completed would not improve the rigour of the investigative process and there is a risk that the absence of a decision by the FCA within such a time limit could be interpreted as an approval by default.
10.	Do you have any comments on the competition proposals for the FCA set out in paragraphs 2.111 to 2.119 and in Chapters 3 and 4?	We do not have specific comments with regard to the FCA's regulatory competition powers, but are uncertain whether the OFT currently has the expertise and resources to fulfil the role envisaged for it under the proposals.
11.	Do you have any views on the proposals for markets regulation by the FCA, described in paragraphs 2.120 to 2.123 and in Chapters 3 and 4?	We welcome the Government's decision to leave the Tribunal's scope of review of supervisory decisions unchanged. However, we were concerned to note that the Tribunal will lose the power to overturn a decision by the Prudential Regulation Authority ("PRA") other than in the case of a disciplinary matter or one involving third party rights. This represents a serious erosion of firms' rights to an independent review of contested decisions and we believe that it would be more appropriate for the Tribunal to retain the authority to overturn decisions with which it disagrees.
12.	Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described in paragraphs 2.124 to 2.132 and in Chapters 3 and 4?	The governance structure of the FCA needs to be made as transparent as possible, with clear accountability, reporting lines, delegation of authority, role descriptions, terms of reference and regular reviews. In particular we would welcome greater clarity around the reporting lines, membership and linkages between each of the FPC, the FCA and the PRA. Whilst we recognise the value in the FCA's proposed obligation to investigate and report on regulatory failure, we would welcome a statement of definition as to the exact meaning of "regulatory failure" in this context. We note that both the FSB proposals and the Proactive Intervention Framework within the proposed PRA supervisory framework imply a 'grey zone' between going and gone concern with significant potential for supervisory intervention, and lack of clarity on directors' and officers' liabilities and obligations. This ambiguity entails potential for fundamental conflict which we feel has not been fully thought through in these proposals, and could in practice lead to delay or even paralysis in the implementation of recovery plans. We believe that directors' and officers' liabilities should be clarified, noting that these should be protected in law when taking actions to comply with the decisions of supervisory authorities within the 'recovery phase' (in the same manner as they are when complying with the decisions of resolution authorities during resolution). This will in essence position regulatory authorities as shadow directors. Moreover it may require the then directors of the institution to resign their roles.
13.	Do you have any comments on the general coordination arrangements for the PRA and FCA described in paragraphs 2.138 to 2.149 and in	We welcome the introduction of a specific statutory obligation for the FCA and PRA to coordinate, along with the statutory obligations regarding the existence and content of the MOU between them. We note that MOUs are repeatedly cited as a key mechanism in resolving other

Question No.	Question	SCB Response
	Chapters 3 and 4?	concerns regarding co-ordination (for example, between the FCA and the BoE). In the interests of simplicity and efficiency we would suggest that a single consolidated MOU, appropriately drafted, would be more effective than multiple MOUs covering the same issues. We would encourage this MOU to be developed as a priority, in the light of full public consultation. We would strongly support an overlap of membership between the PRA and FCA in order to help ensure there are no gaps and so that there is general oversight of each.
14.	Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described in paragraphs 2.150 to 2.195 and in Chapters 3 and 4?	To avoid duplication (e.g. in collecting information) and enhance efficiency, one regulator should be charged with the responsibility to take the lead in processing each application, seeking the consent of the other authority where appropriate. While it is reasonable for both the PRA and the FCA to have the current conditions powers (the OIVoP and VVoP powers), the two regulators should be required to exercise these powers in a coordinated way. We would welcome the establishment of a forum in which firms were able to report to regulators how effectively the regulatory teams from the various authorities were working together, and in which any concerns could be aired. There should be a lead regulator for dual-regulated firms in charge of the approval application process for all controlled functions. A mechanism should be established to ensure that the lead regulator coordinates and consults with the other regulator to ensure that the interests and objectives of the other one are duly addressed. There is significant risk of overlapping rules being developed by the PRA and the FCA and we are concerned about duplication and potential conflicts. To avoid duplication and conflicts, we believe that the two authorities should be required to jointly develop a single rule book which will help to ensure that the division of responsibilities in regulation and rule making are established and protocols are developed to deal with firms that are dual-regulated and where there are areas of overlapping responsibility. Coordination and communication between home and host regulators for internationally active banks is in need of radical improvement. There is a risk that the creation of the PRA and FCA could complicate and thereby hinder this process. For internationally active banks, careful consideration needs to be given to which of the new UK authorities should lead when dealing with offshore regulators so that the host regulators have clearly defined, and preferably a single point of contact in the UK regulatory framework. Where a firm's business is predominantly international, we think it sensible for the PRA to be the lead regulator in the international domain with the FCA feeding into the PRA on consumer protection and markets related issues. This is consistent with a view that the FCA's jurisdiction on conduct issues should generally be restricted to the UK, or where required, to the EU. We think it is important that the proposals encourage UK regulators to work together collaboratively with their counterparts overseas to assess the global risks to an international firm and to ensure

Question No.	Question	SCB Response
		that the decisions they take are consistent, harmonised and minimise duplication.
15.	Do you have any comments on the proposals for the Financial Services Compensation Scheme and Financial Ombudsman Service set out in paragraphs 2.196 to 2.204 and in Chapters 3 and 4?	We do not have specific comments on this question.

Standard Life

David Nish
Chief Executive

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Mark Hoban MP
Financial Secretary to the Treasury
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

1 September 2011

Dear Mark.

A new approach to financial regulation: the blueprint for reform

Standard Life welcomes the opportunity to respond to HM Treasury's consultation on the blueprint for reform. I want to outline our thoughts in some issues that we consider are particularly important.

As you know, Standard Life strongly supports initiatives that enable more people to save for the long term. These are vital for sustainable economic growth and the long-term well being of society. A regulatory structure that strengthens customer confidence in dealing with financial products and taking responsibility for their decisions is an important element of this.

Alongside this, we strongly support the Retail Distribution Review and other initiatives such as the Money Advice Service. These are examples of the positive regulatory steps that can be taken to achieve better outcomes for customers.

In reviewing the consultation paper we liaised closely with the Association of British Insurers and CBI, contributing to their responses.

I would like to emphasise some key points in the following areas:

Governance, accountability and coordination

Standard Life considers that the draft legislation provides appropriate details of the accountability and governance requirements. We welcome the proposed statutory requirement to have Memorandi of Understanding (MoUs) between the different regulatory bodies. We look forward to having the opportunity to review the draft MoU between the PRA and FCA to ensure that it adequately addresses the need for cooperation and coordination between the two.

Whilst the FSA and Bank of England have published documents setting out the PRA's and FCA's approach to regulation, there is a lack of information at an operational level about each body's approach. Standard Life is keen to see these details published, to gain assurance that there will be a coordinated approach in areas where overlap may occur. As a dual-regulated entity, Standard Life supports a regulatory approach that will avoid duplication of effort for the regulators and firms and promotes an efficient regulatory process.

Standard Life plc is registered in Scotland (SC286832) at Standard Life House, 30 Lothian Road, Edinburgh EH1 2DH.
Calls may be monitored and/or recorded to protect both you and us and help with our training. Call charges will vary.
www.standardlife.com
LETPLC 0211

European and international coordination

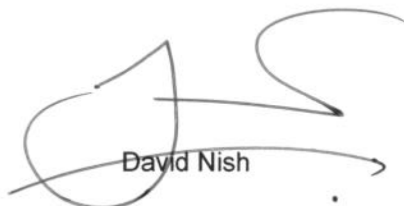
The draft legislation is very UK-focussed. Standard Life suggests the legislation acknowledges the effect of European legislation and regulatory developments on the UK's ability to develop regulations.

Regulatory staff

We consider it important that the PRA and FCA ensure they have appropriately skilled and experienced staff to deliver the required high standard of regulation. This includes having staff with the appropriate level of negotiating, influencing and technical skills to deal with European regulatory issues.

Standard Life's detailed response to the consultation paper's specific questions is attached.

Yours sincerely



David Nish

HM Treasury's consultation: a new approach to financial regulation
Standard Life's response

About Standard Life

Standard Life is a leading provider of long term savings and investments to around 6 million customers worldwide.

The Standard Life group operates across UK, Canadian and International retail markets, with corporate pensions and benefits businesses in the UK and Canada; Standard Life Investments, a global investment manager; and its Chinese and Indian Joint Venture businesses. At June 2011 the Group had total assets under administration of £200bn.

Question ref.	HM Treasury questions	Standard Life response
1	Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?	No.
2	Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems as described in paragraphs 2.32 to 2.40 and in Chapters 3 and 4?	No.
3	Do you have any comments on: • the proposed crisis management arrangements; and • the proposals for minor and technical changes to the Special Resolution Regime as described in paragraphs 2.41 to 2.44 and in Chapters 3 and 4?	No.
4	Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?	No.
5	Do you have any comments on the detailed arrangements for the PRA described in paragraphs 2.62 to 2.78 and in Chapters 3 and 4?	Regarding point 2.68, the paper acknowledges the insurance sector's request that insurance expertise should be represented on the PRA Board. However no explicit requirement has been included in the draft legislation. We suggest that the legislation provides explicit requirements for the structure of the PRA's Board to ensure all financial sectors are

Question ref.	HM Treasury questions	Standard Life response
		appropriately represented.
6	Do you have any views on the FCA's objectives – including its competition remit - as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?	No.
7	Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?	**Product Intervention** We welcome the Regulatory Principles that require the regulators to use their resources efficiently and economically and to ensure that any regulatory burden or restriction is proportionate to the benefits. We hope that the FCA will apply these principles to their use of their product intervention powers. This should ensure that customer choice and competition are not adversely affected as a consequence of inappropriate use of these powers. **Warning notices** We suggest care is taken in the use of such notices, given the risks of potential reputational damage if the FCA publishes notices about firms/individuals before deciding whether enforcement action will be taken. We hope that the FCA will use this power in a considered manner to avoid diluting the power's effect with inappropriate over-use. For example, we suggest that the power could be restricted to situations where the FCA identifies a real risk of significant customer detriment where swift action is required to warn customers of this risk to prevent further detriment.
8	What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?	We support the ability for any party to be able to refer issues concerning potential mass detriment to the FCA. This will help promote FCA's credibility as a regulator that listens to the public's concerns and responds in a timely manner. This could also help to increase customer confidence.
9	What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated	We support a process that provides clarity for customers and enables the regulator to demonstrate its ability to act promptly in cases of mass detriment.

Question ref.	HM Treasury questions	Standard Life response
	parties, to do so within a set period of time?	
10	Do you have any comments on the competition proposals for the FCA set out in paragraphs 2.111 to 2.119 and in Chapters 3 and 4?	We support measures that will promote and sustain competition within the UK financial services industry.
11	Do you have any views on the proposals for markets regulation by the FCA, described in paragraphs 2.120 to 2.123 and in Chapters 3 and 4?	No.
12	Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described in paragraphs 2.124 to 2.132 and in Chapters 3 and 4?	No.
13	Do you have any comments on the general coordination arrangements for the PRA and FCA described in paragraphs 2.138 to 2.149 and in Chapters 3 and 4?	We support the proposed statutory duty for co-operation between the PRA and FCA. Such co-operation is key to avoiding regulatory overlap (or underlap) when dealing with dual-regulated firms.
14	Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described in paragraphs 2.150 to 2.195 and in Chapters 3 and 4?	We support mechanisms that will allow joint issues to be dealt with efficiently and effectively. The proposed legislation addresses some dual-regulation issues. We suggest that the PRA and FCA produce detailed operational processes to ensure further clarity in areas of dual-regulation such as authorisation and supervision.
15	Do you have any comments on the proposals for the FSCS and FOS set out in paragraphs 2.196 to 2.204 and in Chapters 3 and 4?	No

Reference: Arrangements for Improved Financial Stability

It should be obvious that the newly proposed regulatory function will not make any significant improvements to financial stability within the UK as the regulatory function only had a small impact on the management of the financial collapse: that is to say that by the time the collapse had happened it was already too late for any type of intervention. The tripartite nature of the crisis management function was not a significant contributor to the problem and without financial structural reforms it is highly unlikely that a "one stop shopping" approach to market and participant regulation will make any difference in respect of changing the outcome of potential future events.

There is a pressing need to look at putting structural elements in place around markets and institutions that help the institutions achieve diversity of risks in a far more robust fashion than has been achieved to date.

For instance, a small change in the regulatory requirements concerning the handling of monies supporting the firm (not market) liquidity position of insurance institutions with the support of the Bank of England could bring a solidity to a firms liquidity currently beyond reach. This would be a great boost for systemic confidence in this market, for consumers and regulators alike. Such ideas should be fully explored, especially given the current continuing fragility of the global financial system.

I would be happy to discuss my proposals face-to-face and may be contacted at this email address or alternatively at the phone number below. Also my personal mobile number is 07889 979750.

Kind regards,
Paul Bates.

Paul Bates | Head of Financial Risk | Sun Life Financial of Canada | Matrix House | Basing View | Basingstoke | Hampshire | RG21 4DZ

Response to Consultation by HM Treasury

A new approach to financial regulation: the blueprint for reform

8 September 2011

About TheCityUK

1. TheCityUK is an independent membership organisation which represents the UK's financial and professional services industry. Our membership is drawn from over 250 financial and professional services firms from across the UK and includes retail and wholesale banks, insurers, asset managers, accountancy and legal firms. TheCityUK's key areas of activity include:

   - promoting the UK-based industry as a world leader offering unrivalled service and expertise to partners around the world;
   - creating a partnership for a sustainable industry: demonstrating the industry's role in enabling growth and prosperity in the wider UK economy; and
   - using research, evidence, insight, data and analysis to meet the needs of its members and to provide the evidence to support our promotional objectives.

2. TheCityUK welcomes the opportunity to respond to the Treasury's consultation. In this response, TheCityUK builds on its submissions to HM Treasury's prior consultations into the 'new approach to financial regulation'.

3. TheCityUK is primarily concerned with the international attractiveness of the UK as a place to do business and the role of the UK financial and professional services industry in facilitating growth. This response focuses on the importance of the regulatory bodies taking a balanced approach in using their new powers, and of effective coordination in the EU and further afield. This corresponds to questions 1, 4, 6, 7 and 13 in the consultation document.

Background

4. The UK has a vital national interest in the outcome of European and international financial regulation. Not only because nearly 2 million people are employed in the industry across the country, helping to make the UK the leading global exporter of financial and professional services, but because the UK sits at the crossroads of global commerce: recent Foreign Direct Investment figures showed that the UK is the leading European destination for FDI – across the globe only China and the USA hold a larger stock of FDI.

5. We should use the UK's considerable resources and expertise in financial services across government, regulatory bodies and above all in financial and professional services firms throughout the country to champion the UK's interests. We have a shared goal to shape global

financial regulation along the principles of open and competitive markets espoused by the UK and to deliver a new system of financial regulation which restores confidence in financial stability and unlocks the flow of finance which is vital to economic growth.

6. Changes to financial regulation are clearly required to address failures in financial firms and in regulatory authorities which were highlighted by the financial crisis. Protecting consumers, businesses and taxpayers from the costs of failures in financial firms is rightly the priority. A significant programme of change is already underway, and TheCityUK's members, alongside financial firms across the country, are willing partners working with policymakers and regulators to complete this programme of reform.

Balancing financial stability with economic growth

7. The new UK regulatory bodies will enjoy a wide range of new powers. Whilst it is important that they have the powers that will be required to enhance financial stability and to rebuild public confidence in the financial system, it is equally critical that the financial services sector can support economic growth: we should remember that the primary purpose of greater financial stability is to provide a platform for sustainable growth.

8. Our members believe that this need to balance the goals of financial stability and economic growth should be embedded in the objectives and governance of the new regulatory bodies.

    - The regulatory principles of the PRA and FCA should require them to assess ex-ante, and to measure ex-post, the impact of their decisions and actions on regulated firms and their customers across the economy and society. Such assessment should specifically address the impact on economic growth and employment and the sustainability of the UK as an international financial centre.

    - The governance and oversight of the new bodies should provide appropriate channels for independent challenge, particularly in the exercise of new powers such as the use of new macroprudential tools by the FPC, judgment-led regulation by the PRA and product intervention by the FCA.

    - The FPC and the Boards of Directors of the PRA and FCA should have a balance of experience from across the financial sector. The selection process for appointing members should be open and transparent.

9. We believe that balance in regulatory objectives, backed by independent challenge and oversight of regulatory approach and decisions, will lead to better outcomes for consumers and businesses across the UK, as well as maintaining the vibrancy and important economic function of the UK's financial and professional services sector.

Setting the international regulatory agenda

10. The financial services industry, the Government and UK regulatory authorities all have an important role to play in representing the UK in international discussions on financial regulation. TheCityUK's members recognise the need for the UK financial sector to engage with its international counterparts and with authorities in Europe and further afield.

11. The FSA and other UK regulatory bodies have a strong record of constructive engagement and influence in European and international bodies. The former head of the FSA's international

division now leads ESMA, the Governor of the Bank of England holds leading roles in the ESRB and on governing committees of the Bank for International Settlements (the so-called "central bankers' central bank"), and the UK enjoys senior representation at the EBA, EIOPA and the Financial Stability Board.

12. The transition to the new UK regulatory regime will change responsibilities for representing the UK in European and international committees. There will not be a perfect match between the scope of responsibilities of the new UK bodies and those of European and other international bodies, so there is a requirement for coordination between different UK bodies to effectively represent the UK's interests.

13. The proposed measures in the government's white paper and draft legislation oblige the UK regulatory bodies (HM Treasury, the Bank of England, the PRA and the FCA) to sign a statutory memorandum of understanding which should describe *"how they intend to coordinate the exercise of their relevant functions so far as they relate to membership of, or relations with, the European Supervisory Authorities, EU institutions and other international organisations."*

14. Our members believe that effective international coordination is so important to the broader UK economy as well as the financial sector, that a dedicated group or committee should be appointed to place sufficient priority, resources and responsibility into mobilising the UK's European and international representation. We note that recent comments by the IMF, in its report into the future of regulation and supervision in the UK, expressed a similar opinion. We propose the formation of an international coordination committee with specific responsibility for leading the UK's representation on European and international committees. The mandate of the committee should be to:

    - establish clear ownership and responsibility for any single issue: overlap or 'underlap' is undesirable in the UK's international representation just as in domestic regulation;

    - enable strategic objectives and the full extent of "the UK position" to be agreed in advance of EU or international negotiations, so that authority can be delegated to the UK representative to negotiate freely within the bounds of the agreed objectives; and

    - ensure that when determining international objectives Government and regulatory bodies harness the views, knowledge and skills of financial industry practitioners in the UK.

15. We would further advocate that the work of the international coordination committee should be supported by a shared international secretariat, staffed by members from the different regulatory bodies.

16. TheCityUK encourages the Government to consult further with financial services firms to make detailed proposals governing the UK's international representation and coordination. Procedures for incorporating the views of industry practitioners into the UK's strategic regulatory objectives, via market consultation, are of particular interest.

TheCityUK
September 2011

THE UKCARDS ASSOCIATION

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2 September 2011

Dear Sirs

A New Approach to Financial Regulation: the Blueprint for Reform

I am writing in response to the HM Treasury's consultation document entitled 'A new approach to financial regulation: the blueprint for reform'.

The UK Cards Association is the leading trade association for the cards industry in the UK. The Association is the industry body of financial institutions who act as card issuers and/or acquirers in the UK card payments market. It is responsible for formulating and implementing policy on non-competitive aspects of card payments. Members of The UK Cards Association account for the vast majority of debit and credit cards issued in the UK, issuing in excess of 56m credit cards and 85m debit cards, and cover the whole of the plastic transactions acquiring market.

The Association promotes co-operation between industry participants in order to progress non-competitive matters of mutual interest and seeks to inform and engage with stakeholders to advance the industry for the ultimate benefit of its members' consumer and retail customers. As an Association we are committed to delivering a card industry that is focused on improved outcomes for the customer.

Whilst the views expressed in this letter are those expressed collectively by the members of the Association, individual participants in the UK card payments market may also wish to submit their own responses to the consultation.

The UK Cards Association Limited. A company registered in England No. 7066141. Registered address as above

In responding to the consultation, The UK Cards Association considers that it is appropriate to provide some general observations regarding how we see the regulatory environment developing for retail credit products together with specific comments regarding aspects of the consultation itself which relate to the formation and role of the FCA.

Specific Comments

As an Association, we support the strategic objective of the FCA as outlined in the paper, with regard to protecting and enhancing the UK financial system. It is imperative that consumers and businesses have confidence in the financial system and, as a result, feel able to use it to the benefit of all stakeholders.

We welcome and encourage the focus on consumer outcomes. This is particularly pertinent as the industry embraces technological developments and an expanding range of delivery channels - as we believe that a channel neutral approach to regulation is appropriate (i.e. does not favour the provision of credit through one channel over any other).

The role of the FCA in promoting competition is one that we would endorse. However, we would argue that there is a role for both the markets and customer demand to play in facilitating and driving competition - this should be allowed to continue if credit is to be offered within an effectively operating and competitive market. We would argue that, for credit cards, the industry continues to exhibit a highly competitive environment through the number of participants in the market, the range of products available and targeted functionality where appropriate.

HM Treasury will recognise the significance of responsibility for consumer credit regulation to the industry and, in particular, where this will reside going forward. As an Association, we are very keen to understand what is intended and how any transfer of responsibility will be managed in such a way that the corporate memory of the current regime is not lost and that any uncertainty is minimised.

General Observations

The UK Cards Association remains supportive of the single regulator model as we believe it removes many of our concerns around matters such as multiple regulation; the risk of inconsistency; and conflict and ambiguity of the existing oversight regime, which are shared by lenders in the current consumer credit environment.

As HM Treasury will appreciate, the main focus for UK Cards Association members will be on implementing the required changes to ensure continued compliance with the regulatory framework within which credit product, including cards, are offered. As such, the industry is very keen to understand how thinking is developing as it remains unclear whether the CCA is to be repealed (in full or in part) and/or a FSMA-style approach to regulation adopted.

It must be understood that there is a significant cost and implementation lead-time in relation to regulatory change and we would encourage HM Treasury and others to ensure that it engages industry as early as possible to outline the model to be adopted so that full consideration can be given to the impact this is likely to have and the risk of indirect consequences. The Association's members require a detailed level of understanding and clarity of the changes intended to enable any planning and/or development to be initiated at organisational level. It is therefore imperative that detail is made available to industry as a matter of priority.

The impact of the cost of regulatory change, something that lenders incur on an ever increasing basis, is one that should not be under-estimated. There is a significant risk that competition could be damaged where the costs of regulatory change are such that they have a proportionately greater impact on smaller volume lenders as they do on the larger financial institutions. Ultimately, this will adversely impact on a lender's ability to continue to offer particular products and services and could, in extreme cases, lead to lenders withdrawing from this area of the market as it is no longer a viable proposition – this would be to the detriment of consumers and market competition. A proportionate and balanced approach must therefore be taken to minimise such risk.

In arriving at a model which the Government believes is appropriate, The UK Cards Association urges that consideration be given to a comprehensive gap analysis. Our concern is to ensure that there is no loss of consumer, or lender, protection and equally, that no additional or un-scoped requirements are placed on industry during the process. A gap analysis is, we believe, critical if there is any suggestion of a move away from the current legislative framework (CCA). This should also consider the risks of creating situations where any uncertainty or ambiguity might be exploited by unscrupulous Claims Management Companies.

In determining the right approach, we would encourage any potential credit regime models to be measured against the following success factors:

- a proportionate, balanced approach to regulation which recognises the responsibility of all parties;
- a focus on appropriate outcomes – we appreciate that this is an approach that is recognised by the FSA and other regulators and is also one that takes into account the multi-channel and technological environment within which credit is offered;
- building on the robust framework within which consumer credit has operated for many years and has, for the large part, operated reasonably well;
- recognition of the dynamics of consumer protection and minimising the risk of misuse of the system and exploitation of any ambiguities (e.g. by Claims Management Companies).

We would welcome the opportunity to work with HM Treasury as the regulatory structure develops.

Yours sincerely

Jacqui Tribe
Manager, Legal, Regulatory & Schemes

HM TREASURY CONSULTATION

A New Approach to Financial Regulation: the blueprint for reform

Introduction

Virgin Money appreciates the opportunity to respond to this consultation and we would like to reconfirm our overall support for the measures being taken to address the perceived weaknesses in the UK financial system, as expressed in our response dated 11 April 2011 to the earlier consultation "A new approach to financial regulation: building a stronger system".

We believe that the measures set out in this document create the framework for a more stable and effectively managed UK financial system, addressing the fundamental needs of both retail consumers and UK taxpayers. Before providing our detailed responses to the questions posed, we would like to repeat some key points:

People - We would like to re-iterate the importance of having highly skilled and competent staff to deliver successfully a more judgement led, interventionist approach in both the PRA's and FCA's areas of responsibility.

Alignment and Co-ordination - In the new, multi-regulatory approach, it will be critical that there is clear line of sight, alignment, co-ordination and co-operation by all the parties involved to ensure the delivery of the goals of financial stability, protection of confidence in the financial system, consumer protection and efficiency, choice and resilience. The co-ordination of all the UK bodies through Memorandums of Understanding and other measures will be a huge task, and failure to manage relationships successfully could jeopardise the new approach to financial regulation.

European Engagement - Adding to the internal UK co-ordination challenge is the need for successful engagement at a European level in a multi-regulator environment protecting the UK's firms and consumers as the Commission progresses both the goal of a single prudential rule book and its consumer agenda through the various European Supervisory Authorities. It is vital that the various UK bodies provide a clear and co-ordinated message in their European interactions and ensure that policy formation addresses the national needs.

Operation of the Special Resolution Regime – We urge the government to consider a two-stage approach to operation of the SRR in such a way that the immediate solution to achieve financial stability, which may often involve a large incumbent taking initial control in the short term, is then followed by a review to consider whether the solution has acted against the interests of consumers by preventing potentially smaller banks who would require longer periods to raise necessary capital and funding to acquire parts of the failing business. This form of two-stage approach would avoid losing opportunities to promote competition. It would also mitigate the risk of further compounding the "too big to fail" position of incumbent high street banks.

Consumer Credit - Consultation has been deferred on proposals for the regulation and oversight of consumer credit matters. This is an important aspect of the UK consumer regulatory landscape and, in order to get a full picture of the UK's future financial services model architecture, it is important that plans in this area are progressed promptly and embedded within the overall strategic approach that is emerging.

Competition – Given the view of the ICB and the TSC that the FCA should have a primary duty to promote competition, we are concerned that "the FCA will have a duty to discharge its general functions in a way that promotes competition, insofar as is compatible with its objectives" may not be sufficiently strong. We would prefer to see an explicit reference to competition in the FCA's strategic objective, or at least in one of its three operational objectives. Our concern is that, given the roles of the PRA and the FCA, and the fact that the PRA will have some powers to veto the decision-making ability of the FCA, competition may be subordinate to financial stability, as it seemed to be when Lloyds TSB was allowed to buy HBOS despite the view of the OFT that the transaction might lead to some lessening in competition. We welcome the proposal that the FCA should have a new mechanism to refer matters to the OFT, but would appreciate greater clarity on how this mechanism will operate after the OFT is abolished.

Answers to Specific Questions Posed

1 Do you have any specific views on the proposals for the FPC as described above and in Chapters 3 and 4?

We believe the FPC model will ensure better management and awareness of macro-prudential issues. We were impressed by the commitment to the operating model demonstrated by the level of prescription of meetings and reports as set out in the draft Bill, and noted the lack of discretion it appears to give senior officials in varying the required approach.

2 Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems as described above and in Chapters 3 and 4?

Recognised Clearing Houses, settlement and payment systems have a key role to play in the effective operation of the UK economy. Failure of many of these organisations could have a catastrophic impact on the financial system's ability to operate. Management information on settlement queues and transaction processing difficulties can often provide useful intelligence about weaknesses and emerging issues in the wider financial system. For this reason, we believe the approach of deeming the Bank of England to be the regulator of these systemically important pieces of infrastructure is likely to be appropriate, and we agree that the nature of the risks attaching to Recognised Investment Exchanges make FCA regulation the most effective option for these organisations.

In addition to the primary "appropriate" regulator model that is proposed, the Bill rightly recognises the interconnectivity of the Bank and the FCA's oversight. The contents of the required memorandum setting out interaction and specific responsibilities will be key to ensuring the effective co-ordination and operation of the separate regulators and to assist them in achieving their common objectives. While the approach is logical, it introduces a third direct supervisory involvement into the overall model. One of the themes of our response is the complex set of interactions between regulatory bodies that the new architecture will entail. As developed below, the importance of well co-ordinated and effective management of the many interfaces will be vital to the success of the new framework. The Bank will have to work closely and relatively seamlessly

with the PRA and FCA on matters of both prudential and market conduct to avoid the risk of regulatory under or over lap.

3 Do you have any comments on:

• the proposed crisis management arrangements; and

• the proposals for minor and technical changes to the Special Resolution Regime as described above and in Chapters 3 and 4?

The approach taken to crisis management appears sound. It is sensible that clarity is given regarding a) the Bank of England's responsibility to identify, plan for and implement crisis management arrangements and b) the Chancellor of the Exchequer's responsibility for decisions relating to the use of public funds and public liabilities.

With regard to the changes to the operation of the Special Resolution Regime, the specific plans that have been put in place regarding: reports on the operation of banks in temporary public ownership; the required reporting on the exercise of the private sector purchaser tool; the legal mechanisms for effecting changes in ownership; and, the specification of the need for a bank administrator to seek European Commission approval for state aid; all indicate that policy makers have considered and learnt from the experiences of the last few years.

Key to the proposals are the principles of regulatory transparency and accountability, of which Virgin Money are supportive. Again, a Memorandum of Understanding (MOU) will be vital to the successful interaction between the Treasury and the Bank of England. Both the drafting and the procedural controls around the operation of the MOU will be critical to the delivery of the financial stability objective.

One area of potential concern is, however, that the operation of the Special Resolution Regime could achieve its intended vital objective of financial stability at the expense of competition in UK banking. It is inevitable that, should the Bank of England identify the urgent need to transfer ownership of a failing institution to a better capitalised firm with more liquid assets available, the obvious solution would be to enter that arrangement with a large incumbent UK firm. While this would create an expedient outcome from a financial stability perspective, it may, as in the case of the Lloyds /HBOS merger at the peak of the financial crisis, create a situation where choice is reduced, to the future detriment of consumers. In addition, channelling deposits predominantly to incumbents could exacerbate the existing "too big to fail" problem that is a serious threat to the UK economy.

We would, therefore, urge the government to consider building into the Special Resolution scheme the concept of creating an initial "safe harbour" by transfer to a dominant institution to achieve the desired level of stability for depositors. This initial transaction, which would be borne out of the immediate need for financial stability, would then be followed by a further review undertaken to determine whether a more competitive solution can be achieved (this has in effect already happened for LBG and RBS, where the EU required certain divestments). This review period would allow smaller banks or new entrants time to develop plans for capital raising to offer an alternative solution that could, if given sufficient time, create an equivalent level of medium to long term

financial stability, engender greater competition in the market and reduce the systemic risk of compounding the existing "too big to fail" problem.

4 Do you have any comments on the objectives and scope of the PRA, as described above and in Chapters 3 and 4?

Virgin Money is supportive of the approach and scope of the PRA as set out. We do, however, feel that the specific objectives set out would benefit from further consideration in order to communicate more clearly the role and importance of the PRA to ongoing maintenance of the financial system.

The PRA's general objective is: "promoting the safety and soundness of PRA-authorised persons."

The use of the term "promoting" and not, for instance, "ensuring" is clearly intended to avoid confusing the primary responsibility for the prudent management of regulated firms, which must at all times lie with the directors and management of firms, with the separate and distinct responsibilities of the regulators. However, as expressed in our previous consultation, "promoting" does not, in our view, adequately clarify the role played by the regulator in its oversight capacity. We continue to feel a more direct objective such as *"supervising and directing approved persons in order to maintain the stability of the UK financial system"* better clarifies the regulator's intended purpose and role without detracting from the primary responsibilities of the senior management of regulated firms.

It is useful that the PRA's insurance objective is clarified, but the objective of "contributing to the securing of an appropriate degree of protection for those who are or may become policyholders appears capable, again, of being clarified. An objective of "contributing to" does not confirm the nature of the role played, and the use of "appropriate" within the rules without further clarification creates a potential for very different interpretations to be made.

We suggest that rather than "contributing to" as the overall objective, *"supervising and directing approved persons to secure an appropriate degree of protection …."* would send a stronger message. We also recommend that the rules set down some benchmarks or guidance regarding the meaning to be attributed to the term "appropriate" in this context.

The draft regulation seems to give the PRA a significant amount of discretion as to whom it consults, and the ability to set up practitioner panels as it "sees fit". These requirements seem neither specific nor onerous. We recommend that consideration be given to creating more prescription around the regulator's obligation to consult with practitioners. Additionally, as the PRA will in certain circumstances have the ability to veto the decision making ability of the FCA, it seems reasonable to either oblige the PRA to consult with consumer representatives from time to time or, alternatively, to oblige the PRA to be mindful of the representations made by the consumer panel of the FCA in the use of its veto.

5 Do you have any comments on the detailed arrangements for the PRA described above and in Chapters 3 and 4?

Much of the detailed arrangements consider the interaction between the PRA and the FCA in areas such as authorisation, granting, variation and revocation of permissions and ongoing supervision of firms. There are also requirements for both bodies to consult each other on issues such as the making of rules, the granting and withdrawal of controlled functions and in taking regulatory action against individuals and firms. The interaction between the two organisations will, therefore, clearly involve an inherent high degree of complexity, particularly when the FCA is the "appropriate" regulator for a firm with a PRA regulated firm within its group.

The risk of delay and bureaucratic complexity can be mitigated in part through a clear MOU, but the efficiency of processes will also depend on the abilities of the individuals involved. As noted in our response to the previous consultation, we believe that the recruitment, training and retention of highly qualified, competent and experienced staff will be key to the success of the new regulatory structure. In particular, the management of the relatively complex set of interactions between the PRA and FCA will create particular challenges which will require staff of a high calibre. The hiring, training and ongoing development of staff will be vital to successful deployment of the new model.

We also believe that efficiencies for both the regulators and firms would be derived if the regulators avoided duplication in processes for authorisation, permissions and approved person issues, working together where possible.

6 Do you have any views on the FCA's objectives – including its competition remit – as set out above and in Chapters 3 and 4?

The inclusion in the FCA's operational objectives of concepts such as efficiency and choice makes them simple and clear, but we note discussions between the TSC and Sir John Vickers about the FCAs single strategic objective. We note that, unlike the questions posed in respect of the PRA, there is no question that asks specifically about the scope of the FCA. As noted in our introduction, we feel that the currently open issue of the future regulation of consumer credit is a major uncertainty in the proposed framework. It seems anomalous to us that conduct of business oversight of a customer's banking relationship in terms of deposits, mortgages, current account management and, potentially, investments and insurance will rest with the FCA but, when the customer moves into overdraft or takes out an unsecured loan, the handling of that debt may be the responsibility of a separate regulatory body. Given the risks to consumers and considerable detriment that can arise from consumer credit issues, it is important that governmental plans in this area are clarified in order that a full understanding of the overall consumer regulatory framework can be achieved. It would be our recommendation that responsibilities for consumer credit oversight, at least for banks, be passed to the FCA.

7 Do you have any views on the proactive regulatory approach of the FCA, detailed above and in Chapters 3 and 4?

We are supportive of the concept of the FCA taking proactive regulatory intervention at an early stage when it identifies consumer detriment or a failure to achieve the right outcomes for consumers. As already noted, successful implementation of a judgement-led interventionist approach will require experienced and highly skilled staff who are capable of assessing matters of

fairness and making judgements that are reasonable and lead to positive outcomes for both consumers and firms. We would hope that the FCA will exercise its powers through an approach of constructive engagement with firms and other interested parties and in a way that will support trust between banks and their regulators. Positive interaction over perceived challenges and risks is more likely to lead to an informed debate that will drive better outcomes for consumers than adversarial intervention on specific issues.

It is hoped that the regulator's enhanced power to publicly censure those firms that fail to deliver financial promotions of the highest standard will be used fairly, and these powers will not be exercised without offering firms reasonable opportunities to make amends for any unintended detriment that customers may have suffered. It is also hoped that the approach will recognise the efforts of those firms that look to engage in an open and constructive manner with the regulator about potential failings identified within their organisations.

We consider it positive that the planned approach will recognise the principle of consumer responsibility. Consumer responsibility should not be used as a justification for firms failing to meet their obligations to consumers but, in order for consumers to arrive at positive outcomes regarding their purchase and use of financial services products and services, it is important that they actively seek out information from firms and think carefully about their needs and preferences before making decisions. The Money Advice Service (MAS) will have a key interdependency with the FCA to understand the type of detriment that consumers are experiencing in practice and ensure that MAS is equipping consumers with the skills to stay alert to potential risks and issues in the marketplace and the wider economic environment.

The FCA's strategy document notes the role of the Business and Markets team in analysing issues and identifying areas for intervention. This will be a vital function, which will need to have access to a wide range of information and have the skills and experience to draw the correct conclusions from the information provided.

8 What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

We are supportive of the proposal for FOS to refer issues to the FCA that may be causing mass detriment. FOS is ideally placed to identify issues of this type, and the referral mechanism should contribute to the FCA's ability to make early interventions. In addition to bringing issues of detriment to more rapid conclusion, the approach should avoid placing FOS in the place of a quasi-regulator, allowing the Ombudsman to focus on non-systemic issues of consumer fairness on a case-by-case basis.

The approach will also have the benefit of simplifying the lines of communication for firms, consumers and the regulator, and greater consistency of decision making. It should also minimise the costs involved in mass detriment issues for firms, stop detriment arising in the first place and, where redress is required, ensure that it is both paid promptly and tailored to the needs of the individual complainant.

We recommend that care is taken before recognising other nominated parties to avoid issues being put forward for consideration that allow bodies with particular vested interests to gain a platform for either their views or to promote their organisations – particularly if bodies have effectively appointed themselves as representatives of consumer interests without having an appropriate level of accountability and transparency.

9 What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

It is important that the FCA makes clear statements as early as is practical, although, before decisions are made, there should be consultation with interested parties, and representations should be possible by consumers, individual firms and industry bodies.

While it is important that action is taken to avoid the repetition of historic situations where potential detriment continued over many years, care should be taken to avoid making decisions in haste within set periods of time.

10 Do you have any comments on the competition proposals for the FCA set out above and in Chapters 3 and 4?

We appreciate the inclusion of efficiency and choice in the FCA's second operational objective, since measures of efficiency and choice give important evidence as to whether there is adequate competition, and whether it is being effective. However, measures of efficiency may not be directly comparable between banks, for example because of different business mixes (with different levels of operating costs and credit costs), or because a bank may invest in higher current costs to reduce its future credit costs. Also, there are likely to be aspects of competition which do not fall under the headings of efficiency and choice. For example, banks offered personal loans with low prices, which could easily be compared with the prices offered by other providers, and hoped to cross-sell profitable PPI, where it was not easy for consumers to assess the fairness of the price. For loans and PPI together, there may have been plenty of choice, and reasonable overall efficiency.

We would prefer the strategic objective of the FCA to be restated to include a specific reference to competition. Whether or not competition is mentioned in the FCA's strategic objective, or at least in its second operational objective (with efficiency and choice being important aspects of competition), we are concerned that the current plan that "the FCA will have a duty to discharge its general functions in a way that promotes competition, insofar as it is compatible with its objectives" could leave the possibility that competition will be subordinated to financial stability, as it was in the decision to allow the proposed acquisition of HBOS by Lloyds TSB to go ahead despite OFT reservations, or to maximising value, as it was in the sale of RBS retail banking assets to Santander, which the TSC has described as a "missed opportunity" to create greater competition.

We agree that the FCA should focus on the promotion of greater transparency and easier switching, as suggested by the TSC and the ICB. We support the proposal that the FCA should have the power to initiate an enhanced referral to the OFT, with the OFT having a duty to respond within 90 days.

However, it is not clear what body will take on this responsibility if, as intended, the OFT is abolished. There has been great value in the comprehensive market studies carried out by the OFT, and in the OFT's input on relevant issues before decisions to refer matters to the Competition Commission. We believe that there is a case for considering whether, as has been suggested, a Financial Competition Commission should be established in the FCA when the OFT is abolished. One immediate benefit is that carrying out market studies would give the FCA deep knowledge of banking product markets. Another benefit is that is would support the ability of the FCA to scrutinise the regulation of financial services from a competition point of view, after the OFT is abolished.

We note the comments in the FSA paper on the FCA, that, although the FCA will not be an economic regulator, it will "be interested in prices". While understanding the FSA's powers on pricing in certain specific circumstances such as the requirement not to charge customers amounts in excess of cost for the administration of mortgage arrears and the planned requirement that an adviser charge covers the true cost of providing an investment advisory service, we have some general comments relating to the regulation of prices:

- As mentioned above in relation to cost:income ratios, prices of banking products do not necessarily reflect operating costs, because of the substantial amounts of credit and liquidity risks, and the variability of these risks over different economic circumstances.
- As in the example of PPI above, or the example of insufficient funds charges on PCAs, it seems better to assess products as a whole rather than to tackle individual elements in a piecemeal manner.
- As the Treasury paper on simple financial products observed, price caps on financial products had unintended consequences, in that they reduced the willingness of providers to promote price-capped products, and so limited their availability for consumers. Also, it is widely believed that, when price controls were imposed in SME banking about ten years ago, they discouraged new entrants and restricted competition. We suggest that any powers to impose price controls should only be used in exceptional circumstances.
- We believe that it is much better to support factors which encourage competition, such as by encouraging greater transparency and easier switching, than to treat the symptoms of inadequate or ineffective competition by imposing price controls.

11 Do you have any views on the proposals for markets regulation by the FCA, described above and in Chapters 3 and 4?

Given its responsibilities for financial crime, including market abuse and consumer regulation, the FCA is the obvious regulator to have responsibility for market regulation. The regulator's relationship with the Bank of England, which will be looking after systemically important infrastructure such as recognised clearing houses, will be important, as will the engagement with overseas regulators, particularly with respect to financial crime matters.

12 Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described above and in Chapters 3 and 4?

The arrangements in respect of these areas for the FCA appear satisfactory and to have been carefully considered. A reasonable balance has been struck between the requirements to operate in an accountable and open manner and the risk of creating excessive bureaucracy and consequent inefficiency in the regulator's operation.

We believe that the creation of a SME panel to supplement the existing set of consultative forums is a sensible additional step to ensure that the particular perspective and interests of that important customer group are adequately understood and considered.

13 Do you have any comments on the general co-ordination arrangements for the PRA and FCA described above and in Chapters 3 and 4?

As noted above, successful co-ordination between the two entities will be vital, as will the interaction with relevant UK bodies such as the Bank of England, FOS and the Money Advice Service. The government is urged to ensure that there are mechanisms that create incentives for the two bodies to co-operate and support each other's objectives to arrive at optimal outcomes for the UK's economy and consumers.

If these mechanisms are not successfully managed, as well as the risk of sub-optimal outcomes in the UK financial services market, there could also be harm to the UK's interest at a European level.

These proposals represent a major change to the architecture and approach to financial regulation in the UK. We urge the government to undertake a formal and open evaluation of the effective working of the system after a year, and every three years after that, to consider whether any modifications or enhancements are required.

14 Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described above and in Chapters 3 and 4?

As noted earlier in the response, we believe that it would be to both regulators' and firms' benefit to avoid duplicating administrative processes such as approved persons, change of controller and regulatory reporting functions. We suggest that it might be helpful to all parties if the PRA and FCA were to identify areas where it would be beneficial for them to work together and avoid situations arising where firms would have to engage in separate interactions with the two regulators. This approach should achieve efficiencies for both firms and regulators.

Financial Regulation Strategy
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ

The comments made are in a personal capacity drawn upon my experience serving on the Council of Lloyd's and on the Lloyd's Taskforce of 1991 and also on behalf of Besso Insurance Group Ltd which is an SME owning a Lloyd's insurance broking firm with 180 employees generating $0.5bn of premiums annually of overseas business into the London Market.

Please accept these views as being specialist by nature; they specifically relate to the prospective regulation by the FCA in respect of an insurance or reinsurance 'wholesale' broker operating in the London Market as a 'generic sector focused' category and where the customer is not 'retail' and where the placement originates from outside the UK.

Consequently, I refrain in commenting on other similar businesses and the essential main thrust of the new regulatory objectives / framework in areas such as systemic risk and consumer protection.

The intention is to be both respectful and supportive of the new regulatory principles set out in the blueprint for reform dated June 2011 and the general objective of maintaining the UK's ability to regulate to the highest international standards.

May I offer the following comments:

It would seem more appropriate to **house the regulation of wholesale Lloyd's brokers under the PRA rather than under the FCA**; in common with the regulation of Lloyd's itself by the PRA. There is likely to be a much greater understanding of the business transacted and the nature of regulation necessary – might this still be considered ? However, I will address my comments towards the FCA as proposed.

I would suggest that **there needs to be a greater 'regulation of the Regulator'** to ensure that fairness is achieved in dealing with the regulated. For each generic business area regulated it would be beneficial if there were an **independent appeals panel** with the power to direct the regulator if it's actions prove to be disproportionate or incorrect – and with the obligation by the **FCA to compensate** the regulated if complaints are upheld.

It has been correctly stated that **rules should be appropriate within the FCA for each 'generic sector' regulated and not a 'one rule fits all' approach** (In particular, I refer to 'Section 166' notices where there is no accountability for such requests nor compensation of costs of the regulated; accounting rules within the international insurance business which require a bespoke approach and inappropriate use of the TC4 rules are examples in this sector.) And so it is really important for the FCA to **develop expert internal teams with generic specialist remits** as seems to be envisaged although with no detail at this stage. In turn, they would interact with the independent appeals panel, as above.

In turn, such a structure with strong checks and balances will give confidence to the regulated and enable a culture of partnership to achieve excellence of standards that HMG seeks.

It would seem reasonable to propose that **the FCA should not be able to take Enforcement actions without fully explaining it's position, providing due notice of it's intentions and providing an appropriate mechanism for the regulated entity (such as the panel) to challenge any proposed action under *normal* circumstances.** It should be *'exceptional'* not to follow this procedure (for example, in cases of suspected fraud etc). Further, it would be fairer if the FCA were not permitted to make public any investigation or action during any normal process.

I think it **misguided to fine an entity *purely* on the grounds that, in the view of the regulator, inadequate systems and controls were not in place** - unless prior written notice about what should be in place had been previously given. It would be better, and **should be, based upon *actual* failures or wrong doing**. If a culture of co-operation is to be cultivated then the relationship between the regulator and the regulated needs to be a two way street with the same objectives of high standards. The regulated should not fear open discussion or recommendation in order to improve systems and controls.

The FCA will **need to define much more clearly what it means by 'encouraging competition'**. Ironically, it is the weight of regulation that is actually reducing competition by favouring larger companies – as the smaller competing firms become uneconomic. My earlier comments above protect the smaller companies and therefore underpin the number of entities operating – and competition. My view is that it is an **inappropriate objective for the FCA to ensure there is competition in the supply or pricing of an insurance or reinsurance contract within the 'London Market'** which is highly competitive and complex - where there is also a subscription market placement.

The number and amounts of **fines levied against regulated firms should surely be seen as a failure not as a success** – and the regulator should not retain any fines or have staff remunerated against such measure ? Otherwise this presents a conflict of interest and an inappropriate relationship to the cultural objective of co-operative regulation. It has been suggested, and not denied, that the FSA sets internal targets for fine generation and also for number of S166 notices issued – if true, hardly the basis of an appropriate culture for a regulator ?

It would be of great advantage **if it were possible to approach the regulator and seek a binding agreement** on handling particular aspects being regulated in respect of this generic area of business. For example, in dealing with individuals or firms overseas which are often in the Middle East, Africa, Asia, South America. The Anti-Bribery Act places a serious burden of uncertainty upon firms wishing to trade with overseas firms or individuals in these territories if coupled with the current regulatory approach adopted by the FSA. My view is that the regulated should be working with the regulator to examine how to deal with these complex tasks in a constructive culture – can we introduce / examine some process if this principle were adopted ?

As has been stated within the documents, it is essential that staff employed by the regulator are experienced personnel and that longevity of employment is achieved for good regulators; failure to retain staff becomes hugely wasteful for the regulated too.

In conclusion, the establishment of a generic specialist business assessment board to regulate the regulator would address many of the issues and concerns raised here; it would 'partner' an equivalent generic specialist unit within the FCA. The objectives would be to achieve the

highest standards of regulation whilst also recognising the practical realities of generating overseas business into London, the nature of wholesale activity in this respect and, above all, proportionality to the issues it addresses. In this way, it will be possible to be excited and embracing in the function of regulated wholesale insurance and reinsurance brokers and their value in helping the UK in its quest to deliver an export led recovery for the Economy.

Michael J Wade

Chairman
Besso Insurance Group Ltd
8 - 11 Crescent, London, EC3N 2LY

Dear Sirs,

Thank you for sharing with me your 400 odd page document regarding the proposed legislation covering banking regulation.

I'm sure you will not be surprised when I tell you that, as a retired banker who lives outside of the UK, I have little interest in reading this document. What I am interested in, though, is ensuring that full confidence in the UK financial system is restored to the benefit of all the people in the world.

I would therefore like to make the following points:

1.) As a saver and not a borrower, I am interested in ensuring that the crazy policies of the past (such as 130% mortgages, and giving customers overdraft facilities which they have not requested) are discouraged, even outlawed, and that banks are run and managed properly by appropriately qualified staff. For senior staff members, the final exam of the Institute of Bankers should be the minimum qualification. From my vantage point, it seems to me that most banks are run by lunatic cowboy salesmen masquerading as bankers!

2.) For any system to work, the public also has to have full confidence that any problem within the system is addressed without undue delay. I would think that the UK is no different to any other financial system, and that complaints are an exception rather than the rule. (Perhaps less than 1% of all transactions?) So in the case of the FSCS, this business of giving answers, such as the ones below, is thus totally out of order.

"In order to establish whether or not the firm has the ability to satisfy claims made against it, we have to undertake detailed enquiries and investigations. etc etc. THIS PART OF THE PROCESS MAY TAKE SEVERAL MONTHS. If we are satisfied that the firm cannot meet your claim, we will move to the next stage of our assessment, to consider whether your claim is ELIGIBLE to receive compensation under OUR RULES. (Surely this is the FIRST step that should be taken??) This part of the process generally takes AROUND 6 MONTHS. Finally, once we have established that your claim is eligible under our rules, we will assess whether any compensation is payable to you. You should be aware that sometimes claims fall outside the scope of OUR RULES and when this happens we are unable to pay compensation. We will write to you to let you know the outcome of our work." (No timescale given and my capitals.)

To have small claims such as mine clogging up the system for upwards of one year or more is frankly ridiculous. What you need is a transparent system that addresses problems quickly, not the long drawn-out affair that I

have been subjected to. You also have to give proper reasons, not the lies that this august institution has tried to foist on me!

But once you have submitted an appeal, it seems the system suddenly miraculously changes to:

" A manager will then reassess your claim. We'll aim to tell you the outcome of their review WITHIN 15 WORKING DAYS." Of course this hasn't happened yet, (I was told this on 23 May, 2011 and four weeks has since passed), but I like the thought. This kind of response should be encouraged throughout the system, as depositors are the life blood of the system and not a nuisance.

3.) All stakeholders need to know the so-called "RULES"; why is it a big secret? In this global village, more and more members of the public are relying on British financial institutions. I can understand the reason why you may not want to extend cover to every depositor/investor using a British institution, but certainly cover should include all British subjects living within the European Union. To say that business conducted in Spain is "OVERSEAS" business and is thus not covered by the FSA, is ingenuous to say the least. This must surely be a policy borrowed from Robert Muagbe!

I hope that the points above I have made will be taken into consideration when enacting the legislation.

Yours sincerely,

A J WATERS

CAIB (SA) AIB (Z)

which ?

A new approach to financial regulation: a blueprint for reform

DATE: 8 September 2011

FROM: Dominic Lindley, Which?; Tori Henderson, Which?

EXECUTIVE SUMMARY

1. We welcome the draft Financial Services Bill and the proposed reforms which will involve a fundamental shift in approach to consumer protection and prudential regulation. The draft Bill contains many commendable proposals to deliver improvements for consumers and to create a more open, transparent and accountable conduct regulator. We strongly support the presumption of transparency, an increased role in promoting effective competition and the product intervention and financial promotion powers. However, we believe that it is necessary to make a number of changes to the Bill to hard-wire the new proactive approach and regulatory culture into the way the FCA operates. These include changes to the strategic and operational objectives and reforms to ensure a more diverse and accountable board and a tougher approach to enforcement. The introduction of a super-complaint power allowing nominated groups to highlight areas of consumer detriment and requiring the FCA to report back in 90 days would also be beneficial.

2. The PRA is being given responsibility for conduct regulation of with-profits funds which contain £330 billion of assets backing 25 million policies. The insurance objective of the PRA needs to be changed so that it has a clear remit to protect policyholders. It should be given an overarching duty to discharge its functions in a way which promotes competition. Whilst we reluctantly accept the need for the PRA to veto an FCA action, we are clear that the veto should be seen as a regulator failure and trigger an independent inquiry. It is vital that the concept of too-big-to-fail does not become extended to too-big-to-be-forced-to-treat-your-customers-fairly. Given the impact of its action on consumers the PRA should be required to maintain, consult and consider representations from a consumer panel.

Financial Conduct Authority

3. The ultimate purpose of regulation is to ensure that markets work well for consumers. We welcome the intention to place appropriate consumer outcomes at the centre of the regulatory process and for the FCA to use early and proactive intervention to ensure that the interests of retail customers are protected. In order to achieve this aim we believe the following measures should be adopted.

- The strategic objective should read "Ensuring a fair and transparent market in

financial services". The current wording of the strategic objective, with its focus on confidence, could discourage the regulator from publicising poor practice or drawing attention to areas where markets are not working well for consumers.

- We support the operational objective to secure the appropriate degree of protection for consumers. The requirement to 'have regard' to consumers need for information should be amended to recognise consumers need for information which is timely, accurate, intelligible to them and appropriately presented". There also needs to be an express requirement for the FCA to have regard to the potential scale of consumer detriment.

- Amendments are needed to the 'efficiency and choice' objective to give a clear definition of choice. This should include the ease with which consumers may obtain appropriate products at competitive prices and the ease with which consumers may discriminate between products which represent good and poor value for money.

- We welcome the duty for the FCA to discharge its general function in a way which promotes competition. Designated bodies such as Which? should be given the ability to make super complaints to the FCA. The regulator should have the power to tackle unfair ancillary / default charges which distort competition such as those on unauthorised overdrafts. To ensure that it uses its powers to promote competition the FCA should ask an independent person to review its performance.

- There is a significant imbalance in the regulatory principles between the responsibilities of consumers and of firms. The concept of consumer responsibility should not be extended beyond the common law principles. We would oppose any attempts by those in the industry to argue for a responsibility to be imposed on consumers to understand long and complex disclosure documents.

- The Board should contain a number of individuals with experience and knowledge of consumer issues.

- The FCA should have the power to regulate products and to take immediate action to prohibit the sale of a particular product or to control a particular product feature. It is important that the FCA is able to take prompt action so we support the product intervention powers.

- Proper accountability can only come alongside improved transparency, so it is very important that the legislation does not constrain the FCA. Section 348 of

FSMA must be amended so it does not constrain the regulator from publishing information which would help promote consumer protection.

- The FCA should take a stronger approach to enforcement with higher financial penalties and action against senior management. A portion of the revenue raised from financial penalties can be used in ways which benefit consumers (such as funding increased access to debt advice and measures to improve financial capability) rather than being returned to firms.

- The FCA should tackle the root causes of consumer detriment such as remuneration structures which encourage mis-selling. It should make greater use of market testing and mystery shopping to test the actual outcomes being received by consumers.

Coordination between the FCA, PRA and FPC

4. Splitting responsibility between three different regulators does not remove the conflicts which can exist between different functions, but merely externalises them. To permit the PRA to prevent the FCA taking a firm-specific conduct decision sends a dangerous message to the industry that only firms which are small enough to fail without causing damage to financial stability will be forced to bear the full consequences of mistreating consumers. Whilst we reluctantly accept the need for the PRA to veto an FCA action, we are clear that the veto should be seen as a regulator failure and trigger an independent inquiry. The PRA does not currently have a specific duty to promote competition and we believe that this raises the risks of it preserving existing banks rather than allowing them to face the consequences of their commercial decisions.

5. We strongly object to the proposal to give the PRA the responsibility for specific regulatory duties connected with Part VII applications. In our experience, Part VII transfers involving with-profits funds have led to substantial consumer detriment with policyholders losing out on billions of pounds. Transferring responsibility to the PRA would be a serious mistake which risks a further deterioration in the regulators already woeful performance.

Prudential Regulatory Authority

6. The PRA's insurance objective should be changed to give it a clear remit to protect policyholders. The objective should be "securing an appropriate degree of protection" for policyholders rather than merely "contributing to the securing of an appropriate degree of protection". We agree with our lawyer that drafting a statutory objective as merely "contributing to the desired outcome seems a virtual licence for

failing to take a leading role and/or passing the buck if the objective is not met."

7. We are very concerned about the decision to place certain aspects of the regulation of with-profits policies with the PRA. The PRA lacks the remit and culture to take the proactive approach to consumer protection which is needed for with-profits policyholders. The Bill also proposes to reintroduce the concept of 'Policyholders Reasonable Expectations'. This was a flawed regulatory concept which relied on the interpretation of actuaries and was at the heart of the problems at Equitable Life. The regulatory framework for with-profits policies must focus on the fair treatment of policyholders.

8. We recommend that the PRA be given a specific duty to discharge its functions in a way which promotes competition. This would help ensure that its focus on not preserving existing institutions, but creating a market where individual institutions face a realistic prospect of failure.

9. The PRA will be making a significant number of decisions which will have dramatic implications for consumers. It is vital that the PRA establishes mechanisms to ensure that consumer interests are appropriately represented in its governance structure. We recommend that the PRA should receive input from a Consumer Panel and that the Panel should have the power to make representations to the PRA and gain a written response to its representations. The PRA's general duty to consult should require it to consult consumers.

Macro-prudential regulation (Financial Policy Committee)

10. The potential impact on consumers of the different macro-prudential tools should be studied by the Treasury and an assessment of the impact included in the FPC's policy statements. The FPC should ask the Consumer Panel to approve its analysis of the potential impact on consumers.

Financial Conduct Authority

11. Which? sees the impact of poor financial regulation across numerous areas of our work. Our mystery shopping frequently reveals unacceptable standards in financial services, our money research team comes across numerous badly designed products, and our money helpline hears from a plethora of people who've suffered financially and emotionally as a result of these poor products and services. Because of this we have worked closely with the Financial Services Authority (FSA) on numerous issues since its creation. This has given us insight into the way in which the regulator works, and clearly showed us that their approach to regulation did not deliver for consumers.

12. While the failures of the FSA in the prudential sphere in the run-up to the financial crisis have been much documented, it should not be forgotten that there were also serious flaws in conduct of business regulation over the past ten years. There have been numerous areas in which the FSA's regulatory approach has failed to ensure consumer protection: the endemic mis-selling of payment protection insurance, long delays in properly resolving complaints about endowment mortgages, mis-selling of precipice bonds and structured products, the proliferation of poor quality financial advice and the introduction of poor affordability assessments for mortgages all occurred under its watch. Indeed, in our review of the regulator in February 2007 Which? concluded "the FSA still has to do considerably more to ensure consumers are properly protected and to ensure the industry genuinely treats its customers fairly"

13. Our research supports this view and shows that consumers believe that the FSA does an important job in principle and practice, but does so imperfectly. Criticism focuses on the fact that consumers believe that the FSA isn't powerful or sophisticated enough to control providers, or is too close to those it regulates.

Consumer views on the FSA

"I think the FSA wait for people's responses. I don't think they investigate something before it comes on the market, only after it has gone wrong"

"I think the problem with the FSA is that they are trying to regulate an industry which has the means to hire much cleverer people than it can, so they are always ten steps behind what the industry is doing, especially investment banks."

"The people in the FSA are the same people who used to be bankers. They're from the same school"

"They're too close to the industry. The industry can get away with anything"

14. As a result we have welcomed the changes the FSA have made to their approach since the crisis, including an increasing pro-activeness and a greater willingness to tackle the root causes of consumer detriment. We also support the commitment the Government has made to putting the consumer at the heart of the regulatory system and ensuring the FCA has the tools and powers it needs to secure protection for consumers. Our key focus during the passage of the legislation will be to ensure these changes are hard-wired into the new system so consumers receive the protection they deserve.

6 Do you have any views on the FCA's objectives – including its competition remit - as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?

15. We welcome the intention that the FCA will involve a "fundamental shift in approach" which will use early and proactive intervention to ensure that the interests of retail customers are protected. The ultimate purpose of regulation is to ensure that markets work in the interests of consumers so we also warmly welcome the statement that it will be a 'consumer champion' in the sense of putting appropriate consumer outcomes at the centre of the regulatory process.

16. It is vital that the powers in the new Bill support the new proactive approach to regulation which will tackle the root causes of consumer detriment. We are extremely concerned that the draft Bill does not go far enough to ensure a new regulatory culture and a more proactive approach to regulation. We believe the legislation, as currently drafted, gives the FCA too much leeway to determine its approach to regulation. Under FSMA the FSA was able to swerve from the light-touch approach of its early years to its current, more proactive, approach and we are concerned that under the new legislation the FCA will be able to do the opposite. As a result we would like to see changes made that would ensure the Government and Parliament's intentions are hard-wired into the way the FCA operates. We believe a series of amendments could be made to the objective and powers of the FCA that would help, in a sense, to legislate for the culture of the organisation.

17. As noted over the course of many years by Which? the FSA took an approach that was too reactive and failed to put in place the right incentives for firms, make competition work for consumers or ensure that there was a credible deterrent against poor practice. Instead of tackling the root causes of consumer detriment, the regulator sought to control the sales process. It did not focus on (or indeed do much to measure) the outcomes received by consumers. There was an emphasis on disclosure of information, rather than ensuring that consumers could understand and act on this information. Indeed, the volume of information provided could deter consumers from using it effectively. The previous approach led to a number of major

problems surrounding issues like Payment Protection Insurance (PPI), precipice bonds, endowment mortgages and bank charges. These failures cost consumers and the industry billions of pounds and damaged consumer confidence.

18. The FCA should work to ensure that market forces can work more effectively in the financial services market so that companies which treat their customers fairly and offer good value for money products gain business at the expense of firms which do not. Similarly, it must be made clear to firms, their management and shareholders that a failure to treat customers fairly will have a significant detrimental effect on the firm's reputation and bottom line. It is important that the FCA is given the mandate, powers and tools to deliver improvements for consumers by implementing a more proactive approach which tackles the root causes of consumer detriment.

Strategic objective

19. In order to ensure the FCA takes a more proactive approach, we believe it is necessary to amend its proposed strategic objective. This objective will be vital in conditioning the approach the regulator will take and thus it is essential that the legislation gets this right. We do not believe the current drafting of "protecting and enhancing confidence in the UK financial system" sets the right tone for a regulator which is intended to take a proactive approach and place the consumer at the heart of the regulatory system. As John Kay noted in a recent comment piece on the Government's plan, the stated objective is more appropriate as the duty of a trade association not a regulator:

> *"The mission of the Medicines and Healthcare Regulatory Agency is to "enhance and safeguard the health of the public by ensuring that medicines and medical devices work, and are acceptably safe". If the MHRA is successful in that endeavour, the public is likely to have confidence in the healthcare system. But it is that way round. "Protecting and enhancing confidence in the pharmaceutical industry" is the duty, not of its regulator, but its trade association. "*[1]

20. This strategic objective sends the message that the regulator is more concerned about the perception of confidence than the reality of protection and will do nothing to convince consumers that their interests will be protected. We also have concerns about the unintended consequences that could result from the current proposed primary objective. For example, if the regulator is tasked with promoting confidence, it could be discouraged from publicising bad practice or drawing attention to areas where markets are not working properly for consumers. This would clearly hinder its

[1] "A flawed approach to better consumer protection", John Kay, Financial Times, 28/06/2011

willingness and ability to adopt proactive approach to consumer protection. As a result we strongly believe the Government should reconsider the objective it has set out. We would recommend the strategic objective for the FCA should be of "ensuring a fair and transparent market in financial services". If the Government believes that a reference to confidence is important then the strategic objective should be of "ensuring a fair and transparent market in financial services which justifies enhanced confidence".

Operational objectives

Consumer protection

21. In relation to the consumer protection objective we welcome the 'have regard' which deals with consumers' need for information, but believe this could be better worded to achieve the desired outcome. In the past there has been an emphasis on disclosure of information rather than ensuring that consumers could understand and act on this information. The current draft only includes the term 'accurate' information. We would note that information may be 'accurate' without being practical use to the majority of consumers if it is too complicated, technical or voluminous. We suggest an amendment to recognise consumers' need 'for information which is timely, accurate, intelligible to them and appropriately presented'.

22. We are also concerned that the consumer protection objective does not have an express requirement that the FCA have regard to the potential scale of detriment to consumers, individually or collectively. We do not believe that this is sufficiently dealt with by 1C(2)(a) as 'riskiness' in the context of investment business normally means the chance of losing a significant part of an investment. In contrast, great consumer detriment can be suffered from financial products which carry little or no investment 'risk' in the classical sense. The clearest example of this would be in the detriment caused by PPI, which was not risky but rather ill-designed and often unnecessary insurance. As a result, we would like to see an additional have regard: "the magnitude of financial detriment which may be suffered by consumers, individually or collectively, in connection with different kinds of investment or other transaction."

Efficiency and choice

23. We are concerned that the drafting of the 'efficiency and choice' objective is not sufficient to ensure it achieves the intended outcomes as the legislation does not give any clue as to the intended definitions of these terms or include any 'have regards' to direct the FCA. We would thus suggest section 1E should be amended to give clear definitions. Those relating to 'choice' should include the ease with which consumers may obtain appropriate products at competitive prices, and the ease with which

consumers may discriminate between products or services which represent good and poor value for money. Those relating to efficiency should include a remit to consider value for money and ensure consumers are provided with appropriate products and services to meet their needs at the lowest possible cost.

24. Which? strongly believes that if the FCA is to be effective in promoting effective competition that delivers benefits for consumers, its objective to promote efficiency needs to include a remit to consider the value for money of financial products and services. All too often in financial services, it is difficult for consumers to assess whether they are getting a good deal as they are subjected to charges that are hidden in the small print. This makes it difficult for consumers to compare products, hindering switching. These barriers need to be addressed if the market is to become more competitive.

25. We would generally define market efficiency as a situation where consumers are provided with appropriate products and services to meet their needs at the lowest possible cost. If the Treasury does not intend the FCA to consider value for money, we would welcome clarity about how the Treasury would define 'efficiency' in the context of retail financial services.

26. Which? is concerned that 'promoting choice' can be interpreted in one of two ways. In the more positive interpretation, from the consumer perspective, it will compel the FCA to follow policies that will enable consumers to make effective choices. These could include approaches such as introducing measures to help the easy comparison of products, and looking at ways to facilitate switching. However the FCA could also interpret an objective to 'promote choice' as giving them a mandate to encourage a proliferation in the number of products in the market. This could result in approaches such as reducing regulatory barriers for firms to encourage innovation, or reducing protection around sales processes.

27. Which? is deeply concerned that if the FCA saw their remit as facilitating choice in the second way described, it could not only have a negative impact on consumer protection but also work against the achievement of effective competition. As noted in the OFT study, "Assessing the effectiveness of potential remedies in consumer markets", evidence from psychology suggest that people can be harmed by too much choice. Having a great variety of options complicates decisions and may result in people avoiding making choices altogether, even when there are acceptable option available ('choice avoidance').[2]

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[2] "Assessing the effectiveness of potential remedies in consumer markets", published by the OFT in April 2008, ref: OFT994

28. Which? would point to the experiences of the energy sector, where studies have concluded that the variety of choice on offer is hindering effective decision making. A study by the Centre for Competition Studies in October 2010 found that "Innovation in UK retail markets may confuse not empower consumers. Innovative tariffs and other devices may not result in genuine gains for consumers, many of whom take switching decisions which leave them worse not better off".[3] Ofgem, the energy regulator, has recently concluded that the increase in the number of tariffs available, from 180 in 2008 to more than 300 in March 2011 was hindering easy price comparison. As a result the regulator has now announced that it will take action to reduce the number of tariffs made available by energy suppliers.[4]

29. Meanwhile in the financial services sector there is already a high degree of rivalry and huge number of products on offer. However this should not be seen as evidence of effective competition that is delivering benefits to consumer. As an example, our study into savings accounts in 2010 found that there were over 1,200 savings accounts available in the UK but the number of accounts on offer wasn't leading to good outcomes for consumers – indeed many consumers hold their savings in poor value accounts, losing out on £12 billion a year.[5] This is due to the fact that a large proportion of the accounts available offer extremely poor rates of interest (half of the savings accounts available paid 0.5% interest or less and one in four paid 0.1% or less), but it is difficult for consumers to find out what interest rate their account offers, and banks are not informing customers when better accounts are available.

Discharging functions in a way which promotes competition

30. Which? strongly supported the move to elevate the importance of competition in the FCA's objectives. As set out in our previous submission, we believe the new regulator should have a duty to promote effective competition which acts to protect and benefit consumers. We believe the decision to focus on the positive outcomes of competition in framing the objectives is sensible. After all, competition in retail banking should be seen as the means to achieve better outcomes for consumers, rather than an end in itself.

Regulatory principles

Consumer / senior management responsibility

31. With respect to the principle of consumer responsibility, Which? would note that

[3] "Innovation and Competition in Generation and Retail Power Markets", published by the Centre for Competition Studies, October 2010

[4] Press release, "Supply companies failing consumers: Ofgem proposes radical overhaul, Ofgem, 21 March 2011

[5] Press release, "The £12 billion savings scandal", Which?, 27th October 2010

under the common law consumer responsibilities are already established and include the principles of reasonableness, good faith, participation, disclosure and action. As a result we would question whether this principle is necessary, but understand that many in the industry feel strongly about its inclusion as a 'have regard' under the consumer protection objective. However, we are concerned that there is a significant imbalance between the responsibilities of consumers and firms as set out in the regulatory principles (section 3B of the bill) and would like to see this addressed. We support the following changes identified by our barrister.

32. As John Odgers, the barrister we commissioned, notes:

> *"Regulatory principle (c) is thus the same as one of the principles to which, under proposed new section 1C(2), the FCA is to have regard when considering the degree of protection for consumers that is appropriate. But, whereas in the latter context, the principle's application and relevance is clear, when expressed as a general principle applicable to all the regulators' acts, the statement is perplexing: Why should only consumers accept responsibility for their own decisions? Why not regulated firms? Why not individuals who are approved to perform controlled functions? Indeed, why not the world in general? It is as if the Bill's draftsmen are at pains to ensure that consumers should have only themselves to blame. In my view sub-section (c) should simply be omitted.*
>
> *Sub-paragraph (d) does highlight to some extent the compliance responsibility of senior management but it is not expressed in clear terms. Indeed, sub-paragraph (d) is hard to call a 'principle' at all, it seems to be no more than a reference to 'responsibilities' which are somehow defined elsewhere. It would be preferable if sub-paragraph (d) were reformulated to state outright that senior management should take responsibility in relation to their firm's compliance with requirements imposed on their firm by and under the Act. I would therefore suggest that proposed sub-section 3B(1)(d) be amended, so as to read 'the principle that the senior management of persons that are subject to requirements imposed by or under this Act are responsible for procuring compliance with those requirements'."*

33. Which? would urge the Treasury to avoid any pressure that may emerge from sections of the industry who believe the regulator should designate specific actions that consumers should be responsible for undertaking. In particular we are aware of those in the industry who want to impose a responsibility on consumers to understand long and complex disclosure documents. We fully support the Treasury's analysis that "[retail] consumers…are often at a relative disadvantage when engaging with financial services, given information asymmetries, product complexity and long-term product

payoffs". As a result we believe it would be wholly inappropriate to extend consumer responsibility beyond the common law principles.

34. With respect to the principle of senior management responsibility, we believe that the Government and the FCA should be clear that the interpretation of this principle means that the regulator should be prepared to take action against senior management in firms which breach regulations. For too long, senior management have managed to evade the consequences of their policies which have led to significant consumer detriment. Despite widespread mis-selling of PPI the only senior management person against whom action was taken was the chief executive of Land of Leather (a furniture retailer). No senior management from any of the retail banks have had any action taken against them. This sends a dangerous message to senior management that they can impose inappropriate sales targets for products on their frontline staff and evade the consequences. Senior management have to be clear that breaching regulations will result in serious consequences for themselves and for their firm's reputation and bottom line. The FCA should send a clear signal that it will take action against individuals, including fines and greater use of orders prohibiting the individuals from working in the financial services industry.

Publication of information

35. This must be a key principle governing the approach of the new FCA. The governing principle should be the need to proactively disclose information which might influence a consumer's decision to engage in a commercial relationship with a financial services company: there should be a presumption in favour of disclosure and information should only be withheld where its release would damage the interests of consumers.

36. Our barrister has also raised concerns over principle (e):

> *"I find regulatory principle (e) obscure; and it again raises questions which I find it hard to answer: What 'information' is it deemed good in principle to publish, or require to be published? In what circumstances is it in principle 'appropriate' to publish such information, and why? I think much of the difficulty stems from the phrase 'the desirability of in appropriate cases', which suggest that there may be no general principle at all, but that the matter is to be governed solely by judgments of what is appropriate. I would therefore suggest that sub-section 3B(1)(e) be amended so as to express a recognisable principle."*

37. We therefore believe that principle (e) should be amended so that it reads "the principle that regulators should seek whenever appropriate to advance their

objectives by publishing or procuring the publication of information relating to persons on who requirements are imposed by or under this Act."

Transparency

38. We support the inclusion of the final principle of transparency. However, we have concerns about the lack of definitions included in the legislation. What constitutes transparency? Is it the intention of the Government that this is simply seen as a duty for the regulators to have clear and public procedures and principles? Or is this a duty for the regulator to provide the public with access to information about how they handle particular cases and issues? In order to give the principle sufficient specificity to be easily applicable, we would support the need for further definition. We would support an amendment to principle (f) so that it reads "the principle that the regulators should exercise their functions as transparently as possible in a manner which allows the general public access to information about the regulator's actions and decisions and to the inquiries, information and reasoning which lead to the regulator's actions and decisions."

39. This should also include reporting on the progress that the industry has made in implementing regulatory decisions. For example, where the regulator requires the industry to contact consumers and provide redress it should publish the instructions it has given to the firm and report on the firm's progress in providing redress to consumers. This will improve the accountability of both the firm and the regulator and increase public confidence.

Other principles which the Government has ruled out

40. Promoting financial inclusion: If the Government does not propose to include a specific regulatory principle on financial inclusion then we would welcome further details about how this will be taken into account by the FCA. We also recommend greater clarity within Government as to where responsibility for the financial inclusion agenda will reside.

41. We strongly support the removal of the need for the regulator to have regard to the international character of financial services and markets and the desirability of maintaining the competitive position of the UK and the desirability of facilitating innovation. We do not feel these are suitable objectives for a regulator tasked with consumer protection. The inclusion of "innovation" presupposes that innovation in financial services is always beneficial for consumers and markets. In actual fact, innovation of product design can frequently involve increasing complexity or products which benefit the industry not consumers. The need for regulators to have regard to "international competitiveness" creates a conflict of interest which tends to support the

which

status quo and for regulators to be insufficiently challenging to the industry.

7 Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?

We welcome the intention that "at the heart of the Government's proposals will be a more proactive approach to conduct regulation, with a clear focus on consumer outcomes." In the past ten years we have seen substantial detriment caused to consumers in a number of areas including mortgage endowments and Payment Protection Insurance. The impact of these problems on consumers has been compounded by the slow response of the industry and regulators. Excessively long timescales, poor complaints handling and inadequate redress have become all too common.

It is vital that the powers in the new Bill support the new proactive approach to regulation which will tackle the root causes of consumer detriment. We are extremely concerned that the draft Bill does not go far enough to ensure a new regulatory culture and a more proactive approach to regulation. However we believe the legislation, as currently drafted, gives the FCA too much leeway to determine its approach to regulation. Under FSMA the FSA was able to swerve from the light-touch approach of its early years to its current, more proactive, approach and we are concerned that under the new legislation the FCA will be able to do the opposite. As a result we would like to see changes made that would ensure the Government and Parliament's intentions are hard-wired into the way the FCA operates. We believe a series of amendments could be made to the objective and powers of the FCA that would help, in a sense, to legislate for the culture of the organisation.

Product intervention powers

42. We believe that the FCA should embrace the role that product regulation can play in addressing conflicts of interest, disciplining markets and aligning the interests of producers with consumers. We welcome the intention for the FCA to be able to make rules to place requirements on products or product features; mandate minimum product standards; or restrict the sale of a product to a certain class of consumers.

43. In some cases, this may require the regulator to take prompt action to prohibit the sale of a particular product or to control a particular product feature. It is very important that the regulator is able to act quickly so we strongly support the proposals for the FCA to be able to make temporary product intervention rules for a period of up to 12 months with immediate effect.

44. We are keen to ensure that no unintended consequences result from new Section

137C(7) which allows for the FCA to make rules which provide for relevant agreements to be unenforceable, for money and property paid to be returned, and for the payment of compensation for any loss sustained. We are concerned that there are circumstances in which the proposals could leave a consumer significantly under-compensated for entering into an agreement which the FCA has proscribed. We believe that the legislation should be amended to allow for compensation to place the consumer in the position they would have been in had the rules not been breached.

45. Our barrister notes:

> *"For instance, if the FCA were to require that all contracts of household insurance were to include a minimum level of cover, and an insurer enters into a policy which affording significantly lower cover, the consumer's loss (if the risk eventuates) is not accurately reflected by the premiums which he has paid, as it would include some or all of his uninsured losses, which the policy ought to have covered.*
>
> *"As presently drafted, I do not see how those losses would be recoverable by him under New Section 137C(7). I think it would be beneficial if the drafting were extended to allow for compensation to put the affected person in the position which he would have enjoyed had the specified agreement complied with the product intervention rule(s) which were breached."*

46. Which? believes that product regulation and the product intervention powers could be used by the regulator to address a number of issues. It is important that the FCA uses it:

- Ensure minimum standards for key products: There are certain products, such as current accounts and protection products, that consumers need access to. We believe the regulator should ensure that any such products meet minimum standards. We would draw a parallel with motor insurance where all products on sale must meet minimum legal requirements, and consumers then have the option to add on additional 'bells and whistles'. A further example would be to using 'nudging' principles to set the default standards for some products in the interests of consumers – this could include ensuring that the default setting on current accounts does not involve the provision of an unauthorised overdraft and consumers only use unauthorised overdrafts and incur charges if they have specifically opted-in. In the US, rules have been introduced by the Federal Reserve which only allow banks to process ATM and debit card transactions which would take the consumer into an overdraft (or over their overdraft limit) if consumers have specifically opted-in. A recent survey by Consumers' Union indicated that just 22% of the consumers they surveyed

had opted-in.[6] The regulator may also take steps to ensure that information disclosure is on standard terms, enabling consumers to easily compare products. It could also take steps to introduce industry-wide standards such as portable bank account numbers for current accounts.

- Minimise the toxic aspects of products and in some cases prohibiting a particular type of product or specific product (for example single premium PPI): Product regulation can play a valuable role in limiting the harm that certain products can cause at an early stage. In other areas the regulator could take action when a firm unfairly uses a variation clause in a contract to change the terms or the price paid by the consumer.

- Ensure the availability of 'vanilla' products: Experience has shown that the financial services industry alone will not develop simple, good value for money products which meets consumers' needs. Instead of developing good value protection insurance products the banking industry concentrated on selling poor value PPI products. We believe the regulator should pursue the idea that providers and intermediaries should offer simple, straightforwardly priced 'vanilla' products alongside their additional product offerings.

- Benchmarking of products: The regulator should consider extending requirements such as 'RU64' to additional product categories. This will require firms to benchmark the products they offer against alternatives. It is important to be clear that RU64 does not prevent firms recommending higher charging and more complex personal pensions provided that they can explain in writing why these are "more suitable" than a simple, good value stakeholder pension.

- Preventing the bundling of products: The regulator may take steps where the design of products could encourage mis-selling. One example of this type of circumstance would be where banks offer a higher rate on a one-year deposit account provided that the consumer invests a matching amount in a longer term structured product or investment product.

- Taking action concerning complex 'ranges' of products offered by individual firms: The regulator could take action where firms design complex 'ranges' of products which while not excessively complex on their own are designed to take advantage of consumer inertia and cause confusion rather than in response to genuine consumer need. For example, one building society seems to have around 20 different issues of its instant access ISAs paying over 10 different interest rates. Lloyds banking group offers 30 different

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[6] http://www.consumersunion.org/pub/core_financial_services/017109.html

variable rate savings accounts through its Lloyds TSB brand and around 20 different variable rate savings accounts through its Halifax brand. The regulator would take action to require firms to simplify their range of products. There are precedents from other sectors to consider: OFGEM has recently concluded that the rise in the number of tariffs available from 180 in 2008 to more than 300 in March 2011 is hindering easy price comparison. Their focus group research with vulnerable customers found that some had been put off comparing prices online and switching due to the complexity of the options available.[7]

- Promoting competition: The regulator could use product regulation to promote competition by ensuring that consumers can compare products. Which? has long held concerns that the variety of different methods by which lenders calculate the interest charged on a credit card meant that the cost to the consumer for cards with the same APR could vary. The industry claimed that these different interest calculation methods were dimensions of competition. However we agreed with Sir John Vickers who told the Treasury Committee that if a product characteristic is "invisible to consumers then it cannot be a dimension of competition".[8] Which? launched a super-complaint to the OFT in April 2007 concerning interest calculation methods on the basis that these were not proper dimensions of competition and undermined the ability of consumers to compare products through the APR. There were no clear market incentives for credit card providers to move to more advantageous (for the consumer) methods of calculating interest payments. The result has been continued differences in interest calculation methods with the only moves towards some standardisation being the result of the European Directive which required credit card companies to only start charging interest when the transaction was posted to the account (previously some companies started charging interest from the date when the purchase was made).

New financial promotions power

47. We strongly support the proposed new power in relation to financial promotions. We have long called for the regulator to take a similar approach to the Advertising Standards Authority (ASA) and introduce a Financial Promotions Register which shows where the regulator has received complaints and where a firm has been required to withdraw or amend a misleading financial promotion. The FSA has required firms to amend or withdraw 1,321 misleading financial promotions in the past

[7] http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Ofgem_vulnerable_customers_research_Final.pdf
[8] John Vickers, quoted in evidence to the Treasury Select Committee at paragraph 50 of Transparency of credit card charges, First Report of Session 2003-04, Volume 1, HC125-I.

five years.[9]

48. It is important that there is prompt disclosure of disclosure of action against financial promotions so the specified period for firm to make representations should be kept to a minimum. It may take some time after a promotion is issued for it to be reported to the FCA as misleading. Whilst Firms should not be able to evade the publication of the notice by promising that the promotion will not be re-issued.

49. We seek confirmation from the Treasury that the power is drawn widely enough for the FCA to take action against a misleading financial promotion (and to publish that it has done so) even if the firm is not directly authorised by the FCA. This might be the case if an unauthorised firm has issued a financial promotion in contravention of the prohibition in Section 21 of FSMA.

50. The FCA should also respond to complaints from consumer organisations, individual consumers and other firms and state the action which it has taken in response to their complaint (including where it has investigated and not required the firm to amend or withdraw its promotion).

51. The power to publish the fact that a firm has been required to amend or withdraw a promotion would provide a powerful incentive for firms to improve standards, impose market discipline and would help draw the attention of consumers who may have responded to the misleading promotion, and could motivate more consumers and consumer groups to report adverts they find misleading. We agree with the Government that greater visibility of the FCA's actions in relation to financial promotions will increase confidence in the FCA's ability to protect consumers and increase regulatory accountability.

52. As an example of the drawbacks of the current system, when we submit a complaint about a particular financial promotion to the FSA we do not receive any feedback or adjudication which says whether the FSA agreed that the promotion was misleading and whether the company was required or to amend or withdraw the promotion. The FSA will not even confirm or deny whether an investigation has taken place. We contrast this with the feedback we receive when we submit a complaint to the ASA concerning the potentially misleading health claims made in an advert for Nutella chocolate spread.[10]

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[9] It should be noted that these figures do not include promotions about Credit cards, Store cards and charge cards Personal loans and loan consolidation, Overdrafts and some second charge mortgages which are dealt with by the OFT and Trading Standards

[10] http://www.asa.org.uk/Complaints-and-ASA-action/Adjudications/2008/2/Ferrero-UK-Ltd/TF_ADJ_44078.aspx

Table 1: Number of Financial Promotions amended or withdrawn as a result of FSA action

Year	Number of financial promotions amended / withdrawn
2010	262
2009	170
2008	216
2007	324
2006	349

Source: FSA

Early publication of disciplinary action

53. We support the power to allow for the publication of the fact that a warning notice has been issued and for a summary of the notice (including the grounds on which action is being taken) to be published. We accept the need to put safeguards in place for the use of this power, but are concerned that the current draft provision makes publication, even of appropriate information, discretionary. We believe that if there is information which it would be appropriate to publish, it should be published and would support an amendment to achieve this. In Schedule 8, Part 6, 24(2)(c) we would replace the word "may" with the word "must".

54. In addition, we believe that the list of types of warning notice in respect of which disclosure is permitted contains some undesirable omissions. We would welcome the extension of these to include where it is proposed (1) to limit or cancel a firm's Part 4A permission (sections 55X and 55L), (2) to make a prohibition against a person (section 57), and (3) to require a firm to make restitution (section 385).

55. The publication of warning notices should facilitate a more open enforcement process. This should include the opportunity for consumer groups and individual consumers to be involved and to provide evidence to the enforcement process. For example, if the debt advice agencies become aware through the publication of an enforcement notice that the FCA is considering taking action against a mortgage lender for treating customers in arrears unfairly they may be able to submit evidence to the FCA concerning the way the lender has been treating their clients. In other occasions it may alert us to the practice of a particular firm which we may have evidence of from our engagement with consumers or from our mystery shopping work.

56. A further example of how additional openness could lead to a more appropriate outcome relates to the FSA's thematic work into how banks were handling complaints

about unauthorised overdraft charges. This found a failure to deal with complaints fairly, consistently or in a timely manner, unfair threats to consumers by banks, unfair closure of accounts and the use of false or misleading statements. Despite the fact that two firms were referred to the FSA's enforcement division for further investigation, there has been no additional information about the identity of these firms or the action which was taken against them. If the identity of those firms had been made public then it would have prompted evidence from consumers and consumer groups to the regulator about how those banks had been handling complaints.

Regulatory transparency

57. We agree with the Government that greater regulatory transparency and disclosure will be an important tool for the FCA. We welcome the intention for the FCA to have a regulatory culture based on a presumption of transparency. In the past the approach to disclosure by the FSA has been skewed far too much towards the interests of firms. The FSA has previously stated that disclosure of information would be likely to undermine firms' willingness to engage in a dialogue with it and to provide it with information. It has not put forward any credible evidence for this view. In any case, a regulator should not be relying on the voluntary disclosure of information to undertake its job effectively. A culture of secrecy harms accountability and only benefits those firms breaking the rules.

58. Proper accountability can only come alongside improved transparency. In a competitive market, brand and reputation are valuable. Firms which fail consumers should not be shielded by the regulator from the consequence of their commercial decisions. We believe that regulatory transparency could have a powerful effect towards incentivising firms to improve their practices. It also helps the industry as it ensures that, if scandals do arise, offenders are identified and the entire industry is not labelled as universally poor.

59. The main roadblock to greater regulatory transparency is Section 348 of FSMA that prevents the FSA from disclosing information it receives in the discharge of its regulatory duties, except in certain defined circumstances. In addition to the problems involving its interpretation by the FSA, it also places substantial barriers to organisations making Freedom Of Information (FOI) requests to the regulator. It allows the regulator to reject FOI requests without being subject to a public interest test. Which? has submitted a number of FOI requests to the FSA asking for the names of mortgage lenders which had performed poorly in the FSA's thematic work. We believed that consumers had a right to know which lenders were treating customers unfairly and that this information should also be shared with the Court judges hearing repossession requests from these lenders. The FSA rejected our request and offered a number of excuses including that it would harm the lenders

brand and reputation, would undermine firm's willingness to engage in a dialogue with the FSA and to provide the FSA with information and the restrictions imposed on it by Section 348 of FSMA.[11] It was clear that the FSA believed that the commercial interests of firms which were trying unfairly to evict people from their homes and levying unfair charges were more important than the public interest and the interest of consumers in disclosing this information.

60. The FSA has also refused to disclose the instructions which it had given to firms which had been fined for mis-selling PPI, stating that as the instructions it gave to the firms would invariably involve information received from the firm, they would also not be able to disclose it due to Section 348 of FSMA. It would not even send us the text of the letter which it had required the firm to send to consumers.

61. While the Government is constrained in its ability to reform Section 348 as a result of the secrecy provisions contained within various EU directives, we believe there are areas where the UK has gold-plated the EU directives. We therefore believe the Treasury needs to undertake a review of how it has interpreted the EU provisions and definitions of confidential information and identify areas where the FCA can be more transparent.

62. The actual practice of the FCA would be influenced by a clear mandate to disclose information where it might help the FCA achieve its objective of ensuring good outcomes for consumers or where it might influence a consumer's decision to engage in a commercial relationship with a financial services firm.

63. In addition to the legislative changes, Which? recommends further transparency in nine key areas.

- **Thematic work**: We believe the regulator should disclose the firm-specific results of the thematic work it undertakes. The current failure to name those firms performing poorly means that consumers are kept in the dark and firms are able to get away with not treating their customers fairly without suffering any practical penalty.

- **Conduct risk:** Individual firms should be required to publish SEC style submissions covering conduct risk issues and any investigations currently underway by the regulator into their practices. This may also be an issue which merits investigation by the markets side of the FCA. Banks frequently

[11] For further details pleas see Which? written evidence included in the Treasury Committee's Fifteenth Report of session 2008-09, 'Mortgage arrears and access to mortgage finance", (Ev 63); http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/766/766we06.htm

keep their shareholders in the dark regarding conduct risk issues. Even after the FSA had published the rules which banks were supposed to comply with no major bank had published any information in their annual report regarding their possible liability from mis-selling of Payment Protection Insurance. No indication of the likely provision was given until banks had lost their judicial review. This was despite the fact that banks eventually faced costs of over £7.4 billion from PPI mis-selling.

- **Price data**: We would like the regulator to require firms to provide the relevant price data on their products, and use this data to publish comparison tables. This will make it easier for consumers to shop around to get the best rate and spot when they are getting a bad deal, and for organisations like Which? to warn them about products to avoid. However, section 348 continues to place a substantial roadblock in the way of the regulator disclosing price data. For example, we have concerns that a number of pension providers may be offering poor annuity rates to existing customers when it comes to convert their pension into an annuity. Ideally, we would like to obtain the names of these companies so we can issue specific warnings to consumers. However, we have been informed that participation in CFEB's comparison tables is voluntary and even if the FSA were to gather data from individual pension companies it would be prohibited from publishing it without specific permission from the individual firms.

- **Complaints data**: The FSA has moved to publish complaint numbers for individual firms which receive more than 500 complaints every six months. There is already evidence that firms are taking action in response to the publication of complaints data. Banks are reporting that they are taking action to prevent errors occurring in the first place. Other banks have set targets to reduce the number of complaints received and the proportion of occasions where the Financial Ombudsman overrules the bank's original decision in favour of the consumer. The complaints data has also allowed consumer groups to identify specific occasions where there appears to be systematic problems in the way a firm is dealing with complaints. For example, data from the FSA showed that Capital One upheld just 1% of complaints about General insurance and Pure protection products (including PPI) in favour of the consumer in the first six months of 2010. However, the Financial Ombudsman upheld 57% of the complaints it settled in the first half of 2010 and 40% of those it settled in the second half of 2010 about Capital One in favour of the customer. These differences could indicate problems in the way Capital One is assessing complaints and allows us to send a message to consumers that they should always take their complaint to the Ombudsman if they are dissatisfied with the firm's response. We also believe that the FCA should go

further and publish all of the complaints statistics it receives from all firms online. As these are already collected by the regulator electronically, there should be no additional costs for individual firms. It should also require the largest firms to publish a 'complaints digest' which would outline the causes of the most common types of complaints and what action the bank was taking to address the issues raised by customers.

- **Own-Initiative-Variation-of-Permission**: This would ensure that in a situation where the FCA has concerns about a firm and varies its permission to undertake specific activities, that this is made public. This could include restrictions such as not allowing the firm to accept new business, but can also include actions such as requiring firms to contact customers who have replied to a misleading financial promotion.

- **Usage data**: The FCA should ensure that firms make 'usage data' available to customers. This electronic information could at the request of the consumer be used (in a suitably anonymised form) to quickly and efficiently analyse whether the consumer would be better off switching and the size of any possible gains. This would have significant advantages over the greater use of 'paper-based' information. The regulator should also ensure that firms provide information to consumers about the ongoing costs of their products and bank accounts.

- **Redress schemes**: The FCA should publish the names of the firms which are subject to the scheme, list what activity the firms are undertaking, the text of all letters used in customer contact exercises, the criteria the firms are using to calculate redress, the response rates to any customer contact exercise and the amount of redress paid.

- **Misleading financial promotions (see above)**

- **Warning and enforcement notices**: **(see above)**

8 What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

9 What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties, to do so within a set period of time?

64. We support the proposed measures to allow nominated parties to refer to the FCA issues which may be causing mass detriment. We believe that this could provide a useful mechanism to allow groups who engage with consumers on an everyday basis to flag-up issues with the FCA. We also agree that the FOS, with its evidence base of complaints would be well placed to raise an issue with the FCA. It is important that the process for determining whether the FCA takes action should be clear, transparent and fair. It is important that the FCA does not hide behind the 'confidential information' provisions of s348 of FSMA as a reason for not discussing issues surrounding one or a small number of firms.

65. The specific consumer redress power could supplement the 'super-complaint' process we recommend below that would allow nominated parties to raise emerging conduct risks from individual products, practices or a lack of competition/transparency. The FCA would have to publicly report on action taken to address any issues identified. For example, our contact with the FSA on structured products covered issues regarding misleading marketing material/financial promotions, toxic individual products and poor advice in addition to circumstances where consumers who were complaining about these products were not having their complaints taken seriously or being offered appropriate redress.

66. Careful attention must be given to how consumer complaints are dealt with while the FCA considers an issue. We would be wary of a situation where use of the referral powers leads to delays in consumers receiving redress. It is also for this reason that we do not believe that industry groups or individual firms should be 'nominated parties' given this power. If industry groups are able to use this power then there is a significant risk that they would only activate it to delay the payment of redress.

67. Once the issue has been identified and assessed it is essential that the FCA takes robust action to require firms to identify/contact affected consumers and pay redress. It should also be able to require firms to review unfairly rejected complaints. Once this action is taken the FCA should publish the names of the firms which are subject to the redress scheme, list what activity the firms are being required to undertake, the text of all letters used in customer contact exercises, the criteria the firms are using to calculate redress and report regularly on the response rates to any customer contact

exercise and the amount of redress paid.

68. To supplement the new redress power, two approaches which should be adopted are:

- Past case reviews

69. We welcome the Government's decision to activate the s404 powers. We support an expansion of the s404 powers so that they can also be used to address breaches of FCA principles, FCA guidance and any official industry guidance which has been confirmed by the FCA.

70. The FCA must show greater willingness to utilise s404 powers to require firms to actively review past sales of a particular financial product where detriment has occurred. This would be a similar process to a 'product recall'. Product recalls are a practice used across a number of sectors (from food to cars and other consumer products) to deal with deficient products. In these sectors, firms will typically stress test products and institute national or local recalls in response to defects.

- Collective redress

71. The FCA and the Government should introduce an improved method of collective redress which would allow a collective claim to be made on behalf of all those consumers who are adversely affected. This could have benefits for consumers in improving access to redress while reducing the administrative cost for firms and the regulator of dealing with individual cases. We believe that the Courts should have the power to ensure that claims could be done on an opt-out basis.

10 Do you have any comments on the competition proposals for the FCA set out in paragraphs 2.111 to 2.119 and in Chapters 3 and 4?

72. Which? wants to see a market where competition works to reward banks which deliver good value products and great customer service and to punish banks which do not. We are clear that competition is only effective if it acts to protect and benefit consumers. As we note above a market should not be considered competitive simply because there are thousands of different products available. Competition only works for consumers if they can easily identify (and switch to) products and providers which offer better service and value for money. We believe that competitive markets have the following characteristics. The FCA should report on the extent to which the markets it regulates met these characteristics as part of its thematic work and market testing:

> Competition on the merits – firms genuinely compete on the basis of the quality and price of their products or services rather than exploiting consumers' behavioural biases;

> Consumers are engaged and able to compare the quality or performance of different financial products and firms;

> The price, quality and characteristics of products are transparent and easily comparable;

> Products do not include hidden charges or unfair contract terms;

> There are low barriers to market entry and exit (while preserving essential services for consumers)

> There are low barriers to switching (both real and perceived); and

> Consumers are able to pursue effective and speedy redress where necessary.

> Conflicts of interests between firms and their customers are removed or managed appropriately.

73. Which? considers it vital that a reinvigorated financial regulator should have both the remit and tools to make competition work for consumers and for fair dealing firms. It should have the confidence to intervene in markets to ensure firms offer good value to consumers not simply the illusion of choice or rivalry. The FCA should have considerable latitude under its conduct of business powers to implement measures which should promote competition – for example through the promotion of

transparency and switching.

74. The Government correctly identify the example of Payment Protection Insurance as one of the key failings in recent years of splitting responsibility for competition and consumer protection between two separate agencies.[12] We agree that a regulator with a clearer mandate to promote effective competition would have allowed the regulator to use its regulatory tools to take targeted action at a much earlier stage. This was a key recommendation of the *Future of Banking Commission*.[13]

75. However, Which? agrees with the Government that more general competition powers may at times be suitable. Whilst we welcome the ability for the FCA to refer matters to the OFT and for the OFT to keep the provisions of the FSA under review, it is important that this process is exercised at the appropriate time. Under existing section 160(1) of the FSMA, the OFT has a duty to keep the regulating provisions and practices of the FSA under review. Where the OFT considers that regulations may have a significant adverse effect on competition, it may make a report possibly leading to further action by HM Treasury. We note that in over a decade the OFT has failed to exercise its power to make a report to HM Treasury.

76. The BIS' consultation into reform of the competition regime outlined concerns that sectoral regulators have not used their competition powers sufficiently, in particular to make market investigation references.[14] These concerns were supported by the NAO and other independent commentators. Which? considers that these risks may apply to the FCA. As it develops an approach to meeting its new duties it will need to be confident that referring markets is appropriate. It should not consider reference a failure of its own regulatory over-sight. The FCA will also need to significantly build its capacity to effectively analyse competition issues, make references and develop effective, proportionate remedies.

77. To help ensure that the FCA takes its new remit to promote effective competition seriously and makes appropriate referrals to the OFT we believe the following are necessary:

78. **Super-complaints**: It is important that the FCA is designated as a recipient body for super-complaints and is required to report back within 90 days with regard to the action it is taking in response to the complaint. Super-complaints are made by

[12] Please see Annex 1 for an explanation of the shortcomings of Competition Regulation under the Financial Services and Markets Act 2000. This text is based on the analysis conducted by the *Future of Banking Commission* and has been updated to include further examples. Please see Annex 2 for details of failings in relation to PPI

[13] For further information please see Chapter 3 of the Future of Banking Commission report, http://commission.bnbb.org/banking/sites/all/themes/whichfobtheme/pdf/commission_report.pdf

[14] Paragraph 7.11, *A competition regime for growth: a consultation on options for reform*, March 2011, BIS.

designated consumer bodies (such as Which?) where we have identified a feature (or combination of features) in a market which is significantly harming the interests of consumers. Responses to super-complaints can typically include measures to promote transparency, switching or to take targeted enforcement action – all of which will be within the remit of the FCA. Designating the FCA as a recipient body for super-complaints would help prompt it to exercise its powers in a more pro-active manner to protect consumers and promote competition. It is not practicable or straight-forward to arbitrarily separate failures into 'competition' and 'consumer protection' issues so there may need to be coordination mechanisms in place between the CMA and the FCA. It is vital that the recipient of super-complaints is able to look at all aspects of a market and consider all remedies to address the concerns raised.

79. **Reporting on the extent of effective competition in the markets it regulates**: Where the FCA conducts 'thematic' or similar reviews (analogous to existing market studies), it should report on the extent to which those markets met the characteristics of effective competition which we list above. Where no referral to the OFT arises the FCA should be required to promptly publish its reasons for this.[15]

80. **Annual report**: The FCA, in its annual report, should review and report on its efforts to promote effective competition in the markets it regulates, the extent to which it has used any of its tools available including referrals to the OFT and supply any other relevant information to allow scrutiny of its performance;

81. **Independent review**: The FCA board should also invite and resource a suitably qualified, independent person to review its performance at the end of the business year in respect of how it has exercised its relevant powers to promote effective competition and make enhanced referrals to the OFT. This person should report to the board with proposals to improve the FCA's practices for the forthcoming business year. This report should be published.

82. **Exchange of information between the FCA and the competition authorities**: There should be free and open information disclosure between the FCA and the competition authority, such that information gained under the FCA's statutory powers for any of its objectives can be supplied for the purposes of competition enforcement or investigation without seeking permission or making redaction;

83. **Proactive co-operation with the competition authorities:** The FCA should not exercise powers under the Competition Act 1998 but, instead, should be required to

[15] This should explain why issues are better dealt with through conduct of business rules or why an issue does not satisfy the legal test for a market investigation reference (currently section 131 of the Enterprise Act 2002).

facilitate any investigation by a competition authority. In addition, it should act to enable consumers and regulated firms to raise concerns of abuse by dominant firms or anti-competitive agreements and pass these on to the competition authorities.

84. Finally, we welcome the repeal of section 164 of FSMA. As noted in our previous responses, section 164 was largely irrelevant following the modernisation of competition law, where Articles 81 and 82 EC were now directly applicable by the OFT, and the international nature of most financial services. We strongly argued that banks do not warrant special treatment that insulates them from the normal scrutiny of competition law.

Competition and consumer protection powers in relation to unfair charges

85. We believe clarification is needed over whether the Government intends for the FCA to have the ability to make interventions on pricing issues. The price paid and ‘value for money’ which consumers receive from financial products and services is a key component of the overall outcome. Excessive prices can also be an indicator of weak competition or problems with transparency in a market.

86. We believe it is essential for the FCA to be able to limit ancillary/default charges if it is to take an effective approach to competition. These ‘behind-the-scenes’ prices can lead to a substantial risk of weakening of effective competition between firms, in particular reducing direct price competition as apparently low ‘headline’ prices mask the true costs once ancillary / default charges are accounted for. Discovering the ‘true’ price raises consumers’ search costs, especially if price structures are frequently altered. This will distort consumer decisions leading to inefficient economic outcomes.[16] A regulator with a clear competition mandate would ensure that consumers can be confident that once they have entered into a contract, they will not be subjected to any unexpected charges or, if they are, such charges are fair and proportionate.

87. The section on pricing in the FCA Approach Document sets out the regulator’s view:

> *“The government has said that the FCA will not be an economic regulator in the sense of prescribing returns for financial products or services. The FCA will, however, be interested in prices because prices and margins can be key indicators of whether a market is competitive. Where its powers allow, the FCA will take into consideration more positively the cost of products or services in*

[16] For example, see the Which? March 2011 super complaint on payment method surcharges: http://www.which.co.uk/documents/pdf/payment-method-surcharges---which---super-complaint-249225.pdf

for all consumers

making judgements about whether consumers are being fairly treated.

"Where competition is impaired, price intervention by the FCA may be one of a number of tools necessary to protect consumers. This would involve the FCA making judgements about the value for money of products.

"The FCA will thus consider exercising its powers to take action where costs or charges are excessive."

88. However as our barrister, John Odgers, notes:

"It is not clear whether, by not including in the Bill any specific provisions relating to price intervention, the Government intends the regulators to enjoy no such powers or whether it considers that price intervention is permissible under these rule-making powers."

"It seems to me to be desirable that a power of price intervention should be spelled out, if it is intended. Financial services regulators have not in this jurisdiction previously exercised that type of power, and might in future be loath to do so without a specific statutory authority, as the use of such a power would be particularly likely to attract a challenge."

89. The loss of the Supreme Court case on unauthorised overdraft charges has exposed significant gaps in the ability of regulators to tackle unfair charges so we believe the FCA should be given the authority and powers to challenge these charges and assess whether they are fair and proportionate. We also note that the ICB concluded that the FCA would be the natural body to pursue a review of unauthorised overdraft charges.[17]

90. We outlined a possible approach in our submission to the European Consumer Rights Directive, our submission to BIS and our response to the Treasury Committee's inquiry into Competition and Banking.[18] Our submission to the TSC presents evidence based on market analysis of the changes made to unauthorised overdraft charges by the major banks since the Supreme court case.

11 Do you have any views on the proposals for markets regulation by the FCA, described in paragraphs 2.120 to 2.123 and in Chapters 3 and 4?

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[17] Independent Commission on Banking, Interim Report, para 5.29

[18] http://www.which.co.uk/documents/pdf/consumer-rights-directive-allowing-contingent-or-ancillary-charges-to-be-assessed-for-fairness-bis---which---consultation-response-226521.pdf ; http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/612/612we25.htm

91. We have no comments to make on these issues.

12 Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA, as described in paragraphs 2.124 to 2.132 and in Chapters 3 and 4?

92. We support the steps to improve the accountability of the regulators listed in para 2.128. We particularly welcome the intention to make the FCA subject to audit by the NAO.

93. In the past it has been very difficult to hold the FSA to account for its decisions and the Treasury has been reluctant to question FSA decisions publically in order to preserve the appearance of regulatory independence. The only body that shows sustained willingness to publically question the FSA's policies has been the Treasury Committee who do an excellent job but are obviously limited in the resources they could commit. We think it would be worth exploring whether extra resources could be allocated to the committee to allow them to undertake more regular reviews. These could either be undertaken by the committee as a whole or by a new sub-committee if it was felt this would be more efficient.

94. Proper accountability can only come alongside improved transparency about the regulator's functions and its performance. In order to further increase the accountability of the regulators we believe there needs to be greater transparency around the agendas, forward plan and minutes of board meetings to provide full information about when the Board is taking key decisions - though we acknowledge that financial stability considerations may occasionally limit the amount of information which can be disclosed in advance. This will improve the accountability of both the firms and the regulator and increase public confidence. In addition we believe it would be beneficial if the regulator made itself more available to scrutiny. This could take the form of a monthly question time where senior figures and board members were required to take questions from key stakeholders.

95. However while we support measures to improve the accountability of the FCA, we also support the need for the regulator to be independent from Parliament. We are concerned that some who argue for increased accountability actually want reduced independence. In contrast, while we believe the FCA must report to Parliament and explain its actions and policies, we would oppose moves which would allow politicians to control the FCA and require it to change its approach. At times the regulator may be required to take actions which are necessary to ensure consumer protection in the long-term, but will be politically unpopular in the short term. At other times the regulator may want to pursue a proactive approach to regulation while politicians support a light-touch approach. We believe the regulator should have to justify why it is taking the approach in question but, subject to this accountability, that it should be able to pursue the course of action it believes is necessary within the confines of the

powers granted to it by Parliament in law.

96. We support the continuation of the Consumer Panel. The Consumer Panel must be properly funded and resourced. It is important to recognise the inherent imbalance in resources between those who lobby on behalf of the industry and those who lobby on behalf of consumers. As we note below we are concerned by the lack of a consumer panel for the PRA and propose that the Consumer Panel should overarch both regulators and that the FPC should also ask the Consumer Panel to approve any analysis of the potential impacts of macro-prudential regulation on consumers.

97. The FCA should also improve its ability to engage with consumer groups and ensure that they have equal rights of access to information as individual firms and industry trade associations.

Board structure

98. We believe measures should be put in place to ensure that a diverse range of expertise is included on the board of the regulators. In the past, we have seen a situation where 10 of the 12 members of the FSA board had been currently or previously employed by the industry. This raised the risk that only the prevailing mindset of the industry gained credence in Board deliberations. There was a clear preference to codify existing industry practice instead of asking searching questions about whether markets were working efficiently and in the interests of customers.

99. It is clear that alternative perspectives are needed and the Boards needs to be more diverse. As a result we believe it is necessary to ensure there is an increase in the number of Board members with experience and knowledge of consumer issues. It is also important that all Board members are independent of the industry and should only be allowed to participate in decisions where they are free from conflicts of interest.

100. We propose an amendment to Schedule 1ZA 2 (4) to require that "*the majority of these non-executive members are persons who are experienced in representing the interests of consumers or who otherwise possesses expertise in relation to consumer protection*."

Freedom of Information (FOI)

101. We deal with this issue further below but we believe that it is important that as part of the legislation the Government tackles the substantial legislative barriers to organisations making successful Freedom Of Information (FOI) requests to the regulator. This means removing section 348 of FSMA. Section 44 of the Freedom of

Information Act allows an organisation to reject an FOI request if disclosure is prohibited by or under any enactment. The result is that section 348 of FSMA imposes a significant roadblock to disclosure of information. Furthermore as Section 44 is an "absolute exemption", it allows the regulator to reject FOI requests without being subject to a public interest test and limits the chances of organisations making successful appeals to the Information Commissioner's Office (ICO) or Information tribunal.

Report to the Treasury

102. We welcome the intention to set out in legislation a new requirement on the FCA to make a report to the Treasury where there has been a regulatory failure. We also welcome the provision for the Treasury to have a backstop power to be able to direct the FCA to produce a report. Without this power it is unlikely that the FCA itself will trigger the preparation of a report as it will be an acknowledgement that it has failed. We welcome the fact that the legislation gives the Treasury the power to appoint an independent person to prepare the report. We would support a statutory requirement for the process of compiling the report to involve consultation with consumer groups. As we note below, a decision made by the PRA to veto an FCA decision should trigger an independent inquiry.

Financial penalties – use of monies

103. The draft Bill proposed to continue the current system where any proceeds from financial penalties are applied for the benefit of authorised persons. This system perpetuates consumers' concerns that the regulator does not work in their interests. We recommend that the Government change the law so that a portion of the revenue gained from these financial penalties should be used in ways which benefits consumers rather than being used for the benefit of industry.[19] This could include being used to pay for financial inclusion and education projects or maintaining access to independent debt advice. This will require an amendment to Schedule 1, Part III of FSMA. We recommend that 75% of the revenue from penalties imposed should be used for the benefit of consumers and 25% for the benefit of firms. This would continue to allow the FCA to use some of the fine to pay the cost of the enforcement action.

Financial Penalties – level of fines

104. This change should support the intention that the FCA will take a strong approach to enforcement to ensure credible deterrence and have a willingness to

[19] http://conversation.which.co.uk/money/banks-benefitting-from-bad-behaviour-is-bad-news/

impose higher fines in order to encourage better conduct across the industry.

105. It is clear that to provide an effective deterrent the levels of financial penalties will need to be significantly higher than those levied by the FSA. Examples of fines in Payment Protection Insurance (PPI) cases have shown the level of fines issued were minute in comparison to the revenues firms generated from mis-selling – in the case of the January 2008 fine for HFC Bank Limited it represented less than 0.4% of sales revenue.[20] Even after the FSA had decided to significantly increase the level of penalties it imposed for PPI mis-selling, the fine levied on Alliance and Leicester represented less than 3% of the revenue they gained from selling the product (around 5% of the net income or profit).[21] 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.

106. We would suggest the FCA looks at the example of other regulators who levy substantially higher fines for consumer abuses. Under the Competition Act 1998, the OFT has the power to levy a financial penalty of up to 10% of global turnover of the business involved. OFWAT and OFGEM have similar powers. British Airways was fined £121.5 million for collusion over fuel surcharges.[22] Argos and Littlewoods were fined a total of £22 million for fixing the price of toys and games.[23] OFWAT fined Severn Water £35.8 million for mis-reporting information and providing sub-standard service.[24]

107. Shareholders will only be incentivised to put pressure on senior management to ensure customers are treated fairly when financial penalties represent a significant proportion of the revenue gained from selling a product.

Remuneration systems

108. The FCA should move from a purely reactive approach to one which seeks to tackle the root causes of consumer detriment. In our view, remuneration systems linked to sales targets create a conflict of interest between the consumer and the firm. They encourage banks to recommend courses of action which result in the sale of a product, rather than that which is most suitable for the customer. They also contribute to mis-selling. For example, advisers at Alliance and Leicester received six times as much bonus for selling a loan with PPI as they did for selling a loan without PPI.[25] We

[20] http://www.fsa.gov.uk/pubs/final/hfc_bank.pdf

[21] http://www.fsa.gov.uk/pubs/final/alliance_leicester.pdf

[22] http://www.oft.gov.uk/news/press/2007/113-07

[23] http://www.oft.gov.uk/news/press/2003/pn_18-03

[24] http://www.ofwat.gov.uk/regulating/enforcement/prs_pn2108_svtfne020708

[25] http://www.fsa.gov.uk/pubs/final/alliance_leicester.pdf

welcome the thematic work which is currently being undertaken by the FSA into incentives for frontline bank staff. The FCA should prohibit remuneration and commission systems for both frontline staff and senior management which encourage mis-selling.

Measuring consumer outcomes & conduct risk

109. A regulatory approach which is aimed at improving consumer outcomes will require the regulator to undertake more work to test the 'outcome' received by consumers. This should involve greater use of mystery shopping – a technique used effectively by Which? to test how real consumers are treated by firms. The FCA may also want to make greater use of thematic work and studies of individual product markets.

110. The FCA should preserve the FSA's Conduct risk division which is aimed at the identification of emerging risks before they crystallise and cause major consumer detriment.

111. In addition, there should be a Committee introduced with members from the FCA, OFT, FOS to share information about potential risks and the merits of dealing with the issue through a complaints-led approach or by regulatory action by the FCA. This Committee would gather evidence from consumer and industry groups and set a timetable for investigation. This proposal would enhance the current 'wider implications' process. As we outlined above, we would favour a move towards a more formal process (along the lines of a super complaint process) which allows consumer bodies to raise potential issues with the FCA and for the FCA to publicly report on action taken.

Regulatory processes and coordination

Interaction / Coordination between the FCA, PRA and FPC

13 Do you have any comments on the general coordination arrangements for the PRA and FCA described in paragraphs 2.138 to 2.149 and in Chapters 3 and 4?

PRA veto

112. We are very concerned about the PRA's power to veto an FCA decision which would lead to a firm or group of firms failing. To permit the PRA to overrule the FCA sends a dangerous message to the industry that only firms which are small enough to fail without causing damage to financial stability will be forced to bear the full consequences of mistreating consumers. The concept of 'too-big-to-fail' risks becoming extended to 'too-big-to-be-forced-to-treat-your-customers-fairly'. If a firm has broken the regulations and/or common law and consumers have suffered financial detriment then it should not be possible for the PRA to extinguish the legal liability of the firm. This approach can only strengthen the moral hazard that led to the catastrophic failings in the banking industry which the regulatory reforms aim to prevent.

113. While we reluctantly accept the need for the PRA to be able to veto an FCA action in the interests of financial stability, we are clear that the use of the veto should be seen as regulatory failure. If, for example, the veto is used to prevent a firm becoming insolvent due to the payment of FCA-ordered redress to consumers, the regulatory regime will have fundamentally failed - the PRA will have failed in its role as a prudential regulator for allowing a firm to enter such a perilous prudential situation that it cannot meet its obligations to the conduct regulator, while the FCA will have failed by not clamping down on misconduct at an earlier stage. We would therefore propose an amendment to part 4, section 46 of the draft Bill which would include the use of the veto as one of the cases where the Treasury should arrange an independent inquiry.

114. In relation to when the PRA will exercise a veto, we note that the PRA does not have a duty to exercise its functions in a way which promotes competition. This means that it may have a preference for the maintenance of the position of existing banks despite these banks seriously failing consumers and the economy as a whole. A regulator with a proper duty to promote competition would always have a preference for firms which make mistakes or breach regulations to be allowed to fail, rather than being supported and allowing it to evade the consequences of its actions. It is recognised as essential for effective competition that market discipline must be

made to apply to banks.[26]

115. In the current environment we also do not believe that a decision to prevent the FCA from taking a firm-specific decision which would lead to the failure of the firm would or should ultimately lead to the continued existence of that firm. If a firm has broken the regulations and/or common law and consumers have suffered financial detriment then it will not be possible for the PRA to extinguish the legal liability of the firm. We seek clarification from the Treasury as to what would happen to consumers who subsequently invested in a firm where the PRA had initially vetoed a decision from the FCA and kept this confidential on financial stability grounds but the firm eventually failed. Would the FCA have any duty to prevent the firm from taking on new business? Would customers who had become customers of the firm after the PRA veto be entitled to more compensation? If so, who would pay for this compensation?

Exchange of information / views

116. There will need to be formal information exchange between the regulators. Wherever possible we believe that any instructions, views and recommendations expressed between the regulators should be made public.

14 Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described in paragraphs 2.150 to 2.195 and in Chapters 3 and 4?

117. We welcome the fact that the PRA will be required to gain the consent of the FCA before granting permission and that the Government expects that the FCA will be fully involved in the authorisation process for dual-regulated firms.

118. The supply chain for financial services is complex and it is possible for a firm designing a product to have no contact with consumers (by distributing the product through third parties). We would like clarification about where the regulation of the product design phase would be located if the firm was not regulated by the FCA.

119. We support the ability of regulators to use OIVoP and VVoP powers. However, we are concerned about the lack of transparency which currently surrounds the exercise of these powers. In some occasions there is no indication that the FSA is considering exercising the OIVoP or VVoP powers until they are actually exercised. Whilst we acknowledge that in certain circumstances the regulator will need to act quickly to vary a firm's permission in most circumstances we would expect the written warning of the regulators decision to the firm to be made public.

[26] Future of Banking Commission, Chapters 2 & 3

120. It is important that both authorities will have the power to ban an approved person working in a dual-regulated firm. We note that in the case of DSB bank in the Netherlands the Dutch central bank was criticised for approving leadership of the bank who had "insufficient awareness of the client's interests".

Passporting

121. We would welcome clarification from the Government as to what action the PRA would take if it had concerns about the UK branch of an overseas firm. In particular whether it would have a duty to publicly disclose this information.

Rule-making and rule waivers

122. We agree that it is important that the PRA and FCA consult each other prior to making rules. Wherever possible those views should be made public. To reduce the burden on organisations responding to consultations wherever possible the FCA and PRA could undertake joint consultations (similar to those undertaken by bodies such as the Bank of England/FSA and HM Treasury/BIS).

Part VII transfers

123. We still strongly object to the proposal to give the PRA responsibility for specific regulatory duties connected with Part VII applications. We will comment further and propose amendments when the section of the draft Bill amending Part VII is published.

124. Our experience of Part VII transfers in the with-profits fund sector has been that these do not take sufficient account of the interests of policyholders. With-profits policyholders at AXA and Aviva lost out on billions of pounds worth of value because of Part VII transfers which were rubber stamped by the FSA with clearly inadequate consideration of policyholders' interests. There is a significant risk that giving ultimate responsibility to the PRA will lead to a further worsening in the regulators already woeful performance.

125. The proposal also does not seem to appreciate the role of the regulator in relation to Part VII transfers. The regulator should have a significant role in ensuring that policyholders are treated fairly during the process and providing comment to the Court in relation to the Part VII transfer and is entitled to be heard by the Court under section 110(a) of FSMA. The role of the regulator is also specified in COBS 20.2 in relation to a Part VII transfer which includes a 'reattribution' of an inherited estate of a with-profits fund. The regulator is also required to approve the appointment of a

‘Policyholder advocate’ as part of the process.

126. The regulator is also involved in nominating or approving the appointment of an ‘independent expert’ who is required to prepare an objective report on the Part VII transfer. However, this does not produce sufficient protection for policyholders’ interests as ‘independent experts’ have typically had little success in altering the terms of the scheme and in our experience do not comment on factors which are vital to the overall fairness of the scheme to policyholders such as the firm’s assumptions regarding the level of new business.

127. The ability for the PRA and FCA to apply to the Court for an independent actuary’s report to be carried out after the transfer has been approved provides absolutely no protection for policyholders’ interests.

128. We believe there is a need for a fundamental review of Part VII of FSMA and the Conduct of Business rules governing these issues. We continue to believe that transferring these responsibilities to the PRA – a regulator which will have no specific objective in relation to the protection of consumers would be a serious mistake.

Enforcement

129. We have commented on the enforcement process and the disclosure of warning notices in answer to an earlier question. We welcome reduction in the minimum period for regulators to consider representations to 14 days.

15 Do you have any comments on the proposals for the FSCS and FOS set out in paragraphs 2.196 to 2.204 and in Chapters 3 and 4?

130. We welcome the Government’s commitment to retaining an independent ADR body in the shape of the FOS. The existence of an effective consumer redress system is vital to ensuring confidence in the financial system and to facilitate the smooth running of the industry. Which? as an organisation has redress for consumers as a core principle. We support alternative dispute resolution systems as a cost-effective alternative for both consumers and firms. Which? believes that the FOS is effective at providing a method of dispute resolution which is fair to both consumers and firms. The FOS ensures a level playing field between firms and consumers and provides an effective alternative to the court system. It is important that the reforms to regulation do not downgrade the role of the FOS. We would oppose the introduction of any fee for consumers to access FOS or extra appeals processes for firms.

Prudential Regulatory Authority

2 Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems as described in paragraphs 2.32 to 2.40 and in Chapters 3 and 4?

131. With regard to the regulation of Payments systems we believe that the Bill offers an opportunity to review the role of the Payments Council. The slow implementation of faster payments and the Payments Council's role regarding the possible phasing out of cheques raise significant questions about whether it acts in the best interests of consumers, users of the payments system or the economy as a whole. Which? will be making further proposals in this area during the coming months.

3 Do you have any comments on:
• the proposed crisis management arrangements; and
• the proposals for minor and technical changes to the Special Resolution Regime as described in paragraphs 2.41 to 2.44 and in Chapters 3 and 4?

132. We continue to be concerned that the SRR does not contain any reference to the importance of promoting competition. This may mean the Bank unduly exercises a preference to encourage a resolution process which distorts competition and increases the market power of major banks.

4 Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?

The PRA's insurance objective

133. We believe changes are needed to the PRA's insurance objective which currently reads "Contributing to the securing of an appropriate degree of protection for those who are or may become policyholders".

134. This drafting may be contrasted with that of the FCA's consumer protection objective which requires the FCA to aim to secure protection (see new section 1C(1)). We believe the drafting used in the FCA's objective is more appropriate. This view is shared by John Odgers, a barrister specialising in financial services issues who has given us advice on the draft Bill. He states:

> *"It seems to me quite unnecessary, and unhelpful, that such different language is employed in the insurance objective. Nobody would suggest that either regulator is solely and uniquely responsible for protecting consumers or policy-*

holders, hence the efforts of both are necessarily no more than 'contributions' towards those ends. But drafting a statutory objective in terms of merely contributing to the desired outcome seems a virtual license for failing to take a leading role and/or passing the buck if the objective is not met… In my view, therefore, the drafting of proposed new section 2C(2) should be amended by omitting the phrase 'contributing to the'".

135. As outlined below, we are concerned that the PRA is being given responsibility for areas of conduct regulation in the insurance field. Given the regulator's lack of focus and experience on conduct issues we believe, if it is to have these responsibilities, it is essential that it is given a clear remit to protect policyholders.

136. We also believe it would be beneficial for the PRA to be given the same overarching duty as the FCA to discharge its functions in a way which promotes competition. This would help ensure that it doesn't focus on preserving existing institutions, but instead on creating a market where individual institutions face a realistic prospect of failure. It would also create an incentive and duty for the regulator to limit and remove the implicit subsidy received by the banking sector which distorts competition and disadvantages new entrants.

With-profits funds

137. We are concerned about the Treasury's decision to place certain aspects of the regulation of with-profits policies with the PRA. Consumers have around £330 billion invested in with-profits funds in around 25 million with-profits policies.

138. We have two key issues with respect to the treatment of with-profits in the reform process:

1) PRA undertaking conduct regulation: The PRA's insurance objective is weaker in terms of consumer protection than that of the FCA. Furthermore, the PRA will not have the staff and culture in place to take the proactive approach to consumer protection that is envisaged for the FCA. The PRA also lacks the remit of the FCA to promote competition. In addition unless the Government consents to our suggestion, the PRA does not have in place any consumer representation mechanisms. As a result with-profits policyholders face a situation where they may receive second class protection when compared to holders of other financial services products. We are clear that the regulatory regime for with-profits must focus on the fair treatment of policyholders. Any downgrading of this requirement would be a retrograde step.

2) Terminology in the draft Bill: The draft Bill re-introduces the concept of 'Policyholders Reasonable Expectations' (PRE) which we believe is retrograde step in

terms of policyholder protection. As the FSA stated in their with-profits review in 2002 "'Treating customers fairly', unlike the former 'policyholders reasonable expectations' is an obligation imposed by rule and no longer only a ground for intervention derived, in part from actuarial best practice."[27] Issues surrounding how actuaries interpreted Policyholders' Reasonable Expectations were at the heart of problems at Equitable Life. Unless this drafting is reassessed we are concerned that policyholders will face an unwinding of the positive improvements the FSA has made to regulation in recent years.

139. In order to address these weaknesses we would suggest five legislative amendments. Firstly, as set out above, we believe the PRA insurance objective should be amended. Secondly, we believe the drafting with respect to with-profits should be amended from 'responsibility for contributing to the securing of an appropriate degree of protection for the reasonable expectations of policyholders' to 'responsibility for securing an appropriate degree of protection for policyholders'. Thirdly, the PRA must be given a remit to discharge its functions in a way which promotes competition. Fourthly, the PRA must have a specific duty enshrined in statute to consult the FCA with regard to with-profits funds. Finally, if the PRA is to be given responsibility for areas of conduct regulation, we believe it is all the more essential for the regulator to have statutory duties towards proper consultation and the maintenance of panels as set out below. Unless all of these changes are made and there is a clear commitment for the PRA's regulation of with-profits to focus on the fair treatment of policyholders then moving regulation for with-profits funds to the PRA poses a significant risk of consumer detriment.

5 Do you have any comments on the detailed arrangements for the PRA described in paragraphs 2.62 to 2.78 and in Chapters 3 and 4?

140. We are very concerned by the Government's decision that the PRA will not be required to establish, maintain and consult panels and will instead be given the flexibility to decide what arrangements it wants to establish. This concern is exacerbated by the fact that the PRA's general duty to consult contains no mention of the need to consult consumers or consumer groups. We do not believe it should be in the gift of regulators to make these decisions – it is a matter for Parliament to determine the structure within which regulators operate and their consultation mechanisms should be part of this. Furthermore we do not see any reason why, given the Government accepts the benefits that the panels provide the FCA, they are not seen to be similarly necessary for the PRA. We therefore firmly believe the PRA should have the same obligations, set out in legislation, as the FCA. The existing FSA panels have played a valuable role in allowing the FSA to consult with the industry,

[27] With-profits review feedback statement, FSA, May 2002, para 5.43

small businesses and consumers on issues of regulation. Panels that would overarch both regulators would help to ensure that the cumulative impacts of prudential and conduct regulation are assessed at market, regulated firm and consumer levels.

141. The PRA will make a significant number of decisions which will have dramatic implications for consumers. These will include its decisions on prudential matters, arrangements concerning resolution arrangements (living wills) including how customers will be treated as part of these arrangements. It will also be responsible for making rules in relation to the FSCS for deposit and insurance business. The PRA will also have the ability to overrule the FCA which could have significant negative implications for both consumers and competition. For example, the PRA may veto a requirement for a firm to pay proper redress to consumers.

142. The PRA should also implement a strategy for wider consultation with consumer groups and the general public as part of its processes. The PRA's general duty to consult must be amended to include a requirement to consult "consumers".

Problems with the current approach to prudential regulation

143. Which? is concerned with the current approach to regulation of banks and the legacy of the Government's intervention during the financial crises. These have significant effects on the prospects for competition in retail (and likely SME) banking by creating:

- Distortionary subsidies, direct through state aid bailouts and indirect by reducing funding costs, to the largest market incumbents thereby strengthening their market power; and
- No effective regime to enable market exit by failing banks (whether due to poor management or dissatisfied customers) while preserving financial stability of the economy as a whole.

144. These concerns relate to the public policy for regulation of banks and the role of UKFI in managing taxpayers' stake in those banks that relied upon state aid to avoid failure. Further reform should also be taken in the overall approach to regulating banks: too often regulators are held accountable for banks' decisions that create instability or put consumers at risk and those same banks remain in business regardless.

Regulation – implicit subsidy

145. Which? established a Commission into the Future of Banking early in 2010, and received evidence from key players amongst banks, regulators and government.

Evidence to the Commission made it clear that the banking industry enjoys a significant public subsidy, in the form of tax payers' funds used to protect failing banks from insolvency. Lord Myners noted that "the banking industry, because it's been underwritten implicitly against failure, without paying a premium, has enjoyed a huge subsidy". This was evident in the approach to bank failure during the crises but also marked a long-standing trend, when dealing with risks to financial stability, of preserving the status-quo by state aid or by merger.

146. This subsidy arguably distorts decision making by banks, fostering riskier behaviour than would otherwise be acceptable, while enabling those banks to raise funds more cheaply. For those banks requiring taxpayer support, it has been necessary to support the whole bank, not just the assets and liabilities linked to essential banking activities such as the payment transmission system or securing customers' deposits. Mervyn King noted to the Future of Banking Commission: "Ultimately the heart of the problem does come down in my view to the inherent riskiness of the structure of banking that we've got, and the difficulty of making credible the threat not to bail out the system, which is what is underpinning the implicit subsidy and creating cheap funding for large banks taking risky decisions."

147. It has been argued that the value of this subsidy, which distorts the cost of capital for banks, has increased over the course of the financial crisis as the implicit subsidy became explicit support, and is greater for larger than smaller banks. For example, Andy Haldane of the Bank of England estimates that the subsidy for the biggest 5 banks in the UK amounted to £50 billion for the period 2007-09, representing about 90 per cent of the total implicit subsidy available to the banking industry. In its submission to the Future of Banking Commission Virgin Money estimated private equity investors demanded a 10 – 13 per cent higher cost of capital from new entrants than from the largest incumbents: effectively double the cost facing the largest banks.

148. This subsidy results in a significant moral hazard. It fundamentally erodes the ability of small or new entrant banks to become serious challengers to the large, established incumbents. As a result market discipline, the key mechanism of competitive markets, is made ineffectual: good banks are unable to drive out the bad, while big banks remain big. By encouraging high and excessive leverage, the implicit subsidy actually increases the likelihood of taxpayers being forced to step in and support the banking sector. It also encourages banks to intertwine highly leveraged investment and wholesale banking activities with essential retail banking activities and the payments system.

Powers, function and approach of the PRA

149. Whilst we accept the criticism of the previous regulatory approach to prudential regulation, expecting a move to a more judgement-focused approach with regulators exercising judgements about the safety and soundness of firms through greater supervision to lead to greater outcomes poses two particular problems. Firstly, because the increasing trend to put reliance on the regulator's supervision of compliance with international capital adequacy standards, such as those set by the Basel Committee on Banking Supervision, has created perverse incentives for banks to game the rules. Secondly, judgement-based supervisory regulation can all too easily turn into 'shadow management' and there is a limit to how effective this approach can be to regulating individual firms. Supervisory regulators will always be outnumbered by market participants who retain an informational advantage. It is important that the new judgement-led approach recognises these issues.

150. In his evidence to the Future of Banking Commission, Mervyn King cited the example of Citibank, which still faced near collapse during the crisis despite high calibre management and very close supervision by 'dozens' of regulators embedded within the firm. He note that "I cannot believe that any regulator in the world could honestly pretend that they would do better than what happened [at Citibank], and I think we have to recognise that sometimes things happen which are almost impossible to anticipate, hard to calibrate in advance in terms of how much capital you need to put aside, or how much cash you need to bank, in order to be sure that you won't get into trouble … Having a system that's robust with respect to that seems to me of fundamental importance, and as I understand it, that is exactly what regulators in other industries supplying utilities would encourage us to do".

151. Which? agrees that the lessons of other regulated industries have not been applied to financial services. In other industries, regulators strive to establish the pre-conditions for effective competition. It has always been recognised that for effective competition to be possible, the regulator has to ensure there are specific arrangements in place which allow firms to fail while ensuring the continuity of essential services. For example, in the Water Industry when Enron acquired Wessex Water, OFWAT imposed conditions including requiring the Board to act as if it was an independent company and prohibited cross-default operations.[28] Their primary objective was not to protect Enron's shareholders, but to ensure that customers would continue to receive an essential service and that the creditors of Enron corporation should have no recourse to the assets of the Water company. The result was that when a combination of fraud and incompetence caused Enron to collapse, the ring-

[28] For details of the ring-fencing provisions imposed see OFWAT, The Proposed Acquisition of Wessex Water Limited by YTL Power International Berhad, April 2002

fencing provisions ensured that Wessex Water was able to continue to function and essential services were maintained.

152. The prudential regulator must change its approach from attempting to prevent failure to ensuring banks can fail, but without significant harm to vital banking services or the economy. Stability is not created by preventing failure, but by enabling firms to fail in a controlled way. The PRA would be the guardian of the 'living wills' which banks would be required to produce. It would also be responsible for policing the ring-fencing of retail activities which was recommended by the Future of Banking Commission and any final proposals from the Independent Commission on Banking on the separation/ring-fencing of retail banking and restrictions on a bank's ability to transfer capital between the retail and non-retail subsidiaries.

153. Ensuring that banks face a realistic prospect of failure would help improve the accuracy of the pricing of equity and debt to individual banks and help ensure that these more accurately reflect the risks of a specific bank. Responsibility for prudence must lie with the banking institution, its management and debt providers and not be delegated to regulators.

154. The PRA would take pre-emptive steps to:

1) Protect ordinary depositors and retail customers
2) Ensure the continuity of all essential retail banking services
3) In the case of any institution that is too big or otherwise too significant to fail, intervene to restructure that institution such that its failure would no longer present a systemic risk

155. We would favour objective of the PRA in relation to financial stability to be drafted as "Promoting the safety and soundness of PRA authorised persons includes seeking in relation to each PRA authorised person, to ensure that the failure of that person can occur with minimal adverse effects on the UK financial system."

156. The PRA should will need to work with the FCA to ensure that 'living wills' and the arrangements for the provision of essential banking services offers sufficient protection for customers' interests. We have expressed concern above about the interpretation of the 'consumer responsibility' principle in a way which seeks to impose unreasonable obligations on consumers. Whilst this principle would clearly be more relevant to the FCA, the risk of the PRA wrongly applying the consumer responsibility principle is clearly greater due to its inexperience in these areas and its lack of a consumer panel.

Macro-prudential regulation

1 Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?

157. Which? believes it is important to ensure appropriate safeguards are in place given the extensive powers proposed for the FPC. We support the proposal set out in new section 9L that, in general, orders under section 9K must not be made unless a draft is laid before and approved by Parliament. We also support the safeguards set out in new section 9K(4) that orders may require the FPC to maintain a statement of general policy that it proposes to follow in relation to the exercise of its power of direction. However we believe this drafting should be amended from 'may' to 'must'. This will ensure Parliament has the necessary information on how the FPC will use its powers and will thus be able to make a more informed decision when deciding whether to approve the order.

158. Which? does not have the expertise to evaluate the effectiveness of the different macro-prudential tools proposed, so we have concentrated on their potential impact on consumers. We believe that the potential impact on consumers should be studied by the Treasury before it sets out the precise macro-prudential available to the FPC in secondary legislation. It is also very important that the FPC's policy statement concerning how it plans to employ the tools specifically includes statements concerning how these tools will affect consumers.

159. To ensure this is undertaken we believe that consideration should be given to how the FPC interacts with the panels. It is clear that the FPC is not going to be a consumer-focussed body. However its decisions could have a huge impact on consumers – for example the decision to limit credit to cool a housing bubble will have a huge impact on both potential and existing home-owners. We are concerned that the FPC will not have the expertise, desire or remit to examine these impacts. We therefore believe the FPC should ask the Consumer Panel to approve its analysis of the potential impact of its proposals on consumers.

160. The potential impact on consumers could fall into two different categories:

161. Loan-to-Value limits for residential mortgages: When these are changed they will inevitably lead to a number of consumers being stranded with their existing mortgage provider. For example, if a consumer has just taken out a 95% LTV mortgage and the FPC decides to limit the maximum LTV to 90% then that consumer will be unable to move to a different lender (and unless their mortgage is fully portable, to a different house). It is also likely that a reduction in the maximum LTV would lead to house price falls which would further exacerbate the position of that

consumer. Unless mortgage contracts are tightly defined, banks will be able to exploit these captive customers by increasing their margins. There will also need to be consultation about how customers should be treated if they are part-way through the house purchasing process and already have a mortgage agreement in place, but have not yet drawn down the funds.

162. Other capital requirement changes: It is likely that banks will use any changes to capital requirements or risk weights to alter the price paid by existing customers. For example, many terms and conditions will allow banks to vary the contract in response to decisions by “regulators”. How any changes to price will be applied and the discretion which firms may use to apply these changes are likely to be relatively opaque to consumers (unlike clear contractual terms which could exist for changes in interest rates to follow a clearly defined and transparent reference rate such as a product where the interest rate tracks the Bank of England base rate). We have concerns that firms may seek to apply these changes unfairly or to exercise unfair contract terms. There will also be conflicting messages for consumers if the MPC is lowering the base rate at the same time as the FPC is increasing capital requirements for particular types of consumer lending. The exact terms of contracts are likely to be issues for the FCA, but how firms may exercise their discretion may also have systemic impacts if, for example, all banks are confident that they will be able to react to any changes in capital requirements by immediately passing on the costs to existing customers by increasing rates.

Annex 1

Shortcomings of Competition Regulation under the Financial Services and Markets Act 2000

Competition regulation under FSMA is, at best, wholly inadequate and, at worst, detrimental to the competitive landscape in the financial sector. The ambit of the FSA is currently centred on the maintenance of market confidence, raising public awareness, the protection of consumers and the reduction of financial crime. While the FSA also has, among its primary duties set out in FSMA, the requirement to have regard to 'the desirability of facilitating competition between those who are subject to any form of regulation by the Authority', FSMA does not give the FSA concurrent competition powers with the OFT, which would allow it to either (a) directly apply competition law or (b) refer markets to the Competition Commission, as is the case for the regulators of other industries. It is clear that the FSA's approach is to avoid putting up further barriers against competition, rather than proactively seeking to improve the degree of effective competition in the industry. Indeed, in some sectors of the market such as with-profits funds, the FSA actually applies different rules to existing firms, compared to any recent or potential new entrants.[29] The inadequate focus on appreciating the benefits which competition can bring can also lead to codifying existing industry practice instead of driving improvements for consumers. For example, instead of improving the ability of customers to switch cash ISAs, the FSA simply required that the banks provide a "prompt and efficient service" and referenced existing industry guidance.

Indeed, in its composition, FSMA gives the impression to market participants in the financial sector that they have a degree of immunity from UK competition law since agreements or conduct by a dominant firm, which would usually breach competition rules, are not subject to enforcement if 'encouraged by any of the Authority's regulating provisions'. This provision of FSMA effectively puts the maintenance of effective competitive markets in the financial sector subordinate to FSA regulation, albeit that European competition law can be applied regardless of this exclusion. Competition law considerations were further disregarded when, in the course of the financial crises, the public interest test for merger regulations was widened to include 'financial stability', allowing the Secretary of State to rule in the case of bank mergers, rather than the OFT or the Competition Commission.

The OFT has some specific responsibilities under FSMA 2000, necessary to compensate for the lack of competition objectives in the FSA's mandate. Section 160 of FSMA requires the OFT to keep the regulating provisions and practices of the FSA

[29] COBS 20.2.20

under review, and report any significantly adverse effects to the Competition Commission: a process known as 'competition scrutiny'. There have been no occasions under current legislation where the OFT has exercised this power. So, while the OFT may be suited to 'repairing' or conducting investigations into previous competitive markets, it is not up to the proactive task of regulating vigilantly to make markets in the financial sector more competitive.

This special treatment of the financial services industry sends a clear message to both the regulator and industry that the 'normal' rules of competition do not apply.

Annex 2

Payment Protection Insurance mis-selling

The mis-selling of Payment Protection Insurance (PPI) is an example of how a poorly functioning market, and a failure to intervene at an early stage to fix it, can disadvantage customers. PPI is designed to cover your debt repayments if you can't work – for example, you become ill or have an accident, or you are made redundant. It is sold alongside loans, mortgages, credit cards and store cards. In the past decade, PPI has been subject to widespread mis-selling, and this has resulted in millions of consumers holding expensive insurance they would never be able to claim on.

PPI offers a clear example of a poorly functioning competitive market, as the sale of this product involved: (a) lack of adequate disclosure to customers about the product they were buying, and the resulting asymmetry of information between provider and customer; (b) inappropriate default settings, where it was left to the customer to opt out of buying the product when purchasing another financial product; (c) the existence of inappropriate commission structures, which focused the rewards for salespeople on selling PPI, rather than serving the customer well; and (d) accounting practices which allowed firms to book an upfront profit from selling single premium PPI policies.

The resolution of the problems in PPI has taken a long time. Which? first raised concerns about the mis-selling of PPI in 2002. An initial 'supercomplaint' by Citizens Advice was made in September 2005 to the Office of Fair Trading (OFT). The OFT followed up this complaint with a market study, launched in April 2006, which subsequently led to a market investigation reference, in February 2007, to the Competition Commission (CC). In 2009, the CC ruled it would be banning the sale of PPI alongside credit products, stipulating that lenders and credit card providers would have to wait at least seven days before approaching a customer about the sale of PPI. Following an unsuccessful appeal by the banking industry, the CC provisionally confirmed this ruling in May 2010, and published its final remedies in July 2010, almost five years after the issue was first raised by Citizens Advice.

In 2005, the FSA conducted a series of mystery shopping and supervision exercises and in September 2005 called on firms to take "urgent action" to ensure that their selling practices for PPI were compliant with regulatory requirements. However, firms did not respond to the FSA's regulatory action and continued to mis-sell PPI. The FSA responded by conducting further rounds of mystery shopping and eventually conducting enforcement action and levying fines. However, these fines were such a low proportion of the revenue gained by banks from selling PPI they failed to have the desired effect. Despite, widespread mis-selling, no senior management in financial

services organisations had enforcement action taken against them. The only senior management individual to have enforcement action taken against them for mis-selling unsecured loan PPI was the chief executive of a furniture retailer (Land of Leather).[30] Eventually, at the start of 2009, the FSA eventually secured “agreement” from the industry to stop selling single premium PPI on personal loans. The problems for consumers have been compounded by the failure of firms to deal with complaints fairly. Consumers have faced unreasonable delays and the Financial Ombudsman is upholding over 90% of complaints received about some firms. This indicates that many firms are dismissing valid complaints and hoping that consumers do not go to the Ombudsman. The FSA is currently consulting on an approach to require firms to review previously rejected complaints. The FSA announced in September 2009 that several banking groups had agreed to undertake a voluntary review. However, almost a year later, Lloyds TSB disclosed that it had yet to start its review of past sales.[31] The British Bankers Association has now applied for a judicial review of the FSA’s rules regarding the handling of PPI complaints.[32] This will lead to further delays for consumers.

[30] http://www.fsa.gov.uk/pages/Library/Communication/PR/2008/039.shtml
[31] http://www.lloydsbankinggroup.com/media/pdfs/investors/2010/2010_LBG_Interim_Results.pdf, page 122
[32] http://www.bba.org.uk/media/article/bba-statement-on-ppi

Annex 3

Future of Banking Commission conclusions on Consumer Protection Regulation

The regulator responsible for consumer protection regulation should have both: (a) an explicit mandate to promote effective competition in markets in the financial sector; and (b) the necessary powers to regulate the sector to achieve this, including the ability to apply specific licence conditions to banks and exercise competition and consumer protection legislation. These powers will be concurrent with the competition powers of the OFT, and will enable the regulator to both enforce competition law and make market investigation references to the Competition Commission.

The aim of consumer protection regulation is to promote the conditions under which effective competition can flourish as far as possible, and where not, the regulator will be able to take direct action. In order best to promote the interests of the consumer, the regulator will encourage financial firms to compete:

1 On the merit of the quality and price of their products and services; and
2 To gain a competitive advantage by investment in innovation, technology, operational efficiency, superior products, superior service, due diligence, human capital, and offering better information to customers.

The regulator would step in whenever there is a sign of market failure. Market failures include: (a) poor quality information being disclosed to consumers when they are deciding whether to purchase products; (b) information asymmetry between the provider and the consumer; or (c) providers taking advantage of typical consumer behaviour such as the tendency evident in retail customers to select the default option offered, and reluctance to switch products because of inertia. Any sign of market failure indicates that competition is probably not effective, and the regulator should then take action to counteract the failure.

We are in favour of exploring further a number of specific measures that could be taken by a regulator with a dedicated remit for consumer protection:

1 **Ensure customers can easily transfer products and accounts.** This will significantly reduce barriers to entry for new market entrants, and may help tackle consumer inertia. The regulator could consider the introduction of a portable bank account number for personal accounts.

2 **Ensure customers with overdrafts are not overcharged.** This will ensure customers are treated fairly and reduce barriers for new market entrants.

3 **Set ‘default’ settings on services, products and accounts in the customer’s best interest**. As Cass Sunstein and Richard Thaler point out persuasively in Nudge, customers tend to elect the default setting that they are offered, rather than make a decision about what they actually want. The consumer protection regulator would have the power to set default settings on services, products or accounts in the customer’s best interest.

4 **Allow customers to choose to ‘opt-in’ to unauthorised overdrafts**. Customers who do not opt in may have some payments refused. Customers would therefore be made aware of the potential cost and inconvenience of these refusals resulting from not having an overdraft facility.

5 **Ensure banks do not take advantage of existing customers**. In the retail savings market, for example, consumer inertia often leads to a reluctance to switch accounts and providers. Currently, some providers take advantage of this inertia, by only offering their best deals to new customers, and denying existing customers access to newer versions of their existing products, which may have more favourable terms.

6 **Act to prevent obscure charges or unfair, asymmetrical contract terms where these are present in financial products and services.**

7 **Ensure full and transparent disclosure on all products**. For example, any fund, such as a with-profits fund, should have full annual reports showing how the funds have performed, and how much money has been spent on commissions and management fees. Generally, it should be assumed that information should be placed in the public domain unless there are strong reasons for it not to be disclosed.

8 **Consider introducing standard products for some basic services which all retail providers have to provide, and a common form in plain English to explain the key terms so that customers can easily compare products provided by different providers on the same basis**. Additional comparative information can also be supplied on customers’ use of banking products–for example, through provision of an annual summary of charges, interest forgone and average balances in standardised format.

9 **Empower customers to seek compensation via a collective redress process**. The regulator should allow simple and effective collective redress to empower retail and SME customers who have suffered widespread failures of financial products or sales processes to seek compensation when serious and systemic harm has arisen. This process would allow representative bodies to act on behalf of many customers adversely affected by the same or similar issues, with examples being financial products or services which are (a) mis-sold, (b) sold under misleading pretences or

(c) subject to unfair terms. The Commission advocates that the process should be on an 'opt-out' basis, which would allow representative bodies to take action on behalf of all consumers affected. Previous cases such as Payment Protection Insurance and mortgage endowment mis-selling would have qualified for collective actions.

10 **Promote bank retail depositors to rank ahead of all other creditors, including bondholders**. This will facilitate governments allowing institutions to fail, reducing the risk to taxpayers and forcing management to face the full consequences of their risk-taking.

11 **Ensure consumer deposit accounts clearly highlight whether or not they are covered by the Financial Services Compensation Scheme (FSCS).** This will prevent market entrants like Icesave marketing less securely protected accounts to customers who are not fully aware of the extent of their rights. It is intended, however, that the reform of the liquidation preference, mentioned above, will reduce the likelihood that the insurance provided by the FSCS is called upon.

12 **Prohibit those commission structures which incentivise mis-selling**.

13 **Firewall conflicts of interest, and if the conflicts are intractable, force structural change to address the problem**. Particular attention would be paid to conflicts of interest between the financial institution and its customers.

Federation of Small Businesses
The UK's Leading Business Organisation

Mark Hoban MP
Financial Secretary to the Treasury
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

7th September 2011

Dear Minister,

Re: Panels and the PRA

As consumer groups and trade associations we will not always agree on every issue. However, there are some issues where we are in agreement. We believe that the PRA should have a statutory duty to maintain, consult, and consider representations from the consumer, practitioner and small business panels.

The existing FSA panels have played a valuable role in allowing the FSA to consult with the industry, small businesses and consumers on issues of regulation. Panels that would advise the PRA and FCA would help to ensure that the cumulative impacts of prudential and conduct regulation are assessed at regulated firm and consumer levels. An alternative approach would be to establish a distinct set of statutory panels for the PRA, to complement the Government's proposed FCA panels.

The current panels are an extremely useful source of information and can provide inputs from a wider range of experts than can be appointed to boards. Consulting with a wider source of experts will be beneficial to the PRA and help to flag up any unintended consequences of proposed regulation at an early stage.

We do not believe it should be solely in the gift of regulators to decide their consultation mechanisms. It is a matter for Parliament to determine the structure within which regulators operate and the need to consult with business and consumers should be part of this. Given the Government accepts the benefits that the panels could provide the FCA we do not see any reason why they should not also apply to the PRA.

We very much hope that you will reconsider your approach and introduce the necessary changes.

Yours sincerely,

Otto Thoresen
Director General
ABI

Michelle Mitchell
Charity Director
Age UK

Mike O'Connor
Chief Executive
Consumer Focus

John Walker
National Chairman
Federation of Small Businesses

Peter Vicary-Smith
Chief Executive
Which?

LEBA WMBA

WMBA and LEBA Response to FSA Consultation on HMT Consultation entitled "A New Approach to Financial Regulation"

Introduction

The Wholesale Markets Brokers' Association (WMBA) and the London Energy Brokers' Association (LEBA) (*together "WMBA"*) are the European Industry Associations for the wholesale intermediation of Over-The-Counter (OTC) markets in financial, energy, commodity and emissions markets and their traded derivatives. Our members are Limited Activity/Limited Licence firms (under CRD) that act solely as intermediaries in the said wholesale financial markets. As Interdealer Brokers (IDBs), the WMBA members' principal client base is made up of global banks, primary dealers and energy companies. The comments below should be seen in the context of WMBA members acting exclusively as intermediaries, and not as own account traders. (Please see www.wmba.org.uk and www.leba.org.uk for information about the associations, its members and products).

Overview

The WMBA welcomes the proposed amendment to the UK regulatory structure outlined in the Treasury document "*A New Approach to Financial Regulation; A Blueprint for Reform*" and the opportunity to provide input into the Consultation. Despite the uncertainty raised in the next paragraph, our response is made from the viewpoint of our Limited Licence/Limited Activity firms operating in the wholesale markets and who WMBA consider should in future be supervised by the Financial Conduct Authority.

The recent BOE/FCA consultation paper titled "*A New Approach to Regulation*" stated that the Prudential Regulatory Authority (PRA) will be responsible for a small number of significant investment firms. However, Margaret Cole (FSA), in her speech on 28th June 2011 when launching this paper, also indicated "*for both conduct and prudential regulation, there is likely to be a small number of firms which will require a more active supervisory programme. This will apply to firms whose failure, even if orderly, could threaten the integrity of particular markets. One such example is **Interdealer Brokers***".

As you have read above, an Interdealer Broker only ever acts as an intermediary between typically wholesale counterparties such as banks. As IDBs are not authorised to take a proprietary position at any stage, our risk profile is such that it raises the question as to how, in the quote from Margaret Cole, IDBs could threaten integrity in the wholesale markets. Operating such a straightforward business model and in parallel competition to each other, would ensure in our opinion, that any failure would more than likely cause no discernible impact on the wholesale markets.

An IDB also has no retail clients. In light of this, we would seek clarification as to the definition of a *"significant investment firm".* It has been suggested that IDBs are to be included within a putative classification of "Financial Market Infrastructures" (FMIs) including market intermediaries such as Regulated Exchanges, MTFs and post-trade settlement and clearing systems. Such classification may be jointly regulated by both PRA and FCA. Respectfully, we would again request clarification of whether such a regime is being considered. Following on from this, we also request clarification of the extent to which HMT considers IDBs may create or mitigate systemic risk.

LEBA WMBA

WMBA and LEBA Response to FSA Consultation on HMT Consultation entitled "A New Approach to Financial Regulation"

The WMBA welcomes the recognition in this paper:

(a) that *"financial services is one of the key sectors of the UK economy"* and *"as an employer and contributor of tax revenues, as an exporter of UK services to the rest of the world, and as a vital part of the economic infrastructure, a healthy financial sector is an important driver of growth in the UK"* (paragraph 1.1);

(b) that the potential for significant risks posed by such a financial service sector and the severe impact of the recent financial crisis calls for the kind of *"targeted policy responses"* identified in paragraph 1.5 and a fundamental strengthening of the system *"by promoting the role of judgement and expertise"* (paragraph 1.13); and

(c) that in order to develop an appropriate and workable programme of reform, the Government must *"work closely with all stakeholders"* (paragraph 1.15).

However, in respect of the burden of regulation, the WMBA are concerned that the difference between the requirements of wholesale and retail markets are not fully recognised by the FCA and would reiterate the Government's assertions in its previous consultation paper "A new approach to financial regulation: building a stronger system" (Cm8012), namely:

(a) that "*the key to any new regulatory approach should be proportionality, the principle that a burden or restriction imposed on a person or activity should be proportionate to the benefits which are expected to result" (paragraph 4.25);*

(b) that policy-makers must *"think carefully about the case for regulation"* and, where intervention is required, to explore in full the opportunity for non-regulatory and self-regulatory approaches before considering regulatory measures (paragraph 3.66-7);

(c) that the new regulators must be *"rigorous in their analysis of the impact of regulation on industry"* (paragraph 3.67);

(d) that regard should be paid to the *"potentially negative effects of excessive regulation on market efficiency and consumer choice"* (paragraph 4.9); and

(e) that the new infrastructure must be able to operate in a way that delivers coherence, efficiency, effectiveness and *"the best value-for-money solution for the financial services sector"* ("A new approach to financial regulation: judgement, focus and stability" (Cm7874)).

WMBA also welcomes HMT's intention to ensure that there is full and effective co-ordination between the various bodies that have macro and micro supervisory powers.

WMBA and LEBA Response to FSA Consultation on HMT Consultation entitled "A New Approach to Financial Regulation"

Detailed Comments

Q1. Do you have any specific views on the proposals for the FPC as described above and in Chapters 3 and 4?

The WMBA generally supports the views and objectives laid out in Chapters 3 and 4. The WMBA would reiterate its view that governance of the FCA is "too heavily weighted" towards the retail consumer sector at the expense of wholesale markets supervision.

We repeat that the concept of a "*Wholesale Consumer*" is flawed and indeed may lead to development of less utile financial market infrastructures ultimately damaging the competitiveness of the UK. Wholesale markets are professional and eligible and need to be defined and treated in a very distinct manner from retail markets. This issue is of crucial importance to the UK in a way that doesn't apply elsewhere due to the position of London as the hub of the world's wholesale financial markets.

Q2. Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems as described above and in Chapters 3 and 4?

The WMBA generally supports the views and objectives laid out in Chapters 3 and 4.

We do however note that there is no resolution regime for systemically important Financial Market infrastructures [FMIs] such as CCPs; and these need to be developed in parallel to those in the banking system and before adequate supervision can be established by the Bank of England.

Q3. Do you have any comments on the proposed crisis management arrangements; and the proposals for minor and technical changes to the Special Resolution Regime as described above and in Chapters 3 and 4?

As per Q2 above.

The WMBA notes that there is no resolution regime for systemically important Financial Market infrastructures [FMIs] such as CCPs; and these need to be developed in parallel to those in the banking system and before adequate supervision can be established by the Bank of England. Further, such arrangements need to be recognised and suitable for the framework being established by the European Commission, and to be able to passported out to jurisdictions beyond the EU.

Q4. Do you have any comments on the objectives and scope of the PRA, as described above and in Chapters 3 and 4?

The WMBA supports:

(a) Recognition in Cm8083 of the need for regulatory policy and processes to be appropriately tailored to different types of firms; and

(b) rejection of a "zero-failure" approach to regulation, which would have to be so restrictive in terms of risk, innovation and choice as to undermine the Government's recognition in paragraph 1.1 that "a healthy financial sector is an important driver of growth in the UK". We note that IDBs operate in healthy competition and this environment of necessary high performance contributes not only to resilience, but also to both utility and efficiency.

Q5. Do you have any comments on the detailed arrangements for the PRA described above and in Chapters 3 and 4?

The WMBA supports HMT views that:

(a) the importance of effective information-sharing with the FCA can empower a continuation of a principles-based, as well as a rules-based authority

(b) that all such judgements should be "rigorously evidence-based" and should embody the principal of "consistency of decisions"

(c) that *"the PRA board must provide a robust challenge to the executive"*

(d) the National Audit Office should undertake value-for-money studies of the PRA and FCA

Q6. Do you have any views on the FCA's objectives – including its competition remit – as set out above and in Chapters 3 and 4?

The WMBA supports the Financial Conduct Authority's (FCA) strategic objective of protecting and enhancing confidence in the UK financial system and its three operational objectives:

- Securing an appropriate degree of protection for the consumer;
- Promoting efficiency and choice in the markets for financial services; and
- Protecting and enhancing the integrity of the UK financial system.

The WMBA welcomes HMT's recent statements in respect of key expressions of regulatory policy and notes that it is the FCA's stated position to "*recognise that there are important differences between wholesale and retail markets*" (*Paragraph 3.5*) and "*will adopt a differentiated approach to protecting different categories of consumers*" (*Paragraph 3.6*). However, the WMBA stresses the importance of making sure that these statements are made good in practice and, therefore, that the FCA embraces proportionality and avoids '*scope-creep'*. In light of the wider retail mandate given to the FCA, we highlight the risk that in focusing too strongly on retail issues, the unintended consequence of regulatory COB burdens that are not proportionate or relevant to wholesale market participants may result. For this reason, the WMBA would urge HMT to ensure that there is a continuing and objective balance to the role and processes of the FCA with regards to both regulated firms and consumers and whilst remaining a priority investor protection, and consumer interests should not become the sole perspective of the FCA.

LEBA WMBA

WMBA and LEBA Response to FSA Consultation on HMT Consultation entitled "A New Approach to Financial Regulation"

The WMBA welcomes the proposal that the FCA will have a strong new role in promoting competition, efficiency and choice and notes the Government's recognition of *"the importance of competition as the best driver of good consumer outcomes"* and its intention to *"increase the profile of competition issues in a regulatory system"* (paragraph 1.8 and 1.41).

In particular, the WMBA notes the Government's intention:

(a) to empower the Office of Fair Trading to consider to what extent competitive inefficiencies in specific markets are generated by structural barriers or other anti-competitive elements (paragraph 1.8 and 1.41);

(b) to give the FCA a wide-ranging competition mandate *"which will place competition concerns at the heart of the new conduct regime"*;

(c) to empower the FCA to initiate *"an enhanced referral to the OFT where it has identified a possible competition issue"*, including issues that may be generated by structural market features or anti-competitive business practices (identified in relation to Q10).

However, in order to deliver the HMT's regulatory objectives, the WMBA would urge HMT to reconsider its position regarding the importance of competitiveness and include its facilitation as a key objective for both the FCA/PRA. Whilst the WMBA concur with the Government that financial stability is indeed the platform for sustainable growth and success, this does not remove the specific need for a regulatory recognition of the importance for UK firms to remain competitive and for authorities to pay due regard to the need to facilitate and foster competitiveness. It is difficult to see how both the PRA and FCA can perform the more commercially judgemental and interventionist role expected of them in the future, which will involve taking decisions on commercial matters, reviewing business models and products, and judging growth strategies, without being required to take into full account the need for those same institutions to maintain not just their international, but also their domestic competitiveness

With regards to competitiveness, the current wave of mergers across market infrastructures will likely establish monopolistic or near-monopolistic providers of essential market services and that their position and ability to dominate the market will be enhanced significantly by regulatory policy designed to encourage as much trading as possible to take place on organised trading venues, financial market infrastructures and to be centrally cleared by CCPs (*most of which are vertically integrated within exchanges).* Current market and regulatory momentum are delivering increasingly dominant positions for market infrastructures in execution, clearing, post-trade and market data services. All of these will impact on rights of clearing access, the pricing of services and facilities, the cost of (*and conditions of access to*) market data, the basis for licensing indices and the capability of new market infrastructure entrants to compete in execution and clearing.

The empowerment of FCA to independently monitor the behaviour of infrastructures relevant to market competitiveness and efficiency and choice in market services, the setting of fees and the terms and conditions for issuing licenses and affording access will

be a critically important discipline on infrastructures with considerable market power and will play a key role in delivering on FCA objectives of market integrity and efficiency.

Q7. Do you have any views on the proactive regulatory approach of the FCA, detailed above and in Chapters 3 and 4?

The WMBA supports the need for a more proactive approach to conduct regulation with a *"clear focus on consumer outcomes"*, but subject to standards of proportionality which would reflect:

(a) the category of consumer, e.g. retail or wholesale; and

(b) the need for firms to be competitive and pro-active in terms of service and product innovation in what is a highly competitive environment.

HMT needs to ensure that FCA carefully segments the market so that there is sufficient expertise within each segment. The team responsible for each sector must actively and continuously engage with trade associations and firms to maintain their specialist knowledge and identify market developments.

The WMBA support the Government's observations in "A New Approach to Regulation; Building a Stronger System" that product intervention powers are "unlikely to be appropriate in relation to wholesale market consumers"; however, they are concerned that the recent FCA consultation indicates that product intervention in the wholesale markets must be considered *"to the extent that wholesale products filter down or are distributed to wholesale clients".*

Q8. What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?

No Comment

Q9. What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and, in the case of referrals from nominated parties, to do so within a set period of time?

No Comment

Q10. Do you have any comments on the competition proposals of for the FCA set out above and in Chapters 3 and 4?

The WMBA support the Government's observations in respect of competition and refer to the response to Question 6 above.

Q.11 Do you have any views on the proposals for markets regulation by the FCA, described above and in Chapters 3 and 4?

The WMBA welcomes the fact that the approach to the supervision of markets by the FCA will largely be a continuance of the same approach currently adopted by the FSA,

and that its primary focus will be principals based, participant based, and on the integrity plus efficiency of markets and in providing a level playing field.

Q12. Do you have any comments on the governance accountability and transparency arrangements proposed for the FCA, as described above and in Chapters 3 and 4?

The WMBA welcomes the proposals put forward by the Government, including particularly the proposed six principles of good regulation to which the FCA must have regard, i.e. efficient use of resources, regulatory proportionality, consumer responsibility, senior management responsibility, openness and transparency.

The FCA has provided the assurance that its judgements will be "*reasonable and proportionate*", we support the fact that its regulatory decisions will nevertheless be subject to an effective appeals mechanism, e.g. the scrutiny of an Independent Tribunal.

Q13. Do you have any comments on the general co-ordination arrangements for the PRA and FCA described above and in Chapters 3 and 4?

The WMBA the need for effective co-ordination and welcomes the fact that the Bank and FCA will be publishing a document later this year setting out more fully their plans to deliver "operational co-ordination" and that a key purpose of the general duty to co-ordinate is to "minimise unnecessary overlap, duplication and regulatory burden".

Q14. Do you have any views on the detail of specific regulatory processes involving the PRA and FCA, as described above and in Chapters 3 and 4?

With regard to the issue of enforcement, there is a clear tension between the FSA's understandable drive to develop credible deterrence sanctioning, the principle that the punishment should fit the crime, i.e. sanctioning proportionality, and the right of individuals to be able to reasonably predict the consequences of their actions.

We have as an Association repeatedly asked the FSA for clarity in respect of its approach to Market Abuse in the Wholesale non-equity markets and it is clear that this is still in development beyond the confines of short selling within the equity markets. As such the escalation of prosecutions in number, complexity and their criminal reach needs to be in step and proportional to the clarity of the approach.

Q15. Do you have any comments on the proposals for the FSCS and FOS set out above and in Chapters 3 and 4?

The WMBA has no comments

WMBA and LEBA Response to FSA Consultation on HMT Consultation entitled "A New Approach to Financial Regulation"

Information on the Associations

Operating as the hub of the global financial market infrastructure, Interdealer Brokers (IDBs) are MiFID compliant and highly regulated intermediaries by virtue of their regulatory authorisation and from being subject to supervision under CRD as Limited Activity firms. Our members are neutral, independent, and multi-lateral and provide free, fair and open access to their trading venues for all suitably authorised and regulated market participants. IDBs do not take positions in the markets they operate in and their collective service as the gateway to the global financial marketplace creates price discovery and significant liquidity. All transactions, whether executed via voice, hybrid or fully electronic means, are immediately captured at the point of trade, are subject to straight-through-processing, and are made available for transparent and timely transaction reporting to the relevant regulators.

The WMBA have restricted their comments to the topics that are relevant to their members and hence on which they have the relevant experience

WMBA Members:

- BGC Partners
- GFI Group Inc.
- ICAP plc
- Martin Brokers (UK) Ltd
- Reuters Transaction Services Ltd
- Sterling International Brokers Ltd
- Tradition (UK) Ltd
- Tullett Prebon plc
- Vantage Capital Markets LLP

LEBA Members:

- Evolution Markets Ltd
- GFI Group, Inc
- ICAP Energy Ltd
- PVM Oil Associates Ltd
- Spectron Group Ltd
- Tradition Financial Services Ltd
- Tullett Prebon Energy Ltd

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Passing Money into the Future

response to

A new approach to financial regulation: the blueprint for reform

by

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l. General problems with this consultation

This legislation is intended to create a regulator which protects the industry, while claiming to be neutral between the industry and consumers. There are various problems:

a) Not consulting on the main issues

There does not seem to be consultation on the main issues, such as whether the twin peaks system should be reintroduced.

b) Wrong focus

There should be a focus on protecting savings, and more generally personal finances. There is instead a focus on "persons" and "consumers".

c) Conflation

Different types of firm are conflated, such as banks and insurers which are regulated by both the PRA and FCA. Consumers are also conflated:

> **(3) Consumers means persons who (a) use, have used or may use services within subsection (4) or (5),**
>
> **(b) have relevant rights or interests in relation to any of those services,**
> **(c) have invested, or may invest, in financial instruments, or**
> **(d) have relevant rights or interests in relation to financial instruments.**

b) Vagueness

The above definition of "consumers" seems to result in some vagueness about who

or what is a "consumer". Firms can be "consumers", which is not consistent with "information asymmetries between providers and consumers" (2.89). There are no formal definitions. What is the meaning for example of "judgement-led"? "Objectives" seems a vague expression. They are goals which may not be achieved. The word "objective/s" is mentioned 353 times in the consultation and not at all in the Financial Services Act (1986). What is the difference between "general objective" and "strategic objective"?

2. Protecting the industry

> **The PRA's general objective is: promoting the safety and soundness of PRA-authorised persons.**

The first duty of the regulator should be to help people pass money into the future. Personal finances should be protected by the regulators in the first instance especially savings, rather than "persons" or "consumers". "Consumer protection" has a sales orientation.

> **The FCA's strategic objective is: protecting and enhancing confidence in the UK financial system.**

It is the job of a trade association to promote confidence in an industry rather than a regulator as pointed out by John Kay in the Financial Times (28/6/11) *A flawed approach to better consumer protection*.

3. The division of the financial regulator

The PRA's general objective:

> **is to be met primarily by-(a) seeking ensure that the business of PRA-authorised persons is carried on in a way which avoids any adverse effect on the stability of the UK financial system,**

But stability is the concern of banks. The bailouts Northern Rock etc were banks. Therefore the regulation of banks should be separated. Firms should not be regulated by more than one regulator, to avoid under/overlapproblems.

The regulator should be divided according to: a) banks, b) markets, c) building societies, insurance companies, fund management companies. Separating the regulator in this way, enables different regulators to be concerned with different kinds of consumer: a) depositors, b) investors, c) savers; who: a) pay bills; b) invest - apply money for profit; c) save - transfer money into the future. The latter are

generally just members of the public.

The twin peaks system of regulation is being reintroduced. Products will be the responsibility of the FCA and solvency the responsibility of the PRA. The Equitable Life scandal started with the problem of honouring GAR policies.

> **Finally, one of the core lessons to be learnt from the various reviews of the regulation of Equitable Life Assurance Society prior to its closure to new business was that it was undesirable for prudential and conduct of business regulation to be undertaken separately, and that the much better model was for prudential and conduct of business regulation to be fully integrated. It would be wrong for these important findings on how to improve regulation to be ignored.**

(Memorandum submitted by Berwin Leighton Paisner LLP in response to the Treasury Select Committee's consultation about the reform of financial regulation:

www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/memo/financialreg/m18.htm)

4. Exploiting inertia

The FSA permits the industry to exploit inertia and prevaricates itself. We need a regulator with a different character.

Instant access savings accounts with banks often or usually quote an interest rate which includes an initial "bonus" for one year. After a year the bonus is no longer included so the interest rate drops. New accounts with a new "series number", tend to offer a higher rate of interest. This is exploiting inertia because some depositors do not move their funds when a better account is available. They may be unable to act because they are ill. There are regular complaints on MoneySavingExpert such as:

> **Is there anything the government can do to make banks look after existing customers. I'm not too bothered about getting the top rate for my savings, but an account that gave me a reasonable rate over the long term would be hugely beneficial as I've got far better things to do with my free time than chopping and changing accounts every year or so!**

Will the FCA ban initial bonuses? The FSA already has the power to do this. Whether or not particular products and practices are banned depends on who is in charge of the regulator.

5. The bailout reports - FSA prevarication

5.1 Investigations by the FSA

A problem with not having an independent enquiry and leaving this to the FSA is that the work becomes tangled with various other enquiries and reports of the FSA, providing an excuse for delay. The FSA press release of 2 December 2011 *FSA closes supervisory investigation of RBS* produced a political storm, so the investigation was reopened. A letter from Lord Turner to Andrew Tyrie of 28 March 2011 discusses the: "Supervision Report This report looks at the effectiveness of the FSA supervision of RBS between 2005 and end 2008.".

There have been Section 166 investigations of RBS and HBOS. Why are these necessary before starting work on reports for the public? Lord Myners discusses the RBS report:

> **The problem stems from the fact that the investigation was commissioned from accountants Pricewaterhouse-Coopers as a "Section 166" report, ensuring the confidentiality of all evidence. "The FSA set out on a route of investigation in the knowledge that it would not be able to produce a report which named names and quoted from evidence given. I think the first mistake was to use this method. Secondly, it doesn't look as though PwC, which was commissioned to carry out the report at a cost of over £7m, interviewed everybody that one would have expected to be interviewed senior directors of RBS or the senior executives of the FSA. They didn't interview government ministers or Treasury officials, so I think there was always going to be a mismatch between what the FSA could do with the RBS report and what the broader public might consider to be a good and proper review. Unfortunately the same process is being used to investigate HBOS and Bradford & Bingley."**

http://uk.finance.yahoo.com/news/Lord-Myners-I-want-things-tele-2961043703.html

The Enforcement Report of RBS is mentioned in the FSA press release of 28 March 2011, and the enforcement investigation of HBOS in the press release of 11 July 2011:

Once the investigation process is completed and the final result announced, however, we would intend to begin work on a report into HBOS, .. We propose that, as with RBS, there should be a role for external reviewers, to help provide

assurance that the FSA is being open about any failings of its own.

5.2 Few interviews

A 2,300 page report about the Icelandic banking crisis was presented to the Icelandic parliament last year 2010. About 300 people were interviewed. This contrasts with the UK. For example Paul Moore said in January 2011:

> **There could not possibly have been any sensible investigation by the FSA into the failures at HBOS without my involvement. But I have not been approached.**

www.ianfraser.org/moore-fsa-lacks-competence-to-investigate-bank-failures/

How can the RBS report have been "produced" by April 2011, if even the non-executive directors had not been interviewed? An article by Robert Peston on 31 May 1911 says:

> **The Financial Services Authority is only now arranging to interview all of Royal Bank of Scotland's non-executive directors from the era when the bank failed, some two years and eight months after the collapse and rescue of RBS.**

www.bbc.co.uk/news/business-13600060

The number people interviewed by the FSA for the RBS report was 29 before 26 April 2011, and 57 between 26 April and 8 August:

www.whatdotheyknow.com/request/rbs_report_interviews

5.3 Postponement of the RBS report

In its press release of 15 December 2010 the FSA promised to "deliver" a report about RBS in March. But publication is constantly delayed. They promised to produce a report and have done so, but have changed the status to a draft. This like a girl being promised marriage, and discovering after the wedding that it is only a marriage of convenience.

The TSC press release of 28 May 1911 *Terms of reference for review of FSA's report into failure of RBS independent review* links to three letters from Lord Turner to Andrew Tyrie:

15 December 2010 We would suggest delivering the report to the Government and the Treasury Select Committee by the end of March.

17 February 2011 We are now planning a delivery date in mid-April and will let you know the precise date nearer the time.

28 March All these reports could be ready for publication in early May, .. Our aim will be to agree a timetable which allows publication of the report and delivery to the Treasury Select Committee in good time before the summer recess.

07 June What we hold at present is information that will lead up to a finalised report being published.
(www.whathotheyknow.com/request/rbs_report#incoming-180474)

23 June .. as I read drafts of the report we will produce later this year on the Royal Bank of Scotland (RBS).
(www.fsa.gov.uk/pages/Library/Communication/Speeches/2011/0623_at.shtml)

But the TSC says in the press release that the RBS report has already been "produced":

> **It is why we have appointed independent advisers to assess the report produced by the FSA on the basis of those findings.**

www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news/review-of-fsa-report

Another example of prevarication is my three cases of fraud reported to the SFO:

www.whatdotheyknow.com/request/how_are_my_three_cases_progressi

One of these is about the Equitable Life reinsurance treaty, leading to a Freedom of Information request. The SFO say they cannot disclose information about Equitable Life because this may be needed for a future prosecution, even though they have not prosecuted, or even had "a full criminal investigation", since the Society closed for new business in December 2000. The case is before the Information Tribunal (EA/2011/0084), with a hearing on 27 September 2011. There are details on my website:

www.comparativetables.com

6. Enquiries

Reports about the RBS, HBOS and Bradford & Bingley 2008 implosions should have been published before the present consultation. Why was this left to the FSA without setting up official enquiries? The FSA says it will not publish a report about the Bradford & Bingley insolvency. This was caused by regulatory failure because like Northern Rock, it was borrowing excessively on money markets.

> **Finally, we have considered whether similar public information reports should be published in relation to other firms that failed in the crisis. We believe not. This is because: .. none of the other institutions that failed in 2008 was of the scale of RBS and HBOS. (FSA press release 11 July 1911)**

Surely this size argument is invalid because the FSA did for example write a report about Dunfermline (www.fsa.gov.uk/pubs/other/response_Dunfermline.pdf). Under the new system there will have to be "an investigation and report" in certain circumstances:

> **The draft Financial Services Bill sets out a clear mechanism for the new regulators to conduct regulatory enquiries. Under this mechanism, unless the Treasury direct otherwise, an investigation and report will be needed from the PRA where public expenditure has been incurred, or events have risked a significant adverse effect on the safety or soundness of an authorised firm, which might not have occurred but for a serious failure in regulation. (FSA press release 11 July 1911)**

The regulator should arguably write a report following every failure of a firm irrespective of size, or above a certain size. Badly defined criteria such as "serious failure of regulation" seems unsatisfactory.

Vince Cable was interviewed about RBS on television (Channel 4, 15/12/10), and was asked twice: "Is the FSA the right body to look into this? Shouldn't we get someone else do it?" He did not reply. It is pointless asking questions with no reply. In the same interview he said: “I campaigned for openness in opposition and again in government.”

www.channel4.com/news/rbs-collapse-no-blow-by-blow-account

He said: "I argued in opposition that what we needed was a proper investigation into what were very serious matters." (Sky News 15/12/10) So now he is in government why has he not set up an enquiry? The reason seems to be the cost. It is

cheaper for the government to leave this to the FSA which is financed by the industry. But the industry does not want to be investigated - hence the prevarication.

news.sky.com/skynews/Home/Business/City-Watchdog-To-Publish-Its-Report-On-Near-Collapse-Of-RBS-In-March/Article/ 201012315855954?f=rss

At present it seems rather hit and miss whether there is an enquiry and report or not. When a firm above a certain size fails, the regulators should publish a report and there should in addition be a public enquiry if it is sufficiently large.

7. Product intervention

The FSA says in its June 2011 paper *The Financial Conduct Authority: Approach to Regulation:*

> **Conduct issues since 1990 have been a major factor, particularly the significant instances of widespread mis-selling of financial products to retail consumers. These include personal pensions, mortgage endowment policies, split capital investment trusts and payment protection insurance (PPI). Millions of consumers have suffered detriment on a large-scale and, together, the industry has had to make compensation payments of approximately £15 billion, with most PPI redress still to come. Such outcomes would be regarded as unacceptable in other sectors of the economy. They demonstrate that a new approach to conduct regulation is essential.**

This is saying the industry often behaves badly so we need a "conduct regulator". The regulator should for example prohibit reckless conduct leading to insolvency without having to be called a "conduct regulator".

The FCA will have product intervention powers. FSA already has such powers. If it wanted further such powers it could have asked the government for them. The FSA and industry are continually referring to the merit of "consumer choice", whilst actually exploiting consumer inertia as mentioned above. Consumers prefer the choice of a smaller number of high quality products than a large number of poor quality ones.

8. "Deficiencies in regulatory philosophy"

In his article about RBS in the Financial Times *Rules to make bankers honest* (7/12/10) Lord Turner blames regulatory failure on "deficiencies in regulatory philosophy":

> **It would be possible to add a report looking just at the RBS story. Such a report would be more comprehensive than the FSA's internal investigation, which focused solely on whether individuals broke FSA rules. But it would add little, if anything, to our understanding of what went wrong. It would reveal the same deficiencies of regulatory philosophy already identified, under which the FSA simply did not believe our remit included preventing the ABN Amro acquisition – which was highly risky but breached no regulation.**

The FSA's discussion paper on product intervention (DP11/1) says:

> **In the past the FSA's regulatory approach was based on the assumption that effective consumer protection would be achieved provided sales processes were fair and product feature disclosure was transparent. But this approach has not been effective in preventing waves of severe customer detriment. We have therefore come to recognise that there are fundamental reasons why financial services markets do not always work well for consumers. In response, we are adopting a new regulatory approach, ..**

So there have been waves of taxpayer and consumer detriment because the FSA has had the wrong philosophy! The FSA adopts whichever philosophy suits the industry. When this becomes politically unacceptable it says: "Sorry we had the wrong philosophy."

9. Who's in charge?

The fundamental problem of financial regulation is capture of the regulators by the industry. What happens depends on who is in charge. The FCA will have:

- **a board, with a majority of non-executives to be appointed by the Treasury;**
- **two non-executives to be appointed jointly by the Treasury and the Department for Business, Innovation and Skills; and**
- **a Chair and Chief Executive appointed by the Treasury.**

This seems much the same as the appointment of the board of the FSA, which produced for example the Sir James Crosby - Paul Moore scandal.

The new approach to regulation is business influencing government and law enforcement at the expense of the public. This is one reason for example for: the bank bailouts, the New Labour expansion of the work permit system, the News of

the World phone tapping scandal:

www.guardian.co.uk/media/video/2011/jul/07/news-of-the-world-phone-hacking-nick-davies-rupert-murdoch-video

10. Fees

The regulator should not be financed by fees levied on firms, but by a tax on savings. Otherwise there is a he-who-pays-the-piper-calls-the-tune problem. Savers pay for the regulator by charges on their savings, but these are passed on as though they come from firms.

11. "Authorised", "regulated", "registered"

The difference between "authorised", "regulated" and "registered" seems likely to become more confusing with the introduction of the PRA and FCA. Firms/activities can now be authorised/regulated/registered by/with either the PRA or the FCA (or both). The FSA explains:

> **Most firms and individuals can only conduct regulated activities in the UK if they are 'authorised' by us to do so, or are otherwise exempt. However, there are certain firms that can instead be 'registered' with us. .. You can search our Register to find out whether a firm is authorised.**

In my response to "judgement, focus and stability" (3.1), I mentioned the confusion between "regulated" and "registered" in the case of Crown Currency and the topic "unregulated activities within regulated groups".

The FCA has a consumer protection objective. The PRA has a policyholder protection objective:

> **The PRA's insurance objective is: contributing to the securing of an appropriate degree of protection for those who are or may become policyholders.**

This seems to increase the confusion about the exact difference between the PRA and FCA.

12. Summary

> **1. The objectives of the PRA and FCA seem more concerned with protecting the industry than consumers.**

2. Lessons from the RBS, HBOS and B&B insolvencies have not been learnt because of the lack of official reports.

3. Lessons from the Equitable Life scandal have not been learnt because there is the reintroduction of the twin peaks system.

4. The industry is left in control of the regulators.

5. The method of financing the PRA and FCA by regulatory fees is wrong.

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