PANAHPUR

CONSULTATION ON FINANCIAL SERVICES AUTHORITY REFORM

14TH April 2011

Dear Sir / Madam

I write with reference to the consultation that is currently underway concerning the proposed reforms to the Financial Services Authority.

We are a UK charitable foundation operating as a 'Social Investor', with Program Related and Mission Related investments. Amongst other social investments, we are lead investor in the Social Stock Exchange and have partnered with NESTA on the Big Society Finance Fund project.

We would like to comment as follows:

1. We have good reason to believe that the current regulatory framework will (unintentionally) stifle the growth of the social investment sector.

2. Further, we believe that if the current framework is not adapted to account for the emerging social investment market, it will prevent the government's Social Investment Strategy (published on 14th February 2011) from being a success.

3. We have been involved in the consultation convened by NESTA and Bates Wells Braithwaite, and have seen the paper that they have submitted. We are 100% supportive of their paper, and the core recommendations within it. Were the ideas within this paper to be taken forward sensitively and inclusively, we believe that they have the potential to have a transformational effect on the volumes of capital available to fund social investment.

4. Further, we believe that if properly handled the sorts of recommendations in this paper could materially alter the investment ecosystem for the wider SME sector in the UK. This sector provides 58% of the private sector jobs and yet has found its access to capital severely curtailed since the onset of the credit crunch. The reduced role that debt finance has and will continue to play within the capital structure of SMEs has yet to be replaced by an alternative. Current financial promotions legislation is a major barrier to the potential vibrancy of this sector of the economy by unnecessarily hindering access to the appropriate forms of capital.

We therefore hope that you will engage in a brief and focussed period of consultation in order to free up the market so as to maximise the availability of capital to civil society, and minimise the negative unintended consequences of the regulatory status quo.

Yours sincerely

JAMES PERRY
CEO

84 High St, Tonbridge, Kent, TN9 1AP

PAYMENTS COUNCIL RESPONSE TO HM TREASURY'S CONSULTATION *A NEW APPROACH TO FINANCIAL REGULATION: BUILDING A STRONGER SYSTEM*

1. INTRODUCTION

1.1 Payments Council is pleased to have the opportunity to respond to the second consultation from HM Treasury on reforming financial regulation.

1.2 Payments Council is the organisation that sets strategy for payments in the UK. It was established in March 2007 to ensure that UK payment systems and services meet the needs of users, payment service providers and the wider economy. The Payments Council has three core objectives:

- to have a strategic vision for payments and lead the future development of cooperative payment services in the UK;
- to ensure that the payment system is open, accountable and transparent; and
- to ensure the operational efficiency, effectiveness and integrity of payment services in the UK.

1.3 The Payments Council works closely with its contacted schemes, for the benefit of the UK payments industry. These include:

- Bacs Payment Schemes Limited;
- CHAPS Clearing Company (covering two schemes: the CHAPS Sterling and Faster Payments);
- LINK ATM Scheme;
- Cheque & Credit Clearing Company Limited;
- Belfast Bankers' Clearing Company Limited; and
- UK Domestic Cheque Guarantee Card Scheme (closes on 30 June 2011).

1.4 The Payments Council is a membership organisation, funded by its members, with an independent chairman.

1.5 More information on the Payments Council and a full list of members can be found on our website, www.paymentscouncil.org.uk.

2. SPECIFIC COMMENTS

2.1 We welcome the further confirmation, as set out in the July consultation, that the regulation of payment systems under Part 5 of the Banking Act 2009 will remain with the Bank of England. We were also pleased to see that it will take over the FSA's responsibility for regulating settlement systems under the Uncertified Securities Regulation 2001. Additionally, we welcome that enforcement powers for settlement systems will be aligned with those for payment systems. With one

regulator covering both sectors, it is only fair that a level approach is taken for both.

2.2 We welcome the clarity provided in paragraph 1.128 regarding the changes to Part 5 of the Banking Act, particularly the immunity from liability given to persons who act at the direction of the Bank. This is an aspect that we were very keen to see.

2.3 In our response to the July consultation we had highlighted our request for the relationship between the Financial Stability part of the Bank and PRA to be sufficiently transparent, and supported by good communication. We are heartened to see that clear regulatory and coordination processes are set out; however, it is hard to judge the clarity with which these will perform until we see the detail in the legislation. We look forward to studying the draft legislation in this respect and may have comments to make at this stage.

2.4 We are pleased to read the clarification given to the "consumer champion" role of the Financial Conduct Authority, noting that it is not intended to act as a consumer advocate organisation in any way. We agree that the concept of the responsibility of consumers for their own choices is important, and the empowerment given to consumers through appropriate education. The Payments Council takes the education on payment methods and choices very seriously, including understanding the liability for when things go wrong. We would be very keen to work with both the FCA and Money Advice Service on the presentation and distribution of this type of information.

3. CONCLUSION

3.1 Allowing operators of payment systems to continue their management is paramount, regardless of what customer-facing improvements to financial services are instigated. Given the current work around increasing competition between providers and product offerings, we would ask that the experience of payment systems as infrastructure administrators (which has held them in good stead over the past few years) is borne in mind at all times. We are always very keen to work with the authorities in ensuring that payment systems are protected in this respect and hope that we and the operators of those systems will be fully consulted on regime changes.

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Wednesday, 13 April 2011

Financial Regulation Strategy
HM Treasury
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financial.reform@hmtreasury.gsi.gov.uk

Dear Madam or Sir,

An individual's response to:
Box 5.F: Consultation question
23 What are your views on the Government's proposals on the treatment of mutual organisations in the new regulatory architecture?

A new approach to financial regulation: building a stronger system

Presented to Parliament by the Financial Secretary to the Treasury by Command of Her Majesty February 2011 **Cm 8012**

Locus:
I was one of the last Assistant Registrars of Friendly Societies dissolved by the order Financial Services and Markets Act 2000 (Mutual Societies) Order 2001 (S.I. 2001/2617) under the Financial Services Act 2000. I am therefore well aware that the placing of the then department (the Registry of Friendly Societies) with the Financial Services Authority in 2001 was a mistake.

Advantages of department of the Registrar of Friendly Societies

The advantage the Registry of Friendly Societies had, as part of the Crown, was that there was a person whose obligations were solely related to the registration of what are now termed mutual societies. He was, it is true, involved with the regulation of Credit Unions, but that was exceptional, given that there were commissions responsible for the regulation of the financial services provided by building societies and friendly societies. The Chief Registrar, and Assistant Registrars in dealing with the sector on a daily basis were in continuous touch with the sector and familiar with government business, and thus were able to advise the Financial Secretary to the Treasury, and prepare subordinate legislation as necessary. Once the Treasury had signified its consent, our lawyer was responsible for the administrative procedures of placing the instruments before Parliament and obtaining publication by the Stationery Office. As a result there was no awaiting the Treasury, who were always hard pressed, to formulate policy or to draft legislation using lawyers unfamiliar with the sector.

My Proposal:

The plain registry function of the Mutual societies is similar to company's registry. Financial services regulation and consumer protection aspects should fall to the appropriate regulator as they

do for companies. The process of registration of constitutions and officers and related matters are adequately dealt with on a continuing basis by on line and electronic processes. The question of approval of an initial registration and problems which arise in the life of a society, might occupy the attention of a small number of persons working under a Registrar of appropriate calibre to advise a Minister of the Crown as regards policy for the sector: an office of perhaps not more than half a dozen financed by yearly fees on the societies. Treasury Solicitor might provide a lawyer responsible for advice and the drafting of subordinate legislation since the efficient promulgation of statutory changes is essential, it is unlikely that such a lawyer would be fully occupied unless there were a legislative programme or litigation. The electronic registration processes might be carried out conveniently by an agent such as Companies Registry.

My proposal chimes well with that of Ian Snaith[1] that the Registrar should be a person with the central and pro-active role similar to that of the Business, Innovation and Skills Department of the UK Government in facilitating the use business structures and ensuring that business law is user friendly and uniform across the UK as it resolves many of those problems where companies are concerned.

1. see Ian Snaith Part 6 of Study on the implementation of the Regulation 1435/2003 on the Statute for European Cooperative Society (SCE) http://ec.europa.eu/enterprise/policies/sme/files/sce_final_study_part_ii_national_reports.pdf retrieved Tuesday, 12 April 2011

The placing of the registration of Mutual societies with the Financial Services Authority was ill conceived. It was an agency disinterested in every sense of the word in anything other than financial regulation and consumer protection. It was a recipe for the Mutuals sector to be left rudderless in a developing business scene.

At a time when the nation needs to have its business tackle in order to overcome the economic crises of the current situation there needs to be proper leadership by the Crown in ensuring that the structures for conducting the business and community affairs are adequate to the task.

Yours faithfully,

Anthony J. Perrett

A New Approach to Financial Regulation

We welcome the opportunity to comment on this paper. We fully appreciate that the financial crisis that started in 2007, required changes to the regulation of financial services. With this in mind we propose to only selectively comment on the paper where there might be unintended consequences from the proposals put forward.

We believe it is important that in taking these changes forward; we keep in mind the triggers for this crisis. Likewise we need to be conscious that significant enhancement to insurance regulation is already in train through initiatives such as solvency II, etc. It is important that any new regulation and the regulators themselves fully understand the nature of insurance and adapt their approach accordingly.

We welcome the fact that the government proposes to clarify and document the respective roles of the FCA and FOS. With this in mind we believe it is important to take the opportunity to reiterate that FOS' role is to look at individual cases reflecting the regulation in place at the time the advice was given. Likewise when the FCA and PRA are set up they need to consider how any actions they take may impact contracts written in compliance with regulation in force at the time.

With the separation of the FSA into the FCA and PRA it is essential that there is sufficient time available to work out how these bodies will work together in practice. This must be an open exercise with active industry involvement. There are a number of areas for potential duplication or gaps that must be resolved prior to the new bodies coming into force

The consultation implies that the appeal against Decision Notices will be via judicial review. Does this mean that the RDC and the Tribunal will be discontinued? We feel that judicial review is not an appropriate substitute to the RDC and Tribunal as under judicial review it has to be proved that no reasonable regulator could have made the decision; not that the decision was wrong.

One area of specific concern is question 14 in relation to the early publication of warnings notices. We understand that circa a third of potential disciplinary cases do not currently get to formal enforcement. The impact of adverse publicity, especially if unfounded, on a company can be severe. This is especially a concern with listed companies where the impact on share price can be very detrimental not only to shareholders but indirectly to Customers as well. We believe there are better ways of achieving the government goals on effective enforcement.

In the event that the government wish to proceed down this route then it should be clear in the legislation that this approach can only be taken where the direct benefits in reducing the immediate risks to Customers would be proportionate to the potential impact on the share price of an organisation.

PLUS | SX

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

14 April 2011

Dear Sirs,

Response to HM Treasury's Consultation 'A new approach to financial regulation: building a stronger system'

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Introduction

1. We believe that considerable progress has been made since the last consultation in July 2010 as a result of much open dialogue and engagement on the part of the Government. We are grateful for the opportunity to contribute further towards the Government's thinking and towards the advent of a stronger system.

2. PLUS Stock Exchange plc is a Recognised Investment Exchange (RIE) under the Financial Services and Markets Act 2000 ("FSMA"); the prospects of our business are closely allied to proposed revisions to the regulatory framework.

3. Having been involved in considerable dialogue and lengthy submissions to the Treasury and TSC over the course of the last year our response to the Consultation addresses a limited range of issues. Proposals relating to market infrastructure, the statutory framework and ethos of the FCA as well as the need for close cooperation between regulators are of principal concern to us. In general terms though we're much happier with the Government's thinking which has greatly evolved especially as regards Recognised Bodies under Part XVIII FSMA and the future of the UK Listing Authority (UKLA).

Recognised Investment Exchanges

4. We have publicly advocated and impressed upon the Treasury the need to retain Part XVIII Recognition. Recognised Bodies are quasi-regulatory in nature and are integral to the maintenance of confidence in financial markets by behaving as such; given our competence in markets and responsibilities as front line regulators we're capable of responding to innovation and change in such a way as to uphold the integrity of the financial system. Recognised Bodies are therefore wholly different to investment firms and MTFs which trade on their own account. Recognised Investment Exchanges (RIEs) are responsible for proposing and maintaining regulatory and markets framework, regulating the conduct of member firms and issuers, and acting as neutral and transparent venues for raising capital and trading securities. In our case our public functions, quasi-regulatory nature and role in providing non-discriminatory access were recognised as late as last year when the High Court confirmed in the context of legal proceedings initiated by an issuer on one of our primary markets that decisions of PLUS Stock Exchange plc in the exercise of its public functions are amenable to judicial review[1]. The EU Commission's recent consultation[2] on the proposals to amend the Markets in Financial Instruments

[1] *R. v PLUS Markets plc ex parte Global Brands Licensing plc*
[2] Public Consultation on the Review of the Markets in Financial Instruments Directive (MiFID) 8 December 2010

Directive[3] (MiFID) if anything affirms the importance of non-discriminatory infrastructure and non-discriminatory multilateral access will most likely form the most exacting requirement for a new sub-regime of organised trading facilities eligible to trade derivatives.

5. The Government proposes to make modifications to the Part XVIII Recognition regime involving simplifying the procedure for issuing directions and allowing the FCA to impose penalties on an RIE, extending information gathering powers and removing the special competition regime in Chapter 2 and 3 of FSMA.

Simplifying the procedure for issuing directions

6. We agree that there may be a case for simplifying the procedure for issuing directions to an RIE (pursuant to section 296). The present requirements are contained in section 298 of FSMA and whilst it's hard to identify the precise deficiencies which the Government is seeking to address, a fair point might be that the procedure for giving directions to an RIE takes too long. We note however that the current section 298(7) allows the Authority to derogate from following the prescribed procedure if it considers it essential to do so which will allow for the issue of an immediate direction to an RIE. Whilst the Government still needs to make a case for revising this area we're strongly of the view that RIEs should still be provided with a period to make representations and that the FCA should be bound to take these representations into account before issuing an RIE with a direction.

7. Section 296 FSMA only permits the giving of directions to an RIE in the event that a Recognised Body has failed, or is likely to fail, to satisfy the recognition requirements or any other obligation under FSMA. There must be no extension of the circumstances in which directions may be issued by the FCA. RIEs are autonomous regulators of their own markets and the principle lying behind Recognition should be respected or else Recognised Bodies will lose the initiative and their effectiveness as front line regulators capable of responding to innovation and upholding the integrity of financial markets.

Imposing penalties on RIEs

8. We would argue that this is inappropriate. The section 296 power to issue directions in the event that an RIE has breached or is likely to breach the recognition requirements or any other obligation in FSMA, the ability to revoke Recognition pursuant to section 297, together with the power under section 313A to require the suspension or removal of instruments from trading on the facilities of an RIE, will provide the FCA with sufficient means of ensuring that RIEs comply with their obligations and do not pose a threat to market confidence or the stability of the financial system. We are not aware of any evidence suggesting the contrary. Existing legislative provision together with the obligations of Recognised Bodies at law with respect to the exercise of their regulatory functions should prove sufficient.

9. Sanctions or other punitive measures are inappropriate given that RIEs are quasi-regulatory bodies; the first such instance of a punitive measure being imposed on an RIE could lead to a general loss of confidence in the RIE, the facilities of the offending RIE, Recognised Bodies and market confidence generally. Arguably there are those who would question whether in such circumstances the market operator should retain the status of a Recognised Body. We are (quite rightly) perceived as front line regulators and will be perceived as cooperators of the FCA in regulating financial conduct and maintaining confidence in financial markets, particularly by exchange member firms and issuers. The ability to impose sanctions on RIEs would undermine our effectiveness and the appearance of 'vertical' supervision of RIEs on

[3] Directive 2004/39/EC

the part of the FCA would be counterproductive and mark a departure from the principles that lie behind Part XVIII Recognition.

Extending information gathering powers

10. The notification requirements for Recognised Bodies, section 293A FSMA and other provisions of domestic legislation afford the FSA wide sweeping information gathering powers We provide information in a timely fashion in the interests of maintaining an open, cooperative and constructive relationship with the regulator. We don't have any objection in principle though to any such extension and look forward to being consulted on the details of any additional information gathering powers which should be justified on a cost benefit analysis.

11. We would add that if the additional information gathering powers relate to the FCA's future role as the prosecuting authority with respect to market abuse offences we would suggest that the Government defer implementing any additional measures until the amendment of the MiFID directive. The EU Commission has been consulting on supervisors' right of access to order and trade information on an ongoing basis held by market operators and MTFs. We can expect a settled pan-European position to be reflected in the amendments to the directive[4].

Removing the special competition regime in Chapter 2 and 3 of FSMA

12. We're supportive of such a proposal as the Investment Exchanges and Clearing Houses Act 2006 has made alternative provision.

Measures flowing from amendments to MiFID

13. As regards any substantive measures with respect to RIEs that prove necessary as a result of the outcome of the EU Commission's consultation on the Review of MiFID, we have submitted to the Commission[5] that whilst there may be concerns at a European level to enhance the requirements to which MTFs are subject, exchanges and MTFs as well as their operators are distinct and must continue to be treated as such. We recognise that amendments to MiFID relating to operators of Regulated Markets will require implementation in domestic law.

UK Listing Authority

14. PLUS operates a Regulated Market[6] for listed securities admitted to the Official List by the UK Listing Authority (UKLA) and we've been very supportive of the need for the UKLA to remain with the FCA so that the latter has competence and responsibility for both primary and secondary regulation with a credible basis for engaging with the European Securities and Markets Authority (ESMA). We're aware that the expertise of the UKLA is often called on internally by the FSA in relation to its engagement with organs of the European Union and primary market legislation at a European level as well as in the discharge of its responsibilities for the oversight of RIEs and exchange primary market frameworks.

15. The Government is proposing to make a small number of technical improvements to Part VI FSMA, that part of FSMA which deals with Official Listing and sponsors. In sum we're in favour of the proposed measures and perceive a clear need for these

[4] Domestic implementing legislation will be required to take account of any amendments to Article 25(3) of the MiFID directive

[5] http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/mifid_instruments/individuals_others/plus_markets_group/_EN_1.0_&a=d

[6] The PLUS-Listed market is a Regulated Market under MiFID

amendments. We have however a number of comments which the Government may find useful in revising and improving the listing framework. As the operator of a listed market as well as an exchange-regulated primary market we have pertinent expertise and experience in this area.

Extending the UKLA's powers to impose sanctions on sponsors

16. Falling short of cancelling a sponsor's approval pursuant to section 88 FSMA, the only sanction that may be imposed at the present time by the UKLA is a public censure of a sponsor in accordance with section 89. It is axiomatic that the UKLA needs a greater set of tools given the important role of sponsors (sponsors for example are required to perform certain important functions with respect to admissions to the premium segment of the Official List; sponsors also have a role in relation to reverse takeovers, Class 1 and other significant transactions for issuers with premium listings).

17. In addition to operating a listed market, PLUS Stock Exchange operates an exchange-regulated primary market and we maintain, approve and oversee a class of member firms (corporate advisers) that have an analogous role and similar responsibilities compared to UKLA approved sponsors. Our regulatory framework maintains a power of suspension over such member firms and recognises that the suspension or restriction of a firm's activities may need to enter into force with immediate effect should the member firm's conduct imperil its issuer clients' ability to comply with their market obligations, or pose unacceptable risks to investors or the integrity of the market. Based on our experience regulating primary markets and invoking the suspension power, we would suggest that whilst the burden of proof should reside with the UKLA, Part VI should incorporate an ability on the part of the UKLA to suspend or restrict a sponsor's activities with immediate effect without the need for first instance hearing - the UKLA should be provided with the ability to take swift action to counter a live threat stemming from the conduct of a particular sponsor firm. An appeal mechanism will of course enable a sponsor to challenge a suspension or restriction imposed on its activities.

18. At the same time one particular aspect of sponsor work creates no end of difficultly. Given the plethora of instrument types that may be admitted to the Official List in an environment where product innovation is a reoccurring theme, UKLA approved sponsors need to maintain expertise in a wide spectrum of instrument type. Experience and expertise across the board also needs to be maintained given the variety of transactions hailing from different sectors on the Official List. This can also prove challenging given that investment banking teams within UKLA approved sponsors are often in a state of flux. The requirement can also be restrictive over the range of organisations that are likely to qualify for sponsor status with all applicants effectively excluded from consideration with the exception of sizeable banking institutions which maintain competence across the board. One solution that might be worth considering would be for the UKLA to define as part of the sponsor approval the range of activities which a particular sponsor firm may undertake in respect of which the sponsor can demonstrate real competence (permissions could be added to or subtracted over time as the UKLA sees fit).

Giving the UKLA the power to make rules for, and impose sanctions on, primary information providers (PIPs)

19. We're supportive and would point out that a good number of issuers of unlisted securities make use of PIPs including issuers admitted to the PLUS-quoted market, the retention of at least one PIP being a requirement for issuers traded on this market.

Financial Conduct Authority

20. Our chief concern in July of last year was that the FCA was being orientated towards progressing a consumer and investor protection agenda at the expense of a strong markets function. Much progress has been achieved since then and the present proposals will place the FCA on a firmer footing; the FCA's single strategic objective of protecting and enhancing confidence in the UK financial system will provide the FCA with clear clarity of purpose and a yardstick with which to be measured against without providing undue prominence to any one regulating activity.

21. We agree with the proposed make-up of the FCA's Operational Objectives which will mandate the FCA to take account of the benefits of innovation and enhance rather than constrain markets; also the FCA will be aligned to the European Union's commitment to remove barriers to competition where possible. This does not of course mean that the desirability of facilitating innovation and greater competition should operate in such a way as to impede the regulator's freedom of action but rather brings a positive obligation to keep pace with innovation into being whilst ensuring an appropriate degree of supervision and protection. In the current climate there is greater acceptance that proportionality, burden and competition arguments cannot be used to counter the need on the part of the regulator to take action to mitigate or prevent the build up of risk. It is right however that the FCA's actions should be tempered by a concern not to adversely disrupt the capacity of the financial sector to contribute to economic growth. Likewise, the proposed regulatory authorities will not be excused, for similar reasons, from intervening where it proves necessary to ensure financial stability.

22. Intervention at an early stage and before significant consumer detriment takes place will markedly differentiate the ethos and *modus operandi* of the FCA compared with the FSA. This necessitates a clean break from the past and an interventionist approach will only be made possible if the FCA's skills and resources are sufficient to detect the build up of risk at an early stage. We recognise that proactive intervention in a product's lifecycle at an early stage will at times be justified but this will be difficult to get right and it is imperative that the FCA engage with industry and consult with practitioners to inform such decisions (the renewed system of statutory panels and the FCA's non-executive directors all with industry experience ought to feature prominently in these discussions). The Government's proposal to require the FCA to publish and consult on a set of principles governing the circumstances under which it will use its product intervention powers is a sensible one and should help with some of the concerns recognised in the Consultation relating to the use of this power. The FCA will need to bear in mind that the exercise of these powers might have adverse consequences for the prudential soundness of investment firms particularly when a firm's revenues are derived from a limited range of products. You would expect that the statutory duty to cooperate would include the FCA informing the PRA in the event that an exercise of a product intervention power is likely to have a fatal impact on any PRA regulated firms that are capable of being identified.

23. The principle that consumers should take responsibility for their decisions should be at the heart of the FCA's consumer policy and it appearing as a regulatory principle that both the FCA and the PRA must have regard to, arguably achieves this. The principle needs to be carried into practice by the FCA however – so long as disclosure of risks associated with products is sufficient, in the absence of aggravating factors such as product instability, inefficiencies integral to the products themselves, or inappropriate sales incentives, the FCA's retail consumer policy should in the majority of cases shy away from product intervention and should not work so as to limit of the availability of products offering higher investment returns purely on the basis of the higher risks paired with the anticipated investment returns. The FCA's Operational Objective of facilitating choice should operate to prevent this kind of behaviour on the part of the regulator but the Strategic Objective and the

remaining Operational Objectives should lead to a renewed emphasis on credible deterrence through enforcement action against unethical behaviour on the part of advisers and more intensive focus on the FCA's part on ensuring the appropriateness of investment advice given by FCA authorised investment firms.

24. We note with approval the insertion of the fifth and sixth Operational Principles into the FCA's regulatory framework, openness and disclosure and the desirability of transparency which affirms that the FCA needs to be accountable. It is imperative that a balance is struck between the right decision making process and the need for regulators to be transparent.

25. An area which has received much attention since the publication of the July consultation has been the need for the regulators to cooperate as well as issues stemming from dual supervision of firms by both the PRA and the FCA. Proposals in the Consultation include a statutory duty to coordinate, binding Memoranda of understanding between the PRA and the FCA, cross-membership of respective boards, a power of veto on the part of the PRA and possible approaches to coordinate processes involving both the PRA and FCA in relation to dual-supervised firms. We will refrain from substantial comment beyond noting that the Government rightly recognises the need for complimentary cultures and co-operative leadership between both authorities and that whilst the proposals might be calculated to help with some of the issues that are likely to be encountered, the potential for competing and uncoordinated agenda is acute.

Concluding Remarks

26. We recognise that progress has been made since the July consultation and look forward to seeing draft legislation.

Yours Sincerely,

James Godwin
Director of Regulation
PLUS Stock Exchange plc

11 What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?

12 What are your views on the Government's proposed arrangements for governance and accountability of the FCA?

13 What are your views on the proposed new FCA product intervention power?

14 The Government would welcome specific comments on:

- **the proposed approach to the FCA using transparency and disclosure as a regulatory tool;**
- **the proposed new power in relation to financial promotions; and**
- **the proposed new power in relation to warning notices.**

Our responses are contained in the section of the letter above under the heading 'Financial Conduct Authority'.

16 The Government would welcome specific comments on:

- **the proposals for RIEs and Part XVIII of FSMA; and**
- **the proposals in relation to listing and primary market regulation.**

Our response is contained in the sections of the letter above under the headings 'Recognised Investment Exchanges' and 'UK Listing Authority'.

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5-Apr-11

Overdue Intervention

Dear Financial Regulation Strategy Department,

I have no acknowledgment of my response to Cm 8012. I delivered it by hand to your mail room on 11-Mar-11. Has it gone astray?

I have made some updates to my analysis of 9-Mar-11 now that I have noticed that the OFT's document OFT144 is no longer posted on their web site. I don't know when this change was made. However, the latest statutory method for APR (Statutory Instrument 2010 No.1101) is similar in relevant matters and does not change my position on interest calculation.

Please incorporate the enclosed modified pages.

Improving my work is more difficult without detailed comment.

Yours Sincerely

David Pope

Enclosed:- Pages 8, 9, 10 & 38 from Analysis of 4-Apr-11

Section 1. Review of exponential growth and the definition of AER

Exponential growth is characterised by equations of the form:-

Y=A times (B to the power of C); Y=A x (B^C); Y=A x B^C

The symbol ^ is used for "to the power of". ^ is easier to type than superscripts. Exponentiation takes precedence over multiplication in order of evaluation so the brackets shown above are not essential.

A is the starting quantity of whatever is growing, B is the rate of growth and C is the time since the start of measuring.

Y is the amount that A grows to after time C at rate B.

This is growth where the increase per time is dependent upon how much of the measured variable is already present. As the increment per time increases with time, the graph of the measured variable is curved. Compound interest is such a process. The rate of increase in a bank balance (£/day) is dependent upon the current size of the balance. A £1,000 deposit grows more value in one day than does a £100 deposit at the same advertised rate. A £1,000 deposit should grow more value in day two than it grew in day one since there is more money present at daybreak of day two than was there 24hrs before. Despite claims to calculate interest on a daily basis (see the end of Section 5), higher increase in day two is not found in a typical savings account. Practical equations for true growth and tax are shown in Section 2.

http://www.bba.org.uk/media/article/calculation-of-the-annual-equivalent-rate-aer provides The BBA's equation for AER:-

a) The most general case of the calculation is the rate of interest which, if applied each year to the deposits made by the customer, would result in the same end-value as the contractual interest rates and interest bonuses (if any), ie the solution to the following equation:

$$\sum_{n=1}^{m} D_n \left(1+\frac{\alpha}{100}\right)^{1+m-n} = \sum_{n=1}^{m} D_n \left(\prod_{j=n}^{m} (1+\frac{i_j}{100})\right) \quad (=T)$$

Where: α is the Annual Equivalent Rate
D_n is the deposit to be made at the start of year n
i_j is the interest rate (including bonuses, if any) payable at the end of year j
m is the number of years for which the product has to be held
T is the amount the depositor will receive at the end of year m.

This presentation is based on the deposits of a savings project. The statutory formula for APR (currently The Consumer Credit (Total Charge for Credit) Regulations 2010 No.1011) is based on the advances of a loan but the true time value of money still applies:-

Later value = Earlier value x (1 + Period rate) ^ Periods
Earlier value = Later value / (1 + Period rate) ^ Periods
Growth = (Later Value / Earlier Value) = (1 + Period rate) ^ Periods

The Consumer Credit (Total Charge for Credit) Regulations 2010 No.1011 (http://www.legislation.gov.uk/uksi/2010/1011/schedule/made) has:-

1. The annual percentage rate of charge ("APR") is calculated by means of the equation in paragraph 2 which equates, on an annual basis, the total present value of drawdowns with the total present value of repayments and payments of charges.

2. The equation referred to in paragraph 1 is—

$$\sum_{k=1}^{m} C_k (1+X)^{-t_k} = \sum_{l=1}^{m'} D_l (1+X)^{-S_l}$$

(*Note, the original equation image is fuzzy.*)

where

X is the APR;

m is the number of the last drawdown;

k is the number of a drawdown, thus $1 \le k \le m$;

C_k is the amount of drawdown k;

t_k is the interval, expressed in years and fractions of a year, between the date of the first drawdown and the date of each subsequent drawdown, thus $t_1 = 0$;

m' is the number of the last repayment or payment of charges;

l is the number of a repayment or payment of charges;

D_l is the amount of a repayment or payment of charges;

S_l is the interval, expressed in years and fractions of a year, between the date of the first drawdown and the date of each repayment or payment of charges.

I puzzled over the differences between the BBA and the statutory equations. The BBA multiplies by the rate factor while the government divides by it (note the negative powers). I explain it by their different choice of direction of view along the time line.

The BBA's AER equation is a view into the future from the start of the deal:-

(Sum of final value of deposits) = (Final value of the whole account)
Money grows to a larger sum so The BBA multiplies by the rate factor

The statutory APR equation is a view back in time from the end of the deal:-

(Sum of present value of advances) = (Sum of present value of repayments)
£10 now may equate to £9 repaid earlier so APR divides by the rate factor

Both equations deal with complex accounts on a component basis. Each component (deposit at year 2, advance at year 3, bonus at year 2, interest at year 1, repayment at year 5...) is considered consistently at either the start or the end of the whole deal to come up with one number that represents the true average rate (APR or AER). The underlying time value of money copes with all transactions but mixing deposits and loan advances in one deal would need care as the time directional views of the two equations are different.

The proper tools are there to be used.

Industrial project evaluations deal with cash flows in and out by simple change of sign in routine Discounted Cash Flow (DCF) and Internal Rate of Return (IRR) analyses, which are also based on the true time value of money. Microsoft Excel's IRR(values,guess) function assumes equal time spacing for a list of cash flows. Excel requests a guess for the rate and then iterates up to 100 times to achieve good accuracy. Excel has XIRR(values,dates,guess) to deal with irregular timings and requires a table of flows and corresponding dates. XIRR uses a present value sum (dividing by the rate factor, as in APR) to deliver a rate that you could call an AER or an APR, depending on the nature of the data**. XIRR does not apply any rounding to its raw result. Excel's IRR & XIRR truncate raw date data to whole days, so part days are ignored. Excel's day counts include any 29th of February, as should all money calculations.

** It may be tradition that puts AER with savings and APR with loans. The maths of growth applies to both. You might ask why they need two equations.

For a general presentation of compound growth I prefer the simplicity of the exponential formula on page 91 of "GCSE Mathematics – The Revision Guide for Intermediate Level", 6th Edition, by Richard Parsons, published by CGP, ISBN1841460214. Thus 16 year olds should be able to cope with growth where the number of time periods is an integer. A level maths covers exponential growth in more detail (Core 2 includes logarithmic solutions).

Growth is a continuous curve that can be sampled at any intermediate time. Populations don't increase suddenly at the end of each 24 hours, even when they are counted once each day. Counting (stock taking) can occur at any time.

You don't have to plot every point but they all fit on the same curve.

Rate and Time need to be in compatible units. Expressing time as days/365 allows any day's (or part day's) balance to be evaluated from a rate based on 365 days.

For me, it all comes down to:-

Gross balance = Capital x Rate *to the power of* Time
= Capital x (1+AER/100)^(days/365)

Where AER = Percentage Gross Rate applicable to 365 days

When days = 365, Gross balance = Capital x (1+AER/100)^1, thus providing the coincidence of gross rate and AER for a textbook one year account.

Given the widely accepted exponential equation for the time value of money, there is no need for any approximate methods in the calculation of interest.

Figure 1 summarises exponential growth as applicable to money.

32. Collins' Gem Decimal Reckoner of 1966 (reprinted 1971) tabulated part year interest consistent with Actual/365.

33. Consumer Credit Act 1974 did not define APR - "The Secretary of State shall make regulations..." (prescribing) "the method of calculating...".

34. Consumer credit tables were published by HMSO in 15 Parts in 1977. The tables did not include the exponential equations behind the tables, thus the casual user may have been unaware that not all displayed digits were significant. The worked example on page 4 of Part 11 showed the APR corresponding to an annual flat rate of 16.25% in 52 instalments to be 35.3%APR. I calculate (with Excel) that 35.38595%APR gives 52 future weekly payments of (£100+£16.25)/52 (un-rounded) a total present value of £100.00001... Thus the answer to 1 decimal place should be 35.4%APR.

35. Statutory Instrument No.51 1980 - Consumer Credit (Total Charge for Credit) Regulations 1980 defined APR using "Growth=Rate^Time" equations.

36. The banking industry's own Code of Conduct for the Advertising of Interest Bearing Accounts (CCAIBA) dates from 1985 but I haven't seen versions before 2003. CCAIBA since 2003 (not seen by me until 2005) promotes Actual/365 and allows division by 366. (See my Section 3).

37. Some financial functions built in to the Lotus123 spreadsheet in the 1990s had Actual/365 and Actual/360 as day count basis options, despite its NPV & IRR functions being based on Growth=Rate^Time. Recent Microsoft Excel and Apple Numbers are equipped similarly. Lotus123 is currently my earliest reference for the use of "Actual/365" as a name but I don't expect it was the original source. "Find the naming source" was dropped from my priority list when I read John Ward's work (item 12).

38. Statutory Instrument No.3177 1999 (amending SI No.51 1980). Three equations for APR replaced one but still used Growth=Rate^Time. The traditional approximations:- year=52 weeks and month=year/12 were still allowed. Leap days were not forced to be earning days (366 divisor allowed).

39. Office of Fair Trading issued OFT144 in 2000 describing loan APR using Growth=Rate^Time.

40. 2005 saw the start of my quest to explain annual compound interest on savings on a daily basis to the modern banking industry. I started by comparing my statements with The BBA's definition of AER. I only met the term "Actual/365" some months later (though I had already deduced its method from examining my account statements). Within a few months, one provider agreed to increase my maturity to conform to the definition of AER after others had rejected my claims. Over the next 5 years I put my explanations to industry representatives and watchdogs without success or even detailed criticism. Two other providers saw merit in my position and increased my savings above their default calculations. Nobody has disproved any of the algebra that I presented.

41. The Consumer Credit (Total Charge for Credit) Regulations 2010 No.1101 (implementing European Parliament Directive 2008/48/EC) uses Growth=Rate^Time but still allows division by 366 and so excludes leap days.

42. I first read John Ward's work in December 2010.

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

14 April 2011

Dear Sirs

HM Treasury Consultation Paper – 'A new approach to financial regulation: building a stronger system' (the "Consultation Paper")

PricewaterhouseCoopers LLP ("PwC" or "we") welcomes the opportunity to comment on the Consultation Paper. As requested, we have responded to the topics we believe are relevant to our business and experience. Our response to certain of the individual questions is included in the attached document.

In addition to our individual question responses, we have taken the opportunity to provide some more general observations on certain aspects of the proposals; these are set out in the letter below. We refer also to our response to the previous HM Treasury Consultation Paper 'A new approach to financial regulation: judgement, focus and stability', dated 18 October 2010; many of the comments made in that response remain relevant.

Building a stronger regulatory system

We agree that there were certain failures of the regulatory system during the recent financial crisis and we support the objectives of this and the previous consultation paper to make improvements in order to avoid similar failures in the future.

The proposals represent some of the most significant changes to the UK financial regulatory structure for over a decade. As we highlighted in our last response, we urge the Government to be particularly rigorous when assessing the cost and benefit implications and all potential consequences. These changes will not only impact regulated firms, but also the wider financial services industry and the UK economy. We recommend that the Government be mindful of unintended consequences and learn from previous examples, such as the implementation of the US Sarbanes-Oxley Act in 2002.

Clear governance and accountability

With the proposal to disaggregate the current regulatory architecture, we believe that the overarching governance framework for the Prudential Regulatory Authority ("PRA") and Financial Conduct Authority ("FCA") will be critical to the success of the new model. We would encourage HM Treasury to apply the relevant aspects of the recommendations set out in Sir David Walker's review (November 2009) on the governance of banks and other financial institutions. We highlight in particular the recommendations regarding the need for an institution's governing body to pay close attention to its

overall balance and to be evaluated regularly and rigorously. In implementing these recommendations, the regulatory bodies would not only benefit from robust governance but would also set an example of good practice to regulated firms.

In addition to this recommendation, we also highlight three specific observations on the proposals for governance and accountability of the new regulatory bodies:

- **Veto power of the PRA**

  The Consultation Paper proposes that the PRA will hold a power of veto over the FCA in order to ensure that disagreements between the two regulatory bodies can be resolved. Granting this veto power implies that the PRA will be the "lead regulator" in the new framework. Given that both the PRA and the FCA are essential parts of the new regulatory framework, we are mindful of the need to retain equivalence of power between the bodies except in very unusual situations. We recommend therefore that the detailed rules surrounding operation of the veto power emphasise that it should only be used in extreme circumstances. We believe that in most circumstances, disagreements between the PRA and the FCA should be resolved through appropriate mediation processes.

  We welcome the Consultation Paper's proposals on transparency, including the requirement to lay the circumstances in which the veto is used before Parliament, subject to considerations of public interest. If the disagreement giving rise to the exercise of the veto is in respect of a policy matter, it will usually be appropriate to disclose the surrounding circumstances. However, we anticipate that in most scenarios involving individual firms, the circumstances in which the veto is used will not be made public prior to the veto being exercised. This means that a clear governance framework surrounding use of the veto is even more critical.

- **Governance structure of the Bank of England**

  In the new structure, the Bank of England will have responsibility for regulatory and monetary policy. Therefore a governance structure that ensures that potential conflicts between regulatory and monetary policy are managed appropriately will be necessary. As such, we believe it would be prudent to further clarify governance arrangements relevant to the Financial Policy Committee ("FPC") and the PRA within the overall context of the Bank of England's governance structure.

- **Role of the National Audit Office ("NAO")**

  The Consultation Paper proposes a full audit of the PRA and FCA with accountability to the Public Accounts Committee ("PAC"). We welcome this proposal. In addition, we recommend that it would also be prudent for the NAO to review the working relationship and coordination between the PRA and the FCA two years after implementation of the new framework to assess effectiveness and efficiency and to make recommendations for improvement.

International and domestic competition

The financial services sector is unquestionably a key component of the UK economy. The development of an effective, respected and balanced regulatory framework is a key element of maintaining the UK's competitive position as a leading financial market on the global stage.

In our response to the previous HM Treasury Consultation Paper we recommended that the new regulators should be required to "have regard to" the competitiveness of the UK on the international stage; we continue to believe that this recommendation is appropriate.

In line with a desire to maintain a competitive UK financial services market internationally, we believe that competition within the UK market is positive for consumers and the economy. Whilst we do not believe that financial stability should be compromised solely for the objective of competition, we encourage an approach that allows for growth, flexibility and for the UK market to evolve. We support the comments of the Independent Banking Commission in their Interim Report published this week, which cites the FCA as a "vital spur to competition in banking."

The Consultation Paper proposes that the FCA "must, so far as is compatible with its strategic and operational objectives, discharge its general functions in a way which promotes competition". We believe that a regulatory body needs to be mindful of evolving market demands and be flexible in allowing markets, products and services to develop, allowing the UK financial services market to maintain a high level of choice for consumers. Therefore we would encourage HM Treasury to include a similar objective for the PRA, ensuring that this regulatory body has regard to its influence on the UK and international markets.

Interaction with the European and global regulators

In the future, financial services regulation within Europe and on the global stage will have an increasing impact on the UK. Market participants generally agree that effective regulation requires communication and coordination between global, regional and national regulators.

The Consultation Paper recognises the importance of international coordination. We agree with this acknowledgement and encourage further cooperation within the regulatory framework to ensure that the UK's influence at the European and global level is maximised. The roles of the PRA and FCA in future European regulatory developments should be included in their objectives to ensure that they are able to participate effectively in shaping any potential changes in the EU and global regulatory frameworks.

We note also that part of European Securities and Markets Authority's remit will cover company and auditor regulation which, in the UK, will remain within the scope of the Financial Reporting Council ("FRC"). It will be important, therefore, to ensure that an appropriate Memorandum of Understanding between the FCA and the FRC is adopted to enable the FRC's perspective on relevant matters to be reflected at a European level.

Coordination between the regulatory bodies

As we discussed in our previous response, the proposed regulatory framework should ensure that duplication is avoided, that no gaps in regulatory coverage exist and that firms have no opportunity for "regulatory arbitrage" through taking advantage of differing regulators' objectives. In developing our response to this Consultation Paper, we have also considered the coordination between the new regulatory bodies from the perspective of a dual-regulated firm. These firms will need confidence that the approaches of the new bodies are consistent, co-ordinated effectively and do not create unnecessary inefficiencies.

We understand that a Memorandum of Understanding between the PRA and the FPC will be developed to facilitate coordination between the regulatory bodies. We recommend that this memorandum takes account of those areas of regulation likely to fall into an overlap in the scope of the new regulators; for instance, sections of the current FSA handbook such as SYSC, PRIN and APER are relevant to both prudential and conduct regulation. For overlapping areas, it will be particularly important to be clear how rules and regulation in these areas will be developed, implemented and supervised in the new framework.

Moving towards judgement based regulation

As detailed in our previous response, we support a move towards judgement based regulation, and away from a "check box" approach. We believe that a judgement based regime, properly applied, will result in better regulatory outcomes. Given the inherent challenges in the design and application of such a methodology, we note that it must be supported by:

- Creation and maintenance of a principles based culture throughout the organisation(s);
- Active involvement of well trained and experienced individuals in setting principles, supervising and enforcing regulation; and
- Regular training and education of all people and the ongoing review of additional skilled resource required.

If these challenges are not overcome, future regulatory failures could result through the poor application of judgement based regulation, resulting in a worse outcome than would have been achieved through a more regimented, but less thoughtful, "check box" approach. Nonetheless, we support the move towards judgment based regulation, providing that it is supported by the cultural and organisational developments that are required to implement the strategy effectively.

We hope that you find our response to the Consultation Paper useful and we would be happy to discuss our comments further with you. Please contact Pat Newberry (0207 212 4659), Gilly Lord (0207 804 8123) or Anne Simpson (0207 804 2093) should you wish to discuss or clarify any matter in this response.

Yours faithfully,

PricewaterhouseCoopers LLP.

PricewaterhouseCoopers LLP

Contents:

1. The Bank of England and the Financial Policy Committee

1. What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools?

Many of the examples of macro-prudential tools given in the Consultation Paper would necessarily operate on a firm-specific basis. Whilst we do not disagree with the use of macro-prudential tools in this way, we believe that the FCP should also develop macro-prudential tools that can be operated market and system wide, rather than at an individual firm level.

3. Do you have any general comments on the proposed role, governance and accountability mechanisms of the FPC?

As detailed in our covering letter, the overarching governance framework applied to all of the new regulatory bodies will be critical to the success of the new model. We would encourage HM Treasury to apply the relevant aspects of the recommendations set out in Sir David Walker's review (November 2009) on the governance of banks and other financial institutions. We highlight in particular the recommendations regarding the need for an institution's governing body to pay close attention to its overall balance and to be evaluated regularly and rigorously. In implementing these suggestions, the regulatory bodies would not only benefit from robust governance but would also set an example of good practice to regulated firms.

With specific reference to the FPC and PRA, we note that in the new structure, the Bank of England will have responsibility for regulatory and monetary policy. Therefore a governance structure that ensures that potential conflicts of interest between regulatory and monetary policy are managed appropriately will be necessary.

2. Prudential Regulation Authority

5. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the PRA?

Further to our comments in the covering letter, we highlight two specific areas for consideration with regards to the proposed objectives for the PRA.

- **International and domestic competition**

  The financial services sector is unquestionably a key component of the UK economy. The development of an effective, respected and balanced regulatory framework is a key element of maintaining the UK's competitive position as a leading financial market on the global stage.

  In our response to the previous HM Treasury Consultation Paper we recommended that the new regulators should be required to "have regard to" the competitiveness of the UK on the international stage; we continue to believe that this recommendation is appropriate.

In line with the desire to maintain a competitive UK financial services market internationally, we believe that competition within the UK market is positive for consumers and the economy. Whilst we do not believe that financial stability should be compromised solely for the objective of competition, we encourage an approach that allows for growth, flexibility and the evolution of the UK market. We support the comments of the Independent Banking Commission ("IBC") in their Interim Report published this week, which cites the FCA as a "vital spur to competition in banking." We agree with the IBC that the FCA should have a clear primary duty to promote competition.

The Consultation Paper proposes that the FCA "must, so far as is compatible with its strategic and operational objectives, discharge its general functions in a way which promotes competition". We believe that a regulatory body needs to be mindful of evolving market demands and be flexible in allowing markets, products and services to develop, allowing the UK financial services market to maintain a high level of choice for consumers. Therefore we would encourage HM Treasury to include a similar objective for the PRA, ensuring that this regulatory body has regard to its influence on the UK and international markets.

- **Interaction with the European and global regulators**

  In the future, financial services regulation within Europe and on the global stage will have an increasing impact on the UK. Market participants generally agree that effective regulation requires communication and coordination between global, regional and national regulators.

  The Consultation Paper recognises the importance of international coordination. We agree with this acknowledgement and encourage further cooperation within the regulatory framework to ensure that the UK's influence at the European and global level is maximised. The PRA's role in future European regulatory developments should be included in their objectives to ensure that they are able to participate effectively in shaping any potential changes in the EU and global regulatory frameworks.

7. What are your views on the mechanisms proposed to make the regulator judgement-led, particularly regarding: rule-making; authorisation; approved persons; and enforcement (including hearing appeals against some decisions on a more limited grounds for appeal)?

As detailed in the covering letter and our previous response, we support a move towards judgement based regulation, and away from a "check box" approach. We believe that a judgement based regime, properly applied, will result in better regulatory outcomes. Given the inherent challenges in the design and application of such a methodology, we note that it must be supported by:

- Creation and maintenance of a principles based culture throughout the organisation(s);
- Active involvement of well trained and experienced individuals in setting principles, supervising and enforcing regulation; and
- Regular training and education of all people and the ongoing review of additional skilled resource required.

If these challenges are not overcome, future regulatory failure could result through the poor application of judgement based regulation, resulting in a worse outcome than would have been achieved through a more regimented, but less thoughtful, "check box" approach. Nonetheless, we support the move towards judgment based regulation, providing that it is supported by the cultural and organisational developments that are required to implement the strategy effectively.

8. What are your views on the proposed governance framework for the PRA and its relationship with the Bank of England.

Please refer to our response to Question 3.

9. What are your views on the accountability mechanisms proposed for the PRA?

The Consultation Paper proposes a full audit of the PRA and FCA with accountability to the Public Accounts Committee ("PAC"). We welcome this proposal. In addition, we recommend that it would also be prudent for the National Audit Office to review the working relationship and coordination between the PRA and the FCA two years after implementation of the new framework to assess effectiveness and efficiency and to make recommendations for improvement.

10. What are your views on the Government's proposed mechanisms for the PRA's engagement with industry and the wider public?

As highlighted in our covering letter, we believe that good governance is fundamental for a regulator and the financial industry as a whole. The Practitioner Panel and Consumer Panel provide the FSA with an important perspective of the market and, at the very least, are a sounding board with industry. We strongly feel that the PRA would benefit from access to these Panels so that the objectives, strategy and activities of the PRA can be made transparent and challenged, where appropriate. In addition, we believe that it would be prudent for the PRA to engage with the industry and the wider public through holding an annual public meeting.

3. Financial Conduct Authority

11. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?

Further to our comments in the covering letter, we would like to highlight the following specific area for consideration with regards to the proposed objectives for the FCA.

- **Interaction with the European and global regulators**

  In the future, financial services regulation within Europe and on the global stage will have an increasing impact on the UK. Market participants generally agree that effective regulation requires communication and coordination between global, regional and national regulators.

  The Consultation Paper recognises the importance of international coordination. We agree with this acknowledgement and encourage further cooperation within the regulatory framework to ensure to maximise the UK's influence at the European and global levels. The FCA's role in future European regulatory developments should be included in their objectives to ensure that they are able to participate effectively in shaping any potential changes in the EU and global regulatory frameworks.

12. What are your views on the Government's proposed arrangements for governance and accountability of the FCA?

Please refer to our response to Question 9.

14. The Government would welcome specific comments on:

- **The proposed approach to the FCA using transparency and disclosure as a regulatory tool;**
- **The proposed new power in relation to financial promotions; and**
- **The proposed new power in relation to warning notices.**

We welcome the Consultation Paper's proposals on transparency and believe that it is a key consideration to building a stronger regulatory system. We recommend, however, that further thought be given to the risk of any implication that a firm is already "guilty" when a warning notice is published, as publication could then lead to an implicit market penalty for a firm that may not be guilty of a regulatory breach. Any such publication should be subject to an appropriate and rigorous governance framework.

4. Regulatory Processes and Coordination

17. What are your views on the mechanisms and processes proposed to support effective coordination between the PRA and FCA?

As we discussed in our covering letter and previous response, the proposed regulatory framework should ensure that duplication is avoided, that no gaps in regulatory coverage exist and that firms have no opportunity for "regulatory arbitrage" through taking advantage of differing regulators' objectives. In developing our response to this Consultation Paper, we have also considered the coordination between the new regulatory bodies from the perspective of a dual-regulated firm. These firms will

need confidence that the approaches of the new bodies are consistent, co-ordinated effectively and do not create unnecessary inefficiencies.

We understand that a Memorandum of Understanding between the PRA and the FPC will be developed to facilitate coordination between the regulatory bodies. We recommend that this memorandum takes account of those areas of regulation likely to fall into an overlap in the scope of the new regulators; for instance, sections of the current FSA handbook such as SYSC, PRIN and APER are relevant to both prudential and conduct regulation. For overlapping areas, it will be particularly important to be clear how rules and regulation in these areas will be developed, implemented and supervised in the new framework.

In addition, we also refer to our comments regarding the role of the NAO in Question 9.

18. What are your views on the Government's proposal that the PRA should be able to veto an FCA taking actions that would be likely to lead to the disorderly failure of a firm or wider financial instability?

We note that the Consultation Paper proposes that the PRA will hold a power of veto over the FCA in order to ensure that disagreements between the two regulatory bodies can be resolved. Granting this veto power implies that the PRA will be the "lead regulator" in the new framework. Given that both the PRA and the FCA are essential parts of the new regulatory framework, we are mindful of the need to retain equivalence of power between the bodies except in very unusual situations. We recommend therefore that the detailed rules surrounding operation of the veto power emphasise that it should only be used in extreme circumstances. We believe that in most circumstances, disagreements between the PRA and the FCA should be resolved through appropriate mediation processes.

We welcome the Consultation Paper's proposals on transparency, including the requirement to lay the circumstances in which the veto is used before Parliament, subject to considerations of public interest. If the disagreement giving rise to the exercise of the veto is in respect of a policy matter, it will usually be appropriate to disclose the surrounding circumstances. However, we anticipate that in most scenarios involving individual firms, the circumstances in which the veto is used will not be made public prior to the veto being exercised. This lack of transparency makes having a clear governance framework surrounding use of the veto is even more critical.

5. European and International Issues

32. What are your views on the proposed arrangements for international coordination?

In the future, financial services regulation within Europe and on the global stage will have an increasing impact on the UK. Market participants generally agree that effective regulation requires communication and coordination between global, regional and national regulators.

The Consultation Paper recognises the importance of international coordination. We agree with this acknowledgement and encourage further cooperation within the regulatory framework to ensure that

the UK's influence at the European and global level is maximised. The PRA and FCA's role in future European regulatory developments should be included in the regulators' objectives to ensure that they are required to participate effectively in shaping any potential changes in the EU and global regulatory frameworks.

We note also that part of European Securities and Markets Authority's remit will cover company and auditor regulation which, in the UK, will remain within the scope of the Financial Reporting Council ("FRC"). It will be important, therefore, to ensure that there is an appropriate Memorandum of Understanding between the FCA and the FRC to ensure that the FRC's perspective on relevant matters is reflected at a European level.

HM Treasury Consultation Paper
A New Approach To Financial Regulation: Building A Stronger System

Prudential plc

Introduction

1. Prudential plc is an international financial services group with significant operations in the UK, Asia and the United States. Our purpose is to promote the financial well-being of our customers and their families, with a particular focus on saving for retirement and income in retirement. Our portfolio of well-known and respected brands has attracted approximately 25 million customers worldwide. Prudential plc is also one of the UK's largest institutional investors and therefore our comments reflect our views both as a leading financial services group as well as a major institutional investor.

2. We welcome the opportunity to respond to the consultation paper, which helpfully builds upon the proposals outlined in HM Treasury's consultation of July 2010. We also appreciate the recent engagement with HM Treasury in seeking our views and in providing more detail on how the new structures will work. The recognition in the consultation paper regarding proportionate regulation of the insurance sector is welcome, and we look forward to productive discussions with HM Treasury and other authorities as the Bill passes through Parliament over the next year.

Executive Summary

3. We respond below to the specific questions in the consultation paper but we wish to highlight the following key points:

Insurance and asset management regulation

4. We welcome the recognition in the consultation paper that "effective supervision of insurance firms for soundness and stability by the Prudential Regulation Authority (PRA) may be achievable through a less intensive supervisory approach than would need to be the case for a bank."[1] We are also supportive of the view put forward by Hector Sants on 9 February 2011, in which he agreed that in the area of insurance regulation there should be greater emphasis on 'going concern' issues over 'gone concern' issues, in comparison with a bank.[2] We look forward to engaging with the authorities towards the development of balanced regulation and would reiterate our view that any regulatory responses to the banking crisis that are inappropriately read across to insurers will impact our ability to fulfil our role in contributing to growth in the wider economy, in particular as pension providers and long-term investors in infrastructure. To emphasise the importance of this point, we would draw attention to the comment made in the Treasury Select Committee report on Financial Regulation of 27 January 2011: "inappropriate regulation of non-banking sectors could cause serious and unintended damage to companies within those sectors, and to the UK more widely."[3] The insurance and asset management industries can play a helpful role in delivering on areas identified as Government priorities – if properly enabled, we are a solution, not a problem.

Competitiveness

5. Given the overriding focus on financial stability, the consultation paper proposes that the competitiveness of the UK financial services sector will not be a specific objective of the PRA. It is crucial, however, that successful cross-border organisations such as Prudential plc's asset management arm, M&G Investments, continue to be able to compete on a level playing field internationally and that the UK does not lose out to other countries wishing to increase their domiciled funds. The financial services sector represents 10% of UK GDP[4] and it is our view that regulatory action should recognise the wider potential impact on jobs and growth. Similarly, the regulatory principles outlined in the consultation paper have excluded the encouragement of appropriate innovation. Long term product innovation, particularly for savings products, can also contribute to

[1] HM Treasury *A New Approach To Financial Regulation: Building A Stronger System* (February, 2011) p49
[2] Sants, Hector *The Future of Insurance Regulation* (9 February, 2011)
[3] Treasury Committee *Financial Regulation: A Preliminary Consideration Of The Government's Proposals* (27 January, 2011) p11
[4] TheCityUK *Budget 2011 Representation* (4 March, 2011) p5

growth in the economy and the authorities should not undermine the role of responsible companies in developing their businesses.

Judgement-based approach and ensuring procedural fairness

6. The 'judgement-based' approach and more intrusive strategy of credible deterrence includes powers to ban products; to publicise that a warning note has been issued to a firm (or that a misleading advertisement has been withdrawn); and to enable the use of greater transparency with the potential to 'name and shame' firms. It will be vital to ensure that the possibility of any public censure gives firms the opportunity to be presented with and challenge any allegations in advance, and that an effective appeals process is maintained. The Government should legislate for procedural fairness, ensuring that the industry has absolute clarity on how and when the powers will be used. The measures should be applied appropriately and proportionately, recognising the likely unintended consequences for all participants in the financial services sector and for wider financial stability. The exercise of discretionary judgement will also require highly skilled staff able to operate in a balanced and consistent fashion.

Clear roles and effective coordination

7. Improvements have been outlined in the consultation to address the complex issues created by two rule books and the need for establishing clear boundaries between the authorities to facilitate effective coordination. We welcome the possibility that the PRA and Financial Conduct Authority (FCA) may be able to combine their supervisory activities for dual-regulated firms, but there remains considerable confusion in some areas such as the authorisation and approvals process. To avoid unnecessary duplication, we would support the creation of a shared function that could potentially carry out authorisations and approvals for all firms. It may also be helpful for the PRA and FCA to adopt a shared set of 'quality assurance' operating principles, which would incorporate a requirement to ensure consistency, simplicity, clarity and certainty in their approach. In addition, we welcome the inclusion of a unit for the regulation of 'insurance groups' within the FSA transitory structure announced on 4 April 2011. We would suggest that one of the most important tasks of the new unit will be to ensure that the prudential regulation of subsidiary asset managers, such as M&G Investments, by the FCA does not result in duplicative regulation by the PRA. This will enable a level playing field with independent asset managers.

Promoting positive consumer outcomes

8. We support the recognition that the FCA will be a neutral and balanced regulator rather than a 'consumer champion'. We also believe that the operational objective to "secure an appropriate degree of protection for consumers" could be more constructively defined by changing it to "promoting positive consumer outcomes." This would recognise that consumers should not only be protected, but should also gain wider benefits from their engagement with the financial services sector. In addition, as mentioned in relation to the PRA, we do not support the omission from the FCA's regulatory principles of the need for competitiveness and appropriate innovation to be taken into account.

International issues – Solvency II and Systemic Risk

9. Given that regulatory reform is to be implemented at the same time (1 January 2013) as major changes to cross-border insurance regulation (Solvency II), there will be a need for continued and effective engagement on international issues. We therefore support the requirement for a Memorandum of Understanding (MoU) to exist between the Treasury, the Bank of England, the PRA and the FCA to facilitate international coordination. The recognition that core insurance activities are not systemically important should continue to be made in international fora where the Treasury and Bank of England have representation, particularly the Financial Stability Board and European Systemic Risk Board. It is also crucial that the PRA and FCA have sufficient insurance expertise and resources at Board and senior level to engage with the European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA) respectively. We welcome the creation of an insurance division headed up by Julian Adams, particularly as almost half of the firms supervised by the PRA will be insurance companies (1,000 out of 2,200). We look forward to engaging with this division.

Questions for Consultation

The Bank of England and Financial Policy Committee (FPC)	Prudential plc response
1 What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools?	While the instruments listed are wide-ranging, their impact and effectiveness will crucially depend upon how and when they are applied. They must be used on a proportionate basis, recognising that instruments developed in a banking context should not automatically be read across to insurers and asset managers. The global nature of financial services also means that there must be international coordination in the application of these tools, taking account of Solvency II and other European developments that will affect the industry. In view of the socio-economic implications, there should be full consultation prior to their application which takes account of existing monetary and fiscal policy, the impact on growth, and likely implications for the level of savings and investment in the economy.
2 Are there any other potential macro-prudential tools which you believe the interim FPC and the Government should consider?	While the tools listed are comprehensive, we would support the use of secondary legislation to develop the instruments. This will allow for the flexibility to gather evidence in advance to assess their likely usefulness. We would be happy to work with the authorities to discuss the appropriateness and effectiveness of specific tools that might be applied to the insurance and asset management sectors.
3 Do you have any general comments on the proposed role, governance and accountability mechanisms of the FPC?	We welcome the recognition that external Financial Policy Committee (FPC) members will be required to offer insights from their experiences in different sectors, including insurance. As January's Treasury Select Committee report on Financial Regulation pointed out, "there must be no room for accusations that it [the FPC] is overly focused on banking nor that it lacks the expertise to look at important sectors, such as insurance."[5] We support the acknowledgement in the consultation paper that the FPC should not 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 growth. Careful use will also need to be made of the power of direction over the PRA and FCA and the

[5] *Ibid* p21

	authority of the FPC to take action without consultation. The recognition of the need for proportionality is welcome, as the FPC will need to have regard to the broad range of business models across the financial services sector.
4 Do you have any comments on the proposals for the regulation of systemically important infrastructure?	The Bank of England's regulation of payment systems, settlement systems and central counterparty recognised clearing houses (RCHs) will require close coordination with the FCA, in view of the FCA's remit for the regulation of markets. Similarly, the Bank of England will need to work closely with the FCA, in view of the FCA's representation on ESMA. This will ensure that it is fully aware of important developments that will affect systemically important infrastructure, such as the European Markets Infrastructure Regulation (EMIR).
Prudential Regulation Authority (PRA)	**Prudential plc response**
5 What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the PRA?	While we support the PRA's objective to promote the stability of the UK financial system and the range of regulatory principles, we do not support the omission from those principles of the need for competitiveness and appropriate innovation. As a global business domiciled in the UK, we regard the competitive position of the financial services sector as absolutely vital for increasing growth and protecting jobs in a sector which represents 10% of UK GDP.[6]
6 What are your views on the scope proposed for the PRA, including Lloyd's, and the allocation mechanism and procedural safeguards for firms conducting the 'dealing in investments as principal' regulated activity?	We welcome the recognition in the consultation that the supervision of insurance firms by the PRA "may be achievable through a less intensive supervisory approach."[7] We would be happy to work with the Government to support its ongoing thinking in this area.
7 What are your views on the mechanisms proposed to make the regulator judgement-led, particularly regarding: rule-making; authorisation; approved persons; and enforcement (including hearing appeals against some decisions on more limited grounds for appeal)?	The judgement-focused approach raises the potential for inconsistent application across organisations according to the discretion of the PRA and the decisions of individuals. In view of the possibility of inconsistent supervision, we would not support more limited grounds of appeal, such as replacing the existing full merits review with a judicial review. Given the new powers of the European Supervisory Authorities, the PRA's ability to adopt a

[6] TheCityUK *Op.Cit.* p5
[7] HM Treasury *Op.Cit.* p49

	judgement-led approach regarding EU regulation will be severely constrained and it will need to work closely with the European authorities to ensure that it has implemented EU legislation appropriately.
8 What are your views on the proposed governance framework for the PRA and its relationship with the Bank of England?	We welcome the change made in this consultation to allow for the involvement of non-executives in PRA decision-making. There will be a need to ensure that the non-executives are drawn from a diverse range of sectors that represent all industries. We remain concerned, however, regarding the role of the Bank of England as lead resolution authority at the same time as the PRA has a role in putting a failed institution into the Special Resolution Regime (SRR). As a representative on the Board of both the Bank of England and the PRA, this creates a potential conflict of interest for the Governor.
9 What are your views on the accountability mechanisms proposed for the PRA?	We support the wide range of accountability mechanisms.
10 What are your views on the Government's proposed mechanisms for the PRA's engagement with industry and the wider public?	We welcome the changes made in the consultation to improve engagement with industry and the wider public. We note that the PRA will be able to make its own arrangements for the way it consults practitioners, giving it a considerable degree of flexibility. In advance of any arrangements being formed, it would be appropriate to ensure that the views of practitioners regarding these procedures are taken into account.
Financial Conduct Authority (FCA)	**Prudential plc response**
11 What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?	We support the changes in this consultation to recognise that the FCA is a neutral regulator rather than a 'consumer champion'. The operational objective to "secure an appropriate degree of protection for consumers" could be couched more broadly and constructively, such as "to promote positive consumer outcomes." This recognises the value of encouraging access to financial products which meet long-term consumer needs, such as savings and investments. While we support the requirement for the FCA to discharge its functions (where possible) in a way which promotes competition, as discussed in answer to question five we do not support the omission from the regulatory principles of the need for competitiveness and appropriate

	innovation.
12 What are your views on the Government's proposed arrangements for governance and accountability of the FCA?	We would support the proposed arrangements, particularly the new Markets Panel as this provides a recognition of the importance of wholesale financial markets to the UK.
13 What are your views on the proposed new FCA product intervention power?	We will respond to the issues raised by this question in more detail in our forthcoming response to the current FSA discussion paper on product intervention (DP11/1). One of our key concerns is that a more intrusive strategy by the FCA will need very careful management and the involvement of highly competent people able to use their judgement appropriately. There is a need to be aware of the unintended consequences of new rules on product development and innovation, creating the possibility of a reduced range of products for consumers. Ensuring that the Retail Distribution Review (RDR) and EU regulations in this area are taken into account as policy is developed will also be important. There have already been significant improvements in product regulation and we would urge the authorities to give careful thought to the formation and use of even greater powers.
14 The Government would welcome specific comments on: • the proposed approach to the FCA using transparency and disclosure as a regulatory tool; • the proposed new power in relation to financial promotions; and • the proposed new power in relation to warning notices.	We would be concerned about the creation of an environment in which the use of new powers could potentially lead to distrust between the regulators and the industry, and between industry and consumers. The Government should legislate for procedural fairness so that firms are clear on, and can challenge, any allegations before they are placed in the public domain. Greater use of 'naming and shaming', if used without due process and without access to recourse in a timely manner, has the potential to result in serious reputational damage for firms. This could have implications for all participants in the sector and for wider financial stability. It will also be important to ensure that the use of any data is placed in an appropriate context and that sensitive data is protected.
15 Which, if any, of the additional new powers in relation to general competition law outlined above would be appropriate for the FCA? Are there any other powers the Government should	We await further detail in view of the Government's review of the competition environment more generally.

consider?	Any use of a 'competition mandate' by the FCA must be clearly articulated. The FCA would need to have the appropriate skills to undertake market and economic analysis, ensuring that any mandate is not used to champion the rights of consumers in an unbalanced way.
16 The Government would welcomes specific comments on: • the proposals for RIEs and Part XVIII of FSMA; and • the proposals in relation to listing and primary market regulation.	We welcome the limited changes to wholesale regulation and the focus by the FCA on the integrity of markets and level playing field issues. We also support the confirmation that the UK Listings Authority will be part of the FCA.
Regulatory processes and coordination	**Prudential plc response**
17 What are your views on the mechanisms and processes proposed to support effective coordination between the PRA and the FCA?	We particularly support the possibility of combining the supervisory activities of dual-regulated firms. We also welcome the inclusion of a unit for 'insurance groups' within the new FSA transitory structure announced on 4 April 2011. We would suggest that one of its activities should be to ensure that the prudential regulation of subsidiary asset managers, such as M&G Investments, by the FCA does not result in duplicative regulation by the PRA. Regulations should be applied consistently to subsidiary asset managers and independent asset managers, ensuring a level playing field. We would also suggest that the PRA and FCA adopt a shared set of 'quality assurance' operating principles, which could include the requirement to ensure consistency, simplicity, clarity and certainty in the application of judgement-led supervision. These principles could be subjected to ongoing evaluation.
18 What are your views on the Government's proposal that the PRA should be able to veto the FCA taking actions that would be likely to lead to the disorderly failure of a firm or wider financial instability?	We support this proposal.
19 What are your views on the proposed models for the authorisation process – which do you prefer, and why?	To avoid unnecessary duplication/gaps, costs and inefficiencies, we would support a shared function that could carry out authorisations and approvals for all firms. Failing that, we would favour option two, in which one authority seeks consent of the other, as this has the advantage of a single point of contact for firms.

20 What are your views on the proposals on variation and removal of permissions?	We agree that the PRA and FCA should both have the power to vary and remove permissions.
21 What are your views on the Government's proposals for the approved persons regime under the new regulatory architecture?	The proposal for approvals to be split between the PRA and FCA in line with the role of the individual in the firm has the potential for considerable confusion. We would instead favour one approval interview jointly undertaken by the PRA and FCA.
22 What are your views on the Government's proposals on passporting?	We support the Government's proposals on passporting. For firms that passport into the UK, we would also support relevant information being passed from the FCA to the PRA.
23 What are your views on the Government's proposals on the treatment of mutual organisations in the new regulatory architecture?	We welcome the recognition that the authorities will not seek to favour one ownership model over another.
24 What are your views on the process and powers proposed for making and waiving rules?	As with the approvals process, the need for collaboration between the PRA and FCA will be paramount as these proposals leave considerable room for confusion with regard to dual-regulated firms.
25 The Government would welcome specific comments on • proposals to support effective group supervision by the new authorities – including the new power of direction; and • proposals to introduce a new power of direction over unregulated parent entities in certain circumstances?	While we support prudential regulation of M&G Investments by the FCA, considerable care must be taken to ensure that this regulation is not duplicated by the PRA, given that other parts of the Group will fall within the PRA's remit. We would regard the power of direction for group supervision to be a last resort, the use of which would be very limited.
26 What are your views on proposals for the new authorities' powers and coordination requirements attached to change of control applications and Part VII transfers?	We support these changes.
27 What are your views on the Government's proposals for the new regulatory authorities' powers and roles in insolvency	We support these proposals.

proceedings?	
28 What are your views on the Government's proposals for the new authorities' powers in respect of fees and levies?	We support the setting of fees by each body and the collection through a single body, thereby maintaining the existing arrangements.
Compensation, dispute resolution and financial education	**Prudential plc response**
29 What are your views on the proposed operating model, coordination arrangements and governance for the FSCS?	While we support these changes, it is not clearly stated how this new structure will impact the cross-subsidy arrangements, in which insurers are called upon to contribute to the costs of bank failures. As suggested in HM Treasury's consultation paper last year, cross-subsidisation might end if the PRA and the FCA make rules relating to compensation and levies for the different classes of firm which they regulate. As this is the proposal adopted by HM Treasury, we can consequently envisage an end to cross-subsidisation and would support this outcome. In addition, we oppose any move towards a pre-funded scheme because the long-term nature of insurance products means that an immediate call on FSCS funds is unlikely to be required at any stage.
30 What are your views on the proposals relating to the FOS, particularly in relation to transparency?	We support the independent role of FOS and the need for an MoU between FOS and the FCA. Regarding the publication of FOS determinations, we would appreciate further detail regarding how and when this would be undertaken. The use of greater transparency will need to ensure that data is accurate and contextualised, and that FOS has clear objectives which result in helpful outcomes for consumers. It would also be useful to understand the circumstances in which FOS could pass to the FCA any information which the FCA regards as being important in helping to promote better consumer outcomes.
31 What are your views on the proposed arrangements for strengthened accountability for the FSCS, FOS and CFEB?	We support the strengthened accountability arrangements.
European and international Issues	**Prudential plc response**
32 What are your views on the proposed arrangements for	We support the requirement for an MoU to exist between the Treasury, the Bank of England, the

international coordination outlined above?	PRA and the FCA to facilitate international coordination. It is vital that the PRA and FCA, in particular, have sufficient expertise, time and resources at Board and senior level as regulation is increasingly set at an EU level. The focus on domestic reforms should not be at the expense of UK financial services losing out in key international debates (e.g. Solvency II). In addition, the recognition that core insurance activities are not systemically important should continue to be made in international fora where the Treasury and Bank of England have representation, particularly the Financial Stability Board and European Systemic Risk Board.

Prudential plc, 14 April 2011

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Financial Regulation Strategy
HM Treasury
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15 April 2011

Dear Sirs,

HM Treasury: A new approach to financial regulation: building a stronger system

INTRODUCTION

The Quoted Companies Alliance (QCA) is a not-for-profit membership organisation working for small and mid-cap quoted companies. Their individual market capitalisations tend to be below £500m.

The QCA is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The QCA Legal, Markets & Regulations and Corporate Finance Advisors Committees have examined your proposals and advised on this response. A list of committee members is at Appendix A.

RESPONSE

We welcome the opportunity to respond to this consultation. We would like to respond to the HM Treasury's Consultation document 'A new approach to financial regulation: building a stronger system' (the "Consultation") insofar as it relates to small and mid-cap quoted companies and affects the corporate finance and broking houses advising these companies. Our response is limited to the proposed "minor technical improvements" to Part VI of the Financial and Services and Markets Act 2000 ("FSMA") listed at paragraph 4.112 of the Consultation.

EXTENSION OF S.166

We are concerned with one particular aspect of the Consultation, that Part VI be amended to allow "the UKLA to require a listed issuer to have a skilled person prepare a report on a matter in respect of which the UKLA could require information to be supplied".

It is important to distinguish clearly the dual roles of what is currently the Financial Services Authority ("**FSA**") and will be the Financial Conduct Authority ("**FCA**"). The role of the FSA as regulator for authorised institutions under the FSMA ("**Regulated Issuers**") is fundamentally different from the FSA's role as the UK Listing Authority with regard to listed issuers admitted to regulated markets ("**Non-regulated Issuers**"). The power to appoint a skilled person is consistent with the former role, but not the latter. The extension of the section 166 power is a major change which should be fully analysed and justified. Companies should not fall into a regulated sector by default, risking the competitiveness of the UK as a listing venue.

The 'Analysis of costs and benefits' included in Chapter 5 of the Consultation does not deal with the impact of any changes on Non-regulated Issuers but we believe that they could be significant.

We set out below our detailed concerns

1. The FSA has powers to appoint skilled persons under both sections 166 and 168 of the FSMA. The function of the two sections can be described as follows:

   (a) Section 166 provides a power for the FSA to require an authorised person, or person connected to an authorised person, to provide the FSA with a report on certain matters relevant to the exercise of the FSA's functions. The person appointed to make the report must be nominated or approved by the FSA, and have the necessary expertise.

   (b) Section 168 provides a power to appoint competent persons to carry out an investigation and make a report in cases in which the FSA suspects that there has been a particular instance of misconduct or wrongdoing.

   The FSA already has a power to appoint a person to carry out an investigation equivalent to section 168 (section 97 of the FSMA). If a skilled person is appointed other than where there is particular wrongdoing, it is unclear what the outcome would be outside of the regulated arena. Generally we would expect some kind of remedial plan but that is not appropriate for a Non-regulated Issuer.

2. In CP91 (May 2001), the FSA stated that "Under our new approach to regulation, the use of skilled persons is a regulatory tool for diagnostic, monitoring, preventative and remedial purposes. It can be used in risk assessment, risk mitigation programmes and when responding to risk escalation or crystallisation." Thus the use of the skilled person is linked to the role of the FSA relating to risk arising from individual businesses in the regulated sector. It is not the role of the FSA or FCA to scrutinise the underlying business of a listed company and therefore the power to appoint a skilled person is inappropriate.

3. The power to appoint a skilled person relates to the statutory objects of the FSA and therefore is extremely broad. It is a seriously intrusive and costly procedure for the target of the expert and there is no simple and quick way to challenge the use of the power. Whilst Chapter 5 of the Supervision part of the FSA Handbook ("**SUP 5**") sets out the FSA's policy on the use of skilled persons, including at SUP 5.3.3 the likely factors to which the FSA will have regard when making the decision to require a report by a skilled person, a Non-regulated Issuer who disagrees with the FCA's decision to appoint an expert would only be able to apply for judicial review of the decision which is unlikely to be practicable in terms of time or cost.

4. The FSA set out in SUP 5 Annex 1 examples of when the FSA may use the skilled person tool. In general these would not be applicable to a Non-regulated Issuer. Given that the FCA has no role in regulating the underlying business of a Non-regulated Issuer and the existence of section 97 of the FSMA, there would appear to be only one area of possible application: where the FCA believes that a Non-regulated Issuer does not maintain the systems and controls required under the Listing Rules or Disclosure and Transparency Rules but where there is no evidence of contravention of the Listing Rules or Disclosure and Transparency Rules. Therefore, it is unclear why and in what circumstances the FSA would require such an additional power.

   In addition to section 97 of the FSMA, premium listed companies are required to appoint a sponsor when required to do so by the FSA because "it appears to the FSA that there is, or there may be, a breach of the Listing Rules or the Disclosure Rules and Transparency Rules by the listed company." (LR 8.2.1(5)). We are not aware of, and the FSA has not clearly indicated, any evidence of failure of the sponsor regime in these circumstances. The sponsor regime allows Non-regulated Issuers access to knowledge and expertise to guide them in understanding and meeting their responsibilities under the Listing Rules and Disclosure and Transparency Rules. Given the existence of the sponsor regime it is not clear that the circumstances of a Non-regulated Issuer would ever meet the criteria referred to in SUP 5.3.4 (and in particular 5.3.4 (6)) which specify the circumstances in which a skilled person would be appointed.

5. Issuers with a standard listing are not subject to the sponsor regime, but have obtained such a listing on the understanding that, in general, it imposes directive minimum standards. We are concerned that the imposition of a section 166 power will appear to be an imposition of a sponsor regime "by the back door" which will make the UK markets unattractive to such issuers, particularly given that the FSA already has the power given to it by section 97 of the FSMA in circumstances of possible contravention by the Non-regulated Issuer.

6. There does not appear to be evidence of the failure of the current enforcement regime. The FSA has not indicated a lack of co-operation from Non-regulated Issuers. In the FSA business Plan for 2011/2012 it is stated that "In the area of enforcement, meanwhile, the last three to four years have seen a revolution in FSA effectiveness, as we have built a credible deterrence approach based on a far more robust use of our civil enforcement and criminal prosecution powers." There is no discussion in the report of issues relating to Non-regulated Issuers as a particular risk nor that there might be any shortfall in the FSA's powers insofar as they might need to deal with that risk.

7. In contrast, the number of skilled persons being appointed appears to be rising significantly year on year (88 in 2009/2010, 56 in 2008/2009, 30 in 2007/2008 and 18 in 20006/2007) (Freedom of information request available at: http://www.fsa.gov.uk/pubs/foi/foi_1794.pdf). This is concerning in the context of the difficulties noted in DP 10/3 in relation to the appointment of skilled persons and the lack of evidence that such a power is required in relation to the non-regulated sector.

8. In cases where the FCA is concerned that there is wrongdoing, we believe that adequate remedial powers exist at present. These include: the power to suspend or discontinue listing (section 78 and 89L of the FSMA), power to issue a public censure (section 87M and 89K of the FSMA), power to call for information (section 89H of the FSMA), power to impose financial penalties (section 91 of the FSMA), appointment of investigator (section 97 of the FSMA), power to impose penalties for market abuse (section 123 of the FSMA) and restitution orders in cases of market abuse (section 383 of the FSMA).

9. We do not believe that it is the role of the FSA or FCA to regulate Non-regulated Issuers. The extension of the 166 power to Non-regulated Issuers risks giving investors a misleading impression that the FCA is underwriting the business and systems and controls of the company in which they are investing.

OTHER PROPOSALS

10. We agree with the proposal to simplify the procedure for delisting at the request of the issuer.

11. We are unable to give in depth comments at this time on the extension of powers to penalise sponsors as there is not adequate detail given around these proposals.

    However, we are concerned that such a change should be fully justified as we are not aware of any significant weaknesses or behaviours by sponsors, which would require enforcement powers to be reinforced. Our members believe that the FSA's Sponsor Supervision unit maintains a good level of contact with sponsors and supervises effectively, that the listing regime and UKLA processes are robust (involving significant UKLA input and participation where required) and market knowledge and practices are well informed by regular issues of LIST!.

    In addition, we would comment that the FSA can currently cancel its approval of sponsors and censure publicly, both of which are strong sanctions, given that the ability to act as sponsor and sponsor reputation are both critical to the business of any firm providing corporate finance services. In summary, we do not understand the need to add and introduce the ability to suspend or restrict sponsor activities, or how this would operate practically. If a sponsor does not fulfil the Listing Rules' requirements, they should not continue to be approved as sponsor by the FSA.

    We also note that sponsor responsibilities do not technically extend to investor protection (LR 8.3.1), so we are also concerned by the apparent and implicit link in the paper between this and the ability to impose financial penalties.

12. We agree that the limitation period for breaches of the listing rules should be three years.

13. We are not aware of any issues relating to PIPs which suggest that a regulatory regime is required.

14. We cannot comment on the other provisions which are to be amended to facilitate integration as they are not specified.

If you would like to discuss any of these issues further, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
Chief Executive

APPENDIX A

Quoted Companies Alliance Legal Committee

Tom Shaw (Chair)	Speechly Bircham LLP
James Archibald	Nabarro LLP
Jai Bal	Farrer & Co LLP
Chris Barrett	Bird & Bird LLP
Richard Beavan	Boodle Hatfield
Matt Bonass	SNR Denton LLP
Ross Bryson	Mishcon de Reya
Madeleine Cordes	Capita Registrars
Jonathan Deverill	DMH Stallard
Jeanette Gregson	Davenport Lyons
Stephen Hamilton	Mills & Reeve LLP
Susan Hollingdale	Practical Law Company Ltd
Martin Kay	Blake Lapthorn
Carol Kilgore	Curtis, Mallet-Prevost, Colt & Mosle LLP
Philip Lamb	Lewis Silkin LLP
Maegan Morrison	Hogan Lovells LLP
Chris Owen	Manches LLP
June Paddock	Fasken Martineau LLP
Donald Stewart	Faegre & Benson LLP
Gary Thorpe	Clyde & Co LLP
Tim Ward	Quoted Companies Alliance
Kate Jalbert	Quoted Companies Alliance

Quoted Companies Alliance Markets & Regulations Committee

Stuart Andrews (Chair)	Evolution Securities Ltd
Umerah Akram	London Stock Exchange plc
Peter Allen	DWF LLP
Mark Cleland	Capita Registrars Ltd
Andrew Collins	Speechly Bircham LLP
Richard Everett	Lawrence Graham LLP
Martin Finnegan	Nabarro LLP
Alexandra Hockenhull	Hockenhull Investor Relations
Farook Khan	Pinsent Masons LLP
Linda Main	KPMG LLP
Brian McDonnell	Olswang
Richard Metcalfe	Mazars LLP
Katie Morris	Brewin Dolphin Ltd
Philip Quigley	Smith & Williamson Limited
Simon Rafferty	Winterflood Securities Ltd
Laurence Sacker	UHY Hacker Young
Chris Searle	BDO LLP
Peter Swabey	Equiniti
Tim Ward	Quoted Companies Alliance
Kate Jalbert	Quoted Companies Alliance

Quoted Companies Alliance Corporate Finance Advisors Committee

Tom Price (Chair)	Westhouse Securities
Azhic Basirov	Smith & Williamson Limited
Simon Clements	Merchant Securities Limited
Daniel Conti	RBC Capital Markets
John Cowie	Seymour Pierce Limited
Richard Crawley	Espirito Santo Investment Bank incorporating Execution Noble
Lesley Gregory	Memery Crystal LLP
Tom Griffiths	Arbuthnot Securities Ltd
Samantha Harrison	Ambrian Partners Limited

Dalia Joseph	Oriel Securities Limited
Steve Mack	CMS Cameron McKenna LLP
Nicholas Narraway	Moorhead James
Nick Naylor	Allenby Capital Ltd
Simon O'Brien	PricewaterhouseCoopers LLP
Mark Percy	Seymour Pierce Limited
Susan Walker	KPMG LLP
David Worlidge	Merchant Securities Limited
Ray Zimmerman	ZAI Corporate Finance Ltd
Kate Jalbert	Quoted Companies Alliance
Tim Ward	Quoted Companies Alliance

APPENDIX B

THE QUOTED COMPANIES ALLIANCE (QCA)

A not-for-profit organisation funded by its membership, the QCA represents the interests of small and mid-cap quoted companies, their advisors and investors. It was founded in 1992, originally known as CISCO.

The QCA is governed by an elected Executive Committee, and undertakes its work through a number of highly focussed, multi-disciplinary committees and working groups of members who concentrate on specific areas of concern, in particular:

- taxation
- legislation affecting small and mid-cap quoted companies
- corporate governance
- employee share schemes
- trading, settlement and custody of shares
- structure and regulation of stock markets for small and mid-cap quoted companies;
- political liaison – briefing and influencing Westminster and Whitehall, the City and Brussels
- accounting standards proposals from various standard-setters

The QCA is a founder member of European**Issuers**, which represents quoted companies in fourteen European countries.

QCA's Aims and Objectives

The QCA works for small and mid-cap quoted companies in the United Kingdom and Europe to promote and maintain vibrant, healthy and liquid capital markets. Its principal objectives are:

Lobbying the Government, Brussels and other regulators to reduce the costing and time consuming burden of regulation, which falls disproportionately on smaller quoted companies

Promoting the smaller quoted company sector and taking steps to increase investor interest and improve shareholder liquidity for companies in it.

Educating companies in the sector about best practice in areas such as corporate governance and investor relations.

Providing a forum for small and mid-cap quoted company directors to network and discuss solutions to topical issues with their peer group, sector professionals and influential City figures.

Small and mid-cap quoted companies' contribute considerably to the UK economy:

- There are approximately 2,000 small and mid-cap quoted companies
- They represent around 85% of all quoted companies in the UK
- They employ approximately 1 million people, representing around 4% of total private sector employment
- Every 5% growth in the small and mid-cap quoted company sector could reduce UK unemployment by a further 50,000
- They generate:
    - corporation tax payable of £560 million per annum
    - income tax paid of £3 billion per annum
    - social security paid (employers' NIC) of £3 billion per annum
    - employees' national insurance contribution paid of £2 billion per annum

The tax figures exclude business rates, VAT and other indirect taxes.

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Treasury110412

A new approach to financial regulation – a response to the HM Treasury consultation paper

Two aspects of consumer protection merit more emphasis than in the paper.

1. Ensuring that the Financial Conduct Authority enforces the Money-laundering Regulation and Guidelines in accordance with the risk-basis approach laid down by the legislator

The Treasury paper transfers enforcement of the Money Laundering Regulation from the FSA to the FCA, but does not elaborate. When I tried to get the FSA to rule on the legality, one way or the other, of the absurd amount of *certified* documentation which was required for redemption of a small unit trust holding, the FSA fobbed me off with pamphlets, then argued that my complaint against the FSA was inadmissible because it related to their legislative function (?) and, anyway, it was for the firm's commercial judgment (!). The FSA Complaints Commissioner suggested I try the Financial Ombudsman Service (!). The Treasury could offer no legal opinion. It is difficult to resist wondering if non-residents like Colonel Gaddafi had to provide a certified copy of an electricity bill, but at least their funds get blocked by Treasury regulation, rather than by an unaccountable employee of a financial firm.

When the Treasury Select Committee highlighted how UK banks wrongly cited 'money laundering' regulations to refuse non-resident UK citizens a UK bank account, the TSC laid responsibility on the British Bankers Association rather than on the FSA.

The FCA must not display the same 'light-touch' inertia as the FSA when it comes to ensuring respect for the risk-based money laundering regulation and guidelines, particularly as applied to non-resident UK citizens wanting to access their UK savings, or to open (or change) a UK bank account..

2. Ensuring that financial firms and others do not submerge the Financial Ombudsman Service with matters which have nothing to do with it, and that the FOS sticks to its role of ruling on complaints involving financial loss

I make this point since I have been waiting over two and a half years for a FOS ruling on a registered complaint concerning wrongly-deducted back-tax. Three times I have been told that this is due to '*very high volume of enquires and we will provide you with a full response as soon as we can'*. This is a bit rich from an organisation which expects firms to get things right first time, and to respond promptly. Yet the FOS has got itself into this situation by allowing itself to become a basket into which the FSA, and financial firms, can shuffle off all manner of consumer complaints and grumbles, and even constructive criticism. This point seems to be acknowledged in the Treasury paper, but without recognising that the FCA will need to be highly vigilant and pro-active to ensure that financial firms' literature and standard letters correctly set out the role of the FOS, and indeed of the FCA itself.

The above evidence is of a private customer living elsewhere in the EU, and who remained a customer of UK financial firms after receiving emigration treatment in 1973 under the Exchange Control Act 1947 (abolished in 1979).

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April 2011

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14th April 2011

Dear Sirs

A new approach to financial regulation: building a stronger system

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: Building a Stronger System"*. Although we believe that this is a significant improvement on the initial consultation, providing greater clarity of the roles, responsibilities, and objectives of the participants in the new regulatory framework, we still have significant concerns about how the proposed approach will work in practice. In relation to the regulation of insurance companies such as ourselves there are still a number of areas that require further consideration and clarification.

We have five principal points that we urge you to consider. We have suggested ways in which you can address these in our detailed response.

Appropriate Regulation for the Insurance Industry

Representation of the insurance sector

It is essential that the FPC and PRA include insurance representation on their boards. Without this, there is a strong likelihood of disproportionate and inappropriate regulation of insurers. The FPC, PRA and FCA must also 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. Staff must also have the ability to apply the regulatory regime in an appropriate and proportionate manner. This will be of increasing importance as the authorities move towards a more judgement-based supervisory approach. The appropriate level of expertise must be present at all levels and in all functions.

Disproportionate regulation of insurers

The proposed objectives of the Financial Policy Committee (FPC) and the Prudential Regulatory Authority (PRA) are directed towards the regulation of banking and give little indication of how this will influence their approach to the financial stability and prudential regulation of insurers. As stated in the consultation paper, banks and insurers present different risks. While we accept that, at a high level, the regulatory framework will be broadly similar for banks and insurers, we strongly believe that the supervisory approach adopted by the PRA has to be proportionate to the business model and risk of the firm. We believe that this is the intended outcome of the new regulatory framework and, consequently, supervision

must be less intrusive for insurers. It is not yet apparent how this will operate in practice. Therefore, in our response to the questions we have included our thoughts and suggestions on how the authorities can apply their regulatory approach in a manner that is appropriate and proportionate to the prudential and conduct risks posed by insurers.

Regulatory Burden and Overlap

Regulatory Principles and Objectives

We also believe that the objectives of the PRA and FCA lack clarity and must be made more concise to ensure the authorities are properly aligned and reflect all the firms they regulate, not just banks. Furthermore, although we support the aim of the regulatory principles, it is difficult to see how these will have adequate standing if they are not part of the objectives of the PRA and FCA and remain on a 'have regards' basis.

Increased Regulatory Burden

The proposals have not explored in detail the impact of dual regulation on firms and, in particular, we are disappointed that a shared service model has not been explored further.

If the PRA and FCA operate independently, without adequate liaison, this will be a significant burden for dual-regulated firms. At the very least in order to reduce the regulatory burden on firms the PRA and FCA must jointly supervise dual-regulated firms, with the PRA as lead regulator. We believe this will go a long way towards the elimination of duplication and will help the authorities to focus their resources in the most efficient and cost-effective manner.

Memorandum(s) of Understanding

It is imperative that industry is consulted on the content of any proposed Memorandum of Understanding (MoU) between the regulatory authorities. There is a significant risk that, without appropriate consultation, the agreements will not properly reflect many of the practical issues that both regulators and firms will face.

Each MoU must contain detailed information about how the authorities will co-ordinate their activities in practice, in order to minimise and avoid unnecessary duplication or, worse, inconsistency in regulatory decision making processes. MoU's must also set out exactly how any disagreements in approach will be escalated and resolved.

European Representation

The establishment of the European Supervisory Authorities (ESAs) will significantly change the way in which new regulation is introduced to the UK. The ESAs 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. We need to be much more effective in this area, with proactive and early stakeholder dialogue that ensures the views of firms are taken into account. This influencing should also reflect the stated Government aims on growth and prosperity of UK Plc so that this is properly reflected in European regulation. This will require the authorities to commit more resources and to acquire new skills and expertise.

However, while the paper comments on what representation will take place and how it will be co-ordinated, it does not outline the wider approach or strategy that will be adopted, or indicate the resources that will be committed to this area nor how engagement will be co-ordinated across the two regulators. It is important that the regulators consult with firms on how they will establish, implement, and resource a

strategy that will ensure the UK's interests are adequately represented and how they will ensure that the views of industry stakeholders will be obtained as part of the engagement processes.

Excessive Powers

The proposal in its current form for the FCA to have wider powers than those available to the FSA is unwelcome. The suggestion of additional powers relating to the early public disclosure of potential enforcement action and for the suspension of financial promotions, if executed inappropriately, will result in poor outcomes for firms and unwarranted damage to their reputation. The recent press coverage surrounding FSA's investigation into a Gartmore fund manager is a good example. This has had clear repercussions for the fund management firm, albeit an unintended consequence of greater transparency. Should these proposals be implemented they must be accompanied by appropriate safeguards to ensure they take into account the interests of consumers and firms. We have set out some recommendations in our response.

Costs

We 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 £7 million in 2010.

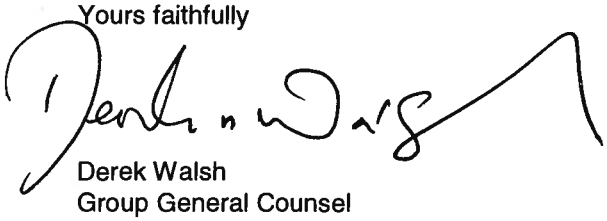
The proposals do not address the pressing issue of how the authorities plan to ensure that future fee increases and overall regulatory costs are kept under control. Effective co-ordination and the avoidance of unnecessary duplication of functions between the PRA and FCA would help to minimise the costs of dual regulation. This can be achieved through a joined up supervisory approach with a lead regulator.

We believe 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 recognise and support the business and political need for reform of the UK regulatory architecture. It is vital that the steps to achieve this are carefully mapped out, taking into account the needs of all players in the financial services marketplace. This must include ensuring that the regulatory approach considers and takes into account the Governments future growth strategy. We note that certain aspects of the Treasury's work have taken into account the Government strategy, for example in the work on taxation.

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, we 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. I can be contacted directly on 020 7111 7302.

Yours faithfully



Derek Walsh
Group General Counsel

Consultation Response - A new approach to financial regulation: building a stronger system

Chapter 2. Bank of England and Financial Policy Committee

Q1. What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools?

We agree that the FPC should be provided with a number of measures by which they can intervene in any instances of actual and / or potential financial instability. However, these are new measures and it is important that the FPC undertakes a proper analysis of the impact and likely effectiveness of these tools.

The FPC's regulatory tool-kit has been developed in relation to the banking and deposit taking sectors. Insurers have different business models and engage in different activities therefore the use of these tools for insurers would be inappropriate. The FPC will need to develop specific tools if they envisage insurers being subject to macro-prudential regulation.

However, please see our response to Question 3 in relation to the direction making powers of the FPC.

Q2. Are there any other potential macro-prudential tools which you believe the interim FPC and the Government should consider?

Please see our response to Q1.

Q3. Do you have any general comments on the proposed role, governance and accountability mechanisms of the FPC?

It is essential that the FPC includes insurance representation on its board. The presence of an insurance market practitioner will help to ensure that the FPC makes informed and proportionate decisions based on the risks posed by insurers. Without representation from the insurance industry the FPC will be unable to make the right recommendations or directions in respect of this market sector.

We believe that in setting out the FPC's toolkit, the FPC must be required to consult on any policy statement in advance and that the consultation and CBA processes should be followed in all cases, to ensure any regulatory action is effective and proportionate.

The FPC should not be given powers over individual firms and should not direct any recommendations or directions specifically at individual firms. This is of particular relevance to insurance firms, which present a significantly lower risk to financial stability. The impact of any macro-prudential risks may vary considerably between individual insurers, according to; their products; the markets in which they operate; their methods of distribution; their approach to pricing, underwriting and claims handling; their reserving policy; their investment strategy; and their overall financial control framework.

Therefore, in setting out the FPC's toolkit in secondary legislation and developing a statement about the circumstances under which the FPC would direct the PRA and / or FCA, the Treasury must pay due consideration to the differences between banks and other financial institutions, particularly insurers. In particular, future legislation should provide sufficient scope for the authorities to vary the supervisory approach to regulating firms and, where appropriate, reduce the regulatory burden.

Q4. Do you have any comments on the proposals for the regulation of systemically important infrastructure?

We have no comments

Chapter 3. Prudential Regulation Authority

Q5. What are your views on the:

(i) strategic and operational objectives for the PRA?

We believe that the PRA's objectives could be made clearer. The PRA's strategic objective focuses on stability of the UK financial system which is appropriate in its role as the prudential regulator for banking. However, the PRA will also regulate insurers who do not pose the same level of systemic risk to financial stability as banks.

This might be achieved by merging the objectives to make one concise statement such as: "Promoting the stability and soundness of the UK financial system and authorised persons". The PRA should also have an objective relating to the promotion of competition, in line with the FCA.

The regulatory principles are helpful but should be part of the objectives of the PRA rather than on a have regards to basis. There is a risk that have regards to principles are not given equal weight.

For the PRA to be an effective judgement-led authority and achieve its objectives in relation to its supervision of insurers, it must ensure it employs persons with experience of the insurance industry and a strong understanding of the business models and risks insurers face. These persons must be employed not only as members of its governing functions, but at all levels and in all functions that form part of its regulatory infrastructure.

(ii) the regulatory principles for the PRA?

As stated above we have concerns as to how much standing the principles will have in practice, if they are only to be considered on a have regards to basis. We suggest that the principles are set out as part of the objectives of the PRA and FCA, putting them on a much stronger footing.

We fully support the principles of efficiency and proportionality within the regulatory framework, that senior mangers are responsible for ensuring compliance, and that consumers should take responsibility for their decisions.

We also support the general principles of openness, disclosure, and transparency, provided these are carried out with due consideration of the potential impact on individual firms and their customers, and not just to serve the PRA's objectives.

Q6. What are your views on the scope proposed for the PRA, including Lloyd's, and the allocation mechanisms and procedural safeguards for firms conducting the "dealing in investments as principal" regulated activity?

As a general insurer, we are pleased to note *"that the PRA will act in a way that recognises insurance business models are different to those of banks ... and the fact that insurance firm failure is generally less likely to be of systemic importance".*

We agree that insurers should be subject to a less intensive supervisory approach. Also, as mentioned above, we believe this is more likely to be achieved if the PRA ensures it has the necessary expertise and experience of the insurance industry within its organisational structure and suitable supervisory processes within its regulatory framework.

We do not have any comments about the prudential regulation of Lloyd's managing agents or firms dealing in investments as principal.

Q7. What are your views on the mechanisms proposed to make the regulator judgement-led, particularly regarding: rule making; authorisation; approved persons; and enforcement (including hearing appeals against some decisions on a more limited grounds for appeal)?

In principle we agree that the PRA adopting a judgement-led supervisory approach will enable regulators to focus on the major risks facing firms. However, we are concerned as to how this will work in practice. To apply this approach to insurers, it is vital that PRA staff have a sufficient understanding and knowledge of both the life and general insurance market and the very different risks it faces.

We require clarity and further consultation as to how a judgement-led approach will operate in an environment where the European Supervisory Authorities will have powers to issue binding technical standards on national regulators and increasingly set the supervisory agenda.

We do not support a move to appeals from judgement led supervisory decisions being heard by the Upper Tribunal on limited grounds (those which could be raised on a judicial review) rather than the current full merits review. There is a real danger that a judgement led approach might lead to inconsistent decision making and therefore the current level of checks and balances should be maintained.

We support the implementation of a Proactive Intervention Framework (PIF), not only to establish a structured approach for regulatory action but also to address any potential conflicts between the PRA and the firms it regulates. In a judgement-led environment, where the PRA and an authorised firm disagree on the financial soundness of the firm and / or any action to be taken, the PRA may decide that their objectives are better served by allowing a firm to fail in an orderly manner, rather than to use all the prudential tools at its disposal to support the firm's efforts to regain its financial equilibrium.

Therefore, the PIF must ensure that such conflicts do not give rise to premature or inappropriate action by the PRA. We need further details on how the PIF will be applied to insurers.

Q8. What are your views on the proposed governance framework for the PRA and its relationship with the Bank of England?

We agree that making the PRA part of the BofE to bring together macro- and micro - prudential regulation, with shared staff at the top of the operation, should provide an effective link and improved harmonisation between the functions with oversight of financial stability and prudential regulation of financial services.

We also have no objections to the proposals for the PRA to be accountable to the Bank's Court of Directors although it is important that the PRA should remain operationally independent, especially as the PRA Board will be responsible for making decisions about individual firms.

However, we must again reiterate our concerns that the PRA recognises the differences in risk and regulatory requirements for insurers, in its judgements, in its rules and principles, and also within its governance framework. Therefore, one or more of the PRA Board's directors must have an appropriate level of expertise and experience of the insurance industry. It is also essential that these non-executives are involved in the decision making structure about insurers and the wider insurance industry, in line with the principles of good corporate governance, which we expect to see reflected in the forthcoming consultation on the PRA's operational procedures.

Q9. What are your views on the accountability mechanisms proposed for the PRA?

We agree with the proposed accountability mechanisms and welcome the Government's proposals for:

- requiring the PRA to report to the Treasury in the event of a significant regulatory failure;
- the PRA to be subject to audit by the National Audit Office (NAO);
- the retention of the powers in FSMA section 12 to commission independent reviews of the economy and the efficiency and effectiveness of the PRA; and
- the PRA to retain a complaints procedure.

Q10. What are your views on the Government's proposed mechanisms for the PRA's engagement with the industry and the wider public?

We note the Government's intention to give further consideration for streamlining the consultation process when implementing EU rules given that national authorities will have little discretion. We are concerned that the quality, clarity and consistency of regulation must be maintained and therefore it is vital that the UK has a clear voice in European regulation.

We agree that there must be effective engagement between the PRA, the industry and industry bodies (such as the ABI), and for public consultation. Regulation should be effective and proportionate, which can only be achieved through a robust consultation process.

We believe that the current requirements for consultation in FSMA 2000 are appropriate and must not be reduced and we welcome the Government's intention to clarify how proportionality will be applied as part of the CBA process.

We also encourage the PRA to continue the FSA's practice of consultation with industry practitioners. In recognition of the different risks and requirements of the insurance industry, we suggest that the PRA establish specific arrangements for consultation with appropriate representatives of the insurance industry.

Chapter 4. Financial Conduct Authority

Q11. What are your views on the:

(i) strategic and operational objectives and

We agree that the FCA's strategic objective should be *"to protect and enhance confidence in the UK financial system".* We are also in broad agreement with the proposed operational objectives relating to efficiency and choice, consumer protection, and protecting the integrity of the UK financial system.

However, we suggest that the objectives are made as clear and concise as possible, and laid out so that they are framed by a strategic objective underpinned by operational objectives. We also believe that the regulatory principles should be part of the objectives of the FCA rather than on a have regards to basis.

We welcome the statements confirming that the FCA will not seek to shift responsibility from the consumer to the regulator, and that different consumers require different degrees of protection. These both support the principles of proportionate regulation.

We also agree, in principle, for the FCA to play a key role in promoting competition. Historically, the financial services regulator has allowed market competition to control price, rather than intervening directly. We believe that this should continue and require clarity that, in adopting a more interventionist approach, the FCA does not intend to become a price regulator in order to promote competition

(ii) the regulatory principles proposed for the FCA?

As we stated in our response to Question 5, we agree with most aspects of the proposed regulatory principles that will be common to both the PRA and FCA. In the case of conduct regulation, the principles of efficiency and proportionality of regulation assume an even greater importance, being more transparent to consumers and having a direct impact on the costs incurred by firms in ensuring better outcomes for consumers.

As noted above, we do however have concerns as to how much standing the principles will have in practice, if they are to be considered on a have regards to basis. We suggest that the principles are set out as part of the objectives of the PRA and FCA, putting them on a much stronger footing.

Q12. What are your views on the Government's proposed arrangements for governance and accountability of the FCA?

We agree with the proposed governance and accountability arrangements, in particular the proposals for:

- the FCA Board to have a majority of non-executives;
- the FCA to be subject to audit by the NAO;
- the retention of statutory practitioner panels; and
- the FCA to maintain a complaints process.

We also support the proposals for legislation requiring the FCA to make a report to the Treasury and for the Treasury to direct the FCA to produce a report, in the event of significant regulatory failure. However, we believe it should only be triggered in the event of a wider failure, perhaps in relation to certain markets, products and / or distribution channels. The FCA will already have sufficient powers in relation to breaches and failures by individual firms.

Q13. What are your views on the proposed new FCA product intervention power?

We do not agree that it is necessary to give the FCA product intervention powers. Effective and consistent use of existing FSA powers will achieve the desired aim.

The risk of consumer detriment is not necessarily just a factor of product design. Other factors are also relevant and it is often the way in which the product is sold that creates consumer detriment, not the product itself. The FCA should use the powers the FSA already has to tackle poor sales processes, rather than simply ban a product that some consumers may wish to purchase.

Product intervention powers would require a stringent set of safeguards that protect both the interests of the firm and the consumer. In addition, we require far more clarity about the proposals to give the FCA powers over the unenforceability of contracts made in breach of its product intervention rules. We accept that any contracts sold after they have been banned should not be enforceable. However, we believe that contracts sold before any ban should not automatically be unenforceable and that any such decision must be based on all the relevant circumstances of the case (i.e. the product will not necessarily be unsuitable for all consumers and not all purchasers will necessarily suffer detriment).

Q14. The Government would welcome specific comments on:

- **the proposed approach to the FCA using transparency and disclosure as a regulatory tool;**

The proposal in its current form for the FCA to have wider powers than those available to the FSA is unwelcome. The suggestion of additional powers relating to the early public disclosure of potential enforcement action and for the suspension of financial promotions, if executed inappropriately, will result in poor outcomes for firms and unwarranted damage to their reputation. The recent press coverage surrounding FSA's investigation into a Gartmore fund manager is a good example. This has had clear repercussions for the fund management firm, albeit an unintended consequence of greater transparency. Should these proposals be implemented they must be accompanied by appropriate safeguards to ensure they take into account the interests of consumers and firms.

Please also see our response to Question 30 in relation to FOS and its ability to publish determinations.

- **the proposed new power in relation to financial promotions; and**

We are concerned with the proposal that will give the FCA powers to require a firm to withdraw a financial promotion. This is an area of regulation that past experience has demonstrated is often subjective and open to interpretation, and where the financial consequences to firms can be quite substantial.

It appears from the consultation paper that the FCA could direct a firm to withdraw a financial promotion without any prior discussion as to its accuracy and / or level of compliance. The decision could be taken without the firm being given an opportunity to address any of the FCA's concerns e.g. through the sharing of consumer research which may address some of the regulatory concerns. This exchange would only take place after the financial promotion had been withdrawn. This is inappropriate as the FCA cannot expect to be able to understand the details of each product and its promotion to make such a decision without recourse to the firm for confirmation.

Firms would not only incur costs of withdrawing the promotion (e.g. operational costs of removing promotions from websites, cancellation costs for the withdrawal of broadcast promotions and / or purchased advertising space) but may also incur financial penalties through the loss of business. In effect, the firm will suffer a financial penalty before a final decision has been reached.

Also, although we agree that it is important that firms comply with the financial promotion rules, a customer who purchases a product as a result of a misleading promotion, does not necessarily suffer any detriment, as long as the subsequent sales process provides all the necessary information to inform their purchasing decision. Therefore, the costs of immediately withdrawing a promotion are often likely to be disproportionate to the detriment caused, and must only be ordered once all relevant concerns have been addressed.

Therefore, we believe that if the FCA are given any new powers, their supporting processes must require the FCA to consult with firms before exercising their powers to direct the withdrawal of the financial promotion.

- **the proposed new power in relation to warning notices**

We do not support proposed early publication of potential enforcement action, when balanced against the possible reputational damage this could cause a firm where the action is subsequently dropped. However, if this proposal is taken forward there must be a number of safeguards implemented. The potential enforcement publication must include a statement to the effect that while a warning notice has been issued it does not necessarily mean they are guilty, and:

- that consumers have suffered or will suffer any detriment;
- that consumers will have a right to any redress from the authorised firm; or
- that the firm its employees or individuals will be subject to any enforcement action.

We also have concerns that the early publication of enforcement action will encourage Claims Management Companies (CMC's) to initiate client acquisition activities (e.g. advertising for clients of the firm(s) to come forward as they have done in relation to endowments and PPI) and to submit complaints and / or claims for compensation before any final conclusions have been reached. This may cause substantial business disruption before a firm is in a position to properly address complaints, whether valid or not. There is also a potential impact on FOS if, as seems likely, this results in an increase in referrals. This must be taken into account when the FCA uses its discretion about whether early publication is appropriate.

Q15. Which, if any, of the additional new powers in relation to general competition law outlined above would be appropriate for the FCA? Are there any other powers the Government should consider?

We agree that it is reasonable to give the FCA additional powers in relation to general competition law. However, of the two options set out in the consultation we would prefer the second, the provision of powers to the FCA's Consumer Panel to trigger the super-complaint process.

In our view, while we agree that the FCA should promote competition in achieving its operational objectives, it is not appropriate for it to become a competition regulator in its own right. This gives rise to potential conflicts of interest for the FCA in its dual role as a promoter of competition in financial services markets and as the arbiter of competition issues.

These wider powers in relation to competition law should only be given to an independent body such as the Competition Commission (or any competition regulator that results from the proposed consultation on the merger of the relevant functions of the Commission and the OFT). However, we believe that in the interests of consumer protection and to speed up the referral process, the Consumer Panel should be able to trigger the super-complaint process.

Q16. The Government would welcome specific comments on:

- **the proposals for Recognised Investment Exchanges (RIEs) and Part XIII of FSMA; and**
- **the proposals in relation to listing and primary market regulation.**

We have no comments on the above.

Chapter 5. Regulatory processes and coordination

Q17. What are your views on the mechanisms and processes proposed to support effective coordination between the PRA and FCA?

As an insurance group that includes insurers, insurance intermediaries, and unregulated holding companies we are particularly concerned about how effectively these processes will work. The proposals have not explored in detail the impact of dual regulation on firms and, in particular, we are disappointed that a shared service model has not been explored further.

There will be a significant burden for dual-regulated firms if the PRA and FCA operate independently without adequate levels of co-operation. At the very least in order to reduce the regulatory burden on firms the PRA and FCA must jointly supervise dual-regulated firms, with the PRA as lead regulator. We believe this will go a long way towards the elimination of duplication and will help the authorities to focus their resources in the most efficient and cost-effective manner.

It is imperative that industry is consulted on the content of any proposed Memorandum of Understanding (MoU) between the regulatory authorities. There is a significant risk that, without appropriate consultation, the agreements will not properly reflect many of the practical issues that both regulators and firms will face.

It is paramount that the MoU sets out how the interaction will operate in practice for dual regulated firms. This must encompass areas of the authorities that will regularly have dealings with these firms to avoid unnecessary duplication or, worse, inconsistency in their regulatory decision making processes. It must set out exactly how any disagreements in approach will be escalated and resolved. It should also list out the areas and processes for escalation and resolution of potential areas of conflict, for example for firms:

- authorisation and processes for approved persons and firms
- the supervision of firms in practice
- notifications and escalations of key issues and risks
- the sharing of appropriate information
- regulatory visits, reviews and outcomes
- decision making - part VII Transfers, change in control applications, waiver applications and so on
- enforcement activity.

We agree that the Memorandum of Understanding (MoU) between the PRA and FCA should be reviewed annually. However, in order to assess the effectiveness of these coordination mechanisms and processes, we propose that the legislation should include provisions requiring each authority to obtain and give due consideration to information from the firms they regulate. This is of particular importance in relation to dual-regulated firms who will bear the burden of any regulatory overlap and / or failure of the authorities to coordinate effectively.

Please also see our responses below regarding specific regulatory processes that affect dual-regulated firms.

Q18. What are your views on the Government's proposal that the PRA should be able to veto an FCA taking actions that would be likely to lead to the disorderly failure of a firm or wider financial stability?

We agree that the PRA should be able to veto the FCA in matters relating to the disorderly failure of a dual-regulated firm or wider financial stability.

Q19. What are your views on the proposed models for the authorisation process - which do you prefer and why?

We are disappointed that there has been no consideration given to how the PRA and FCA might adopt a shared service model and strongly recommend that the HMT re-consider its position on this. At the very least the PRA and FCA should adopt a joint supervisory approach, as this would undoubtedly reduce the regulatory burden on dual-regulated firms.

For dual-regulated firms the PRA should act as lead regulator, and the firm should need to make only one application with the regulators managing the authorisation process internally.

Q20. What are your views on the proposals on variation and removal of permissions?

We agree that the PRA and FCA should both be given powers in relation to Own Initiative Variation of Permission (OIVoP) and Voluntary Variations of Permission (VVoP), in relation to their respective responsibilities for regulated activities.

We also agree that the PRA's veto should apply in relation to dual-regulated firms.

Q21. What are your views on the Government's proposals for the approved persons regime under the new regulatory architecture?

These proposals are unlikely to work in practice. For the PRA and FCA to have separate responsibilities for controlled functions suggests that, for examples, roles such as Chief Executive Officer would be concerned about prudential or conduct activities, not both. The PRA and FCA will therefore need to work together to manage the approved persons process, with a shared gateway for firms to access the approval process.

We also require further clarity on the statement in paragraph 5.49 that *"regardless of which authority led on an application for approval, both authorities will have the power to ban an approved person working in a dual-regulated firm."* It is not clear exactly how this would apply in practice.

We have no objection to both authorities having the power to ban an approved person. However, we do not believe the PRA should be able to ban someone who has been approved by the FCA and vice versa. If this is the intention of this statement, it is not clear how either authority would have the knowledge or expertise to assess whether such a person was fit and proper to undertake their controlled function.

Therefore, we believe the PRA and FCA should only be allowed to ban a person that they have approved, and only in respect of the controlled function for which their approval was given. However, if that person undertakes a controlled function for which they were approved by the other authority, the other authority should be notified and they should make their own decision regarding that controlled function. This is essential, particularly in cases where approval is withdrawn because of their inability to perform a controlled function, rather than for any failures in their personal conduct.

Q22. What are your views on the Government's proposals on passporting?

We agree that the PRA should be responsible for all prudential matters relating to financial soundness in relation to a UK firm establishing a branch in the EEA. Also, the FCA should have responsibility for all conduct issues.

However, we require further clarity on the process to be used, for example, when a dual-regulated firm wishes to establish a branch from which it will also conduct insurance mediation. Although it will be subject to the host state regulator's conduct of business rules, the firm must also notify the regulator that it intends to undertake insurance mediation. The dual-regulated firm should only have to make one notification through the PRA which should act as lead regulator for FCA.

We have recently responded to the European Commission's paper on the review of the Insurance Mediation Directive (IMD), which proposes measures for the simplification of the freedom of services processes. We believe that allowing the PRA to notify the host state regulator in respect of both prudential and conduct matters in relation to dual-regulated firms will simplify the process, for firms, for the

authorities themselves, and for host state regulators. This would be consistent with the intent of the IMD review.

Q23. What are your views on the Government's proposals on the treatment of mutual organisations in the new regulatory architecture?

We have no comments.

Q24. What are your views on the process and powers proposed for making and waiving rules?

We agree that the PRA and the FCA should both have powers for rule-making in relation to their respective areas of responsibility, and for waiving rules that they have made. We also agree that the PRA veto should apply in matters relating to the risks of a disorderly failure of a dual-regulated firm or wider financial stability.

However, we do have some concerns with regards to rules applying to dual-regulated firms. Within the current FSA Handbook, there are a number of sections that apply to both prudential and conduct regulation. These include the Principles for Business (PRIN), Systems and Controls (SYSC), Approved Persons (APER and FIT), and Training and Competence (TC).

For dual-regulated firms to comply with both the requirements of the PRA and FCA, they require certainty of approach to the interpretation and application of principles, rules, guidance etc.

Therefore, we believe that coordination and cooperation between the PRA and FCA over rule-making is not only essential to avoid regulatory underlap and / or overlap, but also in achieving a common approach in a number of areas. For example, in matters relating to:

- the use of principles, rules and guidance;
- the use of common terminology requires the PRA and FCA to agree a common meaning;
- ensuring firms can adopt a common approach to the interpretation of rules; and
- the implementation and application of European directives.

In the case of principles, rules and guidance, without a common approach between the PRA and FCA dual-regulated firms could find themselves in a position where they are in breach of one regulator's rules by complying with the others.

Please also refer to our response to Q. 17.

Q25. The Government would welcome specific comments on:

- **proposals to support effective group supervision by the new authorities - including the new power of direction; and**

We agree that effective supervision should take account of the relationship and interaction between a firm and other members of its group. However, in recognition of the potential complexity of any group supervisory arrangements, that may also include the supervision of one or more consolidated units within the group as a whole, the PRA and FCA should continue the FSA's current practice, which is to carry out consolidated supervision with reference to the wider group only, and not within consolidated units.

- **proposals to introduce a new power of direction over unregulated parent entities in certain circumstances.**

We have no objections, in principle, to the supervisor to being given powers of direction over an unregulated parent undertaking, where that unregulated entity exerts control or influence over an authorised firm. This already exists within the current provisions for approved persons who, in practice, may be the only employees of the parent undertaking, especially if it is a holding company.

Any action taken against the parent undertaking should give due regard to the potential impact on that entity e.g. the level of influence exerted, its ability to pay any financial penalties without adverse affect on its unregulated activities and, ultimately, any of its customers etc.

The power of direction must only be used where other actions taken in relation to the authorised firm would not achieve the required outcome.

Q26. What are your views on proposals for the new authorities' powers and coordination requirements attached to change of control applications and Part VII transfers?

We agree that applications for change of control should be considered by the prudential supervisor of the firm that is being acquired. We also agree that where the firm being acquired is dual-regulated or it is part of a group in which a dual-regulated firm sits, the lead authority should consult the other authority.

We also agree that the PRA should have the primary responsibility for the Part VII transfer process and that the FCA should consider the potential impact on the customers of the firms involved in the transfer.

Q27. What are your views on the Government's proposals for the new regulatory authorities' powers and roles in insolvency proceedings?

We agree that both the PRA and FCA should be able to initiate insolvency proceedings against an authorised firm and must notify the other when it intends to do so. We also agree that the FCA should not be allowed to bring proceedings against a dual-regulated firm (that is not a bank or building society) without the PRA's consent.

Q28. What are your views on the Government's proposals for the new authorities' powers in respect of fees and levies?

We agree, in principle, that both the PRA and FCA should be able to charge fees and that this should remain subject to consultation with the industry and with each other. We also agree that the FCA should be responsible for raising the levy for the FOS and CFEB and that both authorities can raise levies in respect of the FSCS sub-schemes for which they have responsibility.

We 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 £7 million in 2010.

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. Effective co-ordination and the avoidance of unnecessary duplication of functions between the PRA and FCA would help to minimise the costs of dual regulation. This can be achieved through a joined up supervisory approach with a lead regulator.

We believe 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 spiraling costs of regulation from escalating any further. This will benefit both authorised firms and consumers, who ultimately bear the costs of regulation.

Chapter 6. Compensation, dispute resolution and financial education

Q29. What are your views on the proposed operating model, coordination arrangements and governance for the FSCS?

As an insurer and distributor of our own insurance products, and therefore a dual-regulated firm, we are concerned that both the PRA and FCA have powers to make rules on compensation and the funding of the FSCS. This could lead to differences in the way the scheme operates and duplication of any fees and levies. Therefore, it is essential that the PRA and FCA effectively co-ordinate on matters relating to dual-regulated firms and that this is given appropriate consideration in the drafting of any MoU's between the relevant parties.

The PRA and FCA should also take the opportunity to review the operation of the sub-schemes and, in particular, the cross-subsidy between sub-schemes. This is an issue that affects all firms to some degree and the separation of rule-making raises the risk that any error in funding by either the PRA or FCA could result in more frequent calls on and / or greater compensation amounts from sub-schemes.

Q30. What are your views on the proposals relating to the FOS, particularly in relation to transparency?

We agree that the FCA should assume the FSA's existing functions in relation to the FOS. We also welcome the statements confirming that it is essential that the FOS remains operationally independent from the FCA if it is to fulfil its role as an independent dispute resolution service.

However, we have concerns that its independence will be curtailed by the Government's proposals to reinforce its working relationship with the FCA, to the extent that the FOS becomes a quasi-regulator. The Government's proposals must not encourage the FOS to put greater and disproportionate emphasis on helping the FCA meet its objectives, rather than ensuring its decisions are based solely on the merits of the individual case and the evidence provided.

Additionally, while we support the use of transparency as a regulatory tool, in principle, we do not believe that FOS should be given discretion to publish its determinations without appropriate safeguards. For example, one instance of a firm's failure to treat customers fairly is not necessarily indicative of its overall approach to fairness or to the handling of complaints. The adverse impact on a firm's reputation caused by inappropriate disclosure is potentially disproportionate to any customer detriment that may have been caused. Critically, the threat of publication must also not be used to encourage a firm to take inappropriate actions in response to a FOS decision.

It is not the responsibility of the FOS to take enforcement action against individual firms. Therefore, in our view, publication of any determinations must be anonymised, they should only be allowed when they are indicative of any systemic failures, and where publication is intended to inform market participants, not to penalise the firm in question.

Q31. What are your views on the proposed arrangements for strengthened accountability for the FSCS, FOS and CFEB?

We agree with the proposed arrangements, in particular the provisions relating to audit by the NAO. We believe that the proposals should go further in relation to the FOS, which currently operates with very limited accountability mechanisms. The FCA should perform an annual review of the FOS, and seek feedback from firms and other stakeholders to ensure the FOS is effectively and consistently discharging its responsibilities.

Chapter 7. European and international issues

Q32. What are your views on the proposed arrangements for international coordination?

The establishment of the European Supervisory Authorities (ESAs) will significantly change the way in which new regulation is introduced to the UK. The ESAs 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. We need to be much more effective in this area, with proactive and early stakeholder dialogue that ensures the views of firms are taken into account. This influencing should also reflect the stated Government aims on growth and prosperity of UK Plc so that this is properly reflected in European regulation. This will require the authorities to commit more resources and to acquire new skills and expertise.

However, while the paper comments on what representation will take place and how it will be co-ordinated, it does not outline the wider approach or strategy that will be adopted, or indicate the resources that will be committed to this area nor how engagement will be co-ordinated across the two regulators. It is important that the regulators consult with firms on how they will establish, implement, and resource a strategy that will ensure the UK's interests are adequately represented and how they will ensure that the views of industry stakeholders will be obtained as part of the engagement processes.

We agree with the proposal for a statutory Memorandum of Understanding between the Treasury, Bank, PRA and FCA. However, it will be necessary for all the authorities involved to adopt a culture which emphasises the importance of co-operating at working level on international issues to ensure the best outcome for the UK.

HMT Consultation (Cm8012):
"A New Approach to Financial Regulation: Building a Stronger System"

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 response to the Government's initial consultation, these reforms are wide-ranging and important, and have the potential to make a significant impact on the future of the UK's financial services sector. It is crucial that these reforms are carefully thought through and implemented.

RBS fully recognises the direction set by the Government in its consultation and supports the need for change, both in the banking sector and its regulation. This response starts from a position that is broadly supportive of efforts to strengthen the UK's regulatory framework. 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 support efforts to strengthen the UK's regulatory framework and believe the proposals potentially offer a number of advantages – notably, more focused regulatory bodies, a better balance between conduct and prudential regulation, and a more holistic framework that aims to address wider financial stability and macro-prudential issues.

- We welcome some of the changes made to the proposals following the previous consultation – including, for instance, with respect to the PRA being obliged to have regard to certain regulatory principles and to consult on its rules.

- However, whilst generally supportive of the current proposals, we continue to have some specific reservations and believe the framework can be further enhanced. There are also instances where we consider the proposals are either unclear or do not go into sufficient detail.

- We welcome the recognition in the paper of the potential trade-offs between financial stability and growth, and the proposal that the FPC 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. But this restraint remains subjective and therefore weak: we would wish to see this strengthened through a more objective or independent restraint.

- We continue to have concerns that competitiveness is not recognised as an objective in any of the objectives of the new bodies: we think this important, both as providing support to the proportionality principle, as well as helping address the huge growth and competitiveness challenges faced by the UK economy as a whole.

- In addition, we continue to recommend (as we did in response to the July 2010 consultation) that a shared services model be implemented by the new regulatory bodies in order to save costs. The benefits of doing so are, in our opinion, reinforced by the fact that during the transition period the FSA will be split into a Prudential Unit and a Conduct Business Unit but, as stated in the FSA Business Plan 2011/12, will still run central support functions "in an integrated way to ensure maximum efficiency and effectiveness".

- Given the Government's stated policy as regards "Sunset clauses", we presume that such a clause will be incorporated in any proposed legislation. That will necessitate a review, at an appropriate time in the future, to ensure that any legislation enacted as a result of this consultation that is deemed not to be working is reviewed. Additionally, we would suggest that in certain instances for some regulations (in particular those with excessive implementation costs) the requirement for a regular review with a full cost/benefit analysis is included. This would ensure that any regulations that do not deliver benefits are identified sooner so that they can be improved or removed and reflects, to an extent, the current practice in the EU and emerging practices for better regulation worldwide.

Bank of England and Financial Policy Committee (FPC)

A. Key Comments

- We stress the importance of proportionality in the use of the FPC's toolset.

- The FPC should retain the flexibility to develop new macro-prudential tools to tackle new issues as they emerge.

- Consideration should be given to additional accountability mechanisms for the FPC.

B. Responses to Specific Consultation Questions

Question 1: What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools?

We note that the latest consultation proposals somewhat narrow the objective of macro-prudential policy to allow for measures aimed at dampening the credit cycle or asset bubbles, only to the extent that they have a bearing on financial resilience and not as an objective in its own right – we support this change.

In this context, we think that the toolset outlined below is broadly appropriate and retains enough flexibility for the FPC to address a range of risks. We would stress, however, the importance of proportionality, given that many of the tools overlap or potentially duplicate each other in their effect.

The range of risks that the FPC might try to address means that it is difficult to reach firm conclusions on the effectiveness of the tools. Specific comments are outlined below.

We continue to have significant doubts over the practical implementation of a **counter-cyclical buffer**, as agreed at the Basel Committee, believing that a Pillar 2 approach or the use of variable risk weights provide an operationally simpler method of introducing a counter-cyclical bias into regulatory capital requirements. We also believe the effectiveness of such a buffer is easily over-stated. Whilst the intention is that the buffer will be lowered during recessions to help maintain lending, this is likely to be trumped by an increase in investors' risk aversion during such times. Consequently, the overwhelming pressure on banks during downturns will still be to protect capital. Lowering the counter cyclical capital buffer will therefore have little effect during recessions. Also, there will clearly be risks of "leakage" in terms of credit supply from non-regulated shadow banks and international banks not subject to the same requirements. International coordination will be critical.

Liquidity has been a threat to financial resilience in the past so it is appropriate that the FPC should have the relevant tools at its disposal.

Variable risk weights and **collateral requirements** offer the FPC its best chance of addressing the build up of systemic risk in specific markets. However, we would urge the FPC to consider the potential for unintended consequences from using these tools. Specifically, the FPC will need to be careful that changes to RWAs, haircuts, margins and other such changes do not lead to market distortions, arbitrage opportunities and distortions in the level playing field across different jurisdictions. For example, if the haircuts on collateral for repo transactions are higher in the UK than, say, the US this may result in such business moving to the US. More generally, large changes in these levers could push risks outside the regulated perimeter, rather than reduce them. We believe that affordability is the most meaningful indicator of a consumer's ability to repay and therefore do not wish to see the imposition of Loan to Value, Loan to Income or Debt to Income thresholds. Such limits would also negatively impact private banking transactions, with no macro-prudential benefit.

Information disclosure and transparency is an important component of helping the market exert commercial discipline on the financial system. It is appropriate that the FPC should be allowed to facilitate this.

Stress tests are a vital part of understanding banks' vulnerabilities. However, we would urge the FPC to differentiate its tests from those already conducted by the FSA and other authorities. We suggest that there might be more merit in considering stresses that focus on disruptions to banks' funding markets and other market-based events, rather than repeating the economic-led stresses.

Leverage limits based on unadjusted assets were conceived as backstop measures in the Basel III regulations in case the risk adjusted measures failed. We would encourage the FPC to regard them in a similar manner. The implications of banks, collectively or individually, hitting a binding leverage target are difficult to predict but may involve deleveraging at a speed, or through a method, that is undesirable. As the industry has argued previously, the value of a leverage ratio is not its absolute amount – which by itself and by its very nature says very little about risks across a system – but rather its trend. Therefore, we do not expect leverage limits to be a particularly effective tool of macro-prudential policy.

Question 2: Are there any other potential macro-prudential tools which you believe the interim FPC and the Government should consider?

It is not possible to foresee every risk to financial resilience that the FPC will need to address. Therefore, it is important that the FPC retains sufficient flexibility to be able to develop new tools to tackle new risks as they emerge.

This consultation concentrates on tools specifically aimed at banks and has a strong emphasis on quantitative capital and liquidity requirements. To be fully effective, it will be essential that the new framework considers risks to stability that may arise from other sectors and financial sector players (e.g. CCPs) and these in turn may require other tools. Even within banking, non-quantitative tools – such as horizontal supervisory reviews – should be recognised as potentially better suited means of addressing certain concerns.

It will also be essential that the framework recognises, and has an ability to respond to, risks to stability arising from outside the financial sector, if only through FPC reporting and speeches. Poor monetary, fiscal or structural policies are all relevant factors as well. It has been argued, for instance, that the long-standing encouragement of home ownership in a relatively short time scale, drives credit appetite, puts pressure on house prices (in a world of inadequate supply) and feeds expectations that repayments can be made from asset price inflation.

Question 3: Do you have any general comments on the proposed role, governance and accountability mechanisms of the FPC?

As noted above, we support the narrowing of the objective of macro-prudential policy to allow for measures aimed at dampening the credit cycle or asset bubbles only to the extent that they have a bearing on financial resilience (and not as an objective in its own right).

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. This restraint remains subjective and therefore weak, however: we would wish to see this strengthened through a more objective or independent restraint.

As articulated in our previous response, there is the potential for conflict between macro-prudential, monetary and fiscal policies: it remains unclear to us how these might be resolved in a balanced way, beyond the informal mechanism of cross membership between the FPC and the MPC.

The proposals note that the FPC will be committed to making a policy statement on how it intends to use each macro-prudential tool at its disposal, or undertaking a consultation. In order to ensure that the industry has an opportunity to offer its views, we would encourage the FPC to publish its emerging thinking on the use of a particular tool for the industry to comment upon. Furthermore, given the potential impacts such tools might have, we would urge consideration of additional accountability mechanisms, for instance to Parliament.

The FPC will need to have regard to proportionality, openness and international law. All three seem appropriate. The Treasury's power to guide the FPC, in the form of a remit, is appropriately safeguarded by the requirement for such documents to be published, subject to a public interest test.

Question 4: Do you have any comments on the proposals for the regulation of systemically important infrastructure?

We agree that it is appropriate for the Bank of England to regulate all systemically important infrastructure.

Prudential Regulation Authority (PRA)

A. Key Comments

- We continue to stress the importance of competitiveness being taken into consideration as an objective of the PRA, as we do not consider the proposed position of the PRA in this respect to be strong enough.

- We have a number of concerns with respect to judgement-led supervision proposals, particularly with respect to enforcement.

- There is a need for operational independence of the PRA and a majority of "independent" NEDs on its Board.

B. Responses to Specific Consultation Questions

Question 5: What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the PRA?

We are supportive of the starting point for the objectives and regulatory principals being the FSMA. We are also encouraged by the strategic objective of financial stability, are supportive of the principle of proportionality in regard to regulatory burden and also the awareness that consumers should take responsibility for the decisions that they make.

With regard to competition, we would strongly support an explicit statement on this as opposed to the current indirect reliance on stability and proportionality. We believe it important that all the new regulatory bodies (and not just the PRA) have competitiveness factored into their objectives, both as a means of supporting the proportionality principle, as well as helping address the UK's major growth and competitiveness challenges. We note, in passing, that the Bank of England's current published Core Purposes include the statement - "The Bank will also play its part in promoting an open and internationally competitive financial centre in the United Kingdom".

Question 6: What are your views on the scope proposed for the PRA, including Lloyd's, and the allocation mechanism and procedural safeguards for firms conducting the "dealing in investments as principal" regulated activity?

With regard to the scope of the PRA, we do not believe that it has been made clear why the PRA will only regulate systemically significant investment firms. We believe this scope adds complexity as opposed to providing simplification i.e. the result is that the FCA will have both prudential and conduct responsibilities.

It would be interesting to know how many firms (banks, insurance companies and others) the PRA/FCA expect to regulate under this split.

We had assumed that all firms within the RBS Group would be PRA regulated by default. However, paragraphs 3.23 – 3.25 suggest that certain investment firms can be designated by the PRA for prudential regulation by the PRA where they pose significant risks to one or more PRA-regulated entities within their group. This additional step of designation creates a further level of complexity in terms of understanding what entity is regulated by which body.

Question 7: What are your views on the mechanisms proposed to make the regulator judgement-led, particularly regarding: rule-making; authorisation; approved persons; and enforcement (including hearing appeals against some decisions on a more limited grounds for appeal)?

The RBS Group has experience of the new judgement-led approach of the FSA. It is essential that all judgement-led supervision is suitably supported by objective evidence. This evidence will need to take account of peer group analysis/comparison; the skill set of the supervisor will also be paramount. It is accepted that this will be an ongoing process which will need to be reviewed as more outcomes are received/published.

With regard to enforcement, we have concerns that appeals on judgement-based regulatory decisions will be heard on limited grounds rather than on a full merit basis. The subjection of investigation work to, firstly, a panel of impartial industry experts (in the RDC) is of paramount importance to give the Enforcement process credibility and ensure subjects of investigation are confident that investigators are

always challenging themselves as to the veracity of the evidence upon which they are making assessments and that a fair and considered outcome will be achieved. Secondly, the ability to then challenge the FSA's findings at the Tribunal is also an integral part of the system which allows regulated persons to test interpretations placed on rules and evidence, on which views can reasonably differ. Were a judgement-led approach applied and the only right of appeal in some circumstances to be akin to a very limited Judicial Review type test, the position adopted by regulated persons might become more adversarial and defensive, simply due to the perceived inequalities in the process.

We would also advise that, in order to understand the stages within the Proactive Intervention Framework, it will be critical to ensure transparency, particularly on the entry and exit criteria. We will also look for more detail around the particular stages within the framework.

When considering the "whole firm" (paragraph 3.32 dot 2) we assume that this means wherever in the world the firm operates.

Question 8: What are your views on the proposed governance framework for the PRA and its relationship with the Bank of England?

We understand that the composition of the PRA Board will consist of the Governor of the Bank of England, the Deputy Governor for Financial Stability, the Deputy Governor for Prudential Regulation (the CEO of the PRA) and the CEO of the FCA.

While it can be argued that the Governor of the Bank of England, the Deputy Governor for Financial Stability and the CEO of the FCA are NEDs, the level of their true independence is less clear cut given the Bank of England's proposed status over the PRA and the FCA. Rather, we would favour a majority of independent, non-conflicted NEDs on the PRA Board to ensure that the PRA is able to make "without prejudice" decisions.

The lack of "true" operational independence on the part of the PRA is further highlighted by the Court of the BoE having approval rights over the budget and remuneration of the PRA.

Question 9: What are your views on the accountability mechanisms proposed for the PRA?

We generally welcome the accountability mechanisms which have been proposed for the PRA.

We note that HMT will have the power to direct the PRA to produce a report when it is in the public interest and that the report will be laid before Parliament (paragraph 3.59). We believe that in deciding whether a report is in the public interest, HMT should be required to take into account the potential impact on the PRA's strategic objective regarding the promotion of financial stability. We also have concerns over the definition of "public interest" with regard to disclosure of confidential information. We would suggest that this includes a caveat that the firm's position is taken into account when determining whether it is appropriate to disclose confidential information about the firm.

We welcome the confirmation that the PRA will be audited by the National Audit Office.

We would hope 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 CEO will be subject to regular testimony sessions with the TSC.

Question 10: What are your views on the Government's proposed mechanisms for the PRA's engagement with industry and the wider public?

We support the retention of the consultation processes outlined but seek confirmation of how this would be effected in practice, particularly given that the PRA will not be replicating the practitioner panel, and

that it is proposed also to introduce a new exception to the obligation to consult on rules, in cases where to do so would be prejudicial to the PRA's objectives. We would not want this exception to be used as a vehicle for any significant watering down of current levels of consultation and would welcome further details on this matter.

Financial Conduct Authority (FCA)

A. Key Comments

- We continue to stress the importance of competitiveness being taken into consideration as an objective of the FCA, as we do not consider the proposed position of the FCA in this respect to be strong enough.

- Further clarification of the operational objectives of the FCA should be provided.

- We would urge the FCA to consider the need for more constructive engagement with industry on an ongoing basis as regards product regulation and design e.g. prior to the launch of any new products or change in product structure.

- We have concerns about the proposed use of regulatory disclosure and, in particular, publication of warning notices, given the reputational damage they could inflict.

B. Responses to Specific Consultation Questions

Question 11: What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?

(i) Strategic and operational objectives

We broadly agree with the strategic objective but have some comments on the operational objectives – set out below. We also feel that there is a need to further define them and to consider how they will actually work in practice, particularly where there is the scope for conflict between them. The Government needs to demonstrate that these objectives support a fair and impartial conduct of business regulator.

Our specific comments on the operational objectives are as follows:

- We are not convinced that "efficiency in terms of pricing and delivery" is legitimately entirely within the scope of the regulator – what does the Government envisage this covering? Firms must surely retain responsibility for their own efficiency. The reference to "pricing" also suggests that the FCA will step into price regulation, which is not something that we support or consider necessary. Also, how does this overlap with the regulatory principle on efficiency, which seems more appropriate?
- In the examples of the objective on market integrity (paragraph 4.19), the reference to pricing ("the reliability of the price formation process") is concerning and may be interpreted by the FCA as giving it a free reign to engage in price regulation, something which would conflict with competition and customer choice.
- How these objectives will be applied to wholesale as opposed to retail markets also raises questions. The consultation paper (on page 62) recognises that some may be more or less relevant, noting that for wholesale markets, "promoting better outcomes by facilitating a level playing field" may be preferable to the regulator focusing on proactive intervention and protection, in achieving efficiency and choice. Again this is unclear.

(ii) The regulatory principles

We broadly agree with the regulatory principles but again more clarity is needed on how they will be used and how they will interact with the objectives.

We do not think it is enough for the FCA to be required to "have regard to" proportionality – the FCA needs to **ensure** that everything it does is proportionate. As the consultation paper says (paragraph 4.09) proportionality will be crucial. Proportionality is key to consumer confidence and disproportionate actions can impact on consumers just as much as firms.

We welcome the explicit recognition of consumer responsibility, which seems to be in line with the direction that the European Commission is taking with the newly published proposal for a Directive on credit agreements relating to residential property. For example, Article 15 of that proposed Directive introduces a disclosure obligation on the part of the consumer.

Clearly, more work is needed to put this principle into practice and RBS would be happy to be involved in discussions about this, as we recognise that there may be actions that firms need to take to empower consumers. One thing which will need careful consideration is the significant scope for conflict between consumer responsibility and product intervention, as the latter tends to use a "lowest common denominator" approach. If product intervention tools are used badly they could well undermine consumer responsibility and consumer confidence. See further our response to Question 13 below.

We welcome the recognition that consumer education is an important activity and we encourage any mechanisms which make consumers better able to make informed decisions. A key element of this will be consistency in financial education materials.

Competition

We welcome the fact that the paper recognises the need to balance competition with the primary objective of the FCA. However, promoting competition is not the same as competitiveness – the regulator needs to avoid imposing solutions on UK firms which would damage the competitiveness of the UK market as compared with the financial services markets in other countries. Greater clarity is needed in respect of the FCA mandate to deliver its objectives with a view towards increasing competition. Reference is made to the PRA having a role on key regulatory areas impacting on competition, although the line of demarcation between matters impacting the PRA and FCA is not clear.

To help embed the principles and provide appropriate transparency, we propose a statutory duty for the FCA to address each objective, principle and competition impacts in each of its policy documents, such as discussion papers and consultation papers. This should also be done in the FCA's annual Business Plan and any other annual planning documents.

Question 12: What are your views on the Government's proposed arrangements for governance and accountability of the FCA?

We welcome the Government's plans to have a majority of NEDs on the FCA Board.

Panels

We welcome the Government's plans to retain the FSA panels under the FCA but, as mentioned in our response to the previous consultation, we feel that this is an ideal opportunity to improve their function and make them more efficient. Our comments in that response about how this might be done were as follows:

"We feel that the Practitioners' Panel could be improved by giving key industry bodies (such as the BBA) membership of the Panel, generally widening membership and changing its name to "Industry Panel" or "Industry Experts' Panel". We believe that a wider membership of the Panel, subject to checks and balances to ensure impartiality is maintained, would be beneficial to the regulation of the financial services industry as a whole as the range of knowledge and experience available would be significantly enhanced. Underneath the main Panel, lower level committees could also be established to provide the required expertise at a less senior, but more detailed, level on relevant issues (as the main Panel has a very senior membership) – this is how the new Financial Ombudsman Service industry liaison has been structured. Perhaps there could be a committee for each product type or for themed issues such as debt matters. The Panel could be restructured in these and other ways to allow it to become a much more effective forum for constructive consultation with the industry at an early stage in policy development and a more effective route for the CPMA to gain industry expertise when it needs it.

Currently, the Consumer Panel consists of 11 members, some of whom have previously worked for consumer organisations. To ensure that the Panel is fully representative of consumers we would suggest that, going forward, the Consumer Panel would benefit from having current representatives from consumer groups such as Which? and the Citizens Advice Bureau. It also needs to have sufficient resource to conduct surveys of consumers so as to inform the Panel's views.

At present, the Panels meet separately and give advice from their different perspectives to the FSA. We believe that there is scope for the Panels to work more closely together to understand each other's position with the aim of reaching consensus. It would be beneficial, therefore, if the Panels met together regularly.

Transparency of the work of the Panels could be improved through enhanced information sharing and having them serve both the PRA and CPMA. This would help bind the two regulators closer together and increase the prospects of a more consistent approach, as well as strengthen the PRA's accountability."

Reports to Treasury

We feel that the proposals to require a report to the Treasury will improve accountability, however, we are concerned about the fact that these reports – which will be laid before Parliament – may contain confidential information. It is important that proper safeguards are built in around this, given the impact that this could have on individual firms, their reputations, their share prices and indeed the market as a whole. What safeguards will exist and will firms referred to in the report be given any prior notice?

It is also not clear what action may occur following the production of a report, although presumably a change to the legislation is one possible outcome.

Question 13: What are your views on the proposed new FCA product intervention power?

In the past, RBS agrees that there have been examples where firms' product governance processes have not been sufficient to prevent significant consumer detriment arising and the FSA did not intervene at any early enough stage to prevent consumer detriment. This has inevitably damaged consumer confidence in the industry and its regulator.

We also agree that, in the future, issues identified by a regulator at **any** stage in the product lifecycle should be addressed by firms in an appropriate manner and if firms do not do this then the regulator should take appropriate action in a timely way.

As highlighted within the FSA's current discussion paper on product intervention, the FSA has already adopted a new approach to consumer protection which will aim to identify problems earlier, scrutinising the whole product lifecycle from start to finish, rather than just focusing on the point-of-sale. RBS supports this approach and believes it will help to identify and address any issues which could potentially lead to consumer detriment more effectively.

We believe that good product governance, together with appropriate, well informed challenge from the regulator at an early stage, could prevent the vast majority of consumer detriment in the future. It is, however, important that the new approach is not taken too far as this would constrain product innovation which benefits consumers, competition and consumer choice. As the FSA says in its consultation paper, this will not, and should not, create a 'zero failure' regime.

To minimise the occasions when the FCA might have to invoke such powers, we believe there is an opportunity for more pro-active discussions with industry prior to product launches and changes in products' structures. Whilst we would not consider, nor expect, any such discussions to amount to a product "sign off", this would enable the identification and resolution of any issues and allow for constructive debate and challenge. This would enable the FCA to not only keep abreast of innovative changes in the industry but also allow both parties to have parity of understanding on regulatory expectations and the parameters of product regulations.

We therefore believe that specific product intervention regulatory tools, in particular product banning powers, should only be used as a **last resort** following reasoned and balanced investigation. They should never be used as a knee jerk reaction to media commentary. In situations where all other options have been exhausted and the relevant firms have had a reasonable opportunity to address the regulator's concerns, RBS believes the use of these powers is justified in order to prevent large scale consumer detriment.

Whilst RBS is supportive of the use of such tools in these extreme situations, we do believe that a number of considerations must be addressed when formalising these future powers:

1. Clearly defined powers
The introduction of new product intervention tools for use by the FCA will significantly increase the powers at the regulator's disposal. As these powers would represent a significant shift in the way the FCA regulates financial services, they should be clearly defined in the primary legislation.

The legislation should put a high enough test on the powers to ensure that they are available as a last resort only, for example through putting a requirement into the legislation that the FSA/FCA should have exhausted all reasonable other avenues, including appropriate discussions and consultation with firms, before using its product banning power. A product banning power should also only be able to be used if no other tools would achieve the goal of reducing consumer detriment. Other tools would include the less drastic measures described in the FSA consultation paper, for example an FSA communication to customers that says that x type of product is generally unsuitable for y type of customers.

A further condition on a product banning power should be that the product itself is so fundamentally flawed that it causes consumer detriment. For this power to be used proportionately, the issue with the product needs to be a genuinely industry wide one.

2. Consideration of impacts
The legislation should state that the FSA/FCA cannot use the power unless a proper impact assessment has been done and using the power will not result in adverse consumer impacts. For example, an adverse impact might occur where no alternative products would be available, leaving consumers with an unfulfilled financial need or unprotected from the relevant risks. The impact assessment would also need to consider the impacts on competition in the market and on consumer and investor confidence.

Due to the significant impact of any product intervention on firms (which could even be as severe as putting smaller firms out of business in some cases), these powers should only be used in response to clear evidence of actual consumer detriment or clear, reliable and balanced evidence which shows that consumer detriment will occur in the future. This evidence, and the analysis behind it, needs to be made public by the regulator before it uses its power.

3. Guidance on when and how the powers will be used
We understand that the Government plans to bring product banning/intervention powers into force before guidance on how they will be used is issued. Without this detail the impact is difficult to calculate, so we would urge the Government to bring the Guidance forward so that the scale of the impact of the power on firms can be properly assessed and understood when looking at the proposed legislation.

4. Practical Issues
While we accept the Government's plan to provide the FSA (FCA) with the power to ban products, we do not believe there has yet been appropriate consideration of how a product ban could be used in practice. Numerous uncertainties exist, for example:

- How will the regulator categorise the banned products without unintentionally including products which are not inherently flawed?
- What happens to the product during the twelve month period for which it is banned?
- What happens to the customers who may have already purchased a product before it is banned?
- What happens at the end of the twelve month period?
- Will there be an opportunity for the industry to address the issues that have lead to the banning of the product?
- How will a ban be communicated to customers and how can this ensure that it is clear precisely what is – and what is not – being banned?

We presume that a ban would only apply to new product sales and would not impact on existing products but this must be made clear within the legislation itself and in public communications by the regulator when it is using the power. Otherwise, consumer confusion could easily arise.

RBS would be happy to engage with the Government further on product intervention and will share its forthcoming response to the FSA's product intervention paper with HMT.

Question 14: The Government would welcome specific comments on:

- ***the proposed approach to the FCA using transparency and disclosure as a regulatory tool;***
- ***the proposed new power in relation to financial promotions; and***
- ***the proposed new power in relation to warning notices.***

Transparency and disclosure as a regulatory tool

Whilst we appreciate that regulatory disclosure could improve consumer confidence in the regulation of financial services, confidence in a firm and the firm's reputation can evaporate very quickly, even if a notice of discontinuance is issued later. We believe that the media is far more likely to highlight the first notice than the notice of discontinuance. This seems to go beyond creditable deterrence.

Financial promotions

RBS is concerned about the effectiveness of the appeals process to the Tribunal and in particular the time that an appeal could take and it therefore strongly urges the Government to introduce a fast track appeals process which is appropriate to financial promotions appeals. An effective appeals process is very important for two reasons. Firstly, by its nature, a financial promotion may become outdated very quickly and secondly, compliance with financial promotions rules can be extremely subjective. For example, there is significant subjectivity on the interpretation of the "prominence" of certain information and, more generally, principles-based rules such as the requirement for a promotion to be "clear, fair and not misleading". More guidance about the use of the proposed FCA power to withdraw or amend a financial promotion and clearer guidance from the FCA about the financial promotions rules and how to apply them will also be crucial if the use of this power is to be proportionate. It would not be proportionate to use the power for minor rule breaches with little or no scope to cause consumer detriment. The scope for voluntary action by the firm should also be considered as this can often be the best solution. If an appeal is successful, then the FCA will need to publish this fact so it is clear that it "got it wrong" – otherwise the firm may suffer unjustified reputational damage.

There will also need to be greater clarity on the interaction between the FCA and the ASA so that firms do not find themselves subject to both an FCA direction to withdraw or amend a promotion and an ASA case at the same time, with the possibility of duplicating or conflicting judgements.

Finally, the quality and level of experience of staff who are working on financial promotions in the FCA will be crucial if the FCA is to use this power effectively and proportionately. Consumer confidence in the market will only be rebuilt if the FCA does a good job, albeit if the FCA does make mistakes then the important thing is that it is open about these and fixes things in an appropriate way - and is held to public account if it does not.

Warning notices

Please see our comments under "transparency and disclosure as a regulatory tool" above about the dangers of this proposal.

To avoid unjustified reputational damage, the FCA would need to be very careful about the wording of any warning notices it publishes, including making it very clear that its investigations are at a very early stage and that they are investigations *only* into *possible* non-compliance.

The FCA will need to be aware that the publication of warning notices could also generate an increase in consumer claims/complaints to the firm and/or the FOS. The volume of claims/complaints could spiral out of control, particularly if picked up by consumer activist groups or claims management companies.

We are concerned that even very careful wording would not prevent this and believe that it is likely to increase consumer confusion and dissatisfaction (e.g. if claims are put on hold or later declined if the FCA finds that there was no compliance failure).

The FCA will need to be alert to the risk that the publication of a warning notice could have wider implications for the industry and could ultimately undermine consumer confidence. It is also important that regulators and firms are able to work together to achieve positive consumer outcomes outside of the formal warning notice and enforcement procedure where appropriate. How does the Government propose to address this concern?

A further point is that the FSA has only recently been granted new powers – by the Financial Services and Markets Act 2010 – to publish decision notices when it brings enforcement actions. There has been little time for this power to bed in.

Question 15: Which, if any, of the additional new powers in relation to general competition law outlined above would be appropriate for the FCA? Are there any other powers the Government should consider?

At this time we are not convinced about giving additional new powers to the FCA, especially at a time when the Government is looking to concentrate competition powers in one Competition and Markets Authority (CMA). There is scope for much overlap and inconsistency.

The Government argues that having a single CMA will assist in ensuring the flexible allocation of scarce public resource to competition issues. It seems more efficient for competition to be dealt with by one body, i.e. the CMA. The benefits of this would include economies of scale and lack of confusion and overlap. If the Government's view is that the competition authorities have been too slow to resolve issues – the example given in the consultation paper being Payment Protection Insurance – then surely this could be fixed by making the CMA more effective and efficient, rather than creating another body with competing powers which may just add to the confusion.

If the FCA was to have competition powers then it would be very important for the FCA and CMA to use the same criteria and approach when using the powers to provide for consistency.

We note that the work of the Independent Commission on Banking (ICB) will also be relevant to competition in the UK financial services market and the future landscape of that market.

In any event, we feel that it is best for this issue to be considered as part of the consultation on the CMA, rather than as part of this consultation.

Question 16: The Government would welcome specific comments on:

- ***the proposals for RIEs and Part XVIII of FSMA; and***
- ***the proposals in relation to listing and primary market regulation.***

We do not agree that the FCA should be solely responsible for the prudential regulation of RIEs although do support the 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 the 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.

Regulatory Processes and Co-ordination

A. Key Comments

- We have concerns around the proposals on variation and removal of permission.
- There is a need for clarity around the proposals relating to the Approved Persons regime.
- The PRA should have a duty to explain its reasons in the event that it vetoes FCA rules.

B. Responses to Specific Consultation Questions

Question 17: What are your views on the mechanisms and processes proposed to support effective co-ordination between the PRA and the FCA?

A major concern with the proposed new framework is the need to avoid duplicate or uncoordinated requests from the PRA and the FCA which could lead to unnecessary additional regulatory burden on firms.

We therefore broadly agree with the PRA and the FCA's duty to co-ordinate, their obligation to produce a MoU and the cross-membership of Boards. However, we question whether there is a need to go further and include the BoE (FPC) within these duties of co-ordination given its pivotal role in the new framework e.g. with respect to the MoU.

Question 18: What are your views on the Government's proposal that the PRA should be able to veto the FCA taking actions that would be likely to lead to the disorderly failure of a firm or wider financial instability?

We agree that one authority should have the ultimate responsibility with regard to ensuring that a firm does not fail in a disorderly manner and that the threat to the stability of the financial system is minimised.

We would also suggest that further detail is provided on the limited circumstances when this power of veto can be applied by the PRA, and seek confirmation that the power of veto (together with any appeal mechanism open to the FCA or the firm) is clearly set out in the MoU between the two authorities. These further details should include definitions of "disorderly failure" and "wider financial stability". We believe that the veto process needs to take into account the need to act promptly in such circumstances to prevent the spread of instability.

Question 19: What are your views on the proposed models for the authorisation process – which do you prefer, and why?

We hold a preference for the "alternative approach" whereby one authority is charged with processing each application, seeking the consent of the other authority on the areas where they have expertise prior to granting permission. This approach ensures that the additional burden of the dual regulatory system falls on the regulators rather that the firm in terms of the application process.

Question 20: What are your views on the proposals on variation and removal of permissions?

Paragraph 5.41 refers to permission being withdrawn because a firm has "failed to carry out the regulated activity over the preceding 12 months". We believe that there are circumstances where a firm may want to retain 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 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 written warning of its intention to withdraw permissions and the firm's right to appeal.

Question 21: What are your views on the Government's proposals for the approved persons regime under the new regulatory architecture?

With regard to the Government's proposals for the Approved Persons regime, it is difficult to comment on changes to a regulatory process when details of the new process(es) have not been provided. The consultation does not go into any detail about the actual registration process. It also doesn't give any consideration to those elements that contribute to the process, such as pre-registration requirements (e.g. initial assessment of competency, assessment of fitness and propriety, etc.) and post-registration matters (e.g. ongoing training and competence requirements, etc.). Will the Government be consulting the industry on proposed changes to these processes?

The consultation also does not provide details of which regulator will be responsible for processing applications for dual-regulated firms. We would be concerned if dual-regulated firms were expected to submit two separate application forms to the regulators.

As there are two regulators, the most logical suggestion for dealing with applications would be for the regulators to have a "shared back office" to which firms would submit one registration form per person. The regulators could then agree between themselves, depending on the scope of the application form, and respond to the firm accordingly. This would alleviate duplication of application, effort and processing by both the regulators and the firms. Whilst it appears this suggestion has already been dismissed, we believe that it should be reconsidered.

We would welcome more information on how the PRA and the FCA propose to handle NED applications and whether NEDs will be required to identify specific prudential or conduct experience/expertise and responsibilities.

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The proposals indicate that both the PRA and the FCA will be considering approved person applications separately by reference to the different skills, experience etc required for the role. It appears that it will be necessary for both regulators to provide approval before an applicant can take up different controlled functions. For example, under these proposals it would appear that it is possible that the FCA may consider that an applicant is fit to carry out a significant management function role (e.g. Sales & Marketing Director) but the PRA rejects the same individual's application to be CEO. We believe that in these circumstances the individual's FCA application should be approved unless it's a matter of the individual's honesty and integrity. This highlights the contradiction within the consultation on how the authorisation process will be managed by the regulators and needs to be addressed in order for us to understand how the process will work and be in a position to provide useful feedback.

We recommend that the regulators use a single application form for all approved persons (i.e. whether they are to be regulated by the PRA/the FCA or both).

Question 22: What are your views on the Government's proposals on passporting?

Paragraph 5.52 refers to the FCA receiving all notifications from overseas regulatory authorities but further clarity should be provided as to which regulator (the PRA or the FCA) a dual-regulated UK-authorised firm should notify when it wishes to establish an overseas branch in an EEA state.

It would also be helpful to understand the process for when a firm wishes to establish an overseas branch outside the EEA.

Question 23: What are your views on the Government's proposals on the treatment of mutual organisations in the new regulatory architecture?

We agree that neither the PRA nor the FCA should seek to promote or favour one type of ownership model over another, and that consumers should not be advantaged or disadvantaged because of the ownership model of their provider. Therefore, we fully support the statement in paragraph 5.54 of the consultation paper that the same consumer protection, conduct and prudential standards must be applied to every regulated firm, regardless of their ownership model. A level playing field is essential and it is absolutely right that the regulators should remain impartial. The need for a level playing field is why, for example, in our response to the FSA Discussion Paper on the Mortgage Market Review (DP09/3) we said that more direct intervention through increased prudential requirements for non-deposit taking lenders was required so that there was some consistency in the increased capital and liquidity standards. This was important due to the impact of these lenders on financial stability. The quick entry and exit of non-deposit taking mortgage lenders has had a dramatic effect on the availability of mortgages and created significant instability in the sector which must be addressed. This has left a number of consumers in a vulnerable position should they require to move from their current provider. Due to the terms of the mortgage they have obtained, such consumers may find they are unable to obtain funding from a mainstream supplier on similar conditions.

We have no objections to the proposals regarding cost-benefit analysis covering the impact on mutually-owned institutions.

In respect to how the registrar-type functions of the FSA should be mapped into the new regime, creating a new body purely for this purpose may not be consistent with the Government move towards rationalising the number of bodies involved in regulation. Likewise, inconsistencies could emerge – which are not conducive to a level playing field – if mutual organisations are not also prudentially regulated by the PRA when banks are.

Question 24: What are your views on the process and powers proposed for making and waiving rules?

The proposals, as now put forward, ultimately give the PRA the right of veto where there is disagreement between the PRA and the FCA on rules and waivers relating to dual-regulated firms. Whilst a mechanism is proposed whereby the FPC may be consulted where the disagreement relates to an assessment of the rule's impact on financial stability, the FPC recommendation will only be made on a "comply or explain" basis. The PRA will still have the right of veto if it considers that the proposed FCA rule would risk the disorderly failure of a dual-regulated firm or affect financial stability more widely. This effectively makes the FCA the junior of the two bodies.

Whilst it is stated that the PRA's use of its veto will be subject to transparent safeguards, there needs to be an explanation of what those safeguards will be and we would expect it to be explicit that the PRA explains the reasoning behind its veto.

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

Question 25: The Government would welcome specific comments on:

- ***proposals to support effective group supervision by the new authorities – including the new power of direction; and***
- ***proposals to introduce a new power of direction over unregulated parent entities in certain circumstances.***

Whilst we welcome the recognition that a co-ordinated supervisory approach is required where supervision is split between regulators, it is still a major concern as to how this will work in practice to

ensure that it does not lead to inconsistencies, duplication and increased unnecessary bureaucracy for dual-regulated firms.
The power of direction should be a useful tool in ensuring effective consolidation supervision; however, further clarity is required regarding the consultation process prior to the issuing of such a direction. Paragraph 5.69 implies that the firm to which the supervision direction relates will be consulted before the direction is issued but once issued the direction will apply to various firms who have not been consulted.

Along with the introduction of the new control function CF00, the power to make directions to unregulated parent undertakings would allow the regulators the same level of oversight and supervision of financial groups irrespective of the legal structure of a financial group. Paragraph 5.73 states that the power of direction will only be used "in certain circumstances". Unfortunately, the only circumstance mentioned is where the tools the regulator has in respect of authorised person(s) within a financial group would not be effective to fulfil its statutory objectives. Clarity as to the circumstances in which a regulator would use this power is required to ensure regulatory certainty, especially considering the regulator will only be able to use this power over UK unregulated entities, which could lead to a greater regulatory burden on UK-based financial groups.

Question 26: What are your views on proposals for the new authorities' powers and co-ordination requirements attached to change of control applications and Part VII transfers?

We believe that the proposals are sensible given the respective roles and responsibilities of the PRA and the FCA.

Question 27: What are your views on the Government's proposals for the new regulatory authorities' powers and roles in insolvency proceedings?

Again we believe that the proposals are sensible given the respective roles and responsibilities of the PRA and the FCA. It will be essential that they liaise with each other in advance of any proposed action to bring insolvency proceedings against an authorised firm.

Question 28: What are your views on the Government's proposals for the new authorities' powers in respect of fees and levies?

We support the comment in paragraph 5.100 that the current arrangements for the collection of fees should be replicated in the new regulatory structure. We believe that proportionality remains the fairest method of deciding fees and endorse the idea that the collection of fees runs through one organisation, with tariff blocks consistent across each organisation.

Compensation, Dispute Resolution and Financial Education

A. Key Comments

- Responsibility for the FSCS should sit with one regulator – the FCA, with the FCA also being the sole rule-maker.

B. Responses to Specific Consultation Questions

Question 29: What are your views on the proposed operating model, co-ordination arrangements and governance for the FSCS?

We support the views put forward in Chapter 6 that the FSCS underpins consumer and market confidence in Financial Services and thus delivers better customer outcomes. We agree that the FSCS should remain an operationally independent body from the regulators, with a single focused objective to ensure its actions and decisions remain unbiased. Whilst it is our view that it is right for the Government to strengthen the accountability and transparency of the FSCS, we consider that it will be much more difficult to achieve this objective if, as is proposed, the responsibility for the FSCS is split between two regulators. Both the PRA and the FCA will, according to the consultation, have objectives of their own which are likely to interact with the scheme and it is our opinion that sharing responsibility for the FSCS could cause confusion, a lack of transparency and result in potential duplication of effort.

A large proportion of the rules regarding the FSCS are, and will be in the future, set at European level rather than at national regulator level. To ensure that there is a consistent application of the rules set at European level, we would suggest that the Government give further consideration to whether it would be more appropriate for responsibility to sit with one regulator, the FCA, which will then be wholly accountable for the FSCS. The Government could then mandate the FCA to work with the PRA regulator to facilitate their objectives as they relate to the stability of the UK financial system and as they apply to the FSCS. This could be achieved, as suggested, through a MoU. Giving the FCA sole responsibility for the FSCS would enable the scheme to continue to have the single focused objective previously mentioned. We would also suggest that this same consideration be given to the rule making powers and governance arrangements over the FSCS with the FCA being the sole rule maker and assurer for the FSCS and the PRA feeding their requirements in to the FCA as required. Having clear roles and responsibilities for both regulators and the FSCS will be vital irrespective of where the responsibility for the FSCS will reside in the future and we are in agreement with the Government that formal effective mechanisms will be required to be developed and put in place ensuring that the FSCS works effectively with regulators to maximise consumer protection.

We agree that the appointees to the FSCS Board should continue to be appointed on terms which secure their independence and that the Government should retain its right of approval over the Chair. The responsibility for appointments should align with whichever regulator is given responsibility for the FSCS - we would suggest this should be with the FCA.

Question 30: What are your views on the proposals relating to the FOS, particularly in relation to transparency?

RBS welcomes the Government's intention for the FOS to remain an operationally independent alternative dispute resolution service and for the FCA to take on the FSA's existing function in relation to the FOS.

With regard to the measures noted as striking the right balance and the Government's additional steps:

We are supportive of a position that will provide closer working relationships between the FOS and the FCA to support the FCA in its preventative issues-based approach. It would be appropriate if this work could include the objective of creating greater consistency of recommendations by the FOS based on FCA regulation, while crucially still maintaining its remit of dealing with individual cases based on their individual facts.

RBS supports any move towards increased transparency, although recognises that these proposals are quite high level at this stage. The FOS already publishes outcomes of certain cases and we believe that further publication would be beneficial and could improve the accountability of the FOS. It is unclear, at this stage, what additional authority publication of determinations would provide, so we agree that consultation would be appropriate. We would caution that as more detailed proposals are formulated that these take account and provide detail on how publications of this type will maintain customer confidentiality and compliance with data protection requirements.

RBS has previously provided a response to the FSA consultation on a proposal for additional guidance on the processes that firms should have in place to take account of FOS decisions and other relevant material. Many firms already have processes in place to take account of FOS decisions, so while we

continue to welcome further guidance, we would seek assurance that this should be driven by the firm rather than the FOS, whose remit should be to continue to look at each case on an individual basis.

While we recognise that it has been an objective of the FSA, this may be an opportunity for the FCA and the FOS to work in closer alignment when publishing complaints data. The separate disclosure of complaints from the FSA and the FOS has the potential to increase confusion amongst consumers and further undermine confidence in the financial services sector – indeed it has arguably already done this. We would recommend that the two bodies combine their resources to produce a more consumer friendly formatted publication, or at least provide appropriate links.

We are supportive of the proposal to implement closer ties between the FOS and the FCA so long as these help each party deliver on its respective role only and keep the FOS out of the policy-making and mass complaint handling space. Whilst in favour of this high level principle, the details of the MoU will be crucial and we would recommend that input from the industry and other relevant stakeholders would be beneficial. Also, we have some concerns that a MoU will not be beneficial, given that MoUs have not worked well in the past. Will making a voluntary MoU statutory really make a difference? What governance and accountability will surround it?

We are committed to treating our customers fairly. As such, in regard to emerging issues, we believe it is also extremely important that the industry is engaged in order to take its own action to fix issues before they crystallise into mass claims. How the new structure will enable this to happen, including appropriate sharing with relevant firms of the information which the FOS and the FCA have about emerging issues, needs to be made very clear, whether as part of the MoU or separately.

We suggest that this should be used as an opportunity to review Section 404 of the Financial Services Act 2010 (FSA consumer redress schemes). There is a strong need for a collaborative approach between regulators, the Industry and other interested parties, such as consumer groups, to be adopted with regard to the resolution of emerging risks, albeit one that allows for enforcement if collaboration proves ineffective. In situations where the Section 404 power is used, safeguards are needed to allow the relevant firms to appeal the decisions of the FSA – decisions which could have a huge financial impact on those firms.

We consider that the ability to apply for judicial review of a FOS determination is not, in itself, sufficient to ensure that FOS determinations are properly and fairly decided. It is vital that checks and balances are built into the system to ensure fair and reasoned decision-making in all cases.

Question 31: What are your views on the proposed arrangements for strengthened accountability for the FSCS, FOS and CFEB?

We are supportive of the proposals to strengthen the accountability of the FSCS, the FOS and the CFEB. Anything that improves the education provided to consumers, and which increases the accountability of these bodies, should be welcomed.

<u>FSCS</u>
We agree that proposals to require the FSCS to consult on, and publish, an annual plan are appropriate and that it should be audited by the National Audit Office.

<u>FOS</u>
Care should be taken to ensure that cost concerns do not constrain the need to fully investigate issues in an attempt to address underlying industry practice. However, equally important is that every firm should be held to account for its associated cost and benefit. Please also see our response to Question 30.

<u>CFEB</u>
The consultation highlights that consumers' responsibility for their own choices will also be important, with reference to the CFEB and its role in educating retail customers, so that they are empowered to take decisions confidently. This is a key step to ensure a fully functional relationship between lender and borrower. One of the main barriers for the CFEB to overcome to ensure consumers get the

financial education that will help them to be responsible consumers is the public perception that the CFEB has. It is very important that its communications strategy for offering its services reaches all areas of society, especially those in the greatest need of financial education. The method of communication used to reach the most socially excluded groups will have to be carefully considered to ensure that the aim is achieved.

We would also welcome the MoU that is drawn up between the FCA and the CFEB to include an outline of the remit that the CFEB has with regard to debt advice. If the CFEB does not plan to cover both money and debt advice then we feel it is essential that the MoU covers how the CFEB will work with the debt advice sector to ensure both ends of the spectrum are covered.

European and International Issues

A. Key Comments

- We wish to see the establishment of a "co-ordination committee" involving the UK regulatory bodies to agree a UK position to be represented at a European and international level.

B. Responses to Specific Consultation Questions

Question 32: What are your views on the proposed arrangements for international co-ordination outlined above?

Our response to the previous consultation stressed the importance of ensuring that the new UK regulatory framework interacts with the European regulatory structure that came into force on 1 January 2011. It is essential that the UK, as Europe's largest financial market, maximises its participation and influence within Europe (and globally), particularly with the new regulatory bodies, and we are pleased to see the emphasis now being placed upon the need for the UK to play a lead role in international regulation.

We agree, in principle, with the proposal to establish a statutory MoU, as detailed in the consultation, which must be matched by a commitment to maximise the UK's influence. However, historically, MoUs have not always worked well. The existence of a MoU between the FSA and the FOS has not avoided difficulties in practice and thus it is essential that any MoU is very detailed and specific as regards the roles and responsibilities of each party.

Further, the consultation is not clear on how international co-ordination will actually work in practice. We believe that a co-ordination committee, comprising members of the different UK regulatory bodies, should be established. That committee would agree the appropriate representation for particular meetings at an international level, as well as agree a strategy and oversee delivery of actions regarding the placing of a sufficiently large number of UK nationals into relevant EU bodies.

Impact Assessment

Annex B states that the transitional cost of creating the PRA will be in the region of £75 million - £150 million, with the residual cost of creating the FCA being between £15 million to £25 million. That compares to an estimate in the previous consultation for preliminary costs of £50 million, albeit that was caveated with the comment that they would be estimated more accurately based on consultation responses.

We commented in our response to the previous consultation that we believed £50 million to be a significant under-statement and that has been borne out by the latest figures quoted.

We previously urged exploration of the feasibility of a shared services model, such that IT, HR and other support functions are shared across the new regulatory authorities as a means of reducing costs and facilitating operational alignment. We continue to urge the authorities to explore this option.

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Response by Royal London Group to HM Treasury Consultation Paper:

A New Approach to Financial Regulation – Building a Stronger System

1. About Royal London

Royal London is the UK's largest mutual Life and Pensions Company, with funds under management of £42.2 billion.

Group businesses serve around 3.1 million customers and employ 2790 people.

We help our customers create a secure and safe financial environment for their lives by providing a range of products and services to a broad spread of customers. Royal London is committed to becoming a leading provider of financial services products in the UK. We aim to provide the highest standards of customer service and to develop products and services that are recognised as market leading. Our specialist businesses are clearly positioned in each of their markets. Their goal is to provide adaptable solutions that match the needs of distribution partners and customers.

Figures quoted are as at 31 December 2010.

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The Royal London Group's specialist businesses provide pensions, protection and investment products. Products are distributed through intermediaries.

2. Introduction

Royal London is pleased to see that the Consultation contains much greater detail on the workings of the new regulatory architecture than it predecessor. However we do have some strong views on the proposals and these are covered in our General Comments below as well as the detailed answers to the questions.

3. General Comments

Cost of Capital for UK Regulated Firms

We feel that the new approach to financial regulation will inevitable increase costs on regulated firms especially when they are dual regulated by both PRA and FCA. This will have cost implications for the return on capital that can be made in the sector and ultimately the availability of capital. This takes place at a time when a greater proportion of the burden for retirement and protection provision has to be undertaken in the private sector providers. These same providers will need to attract capital and

provide a sufficient return on that capital. The cost of regulation cannot be allowed to price the providers of capital out of UK and other mature EU markets.

Mutual Policy

We cannot believe that Government has rejected "diversity in ownership" as one of the strategic objectives of both PRA and FCA especially as this is a key commitment contained in the Coalition Government agreement of May 2010 (as mentioned in section 3.18). While the other "additional factors" raised as part of the earlier consultation, factors such as "competitiveness" and "public understanding" have been hard-wired in the operation of the regulatory authorities (via OFT and CFEB respectively), "diversity" has been dismissed in a couple of paragraphs (3.18 and 5.54).

We are sceptical that the proposed "level playing field" measures (5.55), specifically the requirement to include analysis of the impacts on mutually-owned institutions as part of the consultation process, will be in any way effective.

In its report on Financial Regulation (January 2011) the Treasury Committee calls into question the operation of the cost benefit analysis under FSA and recommends (paragraph 141) that "cost benefit analysis must be improved under PRA and the [then] CPMA". [1]

We can find no evidence of this recommendation of the Treasury Committee being adopted in the proposals contained in the current Consultation. It is not therefore evident how CBA information will be built up to form an "impartial evidence base" on "whether the legislative framework continues to treat diverse financial business models appropriately." (5. 55)

We would argue that diversity of ownership models in the financial system is a prerequisite of sustained financial stability. Indeed Andrew Haldane, the Bank of England's Executive Director of Financial Stability, in a recent speech "Rethinking the Financial Network" argues that the origins of the financial crisis that started in 2007 can be blamed on an absence of diversity in the system[2].

The Government's proposals for engineering a "level playing field" for diverse ownership models by retrospective reference to highly-subjective cost-benefit analyses is a wholly inadequate policy response.

We do however take some comfort from Hector Sants recent evidence to the All Party Parliamentary Group for Building Societies and Financial Mutuals. In his oral evidence to the inquiry on 27th January 2011 and in a letter to the Chair of the APPG (dated 17th February) Mr Sants stated "I can confirm that the Prudential Regulation Authority (PRA), which I will lead, aims to have a designated individual

[1] http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/430/430i.pdf
[2] http://www.bankofengland.co.uk/publications/speeches/2009/speech386.pdf

responsible for Building Societies and, as I stated during the session, an individual responsible for the life insurance mutual component".

Royal London will be pressing to have Mr Sants's commitment to appoint an individual with oversight for insurance mutuals in PRA written into the forthcoming White Paper and the Bill within it. We will also be seeking an equivalent appointment within the Financial Conduct Authority.

Day-to-day Operation of Regulatory Architecture

There is a very strong case to be made for a single point of contact to be appointed for firms that are regulated by both PRA and FCA. Under the current proposals there is enormous scope for duplication of effort and for miscommunication as both regulatory authorities need to be fully appraised of developments within a regulated firm. A single point of regulatory contact would aid efficient day-to-day communication and dispense with layers of duplicated resource within the authorities.

4. Responses to individual questions from the Consultation

1 What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools?

No comment

2 Are there any other potential macro-prudential tools which you believe the interim FPC and the Government should consider?

No comment

3 Do you have any general comments on the proposed role, governance and accountability mechanisms of the FPC?

In general terms the role, governance and accountability of the FPC seem appropriate.

4 Do you have any comments on the proposals for the regulation of systemically important infrastructure?

Systemically important infrastructure plays a vital role in the efficient operation of markets. It is important that the FCA, in its capacity as markets regulator, has the leading day-to-day role in the regulation of market infrastructure. This needs careful co-ordination with the work of the FPC.

5 What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the PRA?

As we state in the "General Comments" section diversity of ownership has a fundamental part to play in the stability of financial systems. The UK is no exception to this rule. The strategic objective of PRA should include the promotion of diversity.

We agree that insurance companies should be prudentially regulated by PRA despite the complexity that regulation by dual authorities may bring (see "General Comments").

We are in general agreement to the proposed regulatory principles.

6 What are your views on the scope proposed for the PRA, including Lloyd's, and the allocation mechanism and procedural safeguards for firms conducting the 'dealing in investments as principal' regulated activity?

As stated in the answer to Q.5 Royal London fully support the proposal that PRA should regulate the soundness of insurance companies. It is also right that FCA retains the responsibility for policyholder protection.

However we see a very real tension between the respective responsibilities of the two regulatory authorities and this is alluded to in paragraph 3.22. The PRA's focus on insurance firms maintaining a sound balance sheet is potentially at odds with the FCA responsibilities for consumer protection and optimising policyholder returns. This is especially the case of the management of with profit funds where the expectations of the current generation of policyholders may be in conflict with the insurance company's ongoing capital requirements. Here the PRA and FCA may be seen to be facing in opposite directions.

We assume that the PRA's responsibility to promote confidence in the system would prevail over short-term demands for "windfall" type returns to individual generations of policyholder. We believe that the precedence of the PRA in potential areas of conflict such as this will be reflected in the enabling legislation.

7. What are your views on the mechanisms proposed to make the regulator judgement-led, particularly regarding: rule-making; authorisation; approved persons; and enforcement (including hearing appeals against some decisions on a more limited grounds for appeal)?

In principle we agree that the PRA should adopt a judgement-led approach to regulation, focussing on the significant risks within the sectors it regulates.

However we do not see how this approach to rule-making will fit comfortably with the European Supervisory Authorities and their powers to impose binding technical standards on national regulators. The rules made by PRA (paragraph 3.32) must presumably fit within the existing framework of EU directives and the binding technical standards laid down by the ESAs.

We would look to PRA to employ its judgement-led approach in the exercise of its powers of authorisation, approving individuals as fit and proper and in enforcement.

We look forward to receiving details of and commenting on the proposed Proactive Intervention Framework in due course.

8 What are your views on the proposed governance framework for the PRA and its relationship with the Bank of England?

This section of the CP concentrates on PRA accountability to the Court of Directors of the Bank of England. This may be wholly appropriate but PRA must ensure that individuals are appointed to the PRA Board with the required insurance sector expertise to appreciate the very different prudential risks and associated mitigating actions that arise in the insurance sector.

9 What are your views on the accountability mechanisms proposed for the PRA?

We support the proposals that Treasury ministers retain the right to commission independent reviews into the efficiency and effectiveness of PRA and that the PRA should be audited by NAO with an accountability to the Public Accounts Committee.

The new requirement for the prudential regulator to report to Treasury in the event of a regulatory failure is also to be welcomed.

There is no mention of the current arrangements for the regulator to report regularly to the House of Commons Treasury Committee. This is an important component in the scrutiny of the regulator and should be retained. We believe that when the Treasury Committee makes recommendations for changes in the work of PRA that these should acted upon or the reason for their non-applicability explained via Ministerial statement.

10 What are your views on the Government's proposed mechanisms for the PRA's engagement with industry and the wider public?

The PRA should be required to consult widely with practitioners (not just the Practitioner Panel) on all changes to rules policies and practices. Given the nature of its regulatory scope, there is no need for PRA to consult with a consumer panel.

The PRA should be alert to emerging legislation from EU institutions. It should not anticipate emerging legislation from the EU (as is currently often the case) but work in concert legislative developments.

11 What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?

In line with the comments in the "General Comments" section we believe that FCA should have "facilitating diversity" added to its operational objectives. Objective "a" should read "facilitating efficiency, diversity and choice in the market for financial services".

We are in agreement with the Regulatory Principles and especially welcome clarification over the FCA objectives in the promotion of competition.

12 What are your views on the Government's proposed arrangements for governance and accountability of the FCA?

We are broadly happy with the governance and accountability arrangements for the FCA which reflect many of the best practices of the FSA regime.

13 What are your views on the proposed new FCA product intervention power?

We are not clear what regulatory failures that Government is trying to address by giving FCA new interventionist powers. Most of the perceived problems are already being addressed by initiatives such as the Retail Distribution Review which is yet to come into force.

14 The Government would welcome specific comments on:

- **the proposed approach to the FCA using transparency and disclosure as a regulatory tool;**
- **the proposed new power in relation to financial promotions; and**
- **the proposed new power in relation to warning notices.**

We welcome the proposal that FCA should be open in its thinking on developments in the market. This will help firms to embrace good practice and anticipate the direction of regulatory thinking.

We do not have any problem with the proposed power to allow FCA to require firms to withdraw misleading financial promotions provided this action is not on a name and shame basis and firms have a right to appeal against the order.

We are very strongly against the proposal to grant FCA the powers to publish warning notices that enforcement action against a regulated firm may be about to be taken. This early action seems to circumvent due process and poses huge reputational and commercial risks to firms. What if the proposed enforcement action were to prove groundless? Would regulated firms have an automatic right to redress against the regulator if the early publication of a notice were shown to be inappropriate?

We urge Government to abandon this draconian proposal.

15 Which, if any, of the additional new powers in relation to general competition law outlined above would be appropriate for the FCA? Are there any other powers the Government should consider?

We have no views on the proposals.

16 The Government would welcome specific comments on:

- **the proposals for RIEs and Part XVIII of FSMA; and**
- **the proposals in relation to listing and primary market regulation.**

We strongly support the Government's decision to retain the responsibility for the UK Listing Authority within the markets regulator.

17 What are your views on the mechanisms and processes proposed to support effective coordination between the PRA and the FCA?

As stated in the "General Comments" section that where the firm is subject to dual regulation, such as in Royal London's case, that there should be a single point of contact coordinating the flow of communication between regulators and the regulated.

Coordination of effort in this way will improve efficiency and reduce overlap and costs. Wherever possible the PRA and FCA should share processes such as maintaining the register, regulatory approvals / APERS, fee calculation and invoicing.

18 What are your views on the Government's proposal that the PRA should be able to veto an FCA taking actions that would be likely to lead to the disorderly failure of a firm or wider financial instability?

We support the use of a veto in very limited circumstances and note the safeguards that will be built into the process – to notify parliament of the veto in all but carefully circumscribed cases.

We would be surprised to see the veto used in situations where the risks that are being mitigated by proposed FCA action clearly outweigh any prudential issues intended to be addressed by a veto.

19 What are your views on the proposed models for the authorisation process – which do you prefer, and why?

We would prefer to see the alternative proposal examined in more depth. The "lead proposal", involving a dual regulated firm such as the Royal London Group, making separate applications to each regulator would involve potential conflict and duplication of roles, responsibilities and process as well as additional compliance costs. The alternative approach detailed in 5.38 – 5.40 should be examined further with a view to designing an approach that is efficient, whilst at the same time achieving the regulatory objectives of authorisation.

20 What are your views on the proposals on variation and removal of permissions?

We agree that both the PRA and the FCA should have powers to vary permissions, replicating, in effect, the present way of working. However we are concerned that there should be a mechanism in place to address the situation where a unilateral withdrawal of permission by the PRA may have considerable impacts upon the objectives of the FCA in relation to that firm – as per our response to Q18, there may be circumstances in which the achievement of FCA objectives outweighs those of the PRA.

21 What are your views on the Government's proposals for the approved persons regime under the new regulatory architecture?

The proposals seem pragmatic and workable, with clear responsibility for each Controlled Function being allocated to either the PRA or the FCA.

22 What are your views on the Government's proposals on passporting?

Section 5.51 states that the PRA will work closely with the home state regulators of those firms which have branches in the UK to ensure the financial stability of the UK system, even where its own powers are limited in respect of prudential issues. This seems to us somewhat of a dichotomy and will lead to lack of clarity over who is responsible for prudential regulation of such firms. Where the PRA has concerns about a passported in firm what powers will it have to force the home state regulator to take action? We suspect very limited, unless escalated through the relevant ESA.

23 What are your views on the Government's proposals on the treatment of mutual organisations in the new regulatory architecture?

The proposed approach to the treatment of mutual organisations is wholly inadequate. There is no attempt to encourage the growth of mutual organisations or diversity of ownership.

Trying to ensure there is "a level playing field" by reference to historic CBA data is a proposal that does not warrant serious consideration.

See our comment in the General Comments section.

24 What are your views on the process and powers proposed for making and waiving rules?

We support the proposals for each authority to be able to waive its own rules in specific cases at the request of firms. The additional step for the PRA to be consulted where the firm is dual regulated may add delay and cost to the process and the process should be designed in such a way to minimise this impact together with measurable service standards.

25 The Government would welcome specific comments on

- **proposals to support effective group supervision by the new authorities – including the new power of direction; and**
- **proposals to introduce a new power of direction over unregulated parent entities in certain circumstances?**

We have no comments on this section.

26 What are your views on proposals for the new authorities' powers and coordination requirements attached to change of control applications and Part VII transfers?

We support the proposals for the PRA to have responsibility for specific regulatory duties connected with Part VII applications. As the PRA will be required to consult with the FCA on these issues our generic comment relating to the efficiency of such consultation applies.

27 What are your views on the Government's proposals for the new regulatory authorities' powers and roles in insolvency proceedings?

No comment

28 What are your views on the Government's proposals for the new authorities' powers in respect of fees and levies?

We welcome the proposal for a non-statutory arrangement to be put in place for the collection of fees through one organisation, similar to that which currently exists in relation to the collection of the FSCS levy by the FSA.

It seems inevitable that the creation of both the FCA & the PRA will lead to an increase in fees charged to regulated firms. We have substantial concerns that firms will see a large increase in the overall cost of regulation as a result. Many processes are duplicated within the proposals, with both entities being involved in applications for approval, controlled functions, waivers and other regulatory processes. Efficiency in such processes will be critical and duplication must be avoided where possible and sensible.

29 What are your views on the proposed operating model, coordination arrangements and governance for the FSCS?

Royal London supports the view that the FSCS remains a single organisation for administering compensation to consumers and does not have any concerns on the proposed operating model. We do believe and agree that it is vital with each regulator having rule making powers over the FSCS that Memoranda of Understanding are in place from inception and support that MOU's are to be on a statutory footing so that there is full transparency and accountability.

30 What are your views on the proposals relating to the FOS, particularly in relation to transparency?

Royal London supports the proposal for the independent Financial Ombudsman Service to be required to publish an annual plan and to consult on it as appropriate. We firmly believe for the sake of consumer protection that the FOS remains independent of FCA, but understand the need for the two organisations to work closely together. Royal London will welcome in the future further clarification and opportunity to comment on the roles and relationship of the FOS and FCA.

In relation to the proposals on transparency at FOS Royal London has welcomed the initiatives over recent years for providing more guidance to firms on complaint handling, we believe that further can be done and the issue of publishing complaint decisions is a step in this direction. This is an approach that receives our support although with qualification that FOS should be required to consult with stakeholders before issuing policy guidance.

The publication of key decisions illustrating key points is to be welcomed and we fully support this. We do not believe a summary of the decision will be sufficient and believe that the full final decision (not a short form version) will give firms sufficient detail to incorporate the decisions into their own complaint handling when the same issues arise. The decisions should be published with anonymity for all parties.

We do not accept that FOS should be able to rule on cases with “wider implications” for industry participation. This power should reside with the FCA or Upper Tribunal.

31 What are your views on the proposed arrangements for strengthened accountability for the FSCS, FOS and CFEB?

Royal London supports any measure to strengthen accountability and agrees with the proposals for a statutory annual plan and audit by the National Audit Office.

32. What are your views on the proposed arrangements for international coordination outlined above?

It is essential that the UK authorities build influence within the ESAs especially in the area of the setting of binding technical standards. However UK authorities need to be gaining influence not only for their technical expertise but also for their political skill. It is our perception that the UK has lacked political influence in the past and this is not a state of affairs that can be allowed to continue.

It is of course essential that the activities of the UK authorities are coordinated at EU level and internationally. An MoU, as described, is essential for this coordination to be effective.