

**RESTORING THE RULE OF LAW
TO FINANCIAL SERVICES COMPENSATION**

**The Defects of the Financial Ombudsman Service
and Constructive Proposals for Reform**

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EXECUTIVE SUMMARY

Defects in financial services compensation today

1. The Financial Ombudsman Service (“FOS”) scheme is unbalanced. The firm is bound by a decision without any appeal on the merits; the complainant is not bound and can re-run the same case again in court. Complainants pay no fee; firms have to pay, even when a complaint is dismissed.
2. FOS does not have to make decisions in accordance with the law of England and does not do so. Instead it proudly proclaims that it makes its “own law”.
3. FOS does not publish any of its decisions even in anonymised form, and despite the recommendation to it by Lord Hunt of the Wirral that it should do so. FOS does not even keep a register of decisions, although the Financial Services and Markets Act envisages that it should do so.
4. FOS hardly ever holds oral hearings. Its own senior staff have suggested that it does so in 1 out of 10,000 cases. It defies belief that there can be a factual dispute in only so tiny a proportion of disputes. This is at variance with the assurance given to the House of Commons when the Financial Services and Markets Bill was in Committee by the Economic Secretary to the Treasury, who said there would be a hearing whenever either party requested one.
5. There is so close a structural connection between FOS and the FSA as to cast doubt on whether FOS can be regarded as independent of the regulator. Such concerns are exacerbated by the conduct of both organisations as outlined later in this paper.
6. These features make the FOS system incompatible with the rule of law, and unacceptable for a body with jurisdiction currently of £100,000, and a proposed jurisdiction soon of £150,000.

7. The UK Government has recently been called upon by the European Court of Human Rights to respond to a number of the above criticisms in *Heather Moor and Edgecomb Limited v UK*.

Proposals for reform

1. Firms should have to comply with FOS decisions when they are made by paying any sum ordered to the customer, or into court, but firms should have the right to seek a review by way of full rehearing. This would adopt the principle of “temporary finality” of construction adjudication enacted by Parliament, which has proved so successful and popular for the construction industry.
2. The review would be by a first tier tribunal, which might be known as the Financial Services Complaints Chamber (“FSCC”). This tribunal would adopt many of the practices and flexibility which have earned a high reputation for the Financial Services and Markets Tribunal created by the 2000 Act. It would be a specialist tribunal, and could be expected to handle cases with the efficiency already associated with other specialist courts and tribunals.
3. The FSCC would hold oral hearings, allow cross-examination where a case turned on disputed witness evidence, and make decisions in accordance with English law. Like any other court or tribunal, there would be no ceiling on its financial jurisdiction.
4. The FSCC would also provide a review for consumers who are disappointed at their complaints being dismissed by FOS. In addition it could provide a route to full compensation for customers who have succeeded on liability at FOS but, owing to the high quantum of their losses, been unable to secure an award for full compensation owing to the FOS jurisdiction ceiling.
5. Those features of its “own law” which FOS has developed which are favoured by Parliament should be enacted as part of English law in the statute which enacts these reforms.

6. To protect the position of consumers who have succeeded at FOS, the rule on costs when a firm seeks a review at FSCC would be one way costs shifting: the customer would recover costs if it won, but the firm would not be entitled to costs against the customer if it won.
7. Since FSCC would be providing access to justice fully in accordance with the rule of law, a more rough and ready decision-making at the FOS level would be acceptable. Therefore, FOS should cease its 2nd-tier system under which if the first decision maker's view does not commend itself to the parties the case is looked at all over again, and two more decision letters are written, by a second, more senior decision-maker.
8. The costs saved by abolishing the 2nd-tier of FOS work should be channelled into a legal aid fund for consumers at the FSCC. Since FOS is wholly financed by the financial services, this fund would thus also be wholly industry financed.. It would entail no public money. The fund would be administered under the control of a board drawn one quarter each from the Bar Council, the Law Society, the Financial Services Authority (or its successor) and financial services industry trade representative bodies.

The authors

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¹ Including *R (Fleurose) v Securities and Futures Authority* [2001] 2 All ER (Comm) 481, the first case to consider how the Convention affected financial discipline

² Including the Court of Appeal decision *R (Heather Moor & Edgecomb Ltd) v Financial Ombudsman Service* [2008] Bus LR 1486, which is now the subject of an application at the European Court of Human Rights

Peter Hamilton has been involved in the regulation of the retail end of the financial services market since Professor Gower published his review in January 1984.³ At that time he was the company secretary and head of the legal department of Hambro Life Assurance plc.⁴ He returned to practice the Bar in the spring of 1991. Since then, issues arising from the regulation of financial services have formed a substantial part of his practice.⁵

Both are barristers in practice at the chambers at 4 Pump Court.

Response to consultation

This paper is submitted to H M Treasury by way of a response to the consultation (Cm 8012) on a new approach to financial regulation: building a stronger system.

³ *Review of Investor Protection*, Cmnd 9125.

⁴ Later to become Allied Dunbar Assurance plc.

⁵ Full CVs are available on request from the clerks@4pumpcourt.com.

Introduction

1. In Chapter 6 of the Treasury's paper on *A new approach to financial regulation: building a stronger system* ("the paper") which was published in February 2011, at paras 6.17 to 6.23, it is said that the government "intends for the FOS to remain an operationally independent alternative dispute resolution service and for the FCA to take on the FSA's existing functions in relation to the FOS".
2. In our submission, the FOS itself is in serious need of structural reform; and its relationship with the FSA needs to be reconsidered. The legislative process now planned in order to give effect to the government's proposals set out in the paper (and the previous consultation paper published in July 2010), presents an ideal opportunity to reform the FOS.
3. We set out our reasons below. We have adopted the abbreviations used in the paper.

THE DEFECTS OF THE FINANCIAL OMBUDSMAN SERVICE

Current structure of FOS

4. The current structure of the FOS is set out in the Financial Services and Markets Act 2000 ("FSMA") in Part XVI and Schedule 17. Those parts of the FSMA make provision for a scheme under which disputes between clients and firms which have been authorised to provide financial services, "may be resolved quickly and with minimum formality".⁶
5. The jurisdiction of the scheme over authorised persons (who may be either a huge corporation or a sole practitioner IFA in a High Street) is compulsory.⁷ There is also a voluntary jurisdiction.
6. Awards made by the scheme are enforceable as if they were court judgments.⁸

⁶ Section 225.

⁷ Section 226.

⁸ Schedule 17 para 16

7. Schedule 17 provides that the FSA is to establish a body corporate to exercise the functions. The FSA duly established the FOS.
8. The power to make rules for the FOS is shared between FSA and the FOS itself. The FSA and the FOS have promulgated rules entitled “Dispute Resolution: Complaints”, which are commonly referred to as “DISP”.
9. Under these rules FOS has jurisdiction to make binding awards of up to £100,000. The FSA has recently been consulting on its intention to raise that limit to £150,000 from 1 Jan 2012 – an increase of about double what would have been needed to adjust for inflation.

Defects in the scheme of the FOS

10. The scheme is unbalanced in several significant respects:-
 - (a) There is no appeal against an award by a firm which is found liable. On the other hand, if a complainant's complaint is dismissed by FOS, he may bring the same complaint again in court.
 - (b) One of the rule-makers, the FSA, has amongst its statutory objectives the protection of consumers. This is not balanced by any objective to provide fairness for firms.
 - (c) The scheme is free to complainants. On the other hand, the DISP rules provide that the firm, against which a complaint is made, has to pay the FOS's case fee, even if the complaint is dismissed. A District Judge in the Trowbridge County Court held that that was Wednesbury unreasonable. But in *FOS v. Heather Moor & Edgcomb*⁹ the Court of Appeal allowed the FOS's appeal and held that the rule requiring the firm to pay a fee in respect of failed complaints was not unlawful or unreasonable.
11. The ombudsman does not have to apply the law of England (or of Scotland in Scotland). The FSMA provides:¹⁰

⁹ [2009] 1 All ER 328.

¹⁰ Section 228(2).

A complaint is to be determined by reference to what is, in the opinion of the ombudsman, fair and reasonable in all the circumstances of the case.

12. That section was held by the Court of Appeal in *R (Heather Moor & Edgcomb) v FOS*¹¹ to mean that a determination by the FOS need not be in accordance with the law of England, provided it is fair and reasonable. In other words the FOS has power to make a binding award against a firm for payment of up to £100,000, notwithstanding that the firm has committed no wrong under the law, and notwithstanding that the law would recognise no liability upon the firm.

13. The FOS's own rules which form part of DISP provide:-

3.8.1(1) The Ombudsman will determine a complaint by reference to what is, in his opinion, fair and reasonable in all the circumstances of the case.

14. The FOS's approach has been to develop its own law to govern consumer claims against financial advisers and providers. Mr Walter Merricks, who was until recently the Chief Ombudsman of the FOS, has said in a public speech on 6 June 2001, and posted ever since by the FOS on its website:-

We do not have to pretend to 'find' what the law is. We unashamedly make 'new law'.

15. He has made no secret of the fact that FOS decides cases on a basis different from the law of the land:-

Our fair and reasonable jurisdiction has attracted a fair amount of attention. It allows us to look beyond wording of the small print, to take into account the large print in the promotional materials, good industry practice, and, if necessary, adopt a modern and fairer approach where it is clear that the law has lagged behind.

16. Nobody doubts the sincerity of Mr Merricks's belief that his criteria are better than those of the English law. The issue is whether in a democratic society governed by the rule of law, changes to the law should be made other than by

¹¹ [2008] Bus LR 1486.

Parliament.

17. An example of how the FOS does not follow the law of England is in respect of limitation. Financial advisers are currently facing claims about mortgage endowment sales dating back well over the 15-year long stop for negligence claims under the law.¹² Further, financial advisers remain exposed to all claims indefinitely – even after retirement and death. All individuals in that position need to maintain expensive professional indemnity insurance indefinitely. That is causing hardship.

Non-publication of the FOS’ decisions

18. The decisions of the FOS have been observed to contain the same passages of text over and over again. The explanation for this provided by Jane Sanders, a barrister who previously worked at FOS, is that standard text is provided by the FOS computer system. That system has been created so as to take a decision writer step by step through a tree of decision-making. She has written:-

You input data onto Excellence (the all singing and dancing database designed to support adjudicators in the Endowment team) including the complainant's policy number, target maturity sum, basic sum assured, number of dependents, the complainant's age and other salient factors from the point of sale and press a button.

Voila! Excellence creates a template letter which, in the loosest way possible, was tailor made to the complainant's case. You then take further standard paragraphs, emailed to you from your mentor, for you to store on your system, and apply them depending on the type of case you have, and pad out the letter until you have something that was considered acceptable.

19. In 2007 the FOS appointed Lord Hunt of Wirral to conduct a review of some of its procedures. In his Call for Evidence published in autumn 2007 he reported that in making its decisions the FOS uses “a full computer-based knowledge management system called KIT (Knowledge and Information Toolkit)”, which “consists of well over 100 separate notes, produced by senior

¹² Limitation Act 1980, s.14B.

FOS staff”. The information is “layered” and covers such subjects as “products, sectors and more generic topics”.¹³

20. There is nothing inherently wrong with the use of this computer-based decision-writing system. But it is a pity that it is not made publicly available. Presumably it contains the FOS’s “own law”.
21. Another way for citizens to be able to predict the way in which the FOS would be likely to determine rights and liabilities would be if FOS published its decisions. One can quite understand that complainants may prefer that details of their affairs are not published, and that authorised persons may prefer not to have their name published, especially when found liable. But the easy answer to those issues is for decisions to be published, as court judgments occasionally are, in anonymised form.
22. There is a lot of talk from FOS about how much it values transparency, but the reality seems to be that it is a somewhat secretive organisation. For instance, Jane Sanders says:

Whilst at FOS, I was told that I must reply, when challenged, that my qualifications have no bearing on the job at hand; I do the job at hand because FOS says I am competent to do so. Under no circumstances was I to reveal my qualifications.

It was explained to me when I questioned what appeared to me to be a ridiculous stance that the position was that the training was so comprehensive that the background qualifications I held were of little consequence; this despite the fact that formal induction to the service is actually 1 week and you begin issuing views under a mentor a few short weeks later.

23. In April 2008 Lord Hunt recommended that the FOS should select and publish some of its decisions in full, but in anonymised form to show the relationship between the broad principles applied to resolution of cases – which should also be published – and their application in practice. He also recommended that the FOS “commission and publish regular academic analysis of the full

¹³ Hunt para 4.15.

range of Ombudsman decisions alongside future independent reviews". The current Chief Ombudsman has recently been reported as saying she favours more publication, but so far as we can discover there is still not a single full decision on the FOS website, and no sign of academic analysis.

24. Although there is nothing in the FSMA to require the FOS to publish its decisions, the Act does mention a register of decisions. FSMA s.229(8) provides for a FOS money award to be enforceable through the courts "in accordance with Part III of schedule 17", which states:¹⁴

A money award, including interest, which has been registered in accordance with scheme rules may --

- (a) if a county court so orders in England and Wales, be recovered by execution issued from the county court (or otherwise) as if it were payable under an order of that court
(emphasis added)

25. FOS's own rule called DISP 3.9.15 used to provide:

The Ombudsman must maintain a register of each money award and direction made.

26. A couple of years ago Mr Joseph Egerton, a consultant who has given expert evidence on financial services matters, called at FOS and asked to inspect the register. He was told it did not exist. Not long afterwards the rule about a register disappeared from the rule book.

27. This means that there might be some difficulty in a person who has received a money award from FOS enforcing it through the courts. But in most cases this will cause little problem. A decision of the Financial Services and Markets Tribunal in May 2008 held that FSA was justified in withdrawing authorisation from any approved person who did not pay a FOS award, even though in that case there had been an enforcement action commenced in court which resulted in the action being by consent dismissed.

¹⁴ In para 16.

28. The FOS has claimed that it fulfilled this requirement that it maintain a register because its decisions were held in electronic form on an internal database. In *R (Heather Moor and Edgecomb Limited) v FOS*¹⁵ this argument did not impress Lord Justice Rix, who said,¹⁶

I have my doubts whether such an internal database amounts to a 'register' properly so called. A register is an official list or record. It may be that it can be kept in any form, but I suspect that it needs to be open to public inspection.

Lord Justice Laws agreed with Lord Justice Rix.¹⁷

No oral hearing

29. The law of England is that a professional regulator should order an oral hearing where there is a disputed issue of fact which is central to an adjudicator's assessment and which cannot fairly be resolved without an oral hearing: per Clarke LJ in *R v Law Society ex p Thompson*.¹⁸
30. DISP rule 3.2.13 permits the FOS to hold an oral hearing, and seeks to give the impression that such a hearing will be held whenever such would be required by the European Convention on Human Rights.
31. The reality, however, is that FOS hardly ever permits an oral hearing. This was revealed by Mr Tony Boorman, the FOS Principal Ombudsman and Decisions Director at a seminar convened by the Council on Tribunals on the subject "The Use and Value of Oral Hearings in the Administrative Justice System". He said that FOS would allow a hearing in only 1 out of 10,000 cases. The report records him as saying:-

* What about hearings? Because processes are so flexible oral hearings can be held, but chances are very slim. Only 1 oral hearing for every 10,000 cases.

* In what circumstances? A hearing, though exceptional, would be held if it was thought that a case would be particularly hard fought. In

¹⁵ [2008] Bus LR 1486; [2008] EWCA Civ 642.

¹⁶ In para 90.

¹⁷ In para 91.

¹⁸ [2004] 1 WLR 2522 para 45-46.

some circumstances it might be better for the FOS to have a hearing in-house as opposed to letting the matter go on judicial review to the Administrative Court.

* May also decide, off own bat, that a hearing would assist with identifying facts of case or making a judgment about the reliability of the evidence that is being presented.

32. It is hard to reconcile the FOS' attitude there revealed with a proper quasi-judicial approach, and it would defy belief if the suggestion were advanced by the FOS (which it does not really seem to be) that in only 1 in 10,000 cases could oral evidence assist in a just determination of liability or causation.
33. The FOS's practice is utterly at variance with what was promised by the government. On 30 November 1999 Miss Melanie Johnson MP, Economic Secretary to the Treasury, said to the House of Commons committee considering the Financial Services and Markets Bill in relation to a proposed amendments to what has now become section 228 and Schedule 17 of the Act,

It is perfectly possible to operate the [FOS] scheme effectively while also protecting the parties' ECHR rights. Firms and complainants that bring disputes to the ombudsman will be able to exercise their right to a fair and public hearing. The option of a judicial review will be open to both firms and consumers once the ombudsman's decision has been taken, which ensures that all parties will be heard. Article 6(1) stipulates that in the determination of civil rights and obligations, everyone is entitled to a fair and public hearing by an independent and impartial tribunal. The scheme will provide for a hearing to be held if one is requested by a party to the complaint. We do not believe that the scheme will be legalistic. We expect the right to a fair hearing to be exercised frequently.

(emphasis added)

Not independent and impartial

34. There is a close structural connection between the FSA and the FOS, which is indicative of the FSA being in a superior position to the FOS –
 - (a) The chairman and directors of FOS are appointed by, and liable to be removed from office by, the FSA.¹⁹
 - (b) The FOS and its Chief Ombudsman report to the FSA on the discharge

¹⁹ FSMA sched 17 para 3(2)

of their functions.²⁰

(c) FSA approves the budget of FOS.²¹

(d) Those of the rules of the FOS which are made by the FOS require the approval of the FSA.²²

35. On 11 July 2002 the FOS entered into a Memorandum of Understanding with the FSA, under which it was agreed that FSA and FOS would maintain a strong and constructive relationship and would exercise their responsibilities in a complementary fashion. This Memorandum has been more recently re-issued in similar terms. This has increased the appearance of FOS being other than independent of FSA.

36. The unhealthy closeness between FOS and FSA is manifested by the experience of Mr John Calland, a retired independent financial adviser.

(a) By summer 2005 there was in existence what a FOS official described as a “long standing agreement” between FOS and FSA under which FOS would solicit complaints from investors, whose identities were suggested to the FOS by the FSA, but who had not previously intimated any complaint against a firm.

(b) The arrangement between the FOS and the FSA was sufficiently well established for there to be a standard form of letter for use by FOS in soliciting complaints.

(c) The FOS’s readiness to comply with the FSA’s wishes was such that the FOS invited the submission of FOS Complaint Forms from investors who had never complained to a firm, even though the FOS was well aware that its own rule DISP 2.3.1 provided that the FOS could not entertain a complaint unless and until the investor had first complained to the firm, and either the firm had given a final response or 8 weeks had elapsed.

(d) The standard practice of the FOS, when the FSA identified to it an investor from whom FSA wanted a complaint to be solicited, was for

²⁰ FSMA sched 17 para 7.

²¹ FSMA sched 17 para 9.

²² FSMA sched 17 para 14(7).

the FOS to send the investor a partly completed FOS Complaint Form, on which the FOS had typed entries not only for such formal matters as name and address but also for details of the complaint which the investor was making. This was done even in cases in which the investor had given no intimation of the nature of any complaint it wanted to make. Furthermore the language used by FOS in setting out the complaint could be in terms which would mean little to a layman: an example of such FOS language was “FSA D firm methodology pension review”.

- (e) In a decision dated 6 December 2006 Mr Michael Barnes CBE, the FOS Independent Assessor, upheld Mr Calland’s complaint, and stated that the above-mentioned complaints against Mr Calland’s firm “were in effect solicited”.
- (f) Despite Mr Barnes’s decision, and despite having been made aware that FOS staff were operating this arrangement with FSA, neither the Chairman of the FOS Board nor the FOS Chief Ombudsman have expressed any disapproval or reservation about it.
- (g) The FSA considers that information about communications between FSA and FOS relating to specific cases, namely those considered “difficult”, should be withheld even from the firm in question. Not only would the withholding of any information possessed by FOS of potential relevance to a case which FOS was determining, be a breach of the rules of natural justice; but also the attitude of mind on the part of financial regulators revealed by this desire for secret communications evinces a lack of understanding of the requirement for genuine FOS independence.

How these features affront the rule of law: from first principles

- 37. The law might say that I have the right to hold a placard outside the railings of the Royal Courts of Justice, but no such right immediately outside St Stephen's entrance to the Palace of Westminster: in that case I know where I can, and

cannot, go with my placard. But a law which stated that placards can lawfully be held only at such places as the some public official subsequently might hold to be fair and reasonable would give me no right at all.

38. Similarly, if my right to my possessions is watered down to mean only a right to hold them until the FOS decides it is fair and reasonable for me to pay them to somebody else, then I have no “right” in a true sense to my possessions at all.
39. This conclusion is reinforced by the fact that there is no appeal, and the fact that the vagueness of the subjective (“in the opinion of the ombudsman”) fair and reasonable criterion makes any judicial review of a FOS decision on the merits of a case for all practical purposes impossible.

How these features affront the rule of law: in English common law

40. In *R v Misra*²³ Judge LJ referred to the principle of legal certainty and continued:-

The principle enables each community to regulate itself: „with reference to the norms prevailing in the society in which they live. That generally entails that the law must be adequately accessible – an individual must have an indication of the legal rules applicable in a given case – and he must be able to foresee the consequences of his actions“ (*SW v United Kingdom, CR v United Kingdom* (1995) 21 EHRR 363)

41. In *R v Rimmington* ²⁴ Lord Bingham of Cornhill recalled what Jeremy Bentham wrote in 1792 about the judges of that era:-

When your dog does anything you want to break him of, you wait till he does it, and then beat him for it. That is the way you make laws for your dog.

42. Lord Bingham said that the domestic law of England and Wales had over the last 200 years set its face firmly against “dog-law”.

²³ [2005] 1 Cr App R 328.

²⁴ [2006] 1 AC 459 at 33.

How these features affront the rule of law: in Strasbourg jurisprudence

43. In *The Sunday Times v United Kingdom*²⁵ the European Court of Human Rights said:-

In the Court's opinion, the following are two of the requirements that flow from the expression „prescribed by law“. Firstly, the law must be adequately accessible: the citizen must be able to have an indication that is adequate in the circumstances of the legal rules applicable to a given case. Secondly, a norm cannot be regarded as a „law“ unless it is formulated with sufficient precision to enable the citizen to regulate his conduct: he must be able – if need be with appropriate advice – to foresee, to a degree which is reasonable in the circumstances, the consequences which a given action may entail.

44. In *SW v United Kingdom*²⁶ the Court repeated the same principle:-

.... That generally entails that the law must be adequately accessible – an individual must have an indication of the legal rules applicable in a given case – and he must be able to foresee the consequences of his actions

How these features affront the rule of law: in the view of leading jurists

45. In *The Rule of Law* (Allen Lane 2010), Lord Bingham suggests that the core of the principle of the rules of law is –

... that all persons and authorities within the state, whether public or private, should be bound by and entitled to the benefit of laws publicly made, taking effect (generally) in the future and publicly administered in the courts”.²⁷

46. Lord Bingham went on to suggest 8 principles as the ingredients of the Rule of Law. They include:

- (1) The law must be accessible, and so far as possible intelligible, clear and predictable.
- (2) Questions of legal right and liability should ordinarily be resolved by the application of the law and not the exercise of discretion.

²⁵ (1979) 2 EHRR 245.

²⁶ (1995) 21 EHRR 363.

²⁷ At p.8.

47. Professor Finnis suggests the following meaning in *Natural Law and Natural Rights*²⁸:-

A legal system exemplifies the Rule of Law to the extent (it is a matter of degree in respect of each item on the list) that (i) its rules are prospective, not retroactive, and (ii) are not in any other way impossible to comply with; that (iii) its rules are promulgated, (iv) clear, and (v) coherent one with another; that (vi) its rules are sufficiently stable to allow people to be guided by their knowledge of the content of the rules; that (vii) the making of decrees and orders applicable to relatively limited situations is guided by their knowledge of the content of the rules; that (viii) the making of decrees and orders applicable to relatively limited situations is guided by rules that are promulgated, clear, stable, and relatively general; and that (ix) those people who have authority to make, administer, and apply the rules in an official capacity (a) are accountable for their compliance with rules applicable to their performance and (b) do actually administer the law consistently and in accordance with its tenor.

48. Professor Sir Neil MacCormick makes the same point in *Rhetoric and the Rule of Law*²⁹:-

Where the Rule of Law obtains, the government of a state ... is carried on within a framework laid down by law. ... Where the law prevails, you know where you are, and what you are able to do without getting yourself embroiled in civil litigation or in the criminal justice system.

There cannot be a Rule of Law without rules of law.... Values like legal certainty and legal security can be realized only to the extent that a state is governed according to pre-announced rules that are clear and intelligible in themselves.

How these features affront the rule of law: the Convention requires the Rule of Law

49. An order that a person make a payment to another of a sum of money as large as £100,000 involves a determination of his civil rights and obligations. Both Article 6 and Article 1 of Protocol 1 of the Convention are therefore engaged.

²⁸ (Oxford, 1980) page 270.

²⁹ (OUP 2005) at p.12.

50. As to Article 6, in *Golder v UK*³⁰ the Court held that it should be interpreted in the light of the reference to the “rule of law” in the Preamble to the Convention:-

One reason why the signatory Governments decided to „take the first steps for the collective enforcement of certain of the Rights stated in the Universal Declaration“ was their profound belief in the rule of law. It seems both natural and in conformity with the principle of good faith to bear in mind this widely proclaimed consideration when interpreting the terms of Article 6(1) according to their context and in the light of the object and purpose of the Convention.

51. The Court held that this was reinforced by the facts that the Statute of the Council of Europe referred in two places to the rule of law, and by article 31(3)(c) of the Vienna Convention. The Court³¹ continued:-

Were Article 6(1) to be understood as concerning exclusively the conduct of an action which has already been initiated before a court, a Contracting State could, without acting in breach of that text, do away with its courts, or take away their jurisdiction to determine certain classes of civil actions and entrust it to organs dependent on the Government. Such assumptions, indissociable from a danger of arbitrary power, would have serious consequences which are repugnant to the aforementioned principles and which the Court cannot overlook.

52. As to Article 1 of Protocol 1, although we are not aware of any case at the European Court of Human Rights where it has been directly held that that Article implies the rule of law, one can establish that it does so imply by referring to case law on Articles 8 and 10, since:-

- (a) There are similar expressions in article 8(2) (“... except such as is in accordance with the law ...”) and in article 10(2) (“... subject to such formalities, conditions, restrictions or penalties are prescribed by law ...”). It is reasonable to think that the concept of “law” is the same in each case.
- (b) That contention is strengthened by the fact that in the French text of the Convention the wording is identical in Article 8(2), Article 10(2) and in First Protocol Article 1:-

Article 8(2): ... *autant que cette ingérence est prévue par la loi ...*

³⁰ [1979-80] 1 EHRR 524.

³¹ *Golder*, at para 35.

Article 10(2): ... *restrictions ou sanctions prévues par la loi* ...

First Protocol Article 1: ... *conditions prévues par la loi* ...

- (c) In *The Sunday Times v United Kingdom*³² it was stated by the Court at paragraph 48 of the judgment that the Court must interpret Article 8 and the First Protocol Article 1 so as to reconcile them as far as possible.
- (d) In *Malone v UK*³³ the Court held that the expression “in accordance with the law” (or “prevue par la loi” in the French text) implied a law compatible with the rule of law. It said –

The Court would reiterate its opinion that the phrase „in accordance with the law“ does not merely refer back to domestic law but also relates to the quality of the law, requiring it to be compatible with the rule of law, which is expressly mentioned in the preamble to the Convention. The phrase thus implies – and this follows from the object and purpose of Article 8 – that there must be a measure of legal protection in domestic law against arbitrary interferences by public authorities with the rights safeguarded by paragraph 1.

53. Therefore, the First Protocol Article 1 should also be interpreted so that the expression “conditions provided by law” requires a domestic law whose quality is compatible with the rule of law.
54. In the House of Lords it has been suggested by Lord Hoffmann in *R(Alconbury Ltd) v Environment Secretary* [2003] 2 AC 295 at paragraph 73 that Article 1 of the First Protocol implies the rule of law.

Other Convention Requirements

55. Both the traditions of the common law and the Convention, of course, require an independent and impartial tribunal, and an open hearing.
56. Article 6 also states in express terms:

Judgment shall be pronounced publicly...

³² [1979] ECHR 1, (no.6538/74).

³³ [1985] 7 EHRR 14 at para 67.

The current position at Strasbourg

57. In *Heather Moor and Edgecomb Limited v UK* in September 2010 the European Court of Human Rights called on the UK government to answer questions on whether the FOS complied with “the criteria of foreseeability and accessibility that are implicit in the rule of law”, whether the FOS decision should have been delivered publicly, and as to the absence of an oral hearing.
58. In summary, therefore, financial services professionals are now subject, in an unbalanced process, to unappealable decisions arrived at by the application of an opinion which does not have to comply with the general law, which has not been made by Parliament or any democratic body, and unpredictable policies. The process is secret; hearings non-existent; and challenge to evidence forbidden. There are doubts as to the independence of the tribunal. There is no public judgment.

PROPOSALS FOR REFORM

59. The criticisms which have been levelled above at FOS might be thought to point to the conclusion that a binding award of financial compensation against a financial professional ought to be made only by a court. However, there would be some disadvantages of such an arrangement. The great majority of claims are made by consumers against large financial corporations: the imbalance of resources is great. Court proceedings either place consumers at a disadvantage because they are unrepresented, or impose on them an undue financial cost in engaging legal representation. So there may seem to be a conundrum: an existing arrangement which denies the rule of law, or an alternative which unfairly handicaps consumer complaints.
60. We believe there is a possible resolution of that conundrum. In order to explain our proposal we first wish to draw attention to a rarely-observed feature of FOS and to an existing, successful dispute resolution process in another industry.

FOS’s 2-tier decision making process

61. FOS's decision-making staff occupy two levels: Ombudsmen and Adjudicators. The Ombudsmen, of whom it is understood that there are now 71, are of a higher status in the organisation than the Adjudicators.
62. Every complaint to FOS is initially considered by an Adjudicator, who writes a letter summarising the issues and setting out a proposed decision. This is sent to both parties. In the majority of cases the complaint goes no further: the Adjudicator's assessment is accepted by the parties. It is only if his assessment is not accepted by one or other party that a case proceeds to an Ombudsman.
63. If a case does proceed to an Ombudsman he first writes a Provisional Decision. This is sent to the parties for comment. After considering their comments, he then writes a Final Decision. FOS has been heard to claim that this 2-tier procedure amounts in a sense to an internal appeal. However, the Ombudsman stage is subject to all the same rule of law criticisms which we have made, just as much as the Adjudicator stage.
64. Therefore, in that minority of cases which have to proceed the full distance through FOS there are no fewer than three decision letters written. Such letters may be up to a dozen pages in length. In consequence of this drawn out procedure FOS can take a long time to reach its decisions. In the *Heather Moor & Edgcombe* case³⁴ heard in the Court of Appeal in 2008 the complaint was made to FOS by Mr Lodge, the customer, in November 2003, an adjudicator wrote an opinion in April 2004, an Ombudsman wrote a Provisional Decision in February 2006, and issued the Final Decision in November 2006. So in that case the entire FOS proceedings took exactly 3 years. This is hardly a satisfactory performance bearing in mind that s.225 of Financial Services and Markets Act speaks of,

... a scheme under which certain disputes may be resolved quickly and with minimum formality by an independent person
(emphasis supplied)

³⁴ *R (Heather Moor & Edgcomb Ltd) v Financial Ombudsman Service* [2008] Bus LR 1486

65. FOS's most recent annual report provides these figures on the number of cases dealt with at different levels:-

Total number of complaints	-	166,321
Complaints proceeding to an Ombudsman	-	10,730

66. In other words only 6.5% of cases proceeded to a final decision by an Ombudsman, the remainder being resolved consensually, presumably in most case by acceptance of the Adjudicator's non-binding recommendation.

Construction adjudication

67. In 1996 Parliament introduced a radical reform in the field of the construction industry. By the Housing Grants, Construction and Regeneration Act 1996 Part II it was enacted that, with limited exceptions, every construction contract had to provide the right for either party to refer a dispute to a procedure called "adjudication". The procedure has proved hugely popular throughout the construction and property industries.

68. Adjudication meant a decision by an independent person reached within 28 days. If a construction contract does not make such provision, then an adjudication scheme contained in a statutory instrument, known as The Scheme for Construction Contracts³⁵ is automatically imposed. In fact almost all construction projects are now let on contracts which contain express provision for adjudication. In consequence, by reason of the parties having contracted for it, adjudication now frequently applies even in the areas excluded from compulsory adjudication.

69. The decision of an adjudication has what has been paradoxically described as "temporary finality". It must be obeyed when it is made, but either party may later seek a definitive decision from a Court, or, if there is an arbitration agreement, from an arbitrator. Most decisions involve disputes whether sums of money are payable: so an adjudicator's order for the payment of money has to be complied with. The policy of the Technology and Construction Court

³⁵ 1998 SI no.649

has been vigorously to enforce adjudicator's awards by summary judgment, provided they address an issue within the adjudicator's jurisdiction and are made in accordance with natural justice. It is no defence to enforcement that the decision is wrong, either in fact or law – not even if such error is manifest and undisputed. The only significant exception to enforcement is where there are grounds to fear that, by reason of the weak financial position of the party to receive the payment, it may prove impractical to obtain repayment if it is later found in litigation or arbitration that the money was not, in fact, owed: in such cases the Court may require the sum in issue to be lodged in court if immediate, direct payment to the claimant is not to be enforced.

70. The dominating characteristic of adjudication is its speed. The fact that a decision has to be made within 28 days means that there is limited scope for parties to incur high legal costs in the prosecution of potentially complex disputes. There is no power for an adjudicator to make an inter partes costs order: so the fact that everybody will be bearing their own costs acts as another incentive to keep costs low, and in practice in a high proportion of cases parties to adjudications do not use lawyers. Another consequence of the speed is that the justice is rough and ready. In most adjudications there is no hearing at all; and the hearing of live evidence and cross-examination would be very unusual. How is it that a procedure which involves such imperfect justice is tolerated, and indeed so popular, with the construction and property industries? The answer lies in the availability of litigation or arbitration to rectify an adjudication decision if either side believes it to be wrong. That fallback makes it acceptable for adjudication decision-making to cut a large number of corners.
71. However, in practice it is rare for there to be litigation or arbitration on a matter which has been the subject of an adjudication decision. The fact that the adjudicator is genuinely independent, even if his decision is unwelcome, goes some way to leave parties feeling sufficiently content with an outcome not to want to go to the bother of further battle. There is also, perhaps, a psychological factor: after the cheque has been written out and posted off, it somehow fades from the active consciousness. And it may be, too, that

despite the speed, experienced adjudicators can quickly arrive at decisions which are close to those which would be arrived at by a far more prolonged examination. Whatever the explanation, the last decade's practical experience has been that over 99% of adjudication decisions are accepted by the parties without further challenge.

The essence of our proposal

72. The essence of our proposal is that FOS's decisions should have a standing similar to that of construction adjudications. That is to say, we propose that FOS decisions should have to be should complied with as soon as they are made, but we propose that both parties, and not just the customer, should have the right to a later consideration and binding decision by a tribunal operating consistently with the rule of law.
73. This would immediately allow FOS to simplify its own procedure. Since a firm against which an award was made could seek a fuller determination elsewhere, there would be no need for FOS to have more than a single tier and a single decision letter. This would allow considerable staff reductions: at present up to 71 members of staff in the most senior grades are occupied in the later stages of decision-making. We return later to how the costs saved could be redeployed to improve the entire process.
74. The big question, then, is: how should determinations consistent with the rule of law be made in those cases where a firm, against which FOS has made a decision, wishes to challenge it? For our part we would to couple that with an ancillary question: can we improve procedures for those customers who are disappointed by a FOS decision?
75. In the absence of any new procedures, such cases, whether pursued by the firm or the customer, would go to court. Court proceedings would remedy all the deficiencies in a FOS decision – the decision would be governed by English law, there would be the scope for live evidence and proper investigation of facts, and so on. But there would be some significant drawbacks for

consumers who were seeking to uphold a decision in their favour against a challenge by the firm:-

- (a) Some such cases would be likely to be found to be of some factual complexity, especially by a non-specialist tribunal.
- (b) Under the normal court regime the consumer would face a significant risk of an adverse costs order if the firm was successful.
- (c) Normal legal aid is today almost non-existent. So the consumer would either face potential heavy legal costs for his own representation, or would face a legally represented firm on an uneven playing field.

76. We propose that those problems be overcome by creating a jurisdiction in a new specialist tribunal. We propose a body with some similarities to the former Financial Services and Markets Tribunal³⁶, which established for itself a high reputation. We suggest that a new First Tier Tribunal chamber be created, possibly known as the Financial Services Complaints Chamber (“FSCC”).

Financial Services Complaints Chamber

77. The system would operate in a slightly different way, depending on whether a review of the FOS decision were being sought by the firm or the customer. In the case of a request by a firm:-

- (1) A precondition for a firm to be entitled to pursue a challenge to FSCC would be that within 28 days of the FOS decision the firm had either made payment to the customer or had lodged the amount of the award in court coupled with an application to FSCC for the funds to remain in court pending the outcome of the case.
- (2) The FSCC could have an unlimited jurisdiction. Thus supposing a firm lost a pension transfer case at FOS, and faced a maximum FOS award of £100,000, but the actual loss to the customer was £250,000, the FSCC, if it held in favour of the customer, could award the full £250,000.

³⁶ Created by Financial Services and Markets Act s.132

- (3) On such reviews the costs regime would be what is described in the Jackson Report as “one way costs shifting”: in other words, the customer would be entitled to an order for costs against the firm if the FOS award were upheld, but the firm would not be entitled to a costs order against the customer, irrespective of outcome, unless the customer’s conduct was vexatious, frivolous or unreasonable. In line with Jackson Report recommendations and the government’s inclinations expressed in a recent MoJ consultation paper there would be no recovery of success fees or insurance premiums³⁷.
- (4) A special legal aid fund would be established, funded by the savings which FOS would make from the simplification of its procedures. This is further discussed below.

78. We propose that FSCC have jurisdiction to handle two kinds of applications for review by customers. One would be where FOS had dismissed the complaint altogether. The other would be where FOS had upheld the complaint, but full compensation would be in a sum in excess of FOS’s jurisdiction limit, currently £100,000. In the case of a request for a review by the customer:-

- (1) There would be no costs shifting other than entitlement to recovery of the tribunal filing fee from the firm if the customer was successful, unless the firm’s conduct was found to be vexatious, frivolous or unreasonable. This would be in line with general practice in most tribunals
- (2) The legal aid scheme would be available only if there were sufficient funds available after handling the representation of customers opposing reviews sought by firms.

Hearings in the Financial Services Complaints Chamber

79. The Financial Services and Markets Tribunal offers a good model of flexibility: its Chairman decided the composition of tribunal which was suitable for each individual case. In some cases the Tribunal was composed

³⁷ Since there would be no adverse costs risk there would be no reason for any party to wish to have insurance.

simply of a lawyer member sitting alone. On other occasions the Tribunal was composed of a lawyer in the chair with one or two industry expert lay members.

80. The FSCC would similarly be a specialist tribunal. Depending on the nature of a case, its Chairman could direct a composition of up to 3 members. A 3 member tribunal could comprise a lawyer in the chair, a financial services industry expert member, and a lay person, representing the consumer interest. However, all members would, through training and familiarity with financial services gained by experience sitting, be able to deal with technical cases far more quickly than, say, a County Court District Judge drawn at random. Experience of specialist courts shows that they can handle complex cases surprisingly expeditiously, and without detriment to the quality of justice.
81. The FSCC would hold a hearing in every case, unless, unusually, both parties asked for a case to be disposed of on written submissions alone. Where matters of fact were in dispute witnesses would give evidence, and be tested by normal cross-examination. The FSCC would apply the law of England: we suggest below that Parliament should enact as reforms to English law those features of the FOS's "own law" which commend themselves to Parliament. The case would be by way of a full rehearing: it could not just be a review based on facts found by the lower decision-maker in which an appellant would have the burden of establishing that the lower decision-maker went wrong.

How many cases would reach the Tribunal?

82. Entitlement to the rule of law is absolute and unqualified. But in considering the practical implementation of its provision, thoughts naturally turn to how many cases the new review level of the system would have to cater for. We have already mentioned that some 10,000 cases per annum, or about 6.5% of the total, proceed from the Adjudicator stage to the Ombudsman stage at FOS. Since approximately half of all complaints to FOS are upheld, it may be reasonable to infer to each year about 5,000 Adjudicator recommendations are challenged by firms. All that is needed for a case to progress in that way is for

either the firm or the consumer to express unhappiness – or, perhaps, simply to refrain from expressing satisfaction – with the Adjudicator’s recommendation.

83. By contrast, there would be many reasons why a firm might choose not to seek a review from the FSCC. In the first place the firm would be required to have made the payment ordered by FOS. We have suggest that this be a precondition to access to the FSCC.
84. Secondly, the firm would need to prepare a full Originating Application setting out the grounds of challenge. The task of drafting this would itself operate as a disincentive to challenges unless the firm felt genuinely aggrieved by the FOS decision. There would also be a further filing fee to be paid. This might be set at, say, £1,000 or £1,500. Since we are advocating one-way costs shifting, the firm would be unable to recover this cost from the other side, even if the firm were successful.
85. Finally, in cases where the quantum exceeded £100,000 the firm would face the risk that if it initiated a review at the FSCC, it would end up having to pay a larger sum in compensation than FOS had ordered.
86. Bearing those factors in mind, together with the behavioural experience of construction adjudication, it seems likely that only a small proportion of the cases currently taken by firms to the FOS Ombudsman would be taken to the FSCC. A reasonable estimate might be 250 to 500 cases per annum. That would be a sufficient number to keep a specialist Tribunal Chamber occupied, but not so many as make much dent in the overall picture of speedy and simple consumer redress; and certainly not so many as to overwhelm any system.
87. If, as we suggest, the jurisdiction of the FSCC were to be extended to consumers who wished to pursue a challenge after rejection by FOS, this would add a few hundred more cases per annum. At present one hardly ever hears of such cases being pursued, so the availability of such route would be almost pure gain for consumers. The fact of having to pay a filing fee would

again tend to mean that only customers with a strong sense of dissatisfaction with FOS's decision would be likely to wish to avail themselves of the opportunity to go to the FSCC.

88. A further increase in the workload of the tribunal would be occasioned if the jurisdiction of FSCC were also to cover claims by consumers who had been successful at FOS and for whom the quantum of their claim was in excess of the FOS ceiling. This is another type of case which could in theory be brought in the courts today, but of which one scarcely ever hears actually being brought. So again to the extent that there were such cases it would be pure gain for the consumer interest.

What would happen to FOS's "own law"?

89. A consequence of our proposals is that in cases where FOS makes an award on facts which would not justify an award under English law there is likely to be a successful application by the firm for a review. That in turn is likely to lead to FOS ceasing to make awards contrary to English law. That may be considered to leave a problem in those areas where FOS has developed reasonably well understood approaches of its own which are at variance with English law, but are broadly welcomed as an improvement on English law. A notable example may be in some aspects of insurance law.
90. Our proposal is simple. All aspects of FOS's "own law" which commend themselves to Parliament should be codified and enacted as reforms to English substantive law in the same statute as enacts the other reforms of financial services regulation and the changes to FOS and consumer remedies which we are proposing.
91. A related consequence would concern limitation. Since the FSCC would apply the law of England, limitation defences would be available. We suggest that it be enacted that time cease to run in favour of a firm as soon as a complaint is filed at FOS. Parliament could make a greater inroad into the normal law of limitation if it chose, although one might hope that any such reform would be considered in the context of the Law Commission's proposed

reform of limitation. The last government came close to publishing a draft Bill in the 2009-2010 session of Parliament.

Funding for representation for consumers

92. Customers seeking to uphold a FOS decision would face no risk of an adverse costs order. But in order to persuade the FSCC in their favour consumers would naturally wish to match legal representation employed by a firm.
93. There is no reason why the Legal Services Commission or its successor should not fund claims at FSCC, but in practice we doubt if this would happen.
94. There would seem every scope for a customer to secure funding on a full or partial Conditional Fee Agreement or from a commercial or not for profit body offering contingent funding. Bearing in mind that the customer would already have been successful at FOS, it might be thought that the prospects of success for the customer would normally be good enough to attract such funding. This type of funding may be particularly suitable for those high value claims of consumers who have already been successful at FOS and who are applying to the FSCC in order to recover quantum in excess of the FOS limit. Since there would be costs recovery from the firm if the customer won the case, the only outlay by a customer would be the payment, whether calculated on a percentage or other basis, out of the winnings recovered from the firm. That outlay might, however, be regarded in many cases as too high a price to pay.
95. Accordingly, we propose the establishment of a legal aid scheme to be wholly funded by the financial services industry. We emphasise that the legal aid scheme we are here advocating would involve no cost to public funds, would seek no money from government, and would wholly unconnected with the Legal Services Commission and the Ministry of Justice.
96. Funds for this scheme could come from the savings which FOS will make by dismantling its second tier of decision making. There are at present understood to be 71 high status staff at FOS dealing with such work. In

addition to the staff costs of the 2nd stage decision makers, there will also be the costs for ancillary and clerical support, office space and so on. FOS's total staff costs are of the order of £47 million per annum for a total staff of about 1,000 persons. Since the staff handling the 2nd stage processes must be the most highly paid, it seems a reasonable assumption that there could be savings of about £5 million in staff costs and of, perhaps, £8 million overall by the elimination of the FOS 2nd stage process. In addition we observe that in both the last two years FOS has achieved a surplus of £8million. Effectively the whole of FOS's funding comes from the industry, since it charges no fees to complainants.

97. Therefore, it would seem entirely feasible to suggest that funds of about £12 million per annum could be made available through FOS for the industry legal aid scheme.
98. The funding by this legal aid scheme would in our proposal be directed primarily to customers who had been successful at FOS, and whose cases were being brought to the FSCC by the firm. Unless the quality of FOS's decision making is particularly poor – which we do not suggest – one would expect the FOS decision to be upheld in more cases than it is not. That would be consistent with the general experience of civil appeals. Therefore, we would anticipate that the firm would succeed in its review of a FOS decision in only about one third of cases. Since the firm will have to pay the customer's costs in cases won by the customer, this means that the legal aid scheme will end up footing the bill for the customer's legal costs in only about one third of the cases.
99. If our suggestion of a maximum of 500 applications per annum by firms to FSCC were correct, that would mean that the legal aid scheme would end up paying costs in only, say, 170 cases per annum. An annual fund of the order we have suggested above would be enough to fund each such case up to £70,000. Bearing in mind that we are envisaging a specialist tribunal, with the concomitant efficiencies of procedure, that would seem a reasonable budget for the average case.

100. Therefore, whilst the figures which we have mentioned are only very approximate, perhaps only illustrative, we believe that they are sufficient to demonstrate the feasibility of an industry-funded legal aid scheme.
101. The grant of legal aid by this scheme would, of course, as is the case with legal aid from the Legal Services Commission, be discretionary. It would be subject to a merits test. There could also be a means test, although we would wish to see all consumers other than the very wealthy within its potential scope. We see no reason why some financial contributions should not be sought from those who receive such legal aid: this avoids the litigant lethargy which can afflict those who receive “something for nothing”, and would be in line with the government’s ideas in the current Ministry of Justice consultation on legal aid.
102. In order to guarantee both the independence and the expert guidance of this fund, we suggest that it be controlled by a board made up of representatives drawn, one quarter in each case, from the following four directions: the Bar Council, the Law Society, the Financial Services Authority (or its successor) and financial services industry trade representative bodies (such as the Association of Independent Financial Advisers).



The Actuarial Profession

making financial sense of the future

Consultation response

HM Treasury

A new approach to financial regulation: building a stronger system

April 2011

About the Actuarial Profession

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Financial Regulation Strategy
HM Treasury
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14 April 2011

Email: financial.reform@hmtreasury.gsi.gov.uk

Dear Sirs

A NEW APPROACH TO FINANCIAL REGULATION: BUILDING A STRONGER SYSTEM

I am writing on behalf of the Actuarial Profession in response to HM Treasury's consultation entitled 'A new approach to financial regulation: building a stronger system'. The Actuarial Profession represents the members of the Institute and Faculty of Actuaries, the UK based chartered professional body for actuaries. Actuaries work in insurance, pensions, healthcare, investment and banking as well as in the management of risk, and so are directly involved in many of the areas covered by the proposed regulatory structure and, of course, as a profession actuaries are themselves overseen by the Financial Reporting Council.

The Actuarial Profession welcomes the overall proposals, and looks forward to working with the relevant authorities in implementing them with regard to the explicit duties and accountabilities of actuaries. In our response to this consultation we have restricted our comments to the section on Actuaries and Auditors (5.92-5.95) in the document.

Our understanding is that the proposals are intended to transfer to the new regulatory authorities the existing powers vested in favour of the FSA, as set out in section 345 of the Financial Services and Markets Act 2000 (FSMA), which allow the FSA to disqualify actuaries from acting on behalf of an authorised person or any particular class of authorised person. However we also note that it is proposed to strengthen the existing powers by giving the new regulatory authorities power to disqualify any individual professional they deem to have failed to comply with the duties under FSMA, irrespective of whether they were appointed as an individual or were representing their firm.

We do have a concern that the process set out in section 5.95 to disqualify actuaries, as drafted, is so wide in its scope. We believe this revised power should be framed, and exercised, proportionately and preferably in a way that reinforces the Actuarial Profession's own disciplinary arrangements. In fairness to the individuals who might be affected, it is also important that any process to enforce this extended power should follow the principles of natural justice.

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Financial Regulation Strategy
HM Treasury

14 April 2011

As you will be aware the Actuarial Profession has its own disciplinary scheme, and is included within the remit of the Accounting and Actuarial Discipline Board, part of the FRC. There may be circumstances where referral to our disciplinary scheme, or the AADB Scheme, may be a more proportionate and appropriate response. For example, where an actuary performs a statutory duty, we require them to obtain a Practising Certificate, a process which requires annual renewal. A possible outcome of our disciplinary process is a withdrawal of an actuary's certificate to perform regulated tasks.

It should also be noted that in the proposed Solvency II regulatory regime for insurers the performing of regulated actuarial activity is not restricted to members of a recognised actuarial profession. We believe that there are merits in ensuring that any regulation or power pertaining to disqualifying actuaries from acting on behalf of an authorised person should also apply to others, who are not members of an actuarial body, acting in the same fashion.

It will be important for the Profession to establish good working relationships with the new authorities, and a framework in which we can work closely together towards achieving effective and proportionate regulation of actuaries. We stand ready to work with the new authorities to that end.

We hope you find our comments helpful. We would be very happy to discuss these points further with you and the regulatory authorities so that we can together ensure that the new provisions are appropriately framed and that, in the way they are operated, they dovetail effectively with the Profession's own disciplinary machinery.

Yours faithfully



Derek Cribb
Acting Chief Executive

A new approach to financial regulation: AEGON's response to the consultation



General remarks

We welcome the opportunity to contribute to the important debate about the future shape of financial regulation in the UK. What matters to us is that we are able to give the best possible service to our customers and to build our business on that basis. Regulation is an important driver of that. We look for a regulatory framework which will:

- secure a framework for effective competition;
- protect consumers and engender trust and confidence in financial services; and
- ensure that the UK remains internationally competitive.

In addition to our responses to individual questions below, AEGON has a number of general points to make about the future regulatory system:

1. We are pleased that the UK regulatory authorities will continue to take a leadership role in EU and international reforms, complementing change within the UK framework. We believe this role would be enhanced by giving the PRA and FCA a formal obligation to communicate European and international developments, and to engage with the industry and consumer groups at an early stage in establishing the potential implications of these developments. This would help the financial services industry to plan better for future changes, and give confidence that European and international issues are being incorporated into UK regulatory strategy.
2. We have concerns that the regulatory position of groups including different types of organisation (in AEGON's case, a large insurance company with adviser distribution firms) is not clear. Under the Government's proposals, the group, as a systemically significant firm, would be dual regulated, by the PRA for prudential issues, and by the FCA for conduct of business issues. In the case of authorisation, the proposals suggest the PRA will take a 'whole firm' approach to considering applications, and only approve those applications where it is comfortable the firm will be prudently managed with a viable business model in relation to all its activities. This suggests that the adviser firms will be subject to dual regulation by both the PRA and the FCA, whereas competitors which are not part of a wider group will be regulated only by the FCA. If this is to be the case, processes must be clear for authorisation and supervision if a level playing field is to be maintained and any additional regulatory burden is not to be caused to firms operating within a group.
3. We would highlight the differences in risk profiles for insurers and banks, including the differences in liquidity risk, and the fact that the failure of an insurance company is unlikely to cause systemic failure. In particular, we draw attention to the work already being done under Solvency II to improve capital adequacy in the insurance sector.

Answers to Questions

We have not attempted to answer all the questions in the consultation. We have confined ourselves to the general remarks above and to those issues where we feel we have the strongest business interest and/or something important or distinctive to contribute.

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)?

We are supportive of these mechanisms, and would particularly agree with the proposals to require the PRA to include short statements of purpose in relation to the rules it makes to allow regulated firms to understand the rationale behind the rules and the desired outcome. Indeed, we would encourage such an approach throughout the wider regulatory environment, including the work of the FCA.

We believe that existing authorisation procedures are broadly fit for purpose and would be concerned if having two regulators led to two sets of processes. Additionally, the regulators themselves should have an obligation to ensure that they have communicated the new processes to relevant firms, and that firms are not required to second guess what they are required to do and to whom they report.

Anything which adds to the timescales for rule-making, authorisation and enforcement would be unwelcome, as it would add to uncertainty in the operating environment.

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

We are happy with these proposals, in particular the requirement for the PRA to run an annual consultation process. We would welcome further information on what this process might involve, and in particular what types of changes might be foreseen as a result of such consultations.

We agree that there should be no significant reductions to the existing requirements to consult set out in FSMA. We have concerns, however, about the suggestion that the requirement to consult might be 'streamlined' when implementing EU rules. It's far from the case that European regulation can simply be translated directly into UK rules. The transposition of the IORP (Institutions for Occupational Retirement Provision) and Gender Directives, for example, were particularly complex due to differences in common definitions. Even at high level there can be a lack of common ground which can lead to difficulties in transposition. Consultation is necessary and desirable to meet the objectives of the legislation, reduce the potential need for EU enforcement action, and minimise any downside to the industry and to consumers.

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

The consultation stresses that “the FCA will be an entirely impartial regulator from which both firms and consumers can expect fair treatment”. We welcome the clarification and explanation of the term ‘consumer champion’. In particular, we welcome the recognition of the importance of proportionality in the FCA’s approach, as well as the need to consider sector specificity. We nonetheless consider the continued use of the term unhelpful and would urge the Government not to include it in the statutory remit of the new body, or in any associated regulations or guidance.

We would encourage the inclusion of specific objectives both for the PRA and the FCA to engage with the UK industry and consumer groups on the form and impact of EU and international regulatory change. The regulators are often best placed to advise on this, and a process of communication would help to reduce uncertainty on the impact of non-UK issues.

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

We look forward to seeing the details of the FCA’s operating model. Our principal reservation would be that the FCA will itself be responsible for ensuring that the coordination of prudential and conduct regulation is effective for the firms it solely regulates. In order to ensure that, as far as possible, there is consistency of approach, this would benefit from some degree of external monitoring and coordination with the PRA.

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

It is right to give consideration to measures which may improve the operation of the financial services industry to reduce the risk and occurrence of consumer detriment. This is key to rebuilding consumer confidence against a backdrop where poor practice by the minority can create widespread mistrust. Regulatory intervention has a key role to play in this.

Interventions such as pre-approval of products could in certain circumstances be beneficial. While comprehensive pre-approval would be, in our view, neither practical nor desirable, providers are already required to obtain pre-approval of certain products from HMRC and the Government’s ‘Simple Financial Products’ initiative could also result in some form of requirement for pre-approval. Further pre-approval might be appropriate for certain product types regarded as creating heightened conduct risk, or for firms regarded as doing so.

Much depends, however, on when and how this power might be used in practice. The consultation states that the Government will “legislate to require the FCA to publish and consult on a set of principles governing the circumstances under which it will use this

new product intervention power". This aspect of the Government's approach needs to be viewed alongside the FSA's parallel consultation on product intervention,¹ to which we will be responding separately.

We welcome the Government's commitment to ensuring that the new power is used proportionately. It would clearly be inappropriate for the new power to be wielded symbolically if this did not meet the key test of advancing consumers' interests. It would also be unhelpful if the power were over-used to the extent that responsibility for compliance were seen to shift from firms' senior management to the regulator.

We believe the FCA could achieve many of the intentions behind the new power, by extending the concept of the Retail Conduct Risk Outlook (RCRO). We very much support the RCRO as a powerful method for the regulator to explain its current and possible future concerns to the industry, in such a way that the industry is then able to address these voluntarily and engage with the regulator in a constructive manner. Such positive engagement could obviate further regulatory intervention and open channels for improved dialogue between regulators and practitioners in addressing wider concerns.

One possible way of extending the RCRO concept would be to move from its current yearly report to a more dynamic communications medium, with a specific consultation element.

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.**

The consultation promotes the idea of a credible deterrence strategy and "a willingness to impose high fines, in order to encourage better conduct across the industry". We would be interested in seeing any evidence the Government (or indeed the FSA) has regarding the efficacy of such a strategy in terms of promoting better behaviour. The perceived benefits of such an approach need to be evidenced and carefully weighed up against potential downsides. The prospect of incurring large fines may well serve to concentrate the minds of shareholders and senior executives in the short run but if this leads to excessive risk aversion there is the potential for consumer detriment in the medium to long term. If it becomes more difficult to attract investment, this could result in less choice and competition in the market and ultimately to higher prices for consumers.

Similarly we are not convinced that the early publication of warning notices will have the desired effect, but may instead stifle innovation and cause unnecessary damage to confidence in individual firms and the industry. The FCA should seek to identify

¹ [DP11/1: Product Intervention \(FSA, January 2011\)](#)

consumer detriment, but its focus should be on ensuring any underlying problems are fixed quickly, rather than on penalising firms *per se*.

If the FCA is to publish the fact that it has required firms to withdraw a financial promotion, and after representations from the firm reverses this decision, this reversal should also be published, preferably in the same medium and format as the original announcement.

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

We support the publication of a Memorandum of Understanding (MoU) setting out the coordination of the work of the PRA and FCA, in particular:

- detail of processes and regulatory decisions relating to dual-regulated firms and groups, with particular emphasis on coordination, reducing extra regulatory burdens, and, where there is no objective reason for a different approach being taken, ensuring regulatory consistency with firms regulated only by the FCA.
- details of how the regulators will coordinate their engagement with international and European regulatory bodies. In particular the MoU should outline processes for representing UK conduct of business issues to the EBA and EIOPA, where the PRA is the representative, and prudential issues to ESMA, where the FCA is the representative.

If the MoU is to be reviewed annually, it should be clear what changes could be expected as a result of this review and what the process is for input to it. We would like the legislation to specify that the regulators must conduct a joint consultation on the form and content of the initial MoU and on subsequent reviews.

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 with this, and would encourage discussion of whether this is the only power of veto required. Nonetheless, we would hope that such a veto would exist for the most part with the intention that it not be used and we support the use of confidentiality restrictions: clearly the fact of such a veto being deemed necessary could in itself trigger potentially destabilising behaviour on the part of consumers and/or the financial markets.

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

We would prefer to avoid firms having to deal with information requests from two different regulators. The FSA currently has a turnaround time of six months for Part IV approvals, and the process can be quite challenging. Ideally we would like to see this

process simplified, but in the case of both options, there is a risk of an extra layer of complexity being built in to the process.

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 believe existing FSA moves to plug this regulatory gap, by including directors of unregulated parent entities in the Approved Person regime, should be sufficient to address this issue.

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

We strongly support the Government's desire to see the UK continue to play a lead role in the development and implementation of international financial regulation. The consultation powerfully states the case for the UK regulatory authorities to pursue a "single, coherent and consistent overall strategy" towards this end. It is important to ensure that the interests of the UK industry and consumers are effectively represented at EU and global level.

In line with the first of our general remarks, we believe the UK regulators should also take on greater responsibility for communicating international (and especially EU) regulatory developments to the UK industry and, where appropriate, to consumer groups. Having early sight of where international regulatory requirements are headed will enable individual businesses to prepare better for eventual implementation and will also enable them to give UK regulators the feedback and evidence they need to support their contributions and ensure that the UK's interests are accurately represented in discussions and negotiations with other regulators in Europe and beyond.

Age UK is the new force combining

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Concern



Consultation response

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

14 April 2011

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This consultation paper is Her Majesty's Treasury's (HMT) second paper consulting on the Government's plans for reforming the UK's system of financial regulation. The Government's reforms focus on three key institutional changes: (i) a new Financial Policy Committee (FPC) will be established in the Bank of England, with responsibility for 'macro-prudential' regulation, or regulation of stability and resilience of the financial system as a whole; (ii) 'micro-prudential' regulation financial institutions that manage significant risks on their balance sheets will be carried out by an operationally independent subsidiary of the Bank of England, the Prudential Regulation Authority (PRA); and (iii) responsibility for conduct of business regulation will be transferred to a new specialist regulator, the Financial Conduct Authority (FCA), with responsibility for conduct issues across the entire spectrum of financial services. This second consultation document contains the Government thinking informed by responses to the first consultation and has more detail on the new regulators.

The consultation refers to other current key reports and consultations, including the Treasury Select Committee's report on UK financial regulation, published 3 February 2011, the anticipated interim from of the Independent Banking Commission and the Financial Services Authority's discussion paper on product intervention.

The consultation seeks responses on HMT's more detailed plans for each regulator, and especially on coordination between the three bodies.

Key points and recommendations

- In general we welcome the direction HMT has taken in this consultation document.
- More work is needed to ensure the FPC does not monopolise the regulatory agenda.
- The FPC would benefit from strong oversight from both HMT and the Treasury Select Committee, it should also take advice from statutory panels.
- The PRA must be responsible for minimising consumer detriment caused by exercise of its veto powers over FCA decisions. The PRA should work to ensure that firms and the market are sufficiently robust that they can withstand enforcement and reasonable rule changes from the FCA.
- Because of its impact on consumer outcomes, the PRA should also take advice from statutory panels.
- Competition is a tool, not a good in itself, use of competition must always be linked to positive consumer outcomes.
- We strongly support the more interventionist approach proposed for the FCA and the new powers suggested in this paper. In order to be effective the FCA must be able to exercise these powers without undue fetters.
- We welcome the proposals in relation to FOS and the Money Advice Service. All regulators should consider the market intelligence provided by these organisations.

1. Introduction

Age UK appreciates the efforts made by HMT to engage constructively with stakeholders, especially in providing opportunities for industry and consumer groups to share views with each other and HMT. We broadly support the direction taken in this consultation, especially the emphasis on transparency at all levels, the enhanced product intervention powers and the emphasis on outcomes for consumers. We have two main concerns (i) that consumer interests will be subjugated to market stability, rather than recognised as a pre-requisite for stability; and (ii) that the excellent intentions for a more proactive conduct regulator are rendered ineffective by checks and balances.

2. Potential macro-prudential tools, membership and governance of the FPC

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

We appreciate HMT's efforts to maintain the primacy of the PRA and FCA to the maximum extent possible, however we have a number of concerns about the impact

of the FPC's direction making powers on the independence and autonomy of other regulators. Firstly, we are concerned that because of the ultimate authority of the FPC it could in practice set the regulatory agenda. Depending on the time and resource required to consider and implement FPC powers of recommendation and direction the PRA and FCA could have limited scope to pursue their own objectives. The FPC can also require the FCA to gather information, subject only to an assessment of the burden on firms.

Secondly, we agree with HMT that the concentrated nature of the UK financial services sector means that the behaviour of a small number of large institutions – perhaps only one or two – could pose a systemic risk. In reality the line between firm specific regulation and systemic risk measures will sometimes be blurred. If the FPC gives a direction which affects two firms, it is academic to say that the FCA must take all firm specific decisions and it should be recognised that the FPC authority is effectively overlapping with that of the FCA. Thirdly, we note that the FPC's regulatory tools will have an impact on consumers, some (e.g. loan to value limits) very directly.

Given the inter-relatedness of the regulators and the fact that FPC decisions will inevitably impact the way in which the other regulators can pursue their own objectives, we regret the Government's decision to allow the FPC to act without having regard to the objectives of the PRA and FCA. In particular we see nothing which would allow the FPC to take account of the impact on consumers. The addition of the balancing objective stating that *'this does not require or authorise the Committee to exercise its functions in a way that would be likely to have a significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy in the medium or long term'* could be read to focus on the health of firms, rather than how well the market meets the needs of consumers.

Although much of the debate is focused around the FPC's impact on the FCA, the importance of good information flow from the FCA should also be incorporated into the system. We welcome the Government's statement that it will put mechanisms in place to ensure a cooperative exchange of information between the Bank and the FCA. The FCA should be required to provide information on risks it has identified. For example, unsustainable sub-prime lending might come to the FCA's attention as it supervises conduct in the sales process and if this is on sufficient scale it could indicate a systemic risk. The FPC should be required to consider information provided by the FCA and, if it decides that it is not necessary to act on FCA concerns the FPC should provide an explanation of its decision in its Financial Stability Reports.

If the Government is not minded to specify a requirement of this type in primary legislation, it could specify it in the proposed remit letter from the Treasury to the FPC and encourage the regulators to use Memoranda of Understanding to achieve similar results.

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

We strongly welcome the Government's emphasis on the need for transparency and accountability of the FPC, especially the requirement that, although the FCP may sometimes need to withhold information for a time, it will seek to publish it at the earliest opportunity.

We note that in the relationships between the regulators, the duties are generally from the PRA and FCA towards the FPC, with few, if any, reciprocal duties. Even if each individual duty is appropriate, it risks forming a culture in which the FPC 'trumps' the other regulators and sets the regulatory agenda. This should be closely monitored by the Treasury and the Treasury Select Committee. In order to be successful each of the regulators must be strong and able to focus on their objectives. The FPC must therefore be diligent in creating a culture in which it promotes the effective functioning of the other regulators and engages in meaningful dialogue with them.

There must be sufficient non-executives from diverse backgrounds to ensure that consumer voices are heard.

The FPC Board could benefit from the expertise of the Consumer and other statutory Panels. These Panels are a useful source of information and can provide inputs from a wider range of experts than can be appointed to the Board. A requirement for the FPC to have regard to advice from the panels should be included in the MoU between the FCA, FPC and PRA.

The FCA is required to report whenever there has been a regulatory failure in its sphere, similar requirements should apply to the other regulators. To the extent that information is too sensitive for publication, it can be reported in confidence to the Treasury and publicised as soon as possible thereafter. The proposals for accountability focus on accountability for directions. We look forward to further detail on ensuring accountability for other aspects of the FPC's function: e.g. for a failure to make directions when required, inappropriate analysis, or lack of cooperation with the other regulators.

4. Prudential Regulation Authority (PRA)

Q5: What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the PRA?

- (i) We strongly agree with the Government's view that the PRA will not be judged to have failed if a firm it regulates fails.

We note that there has been considerable debate about the desirability of including a competition objective. We welcome the debate, but if such an objective is included, it is essential that it is balanced by a requirement to ensure that competition works effectively for all consumers, including disadvantaged consumers, rather than just those consumers with the highest levels of income, education and access to information.

We are not convinced that a general duty to consult and to coordinate will deliver the effect intended by the Government, in particular in a structure in which the PRA can veto FCA decisions. In the absence of a 'have regards to' type requirement, the duty to consult should be framed to ensure that it is

more than a 'ask and ignore' procedure. This is especially important given the proposed power for the PRA to veto FCA conduct decisions. The decision to use the veto power will most likely indicate a breakdown in collaborative working, at which point the PRA should have a clear duty to have regards to the FCA's objectives.

(ii) Our response on the regulatory principles is included in our answer to Q11.

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)?

We welcome this approach. If regulation is to be effective, the regulator must have room to act. In the past, FSA powers have been made impractical by restrictions and arguments over interpretations of rules. We understand that firms need certainty and that regulation should not unduly restrict innovation which improves consumer outcomes, however we need to find a new balance between freedom of firms and sound market regulation. It is essential that, as the Government develops its more detailed plans, it does not allow regulatory judgement to be fettered by giving firms excessive or lengthy powers of appeal.

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

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

Although we welcome the confirmation that the PRA will have a majority of non-executive directors we remain concerned about the level of influence held by the FPC and the Bank. The fact that the PRA cannot delegate its functions is important, however the extent to which the FPC and the Bank determine culture and priorities will have more impact on how the PRA operates. Respect for the distinct objectives and functions of both the PRA and FCA must therefore be hardwired into the FPC.

Again, we support an extension of the role of the statutory consumer and other panels currently proposed for the FCA to advise the PRA.

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

The PRA will need enhanced mechanisms for engagement with both industry and consumers, especially in light of the proposed veto powers. This would be helped by an extension of the statutory panels currently proposed for the FCA to advise the PRA.

We support the plans to continue with the consultative approach to rule making. The PRA should take account of potential consumer benefit and detriment, as well as costs on industry and benefits to stability when it conducts cost benefit analysis.

5. Financial Conduct Authority (FCA)

Q11: 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 agree with much of the analysis set out in the introduction to section 4 of the consultation, notably the Government's vision of 'putting appropriate consumer outcomes at the centre of the regulatory process, however we are not convinced that the wording of the objectives currently achieves this.

The strategic objective and the facilitation of efficiency and choice in the market should all refer back to positive consumer outcomes. We understand that this is consistent with the Government's current vision as set out in the detail of the consultation; however it should be clear from the face of the objectives.

The concepts of competition and choice can be interpreted in a variety of ways. Choice does not always benefit consumers. We support the inclusion of competition powers which allow the FCA to promote competition which improves outcomes for consumers, however we are concerned that the current wording could be interpreted to make competition an objective in itself, rather than a tool which should be used to make the market work for consumers. Competition should always be linked to consumer outcomes..

We would prefer explicit recognition that financial inclusion is within the mandate of the FCA. We agree with the Government that financial inclusion is a matter of social policy and as such the agenda should be set by Government. However we also see this as a question of growing rather than diminishing importance. Although the Financial Inclusion Task Force has made great strides in reducing the number of people living in a home without a bank account, more and more people are being effectively excluded because increased automation and changes in the way banking services are delivered do not work for them.

- (ii) Regulatory Principles: We welcome the Government's recognition that consumers are often at a relative disadvantage when engaging with financial services. Consumers' ability to take responsibility for their actions will be affected significantly by the both the consumer's personal circumstances and experience and perhaps more decisively by the structure of products and the way in which firms communicate with consumers. With only ten per cent of customers considering switching current accounts in a 12 month period¹ we are a long way from having the kind of consumer demand that can exercise more a market discipline which is more powerful than regulatory action. The principle of consumer responsibility should recognise the limitations on even relatively capable consumers in making good decisions. If the principle is drafted in such a way that it is more extensive than s5 FSMA then corresponding additional responsibilities on firms should be added.

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

We support both the confirmation that the Consumer Panel will be established and the requirement that the FCA will be required to report on regulatory failures. Both Treasury and BIS should consider consumer protection expertise, as well as experience in the financial services sector when appointing directors of the FCA. The

FCA and the Panel must also have the resources and mandate to commission regular research on the customer experience.

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

We strongly support the new approach to conduct regulation and the new product intervention powers. The light touch approach has not worked for consumers or the market, which has been damaged by major examples of consumer detriment, as seen in the current PPI issues. Our key concern is that these powers remain effective and that the FCA is not so fettered that it cannot take action in practice. We recognise that firms need certainty and the space to innovate to create benefits for consumers, however these new product intervention powers will not have the impact intended by Government unless the FCA is able to use them. Enforcement must also be meaningful and the FCA should be prepared and able to use the s.404 powers.

We will be submitting more detailed comments on these issues in our response to the FSA's Discussion Paper on Product Intervention.

Q14: The Government would welcome specific comments on:

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

We are pleased that the Government intends to make this tool available, however are concerned that the FCA will be hampered by s. 348 and that consequently this will be no improvement on the current situation unless amendments are made.

- **The proposed new power in relation to financial promotions;**

We strongly support the new power in relation to financial promotions. If consumers are to feel empowered and have confidence that the market is being well regulated it is important that they can see the FCA taking action.

- **The proposed new power in relation to warning notices.**

We support the provision of this power,

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

We support the availability of market investigation reference powers to the FCA and allowing the Consumer Panel to make super-complaints. However the power to make super-complaints should be available to a range of representative groups. These are not equivalent powers. The FCA is uniquely placed to assess whether a review is needed and should have the power to refer. We therefore also support the FCA receiving concurrent competition powers, – the possibility of a concurrent review could incentivise firms to act quickly, and in practice there is little danger of excessive regulation as regulators will have no incentive to over-act or duplicate.

6. Regulatory processes and coordination

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

Our primary concern in this area is that in the event of a difference of opinion between the regulators the currently proposals effectively give control to the PRA.

Unless this is balanced elsewhere, this is likely to negatively impact on effective coordination between the PRA and FCA. We would therefore support a measure of external reports and checks on how well coordination between the regulators is functioning.

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 instability?

Use of a PRA veto will prevent the FCA from taking actions which it has determined necessary to protect consumers and is therefore likely to cause consumer detriment. The PRA should be required to take this into account when exercising the veto.

If the PRA needs to use the veto it may be an indication that the PRA has failed to ensure that firms can fail safely. We therefore support the requirements that the PRA report on the use of veto. If the notification is confidential, there should be mechanisms for the PRA to report confidentially to the Treasury and for that report to be made public as soon as possible thereafter. The report should be made immediately after the exercise of the power, not only in the annual report of the PRA.

If the veto is proposed due to wider market stability issues, the FCP should be involved.

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

We are concerned about the proposal that the PRA could veto rules proposed by the FCA. Safeguards at least equivalent to those in place for the veto of firm-specific decisions should be in place.

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

We have the same concerns over the PRA ability to veto FCA decisions regarding insolvency as with other firm specific decisions and rule making.

7. Compensation, dispute resolution and financial education

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

We support the proposals relating to FOS, and welcome the Government's recognition of the vital work FOS undertakes and its role in consumer protection. We particularly support the proposals to give FOS discretion to publish its determinations. This will help consumers, consumer groups and firms to resolve complaints more quickly.

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

We broadly support the proposed arrangements. As noted in the consultation, both the Money Advice Service and FOS will acquire information which will provide the FCA and potentially also the PRA and FCP with vital market intelligence. The FCA should be expected to request input from the Money Advice Service and FOS on a

regular basis. The Memoranda of Understanding could include procedures by which the Money Advice Service and FOS can require responses from the FCA on issues which they believe constitute key emerging risks. We strongly support both the Money Advice Service and FOS remaining truly independent bodies. In particular given the knowledge that the Money Advice Service will acquire through its work with consumers, it should be expected to engage fully in relevant policy debates and should be free to challenge the regulators where appropriate.

8. European and International Issues?

Q32: What are your views on the proposed arrangements for international coordination outlined above?

We support these arrangements, given the increasing importance of European and International decisions, it is important that appropriate resource is available from all regulators. In particular we recommend that the UK should engage fully in consumer protection issues at international levels.

ⁱ Review of barriers to entry, expansion and exit in retail Banking (OFT1282)www.offt.gov.uk/shared_offt/personal-current-accounts/oft1282

Andrew Torrance

Chief Executive

Financial Regulation Strategy
HM Treasury
1 Horse Guards Road
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15 April 2011

Dear Sir/Madam

HM Treasury Paper 2011 – A New Approach to Financial Regulation

Allianz Insurance fully supports the ABI's response to this consultation paper and believes that the proposals are a material improvement on those in the initial consultation paper published in 2010. However we would also like to take the opportunity to emphasise our concerns which remain in relation to a number of specific aspects.

1. Dual regulation – we recognise that the proposed reforms are intended to lead to an improved regulatory structure. However in order for this structure to be effective it must deliver effective operational co-ordination if it is to avoid causing unnecessary duplication and cost for firms. We echo ABI's view that close co-ordination between the authorities must be delivered at all working levels.
2. Proposed new power in relation to warning notices – we welcome the Government's acknowledgement that such adverse publicity could cause serious reputational damage for firms and that the regulator, whether PRA or FCA, would be expected to consider the reputational impact on a firm before public disclosure. Nevertheless, as ABI points out there are a number of further possible impacts both for firms and the regulator and we remain uncomfortable about this proposal. As a minimum the regulators should be required to publish guidance regarding circumstances under which it would consider publishing notice of enforcement action so that firms have a fair opportunity to challenge the allegation before it is publicised.
3. The use by FCA of FOS data as a source of intelligence – we support ABI's view that additional measures are needed to ensure that FOS is properly transparent and accountable given that the current system of checks and balances is quite limited for an organisation which can have such a material impact on the market. We also agree that HMT and the Ministry of Justice should consider whether Claims Management Companies should be included within the regulatory remit of the FCA, as they are directly involved in the increasing number of complaints being received by FOS. The view of Allianz is that Claims Management Companies should be regulated by the FCA and that this approach would improve outcomes for consumers.

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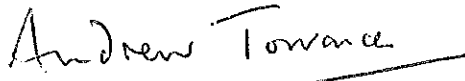
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4. Proposed proactive intervention framework – we appreciate that future consultations will contain more detail. However, whilst fully recognising that it is important for the regulator to act promptly regarding concerns about firms we think it essential that the PRA do not operate a formulaic approach but actively consider the particular circumstances of each case.

Yours faithfully



Andrew Torrance

ALM SUBMISSION

RESPONSE TO HM TREASURY CONSULTATION ON FINANCIAL REGULATION: Cm. 8012 BUILDING A STRONGER SYSTEM

This submission sets out the views of the Association of Lloyd's Members (ALM) on those aspects of the consultation which affect the Lloyd's market place, Members Agents (MAs), and the individual capital providers (Names) who the MAs and the ALM represent. All three MAs are members of the ALM and support those recommendations; but naturally will also be submitting replies separately. While MAs and Names together accounted for 15% of the Lloyd's market place in 2010, they remain a significant and valuable element in it. Moreover, particularly since the final resolution of the problems of Equitas through the retrocession of 2006 to Berkshire Hathaway's NICO and the Business Transfer of 2009 taking residual liability away from Equitas Names, growing numbers of suitable individuals have shown their interest in joining Lloyds. The ALM therefore submits that it is **important to accommodate the reasonable needs and concerns of MAs and Names as far as possible in the new framework**. To that end, we offer the following responses to the issues raised by the consultation which relate to Lloyd's.

The Present Regulatory Role of Lloyd's under the FSA

2. First, by way of preamble, we must underline an important issue for the Lloyd's market place which is not touched on in Cm. 8012. The Financial Services and Markets Act of 2,000 (FSMA) introduced a regulatory regime which we believe has worked well if not perfectly. By leaving regulatory tasks requiring detailed market expertise and familiarity with the Society and Corporation of Lloyd's, while the FSA took charge of strategic direction and oversight of Lloyd's regulation, the FSMA achieved in good measure the best of both worlds.

- 3.
- a) Moving away from this division of labour to any material degree would probably involve **significant (and gratuitous) revision of both the Lloyd's Act and the relevant sections of the FSMA**, which can be incorporated in the new framework with little or no change if the present proposals are adhered to. The same is true of the relevant sections of the Lloyd's and FSA rule books.
 - b) We believe this **remains the best model**; we urge that it be retained; and be modified to fit into the new institutional structure with the minimum of change, whether to the Memorandum of Understanding (MOU) between the Regulator(s) and Lloyd's, or to the Lloyd's Source Book etc.
 - c) Furthermore, we would ask that, should material changes be considered in the key arrangements and regulations cited in b), there should be careful **public consultation beforehand**. Both our market place and our niche within it are unusual and not very widely understood, so the scope for getting things wrong with the best of intentions is very real.

Questions 3, 8 & 12 “Views on the governance mechanisms of the FPC, PRA and FCA”

4. There is a surprising degree of inconsistency between the proposed role and composition of the three boards which will between them be responsible for the new regulatory apparatus. Moreover, several of the key features which such boards should have are not provided for in the present proposals. As is noted in 3.47, it is desirable that the PRA board should have a non-executive majority, contain directors who are independent and who can constructively challenge the executive It is difficult to see why these criteria are not applied to both other boards. In particular

a) It is odd to see that the **FPC will contain eleven individuals of whom only two have substantial business experience in the (private) financial sector** – in this case in investment banking (Hector Sants, latterly of Credit Suisse and Michael Cohrs of Deutsche Bank). Neither is likely to have sufficient direct knowledge and expertise to do justice to the complexities of the insurance world. Even in alliance with the two other non-official members – Donald Kohn and Sir Richard Lambert - the independent NEDs will be outnumbered eleven to three (Alistair Clark has served his whole career in the Bank of England and the Treasury and, whatever his independence of spirit, cannot for that reason quite be classed as independent in the strict sense in which this term is used in modern corporate governance).

b) The world of **insurance clearly needs to be properly represented on the PRA** given not only the general importance of understanding the many different sectors of insurance but also the special sensitivity of the implications of Solvency II; and against the background of a recurrent tendency in the non-insurance world to see it largely in terms of banking or capital markets.

c) The **same issue** of industry expertise applies, though obviously to a **lesser degree**, with the external appointments to be made to the **boards of the FPC and FCA**. Here it is important not only that there should be appropriate insurance expertise, but also expertise in wholesale as well as retail insurance markets.

Question 6 “Views on the scope proposed for the PRA, including Lloyd’s ...”

5. As we noted in our original submission of September 13th, 2010 on Cm 7874,

a) We understand the Government’s desire that prudential regulation and conduct of business should be separated;

b) At the same time, we believe it important that one supervisory body should be in the lead where, as with Lloyd’s, its business falls into both camps. The PRA seems to be the natural lead authority for both Managing Agents and Members’ Agents.

- c) The proposed responsibilities of the PRA for Lloyd's given its prudential role and of the FCA given its regulation of conduct, markets and trading and corporate actions will be important.

6. Regardless of the final institutional structure chosen, the **relationship between the two institutions in Lloyd's matters will need careful co-ordination and co-operation. We must ask that when any draft MOU setting out the objectives and terms of such arrangements comes to be prepared, we be consulted on the relevant provisions.**

Questions 9, 12 Accountability mechanisms proposed for the PRA and FCA

7. Names and Members Agents have not had much occasion to raise issues with the present FSMA practitioner panels. We recognise that as a small group of specialised market participants with a niche activity, it would be unreasonable to expect regular representation on any such panel in future. However, it is clear that such panels can play a useful role, perhaps at times a critical one. This makes it important that there should be a practical method to permit us access to both Panels, should circumstances necessitate it. We recognise that this is not the time to ask for a precise mechanism. But it is not too soon to ask the Treasury for an **assurance that the case for providing such access is accepted.**

Unnumbered questions relating to Box 4A and para 4.14: The FCA operational objective 3(b) of protecting "consumers"

8. Objective 3(b) talks of "securing an appropriate degree of protection for consumers". The last sentence of para 4.14, notes that "the definition of the term, "consumer" will be widely drawn, to cover users of services provided in the course of carrying on a regulated activity by any person" We would note that the relationship between individual capital providers and MAs at Lloyd's is unusual, being based on a principal/agent agreement. There is clearly a risk of undesirable and unnecessary bureaucracy if, however unwittingly, individual capital providers and their MAs become assimilated to conventional retail financial business and their clients under the new legislation. We ask that this risk be recognised appropriately (and avoided) as the details of the new regime are developed.

Unnumbered question relating to authorisation of Lloyd's entities.

9. At this juncture it may be appropriate to underline the importance of the fact that Lloyd's members, most notably Names in this context, do not have to be authorised persons under FSMA s.316. The current procedures for admitting and supervising Names are well established, well tested and thoughtfully strengthened (following the problems of R&R in the 1990s), and we know of no case for changing them.

Unnumbered question: What are your views on “issue-based Supervision”, as outlined in 4.56?

10. Question 13 follows after 4.56, but fails to ask for views on an important question provoked by it, to Para 4.56 states that:

“for the vast majority of firms, the main day-to-day contact will be through a contact centre ...”

We would most strongly urge that **Members Agents and the conduct of the business of private capital should not be supervised by a “contact” or call-centre**. On the one hand, provided today’s division of labour with Lloyd’s is retained, the more routine, day to day administrative matters, which might be relatively well handled by a call-centre, will continue to fall largely to Lloyd’s. On the other, the unusual and specialised world of Lloyd’s private capital will continue to demand limited but skilled review and attention from the Regulator(s), such as it has received from the FSA – from a dedicated team of Lloyd’s specialists. It is impossible to see how the staff of a call-centre could be relied on to meet the minimum technical standards and industry experience which proper supervision will require.

Unnumbered question: How relevant to Lloyd’s Members Agents and the business of individual capital providers would be the objectives for FSA regulation discussed in Box 4E?

11. Question 13 follows Box 4E, but does not explore in the Lloyd’s context the central prudential concerns of protecting customers, minimising the dangers to confidence, and setting capital requirements sufficient to achieve orderly wind-down. In the case of Lloyd’s (not just MA’s and Names), these concerns are not as material as in most other sectors:

- a) There is a highly effective system to ensure that all valid claims from whatever source are always paid, which is based almost entirely on Lloyd’s Central Fund which all market participants finance;
- b) The interests of individual capital providers are protected by the Lloyd’s Ombudsman (disputes with the Corporation of Lloyd’s itself) and procedures for handling complaints including Lloyd’s’ Arbitration Service (for disputes between Names and MAs);

12. That said, there are **two areas where the FCA’s proposed role regulating wholesale market conduct will be directly relevant**. These are:

- a) The **proper conduct** of the market in Lloyd’s syndicate capacity;
- b) Preserving the **integrity** of financial markets – inasmuch as MA’s individual capital providers may have important interest in corporate actions such as sale/mergers and reconstructions of Lloyd’s businesses and syndicates.

Ensuring **proper conduct and integrity** may at times call for the involvement not only of Lloyd's staff, but experienced market specialists from the regulator.

Unnumbered questions not identified in Boxes in Chapter 4: What will happen to the right to appeal FSA decisions under the new regime; and how will European representation be assured for insurance-related businesses supervised by FCA?

13. Paragraph 3.32 of the Cm 8012 notes that the Government has still to decide how far PRA's supervisory decisions should be appealed to the "Upper Tribunal". The section of Cm 8012 covering FCA appears not to refer at all to the issue under the discussion of enforcement in paragraph 4.10.8 (which is analogous to paragraph 3.3.2). **We would presume that the absence of such a discussion is an accidental omission, and that it is intended to provide bodies supervised by the FCA with a right of appeal to the Upper Tribunal, such as they have enjoyed hitherto.**

In addition, we would be extremely concerned if the grounds for such reviews were to be drawn more narrowly under the new act than those involved in the "full merits review" provided for under the FSMA today.

Whatever may be the reason for narrowing the grounds, Cm 8012 contains no analysis or arguments for so doing; and we are not aware of such a case being made in other official policy statements.

14. The need for consideration of **European representation for any insurance-related business** lead-supervised by FCA – whether brokers, or others such as Lloyd's MAs – arises because the FCA's seat on the ESMA is irrelevant, since ESMA is not concerned with insurance. So we must urge the Government to **provide a reliable link with the EIOPA** for such businesses – and presumably with the FCA team dealing with EU insurance policy-making.

Box 5.K Question 28: What are your views on the Government's proposals for the new authorities' powers governing fees and levies?

15. MAs and thus individual capital providers pay significant **regulatory charges** to Lloyd's, which one presumes (following the drift of paras 2 and 3 above) will continue to undertake the lion's share of the supervision to which they are subjected. The substance of the task of regulation to which MA's and names are exposed will not, we presume, change materially as a result of the move to the new structure. We therefore welcome unreservedly the declaration in paragraph 5.99 that:

"it will be essential for the PRA and FSA to use their resources efficiently in order to keep their costs down".

However, since fine words butter no parsnips, we would urge the Government to consider requiring that the **fees for MAs of the two new regulators taken together should not exceed the FSA's fee**, save for any element attributable to the one-off costs of transition.

16. Question 28, paragraphs 5.101-5.102 and Chapter 6 all touch on or raise the question of **funding the Financial Services Compensation Scheme (FSCS), the Consumer Finance and Education body (CFEB) and Financial Ombudsman Service (FOS)**. Lloyd's has no involvement with the FSCS save for a specific exposure restricted to Personal Lines business. That apart, as already noted in paragraph 8 above, the whole Lloyd's Market place, including MAs and individual capital providers, have their own systems for compensating customers (via the Central Fund), and for resolving disputes within the market. In addition, Lloyd's businesses do not deal with consumers directly, and do not therefore have any "consumers" whose education they **might** be expected to help finance. **There cannot, therefore be any grounds for requiring Lloyd's businesses to contribute to the FSCS (save for the limited case referred to above), the FOS or the CFEB.**

THE DANGER OF CROSS SUBSIDY NOW, AND IN THE LONGER TERM IN THE FUNDING ARRANGEMENTS OF THE NEW REGULATORY INSTITUTION

17. By way of conclusion, another important general point. In the early days of the present regulatory regime, the principle was clearly established that **different financial sectors should not cross-subsidise the costs of the Regulator**, or those of the Regulator's compensation, Ombudsman and complaints procedures. In recent years that principle was eroded. To tolerate, let alone deliberately introduce, cross-subsidy in the new regime when there is a rare opportunity to start with a clean sheet would not merely be unfair but economically and commercially unjustifiable. Thus there is no basis other than crude expediency for requiring wholesale and business to pay for retail compensation schemes; nor for sector A to shoulder the costs attributable to Sector B as well as its own. The argument is more powerful still at this time in the aftermath of a crisis in the banking sector some of whose costs will be recovered in future from the firms subject to regulation under the new Act, it would be impossible to justify requiring other sectors which played no part in the crisis – such as insurance – to shoulder any of the reimbursement to the taxpayer of the costs of the banking rescues. For all these reasons we would therefore ask that the **Government includes in the new Act a firm statement that there should be no cross-subsidy in the financing arrangements associated with the new system.**

18. We are aware that the **issues of compensation and market guarantee schemes** and their financing are the subject of **active debate in the European Union**; and that proposals for several new directives relating to such matters are to be expected in the next few years. It would be, if anything, even more undesirable that cross-subsidy should be permitted or imposed, or at least tolerated, in European legislation and regulation than in our domestic regime. The fact that the UK is revising its financial regulation at this time provides a good opportunity for the UK to make a public statement ruling out cross-subsidy which could be embodied in a categorical commitment in the new legislation. Such a move could help us achieve this extremely desirable goal and principle in future EU directives - which may otherwise come to dominate our regulatory institutions and procedures in the longer term.

ANR
13 April 2011



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Financial Regulation Strategy
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By email: financial.reform@hmtreasury.gsi.gov.uk

Dear Sirs

Response to HM Treasury Consultation on Financial Regulation: Cm 8012 Building a Stronger System.

This submission sets out the view of Alpha Insurance Analysts Limited (Alpha), a Lloyd's members' agent, on the aspects of the consultation affecting the Lloyd's market and specifically members' agents and the individual capital providers (members) who we advise.

For 2011, Alpha represents 198 individual and corporate Lloyd's members who provide third party capital to the Lloyd's market, with an aggregate premium income of £364m.

Alpha recognises the need for strong regulation of the UK financial services sector. We agree that the "division of interests" between the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) should take account of the "unique nature of Lloyd's" and the "distinctive roles played by certain participants" (Section 3.29 of the consultation document). Considering the nature of Lloyd's market, we believe that the current regulatory regime for members' agents, by Lloyd's and the FSA, has worked well. The majority of regulatory tasks, which so obviously require Lloyd's market expertise and familiarity, are dealt with by Lloyd's and the FSA takes charge of strategic and oversight of Lloyd's regulations. We suggest that this model, which we consider provides an appropriate and proportionate regulatory regime for the Lloyd's market and members' agents, should be modified with the minimum of change to fit into the new structure and that it would be appropriate for the PRA to be the lead regulator providing an integrated regulatory structure for Lloyd's as a whole and for members' agents.

Considering the approach to the regulation of members' agents specifically and the suggestion that the PRA rather than the FCA is the primary regulator for members' agents, we make the following comments:

Protection of Retail clients

One of the primary objectives of the FCA will be to protect retail clients. Members' agents do not advise or deal with retail clients. The majority of our clients have been members of Lloyd's for many years, through several underwriting cycles, and are considered to be sophisticated investors in the Lloyd's market. In addition, a review of personal and financial circumstances and risk appetite ("KYC") and suitability is considered on an annual basis for existing members while new members demonstrate high net worth and pledge a small proportion of their overall wealth to Lloyd's.

Members' agents and their members are party to a standard agency agreement (in a form prescribed by Lloyd's). Agency agreement and agency law, the Lloyd's Byelaws and codes, to which members' agents are subject, are generally seen to provide adequate protection for members and many of the current FSA conduct of business rules do not apply as a result.

Lloyd's has had an oversight role in matters concerning market conduct and we believe that this position should continue. By way of example, the interests of capital providers are protected by the Lloyd's Ombudsman and procedures for handling complaints. A further issue of market conduct where Lloyd's has always acted in a supervisory role, concerns the transfer of syndicate capacity and Lloyd's capacity auctions. Lloyd's asserted in its submission to the Treasury in October 2010, that the characteristics and scale of the Lloyd's capacity auctions are such that they do not resemble an organised financial market provided by an investment exchange and should therefore be supervised by the PRA. We support this view.

Capital Requirements of Members' Agents

It is noted that the FCA will have responsibility for capital requirements for the firms it regulates. Members' agents are required to comply, and report compliance on a quarterly basis, with Lloyd's minimum regulatory capital and net assets/solvency standards. These requirements currently exceed similar FSA rules that apply to Personal Investment Firms and should address the requirement for the FCA to minimise consumer detriment.

Risk to Statutory Objectives

There are only three members' agents in the Lloyd's market and the risk to the statutory objectives posed by our small community, which are viewed as minimal, must be carefully considered.

Fees and Levies

We currently pay significant regulatory charges to Lloyd's. On the assumption that they will continue in their supervisory role, we hope that the task of regulating members' agents by the new regulators will not change materially and that this will mean that the overall cost of regulation for members' agents will also not change. Lloyd's has its own system for compensating customers (via the Central Fund) and resolving disputes in the market. We therefore hope that there will be no grounds to change the current position and require members' agents to contribute to the FSCS, the FOS or the CFEB.

Conclusion

We are of the opinion that the existing arrangements, particularly in terms of market conduct, between Lloyd's and the FSA, should continue under the new regime. It is our view that the regulatory model followed, in view of the unique characteristics of the small community of Lloyd's members' agents, should be with the PRA as the lead supervisory body for members' agents (as proposed by Lloyd's in October 2010 in its response to the initial consultation). We suggest that Lloyd's should continue with the oversight/supervisory role on issues

concerning market conduct, on the understanding that there would be a link with the FCA on market conduct issues not addressed by Lloyd's or the PRA.

We suggest, in order to ensure proper co-ordination between the PRA and FCA, that a Memoranda of Understanding, accounting for the position of Lloyd's and its market participants, is of utmost importance and urge you to consult with the members' agents and the various market associations when drafting the terms.

We believe it essential that Lloyd's and Lloyd's market participants are represented on the Financial Policy Committee, and at senior level in the PRA and the FCA, and that it is important that the PRA and FCA employ personnel with expert knowledge of the Lloyd's market.

We understand that separate submissions have been made by the other Lloyd's members' agents, the Lloyd's Market Association and the Association of Lloyd's Members.

We would be very happy to meet with you to discuss any of the issues raised in this submission and reiterate our desire to be involved in further consultations.

Yours faithfully



Mrs Jenny Doyle
Compliance Officer and Company Secretary

On behalf of Alpha Insurance Analysts Limited



Alternative Investment Management Association

Financial Regulation Strategy
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Sent by email to: financial.reform@hmtreasury.gsi.gov.uk

14 April 2011

Dear Sir/Madam,

AIMA's response to HM Treasury's consultation paper 'A new approach to financial regulation: building a stronger system'

AIMA¹ welcomes the opportunity to respond to HM Treasury's consultation paper, 'A new approach to financial regulation: building a stronger system' (the Paper). The Financial Services Authority (FSA) currently regulates an estimated 400 hedge fund managers, including many AIMA members who are registered as investment firms as defined in the Markets in Financial Instruments Directive (MiFID).

AIMA supports registration of hedge fund managers by a strong, well resourced financial market supervisor or supervisors and will support any measures proposed that will increase stability in the financial markets and prevent future crises via a coordinated and intelligently designed regulatory framework. To the extent that HM Treasury's proposals achieve these aims we support them; however, we note several areas of the proposal that may require additional consideration before implementation.

AIMA's comments

The new regulatory structure will take time to implement and we note that the FSA has already begun preparing for the transition from 2012. In principle, we have no objection to the proposed new regulatory structure, including the division of responsibility between two agencies dealing separately with prudential and conduct of business regulation. We understand that hedge fund managers and other fund managers would fall under the remit of the Financial Conduct Authority (FCA) and be subject to substantially the same rules and high level of supervision they currently receive from the FSA. The FCA would seem to be the appropriate regulator for hedge funds, since these neither pose systemic risks nor would require intensive bank-style prudential regulation by the Prudential Regulatory Authority (PRA).

AIMA members' main concern with the change in regulatory responsibility is to ensure that this is managed in such a way that regulated firms are not unduly impacted but are kept informed of changes as they occur (especially those that require planning or action by those firms). We believe that the FSA is effectively managing this transition at this early stage and has kept affected firms up-to-date regarding the consequences for them². As part of managing the transition, further reassurances to regulated firms that existing authorisations and permissions will be 'grandfathered' to the FCA would be beneficial³.

¹ AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector - including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,200 corporate bodies in 45 countries, with around 31% of our manager members based in the UK and, of them, 207 are hedge fund management firms (another 59 are fund of funds managers).

² As most recently detailed in the FSA's 'Dear CEO' letter of 4 April - http://www.fsa.gov.uk/pubs/ceo/reg_reform.pdf

³ The Paper is silent on this topic and it is currently unclear if existing regulated firms would have to cancel their FSA registration and re-register with either the PRA or the FCA, or not.



Alternative Investment Management Association

Dual-registration

AIMA is concerned about the proposal that certain firms may be required to be 'dual-registered' with both the PRA and the FCA, each taking a role in prudential and conduct regulation. Although this is not proposed to be applicable to firms which only conduct fund management activities, AIMA members include a range of different types of businesses which undertake a range of activities. Some of these may cause certain firms to fall within the additional remit of the PRA. Our concern is that a requirement to be registered with both authorities and to be subject to each authority's rules may lead to firms having to comply with unnecessary levels of increased supervision and regulations. For example, a single authority may conduct regular examinations of a firm, which would include all aspects of their business. However, if two (or more) authorities have responsibility for a firm, these may require multiple examinations to achieve the same overall regulatory result. Ideally, only one regulator would regulate one firm to ensure consistent treatment and a holistic view of the regulated activities. Inter-authority coordination is highly desirable and, if dual-registration is seen as necessary under the new regulatory structure, the rules and responsibilities for each authority must be made absolutely clear from the start and should be designed in such a way as to avoid unnecessary compliance burdens and costs for regulated firms.

Judgement-led regulation

HM Treasury proposes that the PRA would move from the existing 'principles-based' approach of the FSA to a 'judgement-led' approach to regulation with a 'purposive' application of PRA rules. The result is that firms would be required to comply with the 12 existing FSA Principles for Businesses (presuming these are retained), the FSA handbook rules and short statements of purpose for each of those rules. Although we understand the reasons behind such an approach, the PRA must provide clear and binding guidance on how it will enforce compliance with the rules and new purposive statements. Uncertainty as to the rules under which firms must operate leads to difficulty in compliance, firms' practices may differ and the regulatory authority may face difficulty in enforcing its rules and guidance fairly. It is also unclear whether the approach would equally be applied to the FCA rules and, if it is not, consideration must be given as to what effect differing approaches among the authorities to applying regulatory rules may have. A further concern is that the more subjective and less transparent approach to regulation may make implementation of European-level Regulations and Directives difficult and lead to over- or under-transposition of EU laws into national rules. Overall, judgement-led regulation is likely to lead to greater legal uncertainty and this must be carefully considered against the benefits HM Treasury believes the change would bring.

It is proposed that the judgement-led approach would also apply to the authorisation of firms and registration of approved persons with the PRA. We do not believe this will be a major change in approach to the one currently taken by the FSA, which already includes collection of data and application of appropriate judgement by the FSA. The 'lead proposal' for a new authorisation process for Part IV permissions, which includes a prudential assessment and a conduct assessment, sounds sensible, although we await further details on what this would involve. For dual-registered firms, we again note the issue of duplicative requirements if firms must have a prudential assessment and a conduct assessment carried out by each authority under the lead proposal. The 'alternative approach' may be preferable, such that a lead- or primary-regulator would be responsible for authorisation, with adequate exchange of information with a secondary regulator, where appropriate.

Enforcement

Another proposal with which we are concerned is that on the early publication of enforcement 'warning notices', which HM Treasury believes will create a 'credible deterrence', will signal to firms 'what behaviours the regulator considers to be unacceptable' and will act as 'an important feature of a transparent and effective regulatory system'. Whilst we note that HM Treasury recognises the possible reputational damage to firms or individuals that can be caused where enforcement action is disclosed but later discontinued, we do not believe that any safeguards will be sufficient to combat this risk. Publication of enforcement warning notices which name firms or individuals and the accused's alleged breach(es) of regulatory rules is akin to publicly finding a firm or individual guilty until proven innocent by investigation. Current arrangements avoid this problem by only

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Alternative Investment Management Association

reporting enforcement actions after due legal process⁴ has been completed and a firm or individual has actually been found guilty of breaching an FSA rule or has come to a settlement with the FSA. Notices of discontinuance are likely to come too late and be ineffective in negating the reputational damage that would result. An unintended consequence of early publication of enforcement notices is that firms and individuals may be less willing to cooperate with the PRA and the FCA at an early stage of an investigation if they are immediately and publicly accused of possible misconduct in an enforcement notice. This could lead to more cases being contested at RDC hearings rather than being settled at an early stage, and would thus require greater use of the authorities' time and resources to prepare and present their cases at those hearings. Although giving discretionary powers to the PRA and the FCA in this regard seeks to mitigate the risks where the chances of reputational damage are high, it is difficult to think of a situation in which a large or small firm's reputation would not be damaged by early disclosure. If HM Treasury decides to proceed with this proposal, it must ensure that enforcement notices are only published prior to the conclusion of a full investigation and due legal process if there is powerful evidence to back up the PRA or the FCA's claims.

Transparency and disclosure as a regulatory tool

Transparency and disclosure are important regulatory tools and AIMA's members are happy to provide their regulator with any appropriate information necessary for that regulator to monitor the firm and assess potential risks arising either from the firm's activities or in the system more widely. In exchange for full transparency to regulators, we appreciate efforts by market regulators to limit the information they request to only that which is necessary to achieve their goals so as to reduce compliance burdens and reduce regulatory costs (which may ultimately be passed to end-investors and the wider economy). Ensuring this information remains confidential is key and helps to foster an open relationship between firms and their regulator/s.

Requiring regulated firms to disclose information to the public raises many issues and should always be approached with caution. Publication of confidential, non-public and proprietary data may lead to financial losses at financial firms, and may, for example, lead to 'herding' or 'shadowing' in the markets, in which financial trades may be copied causing distortion of market prices and creation of asset bubbles. We would strongly encourage HM Treasury to consult extensively on any proposed changes to the way in which regulated firms are required to report information to the market.

As discussed above in relation to enforcement notices, there are certain issues with regulators being completely transparent with the public in their actions; however, we agree that the presumption should be for transparency, unless there are good reasons not to disclose information. HM Treasury and the authorities should equally consult on the areas where it is proposed that authorities become more transparent in their actions.

The UK's role in Europe

The Paper states that the FCA would hold the UK's seat in the European Securities and Markets Authority (ESMA), and that the FCA would represent the UK in all matters, including those which are the responsibility of the Financial Reporting Council (e.g., accounting standards), and the Bank of England (e.g., regulating systemic infrastructure, including clearing houses and settlement systems). We agree with the statement that "[i]t will be important, therefore, to ensure that the FCA has the credibility to represent the UK in relation to all matters covered by ESMA"⁵; however, we are concerned that with a 'twin peaks' regulatory model, in which the Bank of England will have control over the FCA (or will appear to have control over the FCA), its negotiating authority will appear weakened. This could be an inevitable consequence of having two regulators instead of one, and lead to poorer representation of UK interests in Europe on financial matters. HM Treasury should seek to negate this concern as much as possible through providing the FCA with day-to-day decision making authority when dealing with institutions of the European Union, without requiring approval of the Bank of England or other market authorities. The Paper states that coordination between the FCA and the Bank of England will be

⁴ E.g. a right to review evidence against the firm or individual, a right to contest an accusation before a Regulatory Decisions Committee (RDC) and the right to appeal decisions of the RDC to the Upper Tribunal (previously, the Financial Services and Markets Tribunal).

⁵ The Paper, Page 80, point 4.118.



Alternative Investment Management Association

achieved through agreement of a Memorandum of Understanding⁶ setting out the FCA's and Bank of England's roles; this will be an important element to ensuring the FCA has the necessary authority to represent the UK.

Conclusion

As the FSA hands over responsibility to the Bank of England, the PRA and the FCA, we hope that HM Treasury will continue to consult the industry on the details of these reforms. AIMA, like HM Treasury, is keen to see a strong regulatory and supervisory framework for all financial firms and we support the proposals in this regard. However, we caution against full implementation of certain changes without further consideration, especially those that could create additional costs and compliance burdens for regulated firms, those that could weaken the UK's position in Europe and those which may have unintended consequences for the market.

We are pleased to have had the opportunity to contribute our views and we will be happy to provide further input as HM Treasury takes their proposals forward.

Yours faithfully,

Anna Larris
Associate Director, Head of Asset Management Regulation

⁶ We note several references in the Paper to 'statutory MOUs'. HM Treasury should seek to explain this term, which we believe may be something different to existing MOUs which the FSA has in place which are negotiated, non-binding agreements.



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Our Ref: #1608816v3

13th April 2011

Dear Sirs

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

Argenta Private Capital Limited (**APCL**) operates as a members' agent in the Lloyd's Market and advises / represents third party capital investment with an aggregate premium capacity of £1.16bn for 2011.

APCL recognises the need for strong regulation in the UK financial services sector. In this submission, we respond specifically to proposal that members' agents should be subject to conduct of business regulation by the Financial Conduct Authority (**FCA**). We understand that the FCA will also be responsible for the prudential regulation of other "non-significant firms", such that, where these do fail, consumer detriment is minimised (principally by requiring adequate capital resources to achieve an orderly wind-down).

We note from 3.29 of the consultation document that "the division of regulatory responsibility will ... largely follow the division of interests between the [Prudential Regulation Authority] (**PRA**) and FCA as they would apply in relation to insurance business or activity generally but will also take account of the unique nature of Lloyd's, including the way it operates as a specialist financial market and the distinctive roles played by certain participants in this market". We consider that the unique characteristics of members' agents should be reflected in determining an appropriate and proportionate regulatory framework going forward and it is with this in mind that we would like to make the following observations :

1. members' agents comprise three out of a total population of over 20,000 firms which are expected to be supervised by the FCA and the commensurate risks to its statutory objectives posed by this community (which are deemed to be minimal) need to be carefully considered;
2. members' agents are not typically advising or dealing with retail clients, the protection of whom will be one of the FCA's primary objectives. The majority of APCL's clients have been members of Lloyd's for some considerable time and, through the experience of several underwriting cycles, have gained sophistication as investors in the Market. All of APCL's clients are subject to an annual 'KYC' / suitability assessment, with the more recent new investors demonstrating high net worth capacity and pledging a small proportion of their overall wealth to their Lloyd's investment;

3. all members' agents' clients are party to an agency contract (in a standard form prescribed by Lloyd's), with the Society also mandating certain Byelaws and codes in the context of members' agents' traditional role in advising on syndicate participation. The standards on business conduct and investor protection afforded under Agency contract / law are such that they are generally seen to provide adequate protection for members. Indeed, this has been recognised by way of a significant element of the existing FSA conduct of business rules being disapplied in the context of members' agents. In addition, Lloyd's operates complaints / disputes resolution arrangements for members which the FSA currently recognises;
4. with regard to other Part IV permissions which members' agents are registered with (e.g. investment advice), again these do not typically concern retail clients and are very distinct from other investment advisers (for example, they generally exclude an ability for members' agents to retain and manage client monies); and
5. all members' agents are required to comply with Lloyd's minimum regulatory capital and net assets / solvency standards (which currently far exceed the prudential rules for Personal Investment Firms) and to evidence such compliance on a quarterly basis and it is assumed that the current requirements applying to professional indemnity insurance continuing would continue to apply. It is felt that the ongoing application of these requirements goes a considerable way in addressing any concern over the ability of the FCA to fulfill its objective to minimise consumer detriment, added to which Lloyd's itself has the power to effect a 'substitute agent' appointment in the (albeit unlikely) event of a failing members' agent.

In view of the unique characteristics described above, it is our preference that the PRA remains as the lead supervisory body for members' agents (as proposed by Lloyd's in the initial consultation), with Lloyd's retaining its existing oversight role in matters concerning market conduct. This would also be reflective of the staffing and expertise within the existing FSA which is envisaged to transfer to the PRA and notwithstanding the expectation of there being a 'dotted line' to the FCA as the ultimate arbiter with regard to any market conduct issues which are not addressed to members' satisfaction by the Society and / or PRA.

The alternative of what would essentially comprise three tiers of regulation (through Lloyd's, the PRA and FCA) would, it is feared, result in unnecessary confusion, duplication and overlap. In a broader sense, we would argue that Lloyd's and its agency participants are regulated on a unitary basis so far as possible, particularly in view of the current expertise and Market knowledge described above.

We note from 3.30 of the consultation document that "The arrangements for cooperation and coordination between the FCA and the PRA (discussed in detail in Chapter 5) will take account of the position of Lloyd's." In this respect, we consider the Memoranda of Understanding (**MoU**) between the PRA and FCA to be of paramount importance and we would ask that the members' agents be consulted (perhaps through the offices of Lloyd's Market Association (**LMA**)) on the precise terms of these, including the extent to which the Bank of England, PRA and FCA is willing to rely on the Corporation of Lloyd's as the supervisor of syndicate capacity and conduct of business issues concerning members of Lloyd's. By way of a specific example, Lloyd's asserted in its previous submission that the scale and particular characteristics of the capacity auctions are such that they do not resemble an organised financial market provided by an investment exchange and should accordingly be overseen by the PRA. We would support this view.

We would dissuade any notion that members of Lloyd's should be regulated, bearing in mind they are not currently authorised persons under FSMA. Lloyd's has argued in its previous submission that neither the essential purpose of prudential supervision of Lloyd's (i.e.

minimising the risk that members will not be able to meet valid claims), nor the PRA's proposed primary objective (being the promotion of stable and prudent operation of the financial system) requires the authorisation of members.

The risk of duplication of effort and costs is also of some concern, particularly bearing in mind the levies charged by Lloyd's against members' agents and members themselves. APCL's contributions towards the Financial Service Compensation Scheme (**FSCS**) and Financial Ombudsman Service (**FOS**) levies (with the Lloyd's Central Fund also paying into the former) are currently an accurate reflection of the limited scope of our investment advisory role and we would wish to preserve this.

We believe it is essential that there is appropriate representation within the Financial Policy Committee (**FPC**), PRA and FCA at board level, by senior people with direct experience in the underwriting (both managing and members' agency) businesses; and that the general insurance teams in both the PRA and FCA employ personnel who have expert knowledge of the insurance market.

Finally, we consider that the costs of transition will be much higher than estimated in the Impact Assessment within the consultation document, bearing in mind that two new handbooks will need to be created for the PRA and FCA and the familiarisation of staff with these and associated training costs, along with involvement in consultations on the new rules, will be more time-consuming than envisaged.

We express our wish to be involved in the further detailed consultations and look forward to providing feedback on further proposals.

Yours faithfully

A handwritten signature in black ink, appearing to read "Chris Fairs", followed by a period.

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

A response from the Association for Financial Markets in Europe (AFME)

Introduction

The Association for Financial Markets in Europe (AFME)¹ welcomes the opportunity to respond to HM Treasury's consultative document (condoc): "*A new approach to financial regulation: building a stronger system.*"

AFME represents European capital market participants and our membership includes European and global banks, as well as key regional banks and brokers; hence, as well as being keenly interested in ensuring strong and well regulated London markets, AFME seeks to analyse issues from a European perspective.

In the new UK regulatory framework, many of our members will, however, be regulated by both the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) i.e. they will be dual-regulated firms. In our response to the July 2010 HM Treasury condoc, we said that: "*for a regime with multiple, judgement-led, regulatory authorities to function effectively, the precise design of the framework will be crucial to its success.*" Hence, given that the most fundamental aspects of the framework will include coordination between the PRA and the FCA and coordination between the UK regulators and the European Supervisory Authorities (ESAs), our members are well placed to comment on, in particular, the proposed coordination mechanisms.

Executive summary

Redesigning a regulatory framework is a difficult task and we do not underestimate the volume of work or the significance of the challenges that HM Treasury, the Financial Services Authority (FSA) and the Bank of England (the Bank) will face.

We welcome, therefore, the many significant and thoughtful advances in policy development contained within the condoc. We also welcome the open and constructive manner in which the Financial Secretary to the Treasury and HM Treasury's Financial Regulation Strategy Team have engaged with stakeholders. The condoc contains a significant degree of granular detail on most aspects of the new framework - one of the exceptions being macro-prudential tools, which are being considered concurrently by the Interim Financial Policy Committee - and we welcome the extent to which issues

¹ AFME (Association for Financial Markets in Europe) promotes fair, orderly, and efficient European wholesale capital markets and provides leadership in advancing the interests of all market participants. AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, and other financial market participants. AFME participates in a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association through the GFMA (Global Financial Markets Association).

raised by AFME, and other stakeholders, in responding to the July condoc, have been addressed and/or clarified.

AFME is committed to engaging constructively with HM Treasury, the Bank, and the FSA to help develop a regulatory framework that addresses the weaknesses in, but builds upon the strengths of, the existing system. In developing the new framework, AFME continues to believe that the key principles should include:

- clarity;
- efficiency; and
- effectiveness.

Whilst the condoc represents a significant advance towards achieving these principles, there is, as the Government is aware, still a considerable amount of work to be done. Inevitably, with additional detail comes additional questions and issues, a number of which we consider significant. In this response we have, however, endeavoured to provide practical and, hopefully constructive, feedback which has been informed by the experience and expertise of AFME members and staffers. In summary, our key concerns include (in the order they appear in the condoc, rather than in order of priority):

- transparency and accountability in respect of the use of macro-prudential tools;
- the governance of the Financial Policy Committee (FPC) and - given the concentration of power within the Bank *per se* - whether there will be appropriate levels of transparency, due process and accountability to Parliament;
- the need for an international-focused regulatory principle that takes into account the effect of regulation on the reputation and international competitiveness of the UK's financial markets and the desirability of preventing regulatory arbitrage;
- given judgement-led regulation and greater enforcement and intervention powers, whether the mechanisms to allow firms to challenge regulatory decisions and provide access to due process (including rights of appeal) provide sufficiently robust safeguards;
- the proposal to allow regulators to publish warning notices and the possibility that appeals from judgement-based supervisory decisions might only be heard by the Upper Tribunal on limited (judicial review) grounds;
- coordination between the PRA and the FCA for dual-regulated firms: particular in respect of regulatory processes, rule-making and supervision;
- the practical operation of the European/international MoU and the need for an EU and International secretariat to, inter alia, provide strategic direction and manage the UK's stakeholder relationships, including the key relationships with the ESAs (in particular the European Securities and Markets Authority (ESMA)).

We are also concerned to ensure that, in addition to a developing a stronger regulatory system, the UK financial services industry is able to make a long term, sustainable contribution to domestic and EU economic growth.

There are also some questions of degree, principally concerning independence and transparency and disclosure, which warrant clarification:

- *Independence:* in developing the new framework, it will be critical to ensure that the regulators are independent from the Government of the day whilst at the same time ensuring that the Government is sufficiently involved in decisions that have socio-economic effects (e.g. the use of macro-prudential tools). It is also important to ensure that, although the PRA and the FCA are separate regulators pursuing different objectives with independent decision-making procedures and powers, independence does not become a barrier to effective co-ordination or give rise to conflicting requirements;
- *Transparency and disclosure:* With respect to transparency, we agree that regulators should be transparent with respect to their regulatory processes and their accountabilities to Parliament. However, given the EU restrictions on the disclosure, by competent authorities, of confidential regulation, there should be no presumption of transparency in relation to the information on firms and individuals that regulators obtain in the exercise of their regulatory functions.

We would be happy to discuss, in more detail, any of the points raised in this response. We recognise that there is balance to be struck between achieving certainty through legislation and allowing regulators an appropriate degree of operational flexibility through, for example, the use of Memorandums of Understanding (MoUs). We also recognise that many of the issues raised in this response will need to be addressed as part of the development of the PRA and the FCA's operational procedures. We await the publication of the PRA and FCA's operational framework documents with interest and trust that the FSA and the Bank will also engage openly and constructively with stakeholders.

Looking further ahead, we welcome and concur with the Government's decision to amend the Financial Services and Markets Act (FSMA). We note that the Government intends to publish a White Paper and draft Bill for pre-legislative scrutiny in May/June 2011 with a view to Royal Assent by mid 2012, thereby compressing the original two year timetable for FSMA into one year. However, although FSMA received Royal Assent on 14 June 2000, the drafting and laying before Parliament of secondary legislation, consequential amendments to an array of other statutes and the development of the FSA's Handbook, operational procedures and transitional arrangements (including grandfathering of firms and individuals) took a further 17 months. We believe it will be a challenge to complete similar exercises before the end of 2012.

In conclusion, AFME stands ready to engage further with HM Treasury in respect of the legislative framework to be enshrined in the draft Bill (and, ultimately, secondary legislation) and the Bank and the FSA in respect of the operational detail.

Responses to the consultation questions

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?*

As the condoc highlights: “macro-prudential measures are likely to prove more effective if the broad framework for their use is designed and adopted at the international level.” It will, therefore, be essential to develop internationally agreed definitions (e.g. of financial stability), common indicators for monitoring risks and effective linkages/synchronisation (e.g. between the FPC, the European Systemic Risk Board (ESRB), the US Financial Stability Oversight Council and the Financial Stability Board). We recognise that the international aspects of the macro-prudential regulation are still under discussion, therefore we would welcome an opportunity to discuss the technical proposals as they develop.

At a domestic level, our members have significant concerns regarding the possible effects – both intended and unintended – of the potential macro-prudential tools listed in the condoc. In addition, as discussed in our response to Q3 below, we also have concerns as to whether sufficient checks and balances will be in place given the power that will be concentrated in the Bank of England.

In respect of the potential macro-prudential tools in paragraph 2.46 *et seq* of the condoc, we recognise that the list reflects tools being discussed/developed at a G20 level and that detailed work on the selection of macro-prudential tools is being carried out concurrently by the interim FPC. However:

- the majority of the “macro-prudential tools” – with the exception of countercyclical buffers – will actually be applied, by the PRA (and the FCA), as micro-prudential tools;
- a number of the tools (e.g. the collateral requirements) could have a significant impact on the ability of market sectors to contribute to economic growth and may create unlevel playing fields that move transactions offshore (not, nevertheless, reducing risk to international financial stability). Indeed, ad-hoc tools, by their very nature, create uncertainty for markets, hence, it will need to be understood that there will be significant and robust checks over their use; as part of this, the FPC will need to articulate in advance the kind of approach it will adopt;
- we have doubts over the extent to which the PRA (and the FCA) will be able to apply some of the tools (e.g. variable risk weights) at a micro-level, within the constraints of EU directives;
- the untested nature of the many of the potential tools warrants a cautious approach to their use – with scenario testing and

careful examination of any (current and future) effects – and the secondary instrument that will set out the FPC's macro-prudential tools should include a review clause;

- many of the tools (e.g. in relation to regulatory capital requirements and often liquidity), would only be applicable to UK incorporated entities only and so would not capture the significant volumes of business conducted through branches of European and third country financial institutions;
- it is not clear how some of the tools listed (e.g. the use of variable risk weights), could be applied consistently to firms using different approaches and models for the calculation of their Pillar 1 capital requirements;
- there are significant and often complex inter-linkages between several areas of the prudential framework (e.g. regulatory capital, leverage measures, liquidity and large exposures) and it will be important for the FPC, the PRA (and the FCA) to understand and be able to model the interplay and effects of changes in these areas to avoid unintended consequences and the potential to cause market distortions;
- in relation to the use of the listed 'collateral haircuts', there is concern that regulatory authorities may seek to directly alter the commercial terms of individual transactions; and
- as a practical matter, given the international nature of markets, deployment of the tools in the UK may be insufficient to address a potential risk.

We do, however, see a key role for the FPC in providing recommendations and directions to the PRA and FCA in respect of stress tests, e.g. the tests and test parameters that need to be modelled in firms' Internal Capital Adequacy Assessment Process ('ICAAP') and Individual Liquidity Adequacy Assessments ('ILAA'). These will, in turn, impact the scale and composition of liquid asset buffer requirements and will alter regulatory capital requirements as part of the Pillar 2 framework rather than through trying to apply more 'rigid' or 'one size fits all' approaches under Pillar 1 calculations. The table in Annex II to this response sets out these and some of the other possible ways in which macro-prudential tools could be used by area of vulnerability.

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

This is an area we are still reviewing; however, we are considering whether an additional macro-prudential tool might be the use of liquidity requirements on specific exposures. For example, the monitoring of data and trends in relation to a particular market sector or product may suggest increased levels of volatility might reasonably be expected, and to mitigate the risk of market disruption it may be prudent to require firms to hold additional levels or types of liquid assets against these areas.

In addition, as discussed above, a number of the potential “macro-prudential tools” will be applied to firms, by the PRA and FCA, as micro-prudential tools. Hence, we consider that the FPC should also monitor the aggregate impact of the micro-prudential tools used by the PRA and FCA.

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

The role of the FPC

We welcome the FPC’s revised objective and the countervailing factors that the FPC will take into account. In particular, we consider that linking the FPC’s objective to the Bank of England’s existing financial stability objective, better defines the FCA’s responsibilities in respect of financial stability. We were also very pleased to note that the Government has incorporated the balance between financial stability and economic growth into the FPC’s main objective. We believe, however, that the duty to have regard to economic growth should be positive rather than negative i.e. in exercising its regulatory functions, the FPC should be required to have regard to the impact on economic growth. The objective for the ESRB states that, inter alia: “*It shall contribute to the smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth*”; the FPC could, likewise, be required to exercise its regulatory functions in a way that enables the financial services sector to make a sustainable contribution to medium and long term economic growth.

We consider that the international nature of financial markets should be reflected in the FPC’s objectives and the factors to which it must have regard, i.e. legislation should provide that in exercising its functions the FPC should also have regard to the international nature of financial services.

We welcome the “*have regard to*” factors, in paragraph 2.20, of the condoc, which will be enshrined in legislation.

In relation to the FPC’s functions, whilst we were pleased to note that “*the Government intends to legislate to exclude individual regulated firms from the FPC’s powers*” we have *significant concerns* that the FPC may become involved in micro-prudential regulation if: “*the FPC’s macro-prudential interventions may be aimed at a very small number of firms that manifest a particular risk*”. The condoc envisages that: “*the behaviour of a small number of large institutions – perhaps one or two – could pose a systemic risk.*” Whilst this may be true, in our opinion, intervention against a single firm or small number of firms is not the role of a macro-prudential regulator. As well as exacerbating the confusion between macro- and micro-prudential regulation - as discussed in response to Q2 above, many macro-prudential tools are applied to individual firms as micro-prudential tools - interventions against individual firms should only be made by a regulator that has

proper processes in place to ensure fair treatment and rights of challenge or even appeal.

We also have questions and concerns in respect of:

- the need to ensure that macro-prudential policy is not delivered through speeches and that when a public pronouncement is made, the status of the communication is clear (e.g. the capacity in which the Governor is speaking, whether the industry should note or take action, the priority status of the risk);
- the status of the “*advice*” given by the FPC;
- the mechanism by which the FPC will deploy “the levers and tools at its disposal,” given that the PRA and the FCA will actually use the tools; and
- the means by which disagreements between the FPC and the PRA and/or FCA will be resolved finally, should the FPC concerns not be resolved by the “*comply or explain*” process.

Governance and accountability

Whilst the question speaks to the governance and accountability of the FPC, given that the FPC is a Committee of the Bank, we do not believe that it can be answered in isolation. In respect of the Bank *per se*, notwithstanding the developments in policy since the July 2010 condoc - we still have questions as to whether sufficient checks and balances will be in place to counterbalance the concentration of power that the reforms will create within the Bank. As discussed in our response to the July condoc, our concern is not the concentration of power *per se* but whether there is, in particular, transparency, due process and proper accountability to Parliament.

The Governor of the Bank will, in addition to executive management of the Bank, chair the Monetary Policy Committee (MPC), the FPC and the PRA and be responsible for, *inter alia*, the Bank’s Special Resolution Unit (SRU) and the regulation of payment and settlement systems. Hence we had, and continue to have, concerns, in principle, over the *perceived* independence of the Governor. We note that given the demanding nature of the Governor’s role going forward, the Bank’s senior management team will clearly be critical in providing support for the additional responsibilities. However, as discussed previously, we believe that further consideration should be given to the responsibilities of the Governor and, notwithstanding the check provided by the majority of non-executive directors on the PRA Board, any measures that could be enacted when a conflict is perceived between specific roles.

The Bank is a unique and historic institution and to understand the wider impact of the decision to bring macro- and micro-prudential regulation under the overall responsibility of the Bank, one has to have a detailed understanding of the Bank’s operations. For example, we note that the FPC will, like the extant Financial Stability Committee, be established as a committee of the Bank’s Court of Directors (the Court) (we assume it will technically be a sub-

committee) whereas the MPC is a committee of the Bank itself. As the Court has different responsibilities in relation to the FSC and the MPC; we wonder if the FPC should, to enhance its independence, also be a committee of the Bank. Notwithstanding, we have questions regarding the FPC's relationship with the Court and the transparency and accountability of the Court.

- Given the demanding nature of the Governor's responsibilities - notwithstanding the operational separations further down the Bank's organisational structure - consideration will need to be given to the administrative arrangements necessary to ensure that unreasonable expectations are not being placed on one individual (particularly in times of crisis), to address perceived conflicts of interest and to ensure that external communication are clear; in particular: notwithstanding the clear legal responsibilities, there is likely to be a perceived conflict when the Governor, as chair of the PRA, is involved in a decision that involves placing a firm that the PRA has supervised in the Bank's Special Resolution Regime (SRR), which also falls under the responsibility of the Governor;
- a perceived conflict of interest may also arise for the Governor when the PRA Board considers its response to a recommendation made by the FPC;
- when making public pronouncements, it will be vital to have clarity in respect of the capacity in which the Governor is speaking.

As a minimum, therefore, we believe that conflict management should be addressed by the Government in the MOU and SRR Code.

The Banking Act 2009 amended the governance arrangements of the Bank and, *inter alia*, created a separation of responsibilities between running the Court (the role of a non-executive chair appointed by the Chancellor) and the executive management of the Bank (the role of the Governor). This leads us to wonder whether the necessity of the Governor chairing the PRA (as opposed to being a member of the Board) has been proven. Notwithstanding, the Governor could be absented from voting on any PRA decision that involved placing a bank in the SRR or considering an FPC recommendation. In respect of the FPC's governance *per se*, notwithstanding the above, we also have continuing concerns that the proposed structure is not yet sufficiently robust. In particular, whilst the emphasis is rightly on quality rather than quantity, we remain concerned that that the number of independent non-executives may not be sufficient to provide independent challenge.

Whilst we note the Government's view that the ratio of 4:5 is similar to that of the MPC - which has a more linear remit than the PRA - we do not believe that the Chief Executive of the FCA, who is counted as one of the 5, should be regarded as wholly independent. The FPC's responsibilities will extend across the UK financial services system and members may need to analyse sector-specific risks and determine the most appropriate macro-prudential tool to address those risks,

mindful of any wider socio-economic impacts of the tool. Hence, we feel that, as a minimum, the FPC should have at least 5 wholly independent non-executives (excluding the Chief Executive of the FCA).

We also consider that:

- the FPC should publish its Financial Stability Report – which we understand will include action taken by the FPC and an assessment of its effectiveness - quarterly rather than twice yearly (which would be consistent with the MPC’s Inflation Report and synchronized with the ESRB’s outlook on key systemic risks);
- the role of the Treasury Committee, in respect to providing independent challenge and scrutiny (particularly as regards the FPC’s use of macro-prudential tools and their socio-economic effects and the appointment of non-executive FPC members), should be strengthened e.g. appointment hearings for new non-executive members and hearings to scrutinize reports;
- given the socio-economic effects of macro-prudential regulation, further thought should be given to a greater and earlier role for HM Treasury e.g. approving the use of macro-prudential tools;
- the FPC should consider the merits of establishing an Advisory Panel of leading academics and industry experts – similar to the ESRB’s Advisory Scientific Committee - to assist its work.

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

We note that details of how the Bank and the FCA will work together and divide responsibilities in respect of the regulation of systemically important infrastructure, “*can only be finalised in the light of the final shape of EMIR [European Market Infrastructure Regulation] and the supporting technical standards.*” Whilst we assume that the UK will not be gold plating the regulatory regime for central counterparties (CCPs) beyond the EMIR requirements, any reserved powers should be clearly defined and justified.

We agree that the areas for coordination that are highlighted in paragraph 2.135 of the condoc are key to mitigating the systemic risk to the regulatory system that will be posed by CCPs, although we would hope to see truly joint (Bank/FCA) supervision of vertically integrated exchanges and/or the establishment of domestic colleges of regulators.

Other comments and questions are as follows:

- The last bullet point in paragraph 2.135 of the condoc, which suggests that the FCA might still have some role in relation to Recognised Clearing Houses (RCHs) business conduct, would benefit from clarification, since it was our understanding that the Bank would have sole responsibility for the regulation of RCHs;

- We would be interested in further and better particulars regarding the regulation of clearing by the Bank, particularly as we are concerned that it might be shoe-horned into a payments systems-type approach. Whilst we recognise the similarities between clearing and settlement systems, it will be important to recognise the differences and create an appropriately tailored supervisory approach.

As the Government will be aware, the question of which regulatory authority is responsible for resolving CCPs that fail and the powers that the authority will have available to do so, is not addressed in the EMIR; nor is it referred to in the condoc. We noted in our response to the July condoc that the FCA had no role in respect of resolution, which, given its markets and client money responsibilities, we continue to believe may be an oversight. Furthermore, if the Bank takes responsibility for resolution of a failed CCP, we are not sure whether it would have sufficient powers and tools available or whether, given that the Bank will regulate systemically important infrastructures, it could resolve the apparent conflict of interest. In the interests of good contingency planning, we believe that this 'worst case scenario' requires serious consideration, ideally at an EU level.

Crisis management

Please see our comments, in response to Q3, on the role of the Governor in respect of the Special Resolution Regime.

We also note that the condoc does not discuss the powers now available to the ESAs or how they dovetail with the UK regulatory framework for crisis management. We consider it vital that UK regulators should map out the full extent of the ESA's powers (e.g. in respect of short selling bans) and resolve any potential conflicts with domestic regulation before they crystallise.

As discussed above, we believe that CCPs and other systemically important infrastructure should also be subject to a recovery and resolution regime, although given that the Bank is also the UK's Special Resolution Authority, this could, however, create conflicts with its role as direct supervisor of infrastructures. Hence, appropriate conflict management procedures would be required.

The PRA is to be responsible for both micro-prudential regulation and triggering the stabilisation options under the SRR - i.e. "*making the assessment that the conditions specified in section 7 of the Banking Act 2009 are met*" - which gives us concerns around the potential for conflict between the PRA and the Bank, given that the Bank's XXXS PRA will be a subsidiary of the Bank. We note this consultation expresses the view that the potential for conflicts to arise is limited because the roles and legal responsibilities are clear and because the PRA will be operationally independent from the rest of the Bank but questions remain.

Chapter 3: Prudential Regulation Authority

Q5. *What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the PRA?*

Strategic and operational objectives

We welcome, and support, the proposed use of operational objectives to complement the PRA's single strategic objective. We believe that the approach is well structured and should give the PRA clarity of focus whilst ensuring that operational objectives are enshrined effectively within legislation.

However, whilst we support the PRA's strategic objective, namely "*contributing to the promotion of the stability of the UK financial system*", it is important to recognise the global nature of financial markets and the likelihood that risks to the UK's financial stability may arise outside the UK (or in respect of EEA incoming firms, the jurisdiction of the PRA). We suggest, therefore, that the strategic objective be widened to "*contributing to the promotion of the stability of the UK financial system, having regard to the international nature of financial markets.*"

We were disappointed, however, by the Government's decision not to include competitiveness as either an objective or principle. As discussed below, we consider it crucial that UK regulators will continue have regard to the competitiveness of the UK's financial services industry.

The regulatory principles proposed for the PRA

We strongly support the proposal "*for a consistent set of regulatory principles to which both the PRA and the FCA must have regard in exercising their general functions.*" Regulatory principles are an important means of recognising the other factors to which the regulators must have regard and, by applying equally to the PRA and the FCA, will help create cohesion in the regulatory framework. We assume – although this is not stated in the condoc – that the regulatory principles will be enshrined within primary legislation.

We welcome, in particular:

- Principle 2: "*the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;* which enshrines the important concept of proportionality;
- Principle 3: "*the general principle that consumers should take responsibility for their decisions*";
- Principle 6: "*the principle that the regulators should exercise their functions as transparently as possible.*"

We do, however, have a number of comments on the proposed regulatory principles, which (as above) apply equally to the FCA:

- **Transparency and disclosure**

We consider that principle 5 – *“the desirability in appropriate cases of each regulator making information relating to authorised persons or recognised investment exchanges available to the public, or requiring authorised persons to publish information, as a means of contributing to the advancement by each regulator of its strategic and operational objectives”* – should acknowledge explicitly the fine balance between public policy and private rights (and the legal restrictions that apply).

As the Government recognises: *“This principle is balanced against the fact that it will not always be appropriate for information to be disclosed, for example, where disclosure would harm the regulator’s achievement of its objectives.”* Indeed, in certain circumstances, increased disclosure may also be counterproductive for firms, the secondary markets and consumers. Whilst the reference to *“in appropriate cases”* reflects the fact that disclosure *per se* is not necessarily desirable, we believe that the principle should set out the countervailing arguments. It is also important to recognise that disclosure *per se* will not, in itself, create better regulation but can lead to value destruction.

As the Government will be aware, section 348 of FSMA contains restrictions on the disclosure of confidential information by the FSA, with gateways provided in section 349 and the regulation made under this section. We consider it vital that the FPC, PRA and FCA be subject to the same/similar restrictions on the disclosure of regulatory information obtained while discharging their regulatory functions. It is also important to be mindful of the fact that the single market directives also contain stringent restrictions on the disclosure, by regulators, of regulatory information. For example, article 54(1) (Professional secrecy) of the Markets in Financial Instruments Directive (MiFID) states that:

“Member States shall ensure that competent authorities, all persons who work or who have worked for the competent authorities or entities to whom tasks are delegated pursuant to Article 48(2), as well as auditors and experts instructed by the competent authorities, are bound by the obligation of professional secrecy. No confidential information which they may receive in the course of their duties may be divulged to any person or authority whatsoever, save in summary or aggregate form such that individual investment firms, market operators, regulated markets or any other person cannot be identified, without prejudice to cases covered by criminal law or the other provisions of this Directive.”

The Banking Consolidation Directive also includes, in article 45, an exhaustive list of uses, by competent authorities, of confidential information.

In sum, to the extent permitted under the EU directives, disclosure of information should only be required for specific reasons, in pre-determined circumstances, where appropriately robust safeguards exist.

- **Competitiveness**

We were disappointed, as we discuss above, by the Government's decision not to include competitiveness as either an objective or a regulatory principle, as we consider it crucial that UK regulators should continue to have regard to the competitiveness of the UK's financial services industry.

Wholesale financial markets are global and competition between financial centres (particularly those in emerging markets) is strong and, post the crisis, becoming stronger. Not surprisingly, a number of international regulators have been given a specific responsibility in respect of competitiveness. We have considered a sample of regulators (see Annex I to this response) and found that these responsibilities can, broadly speaking, be divided into two (not necessarily mutually exclusive) categories:

- promoting/enhancing competitiveness (e.g. China, Hong Kong and Singapore); or
- maintaining/sustaining competitiveness (e.g. Hong Kong and Switzerland).

We understand the view that *promoting / enhancing* the competitiveness of the UK financial services industry is incompatible with the role of a regulator. However, in an increasingly competitive global market place and given the ease with which financial services businesses could relocate or even change their head quarters, it is vital that European capital markets, including the UK's leading financial centre, are promoted effectively. As this is not the role of a regulator, it is vital for the UK economy that the Government continues to ensure that the domestic financial services sector is promoted effectively and also contributes to the promotion of European capital markets.

We consider, however, that, provided it is framed appropriately, *maintaining/sustaining* competitiveness is a legitimate objective for a regulator, as it should properly be concerned with ensuring regulation does not damage financial markets e.g. through inappropriate super-equivalence. We recognise that – although not covering quite the same ground - this may be implicit in the FCA's "*facilitating efficiency and choice in the market for financial services*" operational objective

but, if so, we consider that the importance of competitiveness warrants an explicit reference, which would chime with our view that this objective needs to be more reflective of the international nature of financial services.

We appreciate, however, the negative context in which competitiveness can be viewed and, as discussed above, have endeavoured to distinguish the way in which we consider that 'having regard to competitiveness' should promote the development of globally level playing fields though seeking to create *competitive neutrality* between UK and international financial markets; thereby preventing gold plating and the creation of unnecessary barriers (i.e. by countervailing the pressures for highest denomination regulation, rather than encouraging lowest common denominator regulation).

- ***A new internationally-focussed principle***

Looking specifically at the Swiss Financial Market Supervisory Authority (FINMA), financial market supervision²: "*contributes to sustaining the reputation and competitiveness of Switzerland's financial centre.*" In, particular, in exercising its regulatory powers, FINMA:

"...takes into account in particular of:...

b. the effect that regulation has on competition, innovative ability and the international competitiveness of Switzerland's financial centre;..."

We believe that a new *international regulatory* principle should be developed, along similar lines, for both the PRA and the FCA; for example:

...the need to take into account the effect of regulation on the reputation and international competitiveness of the UK's financial markets and the desirability of preventing regulatory arbitrage.

As this is an important issue, we would be pleased to discuss our concerns with the Government in more detail.

- ***Compatibility statements***

Finally, as part of their duty to consult, both the PRA and the FCA should be required to publish compatibility statements, demonstrating how proposed provisions are compatible with their strategic and operational objectives and regulatory principles and are the best way of achieving intended outcomes.

² Article 5 of the Federal Act on the Swiss Financial Market Supervisory Authority, Financial Market Supervision Act.

Q6. *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 consider that the scope of the PRA, in terms of regulated activities (i.e. deposit taking, effecting and carrying out insurance contracts and, under the most recent proposals, dealing on own account) is logical and we agree that the PRA should not regulate solely nor try to define "systemically important financial institutions". Indeed, as discussed in AFME's October 2010 report, Prevention and cure: securing financial stability after the crisis: "We believe that publicly designating financial institutions as "systemically important" and developing reforms aimed solely at the treatment of such institutions will not meet the authorities' objective of maintaining financial stability. Indeed, such a list could, paradoxically, produce the very opposite as firms known to be on it may be assumed by customers and counterparties to be "too big to fail"."

However, whilst banks fall under the scope of the Banking Consolidation Directive and insurers under the Insurance Directives, responsibility for firms falling under MiFID will be divided between the PRA and the FCA. In our previous response we raised concerns regarding the setting of this PRA/FCA boundary.

We are pleased to note, however, that the proposals have been refined significantly and we welcome, in particular, the proposal that, as a starting point, BIPRU 730k firms "*will be capable of being designated*" for prudential regulation by the PRA. This is a sensible starting point since the BIPRU 730k category applies to firms that "deal on own account"; an activity, defined in Section A, Annex I to MiFID, which has a narrower scope than the UK regulated activity of dealing in investments as principal. Since dealing on own account excludes, if certain conditions are satisfied, dealing in investments as principal to execute client orders, brokers that trade on a 'matched' basis (i.e. not taking positions on their balance sheet) and whose Part IV permission to deal in investments as principal contains a "matched principal basis only" limitation will, quite rightly, not fall within scope of the PRA. Basing the PRA's scope on the dealing on own account category will also facilitate co-ordination with EU Directives.

We await with interest the "*further minimum capital requirements and set of indicators*" that the PRA will use for "*assessing whether the firm's systemic importance or interconnectedness with PRA regulated groups companies require it to be prudentially regulated by the PRA.*" Whilst we note that the criteria "*will form part of the PRA's development of its supervisory approach*" and "*will be subject to consultation with firms*", given the importance of clearly defining the PRA/FCA boundary, we consider that the high-level (capital and non-capital) tests should be recognised explicitly in legislation with the detailed application of these tests being set down in the PRA rules.

We do, however, have the following comments on the proposed approach:

- Given the fluid nature of the PRA/FCA boundary for investment firms, with firms possibly meeting – or failing to continue to meet – the more granular criteria for PRA designation as a result of mergers, changes in business etc – it will be crucial to ensure that, for firms close to the boundary in both the PRA and the FCA, there is consistency in the letter and interpretation of rules and in the approach to prudential regulation. Such consistency should also help mitigate possible regulatory arbitrage. Clarity will also be needed to determine a prudential regulator for new start-ups, so that newly authorised firms are not required to change prudential regulator should their actual business not coincide with their initial business plan. Objective criteria and guidance is also needed on when changes of prudential regulator will be made and how such changes will be handled;
- In the interests of efficient, coordinated supervision, notwithstanding the PRA's scope, we believe that financial services groups should be given an opportunity to elect that all investment firms within their group be prudentially supervised by the same regulatory authority, thereby avoiding parts of the group being subject to different prudential requirements/interpretations. We recognise, however, that further thought would need to be given with respect to the inclusion of group asset management companies within such an election.

Our remaining significant concern under this head, relates to the fact that there is no clear prudential/conduct distinction; particularly since the definition of prudential used in relation to the PRA extends beyond capital adequacy into governance, risk management and systems and controls. Whilst the scope of the Banking Consolidation Directive and the Insurance Directives could be used to delineate the PRA's responsibility for systems and controls, the approach to the prudential regulation of investment firms strongly indicates the need for common systems and controls requirements for all MiFID investment firms (c.f. the FSA's "common platform"). Hence, we strongly believe that a set of over-arching high-level standards should form part of both the PRA and FCA's handbook; for dual-regulated firms these standards could be supervised and enforced by the PRA and, where relevant to conduct, by the FCA (see our response to Q24 on rule-making).

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)?*

We support, in principle, judgement-led regulation, however, we believe that the model proposed for the PRA will be difficult to apply in practice given that a significant percentage of prudential regulation and its interpretation is dictated by fairly prescriptive European legislation. It will be important to be clear as to the powers available to the PRA (such as Pillar 2 requirements) and when and how they might be exercised. As discussed in our response to the July condoc, the success of the approach will also depend on the PRA's supervisors having sufficient knowledge, experience and confidence to make judgements and engage in technical and senior-level dialogue with the firms they regulate.

We have a number of concerns regarding the mechanisms proposed in the condoc, which are set out below.

Rule-making

- We wonder how the PRA will satisfy the transparency regulatory principle, when judgement-led regulation requires supervisors to make subjective decisions in relation to individual firms. It will be important for the PRA to be transparent and be seen to be transparent; in particular, the PRA will need to have internal procedures in place to review individual decisions for consistency with other decisions that turn on similar facts and/or decisions in relation to firms' peer groups.
- Whilst we consider that, in principle, short statements of purpose in relation to PRA rules may be helpful – for example, the statements would record the mischief that policy makers were guarding against – we would be interested to understand the legal status of these provisions and how far the PRA will be able to make such statements given that interpretation of EU directives and regulations is reserved to the Commission and, ultimately, the European Court of Justice.
- We see no reason why the PRA should not be given a power to make statutory guidance. Indeed, if it did not have such a power, we would be concerned both in respect of the loss of helpful guidance in the prudential sourcebooks (e.g. the FSA's guidance on the ICAAP process) and the risk that, as PRA staffers will still need guidance to perform regulatory functions, unpublished internal materials will become a kind of private rulebook. Firms should not have to second guess their regulators or be held to account against unpublished standards. Hence, it is essential to have clarity and transparency in respect of rule interpretations, operating procedures in respect of regulatory processes and regulatory expectations. Statutory guidance is the vehicle through which such

clarity and transparency can be delivered; statutory guidance also helps to ensure consistency in approach and a level playing field, gives advisers a feel for what the regulator would think or do about a particular issue and minimises the incentive for some firms to shop around for favourable interpretations of rules.

Appeals

- Given the more subjective and intrusive nature of PRA (and FCA) regulation, it will be particularly important to ensure that firms have access to a mechanism to enable them to discuss and, if necessary challenge individual supervisory decisions, with independent senior-level FSA staffers. Hence we believe that section 395(2) of FSMA - which requires the FSA (except as provided for by section 395(3) of FSMA) to separate its investigation and recommendation functions from decision making and the issue of statutory notices – should apply to both the PRA and the FCA. We also believe that, to satisfy this requirement, both the PRA and the FCA should establish committees (similar to the FSA’s Regulatory Decisions Committee (RDC)) that have external practitioner and non-practitioner members.
- Whilst we recognise that capital-related decisions may be extremely complex, we do not believe it would be fair to restrict appeals to the Upper Tribunal to the limited grounds (for judicial review). Given that a judgement-led regulatory approach requires more robust safeguards, we consider it vital that the Upper Tribunal continues to hear cases on a full merits review. The availability of Tribunal members with sufficient knowledge and experience to hear appeals on complex prudential judgements is a matter for the court service and not grounds upon which to restrict firms’ rights of appeal (especially given the proposals to publish warning notices, as discussed in response to Q14 below).

As the Court of Appeal held in *R (Davis and Others) v. Financial Services Authority*, judicial review is a last resort and should not be used unless other rights of appeal have been exhausted. A judicial review is also concerned with the legality of the decision-making and not the merits of the decision made. Hence, judicial review would not give a firm an avenue to challenge a subjective judgement, for example, relating to its regulatory capital.

Moreover, we would note that the single market directives also require competent authorities to have requirements in respect of rights of appeal: for example, article 52(1) of the Banking Consolidation Directive states that:

*“Member States shall ensure that any decision taken under laws, regulations or administrative provisions adopted in accordance with this Directive is properly reasoned and is subject to the right to apply to the courts. The **right to apply to the courts** shall also apply where, in respect of an application for authorisation which*

provides all the information required, no decision is taken within six months of its submission.” [emphasis added]

In sum, we believe strongly that an independent appeals process, which enables firms to challenge the merits of individual decisions – and not just their legality – must continue to be enshrined in the legislative.

Enforcement

- We were surprised by the lack of detail regarding the PRA’s enforcement powers and resources: for example, in relation to the PRA’s use of the extended OIVOP powers introduced by the Financial Services Act 2010 or the policing of the PRA’s perimeter. We look forward to further and better particulars on the PRA’s enforcement function when the PRA operational framework is published.

Proactive Intervention Framework

- We look forward to additional detail on the “*Proactive Intervention Framework*”. At this stage, though, we would note that a number of the suggestions have been discussed in some detail in relation to investment firms’ resolutions arrangements/EU crisis management. In particular, we are concerned that, should a decision to place a firm within the PIF become public, the firm may enter a negative spiral as a result of action by its customers and the markets.

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

Leaving aside our concerns regarding the checks and balances necessary to mitigate the concentration of power within the Bank, we are, in principle, not uncomfortable with the proposed governance framework for the PRA *per se* and support, in particular:

- legislation to provide that the Board will have a non-executive majority;
- giving the PRA flexibility to involve non-executive directors in decision-making;
- CEO cross-membership of the PRA and FCA boards without voting powers.

However, as discussed above, we still have significant concerns as to whether sufficiently robust checks and balances will be in place to counterbalance the concentration of power in the *Bank* (particularly given that the PRA will be accountable to the Bank’s Court in respect of, *inter alia*, its remuneration policy and budget). Further explanation of how the PRA will have operational independence from the Bank is, therefore, important. In particular, it will be crucial to avoid conflicts of interest and perceived conflicts.

As discussed in response to Q3, given that the Governor will chair the FPC and the PRA and also be responsible for the Bank's Special SRU, we strongly suggest that, as a minimum, the Governor absents himself from voting on any PRA decisions that could involve placing a firm in the SRR or consideration of an FPC recommendation.

We are also of the view that the PRA's directors – including non-executives – should be appointed and liable to removal by HM Treasury, as is currently the case for members of the FSA's Board under Schedule 1, paragraph 2 of FSMA.

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

We welcome the enhanced accountability mechanisms that are proposed for the PRA. We feel that the revised proposals better reflect the FSA's accountability mechanisms, which, in general, are considered to have worked well.

In particular, we welcome the fact that the PRA will be required to have a complaints process and that: *“Legislation will provide that external scrutiny of [PRA] complaints will be carried out by an independent person...”*. However, to be wholly “independent” we consider that the person should be appointed by HM Treasury (and, hence, answerable to the Government) rather than the Bank. We are also of the opinion that there should be one Independent Complaints Commissioner with jurisdiction over both PRA and FCA complaints. Amongst other things, a single Complaints Commissioner would be better placed to deal with complaints that relate to the PRA/FCA boundary.

We also welcome the confirmation that *“the PRA will be subject to full audit by the National Audit Office and accountable to the Public Accounts Committee”* and the new requirement for the PRA to report to HM Treasury in relation to regulatory failures.

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

We are pleased to note the developments in this area since the publication of the July condoc. In particular, we welcome the Government's proposals that:

- *“there should be no significant reductions to the existing requirements to consult set out in the Financial Services and Markets Act. The PRA will be under an obligation to publicly consult when it makes rules except where to do so would be prejudicial to its objectives.”*

Whilst we note the view that it is *“clearly unrealistic to expect that the regulator will produce quantitative cost-benefit analyses especially where it is not possible to monetise or quantify costs and*

benefits in a meaningful way” we would be interested in further detail as to how proportionality will be applied to the CBA process.

We were also pleased to note that *“the Government will also give further consideration to the question of whether the requirement to consult could be streamlined when implementing EU rules.”* However, it would be important not to reduce consultation periods, as stakeholders would still need time to assess and comment on the application of the EU rules nor to lose impact assessments (which provide useful insights on the likely consequences of particular courses of action).

- the *“PRA will therefore be under a duty to make and maintain arrangements for consulting practitioners on the extent to which its policies and practices are consistent with its role as prudential regulator, and to make the arrangements public.”* However, rather than give the PRA *complete “flexibility in deciding what kind of arrangements it wants to establish”*, we are of the opinion that the scope of the Practitioner Panel should be extended, in statute, to the PRA, so that one industry body is able to take an overarching view of the regulatory framework and, in particular, consider coordination between the PRA and the FCA. If the Government is not minded to extend the scope of the Practitioner Panel, then, as a minimum, we believe that there should be a statutory requirement, as in section 9 of FSMA, for the PRA to establish and maintain a prudential Practitioner Panel.
- *“legislation will put the PRA under a legal duty to run an annual consultation process, inviting comments from industry and the wider public on the content of the annual report, and the extent to which the PRA has achieved its objectives.”* We assume that the PRA’s work plan for the coming year will be included in the consultation. As discussed in response to Q12 below, we believe that this requirement should also be extended to the FCA.

Chapter 4: Financial Conduct Authority

We welcome the greater clarity on the role of the FCA and consider that the Government’s choice of final name far better reflects the FCA’s role as a *“focused conduct authority”* and, in particular, as an *“integrated regulator of retail, wholesale and market conduct”* that will put *“appropriate consumer outcomes at the centre of the regulatory process”*. We were particularly pleased to see that the Government took account of the concerns raised by respondents to the July condoc in respect of the positioning of the (then), Consumer Protection and Markets Authority as a *“consumer champion”* and welcome the clearer definition of the FCA’s consumer protection role articulated in the condoc.

In respect of market regulation, whilst the condoc is clear that the FCA *“will also contain a strong markets regulation function”*, it is important that this is

not seen as, or becomes over time, secondary to the FCA's consumer protection role.

Our responses to the detailed questions raised in the condoc are set out below. In sum though, whilst we have a number of *significant concerns* regarding enforcement and decision-making powers – some of which equally concern the PRA – we see the FCA as building on the lessons learnt from the last ten years of regulation. Although we recognise that the FCA will be a different style of regulator, we are becoming reassured that aspects of the current regime that have been found to work effectively are not being changed for changes sake but are evolving into the new regulatory approach. We await with interest the publication of further detail on the FCA's operational structure and the arrival of the CEO designate, Martin Wheatley.

Q11. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?

Strategic and operational objectives

We welcome and support the proposed use of operational objectives to complement the FCA's single strategic objective. We believe that the approach is well structured and should give the FCA clarity of focus whilst ensuring that operational objectives are enshrined effectively within legislation.

As regards the proposed operational objectives, we welcome, in particular:

- The inclusion of the term "*adequate*" within the consumer protection operational objective, which, as the Government recognises, "*reflects the fact that different consumers require different degrees of protection*" and, crucially for wholesale financial markets, "*makes clear that the regulator may differentiate its approach according to the consumer in question, with a marked difference between the level of protection afforded to a retail customer and the level appropriate for a professional market participant.*"
- The introduction of a new objective of "*facilitating efficiency and choice in the market for financial services.*" As well as reflecting the FCA's role "*in removing regulatory barriers*" the objective will, we hope, be a safeguard against the FCA actually creating inappropriate regulatory barriers. We agree that the objective would be "*especially relevant to wholesale markets, where the regulator may focus less on proactive intervention and protection and more on promoting better outcomes by facilitating a level playing field.*"

However, we believe that the *facilitating efficiency and choice in the market for financial services* objective, whilst quite rightly focused on the UK, should reflect the international nature of financial services and the need for level international playing fields (c.f. the European

Supervisory Authorities' objective of contributing to: "*preventing regulatory arbitrage...*"³ We suggest that the objective is broadened by, for example, the addition of:

"...having regard for the international nature of financial services and the desirability of preventing regulatory arbitrage".

Alternatively, given the global nature of both the wholesale financial markets and regulatory risk, the objective could be extended to include an explicit role in helping to develop international level playing fields. For example:

"Facilitating efficiency and choice in the market for financial services and promoting global regulatory consistency."

We believe that this would help safeguard against the UK 'gold-plating' EU regulation and international standards and would underpin, and highlight the importance of, the FCA's EU and international agenda (see our response to Chapter 7 of the condoc).

The condoc contains several references that could be read as referring to price regulation: "efficiency in terms of pricing and delivery" (under the efficiency and choice objective) and the "price formation process" (under the market integrity objective). If so, we consider that the role of a regulator in price regulation – and the interaction with the competition and consumer choice – warrants separate debate.

The regulatory principles proposed for the FCA

See our response to Q5.

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

We are supportive of the proposed arrangements for the governance and accountability of the FCA and welcome, in particular, the proposals to:

- retain the existing panels and establish a markets panel;
- replicate the existing FSMA complaints provisions;
- retain the existing consultation procedures for rules and statutory guidance; and
- subject the FCA – and its fee arrangements - to audit by the National Audit Office (NAO).

We also welcome the new requirement for "*the FCA to make a report to the Treasury where there is a regulatory failure*" and agree that HM Treasury should have a backstop power to direct the FCA to produce such a report, either where the FCA has failed to do so or where a report is in the public interest. We note, however, that "*reports may*

³ Article 5(d) of Regulation (EU) No 1093/2010 of The European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC

include the disclosure of confidential information where this is justified in the public interest”; we assume that the legislation will also contain safeguards to protect the rights of firms and individuals mentioned in such reports.

We consider, however, that the FCA should, like the PRA, also be under a legal duty to run an annual consultation process, inviting comments from industry and the wider public on the content of the annual report, its annual work plan and the extent to which the FCA has achieved its objectives.

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

As the FSA has identified in Annex 2 to DP11/1: *Product Intervention*, FSMA gives the FSA “*very broad powers to make new rules.*” Whilst certain of the proposals in DP11/1 could have competition implications, there is no suggestion that FSMA requires amendment to give the FSA new legal powers.

We consider, therefore, that the proposals for product intervention in the condoc largely bring together a number of the powers available currently to the FSA through existing FSMA provisions. We note, however, that:

- the power to prohibit products “*is unlikely to be appropriate in relation to professional or wholesale customers*”; and
- any product intervention rules will be “*for a period of up to 12 months*”.

Notwithstanding, whilst we understand the rationale for product intervention, we have a number of concerns as regards the proposed approach.

At a policy level, we are concerned that introducing a specific product intervention power into UK legislation may pre-judge the outcome of the MiFID review and we would be interested to know how the proposed power aligns with/has been reconciled to, the product prohibition powers now available to the ESAs.

It is of interest to note that the joint HM Treasury/FSA response to the Commission Services consultation on the Review of MiFID stated in section 1 (“Powers to ban services and activities”):

“With regard to intervention powers, as the Commission recognises, its proposal for a European level power to ban the provision of investment services and the carrying out of investment activities in certain financial instruments has potentially significant consequences for market participants and businesses. Banning products of any kind should be undertaken with great caution as otherwise innovation, effective risk management and economic growth could be detrimentally

impacted. A greater justification is needed for the introduction of these powers without safeguards.

We note that powers already exist under MiFID that effectively empower national regulators to ban a product, and for European cooperation on such action. Similarly, the new European Supervisory Authorities (ESAs) have been given the power to ban products temporarily (together with appropriate attached powers to obtain information critical to such decisions). We would therefore query how some of the proposals under this section relating to EU banning mechanisms would relate to these existing powers; and the consequent necessity for such powers.”

Particularly given this uncertainty, we believe that the Government should await the outcome of the Commission’s review, rather than risk introducing a power that is found later to be incompatible with the revised MiFID and the wider EU supervisory framework.

At an implementation level, notwithstanding the above, as the Government recognises, “it is important to strike an appropriate balance between enabling the FCA to act quickly to protect consumers and providing an appropriate degree of certainty for firms.” Hence, we strongly support a legislative requirement which provides that the FCA must “publish and consult on a set of principles governing the circumstances under which it will use this new power.” We concur that these principles “will also give greater clarity and certainty to industry about the FCA’s expectations in relation to product design and product governance” and consider it important that the principles “codify the need for proportionate application of such a power to reflect that it is unlikely to be appropriate in relation to professional or wholesale customers.”

We agree that the FCA should not pre-approve products. Nevertheless, it is important that the FCA is open with firms – in accordance with principle 6 – and prepared to discuss its expectations with firms that are in the early stages of complex product design. It will also be essential for the FCA to recruit staffers with appropriate skills and experience to understand new products and to apply any intervention power proportionately.

In sum, it is critical that there is no lack of certainty regarding the FCA’s expectations and use of its product intervention powers since, unless there are sufficient safeguards to give firms certainty when developing new products, the product intervention powers could become a break on development - perversely - for the more risk-averse firms.

We assume that the prohibition power could apply to a particular product and its provider or to a class of product and all its providers. In the former case, it will be important to have clarity as to whether, if the FCA bans a product offered by one firm, all firms offering a similar product have to withdraw them. The precedent value of published

bans must also be made clear to firms so that the regulator's expectations can be taken into account when designing new products.

Enforcement and redress

As a general comment, we do not consider that sufficient clarity is provided in the condoc with respect to enforcement and dual-regulated firms; in particular, there should be no risk of double jeopardy for breaches of systems and controls rules that have both prudential and conduct implications.

As noted above, there is also a lack of detail in respect to the PRA's enforcement resources.

Q14. The Government would welcome specific comments on:

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

We note that: *“As signalled in the regulatory principles, the Government therefore expects the FCA to have a regulatory culture based on a presumption of transparency, so that it makes greater use of existing powers to make disclosures itself, or require disclosures by firms.”*

We support, in principle, a presumption of transparency where the transparency relates, in accordance with the fifth regulatory principle, to the exercise, by regulators, of their regulatory functions. We consider it critical that there is transparency:

- in respect of the operation, by regulators, of their regulatory processes; and
- between regulators and Parliament.

However, with increased transparency comes a need for the FCA – for example, when publishing its *“views on market developments...and firm behaviour”* – to clearly flag the communications firms are expected to consider, the purposes for which firms should consider them and where such communications can be located.

At present, it is often difficult for firms to locate and/or appreciate the relevance of information that is published outside the FSA Handbook (e.g. determining the precedent value, if any, of settled enforcement cases), although information published or clearly signposted on FSA web pages or in focused publications like Market Watch, is easier to locate than speeches. We recognise that the FSA is aware of this communication issue and we strongly support their ongoing work on guidance (e.g. recognition of the need for the new guidance consultation process), since it is vital that general guidance, as defined in section 158(5) to FSMA, is not made without due consultation and that all general guidance, where so ever published is clearly linked to the rules to which it refers. We consider it important that the topic under consultation

and its complexity is considered when determining the length of a consultation period, so that appropriate time is provided for respondents. In the interests of fairness, it is also important to ensure that firms are not judged, in enforcement action, against regulatory expectations that were not brought clearly to their attention through a formal channel of communication. In this connection, greater weight should be given to formal guidance that has been consulted upon.

As discussed in our response to Q5 above, we do, however, have concerns in respect of the disclosure of regulatory information obtained by regulators in the exercise of their regulatory functions. Given the restriction that apply to disclosure of confidential information – which are recognised by the Government in the condoc – and need to define the circumstances in which disclosures may need to be made, the information that may need to be disclosed and the rationale for so doing, we do not believe that a presumption of transparency could or should apply to disclosure of firm-specific information.

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

We understand the case for legislating to give the FCA a power to publish the fact that it has asked a firm voluntarily to withdraw a misleading promotion, however, we do not see the need for the FCA to have a power to direct firms, who would otherwise have complied voluntarily, to withdraw or amend misleading financial promotions. Where a firm refuses to comply with an FCA request, the FSA's existing enforcement powers, which we assume will be replicated for the FCA, should be sufficient to enable the FCA to take action and publish the result. Notwithstanding, if the FCA is given such a power of direction, firms must also be given an expedited right of challenge; for example, a right to make representations to the RDC.

As an alternative, however, we suggest that the Advertising Standards Authority's (ASA's) approach be used as a template for the FCA. In particular, we consider that the FCA should adopt an ASA-style complaints and investigation process which distinguishes between 'informal resolution' and a 'formal investigation'.

In particular, under the ASA's approach:

- *“When a minor or clear cut breach of the Codes has been made, the ASA may resolve the complaint informally, so long as the marketer agrees to change or withdraw its marketing communication straight away. Marketers' co-operation in changing their marketing communication is reported on the ASA website as an informally resolved complaint.”* It is important to note that for “*informally resolved cases*” the information published on the ASA's website is limited to the name of the firm, the date, the number of complaints, the media and the

sector. This a good safeguard against a firm facing vexatious claims from customers.

- Where the ASA “*thinks there is a case to answer under the Codes, the ASA will conduct a formal investigation. In these cases, we will ask the advertiser to provide relevant evidence to support their advertising technique and substantiation for the claims they have made. Final adjudications are made by the ASA Council and are published on our website in full each week.*” It is important to note that the adjudication includes the advertiser’s response to the issues raised.

Given that most firms currently withdraw or amend financial promotions when asked to do so by the FSA, we see no need for added bureaucracy, particularly as the ASA can recognise and reward informal co-operation. In week ended 16th March, for example, the ASA published 28 adjudications (including three complaints “*not upheld*”) and 28 informally resolved cases. The ASA’s website demonstrates its ability to protect consumers and clearly illustrates examples of bad practice. We do not believe that the FCA needs additional powers of direction over firms to achieve similar results.

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

We recognise that there is a fine balance to be struck between public policy and individual rights. However, we are extremely concerned that the proposal to publish warning notices does not strike the right balance and risks creating unfairness to individuals and firms that are the subject of enforcement action by the FCA and the PRA.

As the Government will be aware, the Financial Services Act 2010 amended, *inter alia*, section 391(4) of FSMA, which now requires the FSA to publish: “*information about the matter to which a decision notice or final notice relates as it considers appropriate*”. This amendment was designed to give greater transparency to the FSA’s concerns, as prior to the amendment, the FSA could only publish final notices and, in the case of referrals, had to await the Upper Tribunal’s determination of a case – a process obviously outside the FSA’s control - before publication. To date, however, the FSA has not used this new power and the benefit - of the FSA being able to publish its determination at the conclusion of its own enforcement and decision making process - remains untested. We believe that it is unreasonable to introduce further changes, which have the potential to impose significantly higher reputation costs on firms and individuals, before ascertaining whether the Financial Services Act amendment introduces sufficient transparency.

Nevertheless, it is proposed in paragraph 4.87 of the condoc, to give the FCA the power “*to allow for publication of the fact that a warning notice has been issued, and a summary of the notice*”. Notwithstanding the “*safeguard to ensure that there is procedural*

fairness for affected firms and individuals” discussed in paragraph 4.89 of the condoc, we have a number of *significant concerns*.

Firstly, by way of background, it is important to note that:

- A warning notice marks the commencement of formal enforcement proceedings and will set out (often following an investigation or a ‘section 166’ report from an independent ‘skilled person’) the FSA’s case against a firm or individual (the defendant). Whilst the FSA’s case and the wording of the warning notice will have been reviewed by the FSA’s independent decision makers, the RDC, the firm or individual that is the subject of the enforcement action will *not* have had an opportunity to make their case and/or correct errors, omissions and misunderstandings in the FSA’s case.
- A decision notice, however, is usually issued after a case has been heard in full by the RDC and, therefore, includes the defendant’s case – both written and, if made, oral representations – and reflects any changes to the FSA’s case that have been made by the RDC as a result of factual corrections and the testing of both sides of the case. It is important to note that a number of cases are dropped by the RDC following the hearing (no published figures are available but some estimates point to $\frac{1}{4}$ to $\frac{1}{3}$ of cases being dropped by the RDC). We assume that the Government is aware of the precise statistics. Moreover, as a result of due process, decision notices often look significantly different to warning notices and may contain a reversal of the FSA’s position.

We agree that there may be circumstances involving significant potential consumer loss or detriment, which the FCA may wish to publicise as a matter of urgency, for example, unauthorised investment business, boiler room fraud. However, we are disturbed to note the *“expectation...that the regulator will publish the fact that a warning notice has been issued, unless doing so would not be compatible with its operational or strategic objectives.”* If the FCA is to have such a power, we believe, instead, that it should only be used *in extremis*, subject to robust safeguards.

To give the FCA a *“discretion”* to publish warning notices but to set such a high expectation as regards publication raises a number of serious issues, including:

- **Fairness:** to introduce such a power, new and robust, protections need to be in place to ensure that individuals and firms are given a fair hearing, as required under the European Convention on Human Rights (ECHR). We do not believe that the safeguards, as expressed in the condoc, are sufficient and given that the individuals and firms have had no access to due process at the time of publication of the Warning Notice, we question whether the process is ECHR compliant?

- **Reputational damage:** In most cases, simply publishing the fact that a warning notice has been issued will be enough to significantly damage a firm's or individual's reputation. Publishing a notice of discontinuance, if the FCA decides to take no further action, would be too little too late to repair unjustified reputational damage, particularly since any media coverage of the publication of the warning notice will still be accessible via searches of the Internet.
- **Concurrent civil litigation:** There is a risk that publication of a warning notice may cause many of the firm's clients and counterparties to contact it and ask for clarification or greater protection or to terminate their relationship; this might impede or even prevent the firm from being able to try to rectify the potential problem and/or cause further problems (e.g. by reducing liquidity). There is also a risk that the firm will face civil litigation (e.g. from customers seeking damages) at the same time as it is defending itself against the regulatory action.
- **Significantly lower test than for criminal prosecution.** Whilst some might compare a warning notice to a charge in a criminal prosecution, the tests the FSA has to satisfy to issue a warning notice are *significantly* lower than the tests for prosecution.

The Decision Procedures and Penalties Manual (DEPP) provides guidance (DEPP 2.2.3.G) that, when determining whether to accept the FSA's recommendation to issue a warning notice, the independent FSA decision maker will:

*"(1) consider whether the material on which the recommendation is based is **adequate** to support it; the decision maker may seek additional information about or clarification of the recommendation, which may necessitate additional work by the relevant FSA staff;*

*(2) satisfy itself that the action recommended is **appropriate** in all the circumstances;*

(3) decide whether to give the notice and the terms of any notice given." [emphasis added]

In contrast, a prosecutor decides whether a person should be charged with a criminal offence in accordance with the Code for Crown prosecutors. In general, a prosecutor may only start or continue a prosecution if the case passes both stages of the 'Full Code Test':

- *The evidential stage:* the prosecutor must be "satisfied that there is **sufficient evidence to provide a realistic prospect of conviction...**" and "must consider what the defence case may be, and how it is likely to affect the prospect of conviction." [emphasis added]

- *Public interest stage*: the prosecution must be in the public interest.

We are also concerned that the publication of warning notices may result in behavioural changes that might not necessarily be welcomed:

- the FCA may come under pressure, which may in turn be felt by individual investigators, to continue with enforcement action rather than face the reputational risk and the loss of credibility which may be inherent in dropping a case;
- firms may come under pressure to enter into a settlement – and agree the wording of the statutory notices that reflect the terms of the settlement - due to the reputational risk of trying to make their case; but
- individuals named in action against firms that settle may be more inclined to contest to clear their names.

The FSA's published accounts, in relation to enforcement cases, show:

	09/10	08/09	07/08
Cases open at 01 Apr	198	187	125
Opened during year	89	165	151
Closed during year	114	153	90
Still open at 31 Mar	173	199	186
Private Warnings	?	38	13

Between 1 April 2009 and 31 March 2010, of the 114 cases closed during the year, 79 cases resulted in public disciplinary action (of which 48 by executive settlement), therefore, 35 cases were closed after the warning notice stage. Whilst we do not know how many of these cases resulted in private warnings or how many were 'dropped', one can conclude that 30% of cases under the current system did not result in a public outcome in 2009/10 and, hence, would have been prejudiced by the early publication of the warning notice proposed in the condoc in a way that would have not been justified by the sanction ultimately imposed. In addition, all the settled cases that resulted in a financial penalty were settled in the first stage (i.e. before a warning notice is issued); hence the proposed power to publish a warning notice would not have been required in these cases.

Between 1 April 2008 and 31 March 2009, 71 cases were concluded by executive settlement. During that period, 118 cases were referred to the RDC. Over three-quarters of cases with a disciplinary outcome settled before reaching the RDC

and almost all cases involving a financial penalty were settled during the first settlement stage (i.e. before the issue of a warning notice); hence, the proposed power to publish a warning notice would not have been required in these cases.

Between 1 April 2007 and 31 March 2008, 36 cases were concluded by executive settlement. During that period, 15 cases were referred to the RDC. Approximately three-quarters of cases with a disciplinary outcome settled before reaching the RDC and almost all cases involving a financial penalty settled during the first settlement stage (i.e. before the issue of a warning notice); again, the power to publish warning notices would not have been required in these cases.

Hence, whilst we can understand the objectives, we are not convinced of the case for the FCA to have an unfettered power to publish warning notices. We would, therefore, urge the Government to *reconsider* its proposals as we believe that other options are available to enhance transparency and protect consumers. For example:

- To *enhance transparency*, the FCA could publish alerts/statements relating to enforcement action it has initiated, without naming individuals or the firms concerned or pre-judging the final outcome. Such statements could include generic summaries that would serve to highlight the practices and/or behaviours that the FCA deems unacceptable. Whilst anonymising warning notices would, in principle, protect the names of the defendants, we would be concerned by the significant risk that the defendants would be identified – or even incorrectly identified - by market rumour and speculation. This would have implications for listed firms and, if the issues concern liquidity, possibly even financial stability. In such cases the FCA should not publish summaries.
- To *protect consumers*, individual approved persons could be suspended – rather than have the FCA publish their names – and in egregious cases, the FCA could use the formal intervention powers in Part XXV of FSMA, which we assume will be given to the FCA.

Moreover, we believe that the FCA should be subject to a ‘fair reporting’ duty (particularly in respect of media briefings for enforcement action) and should be required to follow the “maxwellisation” process (i.e. give those named an opportunity to review and challenge proposed text) in respect of any statutory notices etc that it publishes.

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?

The BIS has launched a far reaching consultation on competition in the UK: *A Competition Regime for Growth: A Consultation on Options for Reform*. We note that this consultation document references, in paragraph 58, the fact that the Government “*is considering whether concurrent competition powers should be extended to the future Financial Conduct Authority (FCA).*”

Given the fundamental changes that are likely to result from this consultation, in particular, the merger of the Office of Fair Trading (OFT) and the Competition Commission to form the Competition and Markets Authority, we consider it premature to discuss the FCA’s role in respect of competition in any degree of detail.

That said, we would highlight the following issues at this stage:

- competition regulation needs a different toolkit and different expertise; hence the proposal to give the FCA a limited form of concurrency would require the FCA to employ competition experts; and
- giving the FCA concurrent duties to respond to super-complaints launched by designated consumer bodies may have significant implications for FCA resources.

Wholesale and markets regulation

We welcome the greater detail and clarity on the FCA’s “*proportionate and tailored*” approach to the regulation of wholesale firms. In particular, we welcome the use of the FCA’s objectives and the principle of proportionality to tailor the supervisory approach to the wholesale markets. That said, we recognise that there is an ongoing debate about how far down a chain of product provision regulatory responsibilities to an end retail consumer should reach.

We would be interested to see more detail with respect to how the Markets Division will be embedded in the wider FCA. The Markets Division will constitute a small, but vital, part of the FCA, therefore, it will be critical to ensure that there is appropriate inter-linkage, particularly as the Government has decided that wholesale firms - which have a significant impact on the secondary markets either through their trading activities or the provision of, for example, execution platforms - will be regulated in a separate supervision division.

We note that: “*The FCA will be solely responsible for the conduct and prudential regulation of recognised investment exchanges (RIEs) and operators of multilateral trading facilities (MTFs).*” However, where a BIPRU 730k investment firm operates an MTF platform, will they also be regulated by the FCA for prudential and conduct purposes? Given that an MTF operator sometimes deals as principal in operating the

MTF and may also deal as principal in another business line or have a PRA regulated firm within its group, it would be helpful to confirm whether MTF operators would be prudentially regulated by the PRA.

Since “*MTFs, as authorised persons, will be regulated by the FCA in the normal way*”, we assume that MTF operators will be regulated by the FCA’s Markets Division, rather than supervision. Again, it would be helpful to confirm whether this would be the case for brokers operating MTFs. We also assume that, in the future, if the European Commission’s proposal for organised trading facilities is adopted, they will also become the responsibility of the Markets Division?

Given the systemic importance of CCPs, particularly once OTC derivative transactions are centrally cleared under the EMIR, the regulation of vertically integrated exchanges by the Markets Division will require close communication and joint working with the Bank - which will regulate RCHs - to manage the systemic risks (see also our response to Q4).

Q16. *The Government would welcomes specific comments on: (a) the proposals for RIEs and Part XVIII of FSMA; and (b) the proposals in relation to listing and primary market regulation.*

RIEs and Part XVIII of FSMA

We strongly support the Governments intention “*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 (MIFID).*”

Listing and primary market regulation.

We welcome the Government’s decision to retain the UK Listing Authority (UKLA) as part of the FCA and believe that this will ensure that the FCA’s Markets Division continues to be an effective and efficient regulator of both the primary and secondary markets.

The UKLA, as the competent authority for listing will, however, have different priorities to the FCA: therefore, whilst we understand the rationale for bringing the legislative framework for listing and other primary market regulation “*under the general legislative framework of the FCA (rather than being solely contained in a discrete part of the statute)*” we are concerned that the proposed integration may have unintended consequences, which have not yet been recognised fully. We note that the amendments are considered to be “*minor technical improvements to Part VI*” FSMA - however, we are aware that the GC100 (the association for general counsel and company secretaries of FTSE100 companies) has written to HM Treasury to express their concerns with respect to the proposed changes. Given these differences of opinion, we believe that the proposals should be examined in greater detail as part of a separate consultation process.

Notwithstanding, we have the following, initial, comments on the specific proposals set out in paragraph 4.112 of the condoc:

- we support the proposal to allow the UKLA to suspend a listing without following the statutory notice procedure (provided the issuer indicates its reasons for requesting a suspension and provides supporting facts that should be considered by the UKLA). We suggest that the UKLA should explain its rationale in the event of a suspension decision unless to do so would be detrimental to the company or the market;
- we would welcome further background on the proposal to extend the UKLA's powers to impose sanctions on sponsors e.g. a more detailed explanation of how and when the powers would be used. While the proposal stipulates that such powers would be subject to the normal enforcement and appeal mechanisms of FSMA, there is no rationale in the condoc to support the change of enforcement powers over sponsors, beyond noting the importance of the sponsor's role and the desirability of integrating the legislative framework of the UKLA into FSMA;
- we are also concerned that the proposed change in the limitation period for enforcement action against breaches of the listing rules is change for the sake of change;
- the proposal to allow the UKLA to require a skilled person's report in respect of matters of concern to the UKLA would be a material enhancement of the UKLA's power. The use of this power in practice could - particularly if there is a low level of materiality and frequent use - actually be as onerous to issuers, both in terms of costs and time, as a full external investigation; hence.
- we have no objection to the proposal to empower the UKLA to make rules for, and impose sanction on, primary information providers, subject to the normal enforcement and appeal mechanisms in the FSMA.

Chapter 5: Regulatory processes and coordination

We welcome the statement, in paragraph 5.4 of the condoc, that *“new legislative provisions will be needed to create coordination mechanisms ensuring that regulatory processes will operate effectively and efficiently.”*

Effective and efficient coordination between the PRA and the FCA – particularly in respect of dual-regulated firms – is one of our members' *key concerns*. As the Government will appreciate, the relationship between the PRA and the FCA is a potential fault line which, if not properly addressed, will cause significant operational - and, hence, financial - issues to firms, undermine the foundations of the new framework and, possibly, the attractiveness of the UK as an international finance centre.

We are, however, reassured that the Government has listened to the concerns expressed by respondents to the July condoc and understands the importance of coordination between the PRA and the FCA; particularly in respect of regulatory processes. We also welcome the progress that has been made in respect of both the approach to, and proposals to deliver, effective coordination; however, this remains an area where significant additional thought and input – including from industry stakeholders – will be necessary.

Coordination between the PRA and FCA and achieving clarity with respect to regulatory processes and overarching regulatory standards is one of the most complex aspects of the Government’s proposals in this condoc (not least because there is a grey area between prudential regulation and conduct regulation). Hence, the proposals warrant careful consideration; inter alia by experienced regulatory professionals and financial services lawyers; both to resolve the difficulties that remain and to enhance the efficiency and effectiveness of some of the proposals. AFME members have a deep understanding of regulatory processes and stand ready to assist the Government, in respect of the development of its proposals, and the FSA, in respect of the practical, operational, implementation.

Our initial thoughts on the proposals, in policy terms, are set out below. We look forward to reviewing and commenting on the forthcoming legislative provisions and on the forthcoming operational detail in respect of the PRA and the FCA, to be published in due course by the FSA.

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

High-level principles

We support the proposed high-level principles, set out in paragraph 5.6 of the condoc, which underpin the more granular coordination mechanisms proposed in subsequent sections of chapter 5. In particular, we strongly support the fourth principle; namely:

“from the perspective of firms, coordination must result in regulatory and supervisory engagement that are cost-effective and mitigate the risk of duplication. Firms should not receive conflicting views from regulators;”

We assume that these high-level principles will be enshrined within legislation; they should be.

Statutory duty to coordinate

We note that *“the Government believes that the key to delivering effective coordination is to allow the PRA and FCA flexibility about how they engage with each other, rather than specifying onerous and bureaucratic processes in statute.”*⁴ Whilst we support the need for the PRA and the FCA to have flexibility, and are aware of other regulatory systems in which Memoranda of Understanding (MOUs) play a key

⁴ Paragraph 5.8 of the condoc

role in coordination (e.g. Australia), it is vital that there is complete clarity with respect to the regulators' responsibilities for all regulatory powers and processes set out in FSMA and all high-level regulatory standards in the FSA Handbook.

In our opinion, “*specific responsibility*” for all key (not just “*particular*”) “*processes and regulatory decisions relating to dual-regulated firms or groups*”⁵ included currently within the FSA’s Supervision Manual, should be set out in legislation. Whilst we appreciate the need for flexibility and appreciate that it works well at an operational level, we would be concerned if responsibilities for regulatory processes were not clearly delineated, thereby giving certainty to firms and their advisers and avoiding (given human nature) potential disagreements between regulators.

Complete clarity, again enshrined in primary legislation, is also needed in respect of the PRA and FCA’s rulemaking powers and their duties of coordination in areas where the regulators’ scope overlap e.g. high-level regulatory standards such as systems and controls and regulatory processes such as approved persons and authorisation. We consider it vital that the PRA’s and FCA’s development of rules in areas of overlap is coordinated, so that the rules are consistent.

We also believe that the duty to coordinate, outlined in paragraph 5.11 of the condoc, should:

- be triggered at lower thresholds; the references to “*material*” in the first limb and “*where necessary*” in the second limb set the bar too high (c.f. the MOU between the Australian Prudential Regulation Authority and the Australian Securities and Investments Commission which requires notification of changes in regulatory policy, guidance or regulatory decisions “*which are likely to impact on the responsibilities of the other*”);
- include a fourth limb that requires the PRA and FCA to manage, jointly, the risk of coordination failure i.e. the regulators should be required to manage operation risk in relation to a failure of coordination (for example, by indentifying critical processes and systems and ensuring there are appropriate controls and reporting in place to identify, mitigate and report breakdowns and to resolve them);
- explicitly require, under the third limb, the regulators to have regard to the combined costs of regulation for dual-regulated firms and whether these combined costs are proportionate;
- we are also considering further whether the duty to coordinate should be extended to the FPC in relation to financial stability?

⁵ Paragraph 5.9 of the condoc

Memorandum of understanding

We support an operationally-focused MOU between the PRA and the FCA that is mandated by legislation, and agree with the key areas for coordination, outlined in paragraph 5.13 of the condoc, that should be included in an MoU. In particular, we concur with the fourth bullet point on coordination of interaction with firms and the fifth bullet point on coordination of EU and international engagement. We note, however, that as envisaged currently, the MOU will not consider coordination of enforcement, which we consider to be an omission that should be rectified.

We also believe that the MoU should enshrine, as a principle, the desirability of establishing a designated lead supervisor to act as a single point of contact for dual-regulated firms. We appreciate that the PRA and FCA will be separate regulators, pursuing different objectives, and in asking for a lead supervisor we are not trying to negate the development of a twin peaks system; rather, we believe that allocating each dual-regulated firm a lead supervisor chimes with the PRA and FCA's statutory duty to coordinate. Furthermore, allocating lead responsibility for the supervision of each dual-regulated firm to a specific supervisor or supervisory team – who could coordinate a domestic college of regulators and operational processes such as data sharing and co-ordination of supervisory visits – would help ensure that regulators will continue to have a holistic view of firms.

In accordance with the regulatory principle of transparency, and to ensure proper accountability, the performance of the PRA and FCA in relation to regulatory processes should be measurable. In our opinion, service-level standards should be determined and published for key regulatory processes. The performance of the PRA and the FCA – and, hence, the effectiveness of the processes designed to deliver coordination in practice – should be judged, periodically, against the standards to, inter alia, identify areas where operational enhancement is required (which is likely to be the case as the new processes 'bed-down' in practice and inefficiencies – both for the regulators and firms – are identified and eliminated) or greater clarity needs to be delivered through amendments to the MOU as part of the annual review processes.

We also consider that the PRA and the FCA should be required to carry out specific performance surveys with dual-regulated firms and professional advisers to inform the annual review of the MOU (possibly in connection with the PRA's (and we suggest FCA's) annual consultation on strategy and approach). Such surveys, which should be anonymised and made public, would also accord with regulatory principle of transparency and, in conjunction with the above, enable the regulators' performance – particularly in relation to coordination and efficiency for dual-regulated firms – to be subject to scrutiny by, for example, the Practitioner Panel and the Treasury Committee.

Finally, we agree that the MOUs should be reviewed annually and laid before Parliament whenever changes are made; we trust that – given the importance of this MOU – the industry will also be given a ‘comment period’ in which to provide thoughts on the draft MOU and on any changes proposed in the future.

Cross membership of Boards

We continue to support Chief Executive cross membership of the PRA and FCA Boards and consider that it is vital for coordination. We also believe that it would be appropriate to restrict the Chief Executive board member from voting on firm-specific decisions.

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 instability?

We understand the rationale for, and support in principle, the PRA being able to veto the FCA taking action, in the limited, and hopefully rare, circumstances in which action by the FCA would be likely to lead to a disorderly failure of a firm or wider financial instability. That said, there is a perception – arising from the numerous references to the veto in the condoc – that the veto risks undermining the decision-making powers of the FCA and makes the PRA appear - contrary to the Government’s stated intention - as the ‘senior regulator.’ We believe that this perception could be addressed in part by greater clarity around the definition of financial stability and examples of circumstances in which the veto might be used.

We note that the veto will be a “*limited*” long stop power and that, as set out paragraph 5.25 of the condoc, its use will be subject to requirements set out in legislation, which will include laying “*notification of the veto...before Parliament.*” We assume that the notification will state the reasons for use of the veto and that, except in extremis, Parliament will have an opportunity for scrutiny before the veto is actually. Obviously, as HMT will be aware, the exercise of the veto power would have significant implications for the FCA’s credibility and, therefore, as noted in the condoc, should be used only *in extremis*. We will, however, comment further when the relevant clauses of the draft Bill are available.

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

In our response to the July condoc, we advocated the use of a shared services function to provide a common back office for both the PRA and FCA:

“...we strongly support the establishment of a shared services function that would provide a common ‘back office’ for both the

PRA and CPMA and, in particular, perform regulatory processes and providing IT, data collection and warehousing, HR and finance for both authorities. As well as creating a single contact point in respect of applicants for authorisation and approval, a shared services function could screen applications on a case by case basis to identify whether the application should be determined by specialists from the PRA and/or the CPMA e.g. by considering whether an application for approval poses any prudential risks. A common back office would also provide considerable synergies, assist with information flows and help avoid unnecessary divergence between the authorities at an operational level.”

We believe it is crucial that the PRA and FCA apply consistent operational procedures. We, therefore, remain of the opinion that a shared services approach would be the most efficient and effective, in that it would, amongst other things, create cohesion between the regulators, maximise the use of resources and provide dual-regulated firms with a central contact point for regulatory processes. We would, therefore, appreciate an opportunity to explain our thoughts in greater detail and explore possible variations; for example, a joint regulatory decisions committee, permanently resourced from the PRA and the FCA, which, under joint control of the authorities, processes applications.

Notwithstanding the above, if the Government is to proceed with one of the two approaches to authorisation suggested in the condoc, *we strongly support the “alternative approach.”*

The alternative approach, in addition to being the most coordinated and efficient, best reflects the current processes whereby a single FSA authorisation team receives and processes applications for Part IV permission, carrying out due diligence / fitness and propriety checks before the relevant supervisory teams apply their specialist knowledge and, inter alia, drill down into the detail of the business plan.

Our preferred option is for *“the FCA (as the regulator with scope covering all firms)...[to] be responsible for processing applications (seeking the consent of the PRA)...”*

Under the new framework, the FCA will be processing and determining, in its own right, the majority of applications for Part IV permission and, hence will become a centre of authorisation expertise. We do not believe that such centres of excellent should be duplicated within the new regulatory framework. In addition, given the need for access to intelligence databases, we believe that the FCA’s role in respect of financial crime makes it a logical centre of excellent for due diligence checks.

Hence, in our opinion, the single authorisation processes in FSMA should be retained and the FCA should be given the FSA’s responsibilities in respect of *processing* all applications for Part IV permission.

Where an applicant seeks to carry on regulated activities within the scope of the PRA:

1. the FCA would perform the initial due-diligence and the conduct assessment;
2. concurrently, or thereafter, the FCA would provide the PRA with the application and any relevant background to enable it to carry out its prudential assessment;
3. the PRA would give/or decline to give consent (its decision would determine the outcome of the application);
4. while the FCA would act as a central contact point for applications, this should not preclude direct discussions on prudential matters between the applicant and the PRA (at either party's behest); and
5. the FCA should be responsible for managing the timetable and reporting the joint decision to the applicant and, if minded to refuse, coordinating the statutory notice procedure.

Our *second option* is a variation on the proposal that responsibility be given to "*the authority with prudential responsibility for the activity at the centre of the application...*"

Under the proposal set out in paragraph 5.39 of the condoc, all applications for Part IV permission to, inter alia, accept deposits or effect or carry on contracts of insurance will fall under the responsibility of the PRA (consulting the FCA for their consent on the conduct aspects of the application). As a result, PRA would build up a centre of expertise for banking and insurance applications.

However, as discussed in response to Q6 above, the PRA will not regulate all investment firms and the population of those firms that it does regulate will be fluid at the margin. Hence, an investment firm that was authorised by the FCA may, over time, expand and meet the criteria for designation and regulation by the PRA. As a result, we do not believe that applications for *investment activities and services* should be divided between two regulators, particularly as it might be hard to determine with certainty for some applications whether the firm would be designated and hence be prudentially regulated by the PRA. Hence, following the Australian example, the FCA could also be given responsibility for all applications *not* involving banking and insurance, seeking the consent or input of the PRA where the firm would be regulated by the PRA or near the boundary for designation.

We do *not* support the lead proposal for the following, not exhaustive, reasons:

- the FSA "*gives permission*" under section 42 of FSMA rather than grants "*approval*" and whilst we could envisage separate tests being included in section 41 of FSMA, under which the FSA has a duty, when giving or varying permission, or imposing or varying any requirement, "*to ensure that the person concerned will satisfy, and continue to satisfy, the threshold conditions in relation to all of*

the regulated activities for which he has or will have permission” we do not think that the threshold conditions – particularly threshold condition 5 – could be easily divided into ‘conduct’ and ‘prudential’;

- a process involving two stages – the giving of ‘prudential’ and ‘conduct’ approval – is bureaucratic and inefficient;
- unless there is a lead regulator, applicants for authorisation would have to apply to, and deal directly with, two regulators; this would be time consuming for applicants and is likely to add additional time to the process.

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

As the Government will be aware, a permission given under section IV of FSMA⁶ (a “*Part IV permission*”) specifies all or some of the following elements:

- a description of the activities the firm can carry on including any limitations; and
- the specified investments involved; and, where appropriate,
- requirements.

A firm only has one Part IV permission; elements of that permission may be varied (e.g. removal of individual activities, investments, limitations and/or requirements) or the entire permission may be cancelled. Cancellation leads to a loss of authorised person status.

With respect to *variations* of Part IV permission, it is important to distinguish an Own Initiative Variation of Permission (OIVoP) and a Voluntary Variation of Permission (VVoP). Our views on these processes are as follows:

OIVoP: we agree that both the PRA and the FCA should be given the FSA’s current power to vary (or cancel) a firm’s Part IV permission – provided the reason falls within the scope of their objectives – but for dual-regulated firms the regulators should have a statutory duty to consult each other and reach agreement prior to the exercise of the OIVoP powers. In particular, we agree that, in so far as it is consistent with an authority’s objectives, both the PRA and the FCA should have the power to impose requirements on firms’ Part IV permissions and limitations on the regulated activities for which Part IV permission has been granted.

⁶ A person seeking to carry on one or more regulated activities must - unless an exception applies (as is the case for incoming EEA firm) - apply to the FSA for permission. A permission granted by the FSA under Part IV of FSMA is referred to as a Part IV permission. If the FSA grants an applicant such Part IV permission the applicant will become an authorised person.

VVoP: the procedure should mirror the process for applications for Part IV permission e.g. the FCA should process the application seeking consent from the PRA where necessary.

With respect to *cancellation*, a firm's Part IV permission (i.e. the entirety of the regulated activities a firm has been given permission to carry on subject to any limitations and requirements) is "*removed*" by the grant of an application for cancellation or through a regulator's exercise of its own-initiative powers. A firm's authorisation is then ended by a direction. The procedures for applications for cancellation should mirror those for applications for Part IV permission e.g. the FCA should process all applications seeking consent from the PRA where necessary. Since removal of a firm's Part IV permission means that they can no longer carry on regulated business, both the PRA and FCA should consult and agree on applications for cancellation of dual-regulated firms.

For use of OIVoP powers to cancel a firm's Part IV permission, see our comments above.

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

We consider that the proposals for the approved persons regime - although they recognise and attempt to resolve the overlap between the scope of the PRA and the FCA - still require clarity and significant further thought with respect to their practical application. The overarching proposal that "*lead responsibility for controlled functions will be split between the PRA and the FCA in line with their objectives*", is commendable in theory and a significant improvement on the previous proposal to split control functions by reference to regulated activities. However, as a result of the grey area between prudential/business soundness and business conduct (as referred to in our introductory comments to chapter 5 and in response to Q24), we believe that the revised proposal is still likely to be confusing and hard to operate in practice.

The condoc explains that: "*The PRA would lead on designation (subject to relevant conditions) and approvals of all controlled functions connected to the prudential soundness of a regulated firm (e.g. Significant Influence Functions such as the Chief Executive Officer) consulting the FCA where it has an interest in a particular function, but having the final say on the approval decision. Similarly, the FCA would lead on all functions concerned with a firm's interface with customers (e.g. client assets, anti-money laundering), consulting the PRA where it has an interest.*"

However, in practice it is not possible to draw such clear distinctions. The role of a Chief Executive Officer (CEO) is not primarily "*prudential*"; a CEO and, indeed, the Board of Directors are ultimately responsible for all aspects of a firm's compliance with regulatory requirements, including conduct and financial crime requirements.

The decision to approve a candidate as CEO of a dual-regulated firm should, therefore, be joint between the PRA and the FCA; albeit that, if the authorities are not of one mind there needs to be a process to give the regulator in respect to whose scope the concerns fall, the 'final say.' Likewise the CF1, CF10 and CF29 functions are equally difficult to allocate as prudential or conduct.

Take, for example, the CF29 Significant management function. SUP 10.9.10R provides that:

“ (1) The significant management function is the function of acting as a senior manager with significant responsibility for a significant business unit that:

(a) carries on designated investment business or other activities not falling within (b) to (d);

(b) effects contracts of insurance (other than contractually based investments);

(c) makes material decisions on the commitment of a firm's financial resources, its financial commitments, its assets acquisitions, its liability management and its overall cash and capital planning;

(d) processes confirmations, payments, settlements, insurance claims, client money and similar matters.”

Under the Government's proposals, either all applications for CF29 would fall under the lead responsibility of one regulatory authority – which, given the wide scope of CF29, begs the question which authority should be responsible - or applications would have to be directed, on a case-by-case basis, to the PRA or the FPC depending on the scope of the actual role to be carried out by the candidate (which would be unduly complex and burdensome). Responsibility for applications for the new CF00 function would be even harder to define. This overlap could well give rise to disagreements on responsibilities for individual applications but would definitely create complex procedures for firms/candidates.

As discussed in response to Q19, we remain of the opinion that a shared services function should be established to provide a common back office to the PRA and the FCA, receiving and processing, inter alia, applications for approval.

Notwithstanding, we believe that applications for approval should be processed in the same manner as the alternative approach to applications for authorisation: namely, *“one authority should be charged with processing each application, seeking the consent of the other authority on the areas where they have expertise prior to granting permission.”*

We believe that the FCA should be given responsibility for processing all applications for approval, performing due diligence (e.g. credit and criminal records bureau checks), drawing on its financial crime

expertise, seeking approval from the PRA for any applications that have a prudential impact. Where an application is in respect of a controlled function that concerns both conduct and prudential, the FCA should provide the administration but the assessment should be joint with the PRA; e.g. joint SIF interviews.

We agree, however, that both the PRA and the FCA should have the power to designate controlled functions. We also agree that each authority could have power to ban an approved person working in dual-regulated firm *provided* the disciplinary action falls within the scope of the regulator's objectives and - unless the individual was approved solely by the authority taking the action - both regulators are in agreement. It is important, however, that where the scope of a controlled function falls under the scope of the PRA and the FCA, any risk of double jeopardy is removed by legislation; given the FPC enforcement capabilities, we would envisage that the FPC would take enforcement action with respect to approved persons (including joint actions with the PRA).

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

We agree that the FCA should have responsibility for the inward passporting of EEA firms and should receive all notifications from overseas regulatory authorities. We also support the PRA working *"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."*

In respect of outward passporting of dual-regulated UK firms, while prudential matters are reserved to the home state and fall within the scope of the PRA, as the condoc recognises, the FCA still has an important role with respect to conduct issue

As set out in SUP 13.3.5G: *"If the UK firm's EEA right derives from the Banking Consolidation Directive, 3MiFID3 or the UCITS Directive, the FSA will give the Host State regulator a consent notice within three months unless it has reason to doubt the adequacy of a UK firm's resources or its administrative structure."*

Whilst a *'notice of intention to establish a branch in another EEA state'* largely covers prudential and systems and controls information, firms are required to provide details of the branch's anti-money laundering procedures (including the name of the AML compliance officer). A *'notice of intention to provide cross border services in another EEA State'* also requires a firm to submit a programme of operation, which should contain conduct details such as the types of client.

The FCA will be responsible for regulating the conduct of UK firms providing services into another EEA Member State and UK firms' EEA branches' compliance with, inter alia, the FCA's client asset rules. Hence, the FCA should have a significant role in assessing notices of

intention submitted by dual-regulated firms. It will, therefore, be important to clarify the roles and responsibilities of the PRA and the FCA, with regard to passporting, in the MOU.

As discussed previously, we remain of the opinion that a shared services function should provide common back office services to the PRA and the FCA, including the receipt and coordination of passporting notifications. Notwithstanding, to facilitate communications (including with other EEA competent authorities), to provide a central point for expertise and to improve clarity and efficiency, we consider that there should be one passporting unit, which should be located within the FCA. The unit should receive and process all notifications, with the PRA having primary responsibility for assessing, with the FCA, notices of intention from dual-regulated UK firms.

The FCA passporting unit could also have responsibility for Treaty firms seeking automatic permission under FSMA.

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

Our mutual members have not asked us to comment on this question

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

Rule-making

We agree that: *“Both the PRA and the FCA [should] have the statutory power to make rules that apply to regulated firms within their jurisdiction”* subject to the over-ride that *“the authorities will only be able to make rules in pursuance of their objective.”*

However, the scope of the PRA will extend beyond the FSA's prudential sourcebooks into, for example, systems and controls, approved persons, authorisation. Hence, as has been recognised in the condoc: *“When dealing with dual-regulated firms, the PRA and FCA may both make rules applying to the same functions within individual firms (e.g. their systems and controls).”*

We have *significant concerns* regarding this overlap and do not believe that consultation between the PRA and FCA - and an option to consult the FPC if the regulators are unable to agree on the impact on financial stability - before making such rules, whilst desirable, will be a sufficiently robust solution. Dual-regulated firms will need absolute clarity regarding which regulator's rules apply; hence there can be no scope for overlap or confusion. There is also a danger that the regulators' approaches to the regulation of areas of overlap will diverge over time particularly as it seems likely that the FCA will

continue the FSA's approach to the Handbook while the PRA will move to a purposive approach.

Hence, we are of the opinion that coordination mechanisms have to be 'hardwired' in legislation; in particular, there should be clear and effective processes for making *joint* (PRA and FCA) rules and guidance in relation to the overarching high-level regulatory standards such as SYSC and common regulatory processes (c.f. the FSA's Supervision manual). This set of joint rules should overarch and form part of both the PRA and the FCA's handbooks, thereby creating cohesion and consistency for regulatory processes.

Notwithstanding, we strongly support the need for the PRA and the FCA to consult each other in relation to exercise of their rulemaking powers generally. It is important that an efficient and robust mechanism is put in place to facilitate this process; hence, we consider that details regarding this coordination – e.g. the establishment of a joint rule-making committee – should be enshrined in legislation rather than in the MOU. As well as coordinating new rulemaking in areas of overlap, the committee should ensure consistent interpretations of joint provisions. Equally, it is crucial that the PRA and the FCA coordinate their development of existing rules to ensure they are consistent in practice.

We also continue to believe that the Practitioner Panel's remit should include both the FCA and the PRA, thereby making them well-placed to identify, for example, potential coordination issues manifested in rule-making.

Finally, as noted in response to Q7, we believe that the PRA should have a power to issue statutory guidance.

Rule-waivers

We agree that it is appropriate for both the PRA and the FCA to have the power to consent to modifications or disapplications of their own rules and that, in respect of dual-regulated firms or members of groups including dual-regulated firms, the authorities should be required to consult each other before giving a direction approving the amendment. We assume that this duty to consult will be included within the legislation.

Q25. The Government would welcome specific comments on

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

It is inevitable that two regulatory authorities will increase the complexity of group supervision. It will, therefore, be *essential* that, as a minimum, firms have a designated lead supervisor and that submission of notifications or other information to the lead supervisor discharges any duties the firms/groups may be under to inform the

PRA and the FCA. This applies equally to dual-regulated firms that are not part of financial groups.

We agree that, where a consolidation group exists under EU law, the authority responsible for consolidated supervision should have a power of direction, although such a power should be subject to appropriate safeguards. However, we also believe that groups should be given an opportunity to elect that all investment firms within their group are prudentially supervised by the same regulatory authority, thereby avoiding parts of the group being subject to different prudential requirements/interpretations.

We note from paragraph 5.69 of the condoc that *“all directions will be published, subject to a public interest requirement.”* We are unsighted on the extent of the power envisaged or the likely contents of such directions but are concerned that there may be instances in which the directions contain detail that is sensitive. As discussed in response to Q14, we do not support a view that transparency is appropriate in all circumstances. Hence, we are of the opinion that, in addition to providing a copy of the direction to effected firms, such firms should have an opportunity to comment on the wording.

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

We recognise the rationale for a power of direction over, as per paragraph 5.74, an *“UK unregulated entity”* (which we assume will be a parent undertaking) that exerts control or influence over authorised persons. We would need further clarity of *“certain circumstances”* in which it is envisaged that regulators will have a power of direction in order to comment in detail. However, we have questions with respect to the enforceability of the directions and the unlevel playing field they will create since, despite the wider references a *“parent undertaking”* in paragraph 5.73, we do not believe it would be possible, under EU law, to exercise such powers over EEA-entities and the extension of the powers to third-country entities would create problems of enforceability. We will, therefore, comment further once we have had an opportunity to review the scope and extent of the power, the safeguards and how non-compliance would be enforced.

- 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?***

Section 186 of FSMA sets out the *“assessment criteria”* for changes of control i.e. the limited grounds in relation to which the FSA can object to notification of acquisition of control.

Notwithstanding the link to threshold conditions – in particular, threshold condition 3 (close links) – we do not share the Government’s view, as expressed in paragraph 5.79 of the condoc, that *“the criteria which the regulatory authority has to assess the application*

against are primarily [our emphasis] of a prudential nature.” Indeed, for dual-regulated firms we believe that the FCA has an equally important role in the assessment.

Paragraph 5.80 of the condoc gives the impression that, notwithstanding the PRA being under a statutory duty to consult the FCA and overseas regulators, the FCA will have a more limited role; objecting to an application “*on the grounds of the risks of money laundering or terrorist financing*” (but, surprisingly, not consumer detriment) rather than being jointly involved in the assessment.

In particular, we are concerned that:

- for dual-regulated firms within a group, the proposal in paragraph 5.80 of the condoc will lead to separate ‘section 178 notices’ being submitted to, and assessed by, two regulators: PRA for the dual-regulated firm and FCA for the other authorised firms.

The FSA’s Supervision Manual provides for the submission of a joint “*section 178 notice*” of change of control:

SUP 11.5.9G “If a person is proposing a change in control over more than one firm within a group, then the controller or proposed controller may submit a single section 178 notice in respect of all those firms. The section 178 notice should contain all the required information as if separate notifications had been made, but information and documentation need not be duplicated.”

SUP 11.5.10G When an event occurs (for example, a group restructuring or a merger) as a result of which:

(1) more than one firm in a group would undergo a change in control; or

(2) a single firm would experience more than one change in control;

then, to avoid duplication of documentation, all the firms and their controllers or proposed controllers may discharge their respective obligations to notify the FSA by submitting a single section 178 notice containing one set of information.”

We believe that joint notifications are not only efficient - particular given the urgency frequently surrounding changes of control - but also ensure consistency; hence, joint notifications should be facilitated in the new regime.

- the criminal offence, in section 119F of FSMA, of failing to comply with the FSMA change of control requirements, should fall within the scope of the FCA’s enforcement division, given its role as a criminal prosecutor:

“People seeking to bypass the FSA as gatekeeper can expect little sympathy. In September this year we brought our first prosecution against an individual for acquiring a controlling interest in a regulated firm without giving the FSA prior notice

and for making false and misleading statements – and we obtained a conviction. A second prosecution is under way.” The FSA’s agenda for fighting financial crime: speech by Margaret Cole to the BBA (19th November 2009)

Hence, we believe that the FCA – as the regulator of all firms, as the regulator with responsibility for financial crime and as the regulator with an enforcement division that has the expertise to investigate criminal offences – is more appropriately placed to receive and assess all change of control notifications, subject to a statutory duty to work with the PRA in respect of dual-regulated firms and groups containing such firms.

It should be noted that, although not addressed in the condoc, similar consideration apply to the requirement to notify changes in close links and the joint close links notification that a group is permitted to submit under SUP 11.9.1R(2).

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

We believe that the PRA should be under a duty to consult the FCA.

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

We support the proposal, in paragraph 5.100 of the condoc, that “*the current arrangements for the collection of fees are replicated within the new structure*” and a requirement that each authority abides by the principle of proportionality in setting its fee structure. However, to achieve effective coordination, it is important that the PRA and the FCA are required to use the same fee base for dual-regulated firms, to avoid firms having to submit separate reports to the PRA and the FCA.

We strongly support the use of a non-statutory arrangement for the collection of fees through one organisation and still believe that, as discussed in relation to Q17 above, a shared services function should carry out such a role. If this is not feasible then we would prefer that the FCA, as the regulator of all firms, collects all fees and levees.

Chapter 6: Compensation, dispute resolution and financial education

Given AFME’s focus on European capital markets, our members have not asked us to comment in detail on this chapter of the condoc. However, to reflect the concerns that members have raised, we do wish to make a number of high-level comments in respect of the Financial Services Compensation Scheme (FSCS) and the Financial Ombudsman Services (FOS).

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

The proposals for the FSCS appear sensible. However, as it is important to ensure consistency and given the proposals for an EU directive, we believe that either the PRA and FCA should be required to coordinate their rules *or* lead responsibility be given to the FCA, to ensure that there is a single set of rules that are common to all product types; thereby avoiding duplication and inconsistency.

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

The proposals for the FOS also seem sensible. However, we believe that this opportunity should be taken to address a key issue identified by stakeholders: namely, to establish an independent appeals mechanism that enables firms to challenge the basis of a FOS decision, rather than be limited, as is currently the case, to the grounds for a judicial review.

Given that the Government intends to give the FOS the ability to publish its own determinations, it is vital that the FOS should be required to follow legal rules and procedure, as the implications of one case may have far reaching consequences for firms (e.g. a class action may be brought by customers of the same firm, or other firms, who believe that, on the basis of the determination, they are also entitled to compensation).

Currently, FSMA gives limited powers to the FSA regarding the FOS, which are concerned with approval of rules; the FSA has no powers to direct the FOS, for example, if it received a volume of complaints in relation to a specific product or practice, which suggested a business conduct issue. Hence, in addition to the coordination mechanism, the FCA should be given the power to direct the FOS in respect of issues that concern a significant number of firms, so as to ensure that the FCA is in a position to take consistent action across the firms or sectors concerned, rather than the FOS determining the complaints on a case-by-case basis.

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

We welcome the proposals for strengthened accountability, particularly for the FSCS and the FOS.

Chapter 7: European and international issues

We welcome the greater detail on European and international issues and the Government's recognition that *"it is imperative to get the regulatory framework right for the future strength and stability of the UK, European, and global economy."*

We believe the condoc articulates a well considered approach to European and international engagement. In particular, we strongly support the following statements:

- *"Though many of the EU reforms are strongly rooted in lessons learnt from the recent crisis, and focused on delivering the G20 priorities, as individual [EU] legislative proposals come forward it is critical to ensure that these are evidence based, proportionate and able to address systemic risks to financial stability. Reforms must also reinforce the single market and deliver a level-playing field across Member States, which is central to supporting EU competitiveness in global financial markets."*
- *"The Government has placed renewed emphasis on international engagement and this will remain an ongoing priority. Consistent with this emphasis, the Government expects the UK's regulatory agencies to put significant time and effort into ensuring that the UK's voice is heard at the European level and that the decisions taken by the new authorities are appropriate"*

One of our main areas of concern in respect of the July condoc was around ensuring *"the continued effectiveness of International and Europe engagement – both at a policy formation and a policy negotiation stage - and a strong, credible and coherent representation for the UK."* Therefore, we also welcome the statements that:

- *"The Government's priority is to ensure that there is a strong and credible voice to promote the UK's interests in these new [EU] institutions, and ensure effective cooperation with European counterparts on the regulation of large, cross-border financial firms."*
- *"...the authorities will continue to take a leadership role in EU and international reforms..."*
- *"The UK regulatory authorities will be well placed to influence and take part in the technical work of the ESAs, for example the development of binding technical standards, and the production of guidance and advice."*
- *"Therefore, a principle of continual reciprocal engagement between the Treasury and the authorities will be crucial as negotiation of legislative provisions moves from political to technical levels."*
- *"The UK will ensure that influence in these bodies remains strong, both during and following transition to the new regulatory architecture"*

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

As the UK regulatory framework does not map to the new EU supervisory structure and “each ESA covers both prudential and conduct of business issues and there will be substantial areas of the ESAs’ work which are not the primary responsibility of the institution that holds the voting seat”, we note the Government’s aspiration that: “When this occurs, effective domestic coordination and cooperation between the regulatory authorities will ensure the UK’s views are best represented”. However, while we believe that the mechanisms for coordination referred to in chapter 7 of the condoc appear sensible, we have some concerns in respect of their practical, day-to-day application.

When a UK authority takes the lead in respect of a specific legislative proposal, we believe that replicating the current arrangements between the HM Treasury and the FSA will help to ensure that they continue to “consult other interested domestic authorities and take their views into account when communicating the UK’s position.” However, identifying the potential impacts – and interested domestic authorities/stakeholders – at an early stage of policy development may be more challenging, as it could depend upon staffers scrutinising agenda for future meetings and recognising the full implications of items. Late or overly summarised agenda and pressures of work within the regulatory authorities may conspire against the UK being able to field the right delegation to particular meetings. It may be that strengthening the financial services sector in UKREP would help to address this problem.

The FSA’s International Division provides currently: “a centre of excellence for international stakeholder management and analysis....delivered by enhancing our support for representatives on key international committees, strengthening our relationships with key stakeholders required to deliver FSA international strategy and improving our development, implementation and co-ordination of policy.”⁷ As discussed in our response to the July condoc, we believe that will be crucial to ensure that the work of this division is not diluted and that a similar, operational-level, support function is available to manage the UK’s international and EU engagement and to coordinate within the UK regulatory framework e.g. by ensuring that the right policy experts are involved on committees and working groups and delegations. Hence, we consider it *crucial* that a joint European and International secretariat be established, staffed from the FCA, PRA and Bank, to assist the coordination process for the UK regulatory authorities, to provide a central point of contact and, crucially, to think strategically about the UK’s medium and long term EU and international relationships.

⁷ FSA website

We would envisage that the secretariat should:

- actively monitor and coordinate the UK's short term engagement with EU and international stakeholders (e.g. participation in EU and international meetings, working groups; ensuring that the right UK stakeholders are involved or have been consulted);
- provide strategic direction in respect of the UK's medium to long term relationships with EU and international stakeholders (e.g. positioning the UK to engage proactively with the ESAs);
- identifying the implications of potential regulatory developments and developing advocacy strategies;
- developing UK positions in respect of regulatory proposals that concern more than one regulatory authority;
- advise on/facilitate the sharing of UK resources (e.g. secondment programs to the ESAs);
- assess the operation of the international coordination MOU; and
- provide a central point of contact for overseas regulators or other international bodies wishing to engage with the UK - for example, to arrange visits, provision of speakers at key note events and the provision of assistance in respect of, or involvement in, policy initiatives – and a possible access point for firms.

Coordination between the PRA and FCA

Whilst the bilateral MOU between the PRA and FCA will be critical in ensuring effective and efficient coordination of engagement, particularly with the ESAs, we believe that:

- the statutory duty to coordinate should, given its importance, refer specifically to European/international co-ordination; and
- as discussed above, the MOU should, inter alia, provide for an European/international secretariat to assist and oversee the day-to-day coordination process.

Coordination between the PRA or FCA and other domestic authorities

We agree that coordination mechanisms should be established on a bilateral basis with other UK stakeholder authorities. Given that the Bank will have responsibility for regulating clearing houses and the FCA will be responsible for regulating exchanges, a bilateral agreement between the FCA and the Bank will be particularly important. Amongst other things, the FCA will need to ensure that where clearing or markets regulation issues are to be addressed at ESMA meetings, the FCA delegation includes representatives from the

Bank, as non-voting observers, and the FCA takes account of their views.

Bilateral MOUs will also be needed with other stakeholders such as the Financial Reporting Council (FRC). However, as noted above, we believe that an European/international secretariat should be responsible for assisting/overseeing day-to-day coordination with other stakeholders.

Wider coordination to agree a single, consistent UK negotiating position in international discussions

We agree that: *“Effective international coordination is central to securing financial stability, and managing global risks, going far beyond simply ensuring that the relevant competent authority has the opportunity to feed in their views. In order for the UK to successfully influence and steer the development of international policy on financial regulation, all the UK authorities – including the Treasury and the Bank of England – must work together to ensure that, while respecting the objectives of the individual authorities where possible, international negotiating positions represent a single, consistent, agreed UK position.”*

Hence, we strongly support the proposal that: *“The Government...legislate to require the establishment of a statutory MoU between the Treasury, the Bank of England, the PRA and the FCA on overall international coordination within the UK’s system for financial regulation.”* Given the importance of this MoU, we consider that it should also be laid before Parliament and subject to an annual review process (with input from relevant stakeholders, including the industry).

We agree that legislation should set out a *“non-exhaustive list of the key areas that the MoU should cover”* and concur with the list in paragraph 7.30 of the condoc. It will, however, be important to ensure that the bilateral co-ordination MoU between the PRA and the FCA is consistent – and remains consistent – with this overarching MoU in respect, of international engagement.

In practice, the success of any MoU will depend, to a great extent, on the culture of the signatory organisations, personal relationships and the degree to which the operation of the MoU is monitored and complied with. Hence, as discussed above, we believe that an European/international secretariat should be responsible for overseeing the day-to-day application of this multipartite, international coordination MoU.

More broadly, in respect of the UK’s (FSA’s) seat on the International Organization of Securities Commissions (IOSCO), the condoc rightly recognises that: *“IOSCO’s responsibilities in setting rules of conduct might imply that the FCA should retain the seat currently held by the FSA. However, the Bank is responsible for regulating central counterparty (CCP) clearing houses while the PRA will be responsible for*

the regulatory capital regime around exposures to CCPs; IOSCO agreements may impact significantly on each of these.”

We were surprised, therefore, that the condoc went on to state that, inter alia, “*seats currently held by the FSA are expected to be transferred to equivalent roles in the PRA.*” Given IOSCO’s focus on securities regulation and its natural links to ESMA, we believe that the FSA’s seat should be transferred to the FCA’s Market Division who should then engage with the PRA and the Bank, as necessary, in respect of any prudential or clearing-related work streams.

We believe in addition, that the FCA - as the regulator responsible for financial crime - should also replace the FSA as a non-lead UK authority on the Financial Action Taskforce (FATF).

The Association for Financial Markets

April 2011

Annex I

Competitiveness: a sample of regulatory authorities

<i>Country</i>	<i>Regulator</i>	<i>Objectives [emphasis added]</i>	<i>Legislation</i>
Hong Kong	Securities and Futures Authority	<p>“The regulatory objectives of the Commission are-</p> <p>(a) to maintain and promote the fairness, efficiency, competitiveness, transparency and orderliness of the securities and futures industry...”</p>	Section 4 (Regulatory objectives of Commission) of the Securities and Futures Ordinance
Australia	Prudential Regulation Authority	<p>“(2) In performing and exercising its functions and powers, APRA is to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality and, in balancing these objectives, is to promote financial system stability in Australia.”</p>	Section 8 (Purpose for establishing APRA) to the Australian Prudential Regulation Authority Act 1998,
Singapore	Monetary Authority of Singapore	<p>“4. —(1) The principal objects of the Authority shall be —</p> <p>(a) to maintain price stability conducive to sustainable growth of the economy;</p> <p>(b) to foster a sound and reputable financial centre;</p> <p>(c) to ensure prudent and effective management of the official foreign reserves of Singapore; and</p> <p>(d) to grow Singapore as an internationally competitive financial centre.”</p>	Section 4 (Principal objects and functions of Authority) Monetary Authority of Singapore Act
Switzerland	Swiss Financial Market Supervisory Authority	<p>“In accordance with the financial market acts, financial market supervision has the objectives of protecting creditors, investors, and insured persons as well as ensuring the proper functioning of the financial market. It thus contributes to sustaining the reputation and competitiveness of Switzerland’s financial centre.”</p> <p>2 It exercises its regulatory powers only to the extent required by its supervisory</p>	Article 5 (Objectives of financial market supervision) of the Federal Act on the Swiss Financial Market Supervisory Authority (Financial Market Supervision Act, FINMSA)

<i>Country</i>	<i>Regulator</i>	<i>Objectives [emphasis added]</i>	<i>Legislation</i>
		<p>objectives. In doing so, it takes account in particular of:</p> <p>a. the costs that the supervised persons and entities incur due to regulation;</p> <p>b. the effect that regulation has on competition, innovative ability and the international competitiveness of Switzerland's financial centre;</p> <p>c. the various business activities and risks incurred by the supervised persons and entities; and</p> <p>d. the international minimum standards.</p>	
China	CBRC	<p>a. Promote the financial stability and facilitate financial innovation at the same time;</p> <p>b. Enhance the international competitiveness of the Chinese banking sector;</p>	<i>Supervisory and regulatory criteria of the CBRC (from website)</i>

Annex II

Use of Macro-prudential Measures by areas of vulnerability

Area of vulnerability	
Liquidity	<ul style="list-style-type: none"> ● FPC requirement for particular stress test/ stress test parameters as part of banks' Individual Liquidity Adequacy Assessments ('ILAAs'). This in turn impacts the scale and composition of liquid asset buffer requirements. N.B. FSA's current approach to stress testing under the ILAA framework serves in effect to limit FX exposures through the very severe assumption that under a market wide stress, FX markets would not be available. ● Establishment of a macro-prudential buffer requirement in addition to the LCR and NSFR to allow the FPC to alter liquidity requirements. It is unlikely that the FPC would be able to adjust the underlying LCR and NSFR requirements owing to the European legislation.
Capital adequacy (including Leverage)	<p><u>Overall levels of regulatory capital</u></p> <ul style="list-style-type: none"> ● FPC requirement for particular stress tests/stress test parameters as part of bank's Individual Capital Adequacy Assessment ('ICAAP') documents. This would not of course be applicable to branches of overseas banks in the UK. <p><u>Variable risk weights</u></p> <ul style="list-style-type: none"> ● Increased charges/changes in risk weights for particular asset classes/exposures to specific sectors as part of the Pillar 2 supervisory assessment. Interaction /boundaries between micro and macro prudential measures would need to be managed to mitigate the risk of overlap/underlap. Again, this could not be applied to branches of overseas banks in

Area of vulnerability	
	<p>the UK and changes in risk weights may not be straight-forward for firms using IRB or other internal model based approaches.</p> <p><u>Forward Looking Provisions</u></p> <ul style="list-style-type: none"> ● Expected loss provisioning: FPC to influence bank's assessment of assets and/or the assessment of how the broader economic environment is likely to develop. Extent of compatibility of these actions with international accounting standards and their implementation would need to be investigated. ● Dynamic provisioning: FPC to influence/adjust historical average loss rates on particular classes of assets. Again, the extent of the compatibility of this action with international accounting standards and their implementation would need to be considered. <p><u>Countercyclical Buffer</u></p> <ul style="list-style-type: none"> ● FPC to direct the increase/release of the buffer. Again, this would not be applicable to branches of overseas banks. <p><u>Leverage Limits</u></p> <ul style="list-style-type: none"> ● FPC is unlikely to have the ability to adjust the required ratio or its calculation owing to the European legislation.
Concentration risk	<ul style="list-style-type: none"> ● Concentration risk limits ● FPC requirement to adjust stress tests specifically in relation to levels of concentration risk as part of the ICAAP and ILAA documents. N.B. The FSA's starting position under its current approach to liquidity effectively limits intra-group exposure through the asymmetrical treatment of intra-group exposures and intra-group funding.

Area of vulnerability	
Combined/other areas	<p data-bbox="808 419 1115 448"><u>Collateral Requirements</u></p> <ul data-bbox="853 456 2029 485" style="list-style-type: none"> <li data-bbox="853 456 2029 485">● FPC could direct maximum LTVs, in particular in relation to residential mortgage business <p data-bbox="808 523 1413 552"><u>Hair-cuts on repurchase (and other) agreements</u></p> <ul data-bbox="853 560 1957 695" style="list-style-type: none"> <li data-bbox="853 560 1957 695">● It has been suggested by some, including a recent BIS study group for the CGFS, that regulators (potentially including a macro-prudential body such as the FPC) could set haircuts so that they are higher and more stable through the cycle and include a ‘countercyclical add-on’ which could be used to make discretionary changes. <p data-bbox="808 734 1308 762"><u>Information Disclosure and Stress Tests</u></p> <ul data-bbox="853 770 2029 983" style="list-style-type: none"> <li data-bbox="853 770 2029 871">● FPC could identify information problems and direct the regulators to require firms to disclose certain information where it considers this would be beneficial for reducing systemic risks. <li data-bbox="853 879 2029 983">● FPC could require the regulators to undertake systemic stress tests which might provide a useful way for the FPC to identify and assess systemic risks. This could be used to raise awareness of systemic risks, as well as to inform FPC policy and advice. <p data-bbox="808 1021 880 1050"><u>SIFIs</u></p> <ul data-bbox="853 1058 2029 1201" style="list-style-type: none"> <li data-bbox="853 1058 2029 1201">● FPC could provide directions to regulators concerning loss absorption capacity to reflect the greater risks posed by these institutions to overall financial stability, directions concerning recovery and resolution arrangements and instructions in relation to enhanced supervision.

HM Treasury – A new approach to financial regulation

Building a stronger system

A response from the Association of British Credit Unions Limited (ABCUL)

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1. Executive Summary

- 1.1 Credit unions in Britain are a sector of small deposit-taking firms which – whilst growing at a very healthy rate of around 10% annually – remain in need of specific consideration in order that their development can be encouraged and not unduly burdened by inappropriately onerous regulation. Credit unions enjoy cross-party political support for the work they do in providing access to financial services to those at risk of financial exclusion. This includes the recent announcement by DWP of a £73 million modernisation fund for the sector and an ongoing programme of legislative reforms which are set to release credit unions from a legislative framework which has been described by the World Council of Credit Unions (WOCCU) as *amongst the most restrictive in the world*.
- 1.2 Since 2002, credit unions have been regulated by the Financial Services Authority (FSA) having previously fallen under the remit of the Registry of Friendly Societies. ABCUL and our membership supported the move to FSA regulation as, for the first time in the sector's history, it has meant properly enforced and specially developed prudential and conduct standards. This has directly contributed to the professional development of the credit union sector and has been complementary to ABCUL's strategy of supporting credit union development based around prioritising sustainable business-like development as a precursor to effective social intervention. Furthermore, membership of the Financial Services Compensation Scheme (FSCS) and Financial Ombudsman Service (FOS) has greatly contributed to the sector's legitimacy and credibility.
- 1.3 However, the success of FSA regulation of the credit union sector has been thanks to the efforts taken to ensure that the sector was treated proportionately. The Credit Union Sourcebook (CRED) was developed with the specific needs of the credit union sector in mind to ensure that regulations – both prudential and conduct – were appropriate to ensure the financial soundness of the sector whilst not unduly burdening its development. In 2009 and 2010 the sourcebook was reviewed and an updated version – CREDS – with higher regulatory standards is set to come into force later this year. Regulations have been tightened in line with the development the sector has undergone since the original sourcebook was developed back in the early part of the century.
- 1.4 Proportionality, therefore, is the key principle which ensured this appropriate treatment of credit unions. To ensure that credit unions are allowed to continue their strong development into the future it is vital that proportionality is applied by the FSA's successor bodies. There are a number of ways in which we would like to see proportionality applied for the benefit of our sector:
 - 1.4.1 The CREDS sourcebook as recently reviewed must be retained, in its rules (rather than principles or judgement) based format. Whilst it is true that larger, complex firms respond better to less concrete, prescriptive regulation, smaller firms require clarity in order to ensure that they are able to apply regulation in a resource-poor context. The burden of regulatory compliance for credit unions would be unmanageable were CREDS to be lost in this restructuring process.
 - 1.4.2 We would like the governance and industry engagement mechanisms within both PRA and FCA to include small firm and credit union representation in order that the needs of our

sector can be taken into account at the highest levels of regulatory development. We would also like to see Practitioner Panels – or their equivalents – given real power to hold regulators to account where it is apparent that developments run counter to the objectives and principles of regulation – perhaps by referring decisions upwards to the FPC.

- 1.4.3 We would like to see a greater emphasis placed upon the importance of rigorous and thorough Cost Benefit Analysis (CBA). A proper CBA process is vital to the effective application of proportionality as a principle. We would also like to see a new approach whereby a sector's overall regulatory burden can be regularly subjected to CBA taking all regulatory developments into account so that the true proportionality of a sector's treatment in general can be assessed. Currently this is only conducted on a piecemeal basis as individual initiatives come under discussion whilst the combined effect of all initiatives is never properly assessed.
- 1.4.4 We would like to see, for credit unions, the creation of a single portal through which engagement with the various regulatory bodies can be conducted. Given the fact that credit unions are unique as small firms which are dual regulated, we feel that if the burden of supervision by two different bodies is to be manageable that a single point of contact be created through which credit unions can interact with both bodies. Without this we have serious concerns that having to deal with two different bodies simultaneously will double the burden of being supervised for the credit union sector.
- 1.4.5 We feel strongly that, for the new regime to be truly proportionate, fees associated with regulation must not be allowed to rise. It should not be the case that, in creating the new regulatory structure, regulatory fees are allowed to spiral upwards. A single portal would alleviate much of the resource strain but direct fees must not rise either if the new regime is to be truly proportionate. Already regulatory fees are one of the key expenditures for credit unions and therefore co-ordination between the two bodies should be such to ensure that the overall cost does not increase.
- 1.4.6 The cost of the FSCS is a serious cause of concern for us. Since the financial crisis and the unprecedented call on the FSCS following the collapse of various major banks, credit unions have been required to pay significant levies towards the compensation of their depositors. Whilst we have no quarrel with paying towards the compensation of depositors – our sector, too, has benefitted from the FSCS – we are concerned at the sheer scale of the levies we are required to pay. Further changes mooted at EU level include the pre-funding of compensation schemes the cost of which credit unions are unable to pass through to their customers as they operate under a fixed interest rate ceiling. If cross-subsidisation within the FSCS were to end this would likely increase the costs even further. It is imperative that the costs associated with the FSCS must be kept at a manageable level.
- 1.5 In summary we do not have any objection to the Government's plans for restructuring financial regulation in principle. However, the principle of proportionality *must* be rigorously and thoroughly applied throughout the new structures and their future activities if small firms, such as credit unions, are not to be damaged by the framework and its implications.

2. Introduction

2.1 We welcome the opportunity to respond to this consultation. ABCUL is the main trade association for credit unions in England, Scotland and Wales, and our members serve around 80% of Britain's credit union membership. Credit unions are not-for-profit, financial co-operatives owned and controlled by their members providing safe-savings and affordable loans facilities. Increasingly credit unions offer more sophisticated products such as current accounts, ISAs, Child Trust Funds and mortgages.

2.2 At the end of September 2010, credit unions in Great Britain were providing financial services to 780,251 adult members and held almost £634 million in deposits with more than £502 million out on loan to members. An additional 111,035 young people were saving with credit unions.¹

2.3 At 30 September 2010, the 325 credit unions belonging to ABCUL were managing around £512 million of members' savings on behalf of over 611,037 adult members.

2.4 The Credit Unions Act 1979 sets down in statute the objects of a credit union; these are four-fold:

- The promotion of thrift among members;
- The creation of sources of credit for the benefit of members at a fair and reasonable rate of interest;
- The use and control of their members' savings for their mutual benefit; and
- The training and education of members' in the wise use of money and in the management of their financial affairs.

2.5 Credit unions in Britain are small, co-operative financial institutions often extending financial services to those unfairly excluded from the financial services the majority take for granted. They are owned and controlled by a restricted membership and are operated for the sole benefit of this membership. The Credit Union Act 1979 sets down these operating principles in law.

2.6 In the past decade, British credit unions have trebled their membership and assets have expanded four-fold. As this growth has taken place, the role that credit unions can play – both in providing equitable financial services to the whole of their communities and providing diversity in the financial services sector – has been increasingly recognised by government and policy-makers.

3. Consultation Questions

Questions 1, 2, 3 and 4

3.1 No view

¹ Figures from unaudited quarterly returns provided to the Financial Services Authority

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

- 3.2 We are in broad agreement with the strategic and operational objectives proposed for the PRA. The bodies strategic and operational objectives clearly articulate its primary function in ensuring financial stability through ensuring the financial soundness of systematically important firms.
- 3.3 We are also in general agreement the proposed regulatory principles. Our key concern, as a sector of small firms regulated in the same pool as the major financial service providers, is ensuring the proper and thorough application at all times of principle 2 – proportionality. It is critical that this is effectively enforced and applied wherever proposed regulatory changes are set to affect the credit union sector. Given our size there is a very real risk that, were proportionality to be poorly applied, our continued development could be hindered by burdensome regulation which – due to the size of our sector – is unlikely to have any impact on maintaining the PRA’s strategic objective of maintaining financial stability in the UK. Credit unions are not systemically important firms but we are socially important firms.
- 3.4 In order that a truly proportionate regime is maintained for the credit union sector we feel that it is important that, within the structure of the PRA (and in co-ordination with the FCA), there is some overall oversight function for the credit union sector which will ensure that not only do individual regulatory developments not encroach unduly upon credit union operations but also that the sum total of regulatory initiatives affecting credit unions – taken together – do not unduly present a burden to the sector’s continued development either.
- 3.5 However, in general, assuming that the principle of proportionality is applied thoroughly and with special regard for the unusual regulatory position credit unions find themselves in, we have no particular concerns with the objectives and principles as outlined.

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?

- 3.6 It is proposed that, as deposit-takers, credit unions will be dual-regulated by the PRA and FCA. We are pleased that credit unions will remain within the same regulatory remit as the larger deposit-takers which is a key element in the legitimacy of the credit union model as regulated deposit-takers with the same protections and safeguards in place as those which apply to the highstreet banks. To have separated credit union regulation from that of the other deposit-takers would have created a two-speed regulatory system for the market segment and would have left the credit union sector at a disadvantage as it continues to grow over the coming years.
- 3.7 Notwithstanding the above, credit unions – whilst appreciating the recognition of being dealt with in the same way as the wider deposit-taking sector – must be considered as a specific concern distinct from the major highstreet banks and other major financial institutions in terms of their regulatory treatments in the same way as has been seen under the FSA.

3.8 Credit unions – as the only sector of small firms posing little or no systemic risk to be regulated primarily by the PRA – present unique challenges of proportionality to the PRA which must be the primary concern as regulatory developments evolve. It is important that any regulatory changes to the regime currently applied to credit unions are developed with proportionality as their primary concern.

3.9 We are keen to work closely with both the PRA and the FCA to ensure that a proportionate regime for credit unions which – whilst ensuring high standards of prudential soundness and conduct – do not over burden a small sector which faces a critical period of development towards full sustainability in the coming years.

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)?

3.10 Judgement-led regulation, in replacing principles-based regulation, is an interesting development which should promote – in the most general sense – a system which is more disposed to blocking risky practices which threaten the integrity of the financial system. A judgement-led approach may have been more effective in tackling the problems which built up within the financial system causing the 2008 financial crisis.

3.11 However, whilst as a general principle for effectively addressing the PRA's overarching objectives a judgement-led approach is likely to be a positive development, for small firms such as credit unions we feel that it is unlikely to be the most appropriate approach to take.

3.12 Presently credit unions are regulated under a specialist sourcebook – CRED – which is designed specifically for the credit union sector taking into account the specific issues of proportionality that we have highlighted above. During 2009 and 2010 this was reviewed to coincide with anticipated legislative reforms, currently before Parliament, which are set to greatly increase the scope for credit union growth in the coming years. The revised sourcebook, to be implemented later this year, will be known as CREDS.

3.13 The key defining feature of CRED – and its successor, CREDS – is that it operates on the basis of prescribed, rules-based regulation rather than principles-based regulation as seen in relation to larger firms. The reasoning behind this is that, while rules-based regulation is open to abuse and avoidance for large firms, for smaller firms rules-based requirements are much clearer and easier to apply. Small firms prefer to know exactly what is expected of them as this minimises the burden of regulation by making compliance much simpler.

3.14 It is vital that credit unions are allowed to retain the recently reviewed CREDS sourcebook in order that the sector is treated proportionately. Any move away from rules-based regulation for a sector of small firms will only serve to undermine proportionality and multiply the burden of regulation for small firms.

3.15 Furthermore, we feel that it is important that, in applying judgement-led regulation, there is a strong system in place for appeal against judgement-based regulatory decisions. Without this there is a risk that judgement-based regulation might be open to accusations of being arbitrary. At the same time, though, we feel it is also important to ensure that any appeals process does not become overly legalistic and therefore expensive to engage with. If the expense of engaging with the appeals process to high this would necessarily exclude small firms from proper arbitration.

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

3.16 In general we feel that the governance framework is sensible with proper accountability built in and a clear 'chain of command' between the various bodies.

3.17 We would like to see, as part of the new structure's accountability to regulated firms and adherence to the principle of proportionality, small firm and / or credit union representation on the board of both the PRA and the FCA. This would ensure that the needs of small firms were taken into account at the highest levels of regulatory decision making and discussions were not dominated by large firms to the detriment of true proportionality.

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

3.18 The accountability mechanisms seem reasonable.

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

3.19 It is vital that – should the industry panels be discontinued for the PRA – whichever mechanism replaces them is a strong body with real powers to hold the PRA to account. It should have wide representation from all regulated firms – including credit unions – and should have the ability to, in certain circumstances, refer decisions upwards to the FPC where it is appropriate.

3.20 The current arrangement within the FSA, especially as regards the Small Business Practitioner Panel, is a useful mechanism for communicating with smaller firms but we feel that the panel, and its counterparts, do not hold enough power to hold the FSA to account for its actions.

3.21 The structures of industry engagement within the PRA should be able to challenge the decisions where there is a case to answer and where there is reason to believe decisions conflict with the PRA's statutory duties – especially the duty to proportionality.

3.22 We would also like to see an increased emphasis upon Cost Benefit Analysis (CBA) within the consultation process. Properly carried out, thorough CBAs are critical to ensuring true proportionality and we would like to see a greater emphasis upon the requirement to conduct a full CBA within the legislation. We also feel that the CBA process, whilst needing to be increased in importance also needs to take a wider view than at present. Whilst currently only regulations immediately under discussion are subjected to CBA, an across-the-piece look at regulatory

developments in a certain sector as a whole – perhaps yearly – would establish the true cost of regulatory change and improve the overall regulatory regime rather than relying on piecemeal assessment.

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

3.23 As with the PRA, in general we agree entirely with the objectives and principles set out for the FCA.

3.24 Our key concern is that principle 2 – proportionality – is properly and rigorously applied in order that credit unions, as a sector of small firms, are not inappropriately burdened by regulation which imposes significant costs without providing commensurate benefits.

3.25 Contingent upon this is: the retention of the CREDS sourcebook, the continued representation of credit unions on the Small Business Practitioner Panel, a role for credit unions and / or small firms in the governance structure of the FCA as well as the PRA and a full and proper commitment to Cost Benefit Analysis including across-the-piece CBAs looking at the increasing burden of regulation across a sector as opposed to specific one-measure initiatives which only provide a piecemeal look at the potential for disproportionate regulation.

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

3.26 As above with the PRA, we would like to see credit union representation on the board of the FCA to ensure that the needs of the sector are taken into account in regulatory developments.

3.27 We also have some concerns about the proposal for the FCA to report to HM Treasury where regulatory failure has occurred. It would seem more sensible, given that a lack of co-ordination between HM Treasury and the regulator is one of the perceived ills of the current regime, that the FCA be required to report to HM Treasury before regulatory failings occur and to keep HM Treasury updated as a matter of course on risks and issues arising – both potential and actual.

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

3.28 It is as yet unclear to us how the interventionist approach to regulation would affect a small sector such as credit unions which generally provides only simple financial products – savings and loans primarily – and which, given its size, is not subject to significant regulatory scrutiny due to the principles of proportionality and the practical reality of supervisory resource constraints.

3.29 Whilst we agree in principle with the notion that the regulator should intervene to prevent consumer detriment where it is clearly threatened by product developments, we would like clarity around how it will be applied and how it is likely to affect a sector of small firms such as our own.

3.30 It is difficult to see how intervention in the credit union sector would operate given the restricted supervisory resource available and the fact that the sector is neither sizeable nor complex enough to realistically pose a serious threat of consumer detriment.

Question 14 – The Government would appreciate comments on:

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

3.31 We are supportive of the use of transparency as a regulatory tool as long as proper safeguards are in place to ensure that no commercially or personally sensitive information is disclosed and only generalities and anonymised statistics are used to demonstrate a firm's practices.

- *The proposed new power in relation to financial promotions;*

3.32 Credit unions, as with many smaller firms, often experience difficulties in interpreting and applying the rules around financial promotions which can put them at a disadvantage in terms of marketing their products in competition with larger firms. We would like to see – alongside any more transparent enforcement regime – a renewed effort to clarify expectations around financial promotions, especially in light of the needs of smaller firms.

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

3.33 We agree in principle with the FCA's transparent approach to warning notices, however, we feel that if it is to be pursued it should be done in tandem with efforts to intervene in a more timely fashion where firms are in trouble.

3.34 In the past we have found that the FSA, mainly through lack of resource, has been unable to intervene and enforce regulations at the point where a credit union might be in a position to turn around its operations and continue as a going concern. Early publication of enforcement action is unlikely to be of any assistance where the firm in question is beyond being saved. Resource should be focussed on intervention and stabilisation as opposed to declaring enforcement action when the time for viable intervention has passed.

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

3.35 We agree that the FCA should have a stronger role in competition and support the proposals to affect this. The deposit-taking market is particularly concentrated with Lloyds Banking Group and RBS having between them more than 50% of the current account market. There is definitely room for pro-competition intervention here and across the financial services market which would benefit the growth of the credit union sector feeding back into choice and better services for consumers.

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

3.36 In principle we are in support of the proposed mechanisms for co-ordinating activity between the different bodies. We are, however, concerned that there is a significant risk of regulation becoming less efficient if effective co-ordination is not achieved. Duplication of work, as well as missed regulatory issues, will have the effect of increasing the overall cost of regulation if co-ordination is not as effective as possible. We would like to see a commitment from Government that there will be no significant increase in the cost of regulation, in particular for small firms such as credit unions.

Question 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?

3.37 We agree with the proposed approach and the measures put in place to ensure that any use of veto is carried out transparently.

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

3.38 For credit unions we strongly support the second option, whereby one regulator would take the lead and seek consent from the other regulator where appropriate. As the majority of credit union regulation will be carried out by the PRA we believe that this would be the most appropriate lead regulator for the authorisation process.

3.39 Even if HM Treasury takes the view that firms should apply to both the FCA and PRA for authorisation, we would suggest that a special case should be made for credit unions, for the sake of proportionality and to make it easier for credit unions to navigate the regulatory regime.

3.40 The PRA would also be the most appropriate lead authority because it is highly unlikely that a new credit union would launch with a proposed new product which the FCA was not familiar with or that any product would have the potential to present a risk to consumer protection. Credit unions are restricted to offering a narrow range of products and credit unions offer very similar products which are simply and transparently designed. We therefore do not anticipate additional approval from the FCA being a resource heavy process.

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

3.41 We agree with the suggested approach.

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

3.42 We have concerns that credit unions, and individuals within credit unions, will face an undue burden and possible confusion by having to apply to two bodies for authorisation as an approved person. To ensure that the authorisation process for credit union volunteers is as easy as possible

we would suggest that they should not have to apply to two bodies, but would apply through a single portal.

- 3.43 Unlike most firms which will face dual regulation under the new regulatory architecture, credit unions are often run entirely by part time volunteers. Regulation should reflect this and be designed to be proportionate to the risks credit unions pose and the resources they have at their disposal. If the PRA will be consulting with the FCA with regard to approved persons, it would appear to us that a single portal for credit union volunteers seeking approval would not place a large burden on the FCA and PRA but would result in a much clearer and easier to understand system for credit union volunteers, many of whom would be seeking dual authorisation from both regulatory bodies.

Question 22 – What are your views on the Government’s proposals on passporting?

- 3.44 No view

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

- 3.45 We welcome the recognition that the mutual business model sets firms such as credit unions and building societies apart from commercial, profit making firms, and that regulation should take account of these differences. There is always a risk that niche types of firms can be disadvantaged if policy is designed mainly to take account of the needs of mainstream firms and we are pleased that a process is being put in place to ensure that mutual organisations are not disadvantaged when compared to other business models.

- 3.46 As authorised and regulated firms, we agree that the most efficient and sensible place for the registration function for credit unions is within the PRA.

- 3.47 For other mutual organisations which are not currently authorised and regulated by the FSA, we agree that the registrar function may be better located elsewhere.

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

- 3.48 We agree that it is important that the PRA and FCA consult with each other when making rules and granting waivers or modifications.

- 3.49 However, a small credit union seeking a modification or waiver should have a clear contact point for requesting a waiver or modification. A single point of contact for enquiries such as this would be of great assistance to credit unions, especially those which employ no staff, or only have a very small staff team. We would imagine that the majority of waivers and modifications will relate to prudential rules, rather than conduct of business issues, so it would make sense for a contact point for credit union requests to be located within the PRA.

Question 25 – The Government would welcome 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?

3.50 No view

Question 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?

3.51 No view

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

3.52 No view

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

3.53 We welcome the recognition that there will have to be effective co-ordination between the new authorities and that each authority will have to abide by the principle of proportionality in setting its fee structure, and that effects on individual sectors will have to be taken into account. We would also welcome an arrangement whereby just one organisation collects fees, and passes on segments to the relevant organisations, rather than firms receiving multiple bills.

3.54 Credit unions are unique among financial services providers in being unable to easily pass on increased costs of regulation to their customers – the principle income generating activity of a credit union is making loans and they often operate at the upper end of a statutory interest rate ceiling. Because of this it is important that these changes and the resulting dual regulatory structure does not result in higher fees for credit unions. In the current economic environment many credit unions are already struggling to cope with increased expenses, reduced funding, reduced income from investments and a membership more likely to be unable to repay loans.

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

3.55 While we understand the reasons for the PRA and FCA both having rule making powers for the FSCS, we do have concerns that this could have cost implications for credit unions. The cost of the compensation scheme is a major concern to credit unions, which cannot pass on costs to their members as they operate under a statutory interest rate ceiling. Any loss of inter-class cross subsidy could present a risk for credit unions, should any large scale deposit takers be declared in default. But we do understand that a review of funding arrangements for the FSCS is being carried out separately and will be influenced by decisions taken at a European level.

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

- 3.56 We agree with the proposal for the FCA to oversee the running of the ombudsman service. Consumer complaints information can be a valuable tool to help the FCA assess how firms are treating their customers, so it is vital that this is passed on to the FCA and that the FCA acts upon this information.

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

- 3.57 We welcome the proposals to increase accountability for the FSCS, the FOS and the Money Advice Service. Some clarification on what is meant by consulting 'when appropriate' would be welcomed.

April 2011



A New Approach to Financial Regulation

The ABI's Response to HM Treasury's consultation paper

Introduction

1. The ABI is the voice of insurance, representing the general insurance, investment and long-term savings industry. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK. The ABI's role is to:
 - Be the voice of the UK insurance industry, leading debate and speaking up for insurers.
 - Represent the UK insurance industry to government, regulators and policy makers in the UK, EU and internationally, driving effective public policy and regulation.
 - Advocate high standards of customer service within the industry and provide useful information to the public about insurance.
 - Promote the benefits of insurance to the government, regulators, policy makers and the public.
2. The ABI welcomes the opportunity to respond to HM Treasury's consultation paper '*A New Approach to Financial Regulation: Building a Stronger System*'.

Overall Comments

3. We largely welcome the Government's proposals in this consultation paper. We believe that the proposals substantially improve on those in the initial consultation although we continue to have concerns regarding co-ordination between the regulators, costs and effective enforcement. Some high level comments on issues raised by the consultation are set out below with detailed answers to the consultation questions in the attached annex.
4. The Government's declared intention in making these reforms is to enhance the financial stability of the UK and improve on the existing Tripartite arrangements. We believe that the proposed reforms could lead to improvements in the regulatory structures and clarify the role of the different authorities. However, this will be dependent on the authorities being able to deliver the co-ordinated working which the consultation paper envisages. Close co-ordination between the authorities will have to be embedded at working level across all the authorities and cannot be

limited to high-level co-ordination through, for example, cross-membership at board level. It is particularly important for dual regulated firms that there is effective co-ordination in order to ensure a consistent and proportionate approach to regulation. Ongoing external scrutiny and challenge will be needed to contain the overall costs of the regulatory regime.

5. In the retail space, the Government needs to ensure that it, and the new regulators, have an explicit and coherent strategy to ensure that the various regulatory changes impacting upon retail financial services markets – including EU regulatory initiatives, the simple products consultation, the Retail Distribution Review and the FSA's new product intervention proposals – are coordinated and deliver an environment that allows providers to develop and distribute products that meet the financial needs of UK consumers.

Timetable

6. The proposed timetable for implementing these reforms is very ambitious. The Government should bear in mind that the financial sector is at the same time facing other substantial regulatory developments, for example RDR and Solvency II. Both firms and the regulatory authorities are stretched responding to these developments and have limited capacity to absorb further changes. We believe that there is a need for a period of stability for both firms and the regulators to embed the changes already announced and so think that in developing the new regulatory structures the Government should make the minimum changes necessary to the existing requirements.

Transparency and Accountability

7. The proposals in the paper to ensure that the regulatory authorities will, under the new system, be more transparent and accountable are welcome. We recognise that there will be occasions when the need to maintain financial stability or ensure commercial confidentiality means that particular decisions cannot be made public. However, as a general rule it is clear that the system will benefit if it is clear what the authorities are doing and their operation of the system and decision-making is made transparent.
8. We particularly welcome the decision that the PRA should be subject to regulatory principles and will also maintain most of the existing safeguards around consultation with industry and other interested parties. The suggestion in the initial consultation that such safeguards might not apply to PRA was one of our greatest concerns about the original proposals.
9. The independent members of the FPC should be drawn from a wide range of appropriate expertise including those with recent experience at a senior level in commerce and industry. The boards of both the PRA and FCA should include high calibre individuals with expertise in financial services including representatives from the insurance sector.

10. It is important that the staff at the PRA and FCA include a sufficient number with knowledge of the insurance industry. It is particularly important that if the PRA is to pursue a judgement led approach that this is undertaken by staff with the appropriate specialist knowledge of the insurance industry.
11. Further consideration is required, however, on how to ensure that FOS is properly transparent, accountable and adheres to policies set by the FCA. (See paragraph 20 below).

Co-ordination

12. We welcome the Government's proposal to limit the framework legislation to introducing a statutory duty of co-ordination, a requirement for there to be Memorandum of Understanding between the PRA and FCA and cross-membership of the Boards of the two authorities. This will provide a framework to enable co-operation without imposing bureaucratic restraints on how this is done.
13. However, this makes it more important that the authorities are open and transparent when they are setting up their co-operation mechanisms. They should consult fully with stakeholders on the proposed mechanisms. We would hope that the authorities would also welcome these co-operation mechanisms being considered by the Treasury Select Committee.

It is particularly important for dual regulated firms that there is effective co-ordination in order to ensure a consistent and proportionate approach to regulation.

14. One of the key issues from the markets perspective will be the relationship between the Bank of England and FCA as regards regulation of systemically important infrastructure. Although responsibility for this is to be allocated to the Bank of England it relates in part to ancillary architecture that fundamentally supports the operation of equity, debt and derivative markets. It is vital that there should be confidence in the regulatory arrangements here. We consider that requirements regarding co-operation and duties to share information between the Bank and the FCA, which will have the responsibility for regulation of markets, need to be clearly laid out in the legislation.

Competitiveness

15. It is important that the regulatory system contributes towards the strengthening of the UK's financial services sector. Effective regulation can and should provide a positive contribution to competitiveness. Equally, the dangers of unnecessary and poorly specified regulation and the risk that this will undermine competitiveness must be recognised and avoided. The absence of any specific reference to promotion of the UK's financial services sector in the regulatory objectives should not lessen the authorities' appreciation of this.

EU/International Issues

16. Ensuring good co-ordination between the UK authorities on international issues is a vital necessity to ensure that the UK's interests are properly represented at international forums.
17. We believe that the recent setting up of the European Supervisory Authorities (ESAs) represents a significant change from the previous Level 3 committees. The power of the ESAs to set binding technical standards and to settle disagreements between national regulators means that, over time, the ESAs will become the main source of detailed regulatory requirements for UK financial services firms. In order to retain their influence in this environment the UK authorities will have to do more to influence the process of setting EU rules. This is likely to require new skills on the part of UK representatives on the ESAs – negotiating and influencing skills and a higher level of political awareness will be needed in addition to a high degree of technical skill. This needs to be taken into account in selecting UK representatives on the ESAs and more generally in the recruitment of staff to the UK regulatory bodies.
18. The increasing importance of EU regulation means that UK constituents should be encouraged to make their views known as EU proposals are developed and we would suggest that HM Treasury and the PRA should take steps to ensure that UK stakeholders can participate in EU consultation processes.
19. The proposal for a statutory Memorandum of Understanding between the Treasury, the Bank of England, PRA and FCA appears to be a necessary precondition for ensuring co-ordination between the authorities and we, therefore, support this proposal. However, in order to ensure effective co-operation on the ground it will be necessary for all the authorities involved to develop a culture which emphasises the importance of co-operating at working level on international issues in order to ensure a co-ordinated approach that secures the best outcome for the UK.

Wholesale and Market Regulation

20. We note the recognition made of wholesale and market activities and that these should be effectively and proportionately regulated in a way that recognises the particular characteristics of participants in these markets. This is helpful. There is a danger, otherwise, of regulatory matters being seen overly through a retail lens. For example, the absence of any explicit reference to investor protection as a regulatory aim is perhaps an omission that illustrates the danger of this being seen as in some sense a sub-set of „consumer interest“ when this is not an accurate way of characterising the legitimate interest of institutional investors in the quality of the UK's investment markets.

FOS

21. Additional measures are needed, however, to ensure that the Financial Ombudsman Service is properly transparent and accountable. It is currently subject to quite limited checks and balances for a large statutory organisation with a substantive impact upon the market. Legislative changes should ensure that FOS focuses on its core function of resolving individual disputes and is properly embedded within the broader regulatory framework. HMT and the Ministry of Justice should also give consideration to whether Claims Management Companies should be included within the regulatory remit of the FCA, given they are now involved in a growing number of FOS complaints.

Consumer Outcomes

22. We agree with the Government's emphasis on delivering positive consumer outcomes, which should be aided by the references to pursuit of competition and consumer choice within the FCA's objectives. However, we urge the Government to specifically require the FCA to „facilitate“ access to financial services to help ensure that consumers are able to meet their financial needs.

Warning notices

23. We do not support the proposal that the PRA and the FCA should be able to publish warning notices at the start of enforcement proceedings. This is likely to trigger adverse publicity for the firm, which could cause lasting reputational damage, even where enforcement action is subsequently discontinued. Inappropriate or premature use of warning notices may also undermine the FCA's strategic objective to increase consumer confidence in the UK financial system.

Questions for Consultation

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

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

The consultation sets out a number of potential macro-prudential tools which might be used by the FPC. Many of these are, as the consultation acknowledges, untried and we believe that it is important that the FPC undertakes rigorous analysis of the potential impact and likely effectiveness of such tools before it makes use of any of these mechanisms.

Indeed, the way in which „levers“ are used will be as critical as the design of the tool itself. It is critical that they are used in a wise manner by the authorities, responding as far as possible to the development of market bubbles or crunches and changes in risk premia that clearly go beyond straightforward objective responses to changing perceptions of underlying asset values. In due course further thought also needs to be given to the manner in which macro-prudential policy will link with the operation of monetary policy as part of the overall framework of promoting financial stability of the system as a whole.

The consultation notes that many of the proposed tools are being developed at an international level. We agree that it makes sense for such tools to be designed and the framework for implementing them developed at an international level. This will help international co-ordination in future crises and ensure a common understanding of how and when such tools might be used. In particular the FPC will need to co-ordinate its work with the European Systemic Risk Board (ESRB) at EU level – as paragraph 2.47 recognises, it will be important for the respective responsibilities of the ESRB and national authorities to be clearly delineated in order to ensure that there are no overlaps and to minimise the risk of contradictory action in the event of a crisis.

We note that all of the proposed tools are being developed in a banking context and, as currently envisaged, are applicable to banks. This makes sense given the recognition elsewhere in the paper that insurers do not normally represent a classic systemic risk of the type represented by banks. Insurers have very different business models and engage in different activities from banks. The use on insurers of tools developed for banks would, in any case, be inappropriate. Therefore, to the limited extent that it might be appropriate for insurers to be subject to macro-prudential regulation we believe that the FPC will need to develop specific tools appropriate to insurers and should ensure in doing so that it has access to relevant insurance sector expertise.

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

The proposed role, governance and accountability mechanisms for the FPC appear to be largely appropriate. It will be an important body with a policy formulation and

direction role that goes well beyond the remit currently held by the Court of the Bank of England. It is essential that the governance and accountability mechanisms around this role are fit for purpose.

The independent members of the FPC should be drawn from a wide range of appropriate expertise including those with recent experience at a senior level in commerce and industry. We would support the Treasury Select Committee's recommendation that at least one member has recent experience of risk management at the highest level.

In paragraph 2.95 the consultation proposes that legislation will specify for each tool whether the FPC should consult on a policy statement about the use of the tool and whether the PRA and/or FCA should be required to consult before implementing the tool. We appreciate that there will be circumstances where it is not appropriate (or where there is insufficient time) for the PRA and FCA to fully consult on their use of a macro-prudential tool. However, we believe that there should be a requirement on the FPC to issue a policy statement on every macro-prudential tool that it may wish to use setting out the circumstances in which it would propose using the tool and the expected effects of doing so.

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

It is well-understood that the Bank should be closely interested in the effective and safe operation of systemically important infrastructure. However, much of this infrastructure in settlement systems and recognised clearing houses, constitutes the ancillary architecture that supports the operation of equity, debt and derivative markets. It is essential, therefore, that the Bank's regulation of this infrastructure is effected in close co-operation with the FCA given its responsibilities as regulator of the wholesale markets. We think this needs to be clearly referenced in the legislation through a duty to consult the FCA and share relevant information.

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

As drafted the strategic objective of the PRA is expressed solely in terms of contributing to financial stability. Given the increased recognition (for example in paragraph 3.21) that insurers are less likely to give rise to systemic risk it is perhaps questionable whether an objective framed entirely in financial stability terms is appropriate for the prudential regulation of insurers. As has been acknowledged elsewhere by FSA CEO Hector Sants the main purpose of requiring insurers to be prudentially regulated is to ensure that they have the financial strength to deliver policyholders reasonable expectations – this is essentially a micro-prudential concern. This is, of course, a concern that applies to banks which will also be subject to micro-prudential regulation by the PRA.

We believe that it is appropriate for insurers to be prudentially supervised by the PRA and, therefore, believe that the scope of the strategic objective should be expanded to ensure that insurers are encompassed by it. This might be achieved by merging the strategic and operational objectives into an overall objective encompassing both the macro and micro prudential elements of the PRA's mission. We believe that the proposed operational objective appears to be appropriate.

We also believe that the proposed regulatory principles are appropriate. The recognition that the PRA should be subject to such principles is a major advance on the original consultation. It should be axiomatic that regulatory bodies should be subject to robust 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 noted in our response to question 5 above, we agree that the prudential regulation of insurance firms should be included in the scope of PRA. We welcome the recognition in the consultation of the significant differences between the banking and insurance business models and that this will require different, possibly less intensive, prudential supervision for insurers compared to banks. We note that the UK authorities are continuing to consider how the characteristics of insurers can be appropriately recognised in the prudential regulatory framework and we would welcome continuing dialogue with the authorities on this issue.

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)?

In principle we support a move to a more judgement-led approach by the PRA as this should allow the regulators to take an approach more focused on the major risks facing firms (and the risks involved in the failure of a firm) rather than reliance on assessing detailed compliance with rules. In particular we would welcome greater engagement by senior PRA staff in assessing the risks facing firms and the actions taken to mitigate these risks.

However, we remain unclear about how the proposed judgement-led approach will operate alongside the introduction of the European Supervisory Authorities which will have powers to issue binding technical standards on national regulators, and to settle differences between national regulators on supervisory issues. In addition UK regulatory requirements will have to comply with relevant EU directives (such as CRD and Solvency II) which contain many detailed, technical rules. We believe that the authorities will need to consult further on how they intend to operate the PRA regime in a manner that is both consistent with EU requirements and the proposed judgement-led approach.

There is a danger in any judgement-led approach that this could give rise to inconsistent, and possibly arbitrary, decisions by supervisors in respect of individual firms. In the worst case it could lead to what would amount to retrospective changes to rules and to supervisors second-guessing management decisions. It is, therefore, essential that the PRA maintain sufficient checks and balances to prevent such outcomes. This must include robust arrangements to enable firms to challenge PRA decisions. We would not, therefore, be in favour of the proposed limits to challenge PRA decisions at the Upper Tribunal.

With respect to the proposed Proactive Intervention Framework we look forward to receiving more detail in future consultations. Our initial observation is that while we understand that there is a need to ensure that the regulator acts promptly on concerns about firms we would be concerned if the PRA locked itself into a

mechanistic response that did not adequately address the specific circumstances of each case.

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

The proposed governance framework for the PRA appears to be satisfactory and designed to ensure the operational independence of the PRA within the Bank of England.

It is important that the non-executive members of the PRA's Board are drawn from a wide range of expertise and backgrounds including from the insurance industry.

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

The proposed accountability mechanisms for the PRA appear to be appropriate. We note that it is intended that the PRA should be audited by NAO but that it will remain for the Treasury to commission value for money studies of the PRA. We believe that it would be more appropriate for the NAO to be able to independently determine when to undertake value for money studies as it does already for other government bodies and for such reports to be scrutinised by the Public Accounts Committee.

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 improvements proposed on consultation and other types of engagement with practitioners and consumers compared to the initial consultation paper. We believe that it is essential, as the Government now proposes, for there to be no significant reduction in the safeguards currently in FSMA requiring proper consultation and engagement.

The proposals on consultation appear satisfactory. We agree that in many cases consultation could be streamlined when implementing EU rules given that national authorities will often have little discretion in how to do this. However, this makes it more important that UK constituents are encouraged to make their views known as EU proposals are developed and we would suggest that HM Treasury and the PRA should take steps to ensure that UK constituents can participate in EU consultation processes.

We agree with the proposal that the PRA should be required to consult with practitioners. We note that rather than mandate a particular method of consultation (for example requiring the PRA to set up panels) the consultation proposes that the PRA will be under a legal duty to consult but that the form of such consultation can be decided by the PRA. We believe that in order for this to be acceptable the PRA should, before setting up its arrangements, be required to consult on these so as to ensure that practitioners' opinions are taken into account when developing the proposals. There should also be a mechanism for Parliament to strengthen the consultation process if the PRA does not develop a satisfactory process.

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

The ABI broadly welcomes the objectives and principles proposed for the FCA. In reforming the regulatory framework, the Government should focus on the ultimate goal of positive consumer outcomes. The consumer and public interest extends beyond protecting consumers from negative or sub-optimal outcomes – it should also include consumers’ access to financial services products that meet their needs and expectations.

To that end, we are encouraged by the references to consumer confidence and choice within the proposed objectives, which should give appropriate direction and context to the FCA. We also welcome the Government’s recognition of the important role of effective competition in retail and wholesale markets in delivering benefits for consumers, and note the recent reports by the Treasury Committee and the Independent Commission on Banking have proposed the objective of competition should be made more explicit. We urge the Government to go further in securing the necessary focus on positive consumer outcomes, perhaps by amending the first operational objective to require the FCA to facilitate „access“ in the market(s) for financial services, in addition to facilitating efficiency and choice. An alternative approach would be to reflect the need to secure access to financial services within the regulatory principles.

The Government should also consider the important interplay between financial services markets, sectoral regulation and public policy. For example, this (or a future) Government may have a public policy objective such as increasing retirement saving or promoting financial inclusion, and the decisions made by the FCA may impact upon the attainment of that objective. It may, therefore, be logical to include within the legislation a provision to allow HMT to provide guidance to FCA about its contribution to broader social/economic policy objectives. The utility regulators Ofgem and Ofwat are subject to similar provisions in their respective fields.

The proposed regulatory principles are generally appropriate, particularly the requirement that FCA should operate in the most efficient and economic way, given that it will be funded by a compulsory levy on the industry. We also agree with the general principle that consumers should take responsibility for their decisions. While the FCA will introduce general and specific conduct regulatory requirements on firms, it is reasonable to expect that consumers take some responsibility. If this were not the case, it would limit the scope for consumers to exercise choices and add further regulatory burden when they buy products.

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

The ABI is generally happy with the proposed arrangements for governance and accountability of the FCA, which mirror many of the current and well-established arrangements that apply to the FSA. Although not specifically referenced within this consultation paper, we understand that the FCA will be subject to requirements to consult and conduct cost-benefit analysis before making new rules, as applies to the FSA. We hope this will be the case, because these requirements are not only a discipline on regulators but also an important strand of ongoing accountability. We welcome the new proposals identified, particularly NAO audits, and the commitment to greater transparency of decision-making. We also favour an ongoing role for the Treasury Committee in holding the FCA to account. However, as we outline in our

response to Q31 below, we believe the Government should now focus on strengthening the governance and accountability of FOS.

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

We will provide a full response to the FSA's related discussion paper (DP 11/01) on product intervention. In summary, the insurance industry recognises the need for credible deterrence and proactive regulatory intervention to prevent unfair treatment of consumers. However, rather than creating new regulations, more effective and consistent supervision and enforcement of distribution rules and the existing FSA Treating Customers Fairly requirements on product governance could address any ongoing market failures.

We also urge the Government and the FSA to consider how product intervention fits with other major regulatory initiatives such as the Retail Distribution Review, which will have a fundamental impact upon how retail investment markets operate and should reduce the risk of consumer detriment. Meanwhile, general insurance markets are generally very competitive with low risk of consumer detriment. The Government itself is recognising the importance to consumers of effective competition and choice in framing the FCA's objectives. So given this broader context, we can see little justification for the regulator getting involved in product design.

Our detailed comments focus on addressing the two specific powers floated in this consultation, namely:

- Temporary product intervention rules for a period of up to 12 months with immediate effect; and
- To enable the FCA to make provision on the unenforceability of contracts made in breach of product intervention rules, temporary or permanent. Rules may stipulate the contract is void and consumers may seek recovery of payments made under it.

The rationale behind decisions to invoke the powers to ban products will likely be very different in wholesale and retail market contexts. It follows, as is recognised in the consultation, that the processes to be followed in such circumstances will need to differ considerably.

Product bans

The consultation rightly notes that it is "important to strike an appropriate balance between enabling the FCA to act quickly to protect consumers and providing an appropriate degree of certainty for firms". We agree. It is right that the more radical powers – such as banning products - should only be used in prescribed and extreme circumstances, such as in response to specific significant market failures, and only when other options have been exhausted. The limitations on the use of such powers should be clearly defined in primary legislation. In most circumstances we would expect a product ban to run into conflict with the FCA's own objectives to enhance consumer confidence and consumer choice, so it should be used sparingly.

We further support the proposed requirement upon the FCA to propose and consult on a set of principles that will govern the exercise of its new banning power. In the absence of sight of the proposed safeguards, it is difficult at this stage to gauge whether they will be sufficient to provide firms with a reasonable level of certainty in developing their business models. The Government and/or the FSA should present the draft guidance before Parliament is asked to decide whether to grant the FCA powers to ban products. The regulator should also be wary of the unintended consequences. For example, it would create costs for firms who are properly managing the product and its distribution, as well as restricting choice for those consumers for whom the product is suitable and meets their needs.

The consultation also says that the “Government recognises that FCA action to ban a product could have potential consequences of concern to the PRA”. We consider there is the risk that the banning of a major product may destabilise a PRA firm in a way which is of prudential concern to the PRA itself. This could lead to a conflict between the respective objectives of the FCA and the PRA. Moreover, as was indicated in the Treasury’s July 2010 document, prudential concerns will „trump“ conduct concerns: the PRA will have the power to veto the FCA’s action. The consultation makes clear that the FCA would be able to intervene to block an imminent product launch or to stop an existing product achieving volume sales to prevent retail customers from being harmed.

This raises two issues:

- How would the FCA react if it bans the launch of a product by a particular provider, and then subsequently discovers that other providers already offer essentially the same or similar products?
- If the FCA seeks to ban products already on the market, where will this leave affected consumers in terms of liquidating their position? (e.g. realising underlying assets in an investment product)?

For example, would the only option be to make the contract void and unenforceable (see below) and for the consumer to seek damages (in addition to return of premiums)?

Unenforceability of contracts

We presume that the power to make contracts void and unenforceable is limited in scope to product bans only, but would welcome confirmation.

The Government should bear in mind the unintended consequences of rendering a contract void. For example, this could leave the consumer without insurance cover or an investment vehicle. The consultation mentions that the consumer would be able to seek damages. We seek clarification as to the mechanism that the Government envisages to be most likely to be used e.g. invoking s. 407 FSMA powers (or s.404 where the issue goes wider than a single firm) to require the firm to conduct a business review to identify affected consumers and to calculate and pay redress accordingly. Thought also needs to be given to how the FCA will communicate to consumers the reasoning for, and implications of, banning products, particularly if they already hold similar products.

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.*
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The proposed approach to the FCA using transparency and disclosure as a regulatory tool

We agree that – if used sensibly and proportionately – a culture of regulatory transparency and disclosure can help to underpin the regulator’s statutory objectives and enforce market discipline. The requirement for the regulator to disclose its views on market developments (e.g. trends in products and services, which are currently highlighted through the FSA’s Annual Report) may help firms to identify potentially systemic issues, which can then be addressed before they escalate. On occasions the FSA has been unwilling to take positions and give clear guidance to the market, to the detriment of both firms and consumers. A cultural change in this regard could be beneficial, provided that the FCA has good quality staff that are able to make well-judged early interventions. It is also important that the regulator communicates these systemic concerns regularly, as part of a constructive dialogue with industry.

The consultation rightly recognises the need to ensure that any new powers contain the necessary safeguards to ensure an appropriate balance is struck between the interests of consumers and regulated firms. It is important that the regulator’s supervisory approach is not undermined by an over-zealous approach to the disclosure of commercially sensitive or confidential information. This approach has been built on firms providing information voluntarily in a relationship of openness and trust. This information enables the regulator to discharge its supervisory responsibilities in an efficient way. Issues can be identified that would otherwise not be apparent and the approach enables the regulator to achieve swifter outcomes than if it could only rely on formal approaches. So it is important that greater disclosure of firm-specific information does not lead to a legalistic environment where firms only provide the minimum information necessary to discharge their statutory obligations. In addition, the FCA will need to be wary of providing positive information about the practices or product of individual firms, as this could be interpreted by consumers as an „endorsement“ of the firm/product by the regulator.

The proposed new power in relation to financial promotions

It is proposed that the FCA be given a power to impose an immediate ban on “misleading” financial promotions and to publish the fact of the ban. We support initiatives aimed at reducing the risk of consumers making poor purchasing decisions because financial promotions are unfair, not clear or misleading. But it is important that the FCA strikes the right balance between the information needs and wants of consumers and a fair process for firms.

We accept there may be circumstances where it is appropriate for the FCA to publish details of actions it has taken to address misleading financial promotions. However, we are concerned that publication would take place even if the firm has appealed the decision to the Upper Tribunal. We are also concerned that the

Government appears to be proposing that the FCA should have less discretion around the use of this power than will apply to the power discussed below.

The proposed new power in relation to warning notices

It is proposed that both the PRA and the FCA be entitled to publicise the fact that a warning notice - the trigger for enforcement action - has been issued.

We note that the Government acknowledges that such adverse publicity for a firm could cause lasting reputational damage, even where enforcement action is subsequently discontinued. So the proposed safeguards – namely that the power will be discretionary; that the Government expects the regulator to consider the impact of the disclosure upon the firm; and that any discontinuation of enforcement action must also be duly publicised – are essential

However, we consider that there are a number of further possible impacts, both for firms and the regulator. For example, firms may find that their ability to resist demands made by the regulator in the early stages of a potential enforcement action (i.e. before any public revelations) is inhibited. Secondly, there is a risk that a publicised warning notice might trigger civil litigation against a firm thereby exposing the firm to „double jeopardy“ and find itself having to defend itself in two separate actions. Finally, we believe there is a risk of reputational damage to the regulator if an action against a firm receives much media attention, but the firm is subsequently vindicated (particularly in the likely event that this is well covered by the media). Inappropriate or premature use of warning notices may also undermine the FCA’s strategic objective to increase consumer confidence in the UK financial system.

As with the proposal to ban misleading financial promotions, the FCA will be able to make damaging assertions before the facts have been fully determined and the firm has had a sufficient opportunity to make representations. The publication of warning notices amounts to public censure as the notice will be critical of the firm’s conduct. This circumvents the safeguards of FSMA and deprives firms of their right to due process. Public censure requires due process involving a warning notice, a decision notice (which can be referred to the Upper Tribunal) and finally a published final notice.

We do not support this proposal. But – at the very least – we consider that the safeguards could be strengthened. For example, the regulator should be required to publish guidance as to when it is likely to consider publicising enforcement action, so that firms would have a proper opportunity to challenge the allegation before it is applied and publicised.

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?

The consultation does not really articulate a clear and developed policy on the role of the FCA in competition matters. But it is proposed that the FCA should have a “credible and effective role in competition” to achieve its objective of promoting efficiency and choice and its powers will be refined as part of the ongoing review of UK competition law being consulted on by the BIS. So it would appear that the FCA will give more consideration to competition issues in its regulatory decision-making processes than has been the case with the FSA.

We can see some potential merit in this, provided that FCA employees have the appropriate skills, particularly in economic analysis. As outlined above, we support the references to competition in the FCA's objectives. We also agree there is room for improvement in the interaction between financial services regulation and the competition bodies. As the consultation paper points out, in recent years, the OFT and the FSA have conducted overlapping but not fully coordinated investigations into the same financial services market – payment protection insurance. We agree that this is a good example of a case in which a competition mandate would have been useful in enabling the FSA to address competition issues in financial services in a more efficient and targeted way. So there could be merit in considering transferring some of the OFT's competition and consumer protection powers for the financial services sector to the FCA, although we would expect the competition authorities to retain responsibility for core competition law such as merger control and prevention of cartels.

The Government instead appears to be proposing a „halfway house“ position which provides FCA with some new competition powers but involves the competition authorities retaining the same (and other) powers. For example, we understand the proposal would allow consumer groups to submit super-complaints about the same financial services market to both the OFT and the FCA. We do not think this duplication of responsibilities will lead to coherent regulation and it will create unnecessary and unhelpful uncertainty for firms. The Government is also now consulting on the future of the competition authorities so we urge the outcome of these initiatives to be properly coordinated and preferably involve a single body only having responsibility for promoting competition in financial services markets.

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.*

These proposals seem appropriate. We welcome the confirmation of the Government's intention to retain responsibility for the UK Listing Authority within markets regulation. It will be important though, as the consultation document rightly identifies, for the FCA to represent effectively in ESMA the interests of those UK bodies such as the Financial Reporting Council that have responsibility for matters that will come within the purview of ESMA.

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

As the Government recognises, close co-ordination between the PRA and FCA will be necessary to ensure that the new regulatory structure operates in an efficient and effective manner. It is vital that the PRA and FCA do not duplicate each others' activities. It is particularly important for dual regulated firms that there is effective co-ordination in order to ensure a consistent and proportionate approach to regulation.

We agree that in practice effective co-ordination will need to be worked out in detail by the PRA and FCA working together. Given this we welcome the Government's proposal to limit the framework legislation to introducing a statutory duty of co-ordination, a requirement for there to be Memorandum of Understanding between

PRA and FCA and cross-membership of the Boards of the two authorities. This will provide a framework to enable co-operation without imposing bureaucratic restraints on how this is done.

It is essential 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 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 etc; and
- enforcement activity.

We agree that the 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.

The authorities must be open and transparent when they are setting up their co-operation mechanisms. They should consult fully with stakeholders on the proposed mechanisms. We believe that the proposed mechanisms should be subject to scrutiny by the Treasury Select Committee.

In relation to the detail of the proposed co-ordination requirements we note that the respective information-sharing obligations between the PRA and FCA are asymmetric, the former having the greater powers to require relevant information and lesser obligations to share it. This apparent hierarchy of power runs the risk of cutting across what should be a culture of co-operation between the various parts of the regulatory structure and ensuring that the interfaces between different bodies are characterised by harmonious interaction and not friction. Confidence in the financial system will, in any case, not be engendered if those responsible for regulating it are not fully informed.

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?

The proposed PRA veto would appear to be a necessary power. However, we would expect that this would rarely, if ever, be needed. We, therefore, agree that the power should only be available where the FCA and PRA cannot agree a course of action and the PRA believes that the proposed regulatory action by the FCA would result in the disorderly failure of a firm or wider financial instability. It should

not otherwise be used by the PRA to prevent the FCA taking regulatory action that it believes to be necessary

We note that it is intended that any use of the veto power should be reported to Parliament and disclosed in the PRA's annual report subject to confidentiality and the need to maintain financial stability. We accept that confidentiality restrictions or financial stability considerations will sometimes make it impossible to publish details but in this event we believe that, as a minimum, the Chairman of the Treasury Select Committee should be informed that a direction has been given.

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

We agree that for firms solely regulated by the FCA, it should be solely responsible for granting authorisation.

Where firms are dual regulated the most important issue is that the authorisation process should be as straightforward as possible. This makes it imperative that the FCA and PRA work together closely to ensure that applications are dealt with in a joined up way. Given this we would favour the alternative approach (where one of the authorities has responsibility for processing applications and seeking consent from the other where appropriate) as this will provide applicants with a single point of contact. We believe, on balance, that the FCA should be the responsible authority given that it will already carry out authorisations for the firms it regulates alone and, therefore, it will already have the appropriate mechanisms and expertise available.

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

We agree with the Government's proposals to give both the PRA and the FCA the FSA's current powers 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?

We accept that for dual-regulated firms both the PRA and FCA will have an interest in approving people holding significant influence functions. However, it is unclear to us how the proposed system is intended to work as there is insufficient clarity over which functions each authority would lead on. For example, the paper states that the PRA would be responsible for approving chief executives but it seems to us that the chief executive is as important a figure for conduct issues as he/she would be in relation to prudential issues. Therefore, the FCA's interest in the appointment of a chief executive is likely to be as great as that of the PRA. Likewise appointments of directors are likely to be of equal interest to both authorities. There is a danger that giving one authority the lead on approvals for a particular function will result in an unbalanced focus on issues relevant to that regulator.

We would suggest that it would be more appropriate for there to be a joint responsibility on the part of PRA and FCA to approve holders of significant influence functions for dual-regulated firms.

Whatever system is put in place it is important that it is run as efficiently as possible to ensure that the approval process is undertaken quickly and with the minimum of

overlap. Candidates should only have to put forward one application and attend a joint interview. In order to ensure this it would be appropriate, as with authorisations, for either PRA or FCA to take the lead in processing applications consulting the other as necessary. Many of our Members have expressed concern at the length of time that the current FSA approval process can take and there must be a danger that this will be increased under the proposed new regime making it more essential that the authorities work closely together.

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

The proposals on passporting appear appropriate.

We believe that the creation of a central clearing system through which notifications could be submitted would be useful. The same central clearing system could also be used to store all Member State's „general good“ rules which would make it easier for firms passporting in to other countries to understand any additional regulatory requirements. This would help the Commission to ensure consistency in the presentation of the general good rules, which can often be dense and difficult for passporting firms to understand.

A lack of information and access to the general good rules found in Member States is currently an issue and a potential barrier to cross-border business. Further transparency of these rules along with accessibility to them would assist in increasing consumer protection and legal certainty for provision of cross-border business.

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

The ABI welcomes the re-affirmation in the paper that the authorities will seek to ensure a „level playing field“ between firms regardless of the ownership model adopted.

We agree with the proposal that the PRA and FCA should be required to provide additional cost benefit analysis to make clear whether any proposals have different impacts on mutual and proprietary organisations.

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

The proposed process for rule-making and waivers appears appropriate. 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.

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 agree with the proposal that the PRA and FCA should co-ordinate their activities to ensure effective consolidated and group supervision.

The proposed power of direction appears to us to be a necessary power to be available as „a backstop“ where PRA and FCA have been unable to reach agreement. We agree that this power should be subject to the conditions and limitations proposed.

These proposals appear to have been largely written on the basis that the group being supervised is based solely in the UK. It is unclear how the proposed division of responsibilities between the PRA and FCA would work in relation to a cross-border group where other supervisors would be involved and the group supervisor might be an overseas supervisor.

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?

The proposed powers and co-ordination requirements relating to changes of control and Part VII transfers appear appropriate. In particular we agree with the proposal that the PRA should take the lead in relation to Part VII transfers consulting with FCA as appropriate.

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

The proposed powers and roles for the authorities in insolvency proceedings appear appropriate.

We note that the Government is considering further the division of responsibilities between PRA and FCA in the event that a life insurer goes into voluntary winding-up. We would be happy to discuss the issues further with the relevant authorities.

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

The proposal on fees and levies is essentially to maintain the existing arrangements whereby although each body sets its own fees these are collected through a single organisation. This seems sensible.

Our Members have been concerned for some time at the level of fees and the substantial increases in recent years. We, therefore, welcome the decision that the PRA and FCA should be subject to a requirement to use their resources in the most efficient and economic way. It is important that there is more oversight than exists under the current arrangements both of the amounts that are raised in fees and levies and the use made by the authorities of these amounts. We welcome the decision to make both PRA and FCA subject to audit by the NAO as this will enable the Public Accounts Committee to examine the spending of these bodies. We also suggest that the Treasury Select Committee should regularly examine the annual plans and reports of the regulatory authorities.

We are particularly concerned about the cost of dual regulation for members. It is not yet clear how costs will be apportioned and what safeguards will be in place to ensure that dual regulated firms are not levied twice for the same activity. Dual regulated firms will also incur additional costs to ensure ongoing compliance with the regulatory requirements of two regulators for example supervisory visits, requests for information, rulebooks, documentation etc.

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

We agree that it is important that the FSCS remains a single body in order to ensure that consumers have a single point of contact for compensation matters. We believe that the proposed operating model, coordination arrangements and governance arrangements where PRA and FCA have joint responsibility for the FSCS are appropriate.

It is not clear from the consultation the extent to which these proposed changes will impact on the current design of the FSCS. We believe that the current structure (with the exception of the general pool arrangements which we strongly oppose) works well. In particular we believe it remains appropriate for providers to be linked in classes with the appropriate intermediaries but do not believe that it is appropriate for there to be any linkage or cross-subsidy across classes.

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

We welcome the inclusion in this consultation paper of discussion about the future role of the FOS, which has become a significant part of the regulatory and redress framework as a whole in the UK.

The ABI supports the retention of an independent and accessible, low cost dispute resolution service. However, we agree that the growth in the FOS workload has created challenges for the service and the regulator, and we also agree that the distinct roles of the two bodies need to be made clear. We hope and believe that there will be fewer industry-wide issues triggering mass claims in the years ahead,

not least because of the FSA/FCA commitment to early intervention and the availability of the section 404 powers.

We agree that the coordination and cooperation mechanisms between the FOS and the FCA need to be strengthened and formalised. We are particularly concerned about the lack of clarity around roles and responsibilities when issues with wider implications arise from individual FOS cases. We were recently surprised when the FSA, the FOS and the OFT issued a statement announcing the abolition of the informal wider implications process, and its replacement with a Coordination Committee made up of those three bodies only. It is not clear how trade associations or individual firms can bring ombudsmen decisions with regulatory impact to the attention of the regulator.

So, we believe it is appropriate for Parliament to determine the high-level framework for the handling of such cases, rather than deferring it to the FOS and FCA to address within a Memorandum of Understanding. In our view, it is the regulator which is best placed to make regulatory decisions in these circumstances. They should reach a position following consultation with the industry and consumer groups, and proper assessment of the costs and benefits. We also urge the Government to review the „test case“ procedure, because the current rules give FOS the sole right to decide whether or not it will allow a firm to put complaints that raise important or novel points of law before the court.

On transparency, there are potential costs and benefits from disclosure of determinations, so we agree the FOS should consult on the principles it would apply in relation to publication. The FSA has rules requiring firms to take account of ombudsmen decisions so there is a need to clarify how those requirements connect to publication of FOS decisions. More broadly, we believe the FOS should be required to consult on the internal guidance it provides to inform decision-making by adjudicators and ombudsmen. It has recently started to publish „technical notes“ which is an improvement but it does not consult with external stakeholders before doing so.

Finally, a related issue which should be addressed in the context of financial regulatory reform is the future regulation of Claims Management Companies (CMCs), which now account for 28% of all FOS complaints. Unsatisfactory regulation allows CMCs to generate quick profits from a business model that often offers poor value to consumers, while contributing to something of a „compensation culture“ in the UK. The Ministry of Justice is currently reviewing regulation of CMCs, so we suggest MoJ and HMT should jointly assess whether the FCA’s remit might sensibly be extended to include CMCs. Consideration should also be given to requiring CMCs to make a contribution to the running costs of FOS, particularly where a complaint they have advanced is judged to be frivolous or vexatious.

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

We agree with the Government that strengthened accountability is an important strand of regulatory reform, and we believe this should extend beyond the regulator itself to include the associated bodies.

We agree that proposals to require FSCS to consult on and publish an annual plan appropriate and also that it is appropriate for NAO to audit FSCS.

While supportive of the core purpose of FOS as a dispute resolution service, the financial services industry has become concerned by the limited accountability mechanisms that apply to FOS. As a statutory organisation with an annual turnover of over £100m it is appropriate that its operations, budgets, policies and procedures should be subject to external checks and balances. So we welcome the proposal that the NAO should have audit powers over the FOS as an important first step.

However, while we agree that ombudsmen should make their decisions about individual cases without interference from the regulator (or any other body) we believe it would be appropriate for the organisation as whole to be subject to greater regulatory scrutiny. The FCA might, for example, conduct an annual review of the operation of FOS, following consultation with the industry and consumer groups. We also believe the FCA should have a role in settling disputes about the jurisdiction of FOS, given there is a potential conflict of interest when FOS make major decisions about whether they can determine types of cases. In other sectors, such as legal services, ombudsmen services are subject to accountability mechanisms of this type to their sectoral regulator, so we do not believe it should compromise the FOS when dealing with individual cases.

The ABI supported the establishment of CFEB and we agree they should also be subject to NAO scrutiny.

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

Ensuring good co-ordination between the UK authorities on international issues is a vital necessity to ensure that the UK's interests are properly represented at international forums.

We believe that the recent setting up of the European Supervisory Authorities (ESAs) represents a significant change from the previous Level 3 committees. The power of the ESAs to set binding technical standards and to settle disagreements between national regulators means that, over time, the ESAs will become the main source of detailed regulatory requirements for UK financial services firms. In order to retain their influence in this environment the UK authorities will have to do more to influence the process of setting EU rules. This is likely to require new skills on the part of UK representatives on the ESAs – negotiating and influencing skills and a higher level of political awareness will be needed in addition to a high degree of technical skill. This needs to be taken into account in selecting UK representatives on the ESAs and more generally in the recruitment of staff to the UK regulatory bodies.

HM Treasury, PRA and FCA should also ensure that they co-ordinate their EU and international work with relevant trade bodies and other UK stakeholders. We also suggest that when proposing new rules, the PRA and FCA should be required to take account of EU and international developments in the same area of regulation, to avoid the industry having to deal with two sets of rules and two sets of implementation costs twice in a short period of time.

The proposal for a statutory Memorandum of Understanding between the Treasury, Bank, PRA and FCA appears to be a necessary precondition for ensuring co-ordination between the authorities and we, therefore, support this proposal.

However, in order to ensure effective co-operation on the ground it will be necessary for all the authorities involved to develop a culture which emphasises the importance of co-operating at working level on international issues in order to ensure a co-ordinated approach that secure the best outcome for the UK.

We note that the PRA, as regulator of banks and insurers, will hold the UK seat on the European Banking Authority (EBA), it will therefore be at the forefront of regulatory change to the Capital Requirements Directive. However it will not regulate any „limited licence firms.“ The interests of this group must be appropriately represented in such negotiations and a proportionate approach should continue in the application of this Directive to such firms, which do not trade on their balance sheet and are quite distinct from banks and insurers. In this respect the MoU and lines of communication between the PRA and FCA will be key to ensure the interests of limited licence firms continue to be represented in European fora.



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

13 April 2011

AFM Response to consultation on a new approach to financial regulation

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:
 - Comment on the more detailed proposals for the new regulatory regime provided in the consultation;
 - Highlight areas which we consider are worthy of further review.
2. The Association of Financial Mutuals (AFM) was established on 1 January 2010, as a result of a merger between the Association of Mutual Insurers and the Association of Friendly Societies. Financial Mutuals are member-owned organisations, and the nature of their ownership, and the consequently lower prices, higher returns or better service that typically result, make mutuals accessible and attractive to consumers.
3. AFM currently has 58 members and represents mutual insurers, friendly societies and health planning providers in the UK. Between them, these organisations manage the savings, protection and healthcare needs of 20 million people, and have total funds under management of over £80 billion.
4. In recent years the market share of the mutual sector in insurance has grown rapidly, and even during the financial crisis our members were reporting high sales volumes. There is growing recognition amongst consumers and their advisers that mutuals offer superior value and service.
5. We responded to last year's consultation on the development of a new regulatory system, and we pleased to see that some of our comments had

been taken into account in the latest consultation. There is significantly more detail in the new consultation which provides much more assurance as to the way financial regulation will be conducted in future. We are broadly supportive on the approach proposed.

6. Regulation is today a fundamental element of doing business in the UK, particularly in financial services. This has brought a real focus in the majority of regulated firms on serving the interests of customers but it has also brought with it high costs of compliance, and the ever present risk that regulation can carry consequences that have a detrimental effect on firms or markets in general.
7. In the recent past we have seen regulators respond in what we often regard to be a cavalier manner to political criticism of their contribution to the bank-inspired financial crisis. This has resulted in sometimes poorly designed, reactive regulation, both in the UK and in Europe, which has placed new and disproportionate burdens on many firms which do not pose the same systemic risk. We believe that the new architecture proposed will make this less likely, so long as supervisors properly understand the markets they are regulating, and act in a manner that is balanced and proportionate, both to the likelihood and the impact of any risks they seek to address.
8. Our responses to the specific questions raised in the consultation are attached.
9. We would be pleased to discuss further any of the items raised by our response.

Yours sincerely,

Martin Shaw

Chief Executive
Association of Financial Mutuals

Responses to specific consultation questions

Bank of England and Financial Policy Committee

We recognise many of the structural issues outlined in paragraph 2.6; these undoubtedly contributed to the financial crisis. The extent to which these are a failing of regulation is debatable; FSA has been rightly accused of looking at the wrong issues in the wrong way, and the limitations of the tripartite system and the narrow objectives imposed on it within FSMA have encouraged this. But it is also true that the nature of the market for financial services is a contributor; the market is becoming increasingly concentrated, with large shareholder-owned players often with an international agenda dominant, who see UK consumers as a source of profit rather than an opportunity to serve.

The received wisdom in regulation and legislation is that the shareholder owned model is superior, or else that the time spent regulating different business models in a more appropriate manner is not worthwhile. We are grateful therefore that the coalition Government is seeking to promote diversity of ownership and seeks way to ensure that regulation is more aligned with this ambition.

We support the main functions of the FPC as set out in paragraph 2.24, as well as its power to direct the work of other authorities once it has identified a potential systemic risk. We agree that the FPC's powers though should not be extended to directing individual firms to act, as this would clearly conflict with the role of the PRA and FCA. We agree that FPC has an advisory role, though we also see an important role for the FPC in acting as arbitrator where required between the two bodies. It is essential that there is no absence of consensus of key issues, and that regulated firms and consumers can be confident in the system and that the two different regulators will not express conflicting views.

The consultation proposes FPC would not be required to undertake cost benefit analysis of its views or of the direction it provides to markets and regulators, whilst accepting that the FPC itself may receive input or direction from Treasury. There is a risk therefore that political pressure might be brought to bear, or that a future government might seek to use the FPC as a mouthpiece in support of a particular political, rather than economic, viewpoint. This can be avoided by a combination of: clarity in the tools approved for the FPC; appropriate appointees to the Board of the FPC and a governance structure which requires it to act in a balanced way; and effective transparency as well as regular audit of its functions and performance.

Prudential Regulation Authority

We agree with the statutory and operational objectives proposed for the PRA; these give a broad and appropriate structure to the work to be undertaken. The regulatory principles helpfully amplify the objectives. The requirement for regulation to be proportionate provides a clear steer to PRA to maintain a robust cost-benefit analysis of both its rules and also its supervisory implementation of its powers.

We agree that insurance companies should be subject to the less intensive supervision than banks. We note that Bank of England, Treasury and the FSA are exploring the regulatory approach to insurance further; we are keen to support this work where appropriate.

In this context, paragraph 3.22 refers to “the PRA and FCA will also need to consider how their supervisory approaches should reconcile conflicting issues of policyholder protection and expectation of future return, and balance sheet soundness – particularly in relation to ‘with profits’ business”. We accept this assessment; the current regulatory approach has failed to give balance, and the with-profits policyholders have been assumed greater rights currently than the law or Policyholders Reasonable Expectations allows. More specifically, a more appropriate solution to this issue is critical to the survival of with-profits mutuals. AFM and its members are keen to support this exercise.

We support the proposal for the PRA to be judgment-led. It is important in pursuing this approach that the organisation is both realistic and proportionate in its approach. Solvency II for example requires insurers to model the possibility of one in two hundred year events. This kind of modelling, and reverse stress testing is very expensive for small firms to operate, and we would want to see PRA approach such exercises on a qualitative basis, that takes account of Solvency II work and focuses on the management process within the organisation.

We agree with the proposed governance arrangements for the PRA, including:

- the value of it meeting high standards of corporate governance (as set out in the UK Corporate Governance Code);
- its accountability as a subsidiary of the Bank of England, as well as its accountability to Parliament (for example to explain its role in any future financial failure);
- audit via the National Audit Office; and
- direct Government intervention limited to independent reviews of effectiveness.

For such governance arrangements to work effectively, the PRA Board and the Bank need to have a skill set and knowledge that is relevant to financial services, and which are properly representative of the organisations that they regulate.

The consultation explores the need for PRA to comply with Freedom of Information requests and to handle complaints about its performance. We would like to see this extended to ensure there is a mechanism for appeal against regulation that has a generally bad effect on society at large. This might occur in situations where pursuing the rights of individuals to an unnecessary degree might destabilise certain aspects of the economy or contradict stated government policy. We have also seen in the past the unsatisfactory way in which complaints against FSA are investigated by FSA, and consider that credibility would be greater with a more transparent and independent system of review.

We agree with the principles relating to consultation, and will explore this further in relation to the mutual sector in our response to chapter 5 (on regulatory processes).

Financial Conduct Authority

We recognise the value of establishing a “new, credible regime for conduct regulation”. What regulated firms look for beyond anything else is that the regulatory system is well-conceived; rational and fair- in as far as rules are executed well and after proper consideration; consistent, co-ordinated and proportionate; and which allows firms to compete on an equal basis.

As such we fully support the operational objectives set out in Box 4.1 which sit alongside the single statutory objective. We do believe though, notwithstanding the commentary provided, the use of the term “consumer champion” is an emotive and incongruous description of these objectives, and risks confusing consumers about the need to take personal responsibility. And as proposed by the Independent Commission on Banking this week, we agree that the FCA should have a greater role in promoting effective competition (across all markets).

On the whole we agree with the governance arrangements for the FCA, though the case for why these appear less rigorous than those of the PRA is not made strongly. Whilst FCA will not generally be supervising areas of potential systemic failure, it will have far-reaching powers and should retain the strict accountability arrangements proposed for the PRA.

The proposed product intervention powers for the FCA are valid in theory. Certainly where the authority can adequately address ‘problem products’ at an early stage, there will be significant and broad cost savings, to firms, consumers and society in general. The challenge is to ensure that the powers are appropriate in practice- that FCA does not stifle appropriate innovation; that it is even-handed; that it acts efficiently, proportionately and quickly; and that it communicates fairly.

The consultation explores the role of regulatory disclosure, specifically in relation to financial promotions and enforcement action. The proposals include clear process for circumstances in which FCA might publish its views or actions at an earlier time than is currently the case. We do not disagree with this approach, but it must be clear that FCA cannot use these added powers lightly, and that it must take a cautious and prudent approach. We believe FCA would be likely to be more diligent in the use of such powers if it were subject to greater independent scrutiny, for example through independent and transparent appeals and complaints processes.

Regulatory processes and coordination

We agree with the proposal that there should be a formal and legal duty on the PRA and FCA to co-ordinate their activities, and that this underpins the effective delivery of the co-ordination tools explored in Chapter 5. As well as the duties outlined, we would expect that the annual report of each regulator would report on the effectiveness of co-ordination, and highlight the value this has delivered.

We agree with the statement in paragraph 5.21 that where a firm is dual-regulated by PRA and FCA, it will be incumbent on the PRA to “judge whether a regulatory intervention is likely to lead to a firm or firms failing in a disorderly way”, and to “enable the PRA to prevent the FCA from taking actions where it considers that they are likely to lead to the disorderly failure of a firm or wider financial instability” (paragraph 5.24). For example, FSA is currently consulting on changes to the Conduct of Business rules on with profits. We believe that this will lead to just such a disorderly exit from the market as envisaged in paragraph 5.21, and that this will increase consumer detriment. In such cases the PRA should rightly be required to assess these broader implications before the course of action proposed by FCA was enacted.

As regards the authorisations process, we consider that the “lead” proposal where a dual regulated firm would have to receive authorisation from both authorities is likely to be problematic and lead to delays in authorisations (and variations in permissions) as well as creating a new barrier to entry to the UK market. This would be solved for dual-regulated firms by requiring PRA to consult with FCA during the authorisation process. This is consistent with the provision of a PRA veto covered in the section on disorderly failure, and the approach proposed for approved persons.

That said the proposed role of FPC as arbitrator where there is disagreement between PRA and FCA in relation to rule-making can be extended (paragraph 5.61). We believe that such disagreement is unlikely to happen on a regular

basis- otherwise this would be an indicator that the new regulatory system was not working properly.

We agree that neither regulator should seek to promote or favour a particular business model (paragraph 5.54), and that the same standards of consumer protection should apply for all regulated firms. In our view however FSA's approach to the regulation of mutuals has prevented them from competing on equal terms, because the "one size fits all" rulebook invariably applies a shareholder-owned model to the way firms operate. This in turn has led to FSA pursuing action that fits its approach to regulatory purity whilst increasing the prospect of consumer detriment.

This approach is borne out of a manner statutory objective for the FSA, which it has translated as requiring it to focus on a consumer protection agenda, that fails to assess the broader implications of treating some consumers differently to others, or of failing to balance the interests of consumers with all stakeholders. We are therefore strongly in favour of the proposal for the new regulators to evolve their approach to cost-benefit analysis, to analyse the extent to which those costs and benefits affect mutually-owned organisations differently to others.

In order to fulfill this requirement effectively, each regulator will need to take account of the mutual implications of all proposed rules in future, and we believe this will require them reflect this in their organisational structure. The incoming CEO of the PRA has indicated that there will be an individual appointed to the role of understanding mutual insurance.

As regards to the registrar of mutual societies, we believe there is some merit from stripping out the task of registration from that of regulation. This is consistent with the role of Companies House, and would mean that there would be no confusion regarding firms that do not conduct regulated business. This does not directly affect AFM, as all our members are regulated, but we would be very pleased to engage with Treasury and other mutual trade bodies to explore possible solutions.

The remainder of Chapter 5 largely describes the allocation of current FSA duties between the new regulatory authorities. The proposed allocations appear to be appropriate and we do not propose to comment on these individually.

Compensation, dispute resolution and financial education

We agree that the FSCS, FOS and CFEB are crucial and integral parts of the regulatory system. Each performs a defined and separate role, but the more effectively these duties are delivered in a manner that is compatible with the entire system, the better this role will be executed.

Treasury accepts that there is a need to improve the accountability and transparency of the FOS and FSCS in particular, and we agree with this conclusion. However we do not accept that the approach set out in Chapter 6 will deliver this effectively. The ability of PRA and FCA to set rules, raise the levies, or establish Memoranda of Understanding however do not provide adequate accountability, and have failed to address wider implication issues over the last ten years.

We believe independent day-to-day management of the FSCS and FOS will not be compromised by drawing them more closely into the regulatory system. We conclude that both FSCS and FOS should become subsidiaries of the FCA. This approach does not compromise their core role, but does ensure that management of the FSCS and FOS align with the regulatory system as a whole. We have seen numerous instances where process failure within each of FSCS and FOS has risked undermining the regulatory system, and continued lack of proper accountability will continue to pose a threat. The benefits of seeing FSCS and FOS as subsidiaries of FCA include:

- Joined up approach to regulation across all regulatory bodies;
- More effective information sharing and informed decision making;
- Improved early warning systems;
- Better capacity to act quickly on emerging issues;
- More visible attention to regulatory process;
- Shared commitment to work with a common but proportionate consumer protection purpose;
- Less risk of 'back-door regulation';
- Cost synergies that result from shared services and single management lines.

Mutual organisations suffer particularly from some of the process and accountability shortcomings we see in the current system. A FOS decision that treats some consumers more fairly than others, where all are members of the organisation is contradictory. Similarly the decision to pay excess compensation to one group can only be funded by reducing benefits available to others. Finally, where a decision is made that conflicts with the rules of the mutual, the Board is at risk of acting ultra vires, and risks a class challenge from other policyholders.

European and international issues

As the paper correctly assesses there is an enormous range of new regulation now being developed in Europe. This means the nature of UK regulation is changing dramatically, and the new regulators will be more responsible for implementing rules formed in Europe than they will for developing new rules.

This makes the need for effective representation in Europe of the UK regulators critical. There are some inevitable difficulties in this:

- The Anglo-Saxon form of regulation which permeates through many English-speaking countries is not as apparent in Europe, and very often FSA finds itself in a different position to other countries;
- The importance of financial services to the UK economy means that UK regulation is better developed than it is in some European countries, and this means new EU Directives often have an adverse effect on UK consumers and markets (the Gender Directive is a case in point);
- The new pan-European regulators (EBA, EIOPA, ESMA) have been developed along product lines whereas the UK Government prefers a functional split: this makes aligning work more challenging;
- On the positive side, EU regulators have shown a greater willingness to accommodate alternative business models, and mutual insurers in particular thrive in many European countries as regulators recognise the opportunity to adopt rules that encourage diversity.

These factors highlight the need for PRA and FCA to be effective in Europe and to have clear lines of responsibility. A clearly defined basis by which agencies work together is important, but so too is the need to have a single regulator with lead responsibility in each area, and to represent the UK appropriately. For EBA and EIOPA we believe the lead regulator must be PRA, whilst for ESMA this might be FCA.

Impact Assessment

The impact assessment provides a relatively high-level and vague assessment of the total costs and benefits of introducing the new regulators. We appreciate that cost considerations are not the key driver to the introduction of the new regime, but as costs will be largely borne by the industry it is disappointing that there remains much uncertainty, and little focus on keeping costs low.

Had the Government set out from outset an ambition that the transition to new regulators could be managed at zero cost, there would we believe have been much greater focus on how to achieve cost savings. For example, as we set out above, drawing the FOS and FSCS under the FCA would have removed a lot of duplicative costs in the system. Equally, there appears to have been no consideration of whether all operations of the regulators need to be based in the centre of London.

The benefit side of the assessment relies on the premise that future financial crisis will be averted or less severe. We accept this, though we would have liked again to see a focus on describing more tangible and immediate benefits.



AIFA's Response to HM Treasury's Paper 'A New Approach to Financial Regulation: Building a Stronger System'

April 2011

About AIFA

1. The Association of Independent Financial Advisers (AIFA) is pleased to have this opportunity to contribute to the Treasury's Consultation Paper on Financial Regulation. AIFA is the representative body for the IFA profession. IFAs account for over 70% of all financial services transactions in the UK (measured by value). As such, IFAs represent a leading force in the maintenance of a competitive and dynamic retail financial services market. AIFA's role is to work with industry stakeholders and policy makers to bring about a more positive regulatory and business environment for members. It is AIFA's objective to play a critical but constructive role within the regulation. AIFA is a non-commercial, not-for-profit trade body.

Introductory comments

2. AIFA clearly recognises the important role that regulation plays in making the retail financial services market a safer place for consumers, and a place in which they can have trust and confidence. We are therefore fully in favour of cost effective, proportionate regulation which builds on that which already works. To achieve this, AIFA welcomes the current debate on the purpose of regulation, and hopes that a revised regulatory structure, and the supervision within that structure, will result in better consumer outcomes.
3. We believe the opportunity to develop a regulatory regime, which facilitates the provision of independent, impartial advice to consumers, is vital. The need for access to advice is currently magnified by the increased need for people to save for a longer retirement, against a background of decline in company pensions - and state benefits that are becoming less and less affordable.

4. At a time where consumer responsibility and the need for self-provision are so high on the political agenda, AIFA therefore feels it is appropriate that the overriding purpose of regulation is to encourage better access to more consumers, thus leading to better outcomes.
5. AIFA is also firmly of the view that going forward, regulation must improve its effectiveness, and make absolutely clear its purpose. Constant regulatory flux deters financial investment in firms and weakens consumer trust in the sector. In some cases the implementation of the regulatory system actually threatens to undermine the existence of the market as a viable entity, restricting the ability of consumers to obtain the products and services that they need.
6. For the future, we have therefore identified six high-level principles that we believe should apply to the governance of regulation.

We believe regulation must enable better outcomes for more consumers.

7. This means regulation must not only protect consumers from unscrupulous market participants, but also facilitate more access to advice for consumers, particularly at this stage in the economic cycle. But there is evidence to suggest that in recent years, UK regulatory practice has failed the consumer in a number of ways. The number of people saving has fallen dramatically, the cost of advice has risen, consumer confidence and trust have been damaged, and efforts to promote public awareness through information and disclosure overload have been largely ineffective.
8. The new regulator therefore needs to address the wider public policy agenda in order to help consumers re-engage with their long term financial well-being and making more, and better, provision for themselves. This should involve closing the savings and protection gap as a statutory objective of the FCA. We also need to see consumers take on increased responsibility for their own financial future, as this will ultimately help yield the optimum outcomes for them.
9. However there is little evidence that the majority of consumers – even sophisticated consumers - wish to be educated about the intricacies of financial products and services. On the other hand there is a lot of anecdotal evidence that people want help in dealing with their financial issues which is why financial advice has emerged over the last few decades as an important component of the market. The FCA must therefore act in a way which increases consumer access to financial advice, rather than limit the supply of it through excessive regulatory burdens.

We believe it is essential that regulation has the appropriate checks and balances in place to ensure accountability.

10. In the past the system of accountability for the regulator has relied too heavily on internal self-assessment, with the result that there were few external effective checks and balances in places. Any future regulator should therefore be held more tightly accountable to the delivery of their objectives in the most efficient and cost-effective way. This principle is derived from the single most important lesson learned from the history of regulation. There is no reason to believe that initial objectives, no matter how well-intentioned and well-articulated, will be achieved when a new system is established - unless there is a rigorous process in place to keep it aligned to those objectives.
11. There must also be a relationship of 'legitimate expectation' between the regulator and regulated - this is when the principles of fairness and reasonableness are applied where a regulated firm has an expectation or interest in the regulator retaining a long-standing practice or keeping a promise. In order to assist with this, there needs to be greater transparency about how decisions are taken by the regulator, and how issues are progressed.
12. In the new regime we therefore see a greater role for the National Audit Office (NAO) and Public Accounts Committee in reviewing the new regulatory structures, and the continuation of the Regulatory Decisions Committee (RDC), which we believe should be put on statutory footing given the important independent decision-making function it plays (which becomes even more relevant when one considers the proposed pre-emptive FCA powers in relation to financial promotions and warning notices).
13. Additionally we welcome the continuation and strengthening of the three "consultative panels" including new statutory footing for the Small Business Practitioner Panel. In-fitting with the Government's current agenda, we call for these positions to be open to anyone who wishes to put themselves forward for interview, to avoid any potential bias. The positions also need to be properly communicated so potential candidates are made aware that the vacancies exist.

We believe regulation must work in a proportionate and risk based way, focusing on those aspects of the financial services industry that pose the greatest risk.

14. This has certainly not been the case under the FSA who have tended to pursue actions they viewed as 'bomb-proof', and cascaded them to adjacent markets. The result of this approach has been that IFA firms, who pose no systemic risk to the economy, and are

working in the best interests of their clients, have faced intrusive supervision from FSA to a far greater extent than large banking institutions at the other end of the 'risk' scale.

15. To put this into context, one of our members, a medium-sized provider of independent advice, which has never been fined or sanctioned by the regulator in any way, was the recipient of 3 intrusive and formal 'ARROW' visits by the regulator over a period of 4 years. During the same period, immediately prior to its demise, Northern Rock had none.
16. This undue degree of attention on relatively small firms is bad regulation and damages the market. The new regulator must therefore be very careful to take heed of this delicate 'tipping point' when businesses no longer become economically viable given the cost and risks of being regulated. There must therefore be due governance to ensure a risk appetite is set and managed accordingly.

We believe regulation must change less, with fewer "new ideas" and more consistency of delivery.

17. For market regulation to be effective, it needs to meet the following criteria:
 - The participants of the market need to know what is permitted and what is not, so that they can get on with doing their jobs with confidence;
 - Regulation needs to be applied consistently across the market in order to avoid arbitrage;
 - Regulation needs to be applied reasonably consistently over time;
 - The different parts of the regulatory structure need to act congruently.
18. However we feel this consistency has been lacking in recent years. Although the history of regulation under FSA has been relatively short, there have already been a considerable number of waves of different requirements with the result that a degree of regulatory fatigue has set in. The costs of coping with FSA regulation keep rising, and the combined effect of this and fatigue is to drive members of the market out - to the detriment of consumers.
19. The full FSA rulebook is a large online document with layers upon layers of cross-references by hyperlink – the entire structure and usability of this document is impenetrable before you even get to the language which is in itself difficult to comprehend. As a result there is a new industry of expensive compliance experts who do their best to interpret what they think the rules mean. At the same time the regulators apply principles, most notably 'Treating Customers Fairly', that while sounding perfectly reasonable, are vague and open-ended. The result is that those being regulated do not

know how to behave, and live in fear of unintentionally putting a step wrong. AIFA believes that it is significant that consumer redress schemes, which are based on law, cannot rely on a failure against 'principles' as justification for their use. This is good evidence that activities such as Treating Customers Fairly were flawed.

20. Over time, generations of management at the FSA have taken different positions, meaning that practical agreements about how the rules are to be implemented often change when the management team changes. Our members also report that the messages they receive from different parts of the regulator – whether the policy team, supervision team or the enforcement teams - are often highly inconsistent.
21. An example of regulatory inconsistency is FSA's rebadged "Make a Real Difference" (MARD) initiative, a £50m initiative which aimed to improve the effectiveness, skill and attitude of FSA staff and support its original purpose, the shift to a more principles based regulatory regime. However MARD was effectively abandoned, yet the industry have been paying for it for at a cost of £5million a year since 2007, and will continue to pay £5million a year for the next 6 years, with little or no demonstrable benefit.
22. We therefore believe that there is considerable scope for improvement in how the regulator designs, communicates and implements its rules and principles. We also believe financial rewards for regulatory staff should be based on long-term outcomes and visible success measures of the outcome of policy initiatives, just as has been proposed for the financial services industry which they regulate.

It is essential that the regulator use its resources in the most cost effective and economic way, in order to deliver the best possible value for money for both the industry and ultimately consumers.

23. By definition, consumers will not be able to obtain the products and services they need if the provision of those services is eliminated or made expensive by the actions of the regulators. Yet that is exactly what has been happening under FSA. The complexity and ever rising regulatory costs under FSA meant the cost of advice was also forced to rise rapidly, meaning large numbers of mid and low earners may become excluded from accessing independent financial advice, since its provision became uneconomic.
24. IFA firms bear a disproportionate brunt of the rising fees, especially considering they pose little or no systemic risk to the economy, are the lowest causes of complaints to the Financial Ombudsman service, and are consistently found to be the most trusted part of the financial services sector, as evidenced by the independent annual 'trust index', carried out by the University of Nottingham Business School.

25. Furthermore the true cost of regulation to all of these firms currently increases with experience - the lack of a long stop for the industry means that businesses, especially the smaller ones, have the burden of making provision within their accounts for the increasing risk of complaints as well as the proposed increases to capital-adequacy provisions.
26. These regulatory costs would be more acceptable to firms if they felt there were clear benefits to be gained from the money spent, therefore any new regulatory interventions need to be subject to the highest levels of public scrutiny – and their benefits clearly articulated and measured. We would also propose removing the need for a Cost Benefit Analysis in cases of literal directive copy-out – this would provide an incentive to not gold plate, while also reducing the administration and thus cost for the regulator.
27. Furthermore we believe the FCA’s policy in setting fees should be risk-based and would encourage the FCA to use the tools at its disposal to reward firms that invest in their business and its people e.g. through regulatory dividends. AIFA would also like to continue the debate relating to the cost allocation model within the FCA structure. AIFA has engaged heavily with FSA over recent months on this issue, including substantial work with external consultants. We feel that there are more appropriate allocation methods for the cost of regulation, and would welcome the opportunity to consider this further in light of the revised regulatory structures when they are confirmed.
28. Additionally it is worth noting that we are very concerned by the overall cost of the proposed new regulatory structures - £50m as a transitional budget is potentially insufficient, yet still a considerable further sum to the industry.

Finally we believe regulation must take fully into account the European dynamic at play.

29. Increasing amounts of financial regulation are now emanating from Europe, and it is therefore crucial that the UK is best placed to achieve positive engagement on the continent in the coming years and ensure we remain a leading player, for the benefit of consumers. We also feel there is potentially much to be lost at a European level in the near future, as highlighted by Sharon Bowles’ letter to Vince Cable, further highlighting the need for UK regulators to be fully cognisant of the European dynamic at play in the market.
30. AIFA continues to believe that European regulatory powers are not sufficiently addressed within the proposed new architecture, and that lead regulators may not be most appropriate.

31. Of most concern is the split between the PRA and FCA of the three new European Authorities. It is proposed that the FCA will lead on European Securities and Markets Authority (ESMA) related issues, whilst PRA will lead on European Banking Authority (EBA) and European Insurance and Occupational Pensions Authority (EIOPA) areas. The UK is therefore taking a twin peaks approach, in which the division of regulatory responsibilities is based on the type of institution.
32. However this does not tie in with the vertical approach at the European level, whereby regulation is based on the type of product. Whilst work such as Basel III and Solvency II are addressed by EBA and EIOPA respectively, and therefore appropriately sit with the PRA, there are much wider streams of work which fit less well. IMD and the associated work of the PRIPs initiative is also part of EIOPA's work, as is the RMLaB Directive as part of EBA's work.
33. However, whilst PRIPs will impact the conduct of business practices of all firms engaged in providing 'investment' advice in the UK to retail clients, the lead UK authority would be the PRA, not the FCA. To have the prudential regulator as the lead authority on conduct of business related activity would seem risky. The same is true of the Mortgage Directive, which will impact conduct issues of mortgage intermediaries, yet the interaction is with the EBA and thus the PRA, rather than the FCA.
34. We would therefore welcome further discussion as to the role of a Common Services Department which amongst other things could lead on Europe, and ensure joined up thinking as well as enhanced co-operation between regulators at a European and international level. There has been some support for a more formal context for this co-operation, particularly for prudential matters, amongst our membership.
35. These six principles run the risk of looking so obvious that they could easily be taken for granted, or risk not receiving the degree of serious attention which they deserve. But the point is that no matter how the principles are espoused: in practice, they have not been delivered – and that is what needs to be fixed by the new regulatory structure. The success or failure of regulation in the future needs to be capable of being measured against these yardsticks.

Other Areas of Concern

Consumer Responsibility

37. AIFA has strongly supported Mark Hoban's comments in recent months on consumer responsibility, and welcome the decision to drop the consumer champion aspect of the FCA, which we believed detracted from this important objective. We must be clear about the responsibility of all market participants in financial transactions.
38. Indeed we consider the wider issue of consumer responsibility to be an important factor within the regulatory architecture debate. AIFA's consumer research into this area suggests that consumers are more willing to accept responsibility for their decisions if their confidence in firms increases. This plays well into the Government's desire to build trust in the market. AIFA would like to see consumers embrace their responsibilities without in any way minimising the responsibilities that firms, the regulator and other agencies owe to them.
39. Consumer responsibility is not just about the "entry" level decisions people take (whether to engage or not) but also carries on into their interaction with the financial decisions they have taken. No one would buy a car and not have it regularly serviced, and so it is with financial services products: on-going engagement will yield better results than neglect.
40. General consumer protection laws and the industry regulator offer protection from rogue and fraudulent bodies and consumers' rights are widely championed. With rights, however, come attendant responsibilities and the change in the regulatory landscape provides a timely opportunity to define these more clearly in order to help consumers achieve optimum outcomes.

Lack of a Long Stop

41. The lack of a long stop for the industry is an issue that has been subject to ongoing debate for several years now, and an issue that AIFA and its members feel particularly strongly about. The lack of a long stop means that businesses, especially the smaller ones, have the burden of making provision within their accounts for the increasing risk of complaints as well as the proposed increases to capital-adequacy provisions. We therefore call for the introduction of a 15 year long stop to bring financial services into line with the Statute of Limitations.

42. This would also encourage consumers to take more responsibility for their financial well-being. There is currently no need for consumers to check annual statements or to ensure that they have not been given wrong advice if there is no limit to the time-frame within which they can lodge a complaint. The introduction of a 15 year long-stop is fundamental to bringing financial services into line with other consumer-focussed industries and lifting the clouds of confusion as to where responsibilities lie. Indeed AIFA research shows consumers are in favour of such a move to. 75% of clients believe that there should be some time limit for IFAs to be legally responsible for advice given, of which 32% believe that the responsibility should end when the relationship between the client and the IFA ends. Similarly YouGov research shows 73% of consumers believe that there should be a time limit for advisers to be legally responsible for advice, of which 23% believe that the time limit should end when the relationship between the IFA and client ends.
43. We therefore warmly welcomed FSA's recent comments to the Treasury Committee that they are willing to review the introduction of a long-stop for advisers. We believe this is long overdue and something AIFA has been calling for on behalf of members for some time. We must now see these warm words from FSA put into action and for them to support our call for change during the review of FSMA in Parliament.

Untested Hypothesis

44. Another major concern we have with the proposals as a whole is that the Government is creating a hypothetical model, rather than a new regulatory system which has been tested with scenario analysis.
45. What the Government is aiming to do (by its own admission) is to combat the problems of the past, but this then assumes that any future economic problems will take a similar format. Indeed the twin peaks structure which is being put forward for the UK didn't fail to stop the economic crisis from occurring in the USA where they have a similar system.
46. We are therefore concerned that the Consultation Paper doesn't contain any scientific modelling which shows what would happen if situations occurred in the market and how the new regulatory structures would deal with them. We feel this is an issue which needs to be addressed as soon as possible in order to give the industry and consumers the confidence that the new system will work in reality, and be fit for purpose.

CONSULTATION QUESTIONS

48. IFAs will be regulated by the FCA under the proposed structure. However, clearly the decisions made by the FPC will impact IFAs, and a number of IFA firms in AIFA's membership are part of a wider banking, insurance or mutual group and therefore will form part of a group regulated by the PRA. In our response to the consultation questions, we have focused predominantly on the FCA, as this is the area with most interaction with members and consumers, but we have also addressed the necessary interaction between the other regulatory bodies.

Q11. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?

49. The proposed FCA objectives are considerably different than the ones suggested in the consultation paper last July, and AIFA is seeking further clarity as to the actual difference between 'strategic' and 'operational' objectives, and what this means in practice.

50. While we support these most recent stated objectives, we also believe the FCA should have a clear responsibility to enable better outcomes for more consumers. This means regulation must not only protect consumers from unscrupulous market participants, but also facilitate more access to advice for consumers, particularly at this stage in the economic cycle. But there is evidence to suggest that in recent years, UK regulatory practice has failed the consumer in a number of ways. The number of people saving has fallen dramatically, the cost of advice has risen, consumer confidence and trust have been damaged, and efforts to promote public awareness through information and disclosure overload have been largely ineffective. The FCA therefore needs to address the wider public policy agenda in order to help consumers re-engage with their long term financial well-being and making more, and better, provision for themselves. This should involve closing the savings and protection gap as a statutory objective of the FCA.

51. We agree that unconstrained requirements to have regards to the innovation and competitiveness of the UK financial services sector poses risks. However, we believe it is important to consider not just industry competitiveness, but more importantly consumer competitiveness. If the UK's competitiveness is affected, this will create a disparity which could lead to less-optimal product fulfilment from cross border, to the detriment of consumers.

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

53. We believe it is essential that regulation has the appropriate checks and balances in place to ensure accountability and strong governance. In the past the system of accountability for the regulator has relied too heavily on internal self-assessment, with the result that there were few external effective checks and balances in places. Any future regulator should therefore be held far more tightly accountable to the delivery of their objectives in the most efficient and cost-effective way.
54. This principle is derived from the single most important lesson learned from the history of regulation. There is no reason to believe that initial objectives, no matter how well-intentioned and well-articulated, will be achieved when a new system is established - unless there is a rigorous process in place to keep it aligned to those objectives.
55. We therefore welcome the greater role for the National Audit Office (NAO) and Public Accounts Committee in reviewing the new regulatory structures including the responsibility to audit the FSCS, FOS and CFEB. This is an important step in achieving greater transparency and accountability, and the necessary checks and balances on the regulator. NAO audit will also allow for further parliamentary scrutiny as it will enable the NAO to investigate and report on aspects of the economy, efficiency and effectiveness of the regulators' performance.
56. With specific regard to the "consultative panels" – namely the Practitioner Panel, the Smaller Business Practitioner Panel and the Consumer Panel – we fully support the important role they play, and especially welcome the proposed new statutory footing of the Smaller Business Practitioner Panel. These panels play an important role in scrutinising the regulator's policies and we therefore question whether the panels in fact deserve even stronger powers to better fulfil this role in influencing and holding the regulator to account. In terms of membership we would like to see the Panels continue to be made up of diverse representatives from across the industry to ensure a range of viewpoints are brought to the table. We also wish to see these Panels engage more deeply with the industry to ensure they fully understand the effects of the regulator's policies on the industry and in turn, consumers.
57. However, one key accountability mechanism which we believe is missing is the continuation of the Regulatory Decisions Committee (RDC). The RDC – or appropriate independent decision-making mechanism – is even more important, yet more difficult, in a judgment based regime. However there is no mention of the RDC in either of HMT's Consultation Papers on regulatory architecture and we are therefore seeking further information as to the future of the Committee. We believe the RDC plays an important

function and its role becomes even more relevant when one considers the proposed FCA pre-emptive powers in relation to financial promotions and warning notices. The RDC plays a particularly important role in respect of medium and small firms who are given the opportunity to make representations to the regulator through persons who are not tainted by their knowledge of the investigation.

58. AIFA is aware of discussions relating to the judgemental approach of regulation, and therefore its obvious links to the judiciary. Whilst it is clear that a regulator wishes to make judgements on the judgements of a firm, and therefore an independent decision-making mechanism would have to make 'judgments on judgments on judgments', AIFA would strongly counter that with the fact reliance on courts and Judicial Review (JR) processes are far too expensive and costly for small firms, making it highly unfair and discriminatory. Rather we call for the RDC to be put on a statutory footing through primary legislation, and for the Committee to be suitably resourced to carry out its role.
59. AIFA also believes there is merit in HMT bearing the regulator's costs of any JR taken by a firm. At present, the regulator's cost of a successful JR is borne by the industry through the fees structure. AIFA believes it is both fairer to firms for HMT to bear this cost, and crucially an improved accountability mechanism. If the FCA was forced to justify to HMT why they had to incur costs of defending a JR – whether won or otherwise – we believe it would provide a degree of oversight and responsibility to the FCA in its interactions with HMT.

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

60. AIFA recognises the potential benefits to consumers of a regulatory approach that focuses on the entire life-cycle of the product rather than simply on the point-of-sale of the product. This will ensure the role of product manufacturers is sufficiently scrutinised, reducing the opaqueness of some products, and will also help to provide the clarity on products essential to protect consumers. However we have several concerns with the proposals as they currently stand, specifically the implications for innovation and competition, retrospective judgements, the role of advice, the accountability of the regulator and the overriding cost.
61. **Innovation and Competition** – We have concerns that the current proposals will cause product providers to become risk averse, worried about stepping out of the recognised borders and selling anything other than vanilla products – effectively stifling innovation. Unless firms are resourced to do the research, it will become extremely difficult to bring new products to market. This will penalise small firms, and damage competition. There is also the danger that the risks of products for certain groups e.g. first time buyers, will be

too high, and lenders will pull out of these markets as a result, thus denying sections of society access to products that they need or want.

62. **Retrospective Judgements** – Closely linked to our concerns around innovation and competition is the threat to the industry of retrospective judgements from the regulator. Although Hector Sants has stated product intervention is a move away from retrospection to proactive regulation, risk tolerances will inevitably shift and therefore products that were once deemed acceptable may no longer be under the new regime, raising questions as to where these products then stand from a regulatory and liability standpoint.
63. **Role of Advice** - The suggestion that particularly complex or risky financial products are only available with the advice of a professional is clearly a sensible step in securing better outcomes for consumers, but must be carefully balanced so as not to undermine consumer responsibility. However, the proposals for financial advisers to hold specific higher level professional qualifications before advising on certain complex financial products raises many questions – for example how do these proposals fit in with current RDR plans, especially around the requirement for 'independent' advisers to consider the full range of retail investment products, what will the new qualifications entail, and whether there could be a gap between a new type of product being launched and anyone being qualified enough to advise on it.
64. **Accountability** - FSA has stopped short of using the term 'product regulation' with the word 'intervention'. This implies that much of the onus will now be on product providers, particularly their boards and risk committees, to ensure their products are well designed and competitively priced, which AIFA supports. However it also appears to absolve the regulator of responsibility for anything that it misses, raising questions and concerns for us about its overriding accountability.
65. **Cost** – We are particularly concerned that the associated costs of the product intervention proposals do not rest on the shoulders of the IFA profession. Running conduct of business regulation and a new product intervention approach side-by-side for a period could increase regulatory costs significantly. Following our response to the FSA budget last year, it appears there is a tacit acceptance that such an approach must acknowledge that product manufacturers carry significant ownership of cost and risk.

Q14. 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.

67. AIFA is very concerned about some of the proposed new powers for the FCA, particularly the power to publish public warning notices against firms and individuals before they have had the opportunity to respond.

68. This is a worrying shift towards “guilty until proved innocent”, and will certainly not help in the Government’s quest to restore consumer trust in financial services. It can take the regulator months or years to complete investigations. Meanwhile the reputations of businesses can be left in tatters and their value destroyed even if the subjects of warnings are ultimately shown to be innocent. Despite these dangers, the new proposals aren’t doing anything to speed up the investigation process. There is therefore clearly a careful balance the regulator must achieve between early intervention and treating advisers and manufacturers fairly.

69. The potential danger of this approach is encapsulated by the recent example of Gartmore, whereby FSA spent 12 months probing an employee with regards to inappropriate behaviour. After its investigation FSA found the employee innocent and decided not to take any disciplinary action. Even though FSA didn’t publicly comment during the ongoing investigation, Gartmore had to make an accounting provision/declaration in their accounts, so as a quoted firm the markets found out. This resulted in huge outflows from the £35.5bn hedge fund business, precipitating the eventual sale of what was once the UK’s biggest fund management companies. If the regulator did indeed have the powers to publish warning notices, and used them, situations such as the one that occurred at Gartmore would become far more commonplace.

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?

70. We are concerned that giving the FCA the competition powers that are proposed in the CP would in effect provide a mandate to allow it to be an economic regulator (given competition often means price). This would not be a desirable outcome.

71. Rather we believe the Financial Services Consumer Panel should have the power to make 'super complaints' if it has concerns regarding competition issues. This would add another tool to the Panel's armoury, protect consumers' interests while avoiding the pitfalls of giving the FCA a competition mandate on top of its other numerous powers.

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

72. If the regulatory landscape is to be separated out as proposed by the Government, it is crucial there be close and continuous co-operation between the new regulatory bodies. The objectives of the individual regulators also need to be clear and fit logically together. History has shown us that failures happen when there are gaps in regulatory oversight, when regulators fail to co-operate or when they fail properly to fulfil their obligations.

73. To achieve this, AIFA believes that each of the three regulatory bodies should formally benefit from each other's objectives as specified secondary objectives, rather than just as "have regards to", as we question what legal weight this actually carries. We do not believe the Consultation Paper makes this clear enough.

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 instability?

74. Whilst AIFA understands the implications of such proposals, we feel there is a fundamental difference between coordination and right of veto. We question whether it is realistic to assume that the FCA should ever reach a point of allowing poor market conduct to develop unchecked that remedial action relating to conduct would result in a firm failure of a magnitude to create financial instability.

75. AIFA is concerned that the tone set by offering one regulator a 'veto' the outcome of achieving two regulators "equal in status" may be lost.

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

76. For FCA firms we believe the lead approach seems sensible. As for dually authorised firms, we believe there should be a joint approach through some form of 'Common Services Department'. However, this should be led by the FCA as all firms will be 'touched' by the FCA regardless of business type and size.

77. Furthermore we would recommend HMT considers the use of 'passports' so individuals who are authorised remain authorised if they change firms in an equivalent role, but with minimal new checks. This is rather than people having to undergo the entire expensive, time consuming process of reauthorisation. This would be a welcome reduction in administrative burdens for firms and the regulator.

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

78. AIFA broadly accepts that the OIVOP/VOP approach is acceptable. However we question what assessment of OIVOP has been made since the regulator adopted these powers in 2008, and seek further information as to their sufficiency, and how often they have been used.

79. We also believe there is a strong need for an independent decision-making mechanism to deal with any potential disputes. We would again refer back to our earlier point regarding the need for a statutory RDC as an accountability mechanism.

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

80. AIFA agrees that the customer facing and market activity functions should all sit within the FCA. However, we are very concerned about the proposed split in the significant influence functions (SIF). This could result in a CEO of a non-PRA firm being acceptable to the FCA but not the PRA or vice versa. By splitting the authorisation of certain specific functions across the two bodies you invariably end up with different approaches to what is the same role. We also question where the SIF functions for subsidiaries would end up - for example, would the CEO of an IFA business owned by a PRA-scope firm fit into the FCA or PRA?

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

81. For conduct issues we agree with HMT that this is an FCA issue. Prudential requirements of branch passporting into the UK fall outside scope of the PRA or FCA and instead sit with the firm's home state regulator.

82. However, for UK firms passporting out, we believe the FCA or the Common Services Department should have responsibility for the coordination work as appropriate. The reason for this being that only the FCA will touch all firms and there is a therefore a danger of potential regulatory underlap if the responsibility is split. The management of the firm's prudential requirements will of course remain with whichever prudential regulator they operate under.

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

83. AIFA supports the proposal for all fees and levies to be collected by one organisation, namely the FCA. This is logical because all firms' activity – whether retail or markets – will be policed by the FCA; as such the FCA is the only common denominator of any financial services firm. However, we feel this could be taken further, by the establishment of a Common Services Department which would deal with issues such as fee collection, permissions, data collection, I.T., and European engagement for all the regulatory bodies. The establishment of this Department would avoid duplication of costs in the aforementioned areas, whilst also ensuring simplicity for firms.

84. We must note here that we are very concerned by the overall cost - £50m as a transitional budget is potentially insufficient, yet still a considerable further sum to the industry. Whilst many other Government funded regulators are facing substantial cost pressure, the industry funded FSA is not and this needs to be considered carefully. IFA firms are already facing a barrage of costs due to regulatory changes in 2012, and we therefore call on HMT to carefully consider all aspects of the costs of any changes, as well appropriate weighting towards different parts of the financial services sector; the cost of the RDR alone is equivalent to over £35,000 per 'adviser' in the UK.

85. AIFA would also like to continue the debate relating to the cost allocation model within the FCA structure. AIFA has engaged heavily with FSA over recent months on this issue, including substantial work with external consultants. We feel that there are more appropriate allocation methods for the cost of regulation, and would welcome the opportunity to consider this further in light of the revised regulatory structures.

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

86. AIFA supports the work of the FSCS, and regard it as an essential consumer protection which benefits the wider financial services community. We have witnessed much member interest in the Compensation Scheme, including a variety of proposals as to how the Scheme could be improved. For this reason, AIFA is shortly to publish a discussion document for members outlining potential changes which could be considered. We will be happy to share the results of this discussion with HMT.

87. That being said we agree with HMT that the FSCS should remain a single organisation to administer compensation so that consumers have a single, accessible point of contact for compensation matters. Any other model would merely add further to consumer confusion.

88. With regards to the specific proposals for the operating model, AIFA believes the FCA should have the power to make all of the compensation scheme rules, rather than it being split between the FCA and PRA. This option would ensure consistency in rule-making and help to minimise costs. However there must be strong and transparent coordination with the PRA to help the FSCS operate as effectively as possible.

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

89. AIFA supports the ongoing availability of an accessible, low-cost ADR service in the market as we believe it offers a fair consumer check and balance. Therefore, we support the work of FOS and believe that, in its role as an adjudicator of individual complaints, it has been generally effective.

90. However AIFA is concerned that in the past FOS has operated in a quasi-judicial manner, without the right of representations and appeal. Indeed FOS's role as a quasi-judicial organisation was confirmed by Natalie Ceeney in her Treasury Select Committee evidence in October 2010. On occasions FOS has gone beyond its core remit, and has sought to set higher cross-industry standards, something which should instead be the function of the regulator, industry initiatives or as a result of competition. Challenges arise for the industry from FOS decisions which appear to be inconsistent with regulatory expectations or market norms that were accepted at the time, and/or set precedents which have wider implications.

91. This often impacts on business decisions, due to firms' uncertainty about how FOS might respond to future classes of complaint, even where firms are in compliance with FSA regulations. This has also been exacerbated by the growing influence of Claims Management Companies (CMCs) on financial services markets, which take advantage of the FOS processes.

92. We therefore welcome HMT's plans to reinforce the distinction between the roles of the FCA and FOS, to give firms greater clarity and certainty. We also welcome the proposals to enhance the transparency and accountability of FOS and believe the FCA should conduct regular reviews of its overall operations, policies and procedures.

93. Furthermore we suggest the legislation should go further and remove FOS from the process of determining regulatory issues with wider implications – this should be the responsibility of the FCA or the Upper Tribunal. We also do not believe FOS should have the right to prevent firms from seeking resolution of test cases in the court where a complaint raises important or novel points of law.

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

94. As previously stated, the accountability of the new regulatory structure is one of the, if not the most, important aspect of the changes for AIFA.

95. We therefore welcome proposals to introduce statutory requirements for FOS and FSCS to publish annual plans and consult on them where appropriate. CFEB is already required to publish an annual plan and report under provisions introduced by the Financial Services Act 2010. We also welcome the Government's plan to place in statute provision for the FSCS, FOS and CFEB to be audited by the NAO, providing us with assurance that these bodies are required to carry out their functions in an efficient and economic way.

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A new approach to financial regulation: building a stronger system

A submission by the Association of Investment Companies

The Association of Investment Companies (AIC) welcomes the opportunity to respond to this consultation. The AIC represents some 350 investment companies. These are closed-ended corporate vehicles which invest in a diversified portfolio of assets to secure an investment return for their shareholders.

Our members include UK-domiciled investment trusts, Venture Capital Trusts and non-UK (primarily Channel Island) investment companies. Investment companies are not directly regulated under FSMA. As companies they are regulated by: company law (for UK companies the Companies Act 2006, for non-UK investment companies the relevant law from their local jurisdiction) and by accounting rules (UK GAAP and IFRS).

The majority of our members list their shares on regulated markets and therefore also comply with the listing, disclosure and transparency rules. In the UK context these are created and overseen by the FSA in its role as the UKLA, but they are mainly derived from European Law, notably the CARD, Prospectus Directive and Transparency Directive. Other investment companies trade their shares on exchange regulated markets, such as AIM.

The regulatory context for the investment company sector is changing. We anticipate that all investment companies will fall within the scope of the Alternative Investment Fund Managers (AIFM) Directive. In due course they will therefore be subject to the oversight of the UK's designated competent authority, as required by the Directive.

The shareholders of the investment company sector are roughly split 50:50 between retail and institutional investors. As such, the Retail Distribution Review and the PRIIPs initiative from the European Commission will also impact upon the sector.

The AIC welcomes the Treasury's decision to create a unified markets regulator with the Financial Conduct Authority. The inclusion of the UKLA in this new body is very important for the AIC's Members and promises to deliver a more coherent regulatory structure with a strong and effective voice in Europe.

This submission comments on those questions with the most relevance to the AIC's Members.

Detailed Comments

Q11. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?

The AIC supports in principle the FCA's proposed strategic and operational objectives. These should give the FCA a clear mandate to be an effective regulator. Further detailed comments are listed below:

Promoting competition: The AIC notes that the FCA's objectives will incorporate a secondary requirement to dispense its duties "*in a way which promotes competition*" (paragraph 4.20 – 4.22). The AIC supports including a reference to competition as a secondary (not primary) consideration. We are aware of pressure from elements of the financial services industry to see this reference given more prominence, or even for it to be one of the FCA's objectives. The AIC does not support such an approach. The AIC **recommends** that the Treasury maintains its position that competitiveness be a secondary consideration. This issue should not be allowed to distract the FCA from its core goals and objectives.

The primary duty of a regulator must be to apply considered and fair regulation in order to correct market failures which either damage consumer interest or create perverse incentives which hinder the development of a fair and orderly market. The inclusion of competition in the FCA's objectives could encourage a "race to the bottom" whereby the most lenient regulatory options are chosen in order to create a supposed "competitive advantage". This could lead to regulatory gaps which expose consumers and distort the market.

While reduced regulatory requirements might seem to increase competitiveness in the short-term, the long-term impact of such changes threatens competitiveness in a more fundamental way by undermining investor confidence. In the past, the AIC has been concerned that the FSA's promotion of competition was allowed to affect the regulatory decision-making process. For example, in 2007 the FSA proposed new standards for listing rules for investment companies. These were based on EU rules (which were of a lower regulatory standard than the UK rules). At the time, the AIC argued very strongly that allowing a lower standard of regulation was not in the investment company, consumer, or UK's long-term interest. The FSA subsequently reversed this position and implemented a higher regulatory standard. However, its original presumption was that lower standards were inherently more attractive for businesses. Ultimately, the rules which were introduced have delivered both higher standards and maintained a competitive regime which has continued to attract UK listings. The competitive position of the UK has been enhanced by the higher standards applied.

Regulatory principles: The AIC is supportive of the regulatory principles proposed for the FCA. However, in order to improve on the current system, these principles should include additional measures.

- Currently, the FSA cannot issue guidance without first undergoing a full consultation process. This process is onerous, lengthy and inflexible. This has led to “work-arounds” where the FSA has issued papers which it cannot officially call “guidance”, but which is guidance to all intents and purposes. Certainly, the AIC believes that they can be treated as such by businesses which rely on them. This situation is not ideal and prevents the FSA from being as helpful as it might be.

It is important that the FCA strikes a balance between the need to act quickly to changing circumstance and allowing businesses to inform the development of the regulatory framework.

Where there is a proposal for a material change to regulation, the consultation process is important and should not be by-passed. However, where guidance makes no material change to the regulation itself, the AIC **recommends** that the FCA be given more power to publish this guidance without first consulting on it, where this would clarify the impact of regulations.

- The AIC also **recommends** that a right to an enhanced internal appeals process be introduced into the regulatory principles of the FCA.

The AIC is aware of occasional instances where the FSA has made a decision on regulatory matters where the firm involved has been unconvinced by the FSA’s reasoning for its decisions. Making an appeal in these circumstances is problematic under the current system where the decision would have to be reconsidered within a tight commercial timetable. The appeals process should allow for ‘fast track’ deliberations where decisions (such as new share issues) are time critical.

The AIC **recommends** introducing an enhanced internal appeals process for the FCA which can deal with urgent complaints quickly. The FCA should not have the ability to deny an appeal except in circumstances where the complaint is clearly vexatious or unreasonable.

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

The AIC supports the Government’s proposals in this area. It is especially important that the Consumer Panel is retained. The AIC welcomes this decision. The financial

services industry has a formidable lobbying capability when it comes to regulatory matters. It is essential that the voice of consumers is not lost in this environment.

Recent activity around the Retail Distribution Review demonstrates the importance of the Consumer Panel. Elements of the adviser community and others used their resources to launch a high profile lobbying campaign against the FSA's proposals. The Consumer Panel was able to provide the expert advice which allowed the FSA to maintain its position on a reform which should deliver a financial services market which produces far better consumer outcomes.

Q16. 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.**

The AIC welcomes the Government's decision to keep the UKLA within the markets regulator.

The decision to bring the UKLA under the general legislative framework of the FCA is also welcome. Under the current system, there have been instances where the differences of emphasis between the FSA's and UKLA's obligations created conflicts and confused the decision-making process. For example, this arose during the review of the listing rules for investment companies. Early proposals prioritised the competitiveness of the UK as a financial centre over delivering effective levels of consumer protection. Ultimately, a suitable regime was decided which met investor needs and, in turn, ensured the continuing attraction of the UK as a venue for listing investment companies. Unifying the legislation framework for the FCA and UKLA will help prevent such confusion in the future.

With regard to the technical improvements to Part VI of FSMA (4.112 of the consultation paper), each bullet point is dealt with separately below:

- *Allowing the UKLA to discontinue or suspend a listing at the request of an issuer without following the warning notice and decision notice procedure – these procedures are onerous and unnecessary when the UKLA is agreeing to a request made by the issuer;*

The AIC **supports** this measure where it is at the request of an issuer.

- *Extending the UKLA's powers to impose sanctions on sponsors for breaches of UKLA rules and requirements imposed on sponsors, to include the ability to impose financial penalties and to suspend a person's approval as a sponsor or restrict their activities, subject to the normal enforcement and appeal mechanisms*

in FSMA. Sponsors play a crucial role in listing which is important for protecting investors and maintaining the reputation of London's international markets;

The AIC **supports** this measure. The ability of the UKLA to impose sanctions is important if the sponsor is to be trusted by the regulator and the issuer. Without accountability, the regulatory value of the sponsor is undermined.

- *Extending the limitation period for taking action for breaches of the listing rules from two years to three years – this ensures consistency with other similar FSMA provisions;*

The AIC **supports** this measure. This is a suitable period of time during which the FCA can discuss any issues with businesses prior to taking formal action.

- *allowing 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 – this is an intermediate power between requesting information and launching a full external investigation and would enable the UKLA, therefore, to have certain matters investigated in a less onerous way for issuers;*

The AIC **supports** this measure as it offers an option for an intermediate inquiry short of a full investigation. However, the power to require information must be used proportionally. For instance, a sufficient amount of time needs to be given to the listed issuer for preparation of the report and the FCA should have a clear and communicated rationale for requesting the information.

- *giving the UKLA the power to make rules for, and impose sanctions on, primary information providers (PIPs), organisations which channel news from issuers to the UKLA and announce information to the market. At present, the UKLA approves PIPs and sets conditions for them on a non-statutory basis. The proper flow of information is vital for maintaining market integrity and the reputation of London's international markets; and*

The AIC has no strong view on this matter.

- *removing the provisions which allow the UKLA functions to be transferred to another authority – these are now redundant – and amending other provisions so that the UKLA functions are fully integrated with those of the wider FCA.*
- The AIC **supports** this measure (see comments above).

The AIC also welcomes the decision to allocate the UK's seat on ESMA to the FCA. The technical expertise within the FCA will give the UK substantial credibility in that

forum. The FCA will be regulating the markets on which securities are traded, those issuing the securities, and conduct relating to their sale. This holistic view will strengthen the FCA's position within ESMA.

As the natural successor to the markets division of the FSA, there will also be a degree of continuity despite the domestic restructuring.

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

The AIC warmly welcomes the creation of the CFEB and that the FCA will take the FSA's functions in relation to it. The AIC first called for the establishment of a consumer education body in 2007 and is delighted that this initiative has now been adopted.

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

The AIC is generally supportive of the proposed arrangements. It is very important for the UK to have a strong voice when it comes to secondary technical standards, rules and guidance.

The AIC reiterates its call for the Government not to lose focus on the European agenda as the domestic regulatory system is restructured. The AIFM Directive is currently undergoing detailed work at Level 2. Over the next two years the review of Markets in Financial Instruments Directive will begin the legislative process. These issues are very important for the UK's financial services sector and the Government must ensure that it retains a strong voice during the proposed reforms.

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For more information on the issues raised in this paper please contact:

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AMI's Response to HM Treasury's Paper 'A New Approach to Financial Regulation: Building a Stronger System'

April 2011

About AMI

1. The Association of Mortgage Intermediaries (AMI) is the trade association representing over 75% of UK mortgage intermediaries. Intermediaries active in this market act on behalf of the consumer in selecting an appropriate lender and product to meet the individual consumer's mortgage requirements. Our members also provide access to associated protection products. Our members are authorised by the Financial Services Authority (FSA) to carry out mortgage and insurance mediation activities. Firms range from sole traders through to national firms and networks with thousands of advisers.

Introductory comments

2. AMI clearly recognises the important role that regulation plays in making the retail financial services market a safer place for consumers, and a place in which they can have trust and confidence. We are therefore fully in favour of cost effective, proportionate regulation which builds on that which already works.
3. To achieve this, AMI welcomes the current debate on the purpose of regulation, and hopes that a revised regulatory structure, and the supervision within that structure, will result in better consumer outcomes. At a time where consumer responsibility and the need for self-provision are so high on the political agenda, AMI therefore feels it is appropriate that the overriding purpose of regulation is to encourage better access to more consumers, thus leading to better outcomes.
4. AMI is also adamant that going forward, regulation must improve its effectiveness, and make absolutely clear its purpose. Constant regulatory flux deters financial investment in firms and weakens consumer trust in the sector. In some cases the implementation of the regulatory system actually threatens to undermine the existence of the market as a

viable entity, restricting the ability of consumers to obtain the products and services that they need. For the future, we have therefore identified six high-level principles that we believe should apply to the governance of regulation.

We believe regulation must enable better outcomes for more consumers.

5. This means regulation must not only protect consumers from unscrupulous market participants, but also facilitate more access to advice for consumers, particularly at this stage in the economic cycle. But there is evidence to suggest that in recent years, UK regulatory practice has failed the consumer in a number of ways. The cost of advice has risen, consumer confidence and trust have been damaged, and efforts to promote public awareness through information and disclosure overload have been largely ineffective.
6. The new regulator therefore needs to address the wider public policy agenda in order to help consumers re-engage with their long term financial well-being and making more, and better, provision for themselves. This should involve closing the savings and protection gap as a statutory objective of the FCA. We also need to see consumers take on increased responsibility for their own financial future, as this will ultimately help yield the optimum outcomes for them.
7. However there is little evidence that the majority of consumers – even sophisticated consumers - wish to be educated about the intricacies of financial products and services. On the other hand there is a lot of anecdotal evidence that people want help in dealing with their financial issues which is why financial advice has emerged over the last few decades as an important component of the market. The FCA must therefore act in a way which increases consumer access to real advice, rather than limit the supply of it through excessive regulatory burdens.

We believe it is essential that regulation has the appropriate checks and balances in place to ensure accountability.

8. In the past the system of accountability for the regulator has relied too heavily on internal self-assessment, with the result that there were few external effective checks and balances in places. Any future regulator should therefore be held more tightly accountable to the delivery of their objectives in the most efficient and cost-effective way. This principle is derived from the single most important lesson learned from the history of regulation. There is no reason to believe that initial objectives, no matter how well-intentioned and well-articulated, will be achieved when a new system is established - unless there is a rigorous process in place to keep it aligned to those objectives.

9. There must also be a relationship of 'legitimate expectation' between the regulator and regulated - this is when the principles of fairness and reasonableness are applied where a regulated firm has an expectation or interest in the regulator retaining a long-standing practice or keeping a promise. In order to assist with this, there needs to be greater transparency about how decisions are taken by the regulator, and how issues are progressed.
10. In the new regime we therefore see a greater role for the National Audit Office (NAO) and Public Accounts Committee in reviewing the new regulatory structures, and the continuation of the Regulatory Decisions Committee (RDC), which we believe should be put on statutory footing given the important independent decision-making function it plays (which becomes even more relevant when one considers the proposed pre-emptive FCA powers in relation to financial promotions and warning notices).
11. Additionally we welcome the continuation and strengthening of the three "consultative panels" including new statutory footing for the Small Business Practitioner Panel. In-fitting with the Government's current agenda, we call for these positions to be open to anyone who wishes to put themselves forward for interview, to avoid any potential bias.

We believe regulation must work in a proportionate and risk based way, focusing on those aspects of the financial services industry that pose the greatest risk.

12. However this has certainly not been the case under the FSA who have tended to pursue actions they viewed as 'bomb-proof', and cascaded them to adjacent markets. The result of this approach has been that intermediary firms, who pose no systemic risk to the economy, and are working in the best interests of their clients, have faced intrusive supervision from FSA to a far greater extent than large banking institutions at the other end of the 'risk' scale.
13. To put this into context, one of our members, a medium-sized intermediary firm, which has never been fined or sanctioned by the regulator in any way, was the recipient of 3 intrusive and formal 'ARROW' visits by the regulator over a period of 4 years. During the same period, immediately prior to its demise, Northern Rock had none.
14. This undue degree of attention on relatively small firms is bad regulation and damages the market. The new regulator must therefore be very careful to take heed of this delicate 'tipping point' when businesses no longer become economically viable given the cost and risks of being regulated. There must therefore be due governance to ensure a risk appetite is set and managed accordingly.

We believe regulation must change less, with fewer “new ideas” and more consistency of delivery.

15. For market regulation to be effective, it needs to meet the following criteria:
 - The participants of the market need to know what is permitted and what is not, so that they can get on with doing their jobs with confidence;
 - Regulation needs to be applied consistently across the market in order to avoid arbitrage;
 - Regulation needs to be applied reasonably consistently over time;
 - The different parts of the regulatory structure need to act congruently.

16. However we feel this consistency has been lacking in recent years. Although the history of regulation under FSA has been relatively short, there have already been a considerable number of waves of different requirements with the result that a degree of regulatory fatigue has set in. The costs of coping with FSA regulation keep rising, and the combined effect of this and fatigue is to drive members of the market out - to the detriment of consumers.

17. The full FSA rulebook is a large online document with layers upon layers of cross-references by hyperlink – the entire structure and usability of this document is impenetrable before you even get to the language which is in itself difficult to comprehend. As a result there is a new industry of expensive compliance experts who do their best to interpret what they think the rules mean. At the same time the regulators apply principles, most notably ‘Treating Customers Fairly’, that while sounding perfectly reasonable, are vague and open-ended. The result is that those being regulated do not know how to behave, and live in fear of unintentionally putting a step wrong. AMI believes that it is significant that consumer redress schemes, which are based on law, cannot rely on a failure against ‘principles’ as justification for their use. This is good evidence that activities such as Treating Customers Fairly were flawed.

18. Over time, generations of management at the FSA have taken different positions, meaning that practical agreements about how the rules are to be implemented often change when the management team changes. Our members also report that the messages they receive from different parts of the regulator – whether the policy team, supervision team or the enforcement teams - are often highly inconsistent.

19. An example of regulatory inconsistency is FSA’s rebadged “Make a Real Difference” (MARD) initiative, a £50m initiative which aimed to improve the effectiveness, skill and attitude of FSA staff and support its original purpose, the shift to a more principles based regulatory regime. However MARD was effectively abandoned, yet the industry have

been paying for it for at a cost of £5million a year since 2007, and will continue to pay £5million a year for the next 6 years, with little or no demonstrable benefit.

20. We therefore believe that there is considerable scope for improvement in how the regulator designs, communicates and implements its rules and principles. We also believe financial rewards for regulatory staff should be based on long-term outcomes and visible success measures of the outcome of policy initiatives, just as has been proposed for the financial services industry which they regulate.

It is essential that the regulator use its resources in the most cost effective and economic way, in order to deliver the best possible value for money for both the industry and ultimately consumers.

21. By definition, consumers will not be able to obtain the products and services they need if the provision of those services is eliminated or made expensive by the actions of the regulators. Yet that is exactly what has been happening under FSA. The complexity and ever rising regulatory costs under FSA meant the cost of advice was also forced to rise rapidly, meaning large numbers of mid and low earners may become excluded from accessing financial advice, since its provision became uneconomic.
22. Intermediary firms bear a disproportionate brunt of the rising fees, especially considering they pose little or no systemic risk to the economy, are the lowest causes of complaints to the Financial Ombudsman service, and are consistently found to be the most trusted part of the financial services sector, as evidenced by the independent annual 'trust index', carried out by the University of Nottingham Business School.
23. Furthermore the true cost of regulation to all of these firms currently increases with experience - the lack of a long stop for the industry means that businesses, especially the smaller ones, have the burden of making provision within their accounts for the increasing risk of complaints as well as the proposed increases to capital-adequacy provisions.
24. These regulatory costs would be more acceptable to firms if they felt there were clear benefits to be gained from the money spent, therefore any new regulatory interventions need to be subject to the highest levels of public scrutiny – and their benefits clearly articulated and measured. We would also propose removing the need for a Cost Benefit Analysis in cases of literal directive copy-out – this would provide an incentive to not gold plate, while also reducing the administration and thus cost for the regulator.

25. Furthermore we believe the FCA's policy in setting fees should be risk-based and would encourage the FCA to use the tools at its disposal to reward firms that invest in their business and its people e.g. through regulatory dividends. AMI would also like to continue the debate relating to the cost allocation model within the FCA structure. AMI has engaged heavily with FSA over recent months on this issue, including substantial work with external consultants. We feel that there are more appropriate allocation methods for the cost of regulation, and would welcome the opportunity to consider this further in light of the revised regulatory structures when they are confirmed.
26. Additionally it is worth noting that we are very concerned by the overall cost of the proposed new regulatory structures - £50m as a transitional budget is potentially insufficient, yet still a considerable further sum to the industry.

Finally we believe regulation must take fully into account the European dynamic at play.

27. Increasing amounts of financial regulation are now emanating from Europe, and it is therefore crucial that the UK is best placed to achieve positive engagement on the continent in the coming years and ensure we remain a leading player, for the benefit of consumers. We also feel there is potentially much to be lost at a European level in the near future, as highlighted by Sharon Bowles' letter to Vince Cable, further highlighting the need for UK regulators to be fully cognisant of the European dynamic at play in the market.
28. AMI continues to believe that European regulatory powers are not sufficiently addressed within the proposed new architecture, and that lead regulators may not be most appropriate. Of most concern is the split between the PRA and FCA of the three new European Authorities. It is proposed that the FCA will lead on European Securities and Markets Authority (ESMA) related issues, whilst PRA will lead on European Banking Authority (EBA) and European Insurance and Occupational Pensions Authority (EIOPA) areas. The UK is therefore taking a twin peaks approach, in which the division of regulatory responsibilities is based on the type of institution.
29. However this does not tie in with the vertical approach at the European level, whereby regulation is based on the type of product. Whilst work such as Basel III and Solvency II are addressed by EBA and EIOPA respectively, and therefore appropriately sit with the PRA, there are much wider streams of work which fit less well. IMD and the associated work of the PRIPs initiative is also part of EIOPA's work, as is the RMLaB Directive as part of EBA's work.

30. However, whilst PRIPs will impact the conduct of business practices of all firms engaged in providing 'investment' advice in the UK to retail clients, the lead UK authority would be the PRA, not the FCA. To have the prudential regulator as the lead authority on conduct of business related activity would seem risky. The same is true of the Mortgage Directive, which will impact conduct issues of mortgage intermediaries, yet the interaction is with the EBA and thus the PRA, rather than the FCA.
31. We would therefore welcome further discussion as to the role of a Common Services Department which amongst other things could lead on Europe, and ensure joined up thinking as well as enhanced co-operation between regulators at a European and international level. There has been some support for a more formal context for this co-operation, particularly for prudential matters, amongst our membership.
32. These six principles run the risk of looking so obvious that they could easily be taken for granted, or risk not receiving the degree of serious attention which they deserve. But the point is that no matter how the principles are espoused: in practice, they have not been delivered – and that is what needs to be fixed by the new regulatory structure. The success or failure of regulation in the future needs to be capable of being measured against these yardsticks.

Other Areas of Concern

Consumer Responsibility

34. We have strongly supported Mark Hoban's comments in recent months on consumer responsibility, and welcome the decision to drop the consumer champion aspect of the FCA, which we believed detracted from this important objective. We must be clear about the responsibility of all market participants in financial transactions.
35. Indeed we consider the wider issue of consumer responsibility to be an important factor within the regulatory architecture debate. AMI's consumer research into this area suggests that consumers are more willing to accept responsibility for their decisions if their confidence in firms increases. This plays well into the Government's desire to build trust in the market. AMI would like to see consumers embrace their responsibilities without in any way minimising the responsibilities that firms, the regulator and other agencies owe to them.
36. Consumer responsibility is not just about the "entry" level decisions people take (whether to engage or not) but also carries on into their interaction with the financial decisions they have taken. No one would buy a car and not have it regularly serviced, and so it is with financial services products: on-going engagement will yield better results than neglect.
37. General consumer protection laws and the industry regulator offer protection from rogue and fraudulent bodies and consumers' rights are widely championed. With rights, however, come attendant responsibilities and the change in the regulatory landscape provides a timely opportunity to define these more clearly in order to help consumers achieve optimum outcomes.

Lack of a Long Stop

38. The lack of a long stop for the industry is an issue that has been subject to ongoing debate for several years now. The lack of a long stop means that businesses, especially the smaller ones, have the burden of making provision within their accounts for the increasing risk of complaints as well as the proposed increases to capital-adequacy provisions. We therefore call for the introduction of a 15 year long stop to bring financial services into line with the Statute of Limitations.
39. This would also encourage consumers to take more responsibility for their financial well-being. There is currently no need for consumers to check annual statements or to

ensure that they have not been given wrong advice if there is no limit to the time-frame within which they can lodge a complaint. The introduction of a 15 year long-stop is fundamental to bringing financial services into line with other consumer-focussed industries and lifting the clouds of confusion as to where responsibilities lie.

40. We therefore warmly welcomed FSA's recent comments to the Treasury Committee that they are willing to review the introduction of a long-stop for advisers. We believe this is long overdue and must now see these warm words put into action and for FSA to support our call for change during the review of FSMA in Parliament.

Untested Hypothesis

41. Another major concern we have with the proposals as a whole is that the Government is creating a hypothetical model, rather than a new regulatory system which has been tested with scenario analysis.

42. What the Government is aiming to do (by its own admission) is to combat the problems of the past, but this then assumes that any future economic problems will take a similar format. Indeed the twin peaks structure which is being put forward for the UK didn't fail to stop the economic crisis from occurring in the USA where they have a similar system.

43. We are therefore concerned that the Consultation Paper doesn't contain any scientific modelling which shows what would happen if situations occurred in the market and how the new regulatory structures would deal with them. We feel this is an issue which needs to be addressed as soon as possible in order to give the industry and consumers the confidence that the new system will work in reality, and be fit for purpose.

CONSULTATION QUESTIONS

45. Mortgage intermediaries will be regulated by the FCA under the proposed structure. However, clearly the decisions made by the FPC will impact intermediaries, and a number of mortgage intermediary firms in AMI's membership are part of a wider banking, insurance or mutual group and therefore will form part of a group regulated by the PRA.

46. In our response to the consultation questions, we have focused predominantly on the FCA, as this is the area with most interaction with members and consumers, but we have also addressed the necessary interaction between the other regulatory bodies.

Q11. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?

47. The proposed FCA objectives are considerably different than the ones suggested in the consultation paper last July, and AMI is seeking further clarity as to the actual difference between 'strategic' and 'operational' objectives, and what this means in practice.

48. While we support these most recent stated objectives, we also believe the FCA should have a clear responsibility to enable better outcomes for more consumers. This means regulation must not only protect consumers from unscrupulous market participants, but also facilitate more access to advice for consumers, particularly at this stage in the economic cycle. But there is evidence to suggest that in recent years, UK regulatory practice has failed the consumer in a number of ways. The number of people saving has fallen dramatically, the cost of advice has risen, consumer confidence and trust have been damaged, and efforts to promote public awareness through information and disclosure overload have been largely ineffective. The FCA therefore needs to address the wider public policy agenda in order to help consumers re-engage with their long term financial well-being and making more, and better, provision for themselves. This should involve closing the savings and protection gap as a statutory objective of the FCA.

49. We agree that unconstrained requirements to have regards to the innovation and competitiveness of the UK financial services sector poses risks. However, we believe it is important to consider not just industry competitiveness, but more importantly consumer competitiveness. If the UK's competitiveness is affected, this will create a disparity which could lead to less-optimal product fulfilment from cross border, to the detriment of consumers.

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

50. We believe it is essential that regulation has the appropriate checks and balances in place to ensure accountability and strong governance. In the past the system of accountability for the regulator has relied too heavily on internal self-assessment, with the result that there were few external effective checks and balances in places. Any future regulator should therefore be held far more tightly accountable to the delivery of their objectives in the most efficient and cost-effective way.
51. This principle is derived from the single most important lesson learned from the history of regulation. There is no reason to believe that initial objectives, no matter how well-intentioned and well-articulated, will be achieved when a new system is established - unless there is a rigorous process in place to keep it aligned to those objectives.
52. We therefore welcome the greater role for the National Audit Office (NAO) and Public Accounts Committee in reviewing the new regulatory structures including the responsibility to audit the FSCS, FOS and CFEB. This is an important step in achieving greater transparency and accountability, and the necessary checks and balances on the regulator. NAO audit will also allow for further parliamentary scrutiny as it will enable the NAO to investigate and report on aspects of the economy, efficiency and effectiveness of the regulators' performance.
53. With specific regard to the "consultative panels" – namely the Practitioner Panel, the Smaller Business Practitioner Panel and the Consumer Panel – we fully support the important role they play, and especially welcome the proposed new statutory footing of the Smaller Business Practitioner Panel. These panels play an important role in scrutinising the regulator's policies and we therefore question whether the panels in fact deserve even stronger powers to better fulfil this role in influencing and holding the regulator to account. In terms of membership we would like to see the Panels continue to be made up of diverse representatives from across the industry to ensure a range of viewpoints are brought to the table. We also wish to see these Panels engage more deeply with the industry to ensure they fully understand the effects of the regulator's policies on the industry and in turn, consumers.
54. However, one key accountability mechanism which we believe is missing is the continuation of the Regulatory Decisions Committee (RDC). The RDC – or appropriate independent decision-making mechanism – is even more important, yet more difficult, in a judgment based regime. However there is no mention of the RDC in either of HMT's Consultation Papers on regulatory architecture and we are therefore seeking further

information as to the future of the Committee. We believe the RDC plays an important function and its role becomes even more relevant when one considers the proposed FCA pre-emptive powers in relation to financial promotions and warning notices. The RDC plays a particularly important role in respect of medium and small firms who are given the opportunity to make representations to the regulator through persons who are not tainted by their knowledge of the investigation.

55. AMI is aware of discussions relating to the judgemental approach of regulation, and therefore its obvious links to the judiciary. Whilst it is clear that a regulator wishes to make judgements on the judgements of a firm, and therefore an independent decision-making mechanism would have to make 'judgments on judgments on judgments', AMI would strongly counter that with the fact reliance on courts and Judicial Review (JR) processes are far too expensive and costly for small firms, making it highly unfair and discriminatory.
56. Rather we call for the RDC to be put on a statutory footing through primary legislation, and for the Committee to be suitably resourced to carry out its role.
57. AMI also believes there is merit in HMT bearing the regulator's costs of any JR taken by a firm. At present, the regulator's cost of a successful JR is borne by the industry through the fees structure. AMI believes it is both fairer to firms for HMT to bear this cost, and crucially an improved accountability mechanism. If the FCA was forced to justify to HMT why they had to incur costs of defending a JR – whether won or otherwise – we believe it would provide a degree of oversight and responsibility to the FCA in its interactions with HMT.

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

58. AMI recognises the potential benefits to consumers of a regulatory approach that focuses on the entire life-cycle of the product rather than simply on the point-of-sale of the product. This will ensure the role of product manufacturers is sufficiently scrutinised, reducing the opaqueness of some products, and will also help to provide the clarity on products essential to protect consumers. However we have several concerns with the proposals as they currently stand, specifically the implications for innovation and competition, retrospective judgements, the role of advice, the accountability of the regulator and the overriding cost.
59. **Innovation and Competition** – We have concerns that the current proposals will cause product providers to become risk averse, worried about stepping out of the recognised borders and selling anything other than vanilla products – effectively stifling innovation. Unless firms are resourced to do the research, it will become extremely difficult to bring

new products to market. This will penalise small firms, and damage competition. There is also the danger that the risks of products for certain groups e.g. first time buyers, will be too high, and lenders will pull out of these markets as a result, thus denying sections of society access to products that they need or want.

60. **Retrospective Judgements** – Closely linked to our concerns around innovation and competition is the threat to the industry of retrospective judgements from the regulator. Although Hector Sants has stated product intervention is a move away from retrospection to proactive regulation, risk tolerances will inevitably shift and therefore products that were once deemed acceptable may no longer be under the new regime, raising questions as to where these products then stand from a regulatory and liability standpoint.

61. **Role of Advice** - The suggestion that particularly complex or risky financial products are only available with the advice of a professional is clearly a sensible step in securing better outcomes for consumers, but must be carefully balanced so as not to undermine consumer responsibility. However, the proposals for financial advisers to hold specific higher level professional qualifications before advising on certain complex financial products raises many questions – for example what will the new qualifications entail, and could there could be a gap between a new type of product being launched and anyone being qualified enough to advise on it?

62. **Accountability** - FSA has stopped short of using the term 'product regulation' with the word 'intervention'. This implies that much of the onus will now be on product providers, particularly their boards and risk committees, to ensure their products are well designed and competitively priced, which AMI supports. However it also appears to absolve the regulator of responsibility for anything that it misses, raising questions and concerns for us about its overriding accountability.

63. **Cost** – We are particularly concerned that the associated costs of the product intervention proposals do not rest on the shoulders of the intermediary profession. Running conduct of business regulation and a new product intervention approach side-by-side for a period could increase regulatory costs significantly. Following our response to the FSA budget last year, it appears there is a tacit acceptance that such an approach must acknowledge that product manufacturers carry significant ownership of cost and risk.

Q14. 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.

64. AMI is very concerned about some of the proposed new powers for the FCA, particularly the power to publish public warning notices against firms and individuals before they have had the opportunity to respond.
65. This is a worrying shift towards “guilty until proved innocent”, and will certainly not help in the Government’s quest to restore consumer trust in financial services. It can take the regulator months or years to complete investigations. Meanwhile the reputations of businesses can be left in tatters and their value destroyed even if the subjects of warnings are ultimately shown to be innocent. Despite these dangers, the new proposals aren’t doing anything to speed up the investigation process. There is therefore clearly a careful balance the regulator must achieve between early intervention and treating advisers and manufacturers fairly.
66. The potential danger of this approach is encapsulated by the recent example of Gartmore, whereby FSA spent 12 months probing an employee with regards to inappropriate behaviour. After its investigation FSA found the employee innocent and decided not to take any disciplinary action. Even though FSA didn’t publicly comment during the ongoing investigation, Gartmore had to make an accounting provision/declaration in their accounts, so as a quoted firm the markets found out. This resulted in huge outflows from the £35.5bn hedge fund business, precipitating the eventual sale of what was once the UK’s biggest fund management companies. If the regulator did indeed have the powers to publish warning notices, and used them, situations such as the one that occurred at Gartmore would become far more commonplace.

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?

67. We are concerned that giving the FCA the competition powers that are proposed in the CP would in effect provide a mandate to allow it to be an economic regulator (given competition often means price). This would not be a desirable outcome.
68. Rather we believe the Financial Services Consumer Panel should have the power to make ‘super complaints’ if it has concerns regarding competition issues. This would add another tool to the Panel’s armoury, protect consumers’ interests while avoiding the pitfalls of giving the FCA a competition mandate on top of its other numerous powers.

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

69. If the regulatory landscape is to be separated out as proposed by the Government, it is crucial there be close and continuous co-operation between the new regulatory bodies. The objectives of the individual regulators also need to be clear and fit logically together. History has shown us that failures happen when there are gaps in regulatory oversight, when regulators fail to co-operate or when they fail properly to fulfil their obligations.

70. To achieve this, AMI believes that each of the three regulatory bodies should formally benefit from each other's objectives as specified secondary objectives, rather than just as "have regards to", as we question what legal weight this actually carries. We do not believe the Consultation Paper makes this clear enough.

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 instability?

71. Whilst AMI understands the implications of such proposals, we feel there is a fundamental difference between coordination and right of veto. We question whether it is realistic to assume that the FCA should ever reach a point of allowing poor market conduct to develop unchecked that remedial action relating to conduct would result in a firm failure of a magnitude to create financial instability.

72. AMI is concerned that the tone set by offering one regulator a 'veto' the outcome of achieving two regulators "equal in status" may be lost.

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

73. For FCA firms we believe the lead approach seems sensible. As for dually authorised firms, we believe there should be a joint approach through some form of 'Common Services Department'. However, this should be led by the FCA as all firms will be 'touched' by the FCA regardless of business type and size.

74. Furthermore we would recommend HMT considers the use of 'passports' so individuals who are authorised remain authorised if they change firms in an equivalent role, but with minimal new checks. This is rather than people having to undergo the entire expensive, time consuming process of reauthorisation. This would be a welcome reduction in administrative burdens for firms and the regulator.

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

75. AMI broadly accepts that the OIVOP/VOP approach is acceptable. However we question what assessment of OIVOP has been made since the regulator adopted these powers in 2008, and seek further information as to their sufficiency, and how often they have been used.

76. We also believe there is a strong need for an independent decision-making mechanism to deal with any potential disputes. We would again refer back to our earlier point regarding the need for a statutory RDC as an accountability mechanism.

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

77. AMI agrees that the customer facing and market activity functions should all sit within the FCA. However, we are very concerned about the proposed split in the significant influence functions (SIF). This could result in a CEO of a non-PRA firm being acceptable to the FCA but not the PRA or vice versa. By splitting the authorisation of certain specific functions across the two bodies you invariably end up with different approaches to what is the same role. We also question where the SIF functions for subsidiaries would end up - for example, would the CEO of a mortgage intermediary business owned by a PRA-scope firm fit into the FCA or PRA?

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

78. For conduct issues we agree with HMT that this is an FCA issue. Prudential requirements of branch passporting into the UK fall outside scope of the PRA or FCA and instead sit with the firm's home state regulator.

79. However, for UK firms passporting out, we believe the FCA or the Common Services Department should have responsibility for the coordination work as appropriate. The reason for this being that only the FCA will touch all firms and there is a therefore a danger of potential regulatory underlap if the responsibility is split. The management of the firm's prudential requirements will of course remain with whichever prudential regulator they operate under.

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

80. AMI supports the proposal for all fees and levies to be collected by one organisation, namely the FCA. This is logical because all firms' activity – whether retail or markets –

will be policed by the FCA; as such the FCA is the only common denominator of any financial services firm. However, we feel this could be taken further, by the establishment of a Common Services Department which would deal with issues such as fee collection, permissions, data collection, I.T., and European engagement for all the regulatory bodies. The establishment of this Department would avoid duplication of costs in the aforementioned areas, whilst also ensuring simplicity for firms.

81. We must note here that we are very concerned by the overall cost - £50m as a transitional budget is potentially insufficient, yet still a considerable further sum to the industry. Whilst many other Government funded regulators are facing substantial cost pressure, the industry funded FSA is not and this needs to be considered carefully.
82. AMI would also like to continue the debate relating to the cost allocation model within the FCA structure. AMI has engaged heavily with FSA over recent months on this issue, including substantial work with external consultants. We feel that there are more appropriate allocation methods for the cost of regulation, and would welcome the opportunity to consider this further in light of the revised regulatory structures.

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

83. AMI supports the work of the FSCS, and regard it as an essential consumer protection which benefits the wider financial services community. We have witnessed much member interest in the Compensation Scheme, including a variety of proposals as to how the Scheme could be improved. For this reason, AMI is shortly to publish a discussion document for members outlining potential changes which could be considered. We will be happy to share the results of this discussion with HMT.
84. That being said we agree with HMT that the FSCS should remain a single organisation to administer compensation so that consumers have a single, accessible point of contact for compensation matters. Any other model would merely add further to consumer confusion.
85. With regards to the specific proposals for the operating model, AMI believes the FCA should have the power to make all of the compensation scheme rules, rather than it being split between the FCA and PRA. This option would ensure consistency in rule-making and help to minimise costs. However there must be strong and transparent coordination with the PRA to help the FSCS operate as effectively as possible.

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

86. AMI supports the ongoing availability of an accessible, low-cost ADR service in the market as we believe it offers a fair consumer check and balance. Therefore, we support the work of FOS and believe that, in its role as an adjudicator of individual complaints, it has been generally effective.
87. However AMI is concerned that in the past FOS has operated in a quasi-judicial manner, without the right of representations and appeal. Indeed FOS's role as a quasi-judicial organisation was confirmed by Natalie Ceeney in her Treasury Select Committee evidence in October 2010. On occasions FOS has gone beyond its core remit, and has sought to set higher cross-industry standards, something which should instead be the function of the regulator, industry initiatives or as a result of competition. Challenges arise for the industry from FOS decisions which appear to be inconsistent with regulatory expectations or market norms that were accepted at the time, and/or set precedents which have wider implications.
88. This often impacts on business decisions, due to firms' uncertainty about how FOS might respond to future classes of complaint, even where firms are in compliance with FSA regulations. This has also been exacerbated by the growing influence of Claims Management Companies (CMCs) on financial services markets, which take advantage of the FOS processes.
89. We therefore welcome HMT's plans to reinforce the distinction between the roles of the FCA and FOS, to give firms greater clarity and certainty. We also welcome the proposals to enhance the transparency and accountability of FOS and believe the FCA should conduct regular reviews of its overall operations, policies and procedures.
90. Furthermore we suggest the legislation should go further and remove FOS from the process of determining regulatory issues with wider implications – this should be the responsibility of the FCA or the Upper Tribunal. We also do not believe FOS should have the right to prevent firms from seeking resolution of test cases in the court where a complaint raises important or novel points of law.

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

91. As previously stated, the accountability of the new regulatory structure is one of the, if not the most, important aspect of the changes for AMI.

92. We therefore welcome proposals to introduce statutory requirements for FOS and FSCS to publish annual plans and consult on them where appropriate. CFEB is already required to publish an annual plan and report under provisions introduced by the Financial Services Act 2010. We also welcome the Government's plan to place in statute provision for the FSCS, FOS and CFEB to be audited by the NAO, providing us with assurance that these bodies are required to carry out their functions in an efficient and economic way.

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Dear Sirs

APCIMS Response to HM Treasury Consultation Paper - A New Approach to Financial Regulation: Building a Stronger System

Background

APCIMS¹ welcomes the new approach to financial regulation outlined in the Treasury document “building a stronger system”. We feel this has taken major steps forward from the initial document last year by listening to the many varied market constituents and in particular bodies like the Treasury Select Committee. If we are to build a better stronger system overall, this seems like a good place to start.

The document reaches page 30 before a question is asked and uses this first set of pages to “set the scene”. In our response, we similarly provide a few paragraphs of introduction before beginning our answers.

Introduction

We concur wholeheartedly with the commitment (in 2.3) of restoring the UK economy to sustainable, long-term growth as this particularly resonates with a key role APCIMS clients play, via their firms, in particularly promoting investment in small and medium sized companies (“SME’s”). Our national reach, across 500 locations allied to our direct link to (stock) market activities puts us in a strong position to assist such growth, particularly if the regulatory system works closely with and understands the practising professionals. This is well put in section

¹ The Association of Private Client Investment Managers and Stockbrokers (APCIMS) represent’s firms acting on behalf of investors. APCIMS has 185 members, 118 are private client investment managers and stockbrokers and 67 are associate members providing related services to our firms. Member firms deal primarily in stocks and shares as well as other financial instruments for individuals, trusts and charities and offer a range of services from execution only trading (no advice) through to full portfolio management.

Our member firms operate on more than 500 sites in the UK, Ireland, Isle of Man and Channel Islands, employing c.30 000 employees. Over £400 billion of the country’s wealth is under the management of our members. Our aim is to ensure that regulatory, tax and other changes across Europe are appropriate and proportionate for the investment community.

(1.30), and also means that APCIMS can give useful input into a new market practitioner panel as in section (1.34).

We welcome the clarification provided in sections (1.13) and (4.9) in respect of the FCA putting appropriate consumer outcomes at the centre of the regulatory process rather than it acting as a “consumer champion”. In particular, the additional information bulleted in (4.9) is very helpful. This all bodes well with the entire APCIMS community where typically client relationships are established and cultivated over the long-term. Our firms’ business models are based on client relationships offering a range of services suitable to each client’s needs.

We would like to pick up two specific bullet points from section (1.25):

- Firstly, the principle that, “senior managers (and not regulators) are ultimately responsible for managing their firms in a way that is compliant with the regulatory framework”. We believe that if this principle is really adhered to, then swathes of rules/rule books could be cut out, particularly for communities where there has been a history of successful self-regulation. Key to this is “rooting-out”, via strong regulatory supervision, and where necessary “throwing-out” bad apples when spotted! An obvious point related to this is that for a particular regulator to perform their role well, in conjunction with their respective constituency, the regulatory staff need to be as (or more) aware of the sector they are regulating than the professionals contained therein. Sadly, we seem to have drifted away from such a state.
- Secondly, the principle that, “consumers of financial services are ultimately responsible for their own decisions”. Despite the complexities of many aspects of financial services and the need for sound investor protection which we totally support, this principle often needs re-iterating.

Linked to both of the above points is the comment at the end of bullet 2 in section (4.9) which we agree with: “... but also the potentially negative effects of excessive regulation on market efficiency and consumer choice.”

Underpinning all of the above is the quote from section (1.45), namely: “... that the new regulatory framework will allow for judgement and expertise to be brought to bear on financial regulation” which we welcome wholeheartedly.

Questions 1 & 2

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

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

Reply

In relation to macro-prudential matters, there is a need first to have a clearer understanding of the term “systemically important” and a straightforward answer to the question “what exactly is a systemic firm?”, before one considers the tool set required and the tools contained therein. The tools mentioned all appear quite sensible, and will likely be effective to cover off scenarios such as those that existed or are related to the recent and historical crises. However, we believe the real trick is to try and spot new things (which will no doubt be difficult) before the next potential “crisis” actually becomes a crisis. Therefore the ultimate accountability of FPC to update its toolkit (in 2.73) is welcome but may in practice need to go further and be more firm-specific in an interventionist sense via its close working with either the PRA or FCA as appropriate.

Also, and this is set out again in (2.10), FPC primarily focuses on financial “stability”. We do not wish to labour the need, over time, for there to be clearer definitions of what comprises stability, but we also wonder if FPC will act as a parent-body in an accountability sense, for both PRA and FCA when in extreme situations they are being unreasonable or just not listening. We realise such a situation would need to be carefully controlled (so it is not abused or used too frequently) and a workable solution could be such that if any of the working panels, after “questioning” the PRA or FCA get “no joy”, the chairman of that panel could then approach the FPC on the matter.

In today’s world there is a feeling (which is more than a perception) that FSA has become “all too powerful”, perhaps “untouchable”, in an accountability sense and a situation like this is never good for any such body, so we should try and learn from this experience.

Regarding other tools, we suggest that any increase in volumes which becomes continuous, needs watching. This could be something like the number of complaints (in a particular situation) or something as simple as “volumes of sales” or market volumes. When things are going really well, the old adage of “too good to be true” is a great reminder that some sort of fall may be round the corner.

Question 3

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

Reply

Just the one mentioned above, whereby the FPC (or the Treasury?) need to cover off other situations which are not necessarily stability related. We need an additional pressure-release valve, if for no other reason than to be able to answer the (frustrating) question: “where do we go to next?”, if there seems to be a stonewalling from either the PRA or FPC and engagement is no longer occurring.

Question 4

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

Reply

Apart from what we have said earlier regarding defining “systemically important”, we presume that MTFs are not considered systemically important, partly because they have not, up to now, been classed as “infrastructure”. However, as their volumes have increased, this may need more consideration.

The retail market in the UK does not directly utilise the MTFs having historically built their services around Recognised Investment Exchanges and the RSP model, which means that when, say, the LSE systems stop, retail tends to cease trading. This is not a sustainable situation going forward but links to the need to understand better where other RIEs and MTFs fit in the systemic landscape.

Given that via 2.127, Bank of England would be enabled to impose penalties on settlement system operators, is there not also a case for FCA to be able to impose penalties on RIEs for not complying with, say, system provision during market hours? Such penalties could possibly be used to reduce exchange membership fees.

One last point relates to impacts, if any, from an Irish market perspective. Some Clearers work across both the UK and Irish markets and the settlement system (EUI) is a common platform so these need consideration and then accommodating in the new structure.

Question 5

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

Reply

Largely OK, assuming the “additional” accountability to FPC mentioned in reply to Q.3, can be included.

There could also be a case for placing a requirement for PRA (and FPC) to always act “fairly” as part of the updating of FSMA.

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?

Reply

Where we have members who are (legally) set up as Banks, or can be sometimes considered as “Investment Banks”, they should not on a judgement-led approach, need to have any PRA involvement if they are not systemically important.

Similarly, we would caution on the point in (3.24) regarding “dealing in investments as principal”. This permission may be used for either riskless principal transactions (matched back-to-back) or very low volumes of transactions often linked to placings etc. We need to find a pragmatic way of not mixing such business with PRA’s main focus.

From a European point of view, all of the above will need careful consideration because:

- a) the UK market system (particularly for “retail”) is unique;
- b) at a general level, our experience shows that European financial services work, likes to try and neatly fit “things” into pigeon-holes in order to drive consistency, which then in certain cases is just unworkable from a domestic consumer standpoint; and
- c) where we have a number of smaller investment firms who comply with the CRD, there will need to be strong liaisons across PRA and FCA. (To take a specific example; “forcing” a small partnership to commute bonuses into financial instruments that bear no connection to either the firms’ performance or that of their staff is unproductive and plain daft! ... However, this has recently been considered as part of the remuneration work). We assume that overall, FCA will be “responsible for limited licence limited activity firms (under CRD) but that there will be an important need for PRA to take this into account and liaise very closely on this matter with the FCA, if for no other reason than to keep any regulatory requirements proportionate.

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)?

Reply

If this operates much like the Bank of England has worked historically, then we believe it is a sound way forward. However, we need to watch the practicalities related to the fact that the percentage of BoE staff (to those in FSA) is very small and therefore some form of training/coaching will be needed along with strong management structures to help this work well. Also worth mentioning that there is a strong argument for supervisors (at the regulator) and staff managing complaints (at FOS/FSCS etc) to be as qualified as the staff at firms, so with the new qualification requirements related to RDR, we think this should be taken further, particularly by FCA.

Question 8

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

Reply

The constituency of the Court of the Bank of England will need to be continually reviewed to ensure it can cover PRA work appropriately and FCA work if the FPC takes on the mantle of overall accountability that we have referred to in our reply to Question 3.

Question 9

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

Reply

It is improved from the situation of today, particularly with the various new “reports” which will exist. See also our reply to Q.3), as we think there is still a need for another mechanism.

Question 10

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

Reply

These seem reasonable and we look forward to having more details on how the PRA will act out its duty to consult practitioners etc. This also raises the point of how two practitioner panels (as exists today) are expected to cope with the rich spread of financial services activities across the UK marketplace. Wholesale and Retail can be quite different (as in perhaps PRA/FCA work) but then within retail are many different “sectors”. Work needs to occur on the design of this with input from practitioners!

Question 11

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

Reply

We largely concur but would additionally like to see a specific objective for FCA regarding prudential matters for their firms. Box 4E on page 69 outlines aspects of this but we feel it should be specific in an objective sense. See also our reply to Q.5) regarding acting “fairly”. It is also worth pointing out that the FCA’s single strategic objective, as per (4.13), “to protect and enhance confidence in the UK financial system” really does need more engagement with the total financial marketplace than seems to be the case today with FSA. Areas of “failure” occurring recently such as Keydata, Wills & Co and Pacific Continental that have affected our own community directly are such that we feel earlier action and formal internal enquiries (at the Regulator) are essential to see what has transpired in order to learn from such situations. Having to call an Independent Enquiry (under FSMA) is extreme and should only be needed when all

else has failed. Early identification of issues and “lessons to be learnt” are vital ingredients of a sound regulatory landscape.

As part of facilitating efficiency and choice across the marketplace, we welcome such words as “removing regulatory barriers” in (4.15), but sadly the involvement of the EU in much of the financial regulation today does seem to preclude some of this, particularly when one considers the cultural aspects of the UK regarding most firms adhering strictly to rules.

Question 12

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

Reply

We agree, particularly with sections (4.43/4.44), but as mentioned previously (e.g. regarding an additional accountability in reply to Q.3) it is often too late if events have already “gone wrong”.

We all need to strive to “raise the flag” earlier and then for the overall system we are now building to have a mechanism to accommodate listening to the signals that are vital early warnings. We are aware that Section 11 of FSMA brought an important part of the formal accountability of the FSA to the Panels into effect. This currently requires the FSA to consider representations made by the Panels, and where it disagrees with a view expressed or proposal made in a representation, to provide the Practitioner (or Consumer) Panel with an explanation in writing of its reasons for disagreeing. However, we think there is a need for something else to encourage accountability, and it needs to come from “above” FCA.

Question 13

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

Reply

Provided (as per 4.27 and 4.67) this does not go down a path of widespread vetting/pre-approvals etc, we are broadly in agreement with the product intervention power (even though it “front-runs” the recent FSA discussion paper DP11/1) but may need to carefully understand and define the term “product”.

Where some of today’s “products” are listed and dealt on exchanges, e.g. Exchange Traded Funds (ETFs), Investment Trusts, etc one assumes the current listing arrangements will need coordinating with the products’ dynamics? Also, if a client is about to sell a product that is “on-exchange”, banning the product will have quite different ramifications to banning future sales of a product that has been “sold” to investors.

It is worth mentioning here that issues-based supervision (as referred to in 4.54) may be the best approach, but this should not detract from even small firms receiving a visit at some stage. Alternatively, FSA could operate an efficient process whereby random selections of smaller firms were visited but was such that all small firms knew they may be included at some stage. We believe that whereas the FSA say they visit every firm once in four years, this may have slipped of late. Also, the recent “Dear CEO” letter from Hector Sants talks of reducing supervision during transition; a risk we all need to watch carefully!

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.**

Reply

We most strongly favour a climate of transparency and disclosure but would just urge a little caution in regard to words in (4.74) namely, "... that the FCA will be able to look beyond rulebook compliance and enforcement to more innovative ways to encourage good practice." Ideas that can appear great on paper may have other consequences when put into practice.

With regard to financial promotions, if a firm has been "instructed" to amend or withdraw a financial promotion then care needs to be taken that publication does not invite so-called "ambulance chasers" to practice their trade. Also, it is important that FCA only uses this power where the advertisement is misleading beyond reasonable doubt since on appeal the firm may be proved right.

For "warning notices" we think there needs to be much more thought on this before proceeding as publication could impact confidence if unintended consequences are not well thought through. Recent market reaction to this, particularly from the legal profession, illustrates the concerns. Whereas this may seem to mirror the approach taken more of late whereby the public are "informed" regarding an individual's misdemeanours, it can have seriously damaging effects on consumers of a firm whose "affairs" are reported on. Individuals can, if they so choose, have their "day in court" to put across their side of the case, but quite how this would operate for firms is unclear. Also, just as in certain of the individual cases of late, where the courts have been used to stop stories which are "in the public interest" coming out (one in the first week of March relating to a "bank executive" was stopped by Justice Henriques), a similar concept may be needed to protect consumers of affected firms, but again we are not sure how this will work both in a process sense and in practice and advise proceeding with caution. Much of the benefit arising from publicising warning notices could be achieved without having to name the organisation to which the notices have been issued. By simply publicising the fact that a notice has been issued, and summarising the grounds on which action is being taken, the regulator would, without the disadvantages and unfairness which might be involved in naming the organisation, still be highlighting potential issues to consumers at an early stage and emphasising to firms the behaviours which it considers to be unacceptable.

The formal use of data between bodies such as FOS and FCA (as in 4.72) is certainly a step forward to help transparency, but going further with "publishing" such information does need more thought.

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?

Reply

Introducing powers that may overlap between FCA and the competition authorities is not straightforward. We question whether FCA have the relevant experience and expertise to "cover" such powers and if not today (in FSA) whether it is cost effective for them to do so. However, it may be important for the regulators to have competition as a key consideration (or even objective?) to ensure smooth market operations at all times.

Regarding "other powers", when the FSMA is reviewed, we believe it a good opportunity to check the usage of Section 166 notices relative to the words in the Act. There seems to be quite a wide usage of Section 166 powers but perhaps this has drifted from what was originally intended?

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.

Reply

We do not have specific comments on the two bullets as worded but would like to mention:

- **16A) Section 4.106**

We fully support the need to protect client assets and ensure confidence in their overall processing. However, we feel that on a risk basis, there should be greater distinction between client assets that are segregated and those that are not. APCIMS firms that deal with client assets do so on the basis of a fully segregated regime (backed up by stringent rules and regulations). This treats such assets as, in effect, trust assets and the key work for the regulator then is to ensure via supervision, that the rules and regulations are being followed. No segregated assets appear to have been impacted by any of the recent crises so should not need to receive additional attention as a result thereof.

- **16B) Section 4.118**

Since FCA will represent the UK at ESMA, we think there should be a formal committee created to “feed the representative”. Any other (informal) approach is likely to end up with gaps.

There is certainly the need to input (from BoE) on clearing houses and settlement systems, but there will also be a need, for example, for PRA to fully consult with FCA in respect of such things as CRD developments to ensure Bank/Insurance-type proposals are relevant and proportionate for small(er) investment firms.

Question 17

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

Reply

Broadly OK, with the need also to ensure that there are sufficient formal liaison mechanisms at a practical level (such as those mentioned in 16B) above). To take one specific, perhaps simple situation, in relation to APCIMS’ firms whereby a firm that has limited licence wants to “upgrade” to full scope; this could mean that the firm needs to be dealt with by both FCA and PRA. Only practice will show whether such liaisons (a) work, and (b) are fast and efficient. We assume it is worth mentioning here that if a firm ends up being dual regulated by PRA and FCA that there will always be an appropriate lead regulator to minimise interactions?

Lastly, and this links in part to Q.24), if there are likely to be situations where effectively different rulebooks will exist in PRA and FCA for “similar” areas, there needs to be a mechanism to manage such a situation so that it does not create inequalities and/or unfairness.

Question 18

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

Reply

We believe this may need a little more thought. In situations where there is consumer impact, is it really the case that PRA is best to have the veto? We presume also that the PRA veto will be transparent?

Perhaps this is also a good place to bring out generally the point that due to a number of mentions throughout the whole document of PRA taking action “above” the FCA (and not all saying specifically that it is in regard to stability matters) we think there is a need for it to be made clear that PRA is not “more important” than FCA in any hierarchical sense, i.e. PRA and FCA are indeed equal regulators, albeit there are times when one needs to have a final say. There is therefore a strong case for PRA’s veto to only be used against firms that are subject to PRA regulation.

Question 19

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

Reply

We favour the alternative approach with FCA taking the lead. This, we believe, is likely to provide the most efficient single thread process overall avoiding as much as possible duplication but always having a process leader.

Question 20

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

Reply

(5.40) appears OK, provided the “veto” mentioned is managed carefully, and perhaps with due regard to the words we have added in reply to Q.18).

Question 21

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

Reply

We are not sure how (5.48) will work in practice. We question whether it is possible for the PRA to lead on certain controlled functions as we have never really interpreted the various controlled functions split in the manner of “prudential” and “other”. We feel (5.49) is important but (5.48) may need more thought.

Question 22

What are your views on the Government’s proposals on passporting?

Reply

These seem OK with one question: assuming (5.48) is able to work and therefore PRA “cover” approvals etc connected to prudential soundness, will PRA have an opportunity (and in fact a legal right?) to say no if an individual from a home state was felt to be not suitable for work within the UK?

Question 23

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

Reply

No real comments but (5.55) seems a good approach.

Question 24

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

Reply

Broadly OK, provided PRA are always best placed to gauge a particular situation of a dual-regulated firm that is not stability related. (We raise this due to the “or” in line 4).

We would like to take this opportunity to comment on sections (5.59) to (5.61), even though there is no formal question to answer. Our specific point relates to (5.61) and the “allowance” to consult FPC ... but only when financial stability is involved. This very clearly brings out a point we have stressed previously, i.e. where do the authorities go if they disagree and it is not related to stability?

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?**

Reply

These seem sensible but we would like to understand more about how the “certain circumstances” under which a new power of direction over a parent would operate before we concurred fully with this power.

Question 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?

Reply

We have no comments on most of this except the approved persons aspects related to change of control. We think that the PRA must consult (or at least discuss) with FCA regarding approved persons in dual regulated cases. Our reading of (5.79) is that it does not say this?

Question 27

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

Reply

No specific comments but in a general sense where, in (5.90) it again refers to “PRA’s veto over FCA decisions ...” we would just caution on situations where perhaps large numbers of consumers are involved and FCA may be best placed to “lead”.

Question 28

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

Reply

Largely OK regarding fees and levies with the understanding that co-ordination across PRA and FCA in connection with FSCS will be set down very clearly.

One other point: (5.94) states that “audit work is likely to focus on financial soundness”. However, when it focuses on systems and controls and even perhaps Governance, we think FCA may need to lead.

Question 29

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

Reply

Regarding governance for the FSCS, we are broadly OK, but with PRA covering deposits/insurance and FCA all other types, will this mean that there will be no cross-subsidy from “other” to/from deposits/insurance? Also, there is no mention of the European compensation directive. Presumably one of FCA/PRA will have to lead on this on behalf of the UK?

Two key points regarding operating model and co-ordination arrangements have arisen recently in relation to the situation of the excessive levy demands that impacted our firms recently related to Keydata etc. The FSCS are operating on the basis of compensating clients quickly, i.e. within a matter of days. Whereas this is laudable and may be appropriate for some situations such as deposits, we feel it needs reviewing in regard to monies placed in investment products. Provided consumers know they will be recompensed (in full or part) it is acceptable to phase the timing of payments such that undue burdens (cash flow etc) are not placed on regulated firms.

The recent levy, whereas considered “affordable” by FSA, was approached by FSCS/FSA with little consideration to the practicalities involved. Not only was this the largest ever levy demand, with firms given only 30 days to pay, but it was such that only FSCS/FSA were in a position to understand the impacts at individual firm levels. This was due to a new calculation method for sharing out the levy involving revenue by firm, which could only be seen “in the round” when the full calculation across all firms had been undertaken. Instead of this being “managed”, bills were sent to firms in a mechanistic way with, in some cases, demands for values over 100 times previous levies. The FSCS took responsibility for the total values and FSA took responsibility for “managing the bill process” but no one party took overall responsibility of the situation. This lesson has been learnt, but in future, maybe FSCS need to consider whether or not an outsource to FSA (for bill paying) is the best solution.

One last point in relation to FSCS: what will happen to the existing “debt” situation (related to Keydata etc) as we transition to a new scheme? If recoveries like the Norwich and Peterborough situation continue to occur, how will this operate across PRA/FCA?

Question 30

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

Reply

We welcome the Government’s intention to clarify the statutory designation and functions of FOS, especially with regards to transparency/publication of FOS’s decisions. At the same time, we are concerned that the Government intends to keep FOS and FCA as distinct entities vested with rather different legal functions. APCIMS advocates a different approach which would see FOS being integrated into the “twin-peak” framework. In that case, FOS would be able to operate within the remit of FCA rules.

Whereas the ombudsman’s statutory functions and responsibilities are indeed rather distinct from those of the regulator, we believe it would be unacceptable if FOS delivered inconsistent

decisions based on its own judgment rather than English law and FSA/FCA principles and rules. This would impede legal certainty and may create dangerous precedents in cases where FOS's decisions are inconsistent with concurring statutory provisions and FSA rules. Furthermore, we welcome the proposed MoU between the FOS and FCA which would include provisions on wider implications cases handled by FOS. FOS's competency regarding wider implications needs to be clearly defined.

On the subject of transparency, we welcome the drive towards greater transparency as advertised by the Government. We also welcome the Government's intention to review the FOS's powers to publish information in accordance with its statutory function. We believe that this is a sensitive issue for many firms of the entire financial services sector, which needs to be handled carefully by the Government in cooperation with the sector as well as FOS. We would not like to see publication of FOS determinations used as a form of regulatory censure, i.e. enforcement via another name.

One further issue which we would like to raise is that we think there is definitely a need to ensure the FOS staff are appropriately qualified. To take the specific example of RDR qualification "levels", there is a strong case for mandating that FOS staff who deal with RDR type issues, should be at least as qualified as the industry practitioners whose cases they are opining upon.

Question 31

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

Reply

Following from the previous question, we most definitely welcome the Government's proposed arrangement for strengthened accountability of FOS as well as FSCS and CFEB. We support the Government's proposal to include a statutory requirement for FOS and FSCS to publish an annual plan and budget. One point that we would particularly like to stress is that the Government may wish to consider that it would be easier to ensure FOS's accountability if it is integrated into the "twin-peak" framework. In this case, it will be under a direct supervision from FCA and therefore will be obliged to abide by its rules as well as any common law precedents and statutes. If on the other hand the Government decides to maintain the distinction between FOS and the new regulator (FCA), it may require more than just an MoU to synchronise the operations of two agencies.

Also, with regards to CFEB, we would like to put down a marker regarding its budget. The Government has recently refused to fund £12.5m of CFEB's budget as a result of which FSA appears to have just filled this gap by taking more money from firms' general levies. We have commented on this in the recent consultation on fees etc (CP 11/02) but if FSA does not "listen", what next?

Question 32

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

Reply

We have a few comments arising out of this chapter:

(7.12) could be read as ESMA only "covering" wholesale markets regulation. If this is correct, we were unaware of this and wonder how retail (stock) markets regulation is to be properly represented? To take a specific situation where "retail" needs different consideration: The UK

(stock) markets work on an intended settlement date as opposed to a guaranteed one (which is the default in Europe). Although the majority of market bargains settle on the due date, for those that do not and for which they have been transacted on an agency basis (rather than a principal one) these are likely to have occurred via retail firms who are not geared up to stock borrow, hence the “trades” will remain outstanding and appear as “naked” sales.

This is perhaps a useful place to bring out the fact that much of the retail financial work in the 27 EU member states is very “national” in the way it operates often due to strong links over many years with aspects of national taxation, i.e. products and services have tended to evolve as tax law has evolved. As a result of this, we find that whereas there is a drive for consistency in the wholesale market place (i.e. for “principal” transactions), and this is to be welcomed, there is not the same appetite from each of the member states for similar consistency in retail activities. However, parts of the EU Commission do seem to have an appetite for this! Somehow, therefore, we all need to work closely with the EU to ensure that any drive to make retail activities and regulation consistent, is cognisant of local specificities and does not therefore introduce unworkable regulation.

(7.25)’s co-ordination is welcome in this area and links with our paragraph one in 16B) Section 4.118 under the reply to Q.16).

(7.30)’s bullet points are key as is the MOU that is referred to. We would welcome being involved in work related to the last bullet point that links across to our sector of the UK financial marketplace.

One last point: Overall co-ordination between the UK and Europe would be much more effective if there was one central “planner” containing all work and initiatives across FPC, PRA, FCA and “Europe” available to the marketplace. The FSA diaries and planners which are “available” to the marketplace today do not for example always include “Europe” and are rarely consistently updated.

Yours faithfully

A handwritten signature in black ink, appearing to be 'Tim May', written in a cursive style.

Tim May
Chief Executive



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Financial Regulatory Strategy
HM Treasury
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13 April 2011

Dear Anna Deibel-Jung

Aviva's response to 'A new approach to financial regulation: building a stronger system'

Aviva is pleased to respond to this consultation. We largely welcome the Government's proposals and believe that they substantially improve on those in the initial consultation in a number of areas.

As the UK's largest insurer, with an asset management business and operations across Europe, we have a keen interest in the UK regulatory system interacting effectively with EU institutions. These reforms will affect our non-UK businesses as well as our UK business through the lead UK regulator's actions on regulatory colleges and groups. We set out in the attached appendices our broad views on the proposals and detailed views on the consultation questions.

In our view the key issues are:

- Ensuring appropriate representation on the FPC
- Achieving appropriate prudential supervision for insurers by the PRA
- Ensuring the FPC, PRA and FCA work effectively together
- Transparency and accountability
- Regulatory and supervisory philosophy
- Broadening access to the market
- Achieving oversight and a holistic view of groups
- Remaining active and focused in key European negotiations

We welcome the opportunity to discuss our response with you further.

Yours sincerely

A handwritten signature in black ink, appearing to read "Mark S. Hodges".

Mark S. Hodges
Chief Executive, Aviva UK



Appendix 1: Aviva's broad views

Ensuring appropriate representation on the Financial Policy Committee (FPC)

The UK financial services market is one of the most competitive and diverse in the world and hosts many global banking, insurance and asset management businesses. Financial stability mechanisms, whilst naturally banking-focused, nonetheless need to properly take into account the fundamental differences in business models of different types of firm, their relationships with consumers, and their different roles in the economy.

The selection process for appointing members to the FPC should be transparent. This process should aim to ensure that its expertise covers all financial sectors, including wholesale markets.

Achieving appropriate prudential supervision for insurers within the PRA

Historically, the purpose of the prudential regulation of insurance companies has been the protection of consumers. This reflects the role of insurers as providers of retail consumer products, and the fact they are *participants* in the financial system - rather than *drivers* of it.

Under the proposals, insurers of all sizes will be prudentially regulated by the PRA alongside banks and investment banks. We welcome the consultation's acknowledgment that insurance business models are different to those of banks, especially in terms of liquidity risk and the fact that insurance firm failure is generally less likely to be of systemic importance. In our view traditional insurance activities do not pose any systemic risk to the financial system, and the size of a firm is not a relevant consideration in this assessment, as evidenced by Northern Rock.

It is vital that the prudential supervision of insurance firms is risk based and proportionate. We note that the Prudential Business Unit, the interim function within the FSA which will develop into the PRA, has separate management lines for banks and insurers and we believe this should continue under the PRA. The PRA must recognise the different prudential risks posed by banks and insurers and apply appropriate and prudential supervision to individual insurers and have the focussed insurance expertise to achieve this.



Ensuring the FPC, PRA and FCA work effectively together

As a diverse financial organisation we are used to dealing with multiple regulators. As such we are more interested in the *effectiveness* of the proposed new financial architecture, rather than its *structure*.

It is clear though, that there will need to be considerable cross-consultation and co-ordination between the PRA, FCA and the FPC in the effective discharge of their responsibilities. Much of the success of the Government's proposals will depend on getting the detailed implementation right, including how liaison will happen in practice between these three bodies.

We welcome the proposal that the PRA and FCA will be under a 'duty to co-ordinate' and be obliged to produce an Memorandum of Understanding (MoU) setting out how they will deliver this duty. This co-ordination is critical to minimising the costs to firms of dealing with multiple regulators. It should also help the two regulators to be aware of and manage overlaps between conduct and prudential regulation.

Transparency & accountability

Transparency and accountability are key pillars to an effective relationship between regulator, markets and market participants. Given the wide and significant powers being proposed, appropriate controls and governance are an important part of the model to be implemented. Parliamentary scrutiny is welcome (we recommend that it is extended to cover other actors in the new regulatory regime, specifically the FSCS, FOS and the Money Advice Service) but industry consultation, that is duly taken into account, is also vital. The FPC should consult on and publish a cost benefit analysis on its tools, allowing stakeholders to engage and challenge the FPC. This would be consistent with the PRA and FCA.

We welcome the proposal that the FCA should be scrutinised by a Practitioner, Small Business Practitioner, Consumer and Markets Panels. We consider that these panels should also be able to engage with the PRA and FPC as appropriate. This arrangement would allow the other two bodies to benefit from the Panels' expertise and would provide an overview of the three bodies' actions.

Regulatory & supervisory philosophy

In moving towards a more judgemental and interventionist supervisory approach there must be a clear framework that governs the basis on which supervisors exercise their supervisory judgement.



Firms must be able to identify the rationale and basis for supervisory judgements and have a clear route to challenge them where their application is disputed. The PRA and FCA should only make judgements on material issues that affect their statutory objectives.

Broadening access to the market

We agree with the Government's emphasis on delivering positive consumer outcomes, which should be aided by the references to the pursuit of competition and consumer choice within the FCA's objectives.

We also welcome the FCA's operational objective to facilitate efficiency and choice in the market for financial services. We believe that facilitating choice should include broadening consumer access to suitable products.

We welcome the consultation's acknowledgement that consumers should take responsibility for their own decisions.

Achieving oversight and a holistic view of large, diverse non-banking firms

As an insurance group that includes an asset management business, we have a concern about how Aviva plc will be supervised. Aviva's life and general insurance businesses will be subject to dual regulation whilst Aviva Investors will be mainly subject to conduct and prudential supervision from the FCA alone. Were the PRA to lead on group supervision for Aviva plc, it is vital that it works closely with the FCA to understand asset management issues. It is critical that the regulator that takes the lead on group supervision co-ordinates effectively with the other regulator when making assessments or decisions about the group. This co-ordination is important as the lead UK regulator will impact our non-UK businesses through its actions on regulatory colleges and groups. Relevant expertise must be shared between the regulators and the group should have one point of contact.

Remaining active and focused in key European negotiations

The new EU supervisory architecture, and its interactions with the UK regulatory framework, is very important for businesses like Aviva with operations across Europe.

Activity is underway within the new European Supervisory Authorities (ESAs) to prepare for greater harmonisation across Europe in terms of regulatory rules and methodologies. It is paramount that the UK authorities maintain close and active participation in ESAs as they develop their rule-making



powers. For these reasons, it is critical that the new authorities are well equipped to engage with EU and international bodies such as IOSCO and the IAIS.

We welcome the proposals to ensure co-ordination in the EU and internationally and would urge the Government to consult with industry on the proposed MoU on overall international co-ordination.

Managing risks in the transitional period between now and the implementation of the new structure in the UK

The transitional period between the current and proposed new structure of financial regulation in the UK must be very carefully managed, to ensure there continues to be consistently high standards in the way the UK financial services industry is regulated.

We recommend that a transitional plan is developed by the FSA, with stakeholders, to demonstrate how key regulatory proposals and legislative requirements will be managed over the transitional period. This plan should include how controls over the quality of supervisory decisions and policy formulation will be maintained.

Competitiveness of the UK

The UK is a world leader in financial services and operates in a global market place in which both capital and skilled workers are highly mobile. Improving the industry's international competitiveness is a matter of national interest and helps the UK economy as a whole. It is therefore important that the regulatory system helps strengthen the competitiveness of the UK's financial services sector and does not undermine it. We hope that the absence of any specific reference to promotion of the UK's financial services sector in the regulatory objectives will not lessen HM Treasury's and the authorities' appreciation of this.

Wholesale and Market Regulation

We note the recognition made of wholesale and market activities and that these should be effectively and proportionately regulated in a way that recognises the particular characteristics of participants in these markets. This is helpful. There is a danger, otherwise, of regulatory matters being seen disproportionately through a retail lens.



Appendix 2: Aviva's response to the consultation questions

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

See our answer to question 2 below.

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

We consider it appropriate that macro-prudential measures are developed and implemented internationally, not in isolation to the rest of the global financial services market. Inconsistent speed of development and implementation of measures, potentially in isolation, risk negatively impacting the UK market and the competitiveness of UK based institutions.

It is important that the FPC undertakes rigorous analysis of the potential impact and likely effectiveness of macro-prudential tools before it makes use of any of these mechanisms. It should take care to use its macro-prudential tools in a proportionate and risk based way.

We note that the proposed tools are being developed in a banking context and are applicable to banks. As insurers have very different business models and engage in different activities to banks the use of tools developed for banks on insurers would be inappropriate.

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

The selection process for appointing members to the FPC should be transparent. This process should aim to ensure that the FPC's expertise covers all financial sectors, including wholesale markets, and is not overly focused on banking. The expertise of the membership of the committee should be subject to scrutiny by the Treasury Select Committee.

We agree with the proposal to grant the FPC the power to redact material in the public interest and also, notwithstanding this safeguard, for the FPC to be as transparent as possible. Transparency and accountability are key pillars to an effective relationship between regulator, markets and market participants. Given the wide and significant powers being proposed, appropriate controls and sound governance are an important part of the model to be implemented. Parliamentary scrutiny is welcome



(we recommend that it is extended to cover other actors in the new regulatory regime, specifically the FSCS, FOS and the Money Advice Service); however, industry consultation is also vital.

We agree with the proposals in Paragraph 2.95 of the consultation that HM Treasury should be able to specify, for each tool, whether the FPC should publish and consult on policy statement in advance of using the tool and whether the existing PRA and FCA procedural requirements should apply when implementing that tool. We also agree with the proposal that the FPC provides an ongoing assessment of how it believes the tools are working. Industry consultation will help ensure that the FPC is both effective and efficient in its actions.

We consider that the FCA's Practitioner, Small Business Practitioner, Consumer and Markets Panels should also be able to engage with the PRA and FPC as appropriate. This arrangement would enable these bodies to benefit from the Panels' expertise.

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

The Bank's regulation of systemically important infrastructure must be closely co-ordinated with the FCA given its responsibilities as the regulator of wholesale markets.

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

We consider that both the PRA's strategic and operational objectives are sensible. We continue to believe, however, that given the importance of maintaining a strong financial services sector it would have been appropriate for the PRA to have regard to the global competitiveness of the sector, and the value of innovation.

We consider the PRA's and FCA's regulatory principles to be sensible, although principle 4 should be re-worded to more accurately reflect paragraph 3.10.



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 proposal that the PRA will be responsible for promoting insurance firms' long term soundness and stability. Furthermore, we appreciate the distinction implied between firm stability and the PRA primary objective of stability of the UK financial system (which insurers do not pose a risk to).

We also note that the consultation states that insurers deserve a less intensive supervisory approach and that the Government, the Bank of England, and the FSA will continue to consider how the characteristics of insurance firms should be recognised appropriately within the regulatory framework. This consideration should reflect the aims of the new European Supervisory Authorities in achieving harmonised rules and supervisory practices, and the developing approach to insurance regulation under Solvency II. Recognition that insurers have a different risk profile is welcome, however further clarity on the objectives and the intensity of the supervision of insurers by the PRA is required. Furthermore, given that all insurers are to be prudentially regulated by the PRA, it is important that a proportionate approach is taken dependent on their nature, scale and complexity. Further clarity on the approach to be taken to European and industry engagement to arrive at appropriate harmonised supervisory practices for insurers is also required.

Moving forward into the new structure the responsibility for engaging in and determining the policy relating to the prudential framework for supervision of financial institutions must be the responsibility of the relevant supervisory authority. Therefore, in respect of the Capital Requirements Directive, which applies to both investment banks prudentially regulated by the PRA and investment managers prudentially regulated by the FCA, both bodies must engage at a European level to ensure legislative developments are appropriate to all investment firms.

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 moving towards a more judgemental and interventionist supervisory approach there must be a clear framework that governs the basis on which supervisors exercise their supervisory judgement. The regulators should only make judgements on material issues that affect their statutory objectives. Firms and individuals must be able to identify the rationale and basis for supervisory judgements and have a clear route to challenge them where their application is disputed. The Upper Tribunal ought to consider appeals from firms regarding supervisory judgments and we disagree with the proposed



curtailment of its remit. Judicial Reviews should be considered a last resort given the time and cost involved for both firms and regulators.

The Bank of England and FSA should address these points as part of their intended structure and operation of the Proactive Intervention Framework.

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

It is important that responsibility for regulatory policy and supervision remain within the same regulatory body. So, in drafting the PRA's Articles of Association it should be clear that regulatory policy must remain the responsibility of the PRA and is not a matter where flexibility will be allowed when determining how the PRA and Bank of England will interact.

The selection process for appointing members to the PRA Board should be transparent. This process should aim to ensure that the PRA's Board's expertise covers all financial sectors supervised by the PRA and is not overly focused on banking.

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

We believe that the PRA should be subject to independent scrutiny by Parliament; with both the Chair and CEO attending sessions at the Treasury Select Committee who will review performance of the organisation against its strategic and operational objectives. The discipline of attending regular sessions should ensure sharp focus amongst the Board and Executive Management Team in terms of their roles, delivery and the challenges that exist. It would also add further rigour to oversight of the organisation's governance and accountability.

We agree that the Treasury should have the power to order inquiries by an independent third party into any regulatory failure by the PRA.

We also agree that it is important that the PRA maintains a system for the investigation of complaints by an independent person. Given the move towards more judgement based intrusive supervision it is important that the complaints framework put in place is able to consider matters where the PRA's judgement is disputed and provide a timely adjudication.



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

Transparency and accountability are key pillars to an effective relationship between regulator, markets and market participants. We are pleased to note that the Government proposes that there should be no significant reductions to the existing requirements to consult that are laid down in the Financial Services & Markets Act.

We consider that the FCA's Practitioner, Small Business Practitioner, Consumer and Markets Panels should also be able to engage with the PRA as appropriate. This arrangement would enable the PRA to benefit from the Panels' expertise; and the Panels could help identify and minimise of any conflict in policy with the FPC and FCA.

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

We agree with the Government's emphasis on delivering positive consumer outcomes and consider the FCA's strategic and operational objectives to be sensible. We support the analysis by both the Treasury Select Committee and the Independent Commission on Banking who have called for the FCA to have a statutory objective to encourage choice and competition. We are therefore pleased to see that the Government will ensure that, where appropriate, the FCA must discharge its functions in a way that promotes competition.

We also welcome the FCA's operational objective to facilitate efficiency and choice in the market for financial services and agree with HM Treasury that excessive regulation can negatively impact those objectives. We believe that facilitating choice should include broadening consumer access to suitable products. At the very least, the FCA should not raise barriers to consumers buying suitable products. One way in which the regulator could broaden consumer access is by providing a viable framework for the industry to provide simplified advice to consumers.

We consider the PRA's and FCA's regulatory principles to be sensible.



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

The selection process for appointing members to the FCA Board should be transparent. This process should aim to ensure that the FCA Board's expertise covers all financial sectors supervised by the FCA and is not overly focused on banking.

We believe that the FCA should be subject to independent scrutiny by Parliament; with both the Chair and CEO attending sessions at the Treasury Select Committee who will review performance of the organisation against its strategic and operational objectives. The discipline of attending regular sessions would sharpen focus amongst the Board and Executive Management Team in terms of their roles, delivery and the challenges that exist. It would also add further rigour to oversight of the organisations' governance and accountability. We also support the proposal to subject the FCA to audit by the NAO.

We agree that the Treasury should have the power to order inquiries by an independent third party into any regulatory failure by the PCA.

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

We note that the FCA will take a more interventionist approach to conduct regulation and recognise the value of proactive regulatory intervention in preventing unfair treatment of consumers. We believe that there must be a clear framework that governs the basis on which supervisors exercise their supervisory judgement. The regulators should only make judgements on material issues that affect their statutory objectives. Firms must be able to identify the rationale and basis for supervisory judgements and have a clear route to challenge them where their application is disputed. The Upper Tribunal ought to consider appeals from firms regarding supervisory judgments and we disagree with the proposed curtailment of its remit. Judicial Reviews should be considered a last resort given the time and cost involved for both firms and regulators.

Our initial analysis on product intervention has identified a risk that firms design products with the conduct regulator in mind rather than the consumer, attempting to second guess the position of the regulatory actors (such as FSA (FCA) or FOS). Consequently, there is potential for proposition development to result in a narrower, more homogenised product range for consumers, with diverse consumer needs and attitudes to risk remaining unaccounted for. Intervention measures may prove costly, particularly if product launches are delayed or abandoned. These cost increases will ultimately be passed on to the consumer.



If the regulator is going to intervene at the product development stage it is vital that it completely understands the nature of the product, the needs of the relevant market and the consequences of intervention before taking action. Also, the expected benefits to this approach will need to outweigh the expected costs and so should be subject to a rigorous cost-benefit analysis.

We note that the Government will legislate to require the FCA to consult on and publish a set of principles governing the circumstance in which it will use its new product intervention power. We welcome this initiative and are keen for it to provide the clarity and certainty the industry needs to continue developing products for a wide range of consumer needs.

Consumer detriment can occur as the result of the features of a product or the way it is bundled, sold or managed. The FCA should ensure that its focus on product governance does not detract from effective supervision of other parts of the value chain.

We recognise that enforcement is an important part of the FSA's strategy of credible deterrence. However, the supervisory process should take into account whether or not firms have taken action on their own account to identify, resolve and inform supervisors of issues in determining whether enforcement is appropriate.

14 The Government would welcome specific comments on:

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

The consultation notes that building on the FSA's work on transparency, such as complaints handling, has the potential to be a powerful tool. We consider that for consumers to truly benefit from publication of this type of data there needs to be publication of a number of indicators of a firm's performance to give context to each piece of data provided. Only by sharing with consumers a wide and varied set of indicators could the industry support them in making informed choices about the companies, products and services in the market place. Releasing any single strand of any of these indicators on its own could lead to consumer loss of confidence in financial services or inaction (if the data confuses, is misunderstood or misleads), which could result in a worse outcome than not publishing at all. The FCA should also keep under review whether the disclosure of information is leading to any measurable changes in consumer behaviour and have regard to the cost benefit of disclosure measures put in place.



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

We consider it appropriate to introduce a control to this new power, whereby a firm can make representations to FCA as to why it believes that the promotion is appropriate and not in breach of rules before the FCA publish the fact that they have asked the firm to withdraw a promotion. This will mitigate the reputational risk of a firm being subject to an incorrect public decision that a promotion must be withdrawn. If the firm cannot persuade the FCA that the promotion is compliant, then the notification process could proceed.

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

We are concerned with the intention to publicise warning notices in respect of enforcement action that has been issued against a firm. We disagree with the view that this approach could enhance consumer and industry confidence in the new system and enable consumers to make a more informed decision. In fact, we are concerned that this proposed approach will have the opposite effect and that consumers will lose confidence in the industry and the firm in question, regardless of whether the enforcement action is later discontinued. This approach could have potentially far reaching implications for a firm and any reputational damage as a consequence of this could be significant. Any subsequent statement that enforcement action was not necessary or justified is unlikely to counter the negativity created by the warning in the first instance.

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 do not consider it appropriate to allow for 'concurrent' competition powers between the OFT and sectoral regulators as there is the potential for confusion on the remit of these regulators. This could lead to a failure by firms to meet their regulatory objectives.

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 agree that the UKLA should remain part of the FCA. However we are particularly concerned with the change to Part VI whereby the UKLA could require an issuer to have a skilled person prepare a report on a matter which the UKLA requires information. We consider this to be a significant increase



in power and could add to the regulatory burden and cost of being listed in the UK. This requirement does not fit with the regulatory regime for which UKLA is responsible and our view remains that a skilled persons report is not appropriate for the listed issuer environment.

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

It is clear that there will need to be considerable cross-consultation and co-ordination between the PRA and FCA in the effective discharge of their responsibilities. Much of the success of the Government's proposals will depend on getting the detailed implementation right, including how liaison will happen in practice between these bodies.

We welcome the proposal that the PRA and FCA will be under a 'duty to co-ordinate' and be obliged to produce a MoU setting out how they will deliver this duty. This should help the two regulators to be aware of and manage overlaps between conduct and prudential regulation. The MoU must be clear enough so that stakeholders can judge whether the authorities are abiding by it. It is particularly important that the FCA and PRA effectively implement the proposed requirement to ensure that processes involving both regulators are managed congruently and efficiently.

It is important that the authorities are open and transparent when they are setting up their co-operation mechanisms. The authorities should be required to consult publically on the drafting of the MoU so that industry can participate in the process.

There will need to be appropriate controls and governance to allow for transparent scrutiny of the performance of the different regulatory bodies in the delivery of their objectives. This should include formal external reporting to industry representatives, formal audit by the NAO and appropriate consultation on policy development.

We note that the authorities will set out detailed arrangements regarding co-ordination of specific regulatory processes. Overall, we consider that the new authorities should be required to identify areas of activity that can be undertaken centrally to reduce costs and enable more efficient interaction with firms.

The new authorities should share information and resource to prevent duplication of activity, interaction with firms and to minimise operating costs to both themselves and dually-regulated firms. To help achieve this, firms should have a single process for standard interactions like notifications,



changes to permissions or SIF interviews. Maintaining the ONA online system for the submission of applications and notifications for central access by both authorities would assist in this.

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

We believe that given the twin-peaks model for banks and insurers it is appropriate for one of the two regulators to be pre-eminent in the event of conflict of statutory objectives. This provides a degree of certainty to firms.

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

Option 2 is our preferred model as, of the two models outlined, this is the most likely to reduce the risks of increased costs and inefficiencies.

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

See our answer to question 22 below.

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

See our answer to question 22 below.

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

The proposals concerning these three questions seem broadly sensible and we note that the authorities will set out detailed arrangements regarding co-ordination of specific regulatory processes.

Overall, we consider that the new authorities should be required to identify areas of activity that can be undertaken centrally to reduce costs and enable more efficient interaction with firms.

It is important that the approved person regime is run as efficiently as possible with the minimum of overlap. Candidates should only have to put forward one application and attend a joint interview. Similarly it should be clear to incumbents which regulator they are accountable to in their particular approved function.



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

We do not have views on the treatment of mutual organisations.

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

We agree that the PRA and FPC should only be able to make rules in pursuance of their objectives, and in doing so should have regard to the aims of the new ESAs in achieving harmonised rules and supervisory practices.

We disagree with the proposal that where a firm is a member of a group which includes a dual regulated firm that each authority must consult the other prior to issuing a waiver or modification. Aviva Investors is a member of the dual regulated Aviva group but is prudentially supervised by the FCA. In this case, it would be unnecessary for the PRA to approve a waiver or modification that had no prudential implications.

There should be no rewriting of the Handbook as a consequence of these changes other than to reflect the new regulatory structure. Where change is unavoidable sufficient transitional periods should be allowed to minimise the costs to firms and, as a consequence, consumers.

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?**

As a insurance group that includes an asset management business, we have a concern about how Aviva plc will be supervised. Aviva's life and general insurance businesses will be subject to dual regulation whilst Aviva Investors will be mainly subject to conduct and prudential supervision from the FCA alone. Were the PRA to lead on group supervision for Aviva plc, it is vital that it works closely with the FCA to understand asset management issues. It is therefore critical that the regulator that takes the lead on group supervision co-ordinates effectively with the other regulator when making assessments or decisions about the group. This co-ordination is also important as the lead UK regulator will impact our non-UK businesses through its actions on regulatory colleges and groups. Relevant expertise must be shared between the regulators and the group should have one point of contact.



Paragraph 5.72 proposes that the authorities will determine on a case by case basis which regulator leads on the supervision of a group. To minimise uncertainty, we recommend that the authorities decide which body should be the lead regulator for a group when asked to do so by that group.

These proposals appear to have been largely written on the basis that the group being supervised is based solely in the UK. Consideration should be given to how the proposals would work if the holding company was not domiciled in the UK.

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 are concerned that the proposed responsibility of the FCA is duplicative of the PRA and what an appointed Independent Expert considers and details in his report for the Courts on a Part VII. We do not consider that firms should be expected to liaise with both the PRA and the FCA on Part VII transfers. This would increase costs for the firm and create an unnecessary burden on the FCA. Instead we suggest that the lead regulatory authority (i.e. the PRA in relation to Part VII transfers) should consult with the FCA and collectively satisfy themselves that the proposals for that Part VII transfer is appropriate and submit one joint report to the Court, without adding further complexity to an already challenging and heavily regulated process.

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

In line with our overall position on regulatory processes, any arrangements need to reduce the risks of increased costs and inefficiencies.

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

We agree with the proposal for the FCA to collect fees on behalf of the FSCS, FOS, the Money Advice Service and, on a non-statutory basis, the PRA.

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

We favour the FSCS remaining a single scheme with the cross subsidy between different classes of levy payer being ended. This can be achieved through revision to the existing rules and is not a factor



that should necessarily be linked to the possibility of separate schemes reflecting the different roles of the PRA and FCA. If separate schemes were to be pursued, which we do not favour, this would still leave a potential cross subsidy issue in that insurers and banks would presumably be covered under whatever arrangements were put in place by the PRA.

The Government also needs to consider that the European Commission is currently consulting on changes to guarantee schemes relating to depositors, investors and insurance policy holders that may have a bearing on the functioning of the FSCS in the future. As such this may not be the appropriate juncture to discuss alternative operating models for the FSCS.

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

Further clarity on the FOS 'role and limits to its actions will be welcome. We believe that the FOS has an important role to play as an ombudsman and we appreciate that this role is delivered in challenging circumstances. However, its role is one of an ombudsman service and not policy setting. We are concerned that the FOS on occasion steps outside its remit of ombudsman into the sphere of regulatory policy, assuming, in effect, the role of a quasi-regulator.

This effect is compounded because the FOS make determinations based on an assessment of fairness that can be higher than the level expected by relevant law or regulation; and firms are unable to easily challenge decisions made by the FOS' Ombudsmen. Firms, trade associations and the FOS should be able to refer significant cases (often termed cases 'with wider implications') to the FCA or the Upper Tribunal. The FCA should then conduct a full consultation and cost-benefit analysis regarding the impact of the decision, and set out binding rules on how FOS should handle all similar cases.

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

We believe that the FSCS, FOS and the Money Advice Service (previously called CFEB) should be subject to independent scrutiny by Parliament; with both the Chair and CEO of these organisations attending sessions at the Treasury Select Committee. The discipline of attending regular sessions would sharpen focus amongst the Boards and Executive Management Teams in terms of their roles, delivery and the challenges that exist. It would also add further rigour to oversight of the organisations' governance and accountability. We welcome the proposal that the NAO should have audit powers over the FOS, FSCS and the Money Advice Service.



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

The new EU supervisory architecture, and its interactions with the UK regulatory framework, is very important for businesses like Aviva with operations across Europe. Throughout the transitional period and beyond both senior and working level UK officials must continue to focus on EU level discussions on insurance and asset management so that a strong and effective UK voice continues to be heard. We are pleased to note that key officials within the UK regulatory architecture are to represent the UK on the ESAs. This must be backed up and supported by consistent and ongoing working level engagement.

The new ESAs are preparing for greater harmonisation across Europe in terms of regulatory rules and methodologies. It is important that the UK has regard to these developments and opportunities to influence on matters appropriate to the UK market and for UK headquartered companies. It is therefore critical that the Bank of England and the new authorities are well equipped to engage with EU and international bodies and that this continues during the transition period and beyond.

Working to get the implementation of Solvency II right during the transition period is vital. The final Implementing Measures are still under discussion. Full and active engagement in such crucial EU negotiations is going to be critical for the UK insurance market, particularly in relation to the need for a sensible, workable, definition of capital that includes profits from future premiums and rules on liquidity affecting annuity business.

Under the new structure the PRA, not other parts of the Bank of England, must represent UK insurers' interests with EIOPA to ensure a credible approach to EU negotiations is maintained, provide the industry with clarity and enable constructive engagement in the process for developing future regulation applicable to the sector.

There needs to be strong UK representation on the IAIS and IOSCO so that the views of insurance groups and asset managers are represented on their respective bodies. It is also vital that the UK appropriately represents all elements of the financial services sector to the Financial Stability Board.

We welcome the proposals to ensure co-ordination in the EU and internationally and, in particular, a MoU between HM Treasury, the Bank of England, the PRA and FCA on overall international coordination with UK's system of financial regulation. We would urge the Government to consult with industry on the proposed MoU, particularly regarding how authorities would seek the views of financial sector participants. We consider that the process for discussing and agreeing the UK's strategic objectives should be transparent and involve consultation with industry.

HMT Consultation Paper: A new approach to financial regulation – building a stronger system – AXA UK Group Response

General Comments on the Regulatory proposals

- We are concerned with the speed with which the Government is making these regulatory changes. We think the Government should take the necessary time required to get this reform of financial regulation right rather than rushing the changes through. As we outlined in our response to the first consultation paper, the FSMA took three years for the legislation to be passed and a further 18 months for the secondary legislation and practical arrangements to be put into place. The draft Bill should only be presented after full consideration has been given to responses to initial consultation. The Joint Committee which will be given responsibility for scrutinising the draft Bill must be given appropriate time to consider the legislation and its practical impact on the Financial Services Industry.
- The financial services market is already implementing a number of significant regulatory changes which includes Solvency II, RDR and mortgage market changes. There are also a number of proposed changes to EU legislation including: AIFMD, IMD, PRIPs and MiFID. The impact of these changes must be considered in the overall timetable for domestic regulatory reform since all of these initiatives demand resource of the regulator and firms alike to implement and contribute to their development. We would also not want to be in the position of needing to amend regulation where rules have been made prior to the finalised EU legislation.
- We are still concerned with the initial cost of implementing the changes and ongoing supervisory costs due to the dual regulation of insurance entities. The consultation estimates the cost of the proposed changes to be between £50-60 million. We do not think this adequately reflects the cost to both firms and the new regulators to implement the changes. We agree with the Treasury Select's committee's recommendations (paragraph 37 – 41- conclusions and recommendations) in its report published 3 February concerning the cost of regulation. This must be revisited to ensure that the cost of the proposals does not outweigh the benefits.
- We welcome the Government's renewed 'emphasis on international engagement' and the fact that this will remain an ongoing priority. However we are concerned that insurance firms may not be appropriately represented on EIOPA due to the PRA's potential banking focus.
- While the proposals note that insurers are a lower risk than banks and deposit takers the current draft of the PRA's strategic objective is focused on contributing to financial stability, a macro prudential objective. However the PRA's strategic objective should also reflect the PRA's micro prudential responsibilities in 'promoting the long term soundness and stability' of those firms for which it will have prudential responsibility. This is particularly relevant to insurers which as outlined later in the reform paper are less likely to give rise to systemic risks.
- We note and welcome the acknowledgement of the need for an insurance expert within the FPC however also note that this is not currently reflected in the external appointments to interim committee
- We are concerned with the regulatory overlap between the PRA and CRA in respect of dual regulated firms. This could mean duplication in a number of areas including authorisation, fees and supervision and feel it is important that the co-ordination between the two authorities is efficient with no duplication or underlap.
- The proposals suggest an increase in the FCA's product intervention powers. We think this is not necessary until the current and proposed regulatory changes take effect. For example such developments as the FSA's enhanced supervisory approach, the Mortgage Market Review and the Retail Distribution Review.
- We do not feel that it is appropriate for the FCA/PRA to have powers to publish warning notices without firms being able to make representations. We feel that there is a risk of unnecessary and unwarranted reputational damage caused which cannot be repaired even if/when a notice is withdrawn.

The Bank of England and Financial Policy Committee

Question	Response to questions
<p>1. What are your views on the likely effectiveness and impact of these instruments as macro prudential tools?</p> <p>2 Are there any other potential macro-prudential tools which you believe the interim FPC and the Government should consider</p>	<p>1. We note in paragraph 2.37 the proposal to give the FPC power of direction over the PRA and FCA. However we are still concerned that the FPC may be too focused on banks and will not provide sufficient consideration to other financial sectors such as insurance and investment management. Any power of direction by the FPC must reflect the diversity of the financial services and also consider EU and other international initiatives so that the UK remains a competitive market.</p> <p>The FPC’s recommended actions must reflect the diverse nature of financial services and the risk of each sector to the stability of the financial system. Recommendations applicable to the banking sector would be over burdensome to other sectors</p> <p>(Please also refer to our response to question 3).</p> <p>2. We note that all of the proposed tools are being developed in a banking context and are applicable to banks. This is appropriate in view of the fact that the paper identifies that insurers do not normally represent a systemic market risk of the type represented by banks.</p> <p>Insurers have very different business models and engage in different activities from banks, Therefore the use on insurers of tools developed for banks would be inappropriate. Therefore the FPC will need to develop specific macro prudential tools appropriate to insurers when required.</p> <p>It is also essential that the FPC develops its domestic tools in line with any tools developed at an international level.</p>
<p>3. Do you have any general comments on the proposed role, governance and accountability mechanisms of the FPC?</p>	<p>3 .Due to the international nature of the financial services market we recommend that the Financial Stability Report provides views on the stability of both the domestic and international market. It should also reflect the diverse nature of the financial services market and not be led by banking related issues.</p> <p>We note the interim membership of the FPC. We are disappointed that the recently appointed independent members of the FPC do not adequately reflect the diverse nature of the financial services industry. As outlined in our general comments on the proposals, although the paper recognises the importance of insurance expertise within the FPC this does not appear to be fully reflected in the current make-up of the interim committee.</p> <p>The Government should consider the Treasury Select Committee’s recommendation in its report dated 7 February that one of the external members should have ‘recent experience of risk management at the highest</p>

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	level'. We are not convinced that the current external membership reflects this recommendation.
4. Do you have any comments on the proposals for the regulation of systemically important infrastructure?	<p>4. We note the Bank will be given the power to direct the PRA and the FCA to gather information which the Bank needs. However we consider that this should form part of a due consultation process to ensure that the cost of producing this data both by firms and the regulators does not outweigh the benefits.</p> <p>We have no further comments on the regulation of systemically important infrastructure</p>

Prudential Regulation Authority

Question	Response to questions
5. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the PRA	<p>5 (i) The current draft of the PRA's strategic objective is focused on contributing to financial stability, a macro prudential objective. However the PRA's strategic objective should also reflect the PRA's micro prudential responsibilities in 'promoting the long term soundness and stability' of those firms for which it will have prudential responsibility. This is particularly relevant to insurers which as outlined later in the reform paper are less likely to give rise to systemic risks.</p> <p>It is essential that the PRA's operational objectives also reflect the fact that insurers are less likely to give rise to a systemic risk. This could be achieved by adding after 'authorised persons' the following 'by recognising the different characteristics of those firms it regulates'.</p> <p>5 (ii) We have the following observations concerning the regulatory principles</p> <ul style="list-style-type: none"> • Principle 1 is concerned with the resources of each regulator. This is an important principle and the regulators should ensure that they minimise the impact of regulatory overlap in respect of dual regulated firms so that they are required to coordinate activities in respect of for example authorisation, notifications, fees and supervision. Please also refer to our responses to questions raised in respect of regulatory processes and coordination • We are very concerned about the following regulatory principle without the appropriate accountability measures in place. This could mean that information is published which is detrimental to a firm without the appropriate appeals process <ul style="list-style-type: none"> ○ The desirability in appropriate cases of each regulator making information relating to authorised persons or recognised investment exchanges available to the public, or requiring authorised persons to publish information, as a means of contributing to the advancement by each regulator of its strategic

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	<p>and operational objectives.</p> <p>The regulator can do incredible reputational damage to individuals and firms when it finds no case for them to answer. These proposals could effectively overturn the principle enshrined in English Law that an individual is innocent until proven guilty.</p> <p>We still think the PRA should be required to consider global competitiveness and innovation. It is essential that the PRA considers the impact of any decision on the competitiveness of UK firms in the wider global market. It is also essential that the PRA applies different prudential requirements on the firms it regulates and welcome the fact that this paper has recognised the different characteristics of insurance.</p>
<p>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?</p>	<p>6. We note that the PRA will set its own perimeters with regards to BIPRU 730K firms. We wonder why this approach has been taken since it is usually the Treasury that sets the regulatory perimeter and think this should be the approach that should be taken. This will ensure the appropriate legislative consultation process.</p>
<p>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)?</p>	<p>7. We question whether a judgement led approach will work since EU directives now follow a rules led approach. We also think this needs to reflect rules set at an international level.</p> <p>We are concerned that this judgement led approach appears not to include any adequate or robust appeal mechanisms and that there is a risk of ending up with an 'uneven' playing field in how comparable firms are supervised.</p>
<p>8. What are your views on the proposed governance framework for the PRA and its relationship with the Bank of England?</p>	<p>8. We note that the current proposals combine both aspects of prudential policy within the monetary policy institution. We still question why this approach has been taken because we are concerned that the PRA will have more of a banking focus.</p> <p>We note that the paper discusses the need for the PRA to recognise the difference between banks and insurance entities. However we are still concerned that the PRA will have a more banking focus as a subsidiary of the Bank of England. We also question why the ex officio Chairman of the PRA will be the Governor of the Bank of England. We think the chairman should be independent of the Bank of England. We note that the Board of the PRA will have a non executive majority. It is essential that the experience of the non executive directors reflects the firms regulated by the PRA. We note that appointments to the Board of the PRA will be</p>

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	<p>made by the Bank of England with approval by the Treasury as such we question how independent the PRA will be. We think the chairman and other members of the governing body should be appointed by the Treasury as currently required for the FSA, under Schedule 1 of FSMA 2000.</p> <p>We also question why the proposals suggest that there will be no requirement for the PRA to establish a non executive committee. We think that FSMA Schedule 1 sub-paragraph 3 (1) (b) and 4 – creation and functions of the non–executive committee should apply to the PRA. This will provide independent challenge outside of the Court of the Bank of England.</p> <p>Please also refer to our general comments at the start of the response on dual regulation.</p>
<p>9. What are your views on the accountability mechanisms proposed for the PRA?</p>	<p>9. We welcome the accountability measures the paper proposes and the retention of FSMA sections 12, and 14 to 18 with regards to independent inquiries.</p> <p>However we think that the arrangements as set out in Schedule 1 section 7 FSMA regarding the arrangements for the investigation of complaints should apply to the PRA. We think that the appointment of the investigator should be provided by the Treasury to help ensure independence.</p>
<p>10. What are your views on the Government’s proposed mechanisms for the PRA’s engagement with industry and the wider public?</p>	<p>10. We welcome the proposals to consult on rule changes and that there will be no significant reduction to the existing requirement to consult as set out in the FSMA.</p> <p>We also think it is appropriate to consider streamlining the implementation of EU rules only where there is a straight re-write of the EU provisions with no additional requirements placed on UK firms. However where this is not the case then a full consultation process should be followed.</p> <p>We welcome the proposal to maintain a Practitioner Panel</p>

Financial Conduct Authority

Question	Response to questions
<p>11. What are your views on the (i) strategic and operational objectives and (ii) the regulatory principles proposed for the FCA?</p>	<p>11 (i) We note that the FCA must discharge its ‘functions in a way which promotes competition’. However it is essential that the FCA considers the international character of financial services and the impact of any decision on the competitiveness of UK firms. The implementation of any EU rules must not be ‘gold plated’. This is to ensure that UK firms can easily compete in Europe without additional onerous requirements.</p> <p>11 (ii) The FCA should not only consider the appropriate degree of protection afforded to consumers but the appropriate type of protection. This will help ensure that the protection being considered is proportionate to the</p>

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	<p>benefit so that the industry can work effectively and provide product choice to the consumer.</p> <p>Please also note our comments regarding Principles as set out in response to question 5 (ii).</p> <p>We have no further comments to make on the responsibility of the FCA in relation to financial crime.</p>
<p>12. What are your views on the Government's proposed arrangements for governance and accountability of the FCA?</p>	<p>12. We welcome the proposed Governance and accountability arrangements for the FCA as outlined in the paper.</p>
<p>13. What are your views on the proposed new FCA product intervention power?</p>	<p>13. We note the more interventionist approach the FCA will take with regards to products. The FCA should not be given more product intervention powers before current and proposed regulatory changes to improve the financial services market take effect. These include for example the FSA's enhanced supervisory approach, the Mortgage Market Review, the Retail Distribution Review, changes to the Payment Protection Insurance market etc.</p> <p>The widespread problems that have arisen in recent years have not necessarily been attributable to the product itself but the sales process. Firms are always looking to develop products to provide enhanced benefits which will benefit consumers. This provides a healthy competitive market. Therefore the FCA should not just focus on products but also look at the sales process.</p> <p>We are not in favour of the regulator stipulating mandatory minimum standards for products. We think this should be reached through industry level agreement and codes of practice. Providing minimum product standards could also stifle innovation and the competitive market place. We note that the Treasury Select Committee in its report on the preliminary proposals (para 118) recognises that 'competition is a highly effective means of protecting consumers' interests'.</p> <p>The proposals state that the FCA will not be conducting a product pre-approval process. We feel that there is a risk that consumers will perceive the interventionist approach as a pre-approval mechanism which is misleading. We are not in favour of any pre-approval approach.</p>
<p>14. The Government would welcome specific comments on:</p> <ul style="list-style-type: none"> • the proposed approach to the FCA using transparency and disclosure as a regulatory tool; 	<p>14. We recognise the need for transparency and an open and honest relationship with the regulator. However we are concerned about the use of the term 'presumption of transparency' and disclosures by firms. Any request for information must consider the costs and associated benefits.</p> <p>We have no comments on the proposed new powers in relation to financial promotions.</p> <p>We are not in favour of the new power to publish warning notices. This seems to be contrary to natural justice</p>

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<ul style="list-style-type: none"> • the proposed new power in relation to financial promotions; and • the proposed new power in relation to warning notices. 	<p>and the principle that an individual is innocent until proven guilty. We are particularly concerned that publishing a warning notice could ruin the reputation of both firms and individuals who may later be found not to be at fault. We feel that if warning notices are to be given these must be directed at the relevant individual/firm only until after the outcome of the full investigation/hearing. The Government should review the number of warning notices issued by the FSA compared with the number of final notices in order to assess whether this new power for early publication of enforcement action is appropriate.</p> <p>If these proposals are implemented the appropriate safeguards should at the very least include an appeals process whereby the effected firm/individual can make representations before or immediately on publication of the notice. If an appeal can only be made on publication of the notice, then this fact should also be published. Where the regulator publishes a warning notice and then decides not to take any further action then it must issue a notification that the enforcement action has been withdrawn. This must be published in an easily accessible place on the regulator's website.</p>
<p>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?</p>	<p>15. It is difficult to provide comments on competition proposals outlined here until the wider proposals on competition are published. However we do not consider it appropriate for the regulator to be given the market investigation powers as proposed. It is more appropriate for other bodies to trigger a super-complaint rather than the regulator.</p>
<p>16. The Government would welcomes specific comments on:</p> <ul style="list-style-type: none"> • the proposals for RIEs and Part XVIII of FSMA; and <p>the proposals in relation to listing and primary market regulation.</p>	<p>16. We have no comments.</p>

Regulatory processes and coordination

Question	Response to questions
<p>17. What are your views on the mechanisms and processes proposed to support effective coordination between the PRA and the FCA?</p>	<p>17. We note that the proposals will require the regulators to coordinate their activities. However until more detail is provided we still think that the proposed approach could lead to considerable inefficiencies, additional costs and overlapping jurisdictions between the PRA and FCA. It is essential that the PRA and FCA do not duplicate each others' activities.</p> <p>We note that the primary legislation will specify the legal duty for the PRA and FCA to coordinate their activities. The detail on how the PRA and FCA will coordinate these activities will be set out in a Memorandum of Understanding. However it is essential, to minimise regulatory overlap, that the regulators are open and transparent when creating these mechanisms. It is essential for the regulators to consult stakeholders and we think the Treasury Select committee should be given the opportunity to scrutinise the mechanisms.</p> <p>We are concerned that the proposed dual registration may cause confusion to consumers and it is essential that the proposals for registration meet the registration requirements of Article 3 of the IMD.</p>
<p>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?</p>	<p>18. We agree that the PRA should be able to prevent the FCA from taking action which will lead to the disorderly failure of a firm. However we think the PRA should be able to take swift action to implement its veto to prevent any potential damage to a firm's reputation which could lead to a disorderly failure. We would not want to see these powers extended any further than proposed.</p>
<p>19. What are your views on the proposed models for the authorisation process – which do you prefer, and why?</p> <p>20. What are your views on the proposals on variation and removal of permissions?</p>	<p>19. As set out in our response to the earlier proposals we still think it may be more appropriate to have one centralised body which provides shared services for the PRA and FCA for the following activities:</p> <ul style="list-style-type: none"> ▪ Authorisation of firms and individuals, including variations of permissions ▪ Collection of all fees and levies. ▪ Inward and outward passporting ▪ Notifiable events ▪ Changes in control ▪ Close links reporting ▪ Changes to standing data. ▪ Appointed Representatives

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	<ul style="list-style-type: none"> ▪ A relationship manager to coordinate supervisory activities for dual regulated firms. <p>We feel that this will help ensure coordination of activities. This centralised body will have the appropriate expertise to provide both prudential and conduct approval and allows expertise to be built up in a centre of excellence which should create greater efficiency. However where there is a more complex firm requiring authorisation this centralised body should seek the appropriate expertise from within each regulator.</p> <p>Where firms are dual regulated the most important issues is that the authorisation process should be as straightforward as possible. We think the shared service process set out above will achieve this.</p> <p>20. We have no comments on these proposals.</p>
<p>21. What are your views on the Government's proposals for the approved persons regime under the new regulatory architecture?</p>	<p>21. Please refer to our earlier response to question 19 regarding a centralised function regarding the shared services approach.</p> <p>We agree that for dual-regulated firms both the PRA and FCA will have an interest in approving individuals to perform controlled functions. However it should be a joint responsibility for both the PRA and FCA to approve all controlled functions together with the development of rules. Candidates of dual regulated firms should only be required to submit one application and attend one interview.</p>
<p>22. What are your views on the Government's proposals on passporting?</p>	<p>22. Please refer to our earlier response to question 19 regarding a centralised function. This will provide an easy point of reference for European firms wishing to passport into and out of the UK.</p>
<p>23. What are your views on the Government's proposals on the treatment of mutual organisations in the new regulatory architecture?</p>	<p>23. Regulation should not operate in a way which imposes additional cost on a particular type of firm or disadvantages firms with a particular structure. We should see a level playing field for proprietary and mutual companies.</p>
<p>24. What are your views on the process and powers proposed for making and waiving rules?</p>	<p>24. The rule making powers for both the PRA and FCA should follow the procedural provisions as set out in section 152 – 156 of FSMA which broadly says that the authorities must give notice to the Treasury of any new or changes to rules. The authorities must publish under what provision the rules are made and proposed changes must be consulted on.</p> <p>We agree the regulators should also be required to consult one another prior to publishing any proposed changes to rules where there is a potential for overlap. This will ensure a consistent and coordinated approach.</p> <p>We are concerned that the power of the FPC to intervene in rule making will undermine the autonomy of the regulators.</p>

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	The modification or waiver of rules should follow the process as set out in section 148 of FSMA. Again it may be appropriate to have one centralised body which will coordinate this activity as outlined in our response to question 19.
<p>25. The Government would welcome specific comments on</p> <ul style="list-style-type: none"> • 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? 	<p>25. We would not want to see any additional requirements placed on UK firms which go beyond EU directives in respect of Group Supervision.</p> <p>We think the regulations regarding controllers should not go beyond the requirements as already set out in sections 178 to 188 of FSMA which outlines the need for authorised firms to notify the FSA about any changes in control of an authorised firm and the right of the FSA to approve, approve with conditions or object to a change of control.</p>
<p>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?</p>	<p>26. As outlined in our response to question 25, the regulations regarding controllers should not go beyond the requirements as already set out in sections 178 to 188 of FSMA.</p> <p>The involvement of two regulators where Part VII transfers are being implemented is likely to increase costs and the time required to complete the process. This will act to prevent the simplification of the structures of regulated UK firms. The PRA should be the lead regulator for Part VII transfers since this will impact dual regulated firms only and consult with the FCA on any proposals rather than giving both regulators the right to apply to the court for an independent actuary’s report. This should help to reduce costs and delays</p>
<p>27. What are your views on the Government’s proposals for the new regulatory authorities’ powers and roles in insolvency proceedings?</p>	<p>27. Any delay in implementing insolvency due to the need to get consent from both regulators could lead to customers being disadvantaged (due to less assets being available to meet their liabilities) and increase the risk of disorderly failure.</p> <p>Therefore the PRA should be the regulator responsible for insolvency proceedings for dual regulated firms and be required to consult the FCA as applicable. The FCA should be the regulator responsible for these proceedings for those firms for which it is prudentially responsible.</p>
<p>28. What are your views on the Government’s proposals for the new authorities’ powers in respect of fees and levies?</p>	<p>28. We are concerned with the lack of explanation on how the authorities will apportion and charge fees. We would expect the fees charged by the PRA to those firms it regulates to reflect the extent to which it allocates time for their supervision. We therefore expect a greater proportion of the PRA’s costs to be apportioned to banks and deposit takers since these firms will be more closely supervised than other firms supervised by the</p>

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	<p>PRA.</p> <p>We would also question where the accountability and oversight will sit for the allocation of fees for dual regulated firms. We see the need for a clear coordination mechanism to be put in place between the authorities, to ensure that safeguards are put in place to ensure that dual regulated firms are levied fairly and proportionally.</p> <p>We would expect the consultation process and fee collection for both regulators to take place at the same time. This would allow firms to be able to budget effectively. We have no comments on the method of collecting regulatory fees. However we are concerned that since many matters will require investigation by both regulators overall costs are likely to increase. Costs may be passed on to customers which may result in increased premiums.</p> <p>We are very concerned at the cost of implementing the new regulatory regime. We agree with the Treasury Select committee's recommendations (paragraph 144 – cost of regulation) in its report on the preliminary proposals, that regular updates should be provided by the Treasury on transition costs being incurred.</p> <p>We also agree with the Treasury Select committee recommendations in its report (paragraph 141) that new regulatory requirements should only be introduced if a full cost benefit analysis has been conducted and this analysis must be improved by the new regulators.</p> <p>We would like to know how the implementation costs of the new regulatory regime will be allocated to the industry. We expect this process to be open and transparent and think the most appropriate method would be through the use of a special project fee. Any additional fee costs charged to the industry should follow the current fee consultation process currently in place for the FSA.</p> <p>We are concerned that dual regulated firms will be charged higher implementation fees for the cost of setting up both regulators.</p>
<p>29. What are your views on the proposed operating model, coordination arrangements and governance for the FSCS?</p>	<p>29. We support the proposal that the FSCS should remain a single scheme.</p> <p>We note that the PRA and FCA will both have rule-making powers. It is essential that they consult one another prior to publishing any proposed rule particularly those for investment firms where they will have dual responsibility.</p> <p>Some of our comments on the earlier proposals are still relevant and for ease we have repeated those relevant to these proposals below.</p> <p>We would add that as the FSA, together with the industry, has been carrying out a review of the FSCS we feel that the Government and the new regulators should consider the work already completed by this review when</p>

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	<p>considering the operating model and any rule changes for the FSCS.</p> <p>We believe that the areas that should be reviewed are as follows:</p> <ul style="list-style-type: none"> ▪ Cross subsidy arrangements should be removed. ▪ Recognition that each class of regulated firm is different and should be viewed separately from the deposit class. ▪ Pre-funding proposals should be viewed in the light of other regulatory reforms such as Solvency II. <p>The Government should also consider any European proposals specifically those outlined in the EU White Paper on Insurance Guarantee Schemes. We are in favour of a minimum harmonisation of this directive across Europe. The Government should also ensure a regulatory body responds to these proposals taking into consideration the need to retain the competitiveness of the UK financial services market.</p>
<p>30. What are your views on the proposals relating to the FOS, particularly in relation to transparency?</p>	<p>30. We welcome the strengthening of communication between the ombudsman and FCA and the statutory MoU.</p> <p>We welcome transparency of the ombudsman’s determinations. However it is difficult to provide any further comments on this process until the ombudsman publishes its proposals on the principles it will apply to this process.</p> <p>The FSA, the ombudsman and the OFT have recently published a policy statement, ‘Consumer complaints (emerging risks and mass claims) which confirms the creation of a coordination committee (the Coordination Committee) to contribute to the identification of emerging risks that have a potential to cause widespread detriment. The Coordination Committee will be able to consider how emerging risks with the potential to cause widespread detriment should be dealt with i.e. through firm’s complaints handling and the ombudsman or through regulatory intervention by the OFT or FSA. The Government should ensure that the high level legislative framework outlines the accountability measures that should be put in place for this Coordination Committee. It is essential that there is a clear line between the ombudsman’s responsibilities on alternative dispute resolution and the regulator’s responsibilities on policy setting.</p>
<p>31. What are your views on the proposed arrangements for strengthened accountability for the FSCS, FOS and CFEB?</p>	<p>We welcome the accountability measures proposed.</p>

European and international issue

Question	Response to questions
32. What are your views on the proposed arrangements for international coordination outlined above?	<p>We note the proposals regarding international coordination and the MoU between the new regulators. However we are still concerned that as the UK focuses on establishing its new domestic regulatory approach, there is the risk that any EU and global regulatory changes will be overlooked. It is essential for the Regulators to involve stakeholders and industry bodies in responding to EU developments. This is particularly important in view of the European Supervisory Authorities' powers to interpret directives and provide level 3 guidance and technical standards.</p> <p>We still think there is a need for a central international division to represent the UK on the new EU supervisory committees and other international fora. This international division could also ensure that the existing memorandum of understanding currently between the FSA and other international regulatory bodies continues with the appropriate new regulator.</p>