ICE

Atlanta Calgary Chicago Houston London New York Singapore

Financial Regulation Strategy
HM Treasury
1 Horse Guards Road
London
SW1 2HQ

financial.reform@hmtreasury.gsi.gov.uk

8 September 2011

Dear Sirs

HM Treasury Consultation (Cm 8083): A new approach to financial regulation: the blueprint for reform and Financial Services Bill

ICE is a provider of global market and clearing services; and has invested significantly in the UK. We welcome the opportunity to respond to HM Treasury's further consultation on proposed reform of financial regulation and draft Financial Services Bill (the 'Bill') (together, the "Consultation") and again wish to stress the importance of clarity, continuity and stability in UK regulation.

ICE Futures EU (the 'Exchange'), a UK Recognised Investment Exchange ('RIE'), and ICE Clear EU (the 'Clearing House'), a UK Recognised Clearing House ('RCH'); have set out a joint response below, which builds on our response to the previous consultations (Cm 7874) of 18 October 2010 and (CM8012) of 14 April 2011.[1]

General Comments on Consultation Process

The policies being proposed in the areas which may directly or indirectly impact Recognised Bodies are, in the main, now reserved for secondary legislation.[2] We question the desire to restructure the Recognised Body legislation which has worked well historically, and would repeat our concern that no details, evidence or rationale for any proposed amendments have been forthcoming.

Comments on Proposed Reform of the Recognised Body Exempt Regime[3]

We strongly support the Government's proposal to retain Part 18 of the Financial Services and Markets Act 2000 ("FSMA") - the Recognised Body exempt regime. However, we question whether the Government's commitment has been met and remain concerned that the effect of the outline proposals may be fundamental and/or detrimental. The Government has not yet set out the market failures it is responding to in seeking to amend the Recognised Body regime; nor are we aware of any.

The Government suggests that the changes being proposed will ensure powers available under the Part 18 Regime can be used more efficiently and that the FCA and Bank can thereby act more responsively to the more complex and challenging environment which both Recognised Bodies and the Regulators now face. The powers being proposed are, however, of a disciplinary or information gathering nature only; and therefore do not appear to us to support this statement. No market failures of either the current regime or Recognised Bodies have been identified which would justify disciplinary action. Such action may unintentionally diminish the regulatory functions of Recognised Bodies by risking their reputation and standing when acting as frontline regulators in line with their regulatory

[1] The content of which should be read as being repeated and incorporated herein.
[2] See in particular new Section 286(4F) of FSMA.
[3] Box A, questions 2 and 11.

ICE Futures Europe
Milton Gate
60 Chiswell Street
London EC1Y 4SA, UK
phone +44 (0)20 7065 7700
fax +44 (0)20 7638 4964
online www.theice.com

ice

obligations. Further, in our view information gathering is already amply provided for (as set out below).

More specifically:

- The current Recognised Body regime supports the role of Recognised Bodies as frontline regulators, with responsibility for monitoring and enforcing compliance with their Rules; and, in cooperation with the Financial Services Authority (the "FSA") and other regulators, adopting appropriate measures to reduce the extent to which Recognised Bodies' facilities can be used for a purpose connected with market abuse or financial crime, and to facilitate their detection and monitor their incidence. This distinguishes Recognised Bodies from the users of their facilities (e.g. banks and investment firms), and is in line with overseas jurisdictions and international standards.
- The Recognised Body regime proved effective during the financial crisis. An unintended effect of the proposed amendments will be the introduction of potential delay and/or risk into the system through threat of disciplinary action and/or information requests.
- Recognised bodies are currently subject to extensive notification requirements set out in FSMA,[4] the Companies Act 1989[5] and Chapter 3 of the FSA's REC Source Book (the "Notification Rules"). The Notification Rules were made by the FSA under section 293 of FSMA, which gives the FSA broad information gathering powers, including the power to make rules requiring a Recognised Body to provide:

  > *"...at such times or in respect of such periods as may be specified, such information relating to the body as may be specified"*

  Such Rules extend to a notice or information which is reasonably required for the exercise of the FSA's functions under FSMA. In addition, the Schedule to the Recognition Requirements Regulations[6] requires Recognised Bodies to be able and willing to cooperate by the sharing of information or otherwise with the FSA, with any other authority, body or person having responsibility in the UK for the supervision or regulation of any regulated activity or other financial service or with an overseas regulator. Given the breadth of the current information gathering powers, the need for them to be extended is not apparent, and arguments in support should be made.

Comments on Legislative Text

We attach (as an appendix to this letter) a detailed review of the proposed legislative text together with some drafting suggestions.

General Comments

We agree with, and reiterate, the Government statements made in the previous consultation Paper (CM8012), namely:

- A key priority of regulatory reform is "reducing the burden of regulation and improving the quality of regulation";[7] and
- Regard should be paid to the "potentially negative effects of excessive regulation on market efficiency and consumer choice".[8]

---

[4] Sections 293(5), 293(6), 293(7) and 300B(1),
[5] Section 157.
[6] Paragraphs 6 and 20.
[7] Paragraphs 3.66-7.
[8] Paragraph 4.9

These themes of regulatory proportionality need to be embedded in the legislation and applied to the current amendments to the Recognised Body regime.

We strongly support the Government's commitment to accountability and transparency of the new regulatory institutions including, but not limited to appropriate mechanisms, such as consultation, being in place for engagement with industry. Proportionality and timeliness of regulatory action will also be crucial to the success of the new regime.

To conclude, we support legislative change which demonstrably contributes to, and does not risk impairing, market efficiency, stability and confidence in the UK financial system. The Consultation has yet to provide evidence that amendments to the Recognised Body regime are necessary and will deliver any of these outcomes. There remains a real risk of unintended adverse consequences (including detrimental impact on the integrity and reputation of Recognised Bodies as efficient, neutral and trusted bodies) and less flexibility for regulatory oversight and compliance.

Should you like to discuss any of the issues raised in this response, please let us know.

Yours faithfully

David Peniket
President & Chief Operating Officer
ICE Futures Europe

Paul Swann
President & Chief Operating Officer
ICE Clear Europe

Section of FSMA and Suggested Amendment	Comments
Page[9] 15 New Section: 1C Old Section: N/A **The consumer protection objective** (7) If a person is providing a service within subsection (4) or (5) as trustee **or fiduciary, and such services are regulated activities**, the persons who are, have been or may be beneficiaries of the trust are to be treated as persons who use, have used or may use the service **(where services are provided to such persons by the trustee or fiduciary)**.	This provision could affect a Recognised Body in its capacity as a user of financial services. First, it is not clear why non-trustee fiduciaries are not covered. Many custodians seek to exclude trustee liabilities. Secondly, a firm could be established as a trust without the trustee providing services to the beneficiaries. The beneficiaries could be economic owners of a business which deals with third parties (which third parties are the customers). Finally, it is not clear how this wording would affect pension trustees, who may provide services as a trustee to beneficiaries but not carry on regulated activities. Pension funds often use exchanges and clearing houses as a customer of a member of the exchange or clearing house and many of them are not regulated.
Page 76 New Section: 1E Old Section: N/A **The efficiency and choice objective** The efficiency and choice objective is: promoting efficiency and choice in the market for— (a) the services within section 1C(4)~~, or~~ ~~(b) **services provided by a recognised investment exchange in carrying on regulated activities in respect of which it is by virtue of section 285(2) exempt from the general prohibition.**~~	We would recommend the deletion of paragraph (b) which would extend the efficiency and choice objective to recognised investment exchanges. In the context of exchanges, the primary regulatory objective should be to encourage the development of liquid, transparent and clean markets. Choice in connection with exchanges raises complex issues that ought to be addressed as a separate reform measure and subject to thorough consultation processes with the industry. We do not think that it can properly be addressed in the current reform of the UK regulatory architecture. The general competition objective in the draft section 1B(4), and the provisions of MiFID (as implemented in the FSMA (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001, Schedule, paragraph 7B-7D are sufficient to deal with issues of choice and access in connection with recognised investment exchanges.

[9] Please refer to the page numbers at the bottom of Consultation 8083.

Page 78 New Section: 1I Old Section: 9 **The Practitioner Panel** (4) The FCA must appoint to the Practitioner Panel such— (a) persons representing authorised persons, ~~**and**~~ (b) persons representing recognised investment exchanges, <u>and</u> **<u>(c) persons representing recognised clearing houses,</u>** as it considers appropriate.	We would suggest including representatives of recognised clearing houses in the Practitioner Panel. Recognised clearing houses have an interest in having their views heard by the FCA, given that the actions of the FCA may have a significant impact on clearing houses and financial markets generally and the fact that the FCA will have a seat on ESMA, a regulator with proposed powers over clearing houses.
Page 77 New Section: 1K Old Section: N/A **The Markets Practitioner Panel** (5) The persons within this subsection are— (a) authorised persons, (b) persons who issue financial instruments, (c) sponsors as defined in section 88(2), (d) recognised investment exchanges, ~~**and**~~ (e) primary information providers, as defined in section 89P(2), **<u>and</u>** **<u>(f) recognised clearing houses</u>**.	We would suggest enshrining in statute due representation of recognised clearing houses on the Markets Practitioner Panel. Recognised clearing houses will have an interest in the FCA's regulation of markets and the way this impacts on clearing businesses. Moreover, the FCA's seat on ESMA, a regulator with proposed powers over clearing houses, means this is appropriate.
Page 81 New Section: 2I Old Section:	This definitional issue is relevant to recognised clearing houses, whose default rules will need to interact properly with actions taken by UK

N/A **Interpretation of Chapter 2** (3) In subsection (2)(a) "insolvency" includes— (a) bankruptcy, (b) liquidation **or winding-up**, (c) bank insolvency, (d) administration, (e) bank administration, (f) receivership, (g) a composition between P and P's creditors, ~~and~~ (h) a scheme of arrangement of P's affairs, **(i) administrative receivership,** **(i) any application or order being made for any of the foregoing, and** **(j) processes under the laws of any jurisdiction outside the United Kingdom similar to the ones stated above.**	regulators on insolvency events. The list of events which constitute insolvency should include administrative receivership and processes under foreign law similar to the ones set out in subsection (3). Authorised persons may include non-UK firms passporting into the UK or non-EU firms with a UK branch. More of the Scottish insolvency definitions could also helpfully be added (*cf.* Part VII of the Companies Act 1989).
Page 84 **New Section: 3B** **Old Section: N/A** **Regulatory principles to be applied by both regulators**	We would recommend this addition to ensure that regulated entities are not at a material timing or procedural disadvantage compared to the current *status quo* by virtue of being regulated by two separate regulatory bodies. It is important for regulators to co-ordinate but it is also important

(1) In relation to the regulators, the regulatory principles referred to in section 1B(5)(a) and 2G are as follows— ... (f) the principle that the regulators should exercise their functions as transparently as possible **and within a reasonable period of time**. **Page 85 New Section: 3D Old Section: N/A** **Duty of FCA and PRA to ensure co-ordinated exercise of functions** (1) The regulators must co-ordinate**, promptly,** the exercise of their respective qualifying functions with a view to ensuring—... (2) The duty in subsection (1) applies only to the extent that compliance with the duty— (a) is compatible with the advancing by each regulator of its objectives, ~~and~~ (b) does not impose a burden on the regulators that is disproportionate to the benefits of compliance**, and** **(c) to the extent that the other regulator co-ordinates and responds to any request within a reasonable period of time.**	for regulated firms' timing expectations to be met. The efficiency of regulators' actions will ultimately influence the attractiveness of the City as a place to do business.
Page 104 New Section: N/A Old Section: 285(2) **Exemption for recognised investment exchanges and clearing houses** **(a)** Which is carried on as a part of the exchange's business as	The genesis of this amendment is not clear to us; we believe the policy intention is for the RIE exemption to include the offer of clearing services, with such services supervised by the Bank of England. In seeking to make this change of regulator it appears to us that the drafting in respect of the RIE exemption has become unclear and should be amended. We note from paragraph 2.33 of the consultation document that *"Institutions which*

<table>
<tr>
<td>an investment exchange; <u>or</u>

(b) <u>Which is carried on for the purposes of, or in connection with, the provision of clearing services by the exchange.</u></td>
<td>provide both exchange services and central counterparty clearing services will be regulated by the Bank with respect to their activities as RCHs, and separately regulated as RIEs by the FCA", which supports our interpretation.</td>
</tr>
<tr>
<td>Page 122 New Section: N/A Old Section: 348(5)(d)

Section 18(3) of the Draft Financial Services Bill

In section 348(5)(d) of FSMA 2000 (restrictions on disclosure of confidential information), after "report under section" insert "<u>1N, 2L,</u> 97A or".

Page 273 New Section: N/A Old Section: 348

Schedule 11 Paragraph 17 of the Draft Financial Services Bill

(3) In subsection (5) –

(a) for paragraph (a) substitute –

"(a) the FCA;

(aa) the PRA;".

(b) omit paragraph (b), <s>and</s>

(c) in paragraph (d), for "139E" substitute "166A"<s>.</s> <u>and</u>

<u>(d) add a new paragraph "(g) the Bank".</u>

(4) In subsection (6) –

(a) in paragraph (a), for "the competent authority" substitute "the FCA",</td>
<td>Persons conducting reviews of this nature should be subject to the same confidentiality obligations as the FCA, PRA and appointed skilled persons.

Section 352 (which creates an offence of disclosing information in contravention of section 348 (which currently restricts the disclosure of confidential information by the FSA)) should apply to the Bank of England as a regulator of recognised clearing houses. There is no reason as to why recognised clearing houses should be placed in a more disadvantaged position in relation to the confidentiality of materials as a result of them having a different regulator. It is important that recognised bodies, who have a regulatory function under FSMA, and the Bank are able confidently to exchange confidential information in an open manner, in the knowledge that existing protections would continue. Further, there has been no clear policy change proposed in relation to this matter which has contemplated the Bank being excluded from the application of section 352.</td>
</tr>
</table>

(b) in paragraph (b), for "Authority" substitute "FCA, the PRA **or the Bank**" and (c) for paragraph (c) substitute – "(c) any body or person appointed under paragraph 9 of Schedule 1ZA to perform a function on behalf of the FCA; (d) any body or person appointed under paragraph 17 of Schedule 1ZB to perform a function on behalf of the PRA; **(e) any body or person appointed under paragraph 17 of Schedule 1ZB (as applied to the Bank) to perform a function on behalf of the Bank**" **Page 241 New Section: N/A Old Section: 348, 349, 350, 353** **Schedule 17A Paragraph 18** Sections 348 to 350, **352** and 353 (disclosure of information) apply in relation to information received by the Bank for the purposes of, or in the discharge of, any of its functions relating to recognised clearing houses.	
Page N/A New Section: 139C Old Section: N/A **139C Power of the Bank to give guidance** **(1) The Bank may give guidance consisting of such information and advice as it considers appropriate:** **(a) with respect to the operation of specified parts of this Act,** **(b) with respect to the operation of any rules made**	We would recommend adding these provisions to provide the Bank of England with the powers to give guidance which are equivalent to the powers of the FCA. The provision is based on the draft section 139A and 139B. Recognised clearing houses and recognised investment exchanges will have a similar need for guidance on regulatory rules and these needs ought to be addressed by the Bank of England having equivalent powers to issue guidance.

by the Bank, (c) with respect to the operation of any relevant requirements, (d) with respect to the Bank's functions relating to recognised clearing houses, (e) with respect to any other matters about which it appears to the Bank to be desirable to give information or advice. (2) The following provisions of Part 9A of this Act are to apply in relation to guidance given by the Bank under this section: (a) section 138K (consultation), but with the omission of subsections (1)(a), (2)(c) and (5)(b), and (b) section 138M (consultation: general exemptions), but with the omission of subsections (1), 2(b) and (3). (3) The Bank may: (a) publish its guidance, (b) offer copies of its published guidance for sale at a reasonable price, and (c) if it gives guidance in response to a request made by any person, make a reasonable charge for that guidance. (4) "Relevant requirement" has the same meaning as in subsection (3) of section 312E. (5) Guidance given under this section may be general, addressed to persons generally, or addressed to a	

particular person or class of persons. **139D Notification of Bank guidance to the Treasury** **(1) On giving any general guidance under section 139C, the Bank must give written notice to the Treasury without delay.** **(2) If the Bank alters any of its guidance given under section 139C, it must give written notice to the Treasury without delay.** **(3) The notice under subsection (2) must include details of the alteration.** **(4) If the Bank revokes any of its general guidance given under section 139C, it must give written notice to the Treasury without delay.**	
Page 162 New Section: N/A Old Section: 298 **27 Recognised bodies: procedure for giving directions under s.296 etc** ~~(4) For subsection (4) substitute—~~ ~~"(4) The period for making representations is such period as is specified in the notice (which may, in any particular case, be extended by the appropriate regulator)."~~	This provision should set out a minimum period for making representations. In the current FSMA, this limit is at least 2 months. In particular, for revocation decisions, a period of less than 2 months is unlikely to afford the institution concerned sufficient time to prepare a response. Given the very serious consequences that a revocation order could have for a recognised body, it would be inappropriate to allow the Bank to set any (short) period of its choosing for making representations. Some legislative requirement as to timing should be required. There is no obvious market failure that the two month standard has failed to address which would warrant its deletion.
Page 162 New Section: 312E Old Section: N/A **Public censure** (3) Where the Bank of England is the appropriate regulator, a requirement is a "relevant requirement" for the purposes of	The definition of "relevant requirement" should make it clear that the term does not encompass regulatory guidance. In particular, guidance on the applicability of the FSMA (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001, currently in REC 2, is interpretative and therefore high level, and non-binding. Recognised bodies should not be placed at a risk of non-compliance as a result of a

this Chapter if it is— (a) a requirement that is imposed by or under any provision of this Part that relates to a recognised clearing house; (b) a requirement that is imposed under any other provision of this Act by the Bank; (c) a requirement that is imposed by any directly applicable EU regulation specified (or of a description specified) in an order made by the Treasury; or (d) a requirement that is imposed by this Act and whose contravention constitutes an offence that the Bank has power to prosecute under this Act (see section 401, as applied by paragraph 24 of Schedule 17A). **<u>(4) For the purposes of this section, "relevant requirement" does not include any provision in the nature of guidance, although guidance may be taken into account in assessing compliance with a relevant requirement.</u>**	failure to comply with a particular interpretation of non-binding regulatory guidance.
Page 164 New Section: 312J Old Section: N/A **Statement of policy** (2) An appropriate regulator's policy in determining what the amount of a penalty should be must include having regard to— (a) the seriousness of the contravention in question in relation to the nature of the requirement concerned; ~~and~~ (b) the extent to which that contravention was deliberate or reckless,	Given the systemic role played by recognised clearing houses in the financial markets (guaranteeing transactions, taking insolvency risk on the market as a whole and processing large volumes of payments and deliveries) any penalties imposed on clearing houses should not result in a liquidity stress or otherwise cause disruptions to its operations or working capital, nor should fines exacerbate systemic risks.

(c) the likely impact of any penalty on the ability of the recognised body concerned to carry on its business in an orderly manner and on systemic risk, and (d) the likely impact of any penalty on the customers or users of the facilities operated by the recognised body concerned.	
Page 165 **New Section: N/A** **Old Section: N/A** **Section 29 of the Draft Financial Services Bill** ~~**In Part 18 of FSMA 2000 (recognised investment exchanges and clearing houses)—**~~ ~~**(a) omit Chapter 2 (competition scrutiny), and**~~ ~~**(b) omit Chapter 3 (exclusion from the Competition Act 1998).**~~	The exemption from competition law for the regulatory provisions of recognised bodies enshrined in Part 18 of FSMA is appropriate for a self-regulatory body with statutory powers, such as a recognised investment exchanges and recognised clearing houses. The OFT (or its successor) is best placed, given its expertise in competition matters, and should continue to consider access requirements for users of Recognised Bodies.
Page 174 **New Section: N/A** **Old Section: N/A** **Section 44 of the Draft Financial Services Bill** **Memorandum of understanding: international organisations** (5) The memorandum must, in particular, make provision— (a) stating, in relation to each of the UK authorities, those international organisations of which it is a member or in relation to which it has responsibility for representing the United Kingdom; (b) about the procedures to be followed by the UK authorities in agreeing consistent objectives in relation to matters that materially affect 2 or more of them **or where matters materially affect one of them but where another of them has the relevant seat or**	Note that the FCA will represent clearing houses (who are regulated by the Bank) at ESMA but has no role in relation to regulating such bodies under the proposed UK regulatory regime. The scenario where two regulators have competence would not therefore apply, but it needs to be catered for.

<u>**position with the international organisation**</u>; (c) about how the UK authorities will consult each other about the discharge of their functions relating to international organisations.	
Page 237 New Section: Schedule 17A Paragraph 1(1) Old Section: N/A The appropriate regulators must prepare and maintain a memorandum describing how they intend to work together in exercising their functions in relation to persons who are recognised bodies <u>**(and any members of the same group as a recognised body which are FCA authorised persons)**</u>.	Group structures can include Recognised Bodies and authorised firms, some of which are likely to be FCA-regulated, the regulators should be required to co-ordinate with one another in relation to such authorised firms, as well as recognised bodies. This would be consistent with sub-paragraph 2 of this same section, which requires coordination with the PRA in relation to PRA-authorised firms. FCA-authorised firms should not be excluded from any coordination efforts.
Page 237 New Section: Schedule 17A Paragraph 1(2) Old Section: N/A The memorandum must in particular make provision about— (a) the need for each party when exercising a function in relation to any person ("A") who is a recognised body, or any member of A's group, to have regard to the exercise (or possible exercise) of any function by the other party in relation to A or any member of A's group; (b) the role of each party in cases where they are both exercising functions in relation to the same persons; (c) the obtaining and disclosure of information; (d) the co-ordination by the parties of the exercise of their powers to appoint competent persons under Part 11 (information gathering and investigations) to conduct investigations on their behalf, <u>**(e) facilitating participation by the Bank of England in any proceedings of the European Securities and Markets**</u>	The memorandum between regulators should address the issue of representation before the European Supervisory Authorities. The Government intends the FCA to represent the UK before ESMA, even though under the proposed European Market Infrastructure Regulation, ESMA will be the regulator of central counterparties and therefore recognised clearing houses. Recognised clearing houses will be regulated by the Bank, so will have no statutory locus to raise issues with the FCA that should be discussed at ESMA. The FCA must be empowered to properly represent the interests of the infrastructure sector in Europe. Where proceedings are more wide-ranging, the FCA should be required to take into account and prioritise issues based on their importance to the market as a whole, rather than based on its own corporate priorities. The memorandum between FCA and the Bank should ensure that the Bank is able to participate in the proceedings of ESMA that concern central counterparties. Requirements as to proper prioritisation should also be included.

Authority relating to matters of interest to the Bank. **(f) the proper prioritisation of matters to be addressed with European Supervisory Authorities, based on the relevance and importance of the issues to the UK financial sector as a whole, without regard to the competencies or priorities of particular regulatory authorities.**	
Page 238 New Section: Schedule 17A Paragraph 9 **Old Section: N/A** *Regulatory Principles and General Duty to Consult* **9A In discharging its general functions as a regulator the Bank of England must have regard to the regulatory principles in section 3B.** **9B** **(1) The Bank of England must make and maintain effective arrangements for consulting persons regulated by it or, where appropriate, persons appearing to the Bank to represent the interests of such persons, on the extent to which its general policies and practices are consistent with its general duties as regulator.** **(2) Those arrangements may include the establishment of such panels as the Bank thinks fit.** **(3) The Bank must publish details of any arrangements made under this section.** **9C** **(1) The Bank must consider representations that are made to it in accordance with arrangements made under paragraph 9B.**	We would recommend the addition of this clause in Schedule 17A to ensure the Bank of England takes general regulatory principles into account when acting as regulator of recognised clearing houses, consults with the appropriate persons in the relevant industries and considers any representations made by such persons. It is based upon the equivalent wording which applies to the PRA in the draft sections 2G, 2J and 2K.

(2) The Bank must from time to time publish in such manner as it thinks fit responses to the representations.	
Page 239 **New Section: Schedule 17A Paragraph 10(2) Old Section: N/A** Any reference in any of those provisions to an authorised person is to be read as **including** a reference to a recognised clearing house.	Drafting suggestion / typographical error.
Page 240 **New Section: Schedule 17A Paragraph 14(2) Old Section: N/A** That power is exercisable if it appears to the Bank that there are circumstances suggesting that— (a) a clearing house may be guilty of an offence under section 398(1) or an offence under prescribed regulations relating to money laundering; (b) a clearing house may have contravened a rule made by the Bank under Part 18 of this Act; (c) a **recognised** clearing house may have contravened the recognition requirements; (d) a clearing house may have contravened any directly applicable EU regulation specified (or of a description specified) in an order made by the Treasury; (e) a clearing house **(other than a recognised clearing house)** may have breached the general prohibition.	These are clarificatory but necessary changes. Please note that a clearing house which is not recognised cannot contravene the recognition requirements, because they only apply to recognised bodies. Please note that a recognised clearing house cannot generally breach the general prohibition because it is an exempt person in relation to the provision of its clearing services.
Page 243 **New Section: Schedule 17A Paragraph 30 Old Section: N/A** [No amendment suggested]	We note the draft Part II of Schedule 1ZB (investigation of complaints) refers to the PRA and the Bank of England. In applying Part II to the Bank of England it is not clear if references to the PRA and Bank of England are to be both read as the Bank of England or if it is intended that a further entity be appointed in the role that the Bank of England currently has when Part II is applied to the PRA.

Page 247 **New Section: N/A** **Old Section: N/A** **Schedule 7 to the Draft Financial Services Bill** 17 In section 298 (directions and revocation: procedure), in subsections (1), (2)(a), (3), **4(b),** (5), (6) **(in both places),** (7) (in both places) and (8), for "the Authority" substitute "the appropriate regulator".	Typographical comments, suggested to ensure consistency and correct amendment of FSMA.

6 September 2011

Our ref: ICAEW Rep 82/11

Your ref:

Isabel Summers
Transport, regulation and competition
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Dear Isabel,

A new approach to financial regulation: the blueprint for reform

ICAEW is pleased to respond to your request for comments on your consultation paper entitled *A new approach to financial regulation: the blueprint for reform*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

Ian Michael
Manager, Risk and Regulation

T +44 (0)20 7920 8412
E ian.michael@icaew.com

ICAEW REP 82/11

ICAEW REPRESENTATION

A NEW APPROACH TO FINANCIAL REGULATION: THE BLUEPRINT FOR REFORM

Memorandum of comment submitted in September 2011 by ICAEW, in response to HM Treasury's consultation paper *A new approach to financial regulation: the blueprint for reform* published in June 2011

Contents **Paragraph**

INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *A new approach to financial regulation: the blueprint for reform* published by HM Treasury.

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

4. The Financial Services Faculty was established in 2007 to become a world class centre for thought leadership on issues facing the financial services industry acting free from vested interest. It draws together professionals from across the financial services sector and from the 25,000 ICAEW members specialising in the sector and provides a range of services and a monthly newsletter FS Focus.

MAJOR POINTS

5. ICAEW's views on a wide range of issues were set out in our representation (42/11) on the previous Treasury consultation paper published in February. However, below we comment on a number of new issues raised by the White Paper, and also reiterate a small number of points which we think are particularly important.

6. Regarding the tools potentially available to the Financial Policy Committee (FPC), we believe that careful consideration is needed as to how these dovetail with existing legal frameworks and requirements, and other policy initiatives, whether derived from European rules or domestically.

7. We note that one-half of the recommendations issued following the first meeting of the interim FPC broadly related to financial reporting. Three factors should be borne in mind in that context: (1) responsibility for international accounting standards as used in the UK, and their interpretation, lies exclusively with the IFRS Foundation (subject to the EU 'endorsement' process); (2) the responsibility of directors for accounts as set forth in the Companies Acts; and (3) the desire of the BIS and FRC to see accounts become shorter and more accessible.

8. The best way to reconcile these considerations may be for bodies such as the FPC and the future Prudential Regulation Authority (PRA) to request that any desired 'additional' public disclosures be made as part of Pillar 3. This would allow extra information to be made available to those with particular interests while limiting 'clutter' surrounding published financial statements. That said, it is important that Pillar 3 disclosures do not take on a life of their own to the extent that they become difficult to tie back to published accounts and, potentially, lead to 'two versions of the truth'. Regarding the confidence which can be attached to Pillar 3 disclosures, it would be possible to design assurance procedures around many forms of Pillar 3 information should that be desired by market participants.

9. ICAEW believes that more explanation is required of the proposal to extend the section 166 skilled persons regime to non-regulated listed companies. We are not clear as to the rationale for this. In our view applying an FSMA process to non-regulated entities could potentially have rather dramatic implications – at an extreme, turning them into quasi-financially regulated firms. In our view if there is a strong reason to contemplate a change of this kind, the proposed new powers should be considerably more constrained than in the draft Bill, and there should be specific checks and balances. It would also be necessary to set out how the new powers would interact with those of other official bodies, eg the Serious Fraud Office.

10. In view of the scale of change to the regulatory structure and processes envisaged, we believe that the legislation should place a statutory duty on the Chancellor to commission an independent post-implementation review of the effectiveness and efficiency of the new arrangements after they have been in operation for (say) three years[1]. This should focus particularly on the efficacy of proposed innovations such as the performance and objectives of the FPC, the increased emphasis on judgement in regulation, and the more proactive and interventionist approach of the Financial Conduct Authority (FCA).

RESPONSES TO SELECTED SPECIFIC QUESTIONS

Q1: Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?

11. As noted above, it is important that any FPC actions which relate to published accounts are consistent with the existing architecture for financial reporting. ICAEW believes that generally it would be most appropriate for the FPC and the future PRA to focus on Pillar 3.

12. In that context, we note that the draft Bill envisages that directions by the FPC will be subject to a tool being assigned through secondary legislation, and that section 9G (8) (p64) states that a regulator cannot be directed to act outside its powers. However, no such checks and balances surround the 'Recommendations to other persons' envsiaged in section 9P (p67). While in principle such 'recommendations' are precisely that, in practice they are likely to be seen as highly persuasive. We therefore believe that at a minimum the Bill should state that such recommendations must not suggest that those to whom they are addressed act inconsistently with their legal obligations.

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

13. We agree with the Government that there have been a number of episodes in recent decades which have given rise to very significant consumer detriment, which points to the need for a new regulatory approach. However, we remain concerned about various aspects of the future regulation of wholesale financial markets in the UK. The June 2011 FCA Launch Document reminds readers (para 2.5) that these markets are extremely large in global terms.

14. One risk is that the centre of gravity of the FCA will become the protection of retail consumers, and that wholesale markets will receive insufficient attention. A second risk is that these markets will come to be viewed primarily in terms of any relatively direct linkages from them to retail consumer products.

15. A third risk is that the very broad proposed definition of a 'consumer' (as described in Box 1 of the Launch Document) could lead to approaches best suited to retail regulation being inappropriately applied to wholesale market transactions among professional counterparties. (We are in any event unsure of the policy and/or legal reasons why the Government is proposing such a wide definition of 'consumer', and believe this should be explained).

[1] This would be in the spirit of the Government's intention that Ministers should be required to conduct a review of domestic legislation implementing a European directive every five years.

16. The proposed establishment of the Markets Panel goes some way to alleviating these concerns, but we believe that further steps are necessary. For example, the amended FSMA could require the FCA to 'have regard' to relevant differences between wholesale and retail markets, and that a minimum proportion of the FCA Board members have significant wholesale markets experience.

17. Turning to the approach to retail regulation, we believe that public debate is required about what the future landscape of the retail financial marketplace should look like, particularly for non-advised sales – taking into account trade-offs of the kind outlined in Hector Sants' speech to the FCA launch conference.

18. We agree that a more proactive and interventionist approach is warranted. This reflects not just current levels of consumer complaints, but also the likelihood that subdued macro-economic conditions and historically low real interest rates will lead to consumer detriment as both providers and their customers focus on a 'search for profit / yield'.

19. A prerequisite for the proposed more interventionist approach will be for the FCA, in consultation with consumers and the industry, to articulate a clear view of what a well-functioning retail marketplace would look like. That would provide a benchmark, shortcomings from which would call for FCA action. Since in many instances there will be no clear 'bright lines', publicising examples of good and bad practice is likely to be helpful.

20. In ICAEW's view 'responsible providers' is a key feature of a properly functioning market. There are some requirements on firms which should be a 'given', especially that all the key terms of a retail financial product should be highlighted in a straightforward manner. Proactive intervention should be able to enforce this if necessary. However, as regards product design itself, there may be difficult decisions for the FCA to make regarding how to approach a product which could be appropriate for some consumers, but which could be damaging to many others. It also needs to be borne in mind that even straightforward financial products can be inappropriate in some contexts – eg 'rainy day' savings balances should not normally be invested in relatively price-volatile assets such as an equity index.

21. Potential government liability also needs to be borne in mind. There is a risk of the authorities being held accountable, with the benefit of hindsight, for any failure to ban products which turned out to create significant consumer detriment, even where this was not apparent when the products were being sold. The FCA could be given legal protections, but history suggests that the government may eventually make ex gratia payments. One implication is that the FCA could be too ready to ban products.

22. A decision also needs to be taken on the extent to which the FCA should intervene not in the design of a product per se, but rather the way in which it is used commercially by the provider. For example, should be FCA aim to prevent practices through which retail savers and borrowers often find themselves moving over time into a less-advantageously priced 'back books'?

23. ICAEW believes that 'responsible consumers' should accompany responsible providers. In part this is a matter of consumers being assisted by regulators to appreciate the trade-off between risk and return. The FCA should go further than the FSA in helping retail customers understand this – especially at times like the present when the real returns to low risk assets are generally low. It might be possible for the FCA to publish estimates, perhaps on a monthly basis, of where the efficient risk-return frontier (ie the trade-off between risk and return) lies.

24. Finally, we note the importance of attention being given to how the approach proposed for the FCA (and indeed other parts of the proposed new regulatory structure) will dovetail with existing and prospective EU requirements.

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

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

25. We agree that the FCA may be better placed than the FOS to deal with any instances of 'mass detriment', and that the FCA should address such cases promptly. However we were not sure what purpose is served by creating a group of 'nominated parties'. If this includes only other parts of the regulatory structure, such as the FOS and the Panels, then the proposal does not seem to do much more than set out a particular mechanism for co-ordination. Extension to other bodies, such as consumer groups, might be beneficial if it gave them greater legal protections when providing information to the FCA – and if so presumably the list of nominated parties should be drawn to encompass all bodies with a substantive role in representing UK consumers of financial products.

E ian.michael@icaew.com

Our ref: CAP/HMT Blueprint

2 September 2011

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

THE INSTITUTE OF INSURANCE BROKERS

Higham Business Centre,
Midland Road, Higham Ferrers,
Northamptonshire, NN10 8DW
Tel: 01933 410003 Facsimile: 01933 410020
E-mail: inst.ins.brokers@iib-uk.com
website: www.iib-uk.com

Dear Sirs

A new approach to financial regulation: the blueprint for reform
Response from the Institute of Insurance Brokers

The Institute of Insurance Brokers (IIB) is a trade association for insurance brokers located across the UK. Our members are mainly micro-businesses which provide vital services to consumers and commercial clients in their role as professional intermediaries and risk advisers. We support the new legislation on the whole but we are concerned that the Draft Bill and consultation questions fail to address a number of important issues relating to costs and accountability.

More specifically, under Part 1A of the Bill, we note the body previously known as the Financial Services Authority will be known instead as the Financial Conduct Authority. The FCA, which is funded by regulated firms, could therefore be exposed to liabilities incurred by the failed regulatory body, the FSA. In our view the FCA should begin with a clean sheet, with the ongoing liabilities of the FSA passing to the Treasury. However, it is not clear whether Part 5.25 of Schedule 3, which would provide the FCA with an exemption from liability in damages, would have retrospective effect.

The escalating level of regulatory fees has been a source of anxiety for many firms over recent years with the FSA appearing to take a cavalier attitude to fee-raising. It would be unfortunate if the PRA and FCA were allowed to maintain a similar approach. We are therefore keen to see statutory provision for more transparency over budgeting and fees, including making a requirement for annual consultation on fees and formalising the arrangements for independent reviews of regulatory efficiency and effectiveness. We suggest there should also be a requirement for the FCA to report on its own efficiency and effectiveness perhaps, by extending the criteria for the annual report to the Treasury (under Schedule 1ZA.11).

Our members are also concerned that a more intrusive supervisory approach will lead to even higher fees and compliance costs which could threaten the viability of small firms in the retail marketplace. Whilst we appreciate the need to toughen the regulatory regime to guard against another financial crisis and to build consumer confidence, we believe insurance intermediaries do not present a systemic risk. Generally, insurance brokers do not incur credit risks by lending; they do not acquire underwriting liabilities by taking on insurance risks; and they do not face significant liquidity issues. In a highly competitive market they provide clients with insurance contracts which are annually renewable and capable of being switched. It follows that insurance brokers should bear a lower level of scrutiny compared to other firms carrying out activities which pose much more significant risks to consumers and to regulatory objectives.

In our view, it is vital that the legislation promotes a truly risk-based regime, helping to reduce the compliance burden where appropriate in line with the Government's aim of reducing red tape for small businesses.

Under the proposed new regulatory arrangements our members will become regulated both for prudential and conduct purposes by the Financial Conduct Authority (FCA). We have therefore restricted the scope of our response to the questions relating to the FCA.

6. Do you have any views on the FCA's objectives – including its competition remit - as set out in paragraphs 2.80 to 2.90 and in Chapters 3 and 4?
We agree, broadly, with the proposed strategic and operational objectives. However, firms are likely to become alienated, resulting in damage to the UK market in the long run, if the regulator places too great a focus on the consumer. Bearing in mind that the firms themselves must pay for the FCA, it is vital that they are engaged with the regulatory process and properly understand its remit. The regulator should therefore be obliged to establish and maintain good working relationships with firms and to acquire an in-depth understanding of the economics of different markets.

7. Do you have any views on the proactive regulatory approach of the FCA, detailed in paragraphs 2.91 to 2.110 and in Chapters 3 and 4?
The intrusive approach adopted by the FSA following the banking crisis has affected businesses across the whole range of financial services. Many insurance firms and others which were not to blame for the problems now feel obliged to incur higher compliance costs and/or divert resources away from their core business.

We believe the current style and intensity of regulation is inappropriate for some firms, particularly insurance brokers. In our opinion the legislation should require the regulator to regularly review the basis for classifying firms and regulated activities with a view to maintaining proportionality and fairness.

We accept that the regulator needs to be equipped to intervene at an early stage where consumer detriment is likely but we are concerned that the introduction of an all-encompassing intervention strategy could adversely affect general insurance distribution. We believe that there is a case for developing intervention strategy separately and appropriately for different forms of activity and/or products, with a measured approach being taken in respect of low-risk general insurance products.

8. What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment?
We agree there should be a defined process for identifying and handling conduct which could cause mass consumer detriment. The FCA should determine which issues fall into this category, but other nominated parties should have the ability to raise matters of concern with them.

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

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

In general, we agree that the FCA should be able to initiate an enhanced referral to the OFT along the lines suggested in the document.

We would take this opportunity to raise a key point about promoting competition in the insurance market. There will almost certainly be a further decline in the availability of independent advice for consumers if the number of insurance broking firms continues to reduce as a result of disproportionate regulatory oversight. In order to maintain a wide choice of products, services and providers we would like to see regulatory barriers lowered and compliance costs reduced wherever possible to promote business development and innovation. It is essential that the new body strikes the right balance between consumer protection and promoting competition and develops a regime which is truly risk-based.

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

We are not in a position to comment on the proposals for recognised investment exchanges and listing.

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

We are pleased that the draft legislation makes provision for independent reviews of the economy, efficiency and effectiveness with which the FCA uses its resources. In general, we welcome the possibility that the regulatory process will be more open and transparent, especially with regard to budgeting and cost allocation. The cost of regulation is of major concern to our members and it is essential that costs be adequately controlled.

We are particularly keen to see that firm-specific decisions made by the regulator be properly informed and capable of being challenged, ideally through specialist and/or peer group review arrangements. The relevant decision making processes must therefore be as open and transparent as possible. We are not convinced that the existing consultation process and panel arrangements are sufficiently effective.

Having in mind reports of backlogs and high staff turnover at the FSA, we would strongly support legislation which enables the FCA to make better use of the knowledge and experience of industry specialists. We believe that greater practitioner and trade body involvement, for example through activity-specific consultative bodies, would help the regulator to keep abreast of industry developments. This could make a highly cost-effective contribution to promoting efficiency and the other operational objectives of the FCA.

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

We are pleased to see the statutory requirements for coordination, including the statutory memorandum of understanding and cross membership of boards. It is important that dual-regulated firms, such as insurance companies, are clear as to what is expected of them by each body.

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

We are broadly happy with the arrangements for authorisation, exempting appointed representatives and variations of permission. We are concerned that the revised provisions for approved persons, where both the PRA and FCA are involved in the approval process, could still result in duplication of effort and delays. It will be vital for the new bodies to coordinate and streamline the process as far as possible when implementing the new proposals.

We agree with the proposals on enforcement and information sharing.

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

There still seems to be some uncertainty about the allocation of compensation scheme costs between the PRA and FCA schemes. However, our main concern is that the FSCS funding model be reviewed as quickly as possible and we note that there appears to be nothing in the draft bill to prevent this.

Thank you for considering our response. We would urge the Government to take greater account of the concerns of insurance brokers and other smaller firms which struggle daily to contend with highly disproportionate regulatory costs and demands.

We would be happy to assist further with regard to the regulation of insurance brokers.

Yours faithfully

Ann Peel FCII
Head of Technical Services

A new approach to financial regulation: a blueprint for reform

Response from Intellect

September 2011

Russell Square House
10-12 Russell Square
London WC1B 5EE

T 020 7331 2000
F 020 7331 2040
www.intellectuk.org

Intellect
(Information Technology Telecommunications & Electronics Association)

Contact:
Ben Wilson, Head of Financial Services Programmes
T 020 7331 2161
E Ben.Wilson@intellectuk.org

Overview

'A New Approach to Regulation: A Blueprint for Reform' whilst addressing failures in the assigned roles of/and boundaries between the Tripartite regulatory authorities, does not fully address the failings in the 'abilities' of regulators which the financial crisis exposed. Nor does it appropriately provide for the full spectrum of tools that the new regulators should now have in order to fulfil their objectives and prevent another financial crisis.

Problem:
The financial crisis exposed the weakness of the UK's financial services regulatory framework, in particular the asymmetry of information between the regulators and financial services providers. Specifically:

- Bank's failed to collate and interpret risk data of suitable quality so that they could identify the risk that they were holding across their disparate operations
- Regulators were ill-equipped to interpret the sheer quantity of sub-standard risk data being received from banks and turn it into actionable information

Result:
The financial crisis was not identified in good time and action taken by regulators (and indeed banks themselves) to prevent it. This was a massive failure of corporate governance and was ultimately responsible for the depth of the crisis and the depth of the public bail out of stricken banks.

The Government had to step in and save RBS and HBoS without full knowledge of the risks that the banks faced, and an accurate assessment of what impact their collapse would have posed to the financial system as a whole. Similarly in the US, a slowed response time resulting from poor actionable data meant that regulators had to choose between saving one of Lehman Brothers and AIG. The decision was made to let Lehman Brothers fail, demonstrating the inability within the regulatory system to react quickly and effectively.

<u>There has been little change in the quality of this data since the financial crisis, with no body taking ownership of this issue, and consequently there remains a gaping hole in the reform of the financial system which has not yet been filled.</u> <u>A Blueprint for Reform (and the Draft Financial Services Bill) should address this.</u>

Solution:
In short – 'Better data, more often'. Banks need to undertake significant internal changes to reform their ability to collate accurate risk data, and to improve access for regulators to it so that they can adequately perform their supervisory and financial stability objectives.

However, there needs to be provision within legislation or directive from a regulator to establish a means to compel banks to improve their risk frameworks, as the <u>banks themselves will not voluntarily undertake such reforms to a suitable standard.</u>

Recommendations:

- **A requirement for the regulatory authorities to conduct an evaluation (or gap analysis) of the tools it needs to fulfil their financial stability vs current capability within a specified timeframe of its existence**
- **A legal requirement for regulators to review their risk monitoring capabilities on a periodic basis**
- **Legal obligations for banks to meet the prescribed standard of risk data, as established by the regulators**
- **Legal provision for the establishment of an Office for the Chief Information Officer, within the regulatory architecture, to ensure that risk data standards are improved and maintained by financial institutions**

Intellect is the trade association for the UK technology industry. Our members provide the technology that underpins every both individual financial institutions and the entire financial system. This consultation response reflects the expertise of these members and builds upon the work that Intellect has been undertaking with the Independent Commission on Banking and the Bank of England to inform those whose responsibility it is to reform the financial services system.

Responses to specific questions

Please note, Intellect has not responded to all questions.

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

Intellect believes that 'A Blueprint for Reform' has still not covered one of the significant oversights that the previous two consultation documents on the proposed regulatory regime from HM Treasury, also did not cover.

Ultimately, 'A Blueprint for Reform' (including the Draft Financial Services Bill) does not focus on an important corporate governance issue that is crucial to reform of the financial system – empowering the regulatory authorities (specifically the Financial Policy Committee and the Prudential Regulatory Authority) with the tools that are required to perform the financial stability objectives that they have been assigned and that 'A Blueprint for Reform' sets out. Specifically this is the collation, sharing and interpretation of substandard risk data – the foundation upon which PRA and FPC supervisory decisions will be made.

As HM Treasury has stated in 'Building a stronger System', preceding this Draft Bill, '*the crisis was caused by the failure... of regulators to spot the risks that were building up across the system as a whole'*[1].

Similarly, the Bank for International Settlements recently stated that "*The recent financial crisis highlighted shortcomings in policymakers' ability to measure systemic risk. Gaps are evident in both the analytical framework and the available firm-level and aggregate data that policymakers and market participants use in making decisions. These gaps hinder market participants in pricing and managing risk and policymakers in monitoring and responding to vulnerabilities. This experience should prompt improvements in macro surveillance and data collection.*'[2]

As the financial system undergoes one of the most significant periods of regulatory scrutiny since the 1930s, there is currently a once-in-a-generation opportunity to tackle some of the fundamental, underlying problems within the financial system. It could be argued that whilst the reform options that are being examined are wide reaching they do not, in many cases, bury down into the crutch of the problem. This is the '**plumbing**' of the system. I.e. how data is collated and how it flows to those bodies (i.e. the regulators) that need access to it in order to act to avoid another crisis. If the opportunity is not taken now, at this critical juncture, to address the clearly visible deficiency of substandard reporting data and the risk that this poses to the health of the financial system, it could take another crisis before it is addressed. A crisis that may be caused by the same reason as the last one – a failure of regulators to spot where the real risks are building up across the economy.

On a more granular level the problem has been demonstrated to be:

- The inability of banks to collate and interpret risk data of suitable quality so that they can identify risk that they are holding; and
- The inability of banks to then deliver risk data of suitable quality to regulators so that the build up of systemic risk can be monitored and mitigated. Regulators were ill-equipped to interpret what was already a poor standard of risk data

It was this inability to interpret the sheer quantity of risk data from banks that meant that the financial crisis was not identified in good time and actions taken to prevent it. There has been little change in the quality of this data since the financial crisis and consequently there remains a gaping hole in the reform of the financial system which has not yet been filled. 'A Blueprint for Reform' (and the Draft Financial Services Bill) should address this.

On a systemic level, the financial crisis exposed the weakness of the UK's financial services regulatory framework, in particular the asymmetry of information between the regulators and financial services providers and revealed the dangers of systemic risk. In effect, there was a failure on two levels:

[1] 'A new approach to financial regulation: building a stronger system', HM Treasury, p3
[2] 'BIS Annual Report 2010/11', Bank for International Settlements, p83

- The banks themselves were either not able or not willing to prioritise the reporting of enterprise risk to board level. That banks were taking excessive risks during the economic boom has, in hindsight, exposed this failure of corporate governance.

- Regulators received significant amounts of data from banks but were unable to interpret it, were unable to make informed judgements and therefore unable to make decisive interventions in the market. That there was no standardised format to this data meant that in trying to build up an holistic picture of the financial system, regulators were not only trying to compare apples and pears, but oranges, bananas, and so forth.

The result was that the prudential regulatory system was not equipped to manage systemic risk. The information gap between the tripartite regulatory authorities and the financial institutions slowed the response to the financial crisis. Whilst the Government was able to step in and save RBS and HBOS, albeit at a high cost, this was undertaken without full knowledge of the risks that the banks faced, and an accurate assessment of what systemic risk their collapse would have posed to the financial system as a whole.

In the U.S. where the regulatory system suffered from the same deficiencies, a slowed response time meant that the authorities could, to all intents and purposes, only act to save one of Lehman Brothers and AIG. The decision was made to let Lehman Brothers fail, demonstrating the inability within the regulatory system to react quickly and effectively. That it was expected that Lehman would fail in the months leading up to the autumn of 2008 makes the inadequacies of the data available to regulators even more shocking.

On the issue of timing, the regularity of data submission to regulators by individual banks is of significant concern and has also not been addressed, either by ongoing reform so far or the Draft Financial Services Bill. Whilst each bank will be different, in most cases the standard can be measured in weeks rather than days and this represents a significant problem for two main reasons:

- Much can happen over the space of a few weeks and the health of a particular bank can deteriorate significantly over this time. Any risk or liquidity issues that arise in between scheduled reports will have time to get significantly worse, and require a significantly bigger response from the regulators, than if reporting was on a more frequent basis. In effect, the seeds of another financial crisis could be sown before the regulators are aware of what has happened – if indeed it is then able to interpret the data that it receives from the bank.

- When another risk event occurs, regulators will almost certainly require ‘on-demand’ data from banks so that the impact of the event can be analysed and act accordingly. Many banks have reporting frameworks that are an integration of data, analysis and people intervention across multiple business units. These processes rely upon manual intervention and are often difficult to change at short notice. It will take significant changes to current reporting systems within banks for this to take place. Without frequent and accurate data from the banks, the ability of the regulators to make decisive and effective interventions in the financial system is severely hindered and it may be too late for action to be taken to save a particular bank. We saw this first hand in the responses of the UK and US authorities during the financial crisis, and very little has changed since. In a worst case scenario, a regulator acting on poor data in a financial crisis could actually exacerbate the situation. The Senior Supervisors Group, which includes representatives from regulators across multiple countries, including the UK, stated in a document published at the end of 2010, that ‘some firms still require days and weeks to completely aggregate risk exposures; few firms can aggregate data within a single business day.”[3]

The Governor of the Bank of England has stated that there is no need for banks to provide more data to the regulators so that they can perform their regulatory duties. This may well be true – what is needed is **‘better data, more often’** – that can be collected, analysed and turned into information that the regulators can act upon if required. Much of the data that is supplied by banks to regulators will mean very little to them in its current format and in effect there is a great deal of ‘wastage’ – i.e. data that is collected but cannot be usefully interpreted of used in any constructive way. It may well hold valuable information therein, but not enough and/or it cannot be analysed sufficiently by regulators under current circumstances. At the very least, the right data, irrespective of its timeliness in normal operations, should be accessible to the bank and the regulators ‘on demand’ when a risk event occurs. Ultimately, the regulators’ toolkit should include the ability to predict and forecast outcomes, based on accurate and meaningful data. Currently, there are no provisions within the

[3] “Observations on Developments in Risk Appetite Frameworks & IT Infrastructure”, Senior Supervisors Group, P10

Draft Bill or HM Treasury's 'A Blueprint for Reform' to ensure that the regulators will have the right tools for this job.

What is alarming is that the reform of the financial system since the crisis has not taken on board this crucial point. Whilst political focus has been on those whose actions and deficiencies were deemed to have caused the financial crisis (see 'bankers' bonuses' and 'dismantling the tripartite regulatory authorities'), little attention has been paid to learning from the crisis and installing the systems and processes that are required to avoiding another crisis. As things stand, there is still no system in place, or indeed no obligation within the Draft Financial Services Bill or 'A Blueprint for Reform' to establish such a system to monitor the build up of risk across the financial system, despite the financial crisis demonstrating that such a resource was badly missed. As set out below, this is an issue that the US has taken note of, and acted upon.

The solution – better data, more often

The solution for a safer financial system lies in the implementation of two key changes to the way that data is collated by banks and viewed by regulators:

- ***Improved standards of data for regulatory and financial reporting***
- ***More regular reporting of risk positions***

It is unlikely that banks will implement these large scale reforms under their own volition, and as such it is necessary for the Government/regulators to mandate this change

Essentially there are two interdependent facets to providing a tool for the FPC to accurately view the build up of risk across the financial system, both of which will require the backing of regulators and policy makers to make them happen, as it is unlikely that the banking industry will implement them voluntarily. These are:

- Improved standards of data for regulatory and financial reporting
- Regular reporting of risk positions, with the requirement to provide frequent updates during periods of financial volatility

The 'single source of truth' is an important objective to reach. A large proportion of data submitted to regulators does not offer any information to them. As the Governor of the Bank of England has set out, regulators do not need any more information. That may be true, but what they do need is the large amounts of meaningless data that they do receive to be improved, in order to provide them with insightful and actionable information about the health of individual banks, and therefore the wider financial system. In terms of defining what 'better data' looks like, Intellect believes that there should be a review of the key metrics that will best help regulators perform their duty of identifying and mitigating risk on an institutional and systemic level.

Building a mandate – a role for the regulators

The issue of 'better data' cannot be left to the banks themselves to address under their own volition.

As Francis Gross, Head of External Statistics at the European Central Bank has recently stated, regulators must be driving change in international standards for reference data if it is going to happen, as relying on the banks to do so would be like "asking cats to herd themselves". There is also the argument that as the opacity of the financial system is good for business, shedding light on it may be deemed to be counter to the banks' own commercial interests. On top of this, there may be reluctance amongst the banks to give up their data to regulators, as it is deemed a source of competitive advantage. However, it is the case that standardised reference data can reduce the underlying data gathering and reporting costs (incurred through the collation of data from disparate corners of a bank's operations, and from multiple legacy systems that may also use different data formats) and will help banks adopt a greater degree of cross-departmental risk analytics. The greater the ability of a bank to share risk information across departments and lines of business, the better for business planning and, ultimately, for its own bottom line.

However, the benefits will be accrued in the medium term and it will require a substantial investment of funds in the short-medium term in order to implement better data standards. Banks are unlikely to see the short term commercial benefit at a time when compliance costs from the wide ranging reform agenda must also be factored into the equation. Consequently, if banks are going to undertake the internal change programmes that are beneficial to their own commercial objectives, but also to the stability of the financial system, there needs to be a mandate from Government or the regulator to invest in building this set of standards and processes.

i.e. Unless there is provision within legislation or directive from a regulator to establish a means to receive better data from banks, the banks themselves will not voluntarily reform their own risk frameworks to a suitable standard.

Before this happens there needs to be a concerted period of introspection and evaluation on the part of the FPC where it can identify what monitoring capabilities it wants to have in three or four years time. Once it has identified the capabilities that will allow it to perform its stated objective of effectively monitoring and mitigating risk, it can prescribe the ‘reverse engineering’ of the relevant system. This may take the form of a systemic risk ‘early warning system’ from the dashboard down to the standardisation and improvement of reference data within individual banks. This specific activity will coincide with one of the key responsibilities of the interim FPC, set out in ‘A Blueprint for Reform’ which is to...

‘...undertake analysis of potential macro-prudential tools that could be used by the FPC and report to the Treasury with its recommendations for the permanent FPC’s toolkit. The FPC will provide the Treasury with an update on its thinking in time for the Bill’s introduction towards the end of the year and again after its Q1 2012 meeting (which should coincide with the Bill’s Committee-stage consideration in the House of Commons).”[4]

Other sectors, such as pharma, aerospace and the chemicals industry have all increased their own transparency through regulator-enforced modernisation. Within both the pharma and chemicals industries, companies are legally responsible for the quality of the data that they send to the regulator. If it falls below the required standard, legal sanctions become an option. There is no such legal requirement within the financial services sector and as such the quality is below the required level, and there is little motivation for banks to rectify this situation.

The regulatory authorities are starting to appreciate that there are significant holes in the data that banks collect and that they receive. However, there needs to be greater momentum in enforcing further necessary change on the ways that banks operate. Such a vehicle could be the Draft Financial Services Bill.

Intellect would recommend that HM Treasury consider now what steps will be necessary for the FPC (and the PRA) to receive risk data from banks of a higher quality than was the case during the financial crisis, and which will actually allow the regulatory authorities to fulfil their financial stability objectives.

Office of the Chief Information Officer of the Financial Policy Committee

As an omission from the provisions of ‘A Blueprint for Reform’ and the Draft Bill, Intellect believes that the FPC should consider the appointment of a Chief Information Officer (CIO) with responsibility for data integrity and governance of the regulators and assessment of individual firms’ own data quality and governance. Regulatory bodies need to view risk from three perspectives – how it is measured; how it is managed; and how it is governed. Consequently the regulatory bodies need to have the resources to fairly assess a financial services providers’ ability along all three of these dimensions.

Provision for a CIO within the FPC, will allow the PRA and the FPC receive the right data upon which actionable information can be drawn, such as:

- how good the data and the models within in each institution are;
- how well informed the firm’s management is;
- how well thought out the hedges, mitigants and action plans in simulated crises are;
- how can they ensure that the right actions are taken at the right times

The quality and availability of risk data from financial services providers to regulators was a significant contributory factor to the severity and depth of the last financial crisis and is a key issue that the draft Financial Services Bill must address. A department within the new regulatory architecture responsible for assuring this data quality is essential for the regulators to be effective.

[4] ‘A new approach to financial regulation: a blueprint for reform’, HM Treasury, p 17

Data as a macro-prudential tool - in other countries

In the United States the Office of Financial Research (OFR) has been established within the US Treasury Department, as a result of the Dodd-Frank Bill. Its remit is to improve the quality of reference data available to policymakers and facilitate more robust and sophisticated analysis of the financial system. In effect, the OFR is permitted by law to demand data from financial companies including banks, hedge funds, private-equity firms and brokerages. It would be able to track information such as counterparties for credit-default swaps and would, crucially, afford regulators the sort of system-wide overview (including darker parts of the market) that will allow it to identify when and where there is a risk to financial stability. The OFR also has the authority to set out new legislation based upon its findings. All this, and the fact that the OFR has recently started defining reporting standards for the financial community, puts it way ahead of the FPC in terms of establishing tools to head off the next financial crisis.

On a more general level, US regulators are significantly ahead of their UK counterparts in terms of their attitude towards setting standards for data. The Commodity Futures Trading Commission (CTFC) has recently set up a sub-committee to help develop accepted standards for describing, communicating and storing data on complex financial products. Members range from traditional operators in the financial system such as Barclays Capital, Thomson Reuters and Citi, through to data experts such as Google. This is indicative of the importance that regulators are attaching to the better management of data as a means to protect the US financial system from risk.

In the US it was appreciated that implementing root and branch reforms to reporting systems in each bank, along a standardised format, is a significant task and as such it is something that had been avoided since the financial crisis. Banks will not advocate such change because of the cost and disruption it would bring to their businesses, and regulators are largely unaware of the deficiencies in the data that they are receiving. Consequently, there is nobody driving change to this systemic deficiency. The establishment of the OFR was an acknowledgement that change would only come if it was driven by a specific body or vehicle. It would not be the banks or the regulators, so legislation became the driver for change. There is a significant lesson here for the UK.

On a European level the European Systemic Risk Board (ESRB) was established, again by law, in December 2010 under the auspices of the European Central Bank and has a similar function to the OFR. Whilst it is not yet as advanced as the OFR in terms of its use of data, it is also still way ahead of the UK as it has acknowledged that data standards that will allow it to collate information from 75 different member organisations (including the ECB, the EU national central banks and EU national regulatory authorities amongst others) are not sufficient to allow it to undertake its role effectively.

That both these institutions and the Bank of International Settlements have acknowledged that current data standards are insufficient to afford regulators the necessary tools to identify the build up of systemic risk should be heeded by policy makers in the UK and acted upon now, whilst the regulatory system is being reformed.

Recommended changes to ‘A Blueprint for Reform’ and the Draft Financial Services Bill

Intellect believes that there needs to be a solid policy commitment to ensure:

- **A requirement for the regulatory authorities to conduct an evaluation (or gap analysis) of the tools it needs to fulfil their financial stability vs current capability within a specified timeframe of its existence**

- **Provision for the establishment of an Office for the Chief Information Officer, within the regulatory architecture, to ensure that risk data standards are improved and maintained by financial institutions**

Additionally, Intellect believes that there should be legislative provision (via the Draft Financial Services Bill) for:

- **A legal requirement for regulators to review their risk monitoring capabilities on a periodic basis. Risk issues and the ability of technology to assist monitoring these issues change, and the abilities of regulators should also change to reflect this**

- **Legal obligations for banks to meet the prescribed standard of risk data, as established by the regulators, following their evaluation of their required tools**

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

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

Answer to questions 4 & 5:

Ensuring a 'judgement-based' approach to supervision works

As HM Treasury states its blueprint for reform, 'The PRA's approach to supervision will be judgement-led. The nature and intensity of supervision will depend on the risks posed by each firm; while every firm will be subject to a baseline level of supervision to promote and support their soundness and resilience, supervisory effort and resource will focus particularly on 'big picture' issues with potential systemic impact.'

Rules-based regulation has a tendency to be static. A supervisory approach where the regulator is closer to the banks' own data rather than acting upon reports responding to rules, tends to deliver a more dynamic regulatory framework that can adjust to changing risks and market conditions. However, Intellect believes that the robustness of the PRA's judgement-based regulation could be called into question, if it is not able to receive accurate, useful or timely data from individual banks. Therefore as it is the PRA responsible for extracting and interpreting the risk information from individual banks, there should be adequate provision within the Bill to ensure a minimum standard of granularity and accuracy of risk information that is collected by banks and shared with the PRA. The Canadian supervisory framework is a good basis for a principles-based regulatory regime.

It must also be noted that if the information received by the PRA is substandard, this will also affect the ability of the FPC to undertake its own financial stability role, using the aggregated data that the PRA receives.

Ensuring staff with appropriate skills

If the PRA is to be able to investigate and tackle risks/vulnerabilities in individual firms, it must understand how people, processes and technology within each firm works, and how changing them can tackle existing risks, but also create new ones. For an industry like financial services that is built upon a platform of technology, it is critical that regulatory authorities are equipped with a full understanding of technology and how its application affects business decisions and the implementation of regulation.

In the case of the PRA, it will be almost impossible for it to set lasting 'rules' effectively, exercise judgement over authorisation issues and, on a wider level, lead on prudential regulatory issues if it does not have a detailed understanding of the technology that not only underpins existing banking institutions, but which drives changes to financial providers' operations and strategies.

If the current regulatory focus on the financial services industry is about ensuring that no more avoidable crises befall it; that consumers are adequately protected; yet ensuring the City remains competitive on a global scale and able to contribute to the UK's economy, there needs to be 360 degree consideration of all relevant issues and factors. Regulation and judgements not only need to reflect how technology can facilitate better policy today, but also what technology will empower the financial services industry to do for its customers, investors and the economy tomorrow.

Intellect contact

Ben Wilson, Head of Financial Services Programmes, Intellect
020 7331 2161 or ben.wilson@intellectuk.org

International
Capital
Market
Association

ICMA

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

(by e-mail to financial.reform@hmtreasury.gsi.gov.uk)

12 September 2011

Dear Sirs,

HMT consultation cm8083: "A new approach to financial regulation: the blueprint for reform"

The International Capital Market Association ("ICMA") is responding to HM Treasury's above consultation.

ICMA is a unique self regulatory organisation and an influential voice for the global capital market. It represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges, central banks, law firms and other professional advisers. ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years. See: www.icmagroup.org.

ICMA is responding in relation to its primary market constituency that lead-manages syndicated bond issues throughout Europe. This constituency deliberates principally through ICMA's Primary Market Practices Sub-committee[1], which gathers the heads and senior members of the syndicate desks of 25 ICMA member banks, and ICMA's Legal and Documentation Sub-committee[2], which gathers the heads and senior members of the legal transaction management teams of 19 ICMA member banks, in each case active in lead-managing syndicated bond issues in Europe.

We set out our response in the Annex to this letter and would be pleased to discuss them with you at your convenience.

Yours faithfully,

Ruari Ewing
Director - Primary Markets
ruari.ewing@icmagroup.org
+44 20 7213 0316

[1] http://www.icmagroup.org/About-ICMA/ICMAs-Committees/Primary-Market-Practices-Sub-committee.aspx.
[2] http://www.icmagroup.org/About-ICMA/ICMAs-Committees/Legal-and-Documentation-Sub-committee.aspx.

Annex

This response follows prior submissions to preceding consultations in October 2010, December 2010 and April 2011 in this area[3]. The response focuses on the impact of the proposals on the primary securities markets. We anticipate other constituencies will have responded on other concerns.

We understand and support the overall change in regulatory policy from "light touch" to a more "hands on" model. However, we remain concerned:

- that the existence of a retail investor in a chain that is otherwise wholesale may result in more "retail style" regulation of the wholesale transactions
- that the FCA's single set of strategic objective and operational objectives could, in theory at least, lead to a uniform application of regulatory tools to all aspects of its work. We believe that this would be damaging to the international markets that are hosted by the UK and that it needs to be made clear that the way in which the regulatory toolkit will be applied, say, in relation to prospectus approval and admission to the regulated market will be markedly different from the way in which it will be applied, say, in relation to the direct sale of products to retail investors
- that, even if these issues are resolved at the level of the FCA, it is unclear whether the FPC will be able to alter the result in pursuit of its own statutory objectives.

1. Wholesale/retail distribution chains

Each of the February and the June consultations refers to distribution chains involving an issuer at one end, a retail investor at the other, and a number of financial intermediaries in the middle. For example, the February paper says, in paragraph 1.39, that "the Government . . . recognises that there are wholesale and markets activities which do not directly form part of the transaction chain of products and services sold to retail customers" and goes on to say that such activities are regulated in a proportionate way (which we presume means less onerous regulation, because non-retail investors are better able to look after their own interests). We agree with this. But the implication is that any chain that does directly involve a retail customer should be more strictly regulated.

This implication is made more explicit in paragraph 4.2 which says that "in regulating wholesale markets and market activities undertaken between professional counterparties, a more nuanced regulatory approach will be appropriate. However, in regulating wholesale markets, the regulator must also be mindful of the links that exist, through the transaction chain, between retail products and services and wholesale market activity". The FSA's paper of June 2011 ("The Financial Conduct Authority – Approach to Regulation") makes a similar point, in paragraph 3.9, "the duty to protect retail consumers will necessitate a focus not only on firms' conduct towards them directly, but also on the knock-on effects and adverse implications that may result from activities in retail related wholesale markets". It then goes on, in paragraph 4.7, to say that its activities "could include reaching up the distribution chain, where appropriate, to intervene in wholesale activity where this could be the source of significant retail detriment".

These comments in the consultation papers take on added significance in the light of the new powers that will be given under the proposed legislation allowing the FCA to make product intervention rules. These are contained in new sections 137C and 137D of FSMA (Clause 19 of the draft Bill), and will allow the FCA to prohibit the entry into specified agreements by authorised persons, either at all or unless they contain certain provisions. The powers also permit the FCA to prevent authorised persons from causing others to enter into certain agreements (or to require that such agreements contain certain provisions. So, the power will exist to prevent the issue of certain bonds by authorised persons or to require that they contain certain provisions.

Some colour has been added as to how these powers will be used by various comments by officials at the FSA about the intention to intervene in the product cycle at a much earlier stage

[3] See respectively: http://www.icmagroup.org/ICMAGroup/files/7f/7f7fb4aa-3b11-400a-b3f7-5b923654453d.pdf, http://www.icmagroup.org/ICMAGroup/files/32/32e5bf61-e17e-4c44-a34d-3025d4a48dc8.pdf and http://www.icmagroup.org/ICMAGroup/files/65/65ae180c-c464-4047-aaf5-5c353a3f96a2.pdf.

and to adopt a more intrusive approach to regulation (most recently Hector Sants' 29 June speech "The Future of Banking Regulation in the UK"[4]). The FSA's Discussion Paper DP 11/1 ("Product Intervention"") also heightens concerns by, for example, saying (in paragraph 2.11) that the design of product features will have a major impact on outcomes for the customer (and implying therefore that regulation should address itself to the contractual terms of the product as much as to controlling the terms on which it is sold).

We do not believe that it is right to regulate distribution chains in this way. The EU regulatory framework provides regulatory tools that would allow the FCA to protect retail consumers by taking regulatory action at the point of distribution directly to them – for example, under the know your customer and suitability/appropriateness duties of MiFID. The FCA should make sure that regulation at that level works (for example, by ensuring that the authorised persons who sell products to, or advise, retail investors) are fit for the purpose and that compensation arrangements for mis-selling are adequate. It would be wrong to argue that, because it may be difficult to achieve adequate protection at that level, the regulator should "reach up" into the wholesale links in the chain and try to control there what it has failed to control lower down the chain.

2. Application of regulatory tools to different aspects of FCA's responsibilities

As noted above, it is proposed that there will be a single set of strategic and supporting objectives that applies to the whole range of the FCA's activities and a regulatory toolbox that is designed to enable the FCA to achieve these objectives (including new powers that allow the FCA to judge products and intervene in their design). What is lacking, however, is clarity as to how the tools will, in pursuit of those common objectives, be applied in practice to the various areas of the FCA's responsibilities, which include approval of prospectuses and admission to the regulated markets and regulation of market conduct. In the absence of such clarity, there may be a tendency to apply some regulatory tools to some activities of the FCA in ways that are damaging to the markets.

It would be theoretically possible, for example, for the FCA to intervene in the design of a structured bond to be issued by an authorised person, such as a UK bank. It may argue that the bond in question, if sold to a retail investor, would be inappropriate or unduly risk and therefore, in order to protect the potential retail consumer (as it is bound by statute to do), the product should redesigned or even banned. But should the regulatory intervention be at the level of the sale to the retail investor (so that it cannot be sold or needs modification before it can be sold)? Or could the FCA, as listing authority, "reach up the chain" and prevent damage at its source by requiring redesign of the product before issue (or even banning its creation)? Proposed new section 137C would appear to give it the power to this.

ICMA believes that the listing and prospectus approval aspects of the FCA's role should focus mainly on disclosure and that product intervention should (except in extreme cases where the product is clearly of no benefit to any investor) form no part of its regulatory toolkit. Provided the prospectus makes appropriate disclosure, it should be possible for an authorised person to issue whatever bond it thinks investors may want to buy, and to have a prospectus for that bond approved and (where required) passported by the FCA and (again, where required) to have the bond admitted to the UK's regulated market. This seems to us to be important because:

(a) it allows maximum choice of products to market participants. There may be products that are dangerous or otherwise unsuitable for some elements of the market. But there will be few products that are unsuitable for all investors. Some sophisticated investors may require highly structured products involving considerable risk and they may need these to be admitted to the regulated market for a variety of reasons (such as internally or externally imposed investment restrictions). They should not be deprived of their opportunity of buying such products because they might be unsuitable for others. The way to protect retail investors against unsuitable products is not, therefore, to bar such products from the market but to control their sale to retail investors through regulation of the distributors (for example, under the MiFID regime);

[4] See http://www.fsa.gov.uk/pages/Library/Communication/Speeches/2011/0629_hs.shtml.

(b) it is more consistent with current law and regulation, particularly that coming from the EU. It is difficult to see, for example, how the FCA could do anything other than admit to the regulated market a product that is the subject of a passported prospectus;

(c) it would be anomalous to prevent the issue of a particular product by an authorised person when non-authorised persons (who will be outside the product intervention regime) will not be so prevented.

Clarification is needed in order to give the UK's capital markets, which of course are international in nature, the certainty that they need. This could be given either by inserting appropriate language into the legislation or, perhaps, by suitable declaration of intent by the FCA. The FSA's June paper, referred to above, makes a useful start in giving this clarification by saying, in paragraph 5.17 that (in relation to its role as regulator of markets) the FCA "will mainly be concerned with ensuring the integrity and efficiency of markets, ensuring adequate disclosure of information and providing a level playing field for market participants". But this needs much greater detail.

3. Interaction between the FPC and the FCA

A further area of concern relates to the possible interaction of powers given to the FPC and those given to the FCA. Even if clarification as to how the FCA will apply its regulatory tools to its different roles is given, there will still be uncertainty in the mind of the market if the FPC can use its powers to override the FCA and (for example) require that the FCA should ban certain products from admission to UK markets. Again, it may be important to clarify this aspect of the new structure, either in the legislation or by a suitable declaration.

8 September 2011

Letter sent by email to:
financial.reform@hmtreasury.gsi.gov.uk

For the attention of:
Financial Regulation Strategy
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

THE WORLD
OF INSURANCE

IUA RESPONSE TO THE HMT CONSULTATION
A NEW APPROACH TO FINANCIAL REGULATION:
THE BLUEPRINT FOR REFORM

Please find below our response to the HMT consultation paper, *A new approach to financial regulation: the blueprint for reform (June 2011)*. Please note that our comments also relate to the two documents issued as supplements by the BoE and the FSA, *The Bank of England, Prudential Regulation Authority: Our approach to insurance supervision* (BoE and FSA June 2011) and *The Financial Conduct Authority: approach to regulation* (FSA June 2011).

The International Underwriting Association (IUA) represents insurance and reinsurance companies in the international insurance and reinsurance market working in and through London. Our membership, consisting of 40 general insurers and reinsurers, makes up approximately 95% of the London insurance company market. For further information about our organisation and its membership please visit our website, www.iua.co.uk under the section 'About the IUA'.

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

In the light of the weaknesses in economic governance revealed by the financial crisis, we agree that it is vital that there should be an authoritative body whose prime purpose is to watch over financial stability and which understands the underlying macroeconomic trends, structures and inter-relationships. We believe that the FPC is likely to be able to fulfil that role as a committee of the Bank of England (BoE) with overall responsibility for oversight of the financial services sector and its regulators, the PRA (Prudential Regulation Authority) and the FCA (Financial Conduct Authority). Success will depend, however, on excellent high-level macro-economic analysis, constructive self criticism, independence from the markets, government and the press, and the ability to listen and to communicate ideas effectively to its principal interlocutors.

International Underwriting Association of London Ltd

London Underwriting Centre
3 Minster Court
Mincing Lane
London EC3R 7DD
Telephone +44 (0)20 7617 4444
Facsimile +44 (0)20 7617 4440
E-mail info@iua.co.uk
Web site www.iua.co.uk

Balance of expertise

In response to previous representations from the industry, including ourselves, the HMT consultation document indicates that the Government and the BoE will ensure that the membership of the FPC will have an appropriate balance and breadth of expertise. As we have frequently indicated in the past and the Government has taken on board, insurance is very different from banking, as are life and non-life insurance and retail and large-risk insurance and reinsurance. It will be essential that measures are taken to ensure that a balanced mix and depth of expertise are integrated into the FPC from the outset (please see also our responses to Questions 5 and 12).

Parliamentary scrutiny

Given the vital importance of the role of the FPC to the nation, we would also suggest, as a necessary safeguard, that, in addition to reporting to the BoE and HMT, the FPC should be subject to Parliamentary scrutiny. To require it to report to the Treasury Select Committee on a regular basis would enhance its accountability to all its stakeholders. Moreover, given that the members of the FPC will be closely interlocked with the Bank and with the PRA and the FCA, it will be desirable that there should be supplementary scrutiny at the highest level.

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

We are grateful to the Government for its willingness to accept the need for the specificities of insurance to be taken into account in the new regime. We also agree that it is necessary that the PRA should make it clear how it will interpret its objectives in relation to different types of firm and activity and we look forward to discussing the relevant issues with the PRA.

Insurance-specific requirement

In our view, the proposed insurance-specific requirement for the PRA to protect policyholders will contribute to ensuring that the particularities of the insurance industry will be integrated into decision- and rule-making by the financial-services regulators. The requirement should, moreover, fit in well with the FCA's operational objective of "securing an appropriate degree of protection for consumers", though it will be necessary for the two regulators to consider carefully the consequences of any potential divergences arising from the two different objectives.

No no-failure regime

We also support the Government's position that a no-failure regime is not feasible. To meet demand from the public and the economy for cost-effective, diverse and relevant provision of services, industry needs to be adaptable, responsive and creative. As the Government recognises, that requires flexible, judgement-led, principles-based supervision that is not rooted in box-ticking. Occasional failures may be inevitable, but will be less of a burden on the economy and customers as a whole than a rigid over-prudent and over-capitalised system.

Regard for competitiveness

We regret, however, that the Government does not recognise the need for the regulators to have regard for the competitiveness of the financial services sector, which, despite the financial crisis, remains a mainstay of the national economy and still offers major opportunities for growth and inward investment. There can certainly be no doubt that insurance and reinsurance will remain important contributors to the economy. We believe that, while the essential need to protect the stability of the economy and the markets is paramount, it would also be appropriate that, in making their judgements, decisions, policies and rules, regulators should have regard for the importance of the sector to the economy.

International scope of PRA regulation

The consultation documents express support for the development of a common framework for the regulation of international insurance and respect for international agreements. It is also made clear that the PRA will play an active role in the EU and international supervisory colleges. We welcome the emphasis placed on international engagement and co-operation, as we believe that harmonisation of convergence of regulations across the world will reduce costs for international insurers and reinsurers and the burden of compliance with many different regulatory requirements.

Nevertheless, the BoE/FSA paper on insurance supervision makes several points that are of concern to us.

Paragraph 82 indicates that the PRA will set out to understand the safety and soundness of entities active in the UK and their ultimate parents. That is good practice and in conformity with Solvency II. However, there is also an implication that the PRA will effectively wish to regulate the ultimate parent. To avoid a situation where numerous host supervisors are seeking to regulate third-country parents, we would strongly recommend that agreements be made so that parent companies are regulated by their home supervisors and supervisory colleges according to standards recognised by home and host supervisors. The paragraph also refers to the IAIS ComFrame initiative as a "strengthened supervisory framework for internationally active insurance groups including improved co-operation among supervisors." While we applaud the desire for co-operation, we see no reason to add yet more regulatory requirements to those already to be imposed by Solvency II and hope that it will be possible to develop the ComFrame out of existing requirements and the sharing between equivalent national regulators of existing regulatory reports and disclosures without imposing still more demands for new data in new forms from insurance and reinsurance companies.

Paragraphs 83 (UK subsidiaries of overseas insurers) and 84 (UK branches of EEA insurers) seem to imply that the PRA will question the competence of other EEA or non-EU supervisors recognised as equivalent. We are concerned that this could cause potential damage to the reputation of subsidiaries and branches operating in the UK (and to their parent undertakings and policyholders in the UK and elsewhere). While we would want and expect the PRA to be vigilant, those are negative messages to be sending to foreign partners and to foreign subsidiaries and branches operating in the UK. We wonder also whether PRA would be in breach of the European directives.

Paragraph 85 leads us to think that the PRA could impose significantly more exacting requirements on the UK branches of non-EEA companies and their companies. We question the need and desirability of doing so. The capital requirements for such insurance companies are already stringent. Reporting requirements relating to the governance of the parents should be proportionate and should not be so demanding that they equate to supervision.

Lastly, Paragraph 25 expresses the view of the BoE and the FSA that for internationally active firms, the group supervisor should be ready and able to conduct effective consolidated supervision of all activities (regulated and unregulated) within a group. We wonder whether that is necessary or consistent with Solvency II.

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

The PRA as main regulator

We welcome the Government's decision that the PRA should "have sole responsibility for matters relating to the interests of policyholders which could have an effect on the financial position of the firm" (BoE/FSA paper, June 2011) and that the PRA should consult the FCA in delivering that responsibility. The clarification of the roles of the two regulators, effectively making the PRA the lead regulator for a considerable proportion of insurer and reinsurer activity, should reduce the scope for overlaps and underlaps and make it easier for insurers and reinsurers to evaluate what each of the two regulators will expect from them.

Judgement-led is a difficult approach

We support the Government's aim to promote the role of judgement and expertise. As it proposes, the regulatory regime should be judgement-led and founded on informed understanding and sound data. Reasoned and informed evaluation of the risks represented by each firm and by each category of firm or distinct market must be the best way to identify effectively and sufficiently early where the major problems will arise, how to allocate resources and how safely to oversee the evolving future of each firm and how to engage. As indicated in the consultation documents, however, such a regime will depend on high quality staff and senior management engagement in the judgement-making about each firm and category of firm or market. The staff in question would need to be highly experienced and qualified in order to have acquired the understanding and knowledge needed to exercise the requisite degree of judgement. At present there is a chronic shortage of such personnel within the insurance and reinsurance industries because of the advent of Solvency II and the many changes taking place in the wake of the financial crisis within organisations and in regulatory requirements. As a result, we have reached the reluctant conclusion that implementation of an effective judgement-led regime for insurance and reinsurance may be achievable only over a lengthy period of time (please see also our responses to Questions 7 and 13).

We approve of the Government's decision that the National Audit Office should be able to initiate value for money (VFM) studies of the PRA. Such work will be necessary to evaluate and enhance the effectiveness of the judgement-led system in deciding on which firms, categories of firms and markets it should concentrate its resources. We also believe that the regulatory system in the UK is likely to be significantly more expensive than in other European countries and VFM exercises could be useful in reducing costs.

Resolution and recovery plans and systemic risk

We appreciate that, in the aftermath of the financial crisis, it is necessary for legislators and regulators to focus on arrangements for preventing and managing the failure of financial services firms. However, in the insurance and reinsurance sector, the authorities and the courts have already developed relatively sophisticated systems for winding up entities with insurance liabilities (including the orderly run-off of solvent companies). That is because of the inherent difficulty in evaluating insurance liabilities, particularly in the long term. Thus, to protect policyholders, various schemes of arrangement have been developed to manage the assets and the payment of the claims of insurance companies considered insolvent. Moreover, Solvency II will provide a sensitive system under which supervisors will be alerted to problems within insurers and reinsurers and will be required to take steps to ensure that companies are nursed back to health or wound down with minimum detriment to policyholders. We would suggest that the PIF for insurance and reinsurance will need to be redesigned to incorporate Solvency II and the existing winding-up arrangements. It will also be necessary to ensure that safeguards are maintained to avoid the spooking of creditors, customers and investors.

In relation to the emphasis on resolution and recovery plans, we must also challenge the underlying assumptions made about the potentially systemically risky nature of reinsurance in paragraphs 13, 86 and 87, and Boxes 1 and 3 (stage 3) of the BoE/FSA paper on insurance supervision. As is evidenced in numerous recent publications by the Geneva Association and others, insurers and reinsurers do not present a systemic risk to the economy. They have an innate stability in that, unlike other industries, they are paid in advance and, unlike banks, they do not have to refund deposits when the customer chooses, but only make payments as and when customers make valid claims. They are also not interconnected in the same way as banks. The fall of an insurer will not have an effect on another insurer. Nor will the fall of a reinsurer cause the collapse of its cedants, partly because insurers diversify their assets and reinsurance portfolios and partly because, as stress test scenarios show, that it is most unlikely that a reinsurer will suffer such losses that it cannot go into orderly run-off with all claims being paid (please also see our response to Question 10).

The concern expressed about marine or aviation insurance in paragraph 15 of the same paper is also misplaced. It is true that, occasionally, an event could cause reinsurers to withdraw cover from a particular economic activity and that could have a systemic effect on the industry in question. However, that risk can be dealt with effectively if the state provides a guarantee (as with terrorism insurance in the UK) that it will step in to reinsure the reinsurers (or insurers) against losses above the limits beyond which they cannot honestly and rationally promise to pay claims in conformity with the regulations.

Overall, the stability of marine and aviation cover, the effectiveness of reinsurance for risk-transfer purposes and the potential risks arising from interconnections between reinsurers and insurers may be subjects that will always merit interest, but the regulators will need seriously to consider comparing the benefits of any potential studies with the costs.

Balance of expertise

We are pleased to note that the Government has taken on board our concerns that the right balance of expertise should be present on the board of the PRA and expects that the BoE will ensure that is the case (please see also our responses Questions 1 and 12).

Consultation and complaints

In a judgement-led or principles-based regime, the need for consultation and a good complaints system is particularly acute. As the HMT consultation recognises, erroneous judgements will inevitably be made. Differences of perception, interpretation and understanding of context and degree will affect conclusions and evaluations of importance.

We do not think it appropriate that the PRA should be able to choose for itself the means by which it engages with practitioners. We would suggest, therefore, that the Practitioner Panel should be maintained and that its constitution and role should be decided by an independent body on the basis of consultation with the industry and the regulators.

In our view, the PRA should also be required to hold an annual meeting for stakeholders. While such meetings are often stage-managed and may attract some ill-informed or special-interest participants, they do provide a channel for the expression of concerns that should be kept open in case of need.

The draft Bill sets out a framework for the appointment by the BoE of an independent investigator to deal with complaints made by regulated entities against the PRA (or to refer them to the Upper Tribunal). While the framework appears generally sound, we are concerned that the complaints system is in effect the only mechanism by which the regulator is made accountable to the industry. The industry has no other administrative recourse to check any tendency towards arbitrary, disproportionate or unduly harsh use of power. In order to ensure accountability and effectiveness, we would suggest, therefore, that the industry should be able to scrutinise the appointment and conduct of the investigator (please also see our response to Question 12). The function could be fulfilled by a body analogous to the Practitioner Panel.

We are pleased that the Government has recognised the importance of the safeguard that the Upper Tribunal represents for independent review of supervisory decisions and that it is now proposed that references to the Tribunal should be heard not on the limited grounds of a judicial review, as previously mooted, but within the full merit review framework, as is currently the case in relation to the FSA. The consultation document indicates, however, that, with the exception of disciplinary matters and those involving specific third-party rights, while the Tribunal will be empowered to remit the decision to the regulator with directions, it will not be able to substitute its opinion for that of the regulator as to the regulatory action which should be taken. We understand that it is intended that the specialism of the PRA should be at such a high level that that no other body would be equipped to make better expert judgements on the regulatory matters within its scope. In our view, however, experience has shown, particularly in the context of the financial crisis, that experts can collectively make misjudgements, so we would recommend independent review of the implementation by the PRA of the Tribunal's decisions and directions.

One potential source of disagreement could be the concept of "creative compliance", as identified in the FSA paper on insurance supervision. We understand and respect the regulators' concerns about companies obeying the letter, but not the spirit, of regulations. However, the accusation of creative compliance is potentially so broad in its application that we feel it could easily be levelled at companies that have made every effort to comply with the letter and the spirit. We would suggest that the term should be tightly defined to identify only firms that have evidently set out not to comply with the intentions of the regulator.

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

In our view, the strategic objective proposed for the FCA of promoting market confidence is sound, as are the three operational objectives of protecting consumers, promoting efficiency and choice and protecting and enhancing the financial system.

The definition of the consumer, however, as set out in the FSA paper on the FCA, is poorly adapted to general insurance and appears to have been drafted with other categories of financial services in mind. The categories of wholesale consumer proposed are not meaningful in relation to general insurance and could cause confusion if applied to it.

We would also agree that high-quality market research will help to promote competition and market effectiveness. Nevertheless, we also believe that understanding of context and actual customer needs are very important, so we would suggest that caution be exercised in the use of high–level economic analysis of markets as the results may not take into account the realities of competition and customer demand in the real economy.

We are in favour of full regulatory transparency and we also believe that firms should be as transparent about costs with their customers as is appropriate. We do not, however, believe that information released to regulators in confidence by regulated entities should be made public unless there is a statutory requirement to do so.

We wish to suggest that claims managers could be included in the scope of the FCA. We do not believe that the "compensation culture" is in the interests of the consumer, as market studies would no doubt reveal.

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

Product intervention

Given that the mis-selling of PPI was for the most part an issue relating to the practices of credit institutions at the point of sale, we do not believe that product design issues in general insurance have given rise to sufficient concern to warrant new powers of intervention. We note that the regulators are imposing high-level principles with which the senior management and product designers of all financial services will need to conform. However, we do not think that the regulators will find it necessary or cost-effective to intervene in product development in general insurance. As the Government recognises in the HMT consultation document, it is certainly unlikely to be appropriate in relation to professional or wholesale customers (large risk insureds and reinsurance cedants). We note that the Government intends the new product-intervention power only to be used when it is appropriate and proportionate. That is important as the power could indeed cause considerable reputational damage if misused.

Early publication of disciplinary action

The new power to disclose that a warning notice has been issued in respect of disciplinary action has the potential to cause major detriment to the firm concerned. To avoid causing disproportionate damage, the regulators will need to use it sparingly and with great care. We agree that it is important that the person who will receive the notice should be consulted in advance. In our view, that person should also have a right of appeal to an independent body and also the possibility of seeking redress subsequently for any unnecessary or disproportionate damage. That would constrain the regulators to use the power only when fully appropriate.

Cost of the proactive regulatory approach

As indicated in our answer to Question 5, we have concerns about the effectiveness and cost of the new regulatory regime. It is intended that it should continue to be more intrusive, be tougher and bolder, have lower risk tolerance, engage more heavily in enforcement and invest in a wider range of policy expertise, notably economics. As with the PRA, that will demand more resources than the previous regime, notably in respect of staff, who will also need to be experienced enough to be credible in their tougher, bolder roles. We fear that the FCA will have difficulty in recruiting, retaining and paying the new staff (please see also our response to Question 13). We would also suggest that VFM studies would be a useful tool for the FCA in evaluating the effectiveness of its approach.

Risk framework

The effectiveness of the design of the risk framework of the FCA will clearly be crucial to its success. We look forward to consultation in due course. In particular, we would welcome discussion of the balance the FCA is expected to strike between “severity” and “numbers of consumers”, where the FCA will identify the firms and categories of firms most at risk and therefore deserving of most attention from the regulators.

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

When mass detriment is caused by the industry, it is not only damaging to policyholders. The reputation of the firms concerned and the industry are also harmed, which in turn affects market confidence and profitability. We would therefore support mechanisms designed to ensure rapid redress, but we would not wish to endorse any approach which would generate high legal fees, exaggerated reparations or large numbers of false claims.

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

We are generally supportive of the proposals regarding the promotion of efficiency and choice through fostering open competition in the marketplace.

Some comments in the FSA paper on the FCA have, however, given us grounds for concern. There are a number of cases where it is suggested or implied that the wholesale markets may be detrimental to retail customers or are likely to threaten confidence in the UK financial system. The main contention appears to be that wholesale activity can trigger anti-competitive effects right down the distribution chain to the retail customer. We wish to emphasise that there is no evidence of such detriment being caused to insurance policyholders by reinsurers or large-risks insurers. The reinsurance market is, moreover, extremely competitive and unlikely to have negative vertical effects on the retail market (please also see our response to Question 5 in relation to systemic risk).

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

While the framework appears generally sound, we are concerned, as with regard to the PRA, that the complaints system is in effect the only mechanism by which the regulator is made accountable to the industry. The industry has no other administrative recourse to check any tendency towards arbitrary, disproportionate or unduly harsh use of power. In order to ensure accountability and effectiveness, we would suggest, therefore, that the industry should be able to scrutinise the appointment and conduct of the investigator (please also see our response to Question 5).

<u>Balance of expertise</u>

It is important that the right balance of expertise should be present on the board of the FCA, reflecting all the relevant sectors and branches, notably general insurance and reinsurance (please see also our responses to Questions 1 and 5).

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

In our view, it is vital that the coordination arrangements should work effectively. There is a great deal of scope for overlaps, underlaps and general confusion, which will cause potentially considerable extra costs and administrative burdens for the two regulators and the regulated entities. We are, consequently, pleased to note the attention the Government is giving to the matter. We believe that the proposed statutory duty to coordinate and the Memorandum of Understanding could resolve many of the potential difficulties. Nevertheless, it will take time and regular discussion and review to get the balances right, to develop the culture of cooperation and to keep things on an even keel. It will be important that the two regulators should consult the industry from the outset and continue to do so on a regular basis to ensure that problems are being identified and resolved. We look forward to receiving the draft consultation on coordination between the two regulators and the draft MoU.

As already indicated in our responses to Questions 5 and 7, we believe that the shortage of experienced staff in the field will pose problems for the two new regulators. The existence of two separate bodies will add to the problem because even if they successfully divide up, without overlap, their duties and activities, each will still need senior management tiers, policy experts and teams of experts to develop similar skill and knowledge sets and to establish relationships with the same companies and outside bodies. They will also need staff to manage liaison between them and with the FPC.

We welcome the proposed veto of the PRA to prevent the FCA from taking actions that could lead to failure, though we think it unlikely that financial instability could ensue. The power would protect policyholders from financial loss, as well as preventing destabilisation of the undertaking concerned.

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

Authorisation and approvals

In our view, the proposed harmonisation of authorisation processes, so that one regulator conducts the authorisation process, subject to the approval of the other, is essential. Complicated authorisation processes are costly to the regulators and to the applicant companies. They also represent a significant barrier to inward investment. We believe, therefore, that the two regulators must devote careful attention to ensuring effective, fair and smooth procedures, with a minimum of duplication. The same need for harmonised and streamlined procedures without duplication applies to variations of permission.

For similar reasons, we support the Government's proposal that the PRA should have primary responsibility for designating Significant Influence Functions. Impractical or unnecessarily onerous and complicated Approved Persons procedures are a major source of annoyance and frustration in the insurance and reinsurance industry, so we will welcome attempts by the two regulators to develop a system that is as seamless and practical as possible.

Passporting

We agree that it should be to the PRA that notifications from overseas regulators should be made to avoid confusion for the regulators and the companies concerned.

Rule-making

We also welcome the Government's proposals to ensure that conflicts cannot arise from conflicting rules being developed by the regulators.

Enforcement

The HMT consultation considers that the minimum period of 28 days for representations about the issue of warning notices is currently too long. It indicates that such a long period is not required in many cases, for example in straightforward cases or where the person has admitted their contravention or does not respond at all, and that the existence of the requirement slows down the enforcement process unnecessarily. The Government therefore proposes to reduce the minimum period to 14 days. However, the relevant authority would continue to have the discretion to specify a longer period on an individual basis, should that be considered appropriate. In our view, however, 14 days for a company or an individual to prepare representations may well not be enough. We believe that the relevant authority should be compelled to accept the minimum period of 28 days or longer, should that be requested by the person/s concerned.

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

Financial Service Compensation Scheme (FSCS)

In Paragraph 11 of the BoE/FSA paper on the PRA and insurance it is said that the PRA would seek to ensure that the FSCS has sufficient understanding of a firm's systems to maintain payments to policyholders in the case of insolvency. That appears to imply that the FSCS is a kind of reserve bank for failed companies. We believe that it should rather be viewed as a fund from which monies may be drawn to cover the unpaid liabilities of a wound-up company.

Financial Ombudsman Service (FOS)

We recognise the invaluable role of the FOS in protecting consumers. Nevertheless, there are occasions where an individual decision by the FOS sets the standard for similar decisions in similar cases. That may be entirely appropriate, but there are occasions where it is not, because of the special circumstances of the case about which the individual decision was made. We suggest that the FCA should be empowered to decide whether or not the decision should be regarded as setting the standard in similar cases.

We hope that you will find these comments helpful. Please let us know if you require any further information or suggestions.

Nick Lowe
Director of Government Affairs

Nick Lowe
Director of Government Affairs
International Underwriting Association of London Ltd.
Tel. +44 (0)20 7617 4454
Email nick.lowe@iua.co.uk

ILAG

Investment & Life Assurance Group
The Practitioner Voice

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

8 September 2011

Dear Sirs,

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

ILAG is a trade body representing members from the Life Assurance and Wealth Management Industries.

ILAG members share and develop their practical experiences and expertise, applying this practitioner knowledge to the development of their businesses, both individually and collectively, for the benefit of members and their customers.

A list of ILAG members is at the end of this submission.

We have a number of general comments on the consultation which are listed below. In addition our responses to the specific questions of the Consultation are attached.

General comments

We accept that regulatory change is necessary; however we have concerns as to how the changes will be implemented. The proposals must be carefully considered and not rushed. Regulatory change needs to be proportionate, of measurable benefit to all stakeholders and acknowledge the need for due regard to be taken of the competitive position of UK plc and the effects on the wider national economy and financial stability.

A stable and durable financial services industry is vital for the UK economy, business and consumers.Effective regulation of financial services forms a core part of the Government's plans to ensure a sustainable future for the sector, which is a major contributor to the UK economy. ILAG members fully support the proposals for the creation of the FPC but, as you will see from our responses to the consultation questions, we are not convinced as to the merits of the division of FSA as proposed.

We accept that the recent economic crisis and resulting recession has presented a number of unprecedented challenges. The need for regulatory change has been hightlighted by an

mark.searle@ilag.org.uk
01342 312248

uncertain economic outlook, decreases in funding for business and increase in numbers of consumers who are defaulting on borrowing.

Of paramount importance in the proposed structure will be the strength and quality of leadership, appropriate skills and competence of employees, combined with a need for both cultural and behavioural change. With key personnel merely transferring across to the new regime we question whether the impacts required by Government will actually take place without the effective recruitment of new quality personnel.

Yours faithfully

Mark Searle
Administration Team

mark.searle@ilag.org.uk
01342 312248

Response to specific Consultation questions

Q1 - Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?

We support the proposals and we welcome the creation of the FPC but we are not convinced as to the merits of the division of FSA.

In particular we wish to emphasise the importance of:

- Independence
- Balanced membership
- Accountability
- Transparency

Q2 - Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems as described in paragraphs 2.32 to 2.40 and in Chapters 3 and 4?

No comment.

Q3 - Do you have any comments on:

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

We support the proposals within 2.41 to 2.44 for the co-ordination of crisis management.

However, it would be difficult to plan in detail for every potential crisis which by their nature are unexpected. The main requirements are flexibility, realism and making sure, as far as possible, that there are no ambiguities on where responsibilities lie and no 'gaps' in the apportionment of those responsibilities, so that all key areas are covered.

Proper consideration of communications is fundamental requirement as this can either exacerbate or mitigate any problems ie better informed press releases can prevent miscommunication or concern for the consumer.

Q4 - Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?

Q5 - Do you have any comments on the detailed arrangements for the PRA described in paragraphs 2.62 to 2.78 and in Chapters 3 and 4?

We support the two additions that have been made to the PRA objective within 2.48 and welcome Government agreement with the arguments put forward by respondents representing Mutual organisations and intended legislation to require the new authorities to consider and consult on the impact of proposed rules on mutual societies. It is important that these requirements are reflected in the manner in which the PRA and FCA operate.

We note the introduction of an insurer-specific objective; the protection of policyholders which aligns FSMA with the Solvency II Directive. We note this should be given equal weight with the PRA's general strategic objectives. Nevertheless, we question whether, in practice, the PRA will be able to achieve this given that compliance with Solvency II is required to take

mark.searle@ilag.org.uk
01342 312248

priority - and indeed whether the PRA will have much scope at all to exercise judgements in relation to matters of policyholder protection, since it will be obliged to act in a way consistent with the provisions of Solvency II.

We agree that with the move to ‘judgement-led’ regulation and the increased emphasis on supervisory discretion, that the quality of PRA and FCA staff is paramount.

This is particularly so given that the draft Bill provides for a significant change to the powers that the Upper Tribunal has in respect of appeals from the PRA’s formal supervisory decisions (with the exception of disciplinary matters) with the Tribunal losing the power to substitute its own decisions on the merits for those of the PRA, being restricted to remitting the matter back for a fresh consideration. This represents an erosion of the rights of firms to an independent review and shifts the balance of power to the PRA.

Strength and quality of leadership appropriate skills and competence of employees will be essential. We agree that there needs to be a cultural and behavioural change, but it is not clear how this is going to be achieved. Culture will naturally be guided by those in charge and with key personnel (particularly those who may have been involved with the previous regime) simply transferring across to the new regime we doubt there will be change to the degree, or at the speed, that the Government requires. It is not indicated where the staff competent to operate such a challenging regime will be recruited from and there must be doubts as to whether this reform will meet its objectives if recruitment of quality staff proves to be difficult.

PRA will be much concerned with risk and will challenge the senior management, particularly in large firms, and criticise their competence business strategies, controls, together with any other business area which they think needs attention. This promise of intrusion suggests that FCA will take an increasing role in the management of firms and apply a form of super equivalence on the conclusions the firm’s executives reach.

There must be a proportionate approach by the new regulators on how the new intrusive approach by FSA transfers over to the new regime. We believe that the change to a new regulatory regime provides a good opportunity to take stock and examine the degree to which, and how, an intrusive approach is applied.

The experience of some of our members to date is that FSA appears to be taking the same intrusive approach to all firms regardless of its size, systemic threats, type of business conducted, risk profile etc.

Moreover, the nature and frequency of questioning by FSA includes many low level issues that border on micro-management. It is a widely held view that the recent financial crisis was in part caused by the Regulator micro managing areas of relative insignificance, diverting resources away from looking at the bigger picture and matters which threatened the stability of markets.

We see nothing here which causes us to think that FCA’s intended intrusive approach will not again descend to the depths of detail best left to firm’s executives and those they report to. Such an approach simply adds cost for little regulatory reward and seems to be a continuation of ‘tick box’ regulation with a different label. It perpetuates the risk that the bigger picture issues may be missed.

It is also to be hoped that the Treasury will continue to resist the strident calls by the consumerists for a consumer panel for PRA. The price of that may be the absence of a formal Practitioner Panel for PRA but there could be much value in whatever alternative

mark.searle@ilag.org.uk
01342 312248

arrangements are made for dialogue between PRA and practitioners.

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

The single objective subdivided into three operational objectives does seem to be an improvement, providing a sharper focus. The principles are also being welcomed particularly those relating to consumer responsibility. However, all will depend on how FCA interprets its remit and the way in which this interpretation is controlled.

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

We believe that publishing warning notices without the consent of the firm's involved is unfair and note that Government recognise that the majority of respondents were opposed to this proposal. There may be a public interest case made in the most excessive of cases, where guilt is not in doubt and the outcome of the regulatory processes is guaranteed (but time has not allowed their completion) when publication of a warning to consumers is appropriate. These instances will be infrequent and should have specific controls in place to prevent misuse by the regulator.

Para 2.104 maintains that the FCA should have a duty to publish, as this will increase the visibility of the regulator's activities, provide firms with greater clarity as to good and bad practice, and engender better practice across the industry. We note that it is not stated in what circumstances the publication of a warning notice might occur (Ie due to identification of a 'toxic' product).

Publication would better achieve the stated aims in 2.104 once a Final Notice is served and not before, as there is a danger when publishing warning notices in advance of a final judgement/notice as not all cases will result in any action.

Early publication (unless agreed by the firm) could wrongly result in damage to a firm's reputation. What right of redress would a firm have if unfairly disadvantaged by reputational damage? In severe cases the damage might be irreparable. We are concerned that this factor would not adequately be taken into account in the determination of whether a notice should be made public.

We fully support that the power to create temporary product intervention rules for up to 12 months will only be used where appropriate and proportionate.

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

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

Allowing nominated parties to refer issues to the FCA may work but it would depend on who the groups were and whether they were competent to pronounce on the issues they raised.

There should be a memorandum of understanding between nominated parties and the FCA stating what steps, such as background research, should have been undertaken before referral. This would also aid a more efficient use of FCA resources.

mark.searle@ilag.org.uk
01342 312248

If a system such as outlined came into being, it would also be appropriate for FCA to be set a time limit in which to act and publish the reasons for their decision.

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

These comments seem reasonable but we would be interested to see how this would work in practice.

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

No comment.

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

We are in broad agreement but would emphasise the need for the present robust, formal and transparent process for consultation be retained.

However, some of our members are concerned that it appears the current approach of FSA is increasingly to ignore genuine concerns that are expressed through consultation and we hope that this approach is not carried forward. Consultation/feedback paper CP11/10 ‘Consumer complaints’ was felt to be one such example, with proposals not taking into account any comments made in the responses to CP10/21 that had preceded it.

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

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

The proposals sound reasonable; it remains to be seen how they will work in practice.

Whilst HMT has indentified key areas of focus it is important that proper consideration is given to their implementation and practical application as there are areas of potential confusion, duplication of cost and overlap.

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

The proposed changes to the regulatory structure do not necessitate any changes to either FOS or FSCS. However, we still have concerns about the way that both use their powers. For example FOS often strays outside of the requirements of law and common practice in its decisions and should adhere to a formal requirement to explain and justify these actions and state why it is doing so.

Although there is no mention of the Money Advice Service in the question this service is referred to in the Consultation Paper, and we consider it warrants comment. The use of the word ‘advice’ in the name of this organisation implies that the service does much more than it can and is, at worst, misleading, or, at best, will lead to disappointed consumers finding that they cannot receive advice, affecting the take up and use of the service in the long term.

mark.searle@ilag.org.uk
01342 312248

We consider improved consumer education is a vital area if regulation and distribution reforms are to be successful. We suggest that ‘Money Guidance Service’ would be a more appropriate name especially given the potential increase in use of the service, which is likely to witness more visitors to its website following implementation of RDR.

We would be happy to be involved in any consultation on its future development of this service.

Ends

mark.searle@ilag.org.uk
01342 312248

ILAG Membership

Members

AXA Wealth
Barclays Wealth
Barnett Waddingham
Bupa Health Assurance
Canada Life Limited
Capita Life and Pensions Services
Co-operative Financial Services
Defaqto
Deloitte LLP
Ecclesiastical Insurance Group
Ernst & Young
Family Investments
Fil Life Insurance Limited
Friends Life
General Reinsurance (London Branch)
Hannover Life Re (UK) Ltd
HSBC Bank Plc
Just Retirement Limited
HCL Insurance BPO Services Limited
KPMG
Logica
London & Colonial Assurance PLC
LV=
Milliman
Met Life UK
Metropolitan Police Friendly Society Ltd
MGM Advantage
Mazars
Oxford Actuaries and Consultants plc
Pacific Life Re
Partnership Assurance
Phoenix Group
Pinsent Masons
PricewaterhouseCoopers
Reliance Mutual
RGA
Royal London Group
Sanlam Life & Pensions
SCOR Global UK Limited.
Skandia UK
Suffolk Life
Sun Life Assurance Company of Canada
Swiss Re Europe SA (UK Branch)
The Children's Mutual
Towers Watson
Vertex
Wesleyan Assurance Society
Zurich

Associate Members

AKG Actuaries and Consultants Ltd
Steve Dixon Consultants and Actuaries
McCurrach Financial Services
Meteor Asset Management
NMG Financial Services Consulting Limited
State Street Investor Services

mark.searle@ilag.org.uk
01342 312248

Investment Management Association

8 September 2011

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

Dear Sirs,

HM Treasury Consultation: A new approach to financial regulation: the blueprint for reform

The IMA represents the asset management industry operating in the UK. Our Members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes.

They are responsible for the management of around £3.9 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. As an example, our members manage client positions which in aggregate exceed 40% of the UK stock market.

We welcome the opportunity to comment on this consultation.

Overall

- The absence of competitiveness as a "have regard" is a serious flaw.
- The provisions relating to the FSCS, both governance and powers, and the scheme rules need complete revision;
- Certainty about which firms will be regulated by which regulator is essential, especially within groups and for asset managers with insurance subsidiaries;
- The suppression of details concerning the PRA veto should be a matter for HMT Treasury, not the PRA.
- The so-called product intervention clauses as drafted allow almost unfettered intervention in any business relationship;
- The importance of the client asset protection function at FCA requires it to feature in co-ordination and consultation obligations by PRA.
- The Regulated Activities Order and permission regime reflects out of date and unmappable provisions unfit for the single market.

Consultation Questions

In answering, we refer to clauses of the Bill as clauses and sections proposed to be inserted into FSMA by those clauses as "new Section".

65 Kingsway London WC2B 6TD
Tel:+44(0)20 7831 0898 Fax:+44(0)20 7831 9975
www.investmentuk.org

Box 2.A: Consultation question

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

We do not have any specific comments about the objectives of the FPC as set out in section 9C. We welcome new section 9E(2), the duty to seek to avoid prejudicing the advancing by the FCA and PRA of their objectives. New section 9E(3)(c) is also welcome, the need to have regard to the international obligations of the UK; this is a concept we would like to see advanced to the FCA (and PRA).

Box 2.B: Consultation question

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

We do not given it is now decided that RCHs will be regulated by the Bank of England. We agree that the regulation of CREST and the nature of the RCH regime compared to the European approach, especially under EMIR, will need review (your paragraph 2.38). We welcome the requirements under new Schedule 17A for a MoU between the Bank and the FCA and PRA.

Box 2.C: Consultation questions

3. *Do you have any comments on:*

- *the proposed crisis management arrangements; and*
- *the proposals for minor and technical changes to the Special Resolution Regime as described above and in Chapters 3 and 4?*

The crisis management arrangements are uncontroversial at such high-level; we await the outcome of the FSB and European Commission work in this area to which we are responding.

We do however note that the original separation of powers between FSA and the Bank of England secured under section 7 of the Banking Act 2009 are arguably diminished by the PRA and Bank now needing to consult one another and for the PRA to agree that the threshold conditions are no longer met. Given the policy behind section 7 to use FSA was a safeguard, Government ought at least to review any impacts from this now being transferred to a subsidiary of the Bank of England.

In similar fashion to concerns we have raised with the FSB, we think that the issue of recovery and resolution plans and other crisis management issues have not sufficiently considered the role of the FCA as the body principally responsible for client asset protection policy.

Otherwise, we support the SRR proposals.

Box 2.D: Consultation question

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

A significant issue for firms presently is uncertainty as to which of FCA and PRA will be their lead or only regulator. It is critical that this is made clear as soon as practicable and ahead of the Bill's consideration. We are informed that messages from FSA and HMT are not consistent. Firms should know where they might stand. The draft order on splitting responsibilities should be provided to the pre-legislative scrutiny committee.

Many IMA members are within insurance-owned groups, some in bank-groups, but most are in neither. Of those not in insurance groups, many will have insurance subsidiaries for the sole purpose of writing unit-linked reinsurance contracts. We had asked for these to stay with FCA. We think the order should make provision to allow these connected companies to be FCA-regulated where they only write these unit-linked contracts.

We understand that each firm will be looked at separately and therefore no BIPRU 125K asset manager will be regulated by PRA even if a parent or sister company is a bank or insurer. This will mean that many FCA-regulated firms will have a single and subservient PRA-regulated subsidiary for contractual purposes. We consider the approach of the Bill and the draft documents on approach by the PRA and FCA presume that PRA's involvement will be where the group is by its nature PRA-regulated. It is important to note that the listing of numbers of firms said to be conduct and prudentially regulated by FCA may not tell the whole story for asset managers. Unless exempted, this use of reinsurance will permit PRA to have involvement in groups which in policy terms were probably meant for FCA alone. That alone will add to the complexity of running an asset manager in the UK and we would question the policy benefit in so doing.

In addition, PRA will have a power to designate other types of firm. It is not clear whether the PRA's statements about this proposed power and those of HMT are consistent. We have **annexed** an internal IMA note on the current statements about scope from the Authorities. Clarity through the publication of a draft order as the Bill proceeds is necessary. .

Clause 5, new section 2B: we question whether the PRA's objectives are overly focussed upon the UK. We would expect a provision such as at new section 9E(3)(c) for the FPC to be replicated here.

Clause 5, new section 3B: the regulatory principles are to include "responsibilities, in relation to compliance with requirements imposed by or under this Act, of the senior management of persons subject to those requirements". However section 2(3) of FSMA refers to the broader "responsibilities of those who manage the affairs of authorised persons." It is not clear whether there is a policy change here.

Box 2.E: Consultation question

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

We have recorded in the previous consultation our concerns over the veto power and the risks that some banks will be over-protected; if not only through its use, but through FCA's perception of when it might be vetoed. Generally we think the FPC as well as FCA should be consulted; so section 3J(1) needs amending. As regards publication we think that it is for HM Treasury not PRA to judge the public interest. So section 3J (7) should refer to HM Treasury. Thus HM Treasury will lay a copy before Parliament and notify and publish as the public interest demands. More specifically, we propose that the power under new section 3H should never be able to be exercised in relation to any power given to FCA to prosecute a PRA-authorised person or bring a market abuse action against the same.

We are of the view there should be a single independently-appointed complaints commissioner able to determine all FCA and PRA complaints; this would prevent co-ordination complaints falling between two stools (The Part 2 in each of New Schedules 1ZA and 1ZB). The appointment and removal should be by HM Treasury.

We note PRA has no power to make statutory general guidance (as opposed to guidance on objectives under new section 2H). It would be helpful to understand whether it is expected the PRA will ever issue anything other than a rule (our comments about FSA guidance and other material under section 7 is relevant).

There will be benefits in having a more formalised process of engagement with (but not accountability to) practitioners, particularly in the early years, at least to address overlap and underlap in regulation between the new twin peaks. The changes being made are complex and unforeseen impacts will arise; the Practitioner Panel could assist in this area and Government should re-consider its position in this regard.

Box 2.F: Consultation question

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

We agree the objectives save as stated below.

We maintain our disagreement with Government over the absence of competitiveness as a particular issue to which the regulators must have regard. We have examples where the FSA has decided not to introduce rules to allow certain fund arrangements where these are available in Luxembourg or Dublin under European legislation. The obvious result is that funds are manufactured in those jurisdictions and passported into the UK. It may be that the judgement is correct but the point is that it should be made with an explicit regard to the position of other countries in the Single Market. We believe this issue links to our concern that the PRA's objectives are overly focussed upon the UK. We would expect a provision such as at new section 9E(3)(c) for the FPC to be replicated here.

Clause 5, new section 1D (the integrity objective) is critical in the absence of an explicit safety and soundness objective (such as for PRA's firms at new Section 2B(2)) since the FCA will have a role in ensuring safety and soundness in relation to critically important market infrastructure.

Clause 5, new section 3B: regulatory principles include "responsibilities, in relation to compliance with requirements imposed by or under this Act, of the senior management of persons subject to those requirements". However FSMA section 2(3) referred to the broader "responsibilities of those who manage the affairs of authorised persons." It is not clear whether there is a policy change here.

Box 2.G: Consultation question

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

The New Section 137C is almost unlimited in its width. While we understand there is a need to consider product intervention on a much more proactive basis; the proposed clauses give unprecedented power to the FCA. We think there is still a need for greater thought about how it might operate especially in relation to authorised persons providing cross border services and with contracts formed under the laws of other countries. Alongside a legitimate concern to ensure that consumers do not suffer detriment, there is a need to provide some level of legal certainty so as not to disincentive any form of product innovation in the UK.

It is unclear whether the need to use resources in the most economic and efficient manner (new section 3B(1)(a)), will lead to more s.166 reports. These are very expensive mechanisms for supervision from the point of view of firms but probably relatively cheap from the point of view of FSA and their use appears to be on the increase. The FCA paper on supervisory approach does not address this and we are concerned that this may lead to many costs associated with the FCA supervision not being apparent on the balance sheet of FCA.

FCA must be much more open to learn both from FOS but also from FSCS. More generally for the proactive approach to occur, market practitioners will have to have confidence they can speak about concerns with the FCA. At present dialogue between the industry and the Bank of England is of a different depth and quality than with the FSA. In part this arises from the FSA being the regulator but it is also about an approach which needs to be much less insular in policy formation.

We would welcome far greater clarity from the FCA on the use of its powers compared to the FSA. The publication for years of documents which most viewed as guidance, but which were not subjected to the protections provided in FSMA should not be seen as acceptable in the new regulator. Although the FSA is now taking steps to correct these errors by issuing a large number of consultation guidances, it is doing so on very short notice no doubt to preserve the status of a variety of recommendations upon transition to the FCA. We would welcome a much clearer commitment from the FCA as to how it will identify guidance and other recommendations.

Box 2.H: Consultation questions

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

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

We have no strong views on questions 8 and 9. Widespread confidence amongst consumers will be increased when widespread concerns have an outlet which is effective. Currently an important outlet is through the press and consequent reactions by regulators; in this way there will be an additional and more formalised mechanism for evincing a regulatory response to perceived mass detriment. The existence of the power ought anyway to incentivise early consideration by the FCA of such issues (so as to avoid the unwelcome perception that it was reactive rather than proactive). The nominated parties should command respect as independent and unconflicted bodies.

Box 2.I: Consultation question

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

We have no better ideas than the proposed model in new sections 140A to 140H. We see the sense in repealing section 164.

Box 2.J: Consultation question

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

We support or have no objection to the proposed measures.

This is reference at several points (for example paragraph 1.40) to users of financial markets, such as institutional investors, being "consumers". While we welcome the implicit acknowledgement that investors (the "buy side" of the market) are in a very different position from the "sell side" it is important that this should not translate into any suggestion that comparable levels of investor protection regulation are appropriate between retail individuals and institutional investors. Such institutional investors are in a completely different position from retail ones, and this needs to continue to be recognised.

There will be a need for close co-operation with the Bank of England in relation to its existing markets work (such as the Stocklending and Repo Committee) and its market intelligence activity and with the DMO.

Box 2.K: Consultation question

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

There is a drafting error at new section 139A(5) - reference should be made in the text in subsection (3) to section 130J as well. It is an essential part of the duty of consulting on giving guidance that the regulator is obliged to have regard to any representations made to it

We would like to see a more public role for the non-executives. This could in part occur at the Annual Public Meeting but also we would like to see fuller discussions of the FCA Board's reasoning for supporting or opposing specific rule changes. Dissenting comments should be recorded. Commonly we find the publication by the SEC of supporting and dissenting positions on regulatory issues very helpful.

It is essential that the power of HM Treasury to arrange an independent inquiry under clause 46 of the Bill extends to failures in relation to the co-operation and co-ordination duties in new section 3D. We think clause 46(2)(b)(ii) provides for this.

We note as regards annual reports the PRA must carry out a public consultation but have no annual public meeting, whilst FCA must have such a meeting but are not required to consult. Given transparency and confidence needs in society, is there a policy reason for such differences? Perhaps both should do both. (Schedule 3, paragraphs 12 and 20 refer.)

We are of the view there should be a single independently appointed complaints commissioner able to determine all FCA and PRA complaints; this would prevent co-ordination complaints falling between two stools (The Part 2 in each of New Schedules 1ZA and 1ZB). The appointment and removal should be by HM Treasury.

There are a number of legal protections which should be acknowledged by the FCA when publishing warning notices. We note the proposal to consult the person targeted by the warning notice (2.110 and new section 391(1)(c)) but there may be wider "maxwellisation" obligations. It is vital that court-made protections are not ignored or excluded without explicit intention so to act being announced by Government. In this regard we remain of the view that protections about fair comment ahead of any hearing should apply (we are unconvinced the Contempt of Court Act 1981 would provide such a protection).

We repeat our comments about the RDC and internal governance at the FCA; some of the Bill's clauses appear to reduce the level at which decisions would need to be made and the FCA paper has not explained how protections as provided by the present RDC will be preserved.

We would hope that the National Audit Office would look at the cost of data provision to the FCA very early on.

Box 2.L: Consultation question

13*. Do you have any comments on the general coordination arrangements for the PRA and FCA described above and in Chapters 3 and 4?*

In similar fashion to concerns we have raised with the FSB, we think that the issue of recovery and resolution plans and other crisis management issues have not sufficiently considered the role of the FCA as the body principally responsible for client asset protection policy.

We think it vital that the desire of the FCA to have better market intelligence does not lead to duplication by it (or the PRA) of work conducted at the Bank of England. We consider that the market intelligence unit of the Bank of England is likely to be the central place for a large part of the market intelligence that needs to be gathered.

Box 2.M: Consultation question

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

As we stated in our response to the previous consultation, we think that the regulated activities order and the FSA register need to be fundamentally reviewed. There is no need for such a parochial and arcane system of permissions in light of European directives governing most activities of many firms. We remain to be convinced that the current system does anything other than add to costs and uncertainty. We cannot believe that consumers are assisted by having to consider several pages of permissions for a simple firm.

We consider work still needs to be done in relation to the role of the regulators in relation to firms exercising passporting rights and whether it would be more appropriate for FCA to deal with all notifications and supervision (since prudential issues are matters for the home regulator not the UK host).

Box 2.N: Consultation question

15. *Do you have any comments on the proposals for the FSCS and FOS set out above and in Chapters 3 and 4?*

We support the involvement of the NAO in relation to FSCS and FOS.

We have previously suggested that the role of the FSCS is such that its governance and powers should be reviewed. The size and nature of its role in compensation and resolution suggest that it should be seen as a stand-alone entity whose rules are made or approved by HM Treasury. We also consider that the FSCS could have its own rule-making powers to facilitate its activities, for example in relation to single customer views and other preparedness issues.

Above all these issues however we remain concerned that the Bill leaves at large questions over the structure of the scheme, its rules on funding and issues such as cross-subsidy. Leaving aside all the debates on cross-subsidy (cross-subsidies must end), it is fundamentally wrong that the maximum levy upon IMA firms is proportionately about twice what is imposed upon intermediaries.

We are unconvinced that the high-level co-operation duties will ensure the regulators will seek to learn lessons from the FSCS's experiences of defaults or how FSCS will be able to marshall the regulators to assist in ensuring the cost of failure is apportioned appropriately. In this regard, we have in mind the Keydata debacle; we would have expected that alongside investors being compensated, the FSCS could have required reviews to be carried out at firms who might contribute to the ultimate funding of the losses. And if FSCS itself could not have forced a review, it should have a formal power to require FCA so to act. It is wrong that the fund management industry had to find £223M but FSCS could not go direct to any firm to see if it should make a contribution, based on the firm's own liability for failure, despite them being regulated. Moreover FSA should have required a review and for investors to be told whether there had been any advice failures – to date many may think their intermediary has being wholly compliant (as some may have).

We think as well that it should be made clear that whilst the FSCS will commonly pay out investors upon a default, it would be within its powers (perhaps exceptionally) to "wait and see". This might involve a declaration that a person has suffered detriment but that payment of some or all of what might be the measure of damages can await what happens to a product. Thus if a person bought a 5 year bond and expected no payout till that 5th year, it may still do justice to see if the performance is as the person wanted (notwithstanding that an intermediary has defaulted and perhaps failed in making the right disclosures). We are not seeking to keep consumers from payment, we trust our approach to Keydata shows that ensuring investors were duly compensated was a real concern for our members, but we do think that the FSCS should be seen as a mature body in the regulatory system and not merely asked to act as a mechanical based upon rules made at a time when (as will always occur) some events were just not foreseen.

In case there is a risk that cross-subsidy might persist, we would note that many of our members are manufacturers of an approved product – a UK authorised fund (UCITS or national) - they should be seen as a class ring-fenced from any liability to firms which intermediate securities. At present there appears to be better regulatory treatment in terms of FSCS risks of a firm if it manufactures a fund in continental Europe and passports it in to the UK than vice versa. The historic problem with the FSCS sub-classes partly arises because most classes are organised on a manufacturer/distributor basis – insurance and mortgages are such examples. The issue with investments is that most manufacturers are issuers (PLCs and SPVs) and so do not fall within the FSCS ambit. This has caused FSA previously to require fund manufacturers to be the sole subsidising body for distributors of a range of products unconnected with funds. This is patently unfair, in the sense not of moral outrage, but damaging to the attractiveness of the UK as a place to do business.

In relation to FOS, we have noted the proposed duty, in new section 230A (see Schedule 10) to publish a report of a determination unless the ombudsman deems it inappropriate. We consider FOS should be required to have regard to basic safeguards prior to publication - such as ensuring any individuals named have been consulted (we appreciate that compared to publishing a warning notice by FCA this is after determination – nevertheless some individuals may have had no opportunity to comment).

Conclusion

Government is right to review the regulatory system and the draft bill is a start. There are, as our response has shown, several other areas needing real reform to secure the UK regulatory regime's fitness for purpose.

Yours faithfully,

Guy Sears,
Director, Wholesale

Annex relating to question 4

Current thoughts on scope.

HMT's February paper described the Government's policy. Relevant extracts are annexed and should be read.

The June 2011 paper addresses scope at 2.54 to 2.59. It makes it clear that Government does not intend the face of the bill will define scope but rather the new section 22A will empower HMT to designate both what is a PRA-regulated *activity* and to confer functions on the PRA itself to develop designation criteria for identifying PRA-regulated *firms*.

This matches the proposal at 3.23 from the February paper – whereby two classes of firms will in effect be designated (and notwithstanding any individual firm's systemic significance). These firms will be all those with deposit-taking or insurance permission (a class-based activity designation). It also matches the proposal introduced at 3.23 and developed in 3.24-3.25 whereby PRA will set out criteria against which it will determine which additional specific firms will be PRA-regulated (an objective firm designation).

The power appears to envisage PRA designating firms in addition to insurers and deposit-takers as opposed to de-designating insignificant insurance companies or deposit-takers.

Formally at this stage the new section 22A to be introduced by clause 6 of the draft Bill is at large and provides no limit in practice to what might become a PRA-regulated activity (beyond limits arising from PRA's objectives). However the new s.22A may be seen as objectionable by the pre-legislative scrutiny committee as it allows HMT by order to confer powers upon PRA. If such powers allow *firms* to be designated as opposed to *activities* being designated, when s.22A only mentions activities, then this may be an excessive delegation from Parliament. If however PRA was obliged always to use criteria which linked back to an activity then that would likely narrow what they could ever designate – it is unlikely anyone would find it acceptable if PRA stated that the first criteria for deciding whether to designate was that a firm carried on any regulated activity; thus PRA will need to express a limited set of activities along with other criteria. This activity-linked approach to designating particular firms is consonant with the Government papers to date and Box 2 below which is from the PRA paper on its new approach to supervision.

In all these the activity mentioned is "dealing as principal". But this alone is still too wide since the policy expectation is that the designated firm "could pose significant risks to the stability of the financial system or to one or more PRA-regulated entities within their group". Introducing a qualification that limits the class to BIPRU 730K firms (see 3.25) would beyond doubt remove all IMA members – some do have "dealing as principal" permissions, though it is often historic or for very technical reasons. A BIPRU 730K firm is one that is not a BIPRU 125K, BIPRU 50K or UCITS investment firm.

IMA members are BIPRU 125K or UCITS investment firms. As regards the latter we might not expect that PRA has an interest in these even if technically some can deal as principal in box management.

A BIPRU 125K firm (most non-UCITS IMA firms) is one which it "does not deal on own account or underwrite issues of financial instruments on a firm commitment basis".

Dealing on own account is not the same as dealing as principal.

It is often conflated and it may be that the shorthand of the HMT paper does the same (the former refers to a service of using one's capital; the other a legal characterisation of a transaction). So whilst the paper refers to *limiting* the class of firms which deal as principal by reference to BIPRU 730K qualifications, it is by that proposing that the test is "dealing own account by a firm with a permission to deal as principal" – and the words "with a permission to deal as principal" are then otiose. HMT may therefore be proposing that designation is limited to firms which deal on own account. However although firms which "could pose significant risks to the stability of the financial system" might be expected to be large BIPRU 730K firms, the other policy purpose in having designation is to catch the firms which "could pose significant risks to one or more PRA-regulated entities within their group". Here it is not so clear that such a firm would need to be a large BIPRU 730K firm – but it still might not need PRA to look outside the BIPRU 730K firms as a whole.

However there is a different emphasis between the PRA paper and the HMT papers. HMT sticks to the recognised prudential class of BIPRU730K, whilst PRA acknowledges that most firms which deal as principal "are not likely to pose sufficient risk to the stability of the financial system, however, and so the PRA will develop additional criteria for designation. These criteria are likely to include: the size of a firm; the substitutability of its services; the complexity of its activities; and its interconnectedness with the financial system and any PRA-supervised companies within its group." It is unclear whether PRA really expects readers to take the reference to dealing as principal as a hard-edged legal term in distinction to deal on own account. In other words, PRA may not be challenging the concept that they would only ever designate firms which deal on their own account.

What may be more significant is that PRA flag that it is not content with section 22A as proposed – *"consideration will be given as to whether it is desirable to recommend changes to legislation, to ensure that the PRA will be able to regulate all firms posing potentially significant risks to the financial system because their activities are in substance analogous to deposit-taking".* This points to a power to designate members of the shadow/parallel banking system and is worthy of note (at least) by operators of money market funds.

Extracts from existing policy statements

"3.23 In addition to deposit-taking and insurance, the PRA will be able to designate certain investment firms for prudential regulation by the PRA where it determines that they could pose significant risks to the stability of the financial system or to one or more PRA-regulated entities within their group. These risks are likely to arise through the scale or complexity of such a firm's operations and its interconnectedness with other firms or the system as a whole.

3.24 In order for PRA designation to have value, the risks posed by the firm must be of a kind that can be mitigated through prudential regulation. It is therefore envisaged that designation would apply only to firms which have permission to 'deal in investments as principal' and are therefore subject to substantive prudential requirements. As there are a large number of firms who have permission to carry out this regulated activity, objective criteria will be set out in secondary legislation to refine the number of firms that are capable of being designated for prudential regulation by the PRA. Ultimately, this will be a matter of judgement for the PRA to ensure that, where it is desirable and appropriate, the PRA is responsible for the prudential regulation of certain investment firms.

3.25 It is currently proposed that investment firms that are classed as 'BIPRU €730k'[2] firms will be capable of being designated by the PRA. Further minimum capital requirements may also be appropriate, as well as a set of indicators for assessing whether the firm's systemic importance or interconnectedness with PRA regulated group companies require it to be prudentially regulated by the PRA. Further development of the appropriate additional criteria for firms dealing in investments as principal will form part of the PRA's development of its supervisory approach, and will be subject to consultation with firms."

Box 2 - "Other firms designated for supervision by the PRA"
Under statute, a number of firms that are neither deposit-takers nor insurance companies will be eligible to be designated for supervision by the PRA rather than the FCA, if the PRA determines that the firm could present significant risks either to the stability of the financial system or to one or more PRA-supervised entities within the firm's group.

It is currently envisaged that investment firms authorised to deal in investments as principal on their own account will be eligible for PRA designation. ('Investment firm' is a term used to describe, among other things, a firm undertaking investment banking activities.) Most of these firms are not likely to pose sufficient risk to the stability of the financial system, however, and so the PRA will develop additional criteria for designation. These criteria are likely to include: the size of a firm; the substitutability of its services; the complexity of its activities; and its interconnectedness with the financial system and any PRA-supervised companies within its group.

The PRA will consult on its proposed policy in this area in due course.
In addition to establishing clear designation criteria for firms dealing in investment as principal, consideration will be given as to whether it is desirable to recommend changes to legislation, to ensure that the PRA will be able to regulate all firms posing potentially significant risks to the financial system because their activities are in substance analogous to deposit-taking. If necessary, following consultation, the authorities will make recommendations to HM Treasury.

It will also be possible for the FPC to propose revisions to the regulatory perimeter when a particular type of unregulated activity is considered likely to pose potentially significant risks to the stability of the financial system as a whole."

<u>Extract from PERG on Dealing on own account under MiFID</u>
"Dealing on own account is trading against proprietary capital resulting in the conclusion of transactions in one or more MiFID financial instruments. In most cases, if you were a firm who was dealing for own account under the ISD, the FSA would expect you to be dealing on own account for the purposes of MiFID if you continue to perform the same activities.

Dealing on own account involves position-taking which includes proprietary trading and positions arising from market-making. It can also include positions arising from client servicing, for example where a firm acts as a systematic internaliser or executes an order by taking a market or 'unmatched principal' position on its books.

Dealing on own account may be relevant to firms with a dealing in investments as principal permission in relation to MiFID financial instruments, but only where they trade financial instruments on a regular basis for their own account, as part of their MiFID business. We do not think that this activity is likely to be relevant in cases where a person acquires a long term stake in a company for strategic purposes or for most venture capital or private equity activity. Where a person invests in a venture capital fund with a view to selling its interests in the medium to long term only, in our view he is not dealing on own account for the purposes of MiFID.

In our view, where you are a firm which meets all of the conditions of article 5.2 of the recast CAD (see Q61), you will not be dealing on own account."

HM Treasury consultation June 2011

A new approach to financial regulation: the blueprint for reform

More detail is needed on how twin peak supervisors will work together in practice; how the FPC will operate; and how the UK can improve its connectivity into Europe.

KPMG welcomes the opportunity to contribute to the Government's thinking on changes to the architecture and powers of UK financial supervision. Our comments build on those made previously and will focus on areas of particular concern.

The latest proposals show that the Government has listened to industry concerns but significant issues still remain.

Overall concerns

Key areas of concern which we do not feel the current proposals have fully addressed are:

Who will define the overall risk appetite and what constitutes an "optimal" degree of financial stability?
Beyond a certain point the benefits of greater financial stability are more than offset by the negative impact on economic growth. Greater clarity is required on 'when' and 'how' macroprudential tools would be used.

Threats to financial stability arising from outside the financial sector.
Factors that contribute to overall financial stability such as inflation and sovereign risk need to be taken into account. Both the FPC itself and the prospective macro-prudential toolkit focus too narrowly on threats to financial stability from within the financial sector.

A transparent mechanism needs to be in place to check and challenge whether the new system is working.
Effective coordination and cooperation among the PRA, FCA and FPC will not happen automatically just because of memoranda of understanding being in place; some form of quantitative measure of progress is needed

What constitutes appropriate and proportionate consumer protection?
Important to not diminish the principle of consumers taking appropriate responsibility for their own decisions. Also the wider public interest met by consumers understanding and taking action to make adequate provision for savings, investment and protection. What is appropriate to retail consumers cannot easily be applied to wholesale counterparts so could undermine London relative to other financial markets. A more interventionist approach to supervision to protect consumers could result in the unintended consequence of undermining choice, innovation and liquidity across the market.

More explicitly map out fit to European supervisory authorities.
Need for an improved two-way dialogue with EU. This is becoming increasingly important as more rule-making powers sit within the EU institutions and the increased use of Regulations above Directives. Given the UK's role as a leading financial centre this places additional importance on active leadership in the regulatory agenda.

Specific comments

The Government still presumes that the new structure will become operational from the end of 2012, a challenge given the parliamentary process that still needs to be completed. Financial institutions in the UK need a clear – and realistic – timetable for implementation in order to prioritise these changes relative to the broader regulatory agenda which will continue to drive massive implementation challenges for most institutions.

Financial Policy Committee

The proposed powers and responsibilities of the FPC have remained largely unchanged. Two specific points are discussed but remain less than fully resolved.

First, concern that the FPC would place too much weight on financial stability and not enough on the potential trade-off between the safety of the financial system and the ability of the financial sector to contribute to economic growth. The draft Bill has retained the primary emphasis on financial stability, but with an amendment to achieve some explicit recognition of the potential impact of financial stability measures on economic growth by stating that the FPC "is not required or authorised to exercise its functions in a way that would, in the opinion of the FPC, 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". It is therefore left to the FPC's discretion to determine where to draw the balance between stability and growth in determining its actions and recommendations – which creates incentives that could run contrary to the broader macroeconomic objectives of the MPC and government.

Second, the Government has recognised the continuing debate over the accountability of the Bank of England, as have the Treasury Select Committee. The draft Bill gives a specific role to Court of the Bank of England to set a strategy for financial stability, although it not clear what such a strategy might include and how the FPC might be held to account against any such strategy. The composition of Court to manage financial stability strategies will be key; this is a different role to the one played by Court on monetary policy.

Meanwhile, there continues to be no mention in either the White Paper or the draft legislation of how either the FPC or any other body is supposed to identify and mitigate potential threats to financial stability arising from outside the financial sector, for example through monetary policy, tax and fiscal policy.

Prudential Regulatory Authority

In response to the concerns that the PRA will focus too much on large banks, the draft legislation now sets out the PRA's general objective as "promoting the safety and soundness of PRA-authorised persons". It also includes a new specific insurance objective which the PRA is required to take account of when discharging its general functions. This signals some commitment that more time and resources will be spent supervising insurance companies but does not fully allay insurers' concerns about the potential bank-centricity of the PRA.

Greater clarity has been provided on which regulator will take the lead (albeit with provision for the other regulator to be involved) in firm authorisation and individual approval processes and decisions relating to firms regulated by both the PRA and the FCA. In essence, the PRA will take the lead and have veto on the authorisation of dual regulated firms and on the approval of individuals wishing to undertake significant influence functions of prudential importance in dual-regulated firms, as designated by the PRA, while the FCA will take the lead on the approval of individuals wishing to undertake significant influence functions of importance to conduct of business, as designated by the

FCA. A full list detailing which functions will be approved by each authority is due to be published in due course. In practice it is likely that both authorities will need to be involved and so coordination will be needed to avoid duplication of effort without discernable benefits.

Although the obligation on the PRA to undertake a cost benefit analysis of proposed rules is retained, this is weakened by the requirement that the PRA undertake and publish only an "analysis" rather than the "estimate" of costs and benefits as the FSA is currently does.

Financial Conduct Authority

Although the Government has not introduced a primary competition objective for the FCA (as recommended by the Independent Commission on Banking and by the Treasury Select Committee), the draft legislation does include an obligation on the FCA to "discharge its general functions in a way which promotes competition, so far as is compatible with its strategic and operational objectives". In practice it is unlikely that anything other than an explicit objective is likely to direct the actions of supervisors. Finally, there is no objective to have regard to competitiveness – which may allow a framework of regulation which is disconnected from other jurisdictions.

Recommendations

- Greater clarity is needed on how active and interventionist the FPC is expected to be when tackling perceived threats to financial stability, the toolkit that the FPC will adopt, and how it's recommendations to the PRA and FCA will be factored into the regulations and supervision undertaken by the two authorities.
- With the increasing trend towards European rule-making and regulation, the UK authorities need a much more explicit interface and role within the new European Supervisory authorities, as the twin peaks model will not neatly align to Europe's sectoral approach.
- There needs to be appropriate recognition of the wider reform agenda and inter-connectiveness of the many changes proposed to the various regulations. Firms are already undertaking significant programmes of regulatory change so practical implications on new authorities need to be defined so they can be factored in.
- Though some clarity on cross agency coordination has been set out, firms dual-regulated by both the PRA and the FCA will still face costly and inefficient overlaps between authorities so measures need to be put in place to coordinate actively.
- The danger of an overly risk-averse approach in objectives which incentivise all three of the new bodies needs to be balanced to recognise the cost implications of actions and also the ability of the industry to support other policy objectives around the economy and long-term savings and investments.
- The controversial proposals for tough new enforcement powers and for the publication of draft enforcement notices needs to be set within clear guidelines.

Key contacts

Giles Williams, Partner
giles.williams@kpmg.co.uk

Jon Pain, Partner
jon.pain@kpmg.co.uk

Jon Hogan, Principal Advisor
Public Policy
jon.hogan@kpmg.co.uk

RESPONSE OF THE INVESTOR PROTECTION SUB-COMMITTEE OF THE LAW SOCIETY OF SCOTLAND TO THE H M TREASURY CONSULTATION PAPERS – A NEW APPROACH TO FINANCIAL REGULATION: THE BLUE PRINT FOR REFORM

1. <u>Introduction</u>

   This response is on behalf of the Law Society of Scotland. The Society welcomes the publication by the Government of the consultation paper from H M Treasury entitled – "A new approach to financial regulation: The blue print for reform".

   The Society has responded to this consultation paper through its Investor Protection Sub-Committee, which is the Committee of the Society which deals with all aspects of financial services regulation within the United Kingdom. The Sub-Committee in its response has confined itself principally to answering the 15 questions posed in the consultation paper.

<u>Part B</u>

The Investor Protection Sub-Committee's response to the 15 questions posed in the consultation paper are set out below.

<u>Question 1</u>

Do you have any specific views on the proposals for the Financial Policy Committee (FPC) as described in paragraph 2.6 to 2.24 and in Chapters 3 and 4?

The Sub-Committee is of the view that the majority of the members of the Financial Policy Committee should be recruited on the basis of the "Nolan principles" and drawn from across the business and financial communities of the United Kingdom. Furthermore, the Sub-Committee was of the view that the membership of the Financial Policy Committee should adequately reflect the four constituent countries which make up the United Kingdom.

The Committee is also of the view that the Minutes of the Financial Policy Committee should be published in the same manner as the Minutes of the Monetary Policy Committee of the Bank of England are published. The Sub-Committee also agreed that it would be very helpful if the Financial Policy Committee published clear regulatory statements on its requirements for financial stability for those organisations which it will have responsibility for.

Question 2

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

The Sub-Committee is of the view that with respect to the regulation of settlement and payment systems within the United Kingdom, that the Bank of England should be required by statute to give equal waiting to the needs of the consumer as opposed to the demands of the banks in relation to the regulation of settlement and payment systems.

Question 3

Do you have any comments on: the proposed crisis management arrangement; and the proposals for minor and technical changes to the special resolution regime as described above and in Chapters 3 and 4?

No comment.

Question 4

Do you have any comments on the objectives and scope of the Prudential Regulation Authority (PRA) as described above and in Chapters 3 and 4?

The Sub-Committee was of the view that the objectives and scope of the PRA are adequate given that the Government has now recognised within those objectives, the distinct nature of insurance business which will be regulated by the PRA. The Committee also agreed that the PRA should issue clear guidance written in plain English to assist firms in their implementation of regulations from the PRA. The Committee also agreed that the status of such guidance should be defined within the new legislation.

Question 5

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

The Sub-Committee noted that it is stated in paragraph 2.77 "that the PRA could be required to put in place arrangements for engaging with practitioners." The Sub-Committee seek clarification on what is meant by "arrangements for engaging with practitioners". For such "engagement" to be meaningful there will have to be a culture within the PRA whereby it listens to and takes account of the views of practitioners in developing the future regulatory arrangements. Equally important will be the culture of the PRA which should seek to balance the rights and duties of such practitioners with the requirement for strong investor protection for members of the public. In this regard the Sub-Committee wish to draw a distinction between the consumer interest which has a narrower focus than the public interest. Given the importance of the requirement to have a strong regulatory system within the UK, the Sub-Committee agreed that it should be the wider public interest with which the PRA should have proper regard to.

Question 6

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

The Sub-Committee agreed that the FCA in considering its competition remit should have specific regard to the contact which any regulatory system may have on the provision of financial services advice, particularly in remote geographic areas in the United Kingdom, such as the Highlands of Scotland, and particularly the Western Isles, Shetland and Orkney.

Question 7

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

The Sub-Committee agreed in principle with the proposed proactive regulatory approach which is to be taken by the FCA. However, such an approach has to be balanced against the rights of practitioners, in particular with respect to the evidential standard applied to both criminal and civil matters, the presumption of innocent until proved guilty, as well as the rule of law.

Question 8

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

The Sub-Committee agreed in principle with this proposal, provided that there is a proper system for the determination of such nominated parties. Such a system should be subject to parliamentary scrutiny by the appropriate select committee.

Question 9

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

The Sub-Committee agreed that such a proposal has to be set up within the perimeters of the principles of natural justice, the rule of law, the presumption of innocence, as well as the right to prove proper redress for practitioners if an issue identified by the FCA as causing mass detriment proves not to be the case.

Question 10

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

No comment.

Question 11

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

No comment.

Question 12

Do you any comments on the governance, accountability and transparency arrangements proposes for the FCA, as described above and in Chapters 2 and 4?

The Sub-Committee did not agreed with the suggestion in paragraph 2.129 of the consultation paper that it would not be possible to take forward proposals on governance, accountability and transparency arrangements within primary legislation. No evidence has been produced within the consultation paper for such a statement, and it appears that such proposals have been rejected because they might be inconvenient or difficult to implement. The Sub-Committee agreed that these are not sufficient grounds for ensuring that the governance, accountability and transparency arrangements for the FSA clearly set out at statute.

Question 13

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

The Sub-Committee agreed the question of whether the general co-ordination arrangements for the PRA and FCA will work will ultimately depend on the calibre and nature of the senior appointments made to both organisations. The Sub-Committee therefore agreed that such appointments within both the PRA and FCA should be made on the basis of the Nolan principles. Furthermore, the Chief Executive positions with the PRA and FCA should be subject to confirmatory hearings by the appropriate Select Committee.

Question 14

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

The Sub-Committee reiterated its concerns with regard to the detail of such specific regulatory processes involving the PRA and FCA so that such processes will be subject to the principles of natural justice, the evidential standards set by both the criminal and civil courts within the United Kingdom, and proper regard to the rule of law as well as the fundamental presumption of innocent until proved guilty. With specific regard to the principles of natural justice it is proposed to reduce the period of response to a Warning Notice from 28 days to 14 days. It is the view of the sub-committee that this reduction is unfair and goes against those principles particularly when under the current FSA regime it can take the FSA up to three years to investigate some cases.

Question 15

Do you have any comments on the proposals for the Financial Services Compensation Scheme and Financial Ombudsman Service set out above and in Chapters 3 and 4?

No comment

General Comment

The Sub-Committee agreed that it would have been better if the blue print for reform of financial regulation within the United Kingdom had been set out in a new primary Act of Parliament rather than by way of a Bill to amend the Bank of England Act 1998, the Financial Services Market Act 2000 and the Banking Act 20009. The Sub-

Committee agreed that building a new regulatory system based on a complex and at times somewhat impenetrable set of amendments to the existing primary Act of Parliament was unwise. The Sub-Committee instead agreed that a new financial regulatory system within the United Kingdom should be built on a new primary Act which sets out clearly the principles and detail of this new system for both practitioners and the public.

1.

A New Approach to Regulation: the blueprint for reform

Legal & General Group response to HM Treasury

September 2011

Legal and General Group response to HM Treasury consultation: A New Approach to Financial Regulation: the blueprint for reform

Legal and General Group plc

The Legal & General Group is one of the UK's leading financial services groups. Over seven million people rely on us for life assurance, pensions, annuities, investments and general insurance plans. Legal & General is responsible for investing £362 billion worldwide (as at 30 June 2011) on behalf of investors, policyholders and shareholders.

We welcome the Government's decision to consult further on its reform plans through this pre-legislative process and are grateful for the opportunity to comment on the Government's Draft Financial Services Bill and consultation document.

Introductory remarks

We believe that strong and effective regulation of both the prudential and conduct aspects of financial services firms' activities is in the best interests of the financial services industry and consumers. Effective regulation is essential in increasing consumer confidence, and safeguarding financial stability. It promotes the take-up of appropriate protection and savings products, with consequent wider social and economic benefits and support for economic growth. High-quality, stable and proportionate regulation not only promotes competition but is also an important condition for investment in the UK financial services industry.

We understand the Government's desire to improve the effectiveness of financial regulation following the crisis. But the crisis was a failure of regulators as much as it was a failure of regulation. Changes to the regulatory architecture, although necessary, will not be sufficient to deliver improved regulation. A pre-condition for robust and effective regulation is ensuring a full understanding of the consequence of regulation that comes with appropriate consultation and due process. We believe that a cultural step-change is now needed for both regulators and firms to create a more positive regulatory environment. It is, we suggest, essential that the Government should work to bring the industry along with it throughout this process by acknowledging the validity of certain key concerns; effective consultation, due process and respect for natural justice must not be treated as collateral damage.

To regulate the financial industry effectively, the characteristics and interests of all its sectors must be well understood and catered for in the overall design of the regime. The UK insurance industry manages investments of £1.5 trillion; over 20 percent of the UK's total net worth. It employs more than 300,000 people in the UK alone and is the fourth highest contributor of corporation tax. It is also a major exporter, with one-fifth of its net premium income coming from overseas business. The new regime, and particularly the PRA, must be designed in a way that supports the delivery of differentiated, relevant and appropriate regulation of insurers. As the financial crisis demonstrates; insurers are not banks.

The increased costs that will inevitably arise from dual regulation remain a continuing concern for the industry that must be addressed through exacting requirements on the authorities to keep aggregate costs across the system as low as possible.

Key themes of our response

We are pleased that many issues raised in our earlier consultation responses have been addressed in the draft legislation. However, we continue to have some significant concerns:

- It is not enough simply to acknowledge the different nature of insurance firms, relative to banks. Those differences must be embedded explicitly in an appropriately modulated regulatory regime that delivers a differentiated and risk-based approach to the regulation of key sectors, and is demonstrably consistent with the core principles of relevant European regulation. Failure by the Government to provide an appropriately differentiated regime will disproportionately increase costs and bring about undesirable transfers of risk. If the regulatory regime is focused only on banks, as appears to be the case, then there is a risk that this could negatively impact market stability and customer outcomes.
- The biggest regulatory threat to the insurance industry comes from misguided prudential regulation, rather than inherent business model or insurance risk. In this respect, the capital regime for the UK insurance industry will soon be set by European legislation under Solvency II, an unstable and procylical capital regime that could substantially increase the risk profile of the sector. As it will be the primary basis for insurance prudential regulation in Europe, working to avoid design flaws in the regime should be top of the list in terms of the PRA's insurance related objectives.
- Real-time regulation is an attractive aspiration; but its practice must be tempered by real-time checks and balances if the UK regulatory system is to remain credible and effective. The risks in the Government's new, judgment-led philosophy of regulation are currently insufficiently mitigated through robust due process and transparency of regulatory policy and intent. Natural justice and the prevention of unnecessary harm must not be sacrificed as collateral damage in the pursuit of expediency and dispatch.
- Two aspects of the highly interventionist agenda set for the authorities have not, in our view, been fully thought through. First, we are concerned that the regulators will seek to direct individual firms to a degree approximating to shadow – or indeed, de facto – directorship, without being held accountable for their actions to the stakeholders in those firms. Second, we are not convinced, when the track record of the regulator is considered, that there is a likely prospect that the regulators will ever be able to deploy staff with sufficient in-depth knowledge and experience to deliver the approach that has been indicated at all or in a 'fair, proportionate or consistent manner'.
- It is important to distinguish between disclosure and transparency: the former is a regulatory tool; the latter, an objective. Hasty and injudicious disclosure of regulatory actions, as with the deployment of any regulatory tool, must not be allowed to cause harm where no fault has been proven. There must be proper respect for commercial confidentiality and reputational damage, and firms must be given the right to challenge poor regulatory judgments *before* irrevocable harm may be caused. In contrast, transparency of regulatory risk appetites, strategies, policies and rationales are essential and the Government must ensure that they are delivered through effective consultation and accountability provisions.
- The Government's desire to end uncertainty by maintaining a challenging pace of change is commendable. However, the uncertainties that will arise from poorly

thought-through legislation that allows capricious behaviours on the part of the regulatory authorities to go unchecked, will have far more profound consequences on the future health of both the UK financial services industry and the economy as a whole. The Government must allow sufficient time for effective scrutiny of this important legislation, and it must bring more of the detailed material that puts flesh on the bones of statute - such as regulatory strategy documents and Memoranda of Understanding (MoU) - to be properly reviewed and commented upon before concluding the legislative process.

- The opportunity this process offers to the Government to support growth and innovation in financial services, by clarifying the role of the FOS and differentiating it from that of the FCA, must not be missed. We fully support the provision of an effective, low-cost and speedy process by which our customers may have their disputes with us resolved; but the uncertainties that arise from the current impact that FOS has on regulatory policy cannot be overstated. They have blighted firms' appetite for innovation and prevented the development of solutions to important issues such as the advice gap that will arise from the Retail Distribution Review.

Our responses to your specific consultation questions are set out below. In addition, we enclose a copy of the submission that we have provided to the Parliamentary Scrutiny Committee, which sets our comments on wider aspects of the Government's policy proposals and draft legislation.

Finally, given our profound concerns about:

- the inadequacy of the checks and balances set out in the draft legislation, and
- the weaknesses in the current legislative framework for the FOS,

we have enclosed two separate papers setting out our detailed analyses of current proposals and offering drafting suggestions for improvement.

Detailed response to consultation questions

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

FPC Objectives and strategy

We agree that 'resilience' in the financial system is important; however, it should not be pursued as an objective in itself, given that the measures to deliver it could have market-dampening effects. It is desirable only to the extent that it supports the continued and stable growth of the economy.

It is very likely that a regulator with a single remit will pursue that objective with single-minded enthusiasm; and a regulator is unlikely to take on constraints and disciplines that are not provided for in its statutory framework, given the explicit nature of other aspects of its framework. We therefore believe it is essential that the principles that inform the activities of the FPC be improved, to reduce the risk of over-zealous regulatory activity.

The 'negative' approach taken in 9C(4) to limit the 'damage' that the FPC could cause to the economy:

> *'(the FPC is not) required or authorised to exercise its functions in a way that would … have a significant adverse effect on … the growth of the UK economy'*

is therefore unlikely to be sufficient to prevent excessive regulatory intervention. We suggest a more positive constraint: that the FPC should exercise its functions only to the extent necessary in its opinion to sustain or enhance the capacity of the financial sector, etc.

There should also be an explicit requirement for the FPC to have regard to its impact on the international competitiveness of the UK financial services industry. Again, without such an explicit mandate, we are not confident that the FPC will hold itself, or be held, accountable for its actions in this respect.

To ensure further that the Court of the Bank of England's overall strategy for delivery of the Bank's financial stability objective is compatible with regulatory principles, its strategy, including a clear articulation of its risk appetite, should be subject to public consultation rather than, as currently provided, simple publication.

Membership of the FPC

The legislation should explicitly require the external members of the FPC to have sufficient breadth of knowledge and experience across all financial industry sectors, as it does in respect of the provisions for membership of the various consultative Panels. This is essential to guide and maintain the principle of proportionality across the range of industry sectors affected by its decisions. We are particularly concerned that the unsatisfactory consequences that will arise from a failure by the FPC to discriminate adequately in its approach to insurers could be further exacerbated, should it use its powers to direct the PRA along similar lines.

The identification of macro-prudential tools

We are concerned that, despite the Government's acknowledgement of the novel nature of macro-prudential tools, there will be no further detail available on this subject before the close of this consultation. It is essential that there be further consultation on the detail of the proposed suite of tools, in order to allow us to evaluate their relevance to our industry sector and comment on their likely effectiveness and impact.

For example - it is particularly important for the UK insurance industry that ad-hoc tools should include the ability to:

- base capital regulation on a market-referenced, rather than a purely market-consistent, approach, especially for longer-dated assets and liabilities where there is no deep and liquid market;
- make adjustments to calibrations where this prevents an unfair or perverse result, and
- decline supranational regulators' requests for stress tests which are deemed unreasonable (such as EIOPA's enforcement of inappropriate stress-testing methodologies on the UK insurance industry).

Compatibility with European regulation

Many of the principles of macro-prudential risk management identified by the Government, such as counter-cyclicality, an appropriate balance between national discretion and EU co-ordination and an internationally level playing field, are fully relevant to the insurance sector as well as banks. But we are concerned that these objectives, while entirely appropriate, will be very difficult to achieve for insurers. The Solvency II regulatory regime will allow very little, if any, discretion to the UK domestic regulator, due to the prescriptive nature of the level 2 and level 3 regulations and their application by EIOPA.

It would be useful to have some clarification of how the Government envisages the FPC deploying, for example, capital-related tools within the Solvency II Level 1 Directive and the EU's proposed Capital Requirements Directive IV constraints. It will also be vital to understand whether the Government believes that there is scope to go beyond European requirements, and the conditions in which such a policy, given its impact on UK competitiveness, would be contemplated – particularly in respect of insurers, given our low systemic risk.

Need to resolve problems in Solvency II regime to ensure parity and consistency

If implemented as currently envisaged, the Solvency II Level 1 Directive's capital regime risks creating excessive, volatile and pro-cyclical capital requirements. In addition, it will only apply to EU insurers (thereby creating a wider international competitive distortion).

As it stands, its implementation is also likely to mean that relative to banks, insurers will be subject to far more onerous treatment: a manifestly perverse result given the relative risk profiles (and recent histories) of the two sectors.

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

We suspect that there will be tensions where some RCHs will fall under EMIR regulations and others (such as CREST) will not; it would be helpful to have clarification how these tensions will be resolved, and how the FPC and FCA will recognise these differences in their detailed policy and supervisory approaches.

It appears that the rules and practices of RCHs and RIEs will no longer be subject to competition scrutiny by OFT. We do not believe that this removal is in the interest of the industry and the absence of a clear rationale for removing this important oversight mechanism needs to be explained.

3. Do you have any comments on the proposed crisis management arrangements; and the proposals for minor and technical changes to the Special Resolution Regime as described in paragraphs 2.41 to 2.44 and in Chapters 3 and 4?

It is not possible to comment on this without sight of the detailed MoU on crisis management between the Bank of England and HM Treasury, as we do not feel we have sufficient insight into how, for example, appropriate information flows will be achieved to support the Chancellor in his decision-making.

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

New section 2B(3)(a) suggests that the PRA should seek to meet its general objective primarily by seeking to ensure that authorised firms carry on their business in a way that avoids any adverse effect on UK financial stability. 'Avoid' implies a zero failure risk appetite; instead, the PRA should seek to minimise such adverse effects, as is the standard applied in s2B(3)(b).

The inclusion of 'those…who may become policyholders' in the insurance objective appears irrational; it is impossible to divine who may or may not become a future policyholder, and what different or further protection they might need before they actually become a policyholder (at which point they would benefit from the protections provided to existing policyholders).

HM Treasury's power to amend the PRA objectives by order should be subject to consultation to ensure that any changes adequately discriminate between the different business models and risks of banks and insurers.

We are disappointed that the Government has not provided greater clarity on its intentions for the regulation of investment firms. We do not consider that it is satisfactory simply to leave it to the PRA to designate firms it wishes to regulate without the guidance of more explicit policy criteria linked to the systemic impacts of investment firms. As a minimum, the PRA must be required to consult before exercising its power to designate firms within its scope. There is also a need for a specific requirement to ensure that there is a level playing field between those firms who are regulated by the PRA and those regulated by the FCA.

Large non-bank lenders should be brought within the scope of the PRA, to facilitate the provision of a level playing field between competitors in the mortgage market.

The proposals in respect of unregulated parent entities are as yet insufficiently well-articulated. The draft legislation allows HM Treasury to designate holding companies as 'financial institutions' and as such regulate them as they would authorised persons, but no further insight has been given as to the detail on this. Designating unregulated holding companies as 'financial institutions' would go against all normal understanding of this term. We are not convinced that sufficient argument has been made to justify what can be characterised as a wide extension of the regulators' scope.

Furthermore, the Government's intention that the relevant power should be used only in extremis is inadequately captured in the legislation; as it stands, the exposure of unregulated holding companies to an ill-defined risk of material regulatory intervention may have a disproportionate impact on their perceived value in the market. The clause requiring the regulator to have regard to 'the desirability … of exercising its powers in relation to authorised persons' should instead be a requirement to have exhausted any alternative powers to achieve its purpose before having recourse to this one. The power should also be subject to a public interest test, rather than merely a proportionality consideration.

Regulatory principles

The principles must apply to the authorities' exercise of functions at a collective, as well as an individual, level, to ensure that the regime for dual-regulated entities is proportionate when considered across the piece.

A regulator is unlikely to take on constraints and disciplines that are not provided for in its statutory framework, given the explicit nature of other aspects of its framework. We therefore disagree with the Government's view that a statutory principle relating to the competitiveness of the financial services sector is unnecessary. Experience shows that in discharging their functions, regulatory authorities adhere closely to their statutory responsibilities, but do not seek to exceed them. Given the significant impacts that more interventionist regulatory activity may have on international competition, the regulators must be required to have regard to the competitive impacts of their actions both at a domestic and an international level.

The regulatory principle in section 3B(f), that 'the regulators should exercise their functions as transparently as possible' should continue: 'without unduly risking damage to the reputation or other commercial interests of one or more regulated persons'.

It should not be permissible for two Authorities to impose a financial penalty on a regulated or authorised person in respect of offences that are materially the same. This would be in line with the principle of *ne bis in idem* in criminal law, where no person shall be punished for the same crime twice.

Relationship with Europe

We strongly believe that further direction must be given to the PRA in respect of its role within the European regulatory regime. There must be consultation on the criteria by which any decision to exceed EU standards and requirements will be determined.

We welcome the recognition that insurers are different from banks. However, we do not believe that the PRA's objectives, as they stand, are compatible with the approach taken in the Solvency II Level 1 Directive and EIOPA texts. Furthermore, we do not believe that it will be open to the PRA to act in a way that is inconsistent with the Directive, or 'gold-plate' its requirements; if the Government has arrived at a contrary view, the basis for this should be explained fully, in the interests of transparency.

With-profits Policyholder Reasonable Expectations

We note that responsibility for protecting with-profits policyholder reasonable expectations (PRE) has been allocated to the PRA. However, we do not recognise the definition of a 'with-profits policy', which bears no relation to the features that are widely held to define these products. The most significant differentiator between with-profits policies and other types of investment-based savings products is the smoothing of investment returns, although the use of guarantees, and the participation of the policyholder in the provider's profits and losses are also widely-observed features.

The use of 'eligibility to participate in surplus' as a defining criterion is particularly unhelpful. First, because there is no established legal definition of 'surplus', although it would commonly be defined as the assets in a fund in excess of those needed to meet policyholder reasonable. More significantly, the definition is paradoxical because a policyholder cannot have an interest in a 'surplus' that is, by definition, the excess over and above that which is required to meet their legal and contractual entitlement**.**

Coordination of regulatory activities

It is difficult for us to comment on the overall coordination of regulatory activities between the FCA and PRA as these matters have been largely left out of the primary legislation. We urge the FSA and Bank of England to publish their planned document setting out operational coordination as a matter of urgency.

We also consider that this document should be consultative, as opposed to a definitive statement. Appropriate and effective coordination will be a key challenge for the FCA and PRA and the coordination arrangements between the two bodies will need to be robust to avoid any gaps or overlaps.

Accountability mechanisms in respect of the success of their coordination activities should also be put in place, allowing for regular formal reviews. This issue should also be explicitly included in the audit responsibilities to be given to the NAO.

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

We have provided a separate detailed analysis of the checks and balances and accountability mechanisms in relation to the exercise of regulatory powers (see Annex 1).

The PRA should be subject to a duty to consider representations made by a panel such as the Practitioner, Markets and Consumer Panels to be established by the FCA.

The conditions under which the PRA may direct the FCA include financial stability concerns (FSMA new s. 3H(3)(a)); however, the rationale for this is not made clear, given that financial stability falls more properly to the FPC. As the FPC has both the clear remit to protect financial stability, and the power to direct the FCA, this condition is surely irrelevant to the PRA's pursuit of its own objectives.

Insufficient thought has been given to the impact of giving the PRA an unrestricted power to direct individual firms or impose requirements on them (beyond those relating to authorisation and variation of permissions). Inappropriate use of this power could place directors of regulated entities in the invidious position of choosing between regulatory sanctions and dereliction of their Companies Act duties – for example, if the directors believe that compliance with a PRA direction will cause harm to members of the company. We are also concerned to understand how the PRA can avoid falling within the Companies Act definition of 'shadow' or even 'de facto' director, should it seek to direct too specifically the Boards and operations of relevant regulated entities.

No provision has yet been made to grandfather FSA-authorised firms across to the PRA, which will be a new legal entity; we would be grateful for clarity on how this will work.

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

The FCA approach document refers to the Government's view that it has given the FCA sufficient mandate to address financial exclusion through its efficiency and choice objective and the regulatory principle of proportionality. In contrast, in the Government's second consultation (para 4.31), it states that a formal regulatory principle would be inappropriate as financial inclusion is a matter of social policy rather than regulatory policy. We see these positions as inconsistent, and ask for clarity as to which is the more accurate. If the Government does wish the FCA to give this issue material attention, we consider that unlikely in the absence of an explicit reference to financial exclusion. The Government should articulate explicitly the nature and extent of its desire for the FCA to address financial exclusion.

The FSA approach document also recognises that the FCA will need to make decisions balancing competing interests, and refers particularly to the balance between protection and intervention, and enhancing choice. The regulatory principles that apply to the FCA should provide it with guidance on which of these should be given priority, from a public policy point of view.

For reasons stated earlier in this response, the legislation should clarify whether consideration of competition includes not only domestic impacts but the international competitiveness of the UK financial services industry.

The consumer protection objective has a number of 'have regard' to sub-sections, including 'the needs consumers may have for advice and accurate information'. This should also include 'and access to suitable financial products and markets'.

There is insufficient recognition in the principles that regulatory interventions can cause, as well as prevent, irrational behaviours on the part of consumers. The FCA must be required to foresee and avoid perverse outcomes arising from its actions, such as making it easier for a consumer to borrow than to save. A further regulatory principle, that 'the exercise of regulatory functions should not unduly restrict consumer access to suitable financial products and services', should be specified.

To prevent further consumer detriment, it should be made clear that the FCA's regulatory perimeter captures advice provided by claims management companies in relation to financial products. In many cases, consumers would be better served by retaining a product with partial compensation, rather than surrendering with full compensation. However as claims management companies have an interest in maximising cash payments to ensure that their clients will be in a position to pay they will, in our experience, advise their clients to surrender or liquidate their product, irrespective of the future harm this could cause. We cannot see why such advice does not fall within the regulated activity of 'advice' as currently defined, but understand that clarity on this point might be valuable.

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

We have provided a separate detailed analysis of the checks and balances and accountability, in relation to the exercise of regulatory powers in Annex 1.

The market failure analysis that has been put forward by the FSA in support of product intervention is deeply flawed. It suggests that product intervention is an appropriate remedy for mis-selling, but fails to identify factors that cause inherent product toxicity. We therefore strongly resist the introduction of this power, which is recognised to be a blunt and consequently dangerous tool, capable of generating undesirable consumer and market outcomes.

The proposed framework setting out the conditions for use of the tool is also inadequate. Given the significant risks and impacts associated with misuse of the tool, it must not be possible to deploy it unnecessarily, or without consultation and cost-benefit analysis; indeed, the Government appears to suggest that use of the power without consultation is intended only to be possible in extremis. The inclusion of 'expedient' in the legislative text that provides an exemption from consultation on the exercise of the power is therefore lax and over-generous and may lead to purely practical considerations determining its use. We suggest that instead, the FCA should be allowed to use it only where it is satisfied that no other regulatory measure will deliver the desired outcomes.

The Government must also clarify further its intent in relation to the possible extension of this power into markets.

We remain concerned at the new Financial Promotions power of direction. Although a direction to withdraw a promotion may be revoked, the reputational damage and commercial loss resulting from an unnecessary ban cannot be undone. We encourage the Government to consider the paper prepared by John Armour, Colin Mayer and Andrea Polo of the Said Business School at the University of Oxford: 'Regulatory Sanctions and Reputational Damage in Financial Markets', published in September 2010. In the light of that analysis, and the materiality of this potential harm, we consider that the provisions currently offer inadequate safeguards and clarity for firms.

In particular, the controls around the publication of such a direction are weak. The purpose of disclosure is presumably twofold; to allow any consumer detriment already incurred to be remedied, and to prevent further detriment arising. However, these outcomes can be readily achieved without requiring publication of the direction. Firms may even now be required to review and remedy any customer detriment arising from sales made on the basis of a financial promotion; equally, the FSA can already publish general guidance to regulated firms to prevent others producing similar promotions, rather than using the crude disclosure of a specific intervention as a basis for clarifying regulatory policy.

We also note that a direction would be permissible where 'there is likely to be a contravention of the financial promotions rule', but before any actual investigation or evidence of contravention is shown by the FCA. Publication of a decision on that basis would therefore take place before any wrongdoing or detriment can be shown to have occurred. This flies in the face of due process, and this is not mitigated by the provision of a Tribunal reference, as this is allowed only after publication. No publication should be possible before any period for challenge or appeal has been exhausted.

We dispute the effectiveness of the current test of 'unfairness' in determining whether publication is justified and query how this can be judged objectively. What independent challenge will be available to review the 'fairness' on which the decision has been based? The FCA should instead be required to demonstrate that the benefits that would be delivered by disclosure will clearly outweigh the potential damage to the firm concerned.

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

We welcome the Government's wish to provide greater clarity in relation to the respective roles of the FCA and FOS in respect of potential causes of mass detriment. However, we suggest that the basis for proposing these measures would in fact support a wider scope to include all cases where there is a regulatory concern arising from complaints adjudicated by the FOS. It is essential that the government clarify that individual FOS decisions cannot be taken as creating or modifying regulatory requirements.

We also consider that the right to refer to the FCA a regulatory concern arising from a complaint or from an ombudsman decision should not be limited to nominated parties, but should extend to any interested party. The FCA must be called on to resolve all matters of regulatory policy falling within its scope.

FCA decisions on such referrals must be binding on the FOS, as is currently the position under section 404 FSMA for consumer redress schemes.

Firms may currently request that ombudsman decisions that turn on a novel or disputed point of law be referred to courts as test cases. This process should continue; however, it should not be for the FOS to decide whether such cases can be referred, as it is clearly conflicted. The request should be determined by a competent and independent third party (such as the FCA's legal department, or an independent panel established for the purpose).

9. What are your views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of

action, and in the case of referrals from nominated parties, to do so within a set period of time?

We agree with the proposals. It will be essential that the process is fully transparent.

The publication of the preferred course of action should be a matter of consultation between the FCA and the particular firms that may be affected (similar to the provisions under FSMA s.404). Similarly, we believe that the outcome of any referral of a policy matter to the FCA should be a decision that is binding on the FOS, as per the current process under s404.

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

We welcome the new provisions in 140A-140H but note also that any person can, in principle, raise competition concerns with the OFT. However, we propose that the scope of the new provisions should not be confined to the FCA and PRA but should be extended to the Bank of England in relation to its regulation of RCHs and RIEs, and to the ancillary authorities (FOS and FSCS).

We also suggest that the proposed powers for the OFT should be strengthened, to require regulators to comply with OFT directions. It is not clear, under the present proposals, what the consequences would be of a regulator's failure to comply, even where this might be referred to HM Treasury.

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

We refer to our response at question 2 above:

> *We suspect that there will be tensions where some RCHs will fall under EMIR regulations and others (such as CREST) will not; it would be helpful to have clarification how these tensions will be resolved, and how the FPC and FCA will recognise these differences in their detailed policy and supervisory approaches.*
>
> *It appears that the rules and practices of RCHs and RIEs will no longer be subject to competition scrutiny by OFT. We do not believe that this removal is in the interest of the industry and the absence of a clear rationale for removing this important oversight mechanism needs to be explained.*

We are concerned the extension of the power to require an issuer to appoint competent persons to review matters in relation to markets, as we have a general concern that the FCA may use skilled persons appointments to close gaps in the knowledge of its own staff (as the FSA appears to have been doing increasingly frequently). Skilled persons reviews carried out under statutory provisions give rise to often disproportionately high costs for firms, and the use of those powers should therefore be exceptional. To use them as a means to plug a skill or resource gap offers too great an opportunity to conceal the true cost of regulation.

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

We have provided a separate paper at Annex 1 setting out our detailed concerns and suggestions in respect of checks and balances, consultation and accountability arrangements.

As noted throughout our response, appropriate and effective governance, accountability and transparency will be essential to ensure that the regulatory failures of the past are not repeated. The use of directions and imposition of requirements on individual firms could have a significant negative impact on both the firms affected and the industry as a whole.

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

It is difficult for us to comment generally on coordination arrangements where the details of such arrangements have not yet been published. We remain uncertain as to exactly how the PRA and FCA will coordinate, and are unable to comment on whether their plans are likely to be robust and effective. Coherent, consistent coordination is vital to the success of this reform and we are disappointed that so much of the detail needed to deliver the Government's intentions will be left to subordinated legislation and MoUs. That these will not be subject to consultation is simply unacceptable.

The duty to coordinate the exercise of functions should include a requirement on the regulators to coordinate to minimise as far as possible their aggregate regulatory burden on firms.

We note various points in the legislation where the authorities are required to cross-consult – for example, in the case of a change of control, there will be consultation between the 'lead' and subsidiary regulator. However, these arrangements do not provide for improving the efficiency of the process through direct contact between the subject of the consultation and the subsidiary regulator. Nor do they provide any transparency to firms about the nature of the consultative exchange. There is a risk that decisions could be taken on the basis of inaccurate information and views that the affected party will never have the opportunity to identify and challenge.

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

We do not agree with the proposals in respect of unregulated parent entities and believe these are, as yet, insufficiently well-articulated. The draft legislation allows HM Treasury to designate holding companies as 'financial institutions' and as such regulate them as they would authorised persons, but no further insight has been given as to the detail on this. For example, it is not clear what the regulations mean by the term 'financial institutions'. Should the normal understanding of this term be used, parent holding companies that are 'financial institutions' could be expected to require authorisation, as they would surely be carrying on regulated activities.

Further, non-UK parents are not subject to these new powers. The practical consequences and potential incentives that this could create for current UK based holding companies should not be underestimated. Arguably, the creation of incentives for current UK parent holding companies to relocate could have a negative impact on the UK financial services market and the wider economy.

We are also concerned that a holding company could be directed to act in a way that could be considered to breach the fiduciary duties of directors and their duties to shareholders. For example, where a parent holding company is directed to recapitalise a failing regulated subsidiary this could have adverse consequences for other non-regulated companies in the group. In the more extreme cases, directors may be exposed to liability for wrongful trading where recapitalisation of a regulated subsidiary acts to the detriment of the holding company's own creditors.

We do not agree with the proposed changes to the enforcement process. The proposed reduction from 28 days to 14 days for firms to make representations to the FCA on warning notices is not justified, particularly given the proposals which may now allow the FCA to publish such notices. As noted above, it is imperative that principles of natural justice are not sacrificed in the pursuit of expediency. We have commented on this in detail in Annex 1.

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

FOS

We have provided in Annex 2 our detailed concerns in respect of the regulatory framework for the FOS and our suggested improvements. While we fully support the FOS as a mechanism for resolving individual disputes between consumers and regulated firms, its decisions in respect of individual cases must not be allowed to vary or supplement existing regulatory and legal requirements.

Regulatory principles should be drawn up for both bodies, as per PRA and FCA, to inform and delimit the strategies they employ in pursuit of their objectives.

We are also concerned that the governance and accountability arrangements for the FOS are not yet adequate. For example - the FOS inevitably faces operational pressures when complaint volumes 'spike' unexpectedly. As it is held accountable for operating to budget and timelines, this short-term pressure gives rise to a conflict that we consider could compromise objectivity and create perverse behaviours such as:

- finding more cases in favour of customers, as this effectively forces firms to apply the emerging approach to complaints before they are referred;
- speeding up resolution of regulatory uncertainty by influencing industry-based solutions, rather than leaving the FSA to determine and opine on regulatory requirements – this can lead to inappropriate outcomes; or
- clearing backlogs by applying a bulk process; this can lead to reliance on a single perceived point of failure rather than reference to the individual circumstances of cases.

We suggest that the FOS Board must therefore be held accountable not only for its operational performance but also for the quality of its decisions. In addition, the FOS should be required to seek early advice from the FCA on the way in which emerging issues may be handled.

Neither body should be permitted to make its own rules.

FSCS

The different risk profile of insurance firms should be recognised in the arrangements for compensation in the event of a firm failure. The Government must make clear that pre-funding of the FSCS will not apply to insurance firms. While pre-funding is appropriate and necessary for deposit takers, the likely impact on customers and the compensation scheme in the extremely rare event of a failure of an insurance company would be far less significant. Here, the liabilities unwind over a period. When this is considered alongside the very different capital requirements and fundamentally different leverage position of insurers, it is clear that there is little evidence that pre-funding is needed for insurers.

To oblige insurers to cross-subsidise the costs of failure of structurally more risky institutions through a general pool creates an asymmetric and perverse transfer of risk.

Similar arguments apply in respect of investment companies, where the assets are generally held with a custodian, and the consumer impacts of failure are therefore substantially lower.

We strongly recommend a review of the FSC to reflect these points.

Analysis: Adequate checks and balances in the proposed regulatory architecture

Introduction

Real-time regulation requires real-time checks and balances. This paper argues that insufficient emphasis has been given in the draft legislation to providing robust protections for regulated firms. Fair due process is essential in a regulatory system to offer firms some defence against the irremediable harm that can be caused by inappropriate regulatory actions.

We have identified a number of points where the draft legislation could be strengthened to ensure that it delivers a just, fair, transparent and balanced system of regulation. These fall into two broad areas:

- transparency and consultation on regulatory policies; and
- due process and natural justice for firms subject to regulatory interventions.

We have outlined below our main issues of concern. We would be very happy to discuss any of these thoughts in detail.

Consultation

Duty to consult: FPC

The Bank of England is to acquire full responsibility for protecting and enhancing financial stability, and the Court of Directors must determine a strategy for this. The proposal is that it must consult the FPC and the Treasury on this strategy. We consider this inadequate and propose that it be extended to include a wider public consultation. We can expect the strategy to reflect the FPC/Bank's risk appetite in relation to financial stability and to provide insight into how it intends to comply with s.9C(4) and with the 'have regard to' requirements of s.9E. These are matters capable of having profound impacts on the economy, markets, the financial services industry, and its consumers, and should therefore be subject to public scrutiny and comment.

The ability of the FPC to direct the regulatory activities of the PRA and FCA is not constrained by any duty to consult. This risks subverting the important consultative processes that constrain the exercise of powers by those authorities. The FPC's power of direction should therefore not be capable of binding the PRA and FCA to exercise their own powers or functions without consultation unless the conditions in new FSMA section 138M (Consultation: General Exemption) are met.

Duty to consult: PRA

PRA's general duty to consult allows it full discretion over its consultative arrangements, including the option to consult only selected persons, and unlike the FCA, is not required to establish consultative industry or consumer Panels.

This level of consultative discretion for the PRA is excessive, particularly in the light of its current bank-centric character. The PRA must be required to consult all stakeholders affected by their regulatory proposals, including consumers where there is a likelihood that they will be directly affected. It must also be required, rather than given the option, to establish consultative Panels under arrangements parallel to those applying to the FCA.

Feedback to consultative Panels

The current requirement for the FSA to provide a written statement to the Panels setting out where it disagrees with a view expressed, or proposal made, in the Panel's representations, has not been carried forward in relation to the FCA's Panel provisions in new FSMA section 1M. There is no rationale given for this; but we consider that it is appropriate that both the PRA and the FPC should explain and provide transparency in respect of their post-consultative decisions.

Consultation and accountability: adherence to the Regulatory Principles

It is right that the Authorities should be required to consult on the extent to which their general policies and practices are consistent with their general duties, including the duty to have regard to the regulatory principles (new FSMA s.1H/2J). This broad requirement should be explicitly underpinned by parallel 'compatibility' requirements in each of the specific consultation duty sections (eg new FSMA s.137H, 137I for the PRA). It is also unclear why the 'compatibility' requirement associated with the requirements for the authorities to consult prior to rulemaking (new FSMA s.138J/138K) is restricted to the first sub-section of their respective 'general duties' sections (new FSMA s.1B(1)/2B(1)). Instead, consistent with ss.1H and 2J, the authorities should be required to explain when rulemaking how that exercise of powers is compatible with every aspect of their general duties.

Accountability for coordination

In our main response to the Government's White Paper, we have also proposed that the requirement in new FSMA s.3D(c) for the PRA and FCA to have regard to the Regulatory Principles should, in respect of the principles in sub-sections (a) and (b) be expressed as a collective, as well as an individual, requirement. It is otherwise possible for each regulator to satisfy the requirement to use its resources efficiently at an individual level without being required to seek any efficiencies at an aggregate level that could be gained through further coordinated activity.

In addition, we have proposed that the overall duty to coordinate the exercise of functions should include a requirement on the regulators to coordinate to minimise as far as possible their *aggregate* regulatory burden on firms.

Should these proposals be accepted, they will then need to be reflected in accountability requirements across the piece, and should form part of the independent audit remit to be given to the NAO.

Consultation by the PRA and FCA – Cost benefit analysis (138J, 138K and 138M)

We are concerned at the restrictions in the requirements to provide estimated costs and benefits within the cost-benefit analyses required for consultations. If the benefits and costs of regulation cannot reasonably be estimated, we question how the PRA and FCA will be able to satisfy themselves that their exercise of functions is consistent with the regulatory principle of proportionality set out in new FSMA s.3B(1)(b).

We do not, therefore, believe that it is appropriate for the regulator to be required only to provide an explanation of why it is not practical or reasonable to provide an estimate. Where no estimate can be made the regulators should be required to set out in clearly in their consultations the basis on which they believe that their rules are proportionate.

Consultation: FCA General and Temporary Exemption (138M and 138N)

We acknowledge that the general exemption from the duty to consult where a delay would be 'prejudicial to the interests of consumers' has been carried across from the FSA to the FCA. While we accept the need for such an exemption to allow the FCA to take swift actions in extreme conditions, we do not consider that there is then a need for a further 'temporary' exemption from consultation as proposed in relation to the product intervention rules.

We are not clear why this new section is necessary, given the general exemption already available, and are concerned at the use of the words 'expedient' and 'necessary'. One would hope that the FCA would not, in any case, make rules unless they were necessary and expedient for the purposes of advancing its objectives. The additional exemption therefore appears to allow the FCA to avoid consultation on the basis of mere convenience.

Instead, the general exemption given in s.138M should apply to all rules, including those for product interventions. The proposed temporary suspension of the FCA's duty to consult could – and indeed should – also be incorporated in the general exemption; even though there may be a need for immediate action, this should not result in the introduction of permanent regulatory measures without a public consultation.

We would also suggest that the 'sunset' sub-clauses (2) and (3) of the temporary exemption clause should be amended to require the FCA to consult as swiftly as possible after the introduction of the temporary rules, and in any case, within not more than 12 months of their introduction.

Appropriate avenues of appeal

The FSA's internal enforcement processes have evolved over time with significant improvements resulting from the Enforcement Review conducted by David Strachan. These controls and protections must not be given up. We believe that the FSA's current enforcement process should be more explicitly captured and embedded in legislation, including provision for appropriate time periods for referrals, appeals and representations, and the independent review of the Regulatory Decisions Committee, to prevent further erosion of protections that experience has shown only too clearly to be essential.

Directions to authorised persons

The BoE/FSA papers on how the PRA will supervise banks and insurers state that the PRA will use its powers to reduce the likelihood of firm failure by, for example, requiring a firm to alter its business model (for instance exiting a particular business line or not pursuing a merger) or holding greater financial resources. However, as no stand-alone provision for this appears to have been set out in the draft bill, we assume that this power is to be exercised through variations of permissions.

Decision notices arising from the exercise of powers under the new authorisation provisions (new FSMA ss.55A-Z) will, we presume, rightly be subject to the procedures that the authorities must put in place under FSMA s.395. These procedures are designed principally to ensure that no one individual or function in the authorities can propose and take a significant regulatory decision in respect of an authorised firm or approved person without the proposed decision being subject to independent scrutiny and challenge.

We are, therefore, deeply concerned at the extent of discretion given to the authorities to avoid the involvement of independent challenge in their decision processes in cases where they consider it necessary to do so to advance their objectives. Since 'advancing their objectives' is arguably equivalent to 'doing their jobs', it is hard for us to see this exemption as anything other than a gaping loophole in essential protections.

Effective oversight and independent challenge of the executive is expected of every regulated firm. We consider that the same should apply within the regulatory authorities, particularly when the potential consequences on firms of faulty decisions can be so severe. It has already been acknowledged by key individuals in the FSA that in some instances, the authorities may, in acting on their judgment, 'get it wrong'. This easy language fails to reflect the serious consequences of injudicious regulatory actions. The procedures to prevent this must be highly rigorous and robust, particularly when the authorities are relatively new and are still settling into their revised regulatory culture. Speed of action cannot be the issue here; the procedures may make provision for fast-track mechanisms, but the authorities must not be allowed to minimise unduly or avoid them completely.

Publication of Warning Notices (s391)

The pre-emptive publication of warning notices before an investigation has taken place flies in the face of the notion of natural justice that requires each party to be given the opportunity to ask questions and challenge the evidence of the opposing party. Although firms will be consulted before the publication of a warning notice, it will be difficult, if not impossible for them to contradict the regulator's judgments effectively. We can expect little objective evidence to have been produced at that stage; it will emerge in the course of a full regulatory investigation process. Firms will be forced to challenge opinions, and powerless to prevent ill-judged actions being taken against them

The period for a firm to make representations to the PRA/FCA before it issues (and now publishes) a warning notice has been reduced from a minimum of 28 days to 14. There is no clear rationale for this reduction in time and it raises further concerns that firms will not have an appropriate opportunity to fully review and challenge the evidence or other considerations on which the regulator's view is based.

It is also unconscionable that decisions to publish cannot be stayed and examined by reference to the Tribunal. The over-hasty and ill-judged publication of warning notices may give rise to significant reputational damage and loss to a firm, exposing them to public censure without the benefit of proper process. We fundamentally dispute the need for the regulator to enjoy such an unfettered power to damage the firms it regulates.

The damage which may be caused by the publication of a warning notice that proves to be ill founded will often far exceed the possible benefit of publication prior to the conclusion of a full and fair investigation. If the Government insists on carrying its 'transparency' policy forward, it must put in place appropriate protections in order to avoid significant and unwarranted harm being caused.

We see no material difference in significance between a decision to publish a warning notice or other information about a firm, and any other decision to exercise regulatory functions. Decisions to publish warning notices must therefore also be made subject to the regulators' internal independent challenge procedures set up under FSMA s.395.

Publication of directions in relation to Financial Promotions (s137P)

We are similarly concerned about the proposals regarding the publication of directions to firms in relation to financial promotions, particularly where such a direction may later be revoked. Publication of directions relating to financial promotions is arguably 'public censure' without the appropriate and necessary safeguards.

References to the Upper Tribunal (s133, 133A)

As a reference to the Upper Tribunal is one of the few 'real time' checks on the judgement-led decisions of the PRA/FCA, it is imperative that it is empowered to operate effectively and efficiently. The new powers given to the regulators will need to be tested and full rights of appeal by firms are therefore essential. Effective review by a third party of disputed decisions must be put in place consistently to the worst consequences of inappropriate, unfair or poorly judged regulatory action.

The restriction on the action that the Tribunal can take in relation to some decisions by the regulators is unjustified – instead, the Government should ensure that its powers are not reduced and are extended to cover any new powers granted to the regulators. One of the key drivers to ensure that regulatory decisions and analysis are robust is the regulators' understanding that those decisions are subject to external review and, ultimately, published comment. It has been shown that an independent review can identify flaws and poor practices and prompt change – the criticism of the Upper Tribunal of the poor practices of the FSA following the Legal & General case is a good example of this. We do not believe that the restricted appeals process delivers this.

Suspension of regulatory action pending Tribunal determination

Under the current regime, the enforcement process provides for firms with 28 days to refer the matter to the Tribunal; the decision notice may not then be issued until after the Tribunal has made its determination.

As currently drafted, section 133(4) only prevents the regulators from taking the actions specified in a 'decision notice' where it is subject to a referral to the Tribunal. This suggests that substantive actions taken under other powers, including the power to publish written notices, are not automatically stayed by a referral to the Tribunal but are instead dependent on the discretion of the Tribunal (s133(3)). We see no persuasive rationale for drawing this distinction between decision notices and other definitive regulatory decisions and acts that have impacts on firms.

In addition, there are some circumstances where the right to refer matters to the Tribunal only takes effect *after* the substantive regulatory action. For example, under sections 55L and 55M, the regulators can issue a 'written notice' imposing, with immediate effect, a requirement on an authorised person. There is nothing in the proposed legislation or any of the documents so far published that gives us comfort that the right to refer a matter to the

Tribunal in these circumstances offers anything more than an opportunity to shut a stable door after a reckless horse has bolted. This should be corrected.

Analysis: the Financial Ombudsman Service

We fully support the role of the Financial Ombudsman Service in providing an independent, relatively swift, and free, service to resolve individual disputes between consumers and firms on a case-by-case basis.

However, the uncertainties that arise from the impact that FOS decisions currently have on regulatory policy cannot be overstated. This exposure to random regulatory change without consultation or other due process has blighted firms' appetite for innovation and prevented the development of solutions to important issues such as the advice gap that will arise from the Retail Distribution Review.

The current regulatory reform programme offers an important opportunity for the Government to support growth and innovation in financial services by clarifying the role of the FOS in respect of individual complaints, and differentiating it from that of the FCA as regulatory policymaker.

The role of the FOS in relation to matters of regulation and law

We welcome the Government's wish to provide greater clarity in relation to the respective roles of the FCA and FOS in respect of potential causes of mass detriment. However, we suggest that the basis for proposing these measures would in fact support a wider scope to include all cases where there is a regulatory concern arising from complaints adjudicated by the FOS.

It is essential that the legislation should specify that individual FOS decisions cannot be taken as creating or modifying regulatory requirements.

Although decisions by FOS are made on an individual case basis and its findings are therefore specific to the particular circumstances of each case, the current requirement on firms to take account of the decisions of FOS means that individual decisions can generate wider precedents for firms.

This is, of course, not inappropriate where complaints clearly share a common root cause within a firm, and the findings are consistent with applicable law and regulation. Firms should rightly learn any lessons to be taken from such decisions and apply them to the benefit of their other customers.

However, difficulties arise where the Ombudsman's decision implies a higher standard than that set by current law or regulation, sets a standard of conduct that has not been captured in law or regulation, varies an existing legal or regulatory standard or requirement, or applies one retrospectively. In these circumstances, the FOS is, in fact, generating regulatory policy, but is doing so without the protections that apply to the regulators when they propose new or changed measures.

We believe that it is necessary to clarify in statute that FOS decisions are relevant only to the case in point, and that no FOS determination may be taken to introduce new legal or regulatory requirements or vary those applicable at any given the time.

An explicit objective should be drawn up for the FOS, together with a suite of principles to inform and direct the actions they take in pursuit of their objective:

225A The scheme operator's objective

(1) The scheme operator's objective is to provide a mechanism by which certain disputes between an authorised person and its customer or customers may be determined quickly and with minimum formality by an independent person.

(2) In carrying out its objective the scheme operator must determine each dispute on an individual basis.

(3) Nothing in this part, or in any rules that may be made by the scheme operator or made by the regulator in respect of the scheme operator, should be taken to allow the content of an individual determination by the scheme operator to give rise to an addition to or variation of existing rules, guidance or other regulatory standards capable of binding any authorised person or persons

(4) In carrying out its objective the scheme operator must have regard to the following principles:

(a) the need to use its resources in the most efficient and economic way;

(b) that its determinations must be fair and reasonable, having regard to all the circumstances of the case

(c) that absent any exception factor the scheme must give due account to the extent to which the actions of the respondent were in compliance with relevant requirements of law and regulation applicable at the time

(d) the general principle that consumers should take responsibility for their decisions;

(e) that no matter in dispute should be determined under the scheme if the customer has not previously communicated its substance to the authorised person and given the authorised person a reasonable opportunity to resolve it;

(f) that the scheme operator should exercise its functions in pursuit of its objective as transparently as possible; and

(g) that each dispute should be determined on its own merits alone.

Resolution of regulatory issues by FCA

There should be a right to refer to the FCA any regulatory conduct issues arising from a complaint or from an ombudsman decision. This right should not, as is proposed in respect of issues giving rise to mass detriment, be limited to nominated parties, but should extend to any interested party.

FCA decisions on such referrals must be binding on the FOS, as is currently the position under section 404 FSMA and consumer redress schemes.

Resolution of novel points of law

Firms may currently request that ombudsman decisions that turn on a novel or disputed point of law be referred to courts as test cases. This process should continue; however, it should not be for the FOS to decide such requests, as it is clearly conflicted. The validity of the request should be determined by a competent and independent third party, established for the purpose.

FOS Discretion

FOS is empowered to determine complaints based on what is 'fair and reasonable in all the circumstances of the case'. This means that FOS decisions are not constrained by a pure reading of the law or regulations. The wide discretion particularly allows the FOS to examine all matters relevant to a complaint, such as delays or maladministration, which would otherwise fall outside regulatory or legal consideration.

In the Court of Appeal case *R (on application of Heather Moor v Edgecomb Ltd) v Financial Ombudsman Service* (2008), the Court considered this extensive discretion, and found that, absent an 'exception factor', firms which comply with regulatory requirements should not be held liable. The Court's approach clearly took account of the evolution in the regulatory regime; the high operational standards now expected of firms to meet customer fairness requirements would be sufficient to address most customer problems.

We do not advocate full removal of FOS' wide discretion, as it is appropriate to the resolution of individual disputes. However, we do suggest that for the purposes of clarity and certainty for firms, the basis for its decisions must be more reasonably constrained by due regard for the legal and regulatory requirements that apply to firms.

In determining what is fair and reasonable, therefore, we suggest that the Ombudsman be required to have regard to the extent to which a firm's actions were compliant with rules and regulations in existence at the time of the complaint. Determination of a complaint based on matters which were not a requirement of either regulation or law should only be made as an exception.

Publication of determinations

The FOS has been given a clear remit to publish individual decisions, so as to inform firms and consumers of the basis on which FOS is determining complaints. We have dealt else where with the need to make clear that individual complaint decisions, whether published or not, cannot create regulatory precedent. Nonetheless, there may be decisions that rely on other factors, and there may be some benefit from publication. However, rather than the 'publish all' approach proposed, the FOS should be required to publish only those decisions that are likely to inform firms about general principles being applied by the FOS, where they do not relate to matters of regulation, and pending their adoption into the FOS's canon of technical standards.

Such decisions should be anonymised before publication so that neither the respondent firm nor the complainant can be identified. It would be unreasonable for those reviewing the decision, in particular, consumers, to draw inferences about a firm's general behaviour on the basis of an individual complaint.

Inappropriate Compensation Awards

Current FOS arrangements allow the quantum and basis for compensation can reward consumers beyond reasonable expectations. For example, requiring a full refund of premiums on upholding a mis-selling complaint when a claim under the policy complained of has been paid out. In such circumstances, the policyholder has benefited from free insurance cover, and has therefore been unjustly enriched.

The first objective of redress should be to return the policyholder to the position they would have been in should the cause of the dispute not have arisen. Therefore, in our example, any refund of premiums arising from a determination that the product was mis-sold should take into account any monies that have already been paid out under a claim.

Accountability and Oversight

The legislation currently requires little in the way of accountability and oversight over the FOS.

Operational Conflicts of Interest

FOS is continually placed under operational pressures by the high volumes of complaints it receives. This pressure gives rise to a conflict of interest within the FOS. The pressure to reduce strains on budgets could compromise objectivity or create perverse incentives for the FOS to find more cases in favour of customers (this effectively forces firms to apply a potentially contentious approach to complaints before they are referred). Equally, the FOS could be tempted to apply a bulk process to clear complaint numbers, which could lead to reliance on a single perceived point of failure rather than by reference to the individual circumstances of each case.

We believe that the FOS Board should be explicitly accountable for managing internal conflicts of interest such as these.

Listing Authority Advisory Committtee

Direct line: 0207 995 1415

Local fax: 020 7996 2919

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

22 August 2011

Dear Sir/Madam,

Response to consultation document and white paper

Thank you for the opportunity to participate in the HM Treasury Consultation "A new approach to financial regulation: a blueprint for reform".

I am pleased to respond on behalf of the Listing Authority Advisory Committee ("LAAC"), an advisory committee to the FSA Board comprised of experienced users of the financial markets, including issuers, investors and financial intermediaries.

We believe that many of the key points raised in our previous response, dated 13th March, remain to be addressed in the 'blueprint for reform'. To that end, I have reproduced herewith the original paper that we submitted at that stage of consultation to accompany this letter. I have also taken the opportunity to summarise here our principal concerns.

1. FCA objectives and approach

Whilst we support the notion that the objectives of the FCA should apply to all its constituent parts, we believe that the listing function will need to have the scope to be able to implement those objectives in different ways to other parts of the FCA, such as those more focussed on retail conduct. We think it is very important that this is recognised in the primary legislation.

2. Consumer protection and the relationship between wholesale and retail markets

We note that the conduct of business framework may give considerable scope for product intervention (for example, by requiring specific point of sale disclosures or even by banning products). The listing authority, by contrast, is much more restricted in this area: it can refuse admission to the regulated market, but only in extreme cases.

The focus of legislation therefore should be to reinforce disclosure requirements for the fullest possible range of products admitted to the UK's markets, but with graded conduct of business rules designed to protect the most vulnerable. These rules should allow the more experienced investors to judge the investment opportunities for themselves and take whatever risks they may think appropriate. This needs to be made clear in the legislation to avoid misunderstanding and a possible regulatory creep towards risk aversion in the future.

3. Competitive position of UK markets

We believe that the FCA, and the listing authority in particular, need to ensure that the UK's financial markets continue to attract a diverse range of issuers and financial products. Without reference to an external benchmark of regulatory appropriateness – such as international competitiveness - there is a risk that regulatory thresholds are established at too high a level.

We recognise that one concern behind giving a regulator an international competitiveness objective is that it could give incentives for lower regulatory standards. However, where there has been discretion for the UKLA to set standards, it has generally been used to set higher standards often with the encouragement and support of market participants.

We would be very happy to discuss our views in a meeting, if that could be arranged. Meanwhile, if you have any queries in relation to this paper or require further information please do not hesitate to contact me.

Kind regards,

Yours sincerely

Andrew Tusa

Chairman, The Listing Authority Advisory Committee

The Listing Authority Advisory Committee was established as an advisory committee to the FSA Board.

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

Group Public Affairs
Lloyds Banking Group plc
7th Floor
25 Gresham Street
London EC2V 7HN
United Kingdom
+44 20 8936 5738 direct

8 September 2011

Sent by e-mail to financial.reform@hmtreasury.gsi.gov.uk

Dear Sir/Madam

Lloyds Banking Group response to the HM Treasury consultation – A new approach to financial regulation: the blueprint for reform

Lloyds Banking Group ('the Group') welcomes the opportunity to respond to the Treasury's consultation: 'A new approach to financial regulation: the blueprint for reform'. We have been closely engaged throughout the Government's development of its regulatory reform proposals, contributing responses to formal consultations and participating in industry roundtables.

In common with many stakeholders, the Group supports the development of a robust, fit-for-purpose supervisory regime which balances financial stability concerns, the fair treatment of customers and sustainable economic growth.

The Group has contributed to the BBA, ABI and the CBI responses. We have also submitted a response similar to this letter to the Joint Committee on the Draft Financial Services Bill.

The purpose of this letter is to highlight areas of specific concern and / or interest. For ease, we have selected appropriate questions from the consultation document under which to make our comments.

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

We have concerns about the proposals in the following areas:

Judge and Jury: HM Treasury proposes changes which will allow an individual who has been directly involved in establishing the evidence in a supervisory or enforcement investigation to also be involved in the decision to issue a supervisory notice (amending existing sections 395(2) of the Financial Services and Markets Act). This means that an individual charged with investigating a matter can also determine the penalty to be imposed. It is unclear why this change is necessary when previously emphasis was placed on separating the act of investigation from the decision on penalties. If the Government is minded to proceed, appropriate safeguards will be necessary to ensure the decisions taken are fair.

Judgement-based regulation: the PRA and FCA need to be transparent about the work they do and continue with the early and ongoing dialogue with firms, particularly if there is less scope for appeal.

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

We see potential risks with how the FCA interprets and operationalises its objectives. Too great a focus on transparency and on price may drive product providers towards 'lowest common denominator' offerings, the stifling of competition, and disincentives to innovate.

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

The FCA has been granted new powers in three key areas: product intervention, the amendment/withdrawal of financial promotions, and (along with the PRA) the publication of supervisory notices. We believe that the FCA should apply these new powers responsibly. Regulators should publish guidance on how and when the powers will be used. Equally, safeguards are needed to ensure that the use of these tools must be preceded by supervisory engagement with the firm(s) to resolve the issue.

We acknowledge that high standards of conduct are important to enhancing confidence in the UK financial system. However, it is important that the degree of regulatory protection afforded should be tailored to the type of consumer. The term "consumer" as defined in the draft Bill covers a broad spectrum, from private individuals purchasing long term retail products (e.g., life insurance, pensions) or using their bank accounts on a day-to-day basis to investment banks engaging in financially sophisticated transactions to small companies borrowing directly from banks. This broad definition means that it is essential that the Bill includes reasonable provisions to ensure that regulatory approaches, (whether in terms of policymaking, enforcement or day-to-day supervision) are be proportionate to the customer, the nature of the transaction and the product type.

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

There needs to be coordination across the competition regulatory architecture. Any new proposals regarding competition powers for industry regulators such as the FCA should await the policy outcomes of the Government's proposals for reform of the current competition regime.

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

We remain concerned about the coordination between the regulatory bodies, particularly given that the differing objectives of the PRA and FCA may create situations where a particular product or business area is subject to conflicting policies, e.g., changes in prudential treatment and conduct of business requirements. We look forward to seeing more details on how policy and intervention will be coordinated.

We would be happy to discuss any of the issues raised in the White Paper with Treasury officials and look forward to working with the team working on the Bill as the legislation develops.

Yours faithfully,

Jonathan Gray
Group Regulatory Developments Director
Lloyds Banking Group plc

LLOYD'S

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

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

8 September 2011

Dear Sirs

A new approach to financial regulation: the blueprint for reform

I am submitting this response on behalf of Lloyd's.

We appreciate the opportunity to respond to HM Treasury's consultation paper "*A New Approach to Financial Regulation: The Blueprint for Reform"*. We have responded separately to the papers on supervision by the PRA and the FCA, referred to here as "*PRA approach to insurance supervision*" and "*FCA approach to regulation*".

Government thinking on the reform of UK financial supervision has developed since it produced its first proposals in July 2010 and we welcome evidence that it has considered and responded to concerns expressed by Lloyd's and other interested parties. In particular we welcome recognition of:

- The distinct nature of insurance business and the introduction of a specific insurance objective;
- the need for a separate insurance division within the PRA's internal structure, headed by an appropriately senior official;
- the fact that insurance firm failure is much less likely to be of systemic importance than failures in the banking sector;
- the need for proper coordination between the PRA and FCA, as well as between these entities and the Bank of England;
- the need for the FPC to have access to insurance expertise; and
- a commitment to consult on regulatory proposals, including cost-benefit analyses.

This response is divided into three sections: overall comments, comments on the regulation of Lloyd's under the new arrangements and responses to the questions the consultation paper asks.

Lloyd's One Lime Street London EC3M 7HA Telephone +44 (0)20 7327 1000 Fax +44 (0)20 7626 2389 www.lloyds.com

Overall comments

Timetable for implementation

We believe that the proposed implementation timetable is ambitious. The Government is committed to implementing these reforms as quickly as possible and expects to introduce the Bill before the end of 2011. However, the Joint Committee on the Financial Services Bill is not due to report until 1 December 2011 and Parliament rises less than three weeks later, on 21 December 2011, which gives little time for the Government to produce a response to the Committee's report.

The Financial Services and Markets Act 2000, which the Financial Services Bill will amend, is a lengthy and complex piece of legislation, introduced to the House of Commons on 17 June 1999 after pre-legislative scrutiny, and receiving Royal Assent on 14 June 2000. It was the first public bill in Parliamentary history to be carried from one session to the next. The Financial Services Bill is not as extensive, but will require some review and adjustment and may not progress rapidly through the Parliamentary process.

We agree that it is important for the new UK regulators to be established as soon as possible and that a lengthy interim period between the old and the new regime is undesirable, but it is also important to ensure that the new regulatory approach is appropriate and the amended legislation is properly drafted.

The financial sector faces a major programme of international regulatory change and reform, creating a massive strain on resources for regulated firms and supervisory authorities alike. Many aspects also require a legislative response: for example, UK financial services legislation will need to be amended to bring it in line with the Solvency II Directive by a prescribed deadline, expected to be 31 December 2012. Implementation of regulatory change in the UK should take this into account.

Effective engagement in Europe and internationally

Most financial services regulations applied by UK supervisors derive from EU legislation. So it is crucial that the UK has a strong and effective voice in the development of financial services regulation and supervisory issues within the new European Supervisory Authorities (ESAs) and other European institutions. We welcome the Government's recognition of the significance of European and international reform and of its intention to engage proactively with European and international partners.

We remain very concerned that the proposed structure does not provide clarity on which body is responsible for maintaining and enhancing the international competitiveness of UK financial services and how that will be delivered under the new architecture.

International engagement entails commitment at a range of strategic and operational levels. Under the new structure several different entities will be involved in EU policy making – Ministers, HM Treasury, the Bank of England, the PRA, the FCA. Effective UK engagement requires these entities and their management and staff to share a broadly similar vision of desirable approaches and ultimate outcomes – in other words, a shared UK financial regulatory "doctrine". It will damage the UK's influence if representatives of different UK entities argue from different bases or present contradictory proposals. The need for a shared vision goes beyond the simple – and welcome – commitment to collaboration on the exercise of functions relating to EU and international organisations.

This cannot be divorced from considerations of international competitiveness and of national economic policy. The Government does not wish to retain the FSA's Principle of Good Regulation that explicitly recognises the desirability of maintaining the UK's competitive position, for either the PRA or the FCA (the FCA's obligation to promote competition is an entirely different issue). But the Government should appreciate that when UK representatives are engaged in international policymaking they will be talking to representatives of other national supervisors who recognise the desirability of national competitiveness, sometimes because this is explicitly required by their organisations' objectives.

Furthermore, the size, structure and product mix of the UK's financial services sector means that regulatory proposals may have a significant impact in the UK and a much lesser or different impact in other EU member states. UK representatives will need to decide whether they take into account such UK-specific impacts – part of the UK financial sector's international competitiveness – or concur with regulatory outcomes that other EU member states consider appropriate, notwithstanding risks that they cause disproportionate damage to the UK financial sector.

EU and international regulatory policymaking is not a straightforward technical exercise, in which national and international representatives work together objectively to design and implement perfect regulatory solutions. Considerations of national competitiveness, of national advantage and disadvantage are bound to intrude, as well as questions of varying impacts in different countries for structural, cultural or other reasons. The Government should determine the extent to which it wants UK representatives to take this into account and to act as "national champions", notwithstanding the absence of recognition of UK competitiveness in the new authorities' strategic and operational objectives.

It is desirable that UK supervisory entities develop their approaches to EU and international policymaking in consultation with industry. Industry groups have been established to provide input on particular international topics (such as the FSA's Insurance Standing Group and HM Treasury's Industry Working Group in relation to Solvency II) and it is important that the new financial supervisory structure continues to consult relevant UK financial sectors on international policy issues.

Even though there is more to international policymaking than technical expertise, it is nevertheless important that UK involvement deploys appropriate technical knowledge, as well as strong negotiating and influencing skills. This should be taken into account when selecting UK representatives on the ESAs, who must possess appropriate skills and political awareness, as well as sufficient seniority to exert the kind of influence that the Government may consider appropriate.

The regulation of Lloyd's

General comments

We welcome the Government's intention to make the PRA lead regulator of Lloyd's as a whole and to make the PRA prudential regulator of the Society of Lloyd's and Lloyd's managing agents. We continue to believe that the efficacy of the overall supervisory arrangements would be enhanced by making the PRA prudential regulator of the small number of Lloyd's members' agents as well.

The PRA will be responsible for prudential and organisational rules applying to Lloyd's, including those ensuring the adequacy of members' resources and Lloyd's central assets. We are pleased to note that neither the HM Treasury paper nor "*PRA response to insurance supervision"* propose to change existing arrangements for the supervision of Lloyd's. We therefore understand that the PRA's supervision of Lloyd's will continue to take account of Lloyd's oversight of risk within the market and its role in ensuring capital adequacy.

Authorisation of the Society of Lloyd's

Clause 35(4) of the Financial Services Bill proposes a new section 315 in the Financial Services and Markets Act 2000 ("FSMA"). The new wording does not carry forward the existing statutory language that "The Society [of Lloyd's] is an authorised person".

We understand that the reasons for this are technical. The draft Bill does not specify which authorised persons will be regulated by the PRA and FCA and which will be regulated by the FCA only, as secondary legislation will specify this. It would be an unnecessary time- and resource-intensive exercise for all concerned to require the Society of Lloyd's to apply to the new supervisory authorities for permission to carry on regulated activities and we welcome assurances from HM Treasury that this is not the intention.

Memorandum of Understanding (MoU)

We welcome the statutory requirement for the PRA and FCA to prepare and maintain a MoU describing their respective roles in relation to the regulation of authorised persons and how they will comply with their duty to coordinate the exercise of their respective functions. We are pleased that functions under Part 19 (Lloyd's) are included in the indicative list of issues that the MoU will cover.

The Government has asked the Bank of England and the FSA to produce a draft version of the MoU before the Bill is introduced to Parliament. We believe that the MoU's efficacy will be enhanced by the engagement of regulated firms in its development and we hope that it is intended to invite such engagement. It is particularly important that Lloyd's and Lloyd's firms are consulted on arrangements to coordinate their supervision and that such arrangements draw on experience of existing supervisory approaches.

Co-operation Agreement

"PRA response to insurance supervision" says that

> *"In due course, the PRA, FCA and the Society of Lloyd's will enter into new co-operation arrangements to ensure that the new regulators' interfaces with Lloyd's market discipline functions and its oversight of the market as franchisor are suitably clear."*

These arrangements should build on the existing formal co-operation agreement between the FSA and the Society of Lloyd's (copy attached): we strongly advocate that a similar formal agreement is drawn up, between the PRA, the FCA and the Society of Lloyd's and look forward to working with the PRA and FCA on developing such an agreement.

The existing agreement ensures that duplication is minimised and that the FSA and Lloyd's maintain an effective working relationship on authorisation, supervision and enforcement for firms and individuals operating within the Lloyd's market. The agreement recognises that the FSA, as part of its oversight of the market, utilises Lloyd's extensive systems and controls in respect of the monitoring of managing agents and syndicates.

Conduct regulation at Lloyd's

We have set out our views on conduct regulation at Lloyd's in our response to *"FCA approach to regulation*" (copy attached). We remain unclear about where the boundary between conduct regulation and prudential regulation of the Lloyd's market will lie and therefore of how much engagement the FCA will seek with the Society of Lloyd's and Lloyd's managing agents.

Clearly protection of Lloyd's policyholders will continue to entail the same controls as the protection of the policyholders of other UK insurers. We agree with the FCA's proposed "differentiated approach", which implies recognition of the different regulatory protection expectations of , for example, UK personal lines policyholders and international reinsurance purchasers.

We are not clear on the extent to which activities related to membership of Lloyd's will be viewed as "conduct", since the FSA currently regulates such activities as part of its prudential supervision of Lloyd's. For example, members' capacity transfer is currently supervised by the FSA's Lloyd's Market Supervision team. There is an organised process, with rules in the FSA's Prudential Sourcebook for Insurers (INSPRU Rule 8.4 (*the Capacity Transfer Market*)). Inclusion of these rules in INSPRU reflects the FSA's judgement that, as capacity transfer is not day-to-day conduct of business between Lloyd's and its customers, it more naturally fits with prudential regulation and not with conduct of business rules.

Conduct regulation at Lloyd's should be low impact and should take account of Lloyd's existing and extensive controls over market conduct. We look forward to establishing a dialogue with the FCA to ensure that its supervision of Lloyd's is proportionate, efficient and does not create unnecessary compliance or cost burdens.

Responses to questions

Q1. Do you have any specific views on the proposals for the FPC as described in paragraphs 2.6 to 2.24 and in Chapters 3 and 4?

At least one FPC member should have experience in insurance, to provide input to the operation of the Committee. We therefore welcome the Government's commitment to ensure that the FPC has access to the expertise of various sectors of the financial services industry.

The interim FPC is likely to be operational for some time before a permanent FPC is appointed and will be a significant influence on the FPC's future direction. We are therefore concerned that the only external member with any exposure to insurance is Alastair Clark, who had some exposure to insurance at the Bank of England (he co-authored the 2006 G30 Reinsurance and International Financial Markets Report), but whose right to be considered properly "external" is questioned by the Treasury Select Committee. Ideally, we would like to see a additional external appointment to the interim FPC, of someone with direct experience of the insurance sector.

Q2. Do you have any specific views on the proposals for the Bank of England's regulation of RCHs, settlement and payment systems as described in paragraphs 2.32 to 2.40 and in Chapters 3 and 4?

Lloyd's does not have any comments on this question.

Q3. Do you have any comments on:

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

We agree with these proposals and the commitment to produce a crisis management MoU.

The paper refers to technical changes to the special resolution regime under the Banking Act 2009, but does not refer to resolution arrangements for insurers. "*PRA approach to insurance supervision*" does refer to insurers' resolution arrangements and says that the PRA will consider whether Recovery and Resolution Plans should be introduced for insurers. Any such plans must take into account the existing resolution mechanism for EU insurers, the Winding-Up Directive (2001/17/EC). This Directive harmonises the reorganisation and winding-up of (re)insurers in the EU and provides for claims arising from insurance contracts to be given preferential treatment over other creditors. Both the PRA and the FCA should therefore recognise that the Winding-Up Directive already provides a resolution mechanism for insurers.

Q4. Do you have any comments on the objectives and scope of the PRA, as described in paragraphs 2.46 to 2.61 and in Chapters 3 and 4?

We welcome the introduction of a specific insurance objective for the PRA, which recognises differences in business models between insurers and other financial services. Whereas insurers and regulators must ensure that policyholders are adequately protected, we are unclear how this duty can be extended to those who 'may become policyholders' and what the regulatory implications are for ensuring the adequate protection of this undefined category.

The Bill sets out a general objective for the PRA: "*promoting the safety and soundness of PRA-authorised persons."* It says that this is to be met primarily by reference to the stability of the UK financial system, making systemic risk a key consideration for the PRA. It is therefore important for the PRA and insurers to develop a shared understanding of the extent to which insurers are considered to represent systemic risks.

We agree with "*PRA approach to insurance supervision"* that "*in general, firms carrying out traditional insurance activities do not pose risk to the system in the same way as banks*". As the failure of such firms is less likely to be of systemic importance, their supervision requires a different and less intrusive approach.

However, we are concerned by statements in "*PRA approach to Insurance Supervision*" which suggest that reinsurance failure can be readily equated to the failure of, for example, an investment bank. We do not believe that the core activities of reinsurers present a threat to the financial stability of the UK or the international financial system and we are aware that this view is shared by major European reinsurers. The pattern, timing and settlement of claims, amongst other things, for reinsurers, both when active and in run-off, is typically very different from financial demands faced by investment banks in similar circumstances.

A considerable amount of detailed analysis in support of these views has been undertaken by the reinsurance industry and provided to the International Association of Insurance Supervisors (IAIS). We are anxious therefore to ensure that statements made on the subject should be grounded on strong analysis and evidenced.

This section of the consultation paper deals with the regulation of Lloyd's and we welcome the Government's confirmation that:

- the PRA will be the lead regulator for Lloyd's as a whole;
- the PRA will be the prudential regulator for the Society of Lloyd's and Lloyd's managing agents;
- further provision as to the allocation of regulatory responsibility in relation to Lloyd's will be included in the order to be made by the Treasury under new section 22A; and
- regulatory arrangements will be adapted to Lloyd's unique structure by allowing the PRA to regulate the prudential aspects of the Lloyd's operations although Lloyd's names are not authorised persons.

Q5. Do you have any comments on the detailed arrangements for the PRA described in paragraphs 2.62 to 2.78 and in Chapters 3 and 4?

In principle we welcome the application of judgement-led regulation within a legislative framework, provided it is applied by suitably-trained and experienced personnel. However, UK regulatory requirements have to comply with EU directives containing detailed, technical rules and we are unclear how the proposed judgement-led approach will conform with such EU rules. EU directives are designed to deliver harmonisation in the regulatory requirements applied within Europe and Lloyd's supports such harmonisation. There is a risk that supervisory discretion and judgement could be used to create national super-equivalence on a range of issues in a way that is non-transparent and not subject to consultation. Safeguards should be put in place.

The process of making supervisory judgements must be transparent. Firms should be able to provide input into that process and should feel that their representations have been fully considered before final decisions are taken. Supervisors should not confront firms with unexpected decisions with no proper forewarning, which are difficult to challenge and reverse.

We welcome the Government's intention not to amend the Tribunal's scope of review of PRA supervisory decisions. To ensure fairness of the process, it is important that an independent review process is available to parties subject to supervisory decision-making.

We support the Government's proposals on the PRA's governance framework and relationship with the Bank of England. The PRA board should include non-executive directors with relevant experience of the financial sector, including insurance expertise.

We agree that existing FSMA consultation requirements should remain largely unchanged and that there should be no exception for rules originating from Europe.

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

The HM Treasury document "*A new approach to financial regulation: the blueprint for reform*" released in 2010 said of the conduct regulator (then the CPMA): "*there will be no in-built tensions between different objectives and a dedicated focus on the importance of proper conduct.*" However, under the Bill, the FCA has one strategic objective, three operational objectives and six regulatory principles, as well as two further issues (promoting competition; minimising financial crime) which it must take into account.

We can understand the reasons why the FCA has been given this list of different aims, but we question how easy it will be to satisfy them all. The FCA will sometimes need to reconcile different and possibly conflicting principles, issues and objectives and should develop a culture enabling it to do so fairly and transparently, so that financial customers and firms alike know what to expect. At the same time, the FCA should expect its behaviour to be measured against the full list of objectives and principles and should not disregard particular principles on a regular basis in pursuit of its objectives.

Lloyd's, like other regulated entities, is interested in ensuring that the FCA's supervisory regime is cost effective and proportionate. We therefore particularly welcome the regulatory principles recognising:

- The need for the FCA to use its resources in the most efficient and economic way; and

- Proportionality – the principle that a burden or restriction imposed on a person or activity should be proportionate to the benefits that are expected to result.

We think that the proper application of these principles in particular will immensely strengthen the effectiveness of the FCA's supervisory regime.

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

We welcome the Government's recognition that the new product intervention power is unlikely to be appropriate in relation to the protection of professional or wholesale customers.

We remain concerned about the FCA publishing information on warning notices issued in relation to individual financial firms in circumstances where the outcome of the case has not been determined. This may have severe reputational implications for firms in the event that the enforcement action is later discontinued or unsuccessful.

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

Lloyd's does not have any comments on this question.

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

Lloyd's does not have any comments on this question.

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

Lloyd's does not have any comments on this question.

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

As Lloyd's will be prudentially regulated by the PRA, these proposals will not apply to Lloyd's, so we do not have any comments on this question.

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

Lloyd's does not have any comments on this question.

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

Effective cooperation between the regulatory authorities is crucial to the smooth operation of the new supervisory system. We welcome the requirement for the PRA and FCA to conclude a MoU. Please see our earlier comments on this subject.

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

We are pleased that a single authority (the PRA for dual-regulated firms) will manage the process of applying for authorisation. It is important that the need for consultation between authorities does not lead to delays.

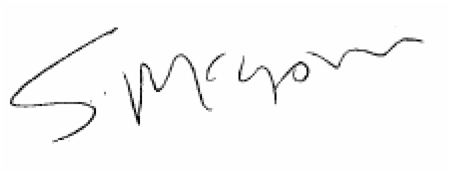
We welcome the requirement that the new authorities consult each other before introducing rules and regulations. This should help minimise risks of compliance confusion among regulated firms.

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

The Government's first consultation on financial regulation, published in July 2010, suggested that arrangements under which the PRA and FCA had separate rule-making powers for the FSCS could lead to an end in the current cross-subsidy between different classes of levy payers. This was not mentioned in the Government's February 2011 consultation or the current consultation paper. We continue to support the ending of cross-subsidy.

Please do not hesitate to contact me should you have any questions on our response.

Yours sincerely



Sean McGovern
Lloyd’s General Counsel

Telephone +44 (0)20 7327 6142
Email sean.mcgovern@lloyds.com

LIIBA is the Trade Association representing Lloyd's Insurance Brokers. London Market brokers' introduce virtually all of Lloyd's business and a significant proportion of London companies business, as well as placing considerable volumes of business in International Markets. They handle in excess of £80bn of insurance premiums and claims annually. Some of our members also handle significant amounts of small/medium sized commercial, as well as, personal insurances.

We have already made a response to the FCA on its paper entitled "Approach to Regulation". There are however, a number of points on which we feel particular emphasis should be placed and these are set out below .

Throughout the financial crisis the London Insurance Market continued to make a significant contribution to facilitating international trade and commerce. In 2009 the insurance sector contributed £9bn in invisible exports with Lloyd's Brokers accounting for £1.9bn. It is not only quite wrong, but potentially damaging to our Market, to tarnish all sectors of financial services as if there were all directly responsible for the financial crisis. It is vital to differentiate the messages, criticising those sectors that have failed to perform but also publicly recognising those that continue to make a positive contribution. It is also vital to recognise this difference as regulatory policy and the approach to supervision are developed.

We have limited our comments on the proposed approach to a number of high level points.

- We strongly support the statutory principles of good regulation in terms, for example, of competitiveness and innovation and would wish these to be preserved.

- We fully support the continuance of improved enforcement capability and principles-based, risk-based regulatory policy, rules and supervision, such that the principles do not become a means of unfair and unpredictable enforcements/disciplinary practice. However, the FCA should not be able to take Enforcement actions without fully explaining its position, providing due notice of its intentions and providing an appropriate mechanism for the regulated entity to challenge any proposed action under normal circumstances. It should be the exception not to follow this rule – perhaps in cases of suspected fraud. It would be fairer if the FCA was not permitted to make public any investigation or action during any normal process.

- We believe that the FCA must adopt full and open consultation on its rule books.

- The Regulator must properly observe the differences between wholesale and retail business. To this end we believe it is of fundamental importance that the composition of the FCA Board, the Rule Book, and the FCA's approach to supervision adequately reflects the different issues facing the wholesale sector. A one size fits all approach is not appropriate.

- There should be greater "regulation of the Regulator" to ensure that fairness is achieved in dealing with the regulated. An independent appeals panel should be set up with the power to direct the regulator if its actions prove to be disproportionate or incorrect – with the obligation by the FCA to compensate the regulated if complaints are upheld. This is particularly true of Section 166 notices where there is no accountability for such requests nor compensation of costs. Equally it would appear to be misguided to fine an entity purely on the grounds that, in the view of the regulator, inadequate systems and controls were not in place, unless prior written notice about what should in place had previously been given. Fines should be based on ACTUAL failures or wrong doing.

- We believe that excessive intervention in the right of commercial self-determination of firms, for example in staff questioning business models, business strategies etc. should be resisted.

- There are a number of interlocking relationships between wholesale insurers and intermediaries, for example, Lloyd's Brokers handle significant sums of premiums and claims monies belonging to both insurers and clients. Appropriate prudential regulation of intermediaries, recognising the complexities of accounting for international insurance and reinsurance business is very important.

- An over-riding consideration is the importance of having an effective and proper management team at the FCA. There have already been a great number of changes in regulatory and supervisory management of our sector in recent months. It is vital to the success of the new regulator that there are appointments at senior level of those who understand the wholesale Market and its relevance to the UK economy.

- We are very concerned about the proposal to disclose investigations before any wrongdoing is established. The impact on the share price of eg Gartmore and CPP demonstrate the dangers. See above.

- The number and amounts of fines levied against regulated firms should surely be seen as a failure not as a success. The regulator should not retain any fines or have staff remunerated against such measures. Otherwise this presents a conflict of interest and an inappropriate relationship to the cultural objective of co-operative regulation. It is understood that the FSA sets internal targets for fine generation and for the number of s.166 notices issued. This cannot be the basis of an appropriate culture for a regulator.

- We have serious concerns that the 'twin peaks' approach will weaken the UK's voice in the European Supervisory Authorities. EIOPA remains responsible for insurance intermediaries but it is clear that the PRA will represent the UK. The new structure gives a great deal of influence to the ESA's in terms of level 2 and 3, the delegated act approach and in developing technical standards. It is essential that the FCA is not regarded as a junior partner and adequate arrangements made to ensure the FCA plays a full role in EIOPA's work on all issues affecting intermediaries.

It is hoped that you will find the above comments of assistance. We would be happy to develop them further if it would be helpful to do so.

LONDON METAL EXCHANGE

Diarmuid O'Hegarty
Deputy Chief Executive

Tel: +44 (0)20 7264 5671
Fax: +44 (0)20 7264 1707

18 August 2011

Financial Regulatory Strategy
HM Treasury
1 Horseguards Road
London
SW1A 2HQ

By email

Dear Sirs

WHITE PAPER – A NEW APPROACH TO FINANCIAL REGULATION: THE BLUEPRINT FOR REFORM

Summary

1 The London Metal Exchange ("the LME") welcomes the opportunity to comment on the White Paper and Draft Bill published on 16 June 2011. The LME is a recognised investment exchange ("RIE") under the Financial Services and Markets Act 2000 ("FSMA").

Recognised Investment Exchange Exemption

2 Section 25(3) of the Draft Financial Services Bill amends section 285(2) of FSMA by deleting paragraph (b). Section 285(2) provides that:-

> *"A recognised investment exchange is exempt from the general prohibition as respects any regulatory activity –*
>
> *(a) …*
>
> *(b) which is carried on for the purposes of, or in connection with, the provision of clearing services by the exchange."*

3 The LME recognises that the primary intention of the amendment is to ensure that an RIE which also wishes to operate as a recognised clearing house ("RCH") must in future make separate applications for recognition as an exchange and for recognition as a clearing house. We also recognise that it is the practice for an RIE and RCH in the same group to operate as separate companies with separate recognitions. However, the deletion of paragraph (b) gives rise to the risk that an

THE LONDON METAL EXCHANGE LIMITED | 56 Leadenhall Street, London EC3A 2DX LME.COM
Tel +44 (0)20 7264 5555 | Fax +44 (0)20 7680 0505 | Email info@lme.com

activity currently undertaken by RIEs as an ancillary activity may need separate authorisation in the future.

4 The LME currently provides a front end electronic application for the purpose on enabling members of the London Bullion Market Association ("LBMA") to register OTC gold futures transactions for clearing by LCH.Clearnet. The FSA has interpreted the role of the LME in these arrangements as possibly falling within paragraph 3(b) of Schedule 2 to the FSMA which states that the following is included in the regulated activity of "*arranging deals in investments*":-

> *"Making, or offering or agreeing to make –*
>
> *(b) arrangements with a view to a person who participates in the arrangements buying, selling, subscribing for or underwriting investments."*

5 To the extent that the LME's participation in this clearing service falls within the meaning of "*arranging deals in investments*" the activity would fall under the current exemption for an RIE to conduct a "*regulatory activity … for the purposes of, or in connection with, the provision of clearing services by the exchange".*

6 The simple deletion of paragraph (b) from section 285(2) of FSMA goes further than merely ensuring that an RIE that also wishes to be a recognised clearing house must make two separate applications. The deletion also calls into question whether an RIE can provide a route to clearing for OTC transactions under the terms of its RIE exemption.

7 We would propose that paragraph (b) of section 285(2) of FSMA should not be deleted. The intended consequence of the deletion does not address an issue that has arisen in practice: there are a number of operational reasons why no one company would operate as both an RIE and an RCH. The unintended consequence of the deletion calls into question an exemption that has been used by RIEs to conduct an activity that should be encouraged: facilitating the clearing of OTC transactions.

Yours faithfully

Diarmuid O'Hegarty

Diarmuid O'Hegarty

London Mining Network,
Finfuture, 225-229 Seven Sisters Road,
London N4 2DA.
Tel: 07929 023214
Email: contact@londonminingnetwork.org
Web: http://londonminingnetwork.org

7 September 2011

Submission to UK Treasury Consultation, *A new approach to financial regulation: the blueprint for reform*

On 14 April 2011, London Mining Network[1] submitted comments to the UK Treasury's consultation on the proposed new UK securities regulatory framework. They were prepared by Nostromo Research, a well-established, independent London-based consultancy specialising in analysis of mining-related impacts, primarily on communities and workers.

We do not seek to comment on proposed reform of regulation of the financial sector *per se.* However, the proposed reform includes transference of the functions of the UK Listing Authority (UKLA), from the Financial Services Authority to a proposed new body, the Financial Conduct Authority. We therefore urge the UK Government to make use of this opportunity to ensure that the new body is equipped with the authority, the expertise, the personnel and the funding to enable it to exercise a vigilance over all UK-listed companies – not only financial services companies – which has been sadly lacking in the past.

The report included with this submission makes clear why we remain strongly of the view that reform of securities regulation must result in much stricter oversight, particularly of companies involved in mining and trading in minerals.

Present regulation of both the main LSE market and AIM is not sufficiently rigorous to prevent harm, as shown by the case studies below, and should be upgraded. The present regulatory system does not adequately operationalise the limited demands on corporate reporting contained in the Companies Act 2006. Findings of non-compliance with IFC, OECD and other widely accepted international standards, as well as convictions in non UK courts, should necessarily be included in corporate reports.

For this reason, LMN is making this submission to the consultation on the Treasury's 'blueprint for reform', including the 'Bill to Amend the Bank of England Act 1998, the Financial Services and Markets Act 2000 and the Banking Act 2009, and to make other provision about financial services and markets'. This submission includes brief answers to specific questions in the consultation document followed by a report, ***London, City of Spoils***, which is an updated and expanded version of the comments which we submitted to the Treasury in April, with updated case studies provided by Nostromo Research.

[1] London Mining Network (LMN) is an alliance of 26 human rights, development and environmental groups concerned about the impacts of the activities of mining companies listed on the London Stock Exchange or financed by London-based institutions. Members include ACTSA (Action for Southern Africa), CATAPA (Comite Academico Tecnico de Asesoramiento a Problemas Ambientales), Colombia Solidarity Campaign, The Corner House, Corporate Watch, Down to Earth (the ecological campaign for Indonesia), Ecumenical Council for Corporate Responsibility, Forest Peoples Programme, LAMMP (Latin American Mining Monitoring Programme), Partizans (People Against Rio Tinto and its Subsidiaries), PIPLinks (Philippine Indigenous Peoples Links), TAPOL (the Indonesia human rights campaign), the Society of St Columban and UK Tar Sands Network. LMN's twelve observer groups include leading human rights, environmental and development organisations.

Responses to specific questions asked in the consultation document

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

If the FCA is to function as the UKLA, its second operational objective (paragraph 2.82) 'protecting and enhancing the integrity of the UK financial system' must include enforcing good conduct on UK listed companies. This must include, at a minimum, that companies and their directors obey the law both in the UK and in the countries in which they operate. The case studies which follow demonstrate that even this minimum has not been enforced by the existing UKLA. 'Protecting and enhancing the integrity of the UK financial system' should also include ensuring that UK listed companies recognise agreements to which the UK is a signatory, including the UN Declaration on Human Rights and the UN Declaration on the Rights of Indigenous Peoples, and act accordingly; and that they implement the highest environmental, social, labour and health and safety standards.

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

and

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

Given its role as UKLA, the FCA's 'proactive approach to conduct regulation' (paragraph 2.93) needs to extend beyond the financial services sector to include active vigilance over the behaviour of all companies listed on UK Registered Investment Exchanges. This will require a sufficient level of funding for the FCA to be able to call on the expertise necessary.

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

The FCA's governing body needs to include people with expertise in human rights and environmental protection, not only financial matters, if it is to exercise its function as UKLA in a competent and acceptable manner. Paragraph 12 of Draft Bill deals with the FCA's Annual General Meeting but does not state who would be entitled to attend it. It is important that anyone concerned about the conduct of UK listed companies should be able to attend, in order to make their concerns known in this important forum.

London, City of Spoils

UK mining companies and the case for stricter oversight

Introduction

The key concern of London Mining Network, from its inception in April 2007, has been to expose the bad conduct of mining and minerals companies listed – or which intend to list – on the London Stock Exchange Main Market (LSE) with a Premium or Standard Listing; or on London's Alternative Investment Market (AIM).

In recent months, we have seen the arrival on the LSE of its largest-ever new entrant, Glencore, whose profits mainly derive from the exploitation and trading of minerals.

Last July, Nathaniel ('Nat') Rothschild's mining investment holding company, Vallar, launched on the LSE's premium market with a sparkling IPO (Initial Public Offering) that raised £707.2 million (US$1.07 billion). This was despite at least fifty other companies (including mining enterprises) around the world, having shelved their own IPO plans within the previous three months.[2] In June of this year, Vallar plc relaunched as Bumi plc, marking the baptism of Indonesian capital in London's river of finance, and allowing the world's second biggest extractor and exporter of thermal coal – the dirtiest of fuels – to trade its shares in the UK.[3] The Bumi IPO had been delayed without explanation, perhaps due to questions raised by the FSA about the nature of the company's Indonesian financial risks, and the distinctly chequered role of the Bakrie enterprises which control Bumi itself.

A fundamental insecurity

The case studies which follow uncover a raft of recent behaviour on the part of six UK-listed companies whose operations have had serious adverse impacts on workers' health and safety, communities' rights, developing country economies, or on the quality and availability of natural resources.[4]

We do not claim that this list is exhaustive (far from it); nor that all mining firms exhibit equal tendencies to commit disturbing – sometimes quite shocking and illegal – acts. However, this should give little cause for comfort. On the contrary, it lends weight to our conclusion that, though there may already be some benchmarks for good governance in place (and a few companies genuinely try to observe them) they are being ignored with impunity by many others.

It is little short of scandalous that none of the companies critiqued in this Report has yet been ousted from either the LSE main market or AIM; nor has there been a thorough official examination of their alleged misdeeds.

We pay special attention to Vedanta Resources plc since this company seems emblematic of multiple failures prevailing under the UK Financial Services Authority (FSA)'s regulatory "light touch" of recent years. Yet Vedanta's star continues rising, while Anil Agarwal, the company's

---

[2] Bloomberg, 9 July 2010

[3] Xstrata plc, 34.5% controlled by Glencore plc, declares that it is the "world's biggest exporter of thermal coal". Glencore itself has a marketing agreement with Bumi for the purchase of the latter's Indonesian coal.

[4] The cut-off point chosen for this Report is 2003 – primarily due to lack of space in which to examine the world-class mining companies registered on the London Stock Exchange before that date. This means that Rio Tinto, BHP Billiton (with a dual UK-Australia listing) and Anglo American, three of the world's seven largest such conglomerates, have been left out. Xstrata plc (another of the Top Seven) was registered on the LSE in 2002 when it acquired Glencore's coal assets in Australia and Colombia. Glencore is currently (at 34.5%) the dominant shareholder in Xstrata. The Swiss firm's entry on the LSE in May 2011has raised expectations that it will soon make a bid to take over Xstrata, or sell its stake in the company. See: *Xstrata chief hints at Glencore merger* by William MacNamara, Financial Times 7 March 2011. For critical information on these, and other mining companies, the reader is referred to: www.minesandcommunities.org

architect and controlling shareholder (with a 62.21%. family stake as of 2 May 2011)[5] has become the UK's 17th richest person, enjoying a privately accumulated fortune estimated at nearly £3.4 billion.[6]

Vedanta may not be the worst environmental and human rights offender in every respect. (The company has yet to be accused of complicity in the shooting down of citizens by security forces: an accusation levelled in May this year against African Barrick plc *[See below].*) Nonetheless, the charges against Vedanta continue to mount, lending urgency to the debate on whether there should be a UK definition of "corporate bad actor" – and one going beyond that outlined in the US Dodd-Frank Act. [7]

We are particularly alarmed that, although the FSA chairman, Lord Turner, promised UK citizens in early 2009 an end to the dark days of corporate derring-do that had chacterised much of the previous decade, some of Vedanta's worst offences have been committed in just the past two years.

Why reform of UKLA Listing Rules is essential: a focus on the mining and minerals sector

In March 2011, several environmental NGOs called on the Hong Kong stock exchange (HKx) to ensure that China's leading gold-copper mining company, Zijin, "come clean" and fully disclose "material risks associated with one of its most controversial overseas projects, the Rio Blanco Mine in Peru" which it had taken over in 2007.

The NGOs went on to claim that, because of this project: "[P]eople have lost their lives, and the fragile ecosystem and waterways of the Piura region are being threatened by pollution…This has not only affected the health and lives of the people, but also economic activities such as eco-tourism, agro-industry and organic farming, which are the main sources of sustainable development in the region."

The letter also raised concerns that "Zijin investors are in the dark about the risks" posed by the mine, "including the company's failure to obtain community authorisation before beginning mining activities, as required by Peruvian law" and "lack of compliance with Peruvian environmental regulations."[8]

The NGOs' initiative followed closely on the heels of China's worst gold mine tailings (waste) disaster in 2010, for which the same company, Zijin, was responsible. In this case, Chinese environmental groups themselves had already urged the Hong Kong Stock Exchange to ensure the company properly report the financial implications of the spill, and Zijin's trading on the Exchange had already been halted several times in advance of announcements of fines and penalties associated with the event.

Indeed, the company was de-listed for a short period earlier this year (March 2011) after Zijin contended that two of its subsidiaries, rather than the parent company. should be held responsible for an "incident" which caused the deaths of 22 people and the destruction of 523 homes in the south eastern province of Guangdong.[9]

Just why is this sorry saga relevant to public discussion on the re-organisation of financial regulations taking place in a country five thousand miles away from Hong Kong?

---

[5] RNS Number: 7870H, Vedanta Resources PLC, 2 June 2011
[6] http://www.minesandcommunities.org/article.php?a=10948
[7] The Dodd-Frank Act addresses the need to stem the trade in "conflict minerals" and in coal and other minerals from operations which pose a substantial danger to their workforces. The "Bad Actor" provisions of the Act concern financial fraud and related criminal activity; some of which will apply to foreign private issuers of securities.
[8] *Groups Call on Hong Kong Exchange to Ensure Zijin Mining Comes Clean about Overseas Investment Risks*, 3 March 2011. See: http://www.foe.org/sites/default/files/Letter%20to%20HKSE%20re_Zijin.pdf
[9] Reuters, 15 March 2011; Bloomberg 14 March 2011

First: Zijin's Rio Blanco mine in Peru is technically owned by a UK-registered company, Monterrico Metals plc; and the most serious human rights abuses committed during its operations were made when Monterrico was firmly under British control, soon after it was accepted for trading on the London Stock Exchange in 2005.[10]

Second: while assuredly guilty of causing huge harm in its home country of China (and already fined US$1.4 million for the Guangdong disaster, with five of its employees sent to jail for up to four years[11]) Zijin has been more circumspect over its obligations to local people and the environment in Peru than was its predecessor management – and arguably more transparent too.

A UK investigation of the Rio Blanco project, reporting in March 2007, found that Monterrico Metals, while in British hands, had made several inaccurate statements, especially in claiming overwhelming support for the project from local people. Later that year, more than 90% of these communities, on turning out for a referendum, voted to reject the mine.[12]

In April 2011, the Chinese chairman of Monterrico Metals agreed that his company had still not obtained the consent to operate that it required from those communities.

Third – and most relevant to our submission: the Hong Kong Stock Exchange requires that minerals companies comply with specific listing requirements[13] that as yet have no counterpart in those imposed by the UKLA.[14]

Importantly these include disclosure of:

- environmental, social, and health and safety issues;[15]
- any non-governmental organisation impact on sustainability of mineral and/or exploration projects;
- any claims that may exist over the land on which exploration or mining activity is being carried out, including any ancestral or native claims;
- [a company's] historical experience of dealing with concerns of local governments and communities on the sites of its mines and exploration properties.

Specific Risks

Perhaps it is little surprise that the Hong Kong Stock Exchange has introduced specific pre-listing conditions on mining and mineral companies. True, these firms may be no more vulnerable to corrupt practices by unscrupulous principals (directors and senior staff) than any other sector, although such propensities must certainly not be discounted. (We raise some related concerns in our study of Brinkley Mining, which follows.)[16] However, extractive companies are much more likely (than banks, retail or services companies, for example) to be directly responsible for

---

[10] *See*: 'British mining company faces damages claim after allegations of torture in Peru', Ian Cobain, *The Guardian*, 18 October 2009

[11] *Mining Journal*, 6 May 2011

[12] 'Peru: Communities Say 'No' to Mining Company in Vote' by Milagros Salazar, IPS,18 September 2007

[13] See http://www.hkex.com.hk/eng/rulesreg/listrules/mbrules/Documents/consol_mb.pdf pages 391-397 of 1036, particularly point 18.05, which includes the points noted above.

[14] See: *A Guide to listing on the London Stock Exchange*, published by the, London Stock Exchange; accessed 10 April 2011: http://www.londonstockexchange.com/home/guide-to-listing.pdf.

[15] Even the basic reporting of company carbon emissions is not yet mandatory in the UK. In May 2011, a study by the UK Environment Agency of 500 FTSE All-share companies showed that only a minority of UK publicly-listed companies currently provides environmental statistics in line with government guidance. The majority disclose some quantitative environmental information in their annual reports but, said the Agency, its quality is highly varied and in some cases quite basic. *See*: http://www.environment-agency.gov.uk/static/documents/Business/Environmental_Disclosures_summary_report.pdf

[16] It should be noted that Richard Ralph, the former chair of Monterrico Metals, was found guilty of insider trading in Zijin shares; that the world's leading aluminium enterprise, UC Rusal, now listed in Hong Kong, would probably have been permitted to list in London by now were it not for an ongoing UK High Court case of alleged fraud committed by its main shareholder, Oleg Deripaska; also one of the most prominent bribery trials in the past two years resulted in the imprisonment of four Rio Tinto staff in Beijing. (They were sacked by the company, which puzzlingly maintained that an internal investigation had acquitted Rio Tinto itself of any wrongdoing).

significant environmental derelictions, such as the ambiental release of highly toxic metals, chemicals and gases, which can have serious impacts on thousands of citizens.

While big global mining companies may report their conformity to a number of benchmarks (particularly ones set by the Global Reporting Initiative (GRI), the majority of mid-cap or small-cap mining companies do not.[17] Nor do these necessarily sign on to several initiatives of the past ten years relating primarily to activities in the minerals sector, such as the EITI (Extractive Industries Transparency Initiative), the Kimberley Process (aimed at staunching supply of "conflict" diamonds), the UN Global Compact, and others.

There is a noticeably heavy weighting of "dedicated" mining companies on the London Stock Exchange. Nonetheless, little or no special regard for the unique capacity of mining companies to "do harm" has been paid by the Financial Services Authority since its inauguration in 1997; nor is this reflected in due diligence procedures (referred to in pre-launch prospectuses), especially on the observance of human rights, required before these enterprises may be listed on the LSE.

The FSA has claimed that regulatory standards set on the Main exchange are unrivalled, but many would find this barely credible; and it certainly does not apply to the markedly lower bar set for listing on the Alternative Investment Market (AIM); for standard (secondary) listings on the main exchange; and for companies domiciled overseas which may also raise capital in London.

The compliance requirements set by other bodies (such as the World Bank/IFC and OECD) are often breached by UK-based mining outfits, but they are not required to announce such breaches under existing rules.

It might be argued that the UK government now has its hands full, simply to prevent future financial disasters of the post-2008 ilk; let others take cognisance of, and publicise, alleged transgressions by non-financial corporations. This is, we submit, both a flawed and unacceptable thesis.

Flawed – because the risks posed by investing in what is, by its nature, a notoriously cyclical sector, are risks also directly related to the performance of the players in the sector. For example, an extra year added to a mine development plan because of resistance to it by a local community, or a change of government, can bring a company down. When an international campaign is launched against a particular project, all investors (not only "ethical" ones) need to be forewarned of the possible consequences; otherwise they might fail in their fiduciary duty to their own clients.

The thesis is unacceptable because, although investment institutions regularly – and increasingly – employ independent agencies to make social and environmental assessments of a company's performance and the risks posed by its projects "pipeline", the most substantial such information often derives from non-governmental organisations, and to a lesser extent journalists. (For example, in the case of African Barrick's operations in Tanzania – *see below*).

However, these civil society groups and individuals are customarily severely under-resourced and their lobbying power is miniscule compared to the companies they may be criticising.

And, while NGO reports are frequently shared with banks and other investors, they are often ignored or considered to be implicitly biased.

Three well-documented suits against Vedanta's Lanjigarh project were submitted to India's Supreme Court in 2004. It was thanks only to the relentless continuation of the campaign in India between 2005 and 2010, assisted by the Norwegian Finance Ministry's decision to de-list Vedanta

---

[17] This does not mean that the big global mining companies – many of which are listed on the LSE Main Exchange – always manage to adhere to the guidelines. In its 2010 Annual Report, the world's second largest mining company, Rio Tinto, admits to several "serious" breaches. It also mentions, for the first time, that the Norwegian Government disinvested from Rio Tinto in 2008 on the grounds of the company's complicity in grave environmental and human rights abuses at the Grasberg copper-gold mine in West Papua.

from its Sovereign Wealth Fund portfolio in 2007, followed by UK-based Survival International's successful a complaint before the UK National Contact Point (under the OECD complaints mechanism) and a detailed examination of the impacts of the company's existing alumina refinery by Amnesty International in early 2010, that this issue became high-profile. These initiatives led directly to the cancellation of the mining project by India's Ministry of Environment and Forests in mid-2010[18].

Civil society organisations should not be burdened with sole responsibility for determining whether UK-listed companies violate, or are complicit in violating, standards of human rights set by the UN Declaration on Human Rights and under UN protocols. Nor should they alone be relied upon to determine whether practices fail to meet "best possible" criteria, or risk jeopardising the "Precautionary Principle".

The UK Companies Act of 2006 sought to clarify directors' duties *inter alia,* to divulge the impacts of their company's operations on the community and the environment – thus (in theory) leading to an abatement of the worst such activities.

As pointed out in a March 2011 assessment of the implementation of the Act by the Corporate Responsibility Coalition (CORE), this obligation is embedded in the concept of creating "enlightened shareholder value (ESV)". But the UK Government, says CORE, has interpreted the term as excusing company directors from taking any decision – even while this may materially favour communities or "the environment" – should the directors consider it not to be "in the interests of their own shareholders."[19]

This is a stark denial of what (one would fairly assume) is most people's reasonable definition of "corporate responsibility": one going beyond decent returns on investment to observing decent behaviour towards others, even though many of these might live beyond home shores.

The 2008 UK Combined Code on Corporate Governance (the "Combined Code") also sought to ensure not only good "house keeping" at a company board level, but also that no one group or shareholder could exercise overweening influence when decisions are taken by the board.

It should therefore be of considerable public concern that, in the case of several UK mining companies, this rule has been honoured more in the breach than the observance. .

This is clearly true in the case of Brinkley Mining (*see below*) and a factor which contributed to that company's downfall. ENRC (Eurasian Natural Resources) was also until recently majority-owned by three oligarchs, Alexander Machkevich, Patokh Chodiev and Alijan Ibragimov, with the Government of Kazakhstan apparently holding the upper hand.

Archipelago Resources, embroiled for several years in conflicts with Indonesian communities, fisherfolk[20] (and, at one point, a provincial governor) as it struggled to bring on-stream a gold project in North Sulawesi, is now majority-owned by the huge, private business conglomerate Rajawali which is registered in Indonesia.[21]

Are we really so naïve as to expect that, simply by virtue of having a few "independent" directors on board, a company can counteract the potentially malign influence of one of more of its leading shareholders?

---

[18] During the period 2005-2008, several banks which were invested in Vedanta despatched advisory notes to clients in which they recognised that delays to this project and the proposed, adjacent, Nyamgiri mine were partly due to legal action taking place in India. In one such note, (shown to Nostromo Research by one of these privileged clients) Citygroup advised investors to "hold" on to their Vedanta shares, despite recognising that the company might be refused legal permission to proceed with the project. Citigroup considered that, since "this is India", a way would most likely be found around the problem.

[19] See: *Directors, Human Rights & The Companies Act: Is the new law any different?* by Hannah Ellis and Kate Hodgson, CORE, London, 18 March 2011

[20] http://www.minesandcommunities.org/article.php?a=10063

[21] See: http://moneytometal.org/index.php/Rajawali_Corp

Once again, Vedanta Resources gives the lie to such fond faith. Appointed as Executive Chairman of the company in 2005, Vedanta's founder Anil Agarwal rubs shoulders with five fellow board members, only two of whom can reasonably be described as "independent".[22]

In defending Agarwal's role as Executive Chairman – a clear violation of the UK Combined Code – Vedanta's 2010 Corporate Governance Report notes merely that he "has shown continuing commitment to developing the Group for the benefit of its shareholders. For this reason the Board is unanimously of the opinion that his continued involvement in an executive capacity is vitally important to the success of the Group".[23]

But of course Mr Agarwal has been "developing" his company for the benefit of shareholders:, Volcan, the trust owned by himself and his family, controls more than 62% of Vedanta's shares.

<u>Case Studies</u>

1) BLOOD ON THE FIELDS: *AFRICAN BARRICK*

Barrick Gold Corp of Canada is the world's biggest producer of the metal, in terms of its mined output. The company's four main Tanzanian mining operations were "spun off" by the Canadian parent in March 2010 when it launched African Barrick Gold (ABG) through an IPO on the London Stock Exchange. Barrick currently holds around 74% of ABG.

Some analysts saw the IPO as an "attempt by Barrick to reduce portfolio risk" – with one commentator judging it simply "a marketing thing"[24] And ABG's entry into the London market did not exactly ring the Bells of Bow.

Within nine months, the company suffered what Numis Securities described as "two false starts" and, by October 2010, its share price had fallen by almost 10%.[25] The redoubtable hedge fund manager, David Einhorn, had disposed of his stake in ABG by January 2011, declaring that only the rising price of gold "prevented an even worse outcome."[26]

African Barrick blamed this poor performance mainly on the theft of fuel destined for trucks and mining equipment at one of its four mines[27]. The impression it conveyed was that such events were all too likely in a country like Tanzania. Barrick spoke of "criminal fuel-theft syndicates" which had "widely infiltrated our mining department."[28]

In June 2009, a report presented to the Christian Council of Tanzania (CCT), and researched by a team under Dr Mkabwa Manoko of the University of Dar es Salaam's Department of Botany, concluded that nickel, cadmium, lead and chromium levels in water sediment and soil samples, taken from the vicinity of Barrick's North Mara mine, were higher than standards set by the WHO and the Tanzanian and US Environmental Protection Agencies. In respect of nickel, lead and chromium levels found in water, these had become much higher than when observed in 2002.[29]

---

[22] Agarwal's deputy executive chairman is his brother, Navin. The company's CEO, M S Mehta, was the CEO of Hindustan Zinc, which was incorporated into Sterlite in 2000; Narish Chandra, a non-executive director, was observed at the company' s 2010 Annual General Meeting literally taking over the meeting on behalf of Anil Agarwal and hectoring the critical audience. Aman Mehta could be described as independent; the only non-Indian on the board is Euan Macdonald.
[23] Vedanta Resources plc Annual Report 2010, page 65
[24] *Financial Times*, 19 February 2010
[25] *Financial Times*, 15 October 2010
[26] Foster Wheeler, 20 January 2011
[27] *Financial Times*, 15 October 2010
[28] *Financial Times*, 15 October 2010
[29] See: Levels of Heavy Metals and Cyanide in Soil, Sediment and Water from the Vicinity of North Mara Gold Mine in Tarime District, Tanzania by Manfred F Bitala, Charles Kweyunga and Mkabwa LK Manoko.

The report followed an alleged poisonous leak from the mine in May 2009, into the Thigithe river, Rarime district, which local people claimed had killed their cattle, and even some people. A number of Tanzanian human rights organisations called for the mine to be closed until an independent enquiry could be held, while Barrick dismissed the accusations out of hand. No independent enquiry has yet been organised; nor has Barrick called for one.

In May 2011, Zahra Moloo, a correspondent for the Africa-wide news service, Pambazuka, published an account of her own investigation into the consequences of this disaster. She found what happened nearly two years ago still at the forefront of the minds of local people – but not apparently that of the company. When Ms Moloo asked African Barrick spokesperson, Charles Chichester, for an interview, she was refused, with Chichester claiming that "the Thigithe River incident was no longer an issue of concern". [30]

Village chairperson, Abel Kereman Nyakiha, told Moloo that "more than 40 people from the three villages of Weigita, Nkerege and Nyakunguru have died since the spillage occurred in 2009, 20 of them alone in the months between June and October 2010." Mr Nyakiha added: "We don't yet have an official record at the village level, but we have asked each hamlet to record all the deaths that have taken place. The problem areas are three and these are the areas that are primarily using Thigithe river water in their everyday life."

Nyahiri Ryoba Mwita, a farmer from Weigita, also testified to the loss of 39 heads of livestock due to the spill, claiming animals continued to die later: "We have complained, but our complaints were not listened to. The company has never been here to talk to the villagers who have been affected by the spillage."[31]

Perhaps parent company Barrick, back in Canada, considered the launch of ABG would align its Tanzanian interests more closely with those of the country's business elite, thus reducing its reputational risk. In March 2011, Bloomberg reported a board member of the Dar es Salaam Stock Exchange saying that ABG planned to start trading shares on the east African bourse later this year[32]. Whether or not one accepts allegations of complicity between politicians (both local and national) and multinational companies, it is not hard to see which side Barrick will swing towards when challenged by communities who declare they have been exploited, polluted, or plain cheated of an equitable stake in its enterprises.

On 23 May 2011, in one of the most serious "incidents" of its kind reported from sub-Saharan Africa in quite a while, five men (some reports claimed seven) were shot dead by security forces at North Mara and at least a dozen injured, when several hundred persons entered the mine site in search of gold ore.

ABG issued a statement that "A number of intruders sustained gunshot wounds, resulting in seven intruder fatalities and twelve injuries. African Barrick Gold sincerely regrets any loss of life or injury on or near its mine sites. The company will continue to support the government and the community in their efforts to improve law and order and security in the North Mara region."[33]

This was by no means the only event of its kind to have impacted on North Mara communities and the company over the past three years – though it was arguably the worst. One Canadian journalist reported that: "[I]t has tainted Canada's international mining image, say industry observers."[34]

---

[30] 'Tanzania: Killings and Toxic Spill tarnish Barrick Gold' by Zahra Moloo, *Pambazuka* (South Africa), 19 May 2011
[31] *ibid*
[32] Bloomberg, 8 March 2011
[33] "Seven dead in clash at African Barrick mine", *Toronto Star*, 17 May 2011
[34] "Black Eye for Barrick taints Canada critics say", by Lisa Wright, Star Business Reporter, *Toronto Star*, 18 May 2011. This tarnished image was hardly improved when ABG allegedly refused permission for the families of the five killed men to hold a memorial service at the mine site itself . See "Memorial for dead banned at Canadian gold mine in Africa" by Jocelyn Edwards, *Toronto Star*, 23 May 2011

Barely nine months after ABG's London listing, evidence provided by an independent journalist cast strong doubts on the company's claim to observe fundamental human rights around its North Mara operations. In an unusually harsh critique of the company's behaviour, Bloomberg journalist, Cam Simpson, reported in December 2010 that: "At least seven people have been killed in clashes with security forces at the mine in the past two years". (The statement was based on testimony given to Simpson by 28 people he interviewed)

"In at least four cases, police acknowledged the shootings in contemporaneous press accounts", says Simpson, while Barrick company documents showed that the company "pay[s] the Tanzanian government for federal police protection at the mine and employ[s] private armed guards".[35]

Barrick did acknowledge deaths at the North Mara mine during 2008 in its 486-page UK pre-listing Prospectus of 19 March 2009, stating that: "In some cases, those involved in security incidents have been injured, sometimes fatally."

However, the company has never admitted any responsibility for such injuries or deaths. A year and a half later, on 19 November 2010, Barrick announced it had joined an international group of extractive companies, governments and non-profits that promotes voluntary standards to foster human rights in security operations.

These "Voluntary Principles on Security and Human Rights" include one which recommends that companies should report credible allegations of human rights abuses by public security forces to the appropriate authorities. Indeed, Andrew Wray, head of "investor relations" for ABG, promised Cam Simpson that his company "will make a formal request to the regional police commissioner's office for an investigation if it's made aware of allegations of abuse."

Nonetheless, says Simpson, ABG "mentioned no violence at the mine in reports describing its social responsibility record on community relations, health and safety for 2009 and 2010". Last year's report simply stated: "At Barrick, we are committed to making a positive difference in the communities in which we work."

In a December 2010 written response to questions posed by Bloomberg, Wray also said that "ABG categorically refutes any claim that any persons injured or killed were artisanal or small scale miners" (as if this justified the shooting of citizens who may not fall into this category). But, according to Cam Simpson, Wray "decline[d] to comment on specific cases, citing active or potential police investigations, except for one. He said allegations that mine security inflicted lethal injuries in that instance are 'fundamentally untrue'. They were the result of a fight between intruders over stolen ore."[36]

In the space of little over a year, this UK company, a subsidiary of one of the most powerful mining corporations on earth, has had a great deal to answer for.

First, it has neglected to take seriously allegations of major failures at its largest Tanzanian project, leading to the poisoning of people and animals. Second, it is accused of effectively just standing by, while "security" forces guarding its assets kill and injure at will those claimed to be sabotaging – or "invading" – the company's operations. Third, and whatever the truth behind these events, African Barrick has not joined calls for an independent enquiry; nor has the UK Financial Services Authority demanded one.

We may strongly doubt that the FSA took much (if any) account of the fact that the Norwegian Government Pension Fund, on the recommendation of its Council on Ethics had – just a year before – thrown Barrick Gold out of its own investment "universe". This followed an investigation of the company's operations at its Porgera mine in Papua New Guinea, which yielded evidence of

35 "Shooting Gold Diggers at Barrick African Mine Coincides With Record Prices" By Cam Simpson, Bloomberg, 23 December 2010

36 "Shooting Gold Diggers at Barrick African Mine Coincides With Record Prices", op cit

significant environmental violations. The Council concluded that the Barrick posed "an unacceptable risk of contributing to ongoing and future environmental damage."[37]

And there is the nub of the matter. A foreign government makes a considered judgment of the consequences of continuing finance for a company whose behaviour it cannot condone; nor does it place much faith in the company changing its ways. In contrast, another government authority, just across the water and just over a year later, invites that same corporate entity onto its premier Stock Exchange. And maintains it there, even as accusations of serious environmental pollution (causing the deaths of humans and animals), and complicity in unlawful killings, continue swirling around it.

What, we may wonder, was the UK Companies Act of 2006 – with its promise to significantly improve the corporate social responsibility behaviour of London-listed businesses – all about?

2) A FAILURE FOREWARNED: BRINKLEY MINING

Before a mining company may be admitted to trading on AIM, an independent "Competent Person" is required to assess its "trustworthiness", by assembling a wide variety of data specific to the industry, such as on the nature, availability, grade, and economic value of a deposit; the extraction and processing technologies to be employed; the environmental implications of any particular project; the legal status of land to be used; the issue of exploration or mining permits, *etc.*[38] (*See also* the Glencore case study in this Report.)

What a Competent Person need not carry out (indeed is not usually qualified to perform) is an assessment of the wider socio-political risks a company may face, even if all the other "rooms" in its particular house appear to be in order.

In the light of what we record below, this is clearly a major omission of what should be a vital prerequisite of the pre-admission process.

SRK Consulting is one of the leading international independent advisory and engineering groups which prepare Listing Particulars for mining company IPO's.

Among SRK's recent reports has been a Resources Estimate, performed for African Minerals' Tonkolili venture in Sierra Leone (*see below*); and an Independent Engineers' report which included "an…opinion of projections and cash flow forecasts" for Vedanta Resources, prior to its incorporation on the LSE in December 2003.

SRK also prepared a Competent Person's Report for Brinkley Mining's application to trade on AIM in May 2006, where it estimated the mineralised potential of the Waterval uranium prospect in South Africa: a lease then 49%-owned by Brinkley through its associate company Western Uranium.[39]

Brinkley's other major interest at the time was in DR Congo's own uranium potential, specifically uraniferous deposits in war-torn Katanga Province. In October 2006, Brinkley signed an agreement with state-run CGEA (the Atomic Energy Authority) under which a new company would be formed, called SOCIMAR, over which Brinkley would have board control.

SOCIMAR would be entitled to access and test five areas for the presence of uranium, while Brinkley also pledged to certify "export materials with a view to implementing proper controls and to restrict the illicit export of radioactive material."[40]

---

[37] See: http://www.regjeringen.no/upload/FIN/etikk/recommendation_barrick.pdf.
[38] It is somewhat perplexing to note that the appointment of a Competent Person, although recommended by the UKLA, is not mandatory for a Main market listing, although it is for AIM.
[39] *International Mining*, May 2007, page 39
[40] *International Mining*, May 2007, page 39

So far, so good. The plan seemed practicable and mostly above suspicion. However, there was an unusual clause in the agreement, whereby Brinkley would also be granted priority rights to any uranium discovered through its explorations. (The clause is unusual because uranium is a strategic mineral whose ownership is, more often than not, restricted to a government authority. Some of this fissile fuel, included in the bombs dropped on Hiroshima and Nagasaki, came from Belgian Congo, today's DR Congo, when the country was a colony of Belgium.)

However, despite this early promise, Brinkley suffered a pre-tax loss of nearly £1 million for the first half of 2007, and by the end of that year was still awaiting its prospecting rights from the Congolese government. According to the Financial Times (17 September 2007), Brinkley's shares had "slumped to a new low … in spite of [the company] insisting that mining agreements signed with the [DRC government] were legally binding. Reports at the weekend suggested the arrangements were under threat as part of a DRC anti-corruption drive"[41].

Indeed they were – to such an extent that, by September the following year, Brinkley had been forced out of DR Congo, as well as withdrawing from Chad. In August 2009 the company announced it would dispose of its two remaining assets in South Africa and the Sudan – instead turning itself into "an investing company with its main asset being its cash balance."[42] [43]

So what had happened to bring Brinkley down?

From the outset, pointed questions should have been asked about the role of the company's Executive Chairman, Gerald Holden. He is a financier who spent most of his career at Barclays Bank, where for seven years he was its Global Head of Mining & Metals. Why was Holden able to take a position which, in principle at least, would seem to violate a key tenet of transparent corporate governance, as laid down in the 1992 Cadbury Report which addressed this very issue?[44]

It is clear that Brinkley was, to most intents and purposes, Mr Holden. Whether or not he was guilty of corrupt dealings in promoting its DR Congo ventures (he has never been charged with doing so), he was certainly less than circumspect in negotiating them and, at the very least, incompetent in defending them.

On 16 September 2007, two days before the company's shares dropped to an all-time low, and while Holden was defending the legality of his agreement with the DR Congo's CGEA, Ben Laurance of the London *Sunday Times* broke a highly-disturbing story.

Laurance claimed to have established that "a convicted fraudster played a pivotal role in securing uranium mining rights in the Congo for the British minerals group Brinkley Mining." The alleged crook, a South African called Niko Shefer, had been "sentenced to 14 years in jail in the late1980s for his part in one of South Africa's biggest bank frauds. Moreover, a 2002 United Nations report into the plunder of the Congo's natural resources named him as one of 54 people who should be subjected to travel restrictions and penalties."[45]

---

[41] *Financial Times,* 18 September 2007
[42] *Mining Journal*, 21 August 2009
[43] In December 2010 what was left of Brinkley was snapped up by Australia's Eurogold, which valued the UK outfit at only a little over £4 million [Reuters 8 September 2010]. By April 2011, Eurogold had apparently sold the Brinkley inheritance and gone out of business itself. A "Riches to Rags" tale indeed!
[44] The Cadbury Report was unequivocal in warning of the risks of failing to make a clear division of responsibilities at the top level of a UK business enterprise. In particular Cadbury argued that the position of Chairman of the Board should be separated from that of Chief Executive, or else that there be a strong independent element on the board [http://www.ecgi.org/codes/documents/cadbury.pdf]. On leaving Barclays Bank in 2005, and as well as taking the helm at Brinkley, Gerald Holden was also instrumental in putting together another highly controversial AIM-listed company, Asia Energy, later renamed GCM Resources plc, of which he is currently non-executive chairman. As we observe in the Vedanta Resources case study of this Report, Anil Agarwal has also played both roles – a position he defends as "in the interests of the company" in which he and his family trust now control 62.21% of the equity.
[45] "Congo purge puts Brinkley deal in doubt", Ben Laurance, *Sunday Times*, 20 September 2007.

"It has now emerged that a Shefer company was instrumental in securing a deal for Brinkley to mine uranium in the Congo," declared Laurance, who went on to say that "since the deal was struck, Shefer was declared persona non grata by the government of the Democratic Republic of Congo (DRC) last month. The minister who approved the deal has been sacked and a civil servant involved in the agreement has been suspended."

Commented Laurance: "[T]he company has yet to tell shareholders of the new developments," while "Shefer's role in Brinkley's DRC uranium project has never been disclosed to investors."

However, "papers seen by *The Sunday Times* show that Brinkley acknowledges that a key role in securing the deal was played by Sentinelle Investments. Shefer's wife's family trust has been a major shareholder in Sentinelle. Shefer's accountant is the company's sole director."

Moreover, according to Laurance: "The other key Congolese player was Fortunat Lumu, head of the country's atomic energy commission. He was suspended from his job this year after being accused of agreeing uranium deals with Brinkley without the authorisation of DRC president Joseph Kabila. Science minister Bonane was sacked from the government in July – only days after Brinkley announced in London that a deal with the DRC had been signed".[46]

On 18 September 2007, Holden stuck up for Brinkley in an interview he gave to Allan Seccombe of miningmx.com. Without naming any specific party, he claimed that: "People have been putting rumours into the market for some months now to damage us and get us out of the DRC." Holden agreed that Sentinelle Investments "had laid the foundations with the CGEA for about 90% of the transaction" although he claimed this was "before Brinkley bought the deal."

Holden then said that Shefer – the convicted fraudster – was "extremely well connected in the DRC, making a valuable consultant (sic)." The former Barclay's mining investment supremo admitted that Brinkley had put some reliance on Shefer, although he claimed this was "sporadic and likely to become less as Brinkley set up and established its own networks in the country." Moreover, said Holden revealingly, "We'll use whoever we need to at different times and if Niko can help then we will talk to him again."[47]

A year later, and with his outfit clearly on the brink of collapse, this saga might have been forgotten. Then, among the numerous "wikileaks" released in early 2011, was a cable dated 11 September 2007, sent back home by Roger A Meece, US ambassador to the DR Congo, which cast some further illumination on this decidedly murky affair.

Meece was concerned to examine allegations that a company called Malta Forest, long active in DR Congo, had been "trafficking" uranium illegally out of the country. The ambassador found no compelling evidence that this was true. But he did confirm that Fortunat Lumu – the CGEA official named in Laurance's *Sunday Times* story – "planned to…push Malta Forest aside and form a personally profitable partnership with Brinkley."[48]

On 3 April 2009, the DR Congo government released its examination of a host of contracts that had been signed under the previous regime and which raised major concerns over their legitimacy, as well as complicity between former political leaders and officials and overseas mining companies.

The Congolese peoples had recently endured the most brutal civil conflict in the recent history of Africa (nor is it yet at an end).

In this regard, the role played by AIM-listed Brinkley Mining may merit only a footnote in a future history of the continent – if that. However, in light of the manifest failure of UK regulatory authorities

[46] "Congo purge puts Brinkley deal in doubt" *ibid*
[47] "Brinkley hits back in DRC uranium fracas", miningmx.com, 18 September 2007.
[48] See: "Wikileak reveals a uranium scandal" Mines and Communities, 11 January 2011: http://www.minesandcommunities.org/article.php?a=10634.

to maintain a thorough, ongoing check on the company's activities – even when allegations of impropriety, verging on corruption, surfaced in the national press – the "Brinkley case" is far from being a mere blip in the struggle by DR Congo's citizens to regain their independence.

At the very least, Brinkley betrayed the financial interests of its shareholders, relieved as it was from a duty of transparency over the company's dubious deals and shadowy negotiations, by virtue of the lack of any official enquiry into its operations.

3) and 4) THE PEOPLE'S INDICTMENTS: AFRICAN MINERALS LTD and LONDON MINING PLC in SIERRA LEONE

African Minerals Ltd

African Minerals Ltd is listed on the Alternative Investment Market (AIM) but is a "non-UK registered company" and, as such, "not all fields of data are available at this time" – to quote the formula used by Hemscott, a leading UK investors' services provider (*see also* Gem Diamonds case study in this report). In fact its registered office is in Bermuda.

What we do know is that the company is "in the gift" of Frank Timis, initially its Executive Chairman (yet another example of a breach of the guidelines for good corporate governance, set down in the Cadbury Report twenty years ago – *see* Vedanta and Brinkley case studies).

Timis is a 46-year-old Romanian-Australian financier, domiciled in London and known as "The Gusher" for an excessive vocal manner. When interviewed by the *Evening Standard* at a London hotel in January 2010, Mr Timis was refused a vodka. "What do you mean, I can't have a fucking vodka?" he asks. The waitress says he has got to eat. "Okay, we'll have a fucking bag of chips then," says Timis."[49]

It is not only waitresses who have felt uncomfortable with Mr Timis – those who took a flutter on his Regal Petroleum outfit some years ago may have shared their unease.

They invested in what seemed a promising Greek oil discovery, hyped up by Timis between June 2003 and May 2005 before the find proved to be chimerical ("commercially unviable"). In 2009, Regal was fined £600,000 by the LSE's AIM – the largest penalty the Market had imposed – when it found that Timis' company had "on 11 separate occasions … failed to take reasonable care to ensure its announcements were not misleading, false or deceptive, and did not omit material information."[50]

Just as he was lording it over Regal, in 2005 Timis bought into AIM-listed Sierra Leone Diamond Corporation, via his Bermuda-registered Timis Diamond Corporation Limited.[51] With the acquisition came some highly prospective diamond fields and the even more inviting Tonkolili and Marampa Iron Ore Projects. On 16 August 2007 Sierra Leone Diamond was renamed African Minerals Limited on AIM.

In January 2008, Sierra Leone Diamond had been fined for putting out "misleading and unrealistically optimistic information" following statements made by the company in summer 2006, that it had found "a significant number" of rare pink diamonds in Sierra Leone. However – and as

[49] "Ex-Regal boss Frank Timis set for another rich seam", by Chris Blackhurst, *Evening Standard*, 15 January 2010
[50] Intriguingly, in the light of Lord Adair Turner's claim of October 2008 that the days of Financial Services Authority "light-touch regulation" were over, the following year Timis acquitted the FSA of being responsible for damning his Regal scam. He told the *Evening Standard* that the FSA had "made a full investigation. I spent eighteen hours with them, answering their questions, and I am in the clear." But Timis had no such charity for AIM, saying, "Then AIM looked at it and held a fucking kangaroo court." *Evening Standard*, 10 January 2010, *ibid*.
[51] *Awareness Times*, Sierra Leone 22 July 2005

the company admitted in December that year – the pink hue got "washed out" when put through an acid-cleaning process.[52]

What is doubly disconcerting about this incident is that, while Timis made some attempt to correct the official record, it took a year and a half before the LSE took any steps to censure the company, and only then by way of a "private censure", accompanied by a relatively modest £75,000 fine (around the price of a genuine 1 carat intense pink Argyle diamond). Worse, it appears that the public was not informed about this censure for another two and half years when the *Financial Times* divulged it in July last year.[53]

It is not so much sparklers as the allure of iron that now spurs Timis on. African Minerals began testing the Tonkolili deposit in Sierra Leone in 2003 and judges that it might host a massive 10 billion tonnes of ore. The company was finally granted a mining licence in July 2009, currently covering an area of 227 square kilometres.[54]

Over the past ten months, some Sierra Leone local citizens claim to have been literally bulldozed by Timis' company, while others declare that they have been fired upon by "security" forces protecting his interests.

According to Sierra Leone's Right to Food network: "Since 2003 African Minerals has…promised development, jobs and better infrastructure. Nevertheless, its operations have resulted in bloody confrontations.

"500 people live in Kemedugu [where African Minerals operates], but when we arrived there it seemed like a ghost town. Only a dozen inhabitants came out to meet us on the village square, and bullet holes from the last riot were still visible on a number of the houses.

"The protest is said to have been triggered by the firm's attempt to conduct surveys regarding the upcoming construction of a dam. One village inhabitant told us, 'If they build the dam, we will lose water for our fields. We are afraid that we will not be able to grow enough rice.'

"According to the police a number of young men working for African Minerals attacked the firm's headquarters and set an excavator on fire. The police response was massive. They stormed the village and destroyed a number of houses. More than eighty people were arrested and there were numerous injuries, some of them serious. The majority of the villagers fled to the nearby forests. Those who have returned to the village fear further attacks. As yet African Minerals has refused to respond to the request by a member of the alliance for the Right to Food for a statement regarding the incidents.

"According to the villagers the firm has refused to engage in any dialogue with them. They have attempted to communicate with the firm on innumerable occasions and negotiate a compromise involving compensation for the land the firm is using – to no avail. The only result has been massive police violence… Even though African Minerals also talks about infrastructural improvements on its website, there is no evidence of these in Kemedugu. 'We are afraid that our land will be ruined by African Minerals and we will not be provided with any compensation,' says [Kemedugu Chief] Musa Turay bitterly."[55]

London Mining plc

Running parallel with African Minerals' forays into Sierra Leone are those of another AIM-listed company, London Mining plc. In contrast to Timis' dubious corporate vehicle, London Mining is

[52] *Financial Times*, 19 July 2010
[53] *Financial Times*, 19 July 2010
[54] http://www.african-minerals.com/Corporate/Operations/Tonkolili_Iron_Ore_Project/default.aspx?id=726
[55] "Merely empty promises?" 17 December 2010: http://www.madam-sl.org/?Projects:Right_to_Food. See also: "Massive iron ore project brings mining tensions back to Sierra Leone" by Paige McClanahan, *Christian Science Monitor*,12 December 2010; and "After diamonds, iron foments Sierra Leone tensions" by Simon Akam, Reuters, 8 December 2010.

driven by an eminent board of non-executive directors, backed by a clutch of "respectable" investment funds (including F&C Asset Management, Schroder Investment Management, Fidelity Investment, BlackRock Inc, the Union Bank of Switzerland, Investec and Barclays Wealth) none of which holds a pre-emptive stake in the company.[56]

Despite (or perhaps because of?) what appears to be a more responsible, if not squeaky-clean, board, London Mining has not progressed half as far at its Marampa project as African Minerals has at Tonkolili. The company has not recorded any revenue for the past two years and, in February 2011, reported a pre-tax loss of US$58 million for the fourth quarter of 2010.[57]

Adding to London Mining's concerns, in November 2010 Sierra Leone's environmental protection agency temporarily suspended London Mining's on-site operations, citing the company's failure to comply with environmental regulations. "Yet by the end of the day the head of the agency recanted and the company announced work was going on as usual."[58]

London Mining had already won some extraordinary concessions from the Sierra Leone government, allowing it an 80% reduction in income tax for ten years (a "tax holiday"), and an 80% reduction in other major revenue streams for no fewer than 26 years.

Its corporation tax was fixed at only 6% (in contrast to the 37.5% set under Sierra Leone's 2009 Mining Act); duty on mining materials at 1% (rather than the official rate of 5%); royalties were reduced to 3%, rather than the 4% mandated by state law.[59] (For its part, African Minerals also benefited from some concessions - its corporation tax rate was set at 26%.)

Sierra Leone is one of the world's poorest nations, yet endowed with some of its richest mineral deposits. For decades its economy has been sacrificed to what is often called the "resource curse" – not to mention the ravages of an horrendous recent war, centred around its mining fields. As the people begin to recover from these traumas, so a number of organisations have vigorously struggled to recapture the proceeds of mineral wealth in order to "rebuild" the nation's civil society.

One of these is Sierra Leone's Network Movement for Justice and Development (NMJD). At the February 2011 World Social Forum, held in Senegal, the NMJD, along with the Association of Journalists on Mining and Extractives (AJME), hosted a symposium on 'Reforms in Mining Regime – Challenges in Sierra Leone', specifically targeting London Mining's operations.

The symposium declared that the West African country "since the early 1980s till date, has produced billions and billions of dollars' worth of precious minerals, but yet remains at the very bottom of the human development index and classified as a least developed nation.

"While structures such as the Presidential Task Force, the Strategic Policy Unit, the Anti Corruption Commission, the Income Tax Act of 2000, the Law Reform Commission etcetera have been put in place to enhance reforms that would ensure that the country benefits most from its already hugely depleted mineral wealth, it came out that the said structures are yet to display much seriousness in fulfilling their all-important mandates."[60]

Concerns were raised that "political will seems to be there but that undue priority is being given to attracting investors of all sorts, rather than striving to change the resource-curse syndrome, thereby meeting the expectations of the electorate and the suffering masses."

According to panellists at the forum, while the 2009 Mines and Minerals Act "has the potential of changing the history of mining in the country", nonetheless "the continued violation of some of its

[56] Hemscott Premium, accessed 12 April 2011.
[57] Dow Jones Newswires, 24 February 2011
[58] See: "After diamonds, iron foments Sierra Leone tensions" by Simon Akam, Reuters, 8 December 2010.
[59] *Mining Journal*, 22 October 2010
[60] http://www.minesandcommunities.org/article.php?a=10732

crucial provisions to so-called attract investors who often turn out to be economic criminals, is undermining the very act and at the same time treating the laws of the land with disregard."

In this key respect, the two AIM-listed mining companies – African Minerals Ltd and London Mining plc – were singled out for indictment.

5) A SERIAL OFFENDER: VEDANTA RESOURCES

In May this year, the world's 17th largest publicly-listed mining company, Vedanta Resources [61], said it soon expected to float its Zambian subsidiary, Konkola Copper Mines (KCM), on London's stock exchange. Anil Agarwal, Vedanta's progenitor, majority share-owner, and Executive Chairman, had expressed a similar intention in 2010.[62]

Now (possibly prompted by Glencore's own May 2011 Initial Public Offering, and with copper prices at what might be the height of their recent boom) the UK-domiciled "Non-Resident Indian" presumably gauges the time ripe to attempt a repeat of Vedanta's own spectacular LSE debut in December 2003.[63]

Neither a pre-listing Prospectus for KCM nor any formal announcement of a float has yet been issued. Serious allegations have been levelled against KCM's behaviour (*see below*) but whether these will be thoroughly exposed well in advance of a listing must be in doubt.

That doubt is strongly compounded when we realise just how inadequate – to the point of misrepresentation – was the Prospectus published by Vedanta itself over a decade ago. We have good reason to demand that the company's appalling record of violations and mismanagement in the succeeding years will be addressed in all its dire detail before the UK's financial regulator admits any of its subsidiaries to public trading of their shares.

If Vedanta is indeed an intrinsically "bad actor" (a concept soon to be discussed by the US Securities Exchange Commission as it works on implementing one of the provisions of the Dodd-Frank Act[64]), what should now be done to prevent the sins of the parent being repeated by the child?

In 2007 Norway's Council on Ethics released the results of a two-year long examination of Vedanta's operations, primarily those in the Indian state of Orissa (*see below*). It concluded that: "[C]ontinuing to invest in the… company would present an unacceptable risk of contributing to grossly unethical activities."[65]

In response to this damning indictment, the Norwegian government sold all its Vedanta shares (valued at around US$13 million). An open invitation had already been extended by the Council to Vedanta to refute its findings and, at any future point, demonstrate a radical improvement in its *modus operandi*, at which time the Council would consider reversing its earlier stance. To date Vedanta has signally failed to do so, and the company remains "blacklisted".[66]

---

[61] According to Forbes magazine, 5 May 2011: http://www.minesandcommunities.org/article.php?a=10891

[62] In 2009, Mr Agarwal also expressed the desire for a public listing of his company's Indian aluminium subsidiary (VAL) on LSE, or another global stock market. However, during the succeeding year he failed to secure Indian government permission to mine bauxite from Orissa's Nyamigiri mountain and to start a five-fold expansion of the neighbouring Lanjigarh alumina refinery. These setbacks, which received a significant amount of attention in the UK, have presumably dampened his enthusiasm for this particular gambit.

[63] Vedanta's late-December 2003 LSE IPO was the second largest of the year and marked the first time an Indian company was admitted to the Exchange

[64] On 25 May 2011, the US Securities and Exchange Commission (SEC) "proposed a rule to deny certain securities offerings from qualifying for exemption from registration if they involve certain "felons and other bad actors." http://www.sec.gov/news/press/2011/2011-115.htm

[65] http://www.regjeringen.no/Upload/FIN/Statens%20pensjonsfond/RecommendationVedanta.pdf
See also: http://www.minesandcommunities.org/article.php?a=8260

[66] Personal communication from Norwegian Council of Ethics to Nostromo Research, August 2010

Norway's is not the only government concerned at allegations of Vedanta's behaviour. In the second half of 2010, Agarwal had inked an agreement (worth around US$9.6 billion) with Cairn Energy plc in order to secure a controlling share of the Scottish oil enterprise's Indian subsidiary. With this deal Vedanta would secure access to India's largest known oil field, in Rajasthan. Although quickly bankrolled by a number of UK and other commercial banks, the arrangement raised fears within India's state-owned oil and gas producer ONGC (itself holding a 30% stake of the field) that it would lose effective control over a prized national resource, and the sacrifice of an equitable share in the project's future royalties.

Prominent ex-civil servant, EAS Sarma (a former adviser on energy to India's government Planning Commission) wrote to Indian Prime Minister Manmohan Singh, questioning the appropriateness of the takeover. Said Mr Sarma: "Vedanta's track record so far in mining and power sectors has not been satisfactory…. To allow that company to get hold of a sizeable share in the equity of the company that controls the extraction of hydrocarbons in Rajasthan and elsewhere may not be desirable."

As a result of this intervention, the Indian Prime Minister's Office (PMO) called for a review of Vedanta's track record. It was an unusual move on the part of government. More importantly, in late 2007, India's Supreme Court had heard compelling evidence of contraventions by Vedanta's aluminium subsidiary (VAL) of state forest and environmental regulations at the company's costliest project to date.

The world-class Nyamgiri bauxite deposit lies at the heart of a thickly-forested tribal area, linked to the nearby Lanjigarh alumina refinery which serves Vedanta's Jharsaguda smelter, 335 kilometres away – all three situated in Orissa. In rejecting Vedanta's application to access Nyamgiri, the judges had paid tribute to the weight of allegations against the company, contained in the Norwegian Council of Ethics' report.[67]

ORISSA: Breaking more than one Law

The Nyamgiri mountain is regarded by local tribal inhabitants as Nyam Raja – roughly translated as "Lord of the Law" or "Lord of Dharma": ample testimony to the reverence paid by the Dongria Kondh to a deeply sacred place.[68]

In September 2005 an inquiry by a leading advisory committee to India's Supreme Court (the Central Empowered Committee, or CEC) concluded that *inter alia* Vedanta had "falsified information" to obtain environmental clearances for the alumina refinery under construction on plains below the mountain. The company had also destroyed more than ten hectares of forest land. The CEC urged the mining venture be rejected on environmental grounds, and also because it would violate the constitutional rights of the Kondh people.[69]

Despite the CEC's forthright recommendation, during the succeeding five years Vedanta continued battling to clear the mining project. Meanwhile many Khonds rose up in vociferous opposition to what they perceived as an unprecedented threat to their land and livelihoods.

The strength of their campaign attracted the backing, not only of several leading Indian human rights and environmental NGOs, but also that of international organisations such as Amnesty International and Action Aid.[70]

---

[67] See: http://www.minesandcommunities.org/article.php?a=8291 &. http://www.minesandcommunities.org/article.php?a=8291. We should point out that, in a distinctly quixotic decision, the Indian Supreme Court promptly endorsed handing control of the mine project to Vedanta's Indian-registered subsidiary, Sterlite Industries, and the state-owned Orissa Mining Corporation, provided certain conditions were met.

[68] http://www.minesandcommunities.org/article.php?a=7777

[69] *See*: http://www.minesandcommunities.org/article.php?a=7769; http://www.minesandcommunities.org/article.php?a=7773

[70] In this regard, the vociferous presence of Kondh representatives and their Indian and UK supporters at successive London Annual General Meetings of the company played a significant role in highlighting its unacceptable activities in Orissa.

The UK-based Tribal Peoples' campaign group, Survival International, in September 2009 submitted a complaint about Vedanta's activities around Lanjigarh to the British government's National Contact Point (NCP) for a ruling under guidelines set by the OECD for the conduct of multinational corporations.[71]

The NCP ruled that Vedanta "did not respect the rights of the Dongria Kondh"; did not "consider the impact of the construction of the mine on the [tribe's] rights"; and that it "failed to put in place an adequate and timely consultation mechanism".

The British government body concluded that a "change in the company's behaviour" was "essential". Moreover, it criticised Vedanta – despite repeated requests – for "fail[ing] to provide any evidence during the examination." According to Survival International, this was "the only time a [UK] company has refused to participate in an OECD investigation.[72]

In February 2010, Amnesty International published detailed allegations about the company's social and environmental violations in the Lanjigarh area, which it has neglected to answer.[73]

Finally, in August 2010, a high-level independent report, commissioned by India's Ministry of Environment and Forests (MoEF), unequivocally rejected the Nyamgiri mining project and also urged a halt to Vedanta's planned six fold expansion of its Lanjigarh refinery. The report's authors concluded that:

"The Vedanta Company has consistently violated the FCA, FRA, EPA[74]and the Orissa Forest Act in active collusion with the state officials. Perhaps the most blatant example of it is their act of illegally enclosing and occupying at least 26.123 ha of Village Forest Lands within its refinery, depriving tribal, dalits [lowest-caste] and other rural poor of their rights." [75]

Shortly afterwards, the MoEF minister, Jairam Ramesh, went on record to criticise India's Supreme Court for permitting construction of the Lanjigarh refinery in the first place; and he placed a ban on expansion of the refinery.[76]

At the time of writing, Vedanta and the state-owned Orissa Mining Company are trying to overturn this ruling. However, in recent months further evidence of mismanagement at the refinery has emerged, specifically relating to involuntary (and illegal) on-site releases of highly alkaline toxic solid wastes, commonly-known as "red mud".

On several occasions between 2007 and 2009, the Orissa State Pollution Control Board (OSPCB) had criticised Vedanta for the poor construction of its red mud pond, issuing three "show cause" notices to the company[77] and ordering that it prevent these wastes entering into the adjacent Vamsadhara river.[78]

On 5 April 2011, part of the pond wall burst open, causing many tonnes of these wastes to cascade into the river for around three hours. Although a video clearly showing evidence of the violation was swiftly posted on YouTube[79], the CEO of Vedanta Aluminium denied that there had been any breach of the wall, even suggesting the footage (whose veracity is not in doubt) was part of a "dirty tricks" campaign by those opposed to the mining.

---

[71] *See:* "GUILTY': UK government blasts Vedanta in unprecedented attack", Survival international Press Release, 12 September 2009

[72] http://www.minesandcommunities.org/article.php?a=9543&highlight=Survival,International

[73] http://www.amnesty.org.uk/uploads/documents/doc_20144.pdf

[74] India's Forest Conservation Act, Forest Rights Act, and Environment Protection Act

[75] http://www.minesandcommunities.org/article.php?a=10322

[76] http://www.minesandcommunities.org/article.php?a=10346

[77] A "show cause notice" allows a person or body corporate the opportunity to provide evidence as to why an administrative action should not be taken against them

[78] See: "India: Toxic sludge leak from Vedanta's red mud pond threatens rural communities", statement by Amnesty International, Delhi, 1 June 2011. See also: http://www.minesandcommunities.org/article.php?a=9388

[79] http://www.youtube.com/watch?v=i_8Tp2skbNM

A mere six weeks later (on 16 May 2011) the pond wall broke once again, prompting Amnesty International on 1 June to issue a statement drawing attention to what the human rights body called a "toxic sludge leak" that "threatens rural communities".

Amnesty estimated that "four to five thousand people in twelve villages are threatened by the leaks, which could worsen during heavy monsoon rains."

It maintained that "[l]ocal people have protested that they have not been given any information by Vedanta Aluminium or the government about efforts to prevent further leaks…Vedanta Aluminium denies that there were any spills from the red mud pond and has reportedly not repaired the damaged areas". But Amnesty "is…not aware of any attempts by the company to assess pollution of land and water caused by the reported leaks, or to clean up any damage that has occurred." [80]

Recently, too, the Indian National Human Rights Commission identified 3.66 acres of land within the refinery that it said legally belonged to the Tribal Khond; as a result of which the local administration registered a case of land-grab against Vedanta.[81]

JHARSAGUDA: In the smelting pot

From the beginning of its trajectory in Orissa, Vedanta conceived a three-pronged design to becoming one of the world's major aluminium producers, and at the cheapest possible cost. It would build a smelter to receive alumina from the refinery it hoped (and expected) would be fed by bauxite on Nyamgiri mountain.

The Jharsaguda smelter has been under aggressive construction since from 2005 onwards. In the last full year (April to April 2010-11), Vedanta claims the plant has produced 380,000 tonnes of aluminium.

During this five-year period, the Lanjigarh refinery has been supplying the smelter daily with hundreds of truckloads of bauxite that travel 335 km between the two points.[82] These journeys have already significantly damaged road surfaces, caused a large number of accidents, and stirred up dust and particulates, the impacts of which will inevitably deepen as output from the smelter mounts.[83]

Prafulla Samantara, a highly-respected Orissa civil society organiser, in mid-2006 accused Vedanta of illegally undertaking construction work on the smelter and its captive coal-fired power plant – specifically of destroying protected forests, trampling over vegetation, and polluting a stream.[84]

In 2007, Prafulla secured an Order from the Orissa State Pollution Control Board (OSPCB) which demanded Vedanta cease the smelter construction. However, within a month, the order had been withdrawn. Mr Samantara issued a vociferous objection to what he considered evidence of pressure by the company on the Board. When – a year later in January 2008 – he pleaded the case further before India's National Environmental Appellate Authority (NEAA), he was refused. The NEAA determined that he was not a "person aggrieved" within the meaning of the law, since he was not directly affected by the project.

---

[80] "India: Toxic sludge leak from Vedanta's red mud pond threatens rural communities", statement by Amnesty International, Delhi, 1 June 2011

[81] http://www.youtube.com/watch?v=cwicLF7s1tE

[82] http://www.vedantaaluminium.com/location-jharsuguda.htm

[83] Design output of the smelter is currently set at half a million tonnes per annum; however Vedanta's original plan was for full operational capacity more than three times this, at 1.75 MTPA.

[84] "Petition submitted by Mr Samantara to: The Chairman, Orissa State Pollution Control Board, Nilakanthanagar, Bhubaneshwar, Orissa, June 5 2006: *"Sub: drawing your attention about the illegal construction work undertaken by M/S Vedanta ltd for its proposed smelter plant and captive power plant at Jharsuguda with out getting environmental clearance"*. See http://www.freewebs.com/epgorissa/vedantasmelter.htm

However, on 6 May 2009, in something of an historic decision, Delhi's High Court recognised that Mr Samantara was indeed "aggrieved", since he was an environmentalist with close connections to communities around the smelter site.

The court delivered an eloquent appraisal of activists like Mr Samantara, recognising that they play a vital role in safeguarding rights and obligations broadly set out under the country's constitution.

Said Judge S Ravindra Bhatt:

"If standing before a special tribunal, created to assess impact of projects and activities that impact, or pose potential threats to the environment, or local communities, is construed narrowly, organizations working for the betterment of the environment whether in form of NGOs or otherwise, would be effectively kept out of the discourse that is so crucial an input in such proceedings..."

The court then ordered Vedanta to pay 50,000 rupees (about US$1,000) to Prafulla by way of a fine and in meeting his costs.[85]

In July the same year, the OSPCB issued show-cause notices against Vedanta, relating to various violations of water and air pollution acts at the Jharsaguda captive power plant: negligent disposal of coal ash, unacceptable emissions from the ESP (Electrostatic Precipitator), defects of the smelter's effluent treatment plant, and in the coal handling area.[86]

More than a year later, thanks to the diligence of the *Hindustan Times* in its use of India's Right to Information Act, journalist Priya Ranjan Sahu revealed that: "[T]wo 135 MW captive power units of Vedanta Aluminium's 500,000-tonne-a-year smelter never got any clearance from the board.[87] Furthermore, said Sahu:"[T]he 'trial consent to operate' order OSPCB issued to the smelter and seven other 135 MW captive power plants, expired on March 31 this year [2010]."

According to Sahu, the board "refused to renew its consent, citing numerous violations of its guidelines", and issued four show-cause notices between May and September 2010. Even if the company had satisfactorily responded to these, Sahu pointed out: "[T]hat doesn't explain how the two power plants for which even trial consent orders were not issued remain in operation."[88]

ZAMBIA: the toxic river

In 2004, Vedanta Resources plc acquired a 51 per cent stake in Konkola Copper Mines (KCM), paying $48 million in cash. During the first full three months of operation, the company posted net profits of $26 million, provoking a number of Zambian politicians to ask why the takeover had been allowed in the first place at such a low price. A "call option", secretly negotiated in 2004, also enabled KCM to exercise a right to purchase another 28.4% in KCM from Bermuda-registered ZCI, effectively granting Vedanta a 79.4 per cent monopoly.[89]

Vedanta benefited from a drastic privatisation of the country's once highly-profitable state-owned copper industry. The labyrinthine process by which the process was engineered, specifically in relation to KCM, was exposed in a November 2001 report by Patricia Feeney of Oxfam.[90] The report raised urgent questions over KCM's already-disturbing record of environmental pollution and the company's impact on the health of workers and communities.

---

[85] http://www.minesandcommunities.org/article.php?a=9245
[86] *New Indian Express* 23 July 2009
[87] "No pollution clearance, Vedanta runs 10 units", Priya Ranjan Sahu, *Hindustan Times*, 9 September 2010
[88] *Ibid*.
[89] http://moneytometal.org/index.php/Zambia_Copper_Investments_Ltd/ZCI
See also: "Copper in Zambia: Charity for multinationals" by Khadija Sharife, *Pambazuka*, Issue 532, 2 June 2011: http://pambazuka.org/en/category/features/73742
[90] "The Limitations of Corporate Social Responsibility on Zambia's Copperbelt" by Patricia Feeney, Oxfam (November 2001): http://www.minesandcommunities.org/article.php?a=244

Ms Feeney's strictures applied to the company's Konkola operations before they were sold to Anglo American plc – and then on to Vedanta. However, in the light of a later disaster, which occurred when KCM had been firmly under Vedanta's control for nearly three years, she sounded an important warning note:

"Women, men and children on the Copperbelt have to live with a range of environmental hazards. Heavy metals such as arsenic and lead and other industrial chemicals have contaminated streams and the main Kafue River."

Although Vedanta took some steps to reduce this contamination, its failure to adopt a comprehensive management plan soon became self-evident. By early November 2006, KCM's nine kilometres-long pipelines, conveying slurry for disposal from its copper tailings leaching plant, had deteriorated to bursting point. And burst they did – precipitating a flood of highly acidic effluents into the Kafue River.

The discharges led to a major disruption of domestic water supply to 75,000 residents of the nearby town of Chingola. The country's Tourism, Environment and Natural Resources Minister, Kabinga Pande, declared in a ministerial statement to Parliament on 14 November 2006 that: "The situation experienced recently is not accidental but is a result of the failure by the current mine owners to implement the KCM Nchanga Mine Environment Plan (EMP) that was inherited from the Anglo American Corporation, the previous owners of the mines."[91]

A detailed examination of Zambia's minerals industry, published in 2007 by an alliance of Zambian civil society organizations[92], noted that the Kafue River had "turned blue " as a result of the disaster, and estimated that the discharges raised the river's raised chemical concentrations to 1,000 per cent of acceptable levels of copper, 77,000 per cent of manganese and 10,000 per cent of cobalt.

Later the same year, in a report by three UK development NGOs, the Environmental Council of Zambia was cited as declaring that KCM management had displayed "grossly negligent" behaviour, resulting in rivers used by local communities for drinking water becoming "significantly polluted". The report threw strong doubt on KCM's claims to be "corporately responsible" towards its sub-contracted workers, and pointed out that the company was failing to make a fair and equitable contribution to government from its profits.[93]

Then, in November 2010, KCM yet again polluted the very Kafue River it had poisoned four years earlier. A court fined the company and found it guilty of willfully failing to report the "accident" to the authorities.[94]

KCM's lawyer, Mr Elijah Banda, reportedly told the court that the company "was remorseful and had undertaken necessary measures to mitigate the damage caused and to prevent future incidents [sic]."[95] This was almost exactly what Vedanta had promised to do following the 2006 disaster.

Readers may note a striking similarity between these Zambian "incidents" and recent events at the

[91] "Zambia: KCM Negligence Blamed for Kafue River Pollution" The Times of Zambia (Ndola), 15 November 2006. See: http://www.minesandcommunities.org/article.php?a=7489
[92] "For Whom the Windfalls: Winners & Losers in the Privatisation of Zambia' Copper Mines" available for download at: http://www.liberationafrique.org/IMG/pdf/Minewatchzambia.pdf
[93] *See*: "Undermining Development? Copper mining in Zambia": A joint report by ACTSA (Action for Southern Africa), Christian Aid & SCIAF, 29 October 2007. The three NGOs accused KCM of 'short changing' Zambia, paying royalty fees of just 0.6 per cent (on production), as opposed to the 5 to 10 per cent industry average in developing countries. It estimated that in 2006-7 the Zambian government would have received mineral royalties of only US$6.1 million from KCM, although the company extracted copper ore worth over US$1 billion. The report quoted claims by some of KCM's sub-contracted skilled labourers that they were paid as little as £37 per month when the average Zambian family is judged to require at least £151 per month to meet its basic needs.
[94] http://www.minesandcommunities.org/article.php?a=10613
[95] *ibid*

Lanjigarh refinery site (*see above*); there is also a pattern to the dismissive attitude adopted by Vedanta in response to them. The "Precautionary Principle" places responsibility for proving that an action or practice will not cause unacceptable harm on the party contemplating the action.[96]

At its refinery in Orissa, and its operations in Zambia's Copperbelt, Vedanta has signally failed this test – and continues doing so. In late March 2011, four sub-contracted KCM miners at the Nchanga Open Pit in Chingola went to their deaths after being suffocated by an excavated heap of soil.[97]

The criminally negligent attitude of Vedanta to site safety, already warned of by the three UK NGOs in 2007[98], has not substantially improved.

This leads us directly to exposing one of the worst examples in recent years of the fatal neglect of its contracted workforce by a UK-listed company.

KORBA, September 2009: 41 workers buried alive[99]

One of the concerns mentioned in Mr Sarma's letter to the Indian Prime Minister's Office (*see above*) was the September 2009 collapse of a power plant chimney, under construction at Korba town in the Indian state of Chhattisgargh.

The disaster claimed the lives of at least 41 workers (possibly considerably more)[100] who were employed by two firms which had been contracted to Vedanta's subsidiary BALCO (Bharat Aluminium Company).[101]

It was around 4pm on 24 September 2009 that the 245 metre chimney toppled to the ground.[102] As local youths ran towards the clouds of billowing dust to help rescue workers and pull bodies from the rubble, BALCO officers were observed to flee the scene.

There are no precise records of who might have died in this worst Indian industrial accident of recent times. In all the confusion immediately following the event the sub-contractors' on-site office was mysteriously burned down – whether by company officials themselves (as some have alleged) or by incensed workers and local people, is still not known. The office contained records of workers' names and other details that might have enabled the authorities to understand the causes of the accident, and exactly how many workers had gone missing.[103]

---

96 http://en.wikipedia.org/wiki/Precautionary_principle

97 "4 KCM miners die", *Lusaka Times*, 29 March 2011

98 "Undermining Development? Copper mining in Zambia": A joint report by ACTSA (Action for Southern Africa), Christian Aid & SCIAF, 29 October 2007 (*op cit*).

99 London Mining Network is grateful to Simon Chambers for researching much of the material used in this section. Simon visited Korba in early 2011, conducting interviews and examining numerous documents which are unfortunately not available in electronic form.

100 Due to the turmoil following the collapse of the power plant chimney, and the destruction of employee records (where these existed) no firm figure of the number of victims is ever likely to be forthcoming. Pravin Patel, an NGO coordinator in India, visited the site soon after the collapse; he reported finding that bulldozers had moved into the area, clearing and compounding the debris, effectively burying any bodies which may not have been recovered by then.

101 Balco was 51% privatised by the Indian government in 2001 – the same year the Zambian government sold off the Konkola Copper Mine to the Anglo American Corporation, and which was acquired by Vedanta three years later. Anil Agarwal's Sterlite Industries took charge of Balco's previously-state-owned assets, assuming management of the company. In 2007, four years after Sterlite had been incorporated as Vedanta Resources plc, Balco began sacking some of its former employees and resorted to employing contracted labour. A report published that year by Delhi's highly-respected V V Giri National Labour Institute found that, under Vedanta-Sterlite's control, Balco had failed to honour virtually all the undertakings it made previously to its labour force: http://www.minesandcommunities.org/article.php?a=3876

102 http://www.minesandcommunities.org/article.php?a=9501

103 BALCO apparently did not keep its own records of the sub-contracted labourers. This, in itself, is a matter of considerable concern. Under Indian law, a company that hires a sub-contracting firm is also accountable for the behaviour of that firm in regard to the treatment of its employees.

Vedanta executive chairman, Anil Agarwal, has claimed the tragedy was the result of "severe thunderstorms and lightning" earlier that fateful day.[104] However, an investigation commissioned by the Korba police and carried out by the Raipur-based National Institute of Technology (NIT) in Chhattisgarh, challenges this assertion.

The NIT spent two days on-site, sifting through the wreckage soon after the disaster and analysing the materials it gathered. Its report states categorically that lightning could not be attributed as a cause of the tragedy, since there were no signs of melted steel re-bars, nor evidence of burns on the recovered bodies.

The Institute concluded that "careless, poor construction practice and poor workmanship in the construction of piles" and "improper cement content in the concrete mix" were likely causal factors.

It found that new layers of the chimney were being built before lower levels had been given time to cure (harden) properly: "The compressive failure of the chimney may have taken place at somewhere in the upper portion of the chimney….the upper portion may have sunk telescopically down to the lower portion, exerting enormous sudden pressure to the bottom portion".

Three BALCO employees, including the project leader for the chimney, Viral Mehta, and one employee of subcontractor GDCL, were charged with culpable homicide not amounting to murder.

All four were released on bail after the Supreme Court overturned a Korba District Court decision to withhold it.

The Deputy Director of Prosecutions in Korba, J.N. Chandra, is palpably annoyed at the hoops he has had to jump through in securing any kind of justice. He told UK researcher, Simon Chambers, in April 2011, that " there is no likelihood of anyone being brought to trial in the foreseeable future because the accused continue successfully applying for stays from the Chhattisgarh High Court and Supreme Court, which could drag out proceedings interminably."

A judicial enquiry into the disaster, the Buxi Commission, has already postponed release of its findings three times due (it says) to "unavailability of witnesses and facts". According to Mr Chandra, most people in Korba see the Commission as an attempt by the state government to appear to "at least be doing something" when in reality, "there are too many powerful people who want nothing to be done."

A senior ex-employee of BALCO, who left the company in 2003 (and did not wish to be named) informed Simon Chambers that, after Vedanta's foundation company, Sterlite Industries, took control of BALCO in March 2001, company practices changed drastically, while the management was told "it should not worry about obtaining approvals from the authorities on pollution, environment and forestry issues."

Indeed, when a Town and Country Planning notice was served on BALCO in December 2003, ordering a cessation of expansion work, the company merely retorted: "We wish to state that only basic preparatory work like sample excavation and site grading are being taken up to ensure timely completion of this prestigious project for the State and people of Chhattisgarh."

The mayor of Korba, at the time of the September 2009 disaster was Lakhaniel Dewanen. He is sure that the fatal chimney was built illegally, on a 92.84 acre plot which is still classified as forest land, owned by the State of Chhattisgarh. The Korba Municipal Corporation (KMC) served a number of "stop notices" throughout 2009, threatening legal proceedings and the dismantling of any previous constructions. All were ignored by the company.[105]

[104] Chairman's Statement, Vedanta Resources Annual Report 2010, page 9
[105] *See* http://www.minesandcommunities.org/article.php?a=9500

According to Mr Dewanen: “Just a week before [the accident] a team from the KMC reached the site and stopped the construction work. But the company started the work again.” BALCO also received notices from the Central Pollution Control Board, (CPCB) and Town and Country Planning department ordering work on the chimney to be stopped.

The families of most of the workers reported dead on that traumatic September afternoon in Korba have each received Rs 5 lakh (500,000 rupees or around £1,370) compensation from BALCO, as well as some monies from the Indian subcontractor, Gannon Dunkerley & Co. Ltd (GDCL), and from the government. Nobody representing BALCO or its subcontractors is known to have contacted the families at any point to offer condolences or explanations.

In October 2010, Anil Agarwal himself was summoned to give evidence at the Korba District Court in answer to a charge of Criminal Trespass, relating to the previous year’s events. His lawyers successfully applied for a stay from the Chhattisgarh High Court, allowing him to remain in London.[106]

A thick pile of official notices from various government departments have been sent to the BALCO offices over the last four years, all ordering that various work should stop at the Korba site – each sounding a little more desperate and impotent than the previous one.

Just five months after those forty and more workers lost their lives, BALCO began constructing yet another chimney on the very spot where the earlier edifice had collapsed. A notice sent to the company by the Korba Municipal Corporation, dated 5 February 2010, declared: “You have started construction without submitting the necessary papers. You have not obtained permission for construction, and we have told you repeatedly to please submit your papers or we shall have to file a case against you.”

Clearly there has been highly regrettable official procrastination in bringing Vedanta to book for its alleged corporate crimes in Korba. But, arguably worse, is the almost total neglect in calling the company on the part of UK authorities.

It is not that the appalling event of “9/9/09” was ignored by international media. (There was substantial coverage on the BBC News channel and Al Jazeera). On 23 September 2009, Dow Jones Newswires filed notice that “Chhattisgarh Chief Minister Raman Singh said in a statement that ‘a judical probe has been ordered’ into the accident” and that “a police case had been filed against BALCO.”[107]

However, the very same day, Vedanta issued just one curt statement in the form of an RNS alert (an LSE Regulatory News Service note), which clearly sought to underplay the magnitude of the disaster.[108]

Vedanta’s executive chairman, Anil Agarwal, stuck to his self-exculpating version of events right through to a statement made to shareholders on 5 May 2010 (published in the company’s Annual Report for last year). Long before then, the “act of God” defence had been demolished by India’s

[106] This summons was issued against the “owner of Bharat Aluminium Company Limited (BALCO) and others.” J N Chandra, deputy director prosecution, representing the Chhattisgarh government, said: "The order does not mention the owner's name since the company's ownership deed was not available to the court, but it is well known that the owner of BALCO is Anil Agarwal, the London-based chairman of Vedanta group." According to a report in the *Times of India* (31 October 2010), “other legal experts suggested the ownership could be vested in the board of directors and not the chairman alone.”

[107] Dow Jones Newswire, 23 September 2009

[108] The note was headlined: “Incident at the BALCO Construction Site” and read: “Vedanta Resources plc's subsidiary Sterlite Industries India Limited ("Sterlite") regrets to announce that a power plant chimney under construction at BALCO, Korba collapsed today. The chimney was being constructed by Gannon Dunkerley & Co. Ltd for the 1,200 MW CPP, associated with the 325 ktpa aluminium smelter project. The relief and rescue operations are in full swing with the involvement of the company and the government resources. Activities in the particular area were temporarily suspended, while the existing operations remain unaffected. A probable reason for the incident appears to be the excessive rains and lightning at Korba. The exact cause for this will however be ascertained only after a detailed investigation is concluded.” RNS Number: 5734Z, Vedanta Resources PLC, LSE, 23 September 2009.

National Institute of Technology (NIT). But Agarwal compounded earlier apprehension that he was deliberately downplaying the tragedy by describing it as "an unfortunate accident".[109]

The British Safety Council (BSC) awarded BALCO two International Safety Awards in 2009. One of these was given to the company itself, just four months before the Korba killings, and a second to one of BALCO's captive power plants.[110] The Awards were not withdrawn until almost a year after the disaster. Even then, the BSC admitted, this step was taken only because its attention had been drawn to the event by a London *Observer* analysis of the deaths of workers at all FTSE 100 mining groups, as recorded in their annual reports.[111]

Although the BSC is a charitable association, it is actively supported by the UK Health and Safety Executive, the UK's official health and safety watchdog, and the two work closely together to sift safety-related data relating to UK-based companies.

As a commentator with the International Trade Union Confederation (representing 175 million workers worldwide) put it at the time: "Th[is] publicity is likely to be a source of embarrassment to both HSE and BSC. It would be remarkable if both organisations were unaware of the disaster in Korba, India, which was widely reported at the time, and any fatality in the award year automatically invalidates an application."[112]

The independent research and advisory consultancy, Pensions Investment Research Consultants Ltd (PIRC) – "The voice of responsible shareholders" – issued a statement just before Vedanta's 2010 AGM. Describing the Korba collapse as a "significant indicator of [the company's] poor governance", PIRC called on Vedanta shareholders to oppose the election of three of the company's non-executive directors, (including senior non-executive director Naresh Chandra, chair of its health, safety and environment committee, and its remuneration committee) "because of their role in the company's poor handling of environmental, social, and governance issues." [113]

The Norwegian government is not the only shareholder to sell its Vedanta stake, finding it incompatible with the responsible manner in which it should invest its clients' (or citizens') funds. When the Church of England sold its Vedanta shares early last year, the chairman of its Ethical Investment Advisory Group, John Reynolds, wrote:

"I am a passionate advocate for engagement with companies when we have ethical concerns. We have an excellent track record of getting our concerns heard and acted upon by the companies in which the Church investing bodies hold shares. We are grateful to Vedanta's senior management for making themselves available to meet us on a number of occasions. However, after six months of engagement, we are not satisfied that Vedanta has shown, or is likely in future to show, the level of respect for human rights and local communities that we expect of companies in whom the Church investing bodies hold shares."[114]

A significant number of investment funds from the UK, Canada, USA, Sweden and Holland have recognised the unacceptable reputational risks of bankrolling this company. There is steadily-

---

[109] Vedanta Resources plc, Annual Report 2010, page 9.

[110] A search of the BSC's website reveals no information about either of these awards. The second was almost certainly made to one of two functioning BALCO captive power plants at Korba, not to the plant under construction when the September 2009 deaths occurred.

[111] *The Observer*, 29 August 2010. The newspaper recorded that, among the FTSE 100-listed mining companies, Vedanta was responsible for by far the highest number of workplace deaths (67); followed by Anglo American with 20, Kazakhmys with 17 and ENRC with 12.
http://www.minesandcommunities.org/article.php?a=10358&highlight=British,Safety,Council

[112] "Hey they are only workers, have an award" by RORY, *Hazards* magazine, ITUC, Brussels, 3 September 2010

[113] Dow Jones Newswires, 20 July 2010. PIRC also found that Vedanta's failure "to engage with explicit investor led concerns over the impact of group activities on the Niyamgiri region" was evidence of the company's "lack of competent oversight." The UK's largest insurance provider, Aviva, responded to PIRC's call at the Vedanta 2010 AGM itself, by voting against three resolutions: those on accepting the annual report and accounts and the remuneration report, and on the reappointment of Naresh Chandra as chair of the health, safety and environment committee [Reuters 23 July 2010].

[114] http://www.minesandcommunities.org/article.php?a=9871

mounting public perception that Vedanta not only operates “outside the law” but is content to do so, displaying marked disdain towards its critics.[115]

Virtually all the worst offences alleged against the company have occurred since Anil Agarwal’s Sterlite Industries of India was accepted for trading as Vedanta Resources plc on the London Stock Exchange more than seven years ago.

Why has only one UK government body (the National Contact Point - *see above*) ever considered examining any one of Vedanta’s many overseas activities?

Should it simply be down to cash-strapped voluntary organisations (not to mention individuals) to research and present evidence of the company’s violations, rather than an official regulatory body?

The “Vedanta case” illustrates both the inadequacy of company reporting provisions under the FSA and a woeful absence of binding rules to govern the conduct of this and other London-listed mining companies.

6) GLENCORE: MINE, ALL MINE

On 24 May 2011, the world's biggest commodities trader sailed into the London and Hong Kong Stock Exchanges with two Initial Public Offerings (IPOs) following the priority issue of shares to its so-called "cornerstone investors" shortly before.

Under its Chief Executive Officer (CEO), the South African-born, Swiss-resident, Ivan Glasenberg, Glencore leapt straight into the FTSE 100 list of the UK's premier companies. With a market capitalisation around £36 billion, it became the fourth biggest mining company traded on the London Stock Exchange's premium main market. [116]

The IPO had tapped the pockets of many investors, including hedge funds, sovereign wealth funds, and so-called Tracker and Pension Funds whose portfolio managers would have felt duty-bound to buy a stake on behalf of their clients – this, regardless of any personal animosity they might feel towards the company (let alone any disquiet that been expressed by the clients whose pensions they supposedly safeguard).

Nonetheless, the hype, the investor road shows, and the glut of media attention preceding this unique listing (the largest ever made in Britain) failed to work consistently in Glencore's favour.

True, this notoriously secretive enterprise will now enjoy access to sizeable chunks of new capital, some drawn from the accounts of investors who would bet on the devil himself were he to ride into town on a white charger. However, this sprawling conglomerate (“A Big Swiss Cheese” as one critic dubs it) was also forced to open its books to greater scrutiny than so far received in its 37-year history.

Of the 1,600-odd pages contained in Glencore’s pre-launch Prospectus, three quarters was devoted to "competent persons'" reports on the firm’s Colombian coal assets, the Mutanda and Mopani mines in Zambia, and on Kazzinc, the rising Kazakhstan zinc, copper and gold miner.

[115] A group of European NGOs on 22 September 2009 organised a one-day seminar for investors in Vedanta, at Amnesty UK’s London offices. They were invited to hear personal testimony about much of the evidence of the company’s violations contained in this report. Around nine leading funds and banks were represented. Vedanta was invited to attend and respond to the presentations, both by letter and in several phone calls. The company did not even deign to reply, marking yet another occasion on which it has been discourteous and dismissive towards its critics. Our report has already noted a similar attitude displayed by Vedanta to the UK government’s OECD National contact Point, just two weeks before; and its failure to respond in any meaningful fashion to the accusations against it contained in the Norwegian Council of Ethics 2007 report.

[116] As of 23 May 2011, BHP Billiton's market capitalisation was £127 billion; that of Rio Tinto, £78.76 billion; that of Xstrata, £40 billion; that of Anglo American £34 billion.

Nearly a fifth of what Glencore expected to raise ($2.2 billion) had already been earmarked to increase its stake in Kazzinc to 93%. Whether it will soon mount a bid to take over Xstrata plc (currently 34.4% owned by Glencore) is a matter of speculation.[117]

But hardly had the champagne corks stopped popping across the exchange floors on May 24th, than "rumours" began circulating that Glasenberg now had his sights fixed on a more modest acquisition – that of ENRC (*see Introduction*).[118]

Don't touch it with a bargepole!

On 20 May 2011, *The Times* Business Editor, Ian King, voiced little doubt that "small" investors, at least, should steer clear of carving out a stake for themselves in this particular golden calf. In a remarkably robust comment, King damned Glencore as "...a business with dubious morals. It trades grain amid food riots and has been accused of profiteering and environmental offences in numerous poor and war-torn countries". He went on: "Most of those signing up to buy shares in Glencore's flotation are major Middle Eastern and Far Eastern investors. Few of the traditional City institutions will touch the shares with a bargepole. The question is, should you?"

Some nine hundred different accounts did indeed put out the boat for Glencore's pre-IPO. According to Reuters IFR, orders were received from around the world including the UK, US, Asia, Middle East and Brazil.

"About 10 per cent went to high-net worth individuals and private banking clients, about a third to hedge funds and the rest to institutions and sovereign wealth funds. Hong Kong retail took just 2.67 per cent of the offering."[119]

Nonetheless, there was marked scepticism on the part of a few funds which would normally have been expected to join the scramble. The fund manager for Schroder's UK equities team, along with Aviva Investors' UK equity manager, warned investors to look to other mining companies with a long history as listed businesses.

Commented Aviva's Chris Murphy: "If we want exposure to the mining space we can buy Rio Tinto, where we know its track record and have visibility on management. We feel there is more value there than the likes of Glencore."[120]

Old game over?

"Why would a giant secret society like Glencore, with a dark past, want to come into the light of day and relinquish the private, backroom-dealing business model that made its partners and founder fabulously wealthy?"

That was the question raised by US investment guru, Shah Gilani, on 18 May, and his answer was a terse one: "Because the old game is over and commodities prices are about to break down – and in a big way…By utilizing its newly tapped source of capital – its own stock, the [Glencore] partners will eventually be able to cash out (they have a lockup provision of four to five years)".[121]

---

[117] http://www.minesandcommunities.org/article.php?a=10902

[118] Reuters 13 June 2011; CITY A.M. 14 June 2011

[119] Thomson-Reuters International Finance Review, 19 May 2011

[120] Reuters 23 May 2011. It is also relevant to note that Aviva voted against three resolutions at Vedanta's 2010 Annual General Meeting; those on accepting the annual report and accounts; on the remuneration report; and on the reappointment of the board member chairing the health, safety and environment committee. In person, Aviva's representative, Steve Waygood, insisted that the board should "open up lines of communication with investors and begin a dialogue with organisations that raise important matters of social and corporate governance" [*The Guardian*, 28 July 2010]. *See also the Vedanta case study in this report.*

[121] Those principally profiting from Glencore's newly-tapped capital (courtesy primarily of the London IPO) are its 485 owner-partners and 2,700 associated traders. In theory the partners are restricted from cashing out their shares for another five years. In the meantime, thanks to the flotation, several of them have become overnight millionaires, while

Gilani added: "[T]he company will also be able to withstand the coming crash in commodity prices and then be perfectly positioned to buy at the bottom, which is what it is planning to do."[122] This may, or may not, prove to be the case. (The market price of copper and other base metals did turn downwards just a day before Glencore "went public".)

But more importantly, we should ask whether the firm's move on London and Hong Kong was not motivated by a somewhat different intent. This would be a reduction of its dependency on commodities trading *per se,* by increasing its vertical control over oil and mining companies beyond that which it currently exercises. Owning minerals in the ground, and controlling related infrastructure, is arguably less risk-prone than sending them across oceans, or tying them down in warehouses.

As Australian financial commentator, Stephen Bartholomeusz, wrote a week before the IPO: "What has changed within Glencore in recent years has been the size and contribution of [its] industrial assets – its interests in mines, oil wells, logistics businesses and port facilities."

Bartholomeusz anticipates the conglomerate will now transform itself "from a trader with some resource production, to a mining house with some trading activities…In fact it would look very much like a BHP Billiton, which might be the point."[123]

Indeed, make no mistake: while Glencore's foodstuffs trading is a key part of its global reach (attracting bales of criticism in recent years) the conglomerate's biggest profits derive from its exploitation of oil and minerals.

Damage, dirt, deceit and death

On 19 and 20 May 2011, the London *Times* lashed into Glencore with several exposes of the company's current operations, following a special investigation. (*The Guardian* followed suit with additional indictments.)

The Times alleged that a Glencore subsidiary "had procured lucrative market-sensitive information from a European Union 'mole'" which, the paper argued "threatens to undermine the EU's Common agricultural policy."[124]

The paper went on to claim that Glencore's Colombian subsidiary (Prodeco) has been operating on government-owned land "that was forcibly taken from its previous residents by paramilitaries; at least 18 people were murdered in a six month 'campaign of terror' at El Prado, northern Colombia."[125]

In February 2007 residents close to Prodeco's La Jagua de Ibirico coal mine in Colombia's Cesar province set up barricades to protest at environmental damage and respiratory illnesses they claimed had been inflicted by these mining operations. In response, police attacked the demonstrators, reportedly killing one man.[126]

CEO Ivan Glasenberg's private wealth is now valued at $8.8 billion, according to a survey by Australia's Business Review Weekly in early May. *See*: http://www.minesandcommunities.org/article.php?a=10948
Australia's *Business Spectator* on 27 May 2011 also noted that "[Ivan Glasenberg's] right-hand-man, Steven Kalmin, has…rocketed onto the [Australian] rich list with a fortune of $560 million. Kalmin, who worked as a commodities trader in Sydney before heading for Switzerland in 2003, was appointed chief financial officer two years ago…"

[122] *Money Morning*, 18 May 2011

[123] *Business Spectator*, Australia, 17 May 2011

[124] *The Times*, London, 19 May 2011

[125] *The Times*, *ibid*.

[126] Colombia's President Alvaro Uribe uncharacteristically responded to this brutal event by ordering high-level officials of the Ministries of Environment and Social Protection to visit the area and "take charge of the issues that each are responsible for". A Civil Society statement, issued by a number of labour, social and human rights organizations on 10 February 2007, unequivocally denounced the attacks and called on Glencore to immediately desist from "contaminating" the area and from contributing to an increase in respiratory diseases among the local population, including workers. See: " Reparos a un megaproyecto carbonífero de Drummond en Cesar" by Herminso Ruiz in *El Espectador*, 10 February

Six months later, on 22 September 2007, Glencore was accused of implementing an aggressive anti-union policy at its Minera Los Quenuales lead-zinc operations in Peru where, a month before, a worker had died by being crushed under a heap of ore. The work force began an "indefinite general strike" to draw attention to their unmet demands, and another person was killed, with dozens reportedly injured, when it barricaded access to the mine site.[127]

According to *The Times*, Glencore was guilty of causing river pollution at its operations in Bolivia. Members of the Wutha Native (Aboriginal) Title Claimants Group in Australia had also been "cheated of an agreement made with Glencore in 1996, under which the company guaranteed to employ some of them in return for mining nickel on their land. (The case was settled only recently out of court.)"[128]

Furthermore, Century Aluminum of the USA (with Glencore at 44% its biggest shareholder), according to the paper, is "being pursued for damages caused by its operations, in a string of cases brought by environmental agencies, local residents and other companies."[129]

Pollution and tax evasion – Zambia

It is Glencore's mining and smelting operations at its Mopani copper-cobalt complex in Zambia which seem to have provoked the greatest ire in recent weeks.

In a May 2011 article, entitled "Billionaire ignored children's pleas to stop toxic pollution from mine", *The Times*' Environment Editor, Ben Webster, reported that Ivan Glasenberg had – a full year before – "received a bundle of letters from children at a school exposed on a daily basis to sulphur dioxide pollution from the nearby Mopani Copper Mines (MCM) complex.[130]

"In the letters… the children described how clouds of toxic particles made them choke, burnt their throats, poisoned the school's fruit trees and forced teachers to close windows, leaving them sweltering in their classrooms."

In 2009, The Environmental Council of Zambia (*see* Vedanta case study, *above*) also reported that sulphur dioxide emissions from parts of the plant had reached up to 70 times the maximum health limit set by the World Health Organisation.

Webster pointed out that "[a] mineral expert's report, published in Glencore's prospectus, also confirmed that "sulphur dioxide emissions from MCM were "consistently exceeding" environmental limits.

"It said that the breaches were a 'significant risk' because MCM had missed even the extended deadline for reducing the pollution. Three monitoring stations outside the plant repeatedly recorded breaches of air pollution limits."

2007:
http://www.elespectador.com/elespectador/.
See also : http://www.minesandcommunities.org/article.php?a=150

[127] This mine is owned by Glencore Finance (Bermuda) Ltd). The local branch of the Union of Mine And Metals Workers (UMM) on 22 September 2007 claimed that: "[S]ome 190 workers work directly for the company and another 900 work through the contracting companies…[T]he company has unilaterally applied unusual work shifts of 14 x 7 (fourteen days straight working twelve hour shifts and then seven days rest). The workers must share rooms and beds, work in the mine under insecure conditions". The Union pointed out that the population of La Jagua de Iberico-Cesar "has for several years been suffering from contamination produced by mining operations and transport of coal in the mines of Glencore A.G. and Drummond … and from unemployment, pulmonary illnesses of children, misery and the military-paramilitary presence … Because of this, two days ago the residents decided to carry out a peaceful protest to block the roads which enter and exit the town.

[128] *The Times*, 19 May 2011, *op cit*

[129] *The Times* ibid

[130] *The Times*, London, 20 May 2011

The report "described various illegal discharges of hazardous fluids into rivers, including an acid leak that had contaminated the town's water supply and resulted in 'hospitalisation and treatment of a number of people'."

Thus far, however, Mr Glasenberg has ignored the children's plea, and his company has done virtually nothing to introduce stringent anti-pollution measures to the area.[131]

Mopani Copper Mines (MCM) is co-owned by Glencore and another London-listed mining company, First Quantum Minerals.[132]

In April 2011, five prominent international NGOs filed a complaint against both companies, alleging they had violated OECD Guidelines for Multinational Enterprises. The NGOs based their case on the results of a 2009 audit, performed at the request of the Zambian government, with support from the Norwegian government, by international accountants Grant Thornton and Econ Pöyry.

Among the anomalies revealed by the report, say the NGOs, were: "an unexplained increase in the company's operating costs in 2007 (+$380 million); stunningly low reported volumes of extracted cobalt when compared to similar mining companies operating in the region, and manipulations of copper selling prices in favour of Glencore which constitute a violation of OECD's 'arm's length' principle…The result of those various processes was to lower by several hundreds of millions dollars MCM's net income for the 2003-2008 period."

These actions, declared the NGOs, "are all the more deplorable when one considers that the Mopani consortium operates in an already attractive fiscal environment, one highly favourable to foreign investment, and that Mopani also enjoys the effects of a 2000 development agreement with Zambia that provides massive financial and tax exemptions."[133]

Pollution and rights abuses – DR Congo

In March 2011, two Swiss NGOs, Bread for All and the Catholic Lenten Fund, accused Glencore of a range of human rights abuses, of employing child labour, causing pollution and evading taxes in the Democratic Republic of Congo.

The accusations centred around Glencore's operations in the province of Katanga, where it has a $250 million, 77 per cent share in Katanga Mining Limited (KML), a major copper and cobalt producer.

According to the NGOs, mining is "driving the locals away from their traditional farming activities, which in turn has led to less food on the market…There are often no safety measures in KML sites. Miners are not protected from uranium radiation." [This radiation allegedly persists in local streams from earlier mining operations]. "Many have short-term contracts and less training, so the accident risk increases."

Houses were also reportedly damaged by explosive charges and the air polluted by emissions from the mining operations. "And all this in total impunity," declared the report. The NGOs say they contacted Glencore both before and after the report's publication "but to no avail."

---

[131] *See also The Guardian*, London, 20 May 2011

[132] MCM is 73.1 per cent owned by the British Virgin Islands-based Carlisa Investments Corporation, itself 81.2 per cent owned by Bermuda-based Glencore Finance Ltd, a100 per cent owned subsidiary of Glencore Switzerland. State-owned ZCCM owns 10 per cent. See: "Copper in Zambia: Charity for multinationals" by Khadija Sharife, *Pambazuka*, Issue 532, 2 June 2011: http://pambazuka.org/en/category/features/73742

[133] "Five NGOs file a complaint against Glencore International AG and First Quantum Minerals for violation of OECD guidelines" MiningWatch Canada Press Release, 12 April 2011, along with Lausanne/Zurich/ Paris/Lusaka - SHERPA (France), the Center for Trade Policy and Development (Zambia), the Berne Declaration (Switzerland), and l'Entraide Missionnaire (Canada).

On being contacted by swissinfo.ch (part of the Swiss Broadcasting Corporation) Glencore denied the allegations. Its spokesperson, Simon Buerk, reportedly argued that: "Some [sic] of the environmental problems revealed in the report are inherited from Gecamines, a company active in the region for more than 50 years."[134]

"Glencore won't change the way it operates…" – Ivan Glasenberg

There is a great deal of "unfinished" business associated with Glencore's past and continuing operations – only some of which can be dealt with in this short study. Many issues, along with the questions they raise, were neglected in the company's pre-IPO Prospectus (despite its being one of the longest on record).

To give just one example: in late 2009, four men were convicted by a French court of supplying weapons to Angola in the midst of its 27-year civil war, and in defiance of an arms embargo imposed by the United Nations.

Pierre Falcone, Arcadi Gaydamak, Jean-Christophe Mitterrand (son of the former president) and Charles Pasqua were all found guilty, but it was Falcone and Gaydamak who had played the dominant roles.[135] Falcone was packed behind bars for six years.[136]

Ken Silverstein of the highly-respected US magazine *In These Times* reports that, in November 1993: "Falcone and Gaydamak helped arrange the sale to Angola of $47 million in small arms. A second deal for $563 million worth of weapons, including tanks and helicopters, got under way early the following year…Angolans paid for the weapons with oil, which Falcone and Gaydamak sold with the help of Glencore…"[137] We are not aware that any response to this serious allegation has been made by the company itself.

For sure, there are checks and balances which Glencore is supposed to observe under recently "tightened" UK rules aimed at improving corporate governance.[138] They will not, of themselves, prevent future irresponsible, if not downright criminal, behaviour such as that recorded here.

So long as Glencore remains a gigantic, globally-spread, commodities trader, rooted in the wheeling and dealing of a close clique of its highly-paid managers, along with thousands of its proprietary on-line traders, manifold opportunities for graft and corruption will present themselves.

Ivan Glasenberg has virtually admitted this himself. On 15 April 2011, five weeks before the IPO, The *Financial Times* commented: "The... financial heft that will result from [Glencore's] initial public offering...will allow the company to vertically integrate through acquisitions, becoming a bigger producer in markets in which it trades." The paper went on to warn that: "This makes an oligopolistic market structure likely...[whose] cost is borne by consumers the world over."

When interviewed by the FT, Glencore's Mr Glasenberg had no scruples about defending his conglomerate's past practices, nor boasting that business will remain the same after the flotation.

"Unfortunately, God put the minerals in different parts of the world," he said. "We took the nice, simple, easy stuff first from Australia, we took it from the US, we went to South America and we dug it out of the ground there. Now we have to go to more remote places."

---

[134] "Glencore accused of rights abuses in DR Congo" by Stefania Summermatter, Swissinfo.ch, Bern, 12 March 2011
[135] *The Guardian*, London, 1 November 2009
[136] *The Times*, London, 28 October 2009]
[137] Ken Silverstein, *In These Times*, 22 December 2010. See also: http://www.gaucherepublicaine.org/lettres/respublica_lettre-655.htm
[138] The UK Corporate Governance Code was updated and changed in eight "key respects" in early 2011. The changes include: that a company board be now responsible for determining "the nature and extent of the significant risks it is willing to take in achieving its strategic objectives"; "more emphasis on the role of chairman", an "enhanced role for the senior independent director"; that "Diversity, including gender…be taken into account for new board appointments", and that there be "externally facilitated evaluations of the board at least every three years for FTSE 350 companies". See: http://www.grant-thornton.co.uk/pdf/corporate_governance.pdf

Just in case we don't get the point, Glasenberg added: " We are not going to change the way we operate. Any talk that going public will hinder us is not true. It will not affect us at all...Being public will have absolutely no effect on the business."[139]

[139] *Financial Times*, London, 15 April 2011

London Stock Exchange Group

LSEG Response to HM Treasury White Paper "A new approach to financial regulation: the blueprint for reform" (Cm 8083)

08 September 2011

Submitted to: financial.reform@hmtreasury.gsi.gov.uk

Executive Summary

The London Stock Exchange Group (LSEG) welcomes the opportunity to respond to the Government's White Paper on the draft Financial Services Bill.

Building on the progress to date, the Government has important opportunities to further strengthen the UK's financial services regulatory regime through this Bill. There are three guiding principles on which we base our response:

- The importance of the UK's **international competitiveness** for our economy;
- The need for **regulatory proportionality**; and
- Effective **interaction with Europe**.

With these principles in mind, we make the following points:

1. **Retain the regulatory principle for the PRA and the FCA to consider the UK's international competitiveness.** Currently, financial services regulators must consider the international competitiveness of the UK's capital markets. But in the draft Bill, this requirement has been lost. We believe that retaining this requirement will help to maintain the UK's ability to attract international businesses, which is a major asset to our economy in terms of generating tax revenues, providing a hub of expertise and increasing the UK's diplomatic weight on the international stage. It also has a knock-on effect on the ability of companies, both in the UK and abroad, to create jobs and growth. There is no need to see this as requiring a trade-off between regulation and a healthy business environment. In fact, effective regulation provides a stable environment in which businesses can operate effectively. This requirement is particularly important to the UK Listing Authority – the UKLA should retain its separate objectives under Part 6 of the Act.

2. **The regulatory burden must be proportionate and fair.** The Government should ensure that the new financial services regulatory regime is effective and not unduly burdensome to all stakeholders, including issuers, authorised firms, investors and infrastructure companies. For instance, the new proposals to allow the FCA to commission a skilled person report could put a heavy and disproportionate burden on SMEs because of their potentially high cost, and could run counter to the Government's own growth agenda to make the UK the best place in Europe to start, finance and run a business.

3. **The new regulatory bodies should lead by example and follow the principles of the UK Corporate Governance Code.** In particular, appointments to the governing bodies of the PRA and the FCA should be based on merit, expertise, experience and fully represents all industry stakeholders, including wholesale markets. Where possible, the bodies should be comprised of a majority of independent members.

4. **Coordination between the UK's regulatory bodies is crucial to ensure that the UK has a strong voice in the EU/ESMA.** Given the importance of European legislation to the UK in this sector, it is essential that a culture of co-operation and co-ordination is embedded within, and applied across, the various regulators and Government departments. This will help to ensure that the UK has a coherent approach and can speak with a powerful voice both, in Europe, and internationally. In addition, the regulatory bodies should be required to consult fully with practitioners, consumers and other stakeholders.

5. **Given the importance of the Recognised Bodies (and the RIEs in particular) in providing fair and orderly markets for trading, any new powers proposed under Part XVIII must be exercised fairly and transparently.** For instance, participants and other relevant stakeholders should continue to be able to make representations to the regulator when it gives notice that it intends making a direction to a Recognised Body.

Table of Contents

RESPONSES TO INDIVIDUAL QUESTIONS

1. The Financial Policy Committee

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

1. Objectives

1.1. Financial Stability

We agree that the first objective of the FPC should be to maintain financial stability.

However we question whether the concept of financial stability is adequately understood or defined for the FPC to be able to perform against this objective. Without a clear definition of financial stability, it is impossible to hold the FPC accountable for its success in achieving financial stability. We suggest that further consultation may be required to determine a suitable definition of financial stability which can be used to measure the performance of the FPC.

1.2. Economic Growth

Whilst we agree that the first objective of the FPC should be to maintain financial stability, **we suggest that the FPC is given a second objective: to support the economic policies of the government:**

- **The responsibility for balancing financial stability and economic growth should belong to the government.** Financial stability is clearly linked to economic policy. As the House of Commons Treasury Select Committee has noted, financial stability is not a free good and there is a necessary trade-off between financial stability and economic growth.[1] For example, there can be perfect stability if the banks stop lending, but that would result in either sluggish or no growth. This decision on how to balance financial stability and economic policy should be a matter for the government.

- **As a precedent, the Monetary Policy Committee (MPC), the sister body to the FPC, already has this objective**.[2] By being able to support the economic policy of the government, including its objectives for growth and employment, as well as having a clear target for price stability (achieving a target inflation rate of two per cent, for example), the MPC is clearly accountable to the Chancellor and its objectives are clear.

- **In order to fulfill this objective, the FPC should be clearly accountable to the Treasury and also to Parliament**. Currently there is little detail about how the FPC will be held accountable. In light of our recommendation for the FPC to support the economic policies of government, we recommend that clear lines of accountability are established between the FPC, the Treasury, and Parliament.

[1] "Financial Regulation: a preliminary consideration of the Government's proposals, Volume 1", 3rd February 2011
[2] Bank of England Act 1998 S11 (a) (b)

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

We welcome RCHs being directly regulated by the Bank, together with Settlement Systems and Payment Systems.

However, as noted in the Government's paper, the majority of legislation that will regulate RCHs now originates in the EU and ESMA will be a key body because of its responsibility for drafting technical standards that. In order to achieve the best outcome for RCHs it is essential that they have an influential and affective voice at ESMA.

It will be important for the Bank and the FCA to co-ordinate closely to achieve this. Although much has been said about the statutory duty of the PRA and the FCA to co-ordinate, there has been little discussion about the way in which the rest of the Bank will co-ordinate with the FCA. It is important that these details are clarified.

Question 3 – Do you have any comments on: the proposed crisis management arrangements; and the proposals for minor and technical changes to the Special Resolution Regime as described in paragraphs 2.41 to 2.44 and in Chapters 3 and 4?

We provide no answer to this question.

2. The Prudential Regulatory Authority

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

The general objective of the PRA to promote the safety and soundness of PRA authorised persons is appropriate, and we agree that the PRA will not be responsible for the successful financial management of firms, but instead will look to ensure that the unwinding of a firm does not have systemic consequences.

However, we believe that it is important that the PRA and other regulators should have appropriate regard for the international character of financial services and the desirability of maintaining the competitive position of the UK.

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

1. Judgement-led regulation

We continue to support a more judgment based approach to regulation; as the White Paper suggests, the following issues will need to be considered:

- It will be important for the regulators to fully set out how they intend to exercise a judgment-based approach, the approach to evidence gathering in support, and the expectations on authorised firms. This is necessary to ensure that the actions regulators take are transparent, consistent and proportionate.

- Focusing on the recruitment and retention of suitably experienced staff with expert knowledge will be critical. In order to exercise high quality judgment, the quality of staff, and of the information, resources and analysis available to staff, will be essential.

2. Governance

In order to lead by example, and to enable the Board of the PRA to provide the robust challenge to its executive (as supported by the Government), we suggest that the PRA should also seek to observe the principles and relevant parts of the UK Corporate Governance Code where it is able to do so, in order to ensure effective governance and accountability arrangement

We welcome the proposal that the Board of the PRA will be comprised of a majority of independent members. Appointments to Board should be made with consideration to the principles of the UK Corporate Governance Code to ensure that appointments are based on merit, assessed against objective criteria, and is given due regard to diversity.[3]

We also suggest that to ensure effective governance and accountability, the Chairman of the Board should be independent.

[3] Principle B.2

3. Accountability

3.1. Requirement to consult

Given the role and scope of the PRA, we feel that an equivalent approach to consulting with Practitioners to that of the FCA might be beneficial in supporting and validating the rule making processes of the PRA.

3. The Financial Conduct Authority

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

1. Objectives and regulatory principles

- **We support the FCA's primary objective of protecting and enhancing confidence in the UK financial system.** We also support the six regulatory principles to which the FCA will need to have regard when conducting its regulatory responsibilities, especially that a burden or restriction imposed on a person should be proportionate.

- **Need for emphasis on proportionality of regulatory burden and fairness.** It is important that the FCA ensures that regulatory burdens placed upon persons are proportionate and fair. Based on the FSA's discussion document on the FCA's approach to regulation, we suggest more emphasis should be given to the proportionality of burdens and restrictions, as stressed by the Government in its earlier consultation document.

- **Need to retain regulatory regard for the UK's international competitiveness and attractiveness.** We believe that it is important that regulators should have appropriate regard for the international character of financial services and the desirability of maintaining the competitive position of the UK.

    - In our view, there is no need to see this as requiring a trade-off between effective regulation and ensuring that the UK remains internationally competitive. On the contrary, it is the way these two elements work together that has proved to be so effective in enhancing London's position as a leading financial centre. For instance, one of the reasons why the UK attracts international companies to list and trade on our markets here is because our strong system of proportionate regulation provides them with the confidence and certainty of a stable environment within which to operate.

    - It is vital for our economy that international firms continue to be drawn to the UK. The UK's continued economic competitiveness is a major asset to the UK in terms of generating tax revenues, providing a hub of expertise and increasing the UK's diplomatic weight on the international stage. Our ability to attract companies at a global level also has a knock-on effect on the ability of companies, both in the UK and abroad to create jobs and growth.

    - We would support an approach where such a consideration is delivered either by way of a need to have specific regard to international "competitiveness" or "attractiveness", or by a requirement that regulation should be applied in a way that is "proportionate, having regard to the interests of stakeholders, including the attractiveness of UK markets".

2. Competition and competition law regulation

We believe that an appropriate emphasis is given to competition, and welcome that the FCA should promote competition in a way that is compatible with its strategic and operational objectives, and not as an objective in its own right. Competition is important for driving innovation, best practice and helps to ensure a better outcome for consumers.

However, the FCA should not be an economic or competition law regulator, and we welcome the Government's commitment that it does not propose to give specific additional competition law regulation powers to the FCA. The financial services sector is materially different to those sectors regulated by authorities that possess competition law regulation powers, such as the water and electricity utility sectors, which have traditionally been dominated by a small number of large entities.

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

1. Product intervention powers

We make the following points in regards to the new powers of product intervention that will be available to the FCA:

- **The Purpose should be to prevent significant consumer detriment**. These powers should only be exercised when there is a clear and demonstrable risk of significant consumer detriment representing large scale loss or damage. These powers should not be used to approve new financial products or guarantee returns.

- **This power should not be used to prevent financial markets from undertaking their key purpose of managing risk and providing choice.** The appropriate balance must be struck between preventing significant consumer detriment on the one hand, and limiting choice and crushing innovation on the other.

- **Powers should be limited to retail consumers only.** Product intervention powers are unlikely to be effective or appropriate where consumers are either professional or eligible counterparties, and should be restricted to retail only. A key principle of financial regulation is that professional clients and eligible counterparties have the knowledge and ability to accurately assess the risk that they are exposed to – it is not for the regulators to determine this.

- **Need for clear guidelines on utilisation of powers.** There must be clear and transparent guidelines defining the circumstances and method for utilising these powers. This will provide the market with a solid framework within which to operate when designing new financial products.

2. Judgement-led regulation

We continue to support a more judgment based approach to regulation; as the White Paper suggests, the following issues will need to be considered:

- It will be important for the regulators to fully set out how they intend to exercise a judgment-based approach, the approach to evidence gathering in support, and the expectations on authorised firms. This is necessary to ensure that the actions regulators take are transparent, consistent and proportionate.

- Focusing on the recruitment and retention of suitably experienced staff with expert knowledge will be critical. In order to exercise high quality judgment, the quality of staff, and of the information, resources and analysis available to staff, will be essential.

3. Early notification of disciplinary action

We support the general principle of transparency in markets and we operate and provide transparent financial markets and believe it is essential that market participants are presented with the fullest possible information to make informed decisions, to contribute to the maintenance of stable and fair markets.

However, we question whether the FCA's proposed power to disclose disciplinary action early would have the beneficial effect intended and whether it might have wide ranging and adverse unforeseen impacts on the UK's financial markets. Whilst the early notification would alert the markets/investors to action being proposed by the FCA, it would by its nature not provide specific details or analysis of the likely outcome. This, in, turn could cause significant market uncertainty, threaten market stability, and the reputation and viability of issuers and investment firms concerned.

Accordingly, we welcome the proposal that exercise of early disclosure will be discretionary, and that the power will be subject to safeguards. In particular, we would suggest that:

- regulators must consider the potential impact on market stability and market participants/investors/issuers of such an announcement, and the potential reputational damage that may occur, balanced against the likelihood of a penalty being imposed; and

- early notification should only be used in exceptional cases as it is likely to lead to a less open and more confrontational relationship between the regulator and the authorised entity. It might also result in the disciplinary processes becoming more costly and time consuming at an early stage as the authorised entity would seek to resist the early notification, because of its potential adverse impact.

In addition, any early identification must only be permitted to take place once the relevant firm, individual or recognised body, had been given the minimum 28 days period in which to review the material relied on by the regulator and make oral or written representations.

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

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

We provide no views to questions 8 and 9

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

Please see our answer to question 6

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

1. Recognised Investment Exchanges

Several "technical changes" have been proposed to Part 18 of FSMA, including simplifying the process by which directions are given to RIEs, the use of financial penalties and public censure, and the use of skilled person reports.

We remain to be convinced of the necessity of these changes, and the market or other failures that they are designed to rectify. During the financial crisis, there was no failure of market infrastructure: organised markets remained open for business, whilst other parts of the financial sector ceased working.

RIEs have an important role to play in maintaining fair and orderly markets, and facilitating the capital raising activities of companies. These are of significant importance to the economy, and ensuring the provision of jobs and maintaining growth. It is essential that any changes do not undermine the value that RIEs bring to the economy.

1.1. Power of direction

The Government proposes that that FCA will, under Section 296, have simplified powers of direction over RIEs. We note that:

- Notice of a direction will only be made to the RIE concerned, and representations may only be made to the regulator by the RIE, and no longer by its members, or other persons likely to be affected by the direction;[4] and

- The procedure by which a direction is given may be abbreviated if the regulator concerned "reasonably considers it necessary",[5] rather than "considers it essential to do so" as at present required by the Act.

We do not believe the reduction of notice proposed in (a) to be in the best interests of the market. Further, proposal (b) would need to be employed with significant safeguards to ensure that the FCA's discretion is exercised reasonably and does not adversely affect market stability.

RIEs, as front line regulators, have an important role to play in ensuring that markets remain orderly, fair and efficient. It is likely that a direction placed on an RIE would have far ranging consequences on the market participants that it regulates and on issuers admitted to its markets.

It is essential that, in order to ensure that the UK's markets remain attractive to issuers and investors, whether domestic or international, **that member firms and other concerned stakeholders continue to be able to make representations**

[4] Section 298 (1) and (3)
[5] Section 298 (7)

where it is apparent that a direction to an RIE is likely to have an impact on them. We attach a mark up of the form we believe the Section should take in Annex 1.

1.2. Financial Penalties and Public Censure

Notwithstanding our view that no market failures have been shown which necessitate granting of additional powers, we feel that it is important that there are appropriate safeguards if such powers are introduced. In particular:

- the disciplinary measures and processes proposed under Part 18 must be equivalent to those measures employed for authorised persons under Part 4;

- the procedure by which penalties are imposed may not be truncated; and

- the RIEs must be consulted before any such decisions are made and can make representations to the regulator.

It is likely that public censure of an RIE will have an adverse impact on the markets that they operate. The regulator must be required to consider this carefully before taking any actions that may undermine market stability or confidence. We suggest appropriate wording for this in Annex 2.

1.3. Skilled Person Report

We are concerned that powers to require a skilled persons report under Section 166 in respect of a recognised body may be exercised on a common practice basis, rather than on an exceptional last-resort basis. Whilst this is true for authorised entities, the close and continuous nature of the supervision of the recognised bodies could be damaged or undermined by the regular deployment of Section 166 reports. We are also of the view, as discussed in question 7 above in the context of the judgement based approach to regulation, that the FCA should be aiming to build its own in-house competence to undertake this type of review/report and not relying on external parties. The FSA suggests that the use of Section 166 reports will be increasing to 140 in 2010/11 from 17 in 2005/06, at an average cost to the subject of £270,000 (though some cost as much as £500,000). The reports should not be seen as an alternative form of penalty.

1.4. Regulators relationship with Recognised Bodies

Finally, we have a general concern that the introduction of the various powers and measures above could have the effect of undermining the nature of the relationship that Recognised Bodies enjoy with their supervisors/regulators. The current regime is based on a relationship of close and continuous supervision and interaction and allows flexibility in the way that authorities deal with the entities that they regulate. This engenders a cooperative and dialogue based approach to regulation. A more prescriptive approach to the regulation of the RBs and extensive use of Section 166 reports could lead to a reduced, less useful dialogue between regulators and regulated entities, resulting in less effective regulation.

2. Listing and Issuers

2.1. Objectives

We welcome the Government's decision to retain the listing function within the FCA. This is important to ensure that the regulation and supervision of markets remains coherent and that UK primary markets interests are properly and fully represented in Europe.

However, the UK Listing Authority (UKLA) <u>must</u> retain its ability to consider the UK's international competitiveness. Currently, the UKLA must consider "the international character of capital markets and the desirability of maintaining the competitive position of the United Kingdom" (73 (1) (d)). In other words, it must consider how its regulation affects the competitiveness of the UK's capital markets. In its current form, the Government's proposal in the draft Bill to bring the functions of the Listing Authority under the general framework of the FCA would result in the Authority losing its ability to have regard for the international competitiveness of the UK.

This matters because London's continued economic competitiveness is a major asset to the UK in terms of generating tax revenues, providing a hub of expertise and increasing the UK's diplomatic weight on the international stage. Our ability to win listings at a global level also has a follow-on effect on the ability of companies, both in the UK and abroad, to create jobs and growth.

2.2. Skilled Person Report

In its White Paper, the Government acknowledged that a number of bodies have expressed concern about the proposal to allow the FCA to require a 'skilled person' report from listed issuers and primary information providers. Despite these concerns, the proposal has been retained. We have two issues with these reports:

- **Potential disproportionate impact on SMEs which runs counter to the Government's growth agenda.** Such a requirement could be unduly burdensome and costly for issuers, especially for SMEs. SMEs are the backbone of our economy – for example, SMEs admitted to our growth market AIM contributed in excess of £20 billion to the economy in 2009.[6] As the cost of such reports is often high (sometimes over £500,000), their introduction and cost could have a disproportionate impact on smaller listed companies. This runs counter to the Government's stated aim to drive growth and "make the UK the best place in Europe to start, finance and grow a business".[7]

- **No clear cost benefit analysis.** It is unclear what market failure this proposal has been designed to address in relation to listed companies, nor its relationship with the potential for Inspectors to make Reports under the Companies Act, and does not appear to have been fully analysed from a cost benefit perspective. Such measures could represent a significant cost to issuers, potentially deterring enterprises from seeking a listing in London, and therefore reducing the liquidity of markets, with a consequent rise in the cost of capital.

---

[6] Both directly and through Gross Value Add - Economic Impact of AIM and the Role of Fiscal Incentives, *Grant Thornton and LSE*, September 2010

[7] Paragraph 1.70, Budget 2011, *HM Treasury,* March 2011

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

1. Governance

We suggest that the FCA observe the relevant parts of the UK Corporate Governance Code where it is able to do so in order to ensure effective governance and accountability.

We welcome that the Board of the FCA will be comprised of a majority of independent members. Appointments to the Board should be made with consideration to the principles of the UK Corporate Governance Code to ensure that appointments are based on merit, assessed against objective criteria, and is given due regard to diversity.[8] Further, it is essential that all industry stakeholders are fully represented on the Board, including equal weight given to wholesale markets, recognised bodies and consumers.

We welcome that the Chair of the FCA will be an independent member.

[8] Principle B.2

4. Coordination and regulatory process

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

1. Co-ordination

Many of the financial services regulations which affect the ability of the UK's financial markets to contribute to our economy come from Europe rather than the UK. Currently, major pieces of European legislation include the Markets in Financial Instruments Directive and Regulations (MiFID), the European Market Infrastructure Regulation (EMIR), the short selling regulation, and the Basel Accords.

As events and measures in the EU have a substantial impact on the UK's financial services industry, it is vital that the UK industry is well represented in Europe.

We welcome the intention to establish a Memorandum of Understanding between the Treasury, the Bank of England, the PRA and the FCA on overall international co-ordination to achieve the best outcome for the UK in Europe, we would like to emphasise the importance of developing a **culture of co-ordination and co-operation** between these institutions to ensure that effective working relationships are established and that there is a clear lines of representation.

2. Power of veto by the PRA

We believe that the FCA should be of equal prominence and importance to the PRA, and do not believe that a power of veto is appropriate. **This is especially important with regards to the UK's ability to influence policy development in the EU – the FCA must not be seen as a second-tier regulator.**

Further, as stated earlier, what is meant by "financial stability" must be clarified. We note that the PRA will only have a power of veto over the FCA where financial stability is at risk, or where the action of the FCA would result in the disorderly unwinding of a firm. For this to be effective, it is important to know what could trigger a risk to financial stability, and therefore at what point the PRA would intervene.

With that in mind, we cautiously welcome the fact that the power of veto will be limited, and subject to transparency and accountability obligations.

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

1. Unregulated holding companies

In our view, we would expect regulators to use the process of authorisation of the regulated entity to access information from the unregulated holding company, making it a condition of initial and continued authorisation that such access and information was provided; we do not see why any further powers are necessary.

It is unclear what the rationale and justification for this change is, and what failings it has been designed to address. Further, it is currently unclear precisely what is being proposed, and under what circumstances such a power would be exercised. It is essential that interested parties are given the opportunity to fully consider, and respond to, any detailed proposals, preferably before pre-legislative scrutiny.

The UK is currently home to 318 authorised banks, 241 of which are incorporated overseas or owned by a foreign entity[9]. This does not account for the significant number of authorised investment firms who are foreign owned. It is likely that such a measure would lead to significant levels of uncertainty and complexity, and further detract from the attractiveness of the UK's markets, and may have the effect of deterring foreign businesses from locating in the UK, with the negative impacts that this would have on the UK economy.

5. Compensation, dispute resolution and financial education

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

We provide no answer to this question

[9] Source: "Financial Markets in the UK – November 2010" The CityUK

6. Annex 1: Suggested wording for Section 298 of FSMA as revised

298 Directions and revocation: procedure

(1)Before giving a direction under section 296, or making a revocation order under section 297(2) [F1or (2A)], the [appropriate regulator] must—

(a) give written notice of its intention to do so to the recognised body concerned;

(b) take such steps as it considers reasonably practicable to bring the notice to the attention of members (if any) of that body; and

(c) publish the notice in such manner as it thinks appropriate for bringing it to the attention of other persons who are, in its opinion, likely to be affected.

(2)A notice under subsection (1) must—

(a) state why the [appropriate regulator] intends to give the direction or make the order; and

(b) draw attention to the right to make representations conferred by subsection (3).

(3) Before the end of the period for making representations—

(a) the recognised body,

(b) any member of that body, and

(c) any other person who is likely to be affected by the proposed direction or revocation order, may make representations to the [appropriate regulator].

(4)The period for making representations is such reasonable period as is specified in the notice (which may, in any particular case be extended by the appropriate regulator) but not less than 21 days.

(5) In deciding whether to—

(a) give a direction, or

(b) make a revocation order,

the [appropriate regulator] must have regard to any representations made in accordance with subsection (3).

(6) When the [appropriate regulator] has decided whether to give a direction under section 296 or to make the proposed revocation order, it must—

(a) give the recognised body written notice of its decision; and

(b) if it has decided to give a direction or make an order, take such steps as it considers reasonably practicable for bringing its decision to the attention of members of the body or of other persons who are, in the Authority's opinion, likely to be affected.

(7) Where the [appropriate regulator] [reasonably considers it necessary] in order to preserve or maintain the stability of, or confidence in, any market operated by a recognised body to do so, it may give a direction under section 296—

(a) without following the procedure set out in this section; or

(b) if the [appropriate regulator] has begun to follow that procedure, regardless of whether the period for making representations has expired.

(8) If the [appropriate regulator] has, in relation to a particular matter, followed the procedure set out in subsections (1) to (5), it need not follow it again if, in relation to that matter, it decides to take action other than that specified in its notice under subsection (1).

7. Annex 2: Suggested wording for Section 312 G and 391 of FSMA as revised

312G Proposal to take disciplinary measures

(1) If the appropriate regulator proposes—

(a) to publish a statement in respect of a recognised body under section 312E, or

(b) to impose a penalty on a recognised body under section 312F,

it must give the body a warning notice.

(2) A warning notice about a proposal to publish a statement must set out the terms of the statement.

(3) A warning notice about a proposal to impose a penalty must state the amount of the penalty.

(4) The FCA may not-

(a) publish a warning notice or statement in respect of a recognised body under section 312E, or

(b) publish a warning notice or impose a penalty on a recognised body under section 312F,

if, in its opinion, publication of the information or imposition of the penalty would be detrimental to the stability of, or confidence in, any market operated by such recognised body.

391-Publication

[**(6) The FCA may not publish information under this section if, in its opinion, publication of the information would be—**

(a) unfair to the person with respect to whom the action was taken (or was proposed to be taken);

(b) prejudicial to the interests of consumers; or

(c) detrimental to the stability of the UK financial system or, in the case of a warning notice under section 312G, to the stability of, or confidence in, any market operated by a recognised body that is the person with respect to whom the action was taken (or was proposed to be taken).

The dilemma is how to make ordinary people's saving safe, make the financial system robust, yet allow wild risk taking by those who want to.

You could apply lighter regulation to small banks, allowing them to take risks.
These could be known as 'risky banks' where people could invest their money if they wanted to take risks.
If they failed however, they would go bankrupt.
To avoid this having a 'Lehmans' effect there would have to be limits on the amount they borrow from the 'safe banks' which is why they would have to be small.

I haven't thought this through, but this could also create much more competitions, as 'risky banks' would have to be small, so there would have to be much more of them.

Philip Meldrum

<u>Comments by Andy Mullineux on "A New Approach to Financial Regulation: A Blueprint for Reform", CM8083, June 2011.</u>

Given the failure of the 'tripartite' model the need for <u>co-ordination</u> is paramount, as acknowledged in the paper. This is true internally in the UK and thus requires co ordination between the Monetary Policy Committee and the new micro and macro prudential regulators. To make this effective the MPC's narrow inflation targeting objective needs to be broadened to include supporting economic activity and financial stability.

<u>International co-ordination</u> is also required to achieve high regulating standards without avoiding a 'race to the bottom' that would undermine the competitiveness of the UK financial sector.

In my view the proposals are flawed with regard to the Financial Conduct Authority. The international wholesale and capital markets in the major financial centre that is London should be separately regulated, as in the US by the SEC *inter alia.*

A separate retail banking (and insurance) utility regulator should be established with powers to set price controls where over charging (or under charging - the basis of 'free banking', which involves dostortionary cross-subsidisation) is evident. This would make retail banking safer and more consumer orientated. The Utility agency (BankInco or BIC?) would naturally also take on the financial inclusion (universal services obligation) and financial education roles and take over from the OFT responsibility for regulating consumer credit.

It would raise the cost for universal banks of doing retail banking business and reduce their options in using it to cross-subsidise investment banking, perhaps inducing universal banks to divest retail banking operations voluntarily. The ICB's proposed ring fencing of retail (utility) banking is laudable, but would increasingly become redundant if BankInco did its job effectively.

Finally, the big banks should be forced to pay for their implicit insurance subsidy. A levy is justified and could be set at levels gauged from the enhancement of bank credit ratings gained from support by credit worthy governments. The enhanced (risk related) capital requirements of Sifis also represent a 'tax' on banks. The levy should be set in light of the higher 'regulatory taxes' to be paid by big banks in order to avoid over-taxing and reducing their international competitiveness and lending to SMEs and households. The 'regulatory taxes' include any contributions they are required to make (ideally risk related and pre-funded so that they do indeed 'tax' risk taking) to the national deposit insurance scheme (which only banks that can be allowed to fail will draw upon). Countries with large (relative to GDP) banks are unable to credibly support their banks (and so too are countries with lower credit standing – the 'too big to save' problem). In an ideal world, this should al be reflected in banks' credit ratings.

One final thought. Financial stability may be hard to define, except in the sense of absence of financial instability, but is clearly a Public Good in the Economics sense. Who should pay for its production (which includes the cost of regulation and supervision)? There is a 'Dutch-Dyke' problem – it is very costly to build protection big enough to eliminate flooding or a banking crisis. The cost will include at least some reduction in bank lending and rise in the cost of credit, though the extent of this is moot. As a result, unless equity finance expands commensurately, there will be slower growth (but maybe only in the expansion phases not on average over the cycle).

How much of the Public Good do we need and how low should we push the probability of a crisis – perhaps we only need to avoid major crises? Should the taxpayer contribute nothing to the production of Financial Stability? Should the cost be borne by bank shareholders and perhaps other creditors i.e. bondholders, and consumers of their financial services and products? Who should pay for bank regulation and supervision and in what proportions and how much of it does the public want?

Andy Mullineux
Professor of Global Finance

Nationwide

Nationwide Building Society
Nationwide House
Pipers Way
Swindon
SN38 1NW

6 September 2011

HM Treasury
Financial Regulation Strategy

Sent by e-mail to: financial.reform@hmtreasury.gsi.gov.uk

Dear Sir/Madam

A NEW APPROACH TO FINANCIAL REGULATION: THE BLUEPRINT FOR REFORM (CM 8083)

Nationwide Building Society including its subsidiaries and regional brands welcomes the opportunity to respond to the Government's White Paper and Draft Bill.

We have responded to the Government's earlier consultations – (1) *Judgement, Focus and Stability* and (2) *Building a Stronger System* – and remain broadly supportive of the Government's overarching objectives. We note that the Financial Services Authority ("FSA") and the Bank of England have published details on how the new supervisory authorities that will be under their control are expected to operate. We have chosen to respond directly to those papers rather than commenting on them here.

We would, though, take this opportunity to endorse the response of the Building Societies Association ("BSA") and its work to date in engaging with the Government and the FSA on matters of significant practical importance. The BSA comments on a number of operational matters in its response. We are particularly interested in securing a common gateway for regulatory processes relevant to dual-regulated firms and retaining a shared, or at least co-ordinated, regulatory handbook; as well as seeking answers to wider questions about how the FCA's product intervention powers will work in practice.

The remainder of this letter (pp. 1-3) contains key points for the Government's consideration. We set out in the Annex (see pp. 4-9) more detailed responses to relevant specific questions.

Proportionality

- We continue to believe that these reforms present an opportunity to emerge from the crisis and implement new supervisory mechanisms and tools, to promote greater stability and rebuild the trust of consumers. However, this must be balanced with careful thought as to the resulting complexity and burdens that risk being placed on firms, especially those that are dual-regulated.
- Regulation should adhere to the "golden rule": it should be a proportionate response to the problem it seeks to tackle with sufficient focus on the opportunity cost to firms. The reality is that the increasing cost of regulation will indirectly flow through to more expensive products and services.
- A focus on proportionality should naturally translate to a regime that is absent duplicative rules that are designed to achieve the same end. Prudential *and* conduct regulation designed to tackle issues in the mortgage market is one such example.

FCA and competition

- We support the FCA's strategic objectives as set out in the draft legislation, which we hope will provide consumers with the degree of protection they require and promote greater choice within the market.

- Improving consumer outcomes and increased competition should be a pivotal element of regulatory reform. The draft Bill strikes an appropriate balance between ensuring that competition is at the heart of the FCA's operational model, while ensuring that its remit does not cut across the existing competition law regime.
- We believe that effective competition occurs where consumers can easily compare products using clear and transparent sales literature, make informed choices and switch providers within a regulatory framework that provides a level playing field for firms irrespective of their ownership structure.

Financial Services Compensation Scheme (FSCS)

- It is important to us that the regulators are able to assess the risk posed by firms under their supervision so that levies can be set on the basis of that risk-based assessment. We would likely support any proposal that allows for a fairer contribution from financial services providers based on the risks taken with customer deposits.
- Our contention with the current system is that the size of our retail deposit base dictates the size of the levy we pay – with no regard to the inherently low risk nature of our business. Building societies have always raised the great majority of their funds from traditional retail sources, and in any case are required to do so by law. We will therefore pay disproportionately more relative to our balance sheet size than those banks that have chosen to neglect their retail deposit base and instead rely excessively on wholesale funding and pursue higher risk strategies – the type of strategy which ultimately contributed to the financial crisis.

Mutuals

- We welcome the Government's efforts to recognise diversity in financial services, and welcome specifically the planned removal of some out-dated anomalies within the Building Societies Act 1986 (although we do not believe changes to the Act should result in fundamental changes to the sector).
- We believe that an explicit diversity 'have regard' or objective is appropriate as a means of recognising the benefits of different "banking models" and the diversity they introduce to the financial system. The Government's alternative to this is the proposal to require the PRA and FCA to assess the impact of new rules on mutuals (new section 138L). This is encouraging, and if the Government pursues this alternative proposal then we would go further and suggest that the regulators should consider, as part of the section 138L impact assessment, the appropriateness of a rule given the legal structure to which it will apply, as well simply the cost of compliance.
- Similarly, we would advocate a further extension to certain parts of the Bill that would involve a joint committee of regulators performing the impact assessment currently set out in new section 138L in order to inform the UK's negotiating position in the context of proposed directly-effective EU regulation.

Co-ordination and costs

- While we broadly support the focus of the future regulatory approach on financial stability we are cautious to unreservedly support the "twin-peaks" approach given the scope – without sufficient co-ordination mechanisms in place – for duplication in certain areas and gaps in others.
- We are concerned that the upper limit for transitional costs for dual-regulated firms has increased considerably from £50-60m to £100m, with total cost estimates now up from £400m to £770m. The primary reason appears to be because the Bank of England does not wish to use the FSA's apparently expensive IT systems. It is crucial that the new regulators avoid transitional paralysis while they develop their own operating models.
- We note that regulators and the Government will review periodically the contents of the statutory memorandum proposed to be drafted jointly by the PRA and FCA. We note with caution, however, that some areas appear to be discretionary. We believe that this review should be extended to consider the cumulative impact of dual regulation and the effectiveness of the arrangements designed to minimise the burden on dual-regulated

firms. The PRA and FCA should each year disclose the results of this assessment in a joint publication.

- We support the 'almost unanimous industry view that there should be a single point of contact for regulatory processes' and, again, endorse the BSA's work in this area.

Governance and accountability

- It is essential that the issues of roles, accountability and responsibility, and an appropriate appeals process, are considered. This is important given the lack of accountability and responsibility that hampered the tripartite system and contributed to the severity of the last financial crisis.
- The Treasury Select Committee (TSC) should scrutinise the Chancellor's appointments to the Boards of both regulators. The TSC has a veto on the appointment of, for example, the Chair of the Office of Budget Responsibility, but an equivalent check does not appear to have been suggested in respect of the regulators.
- The duty to report and investigate on possible regulatory failure placed on the FCA by section 51 should go further. Treasury should be obliged to lay before Parliament any any report it receives. This would be consistent with Treasury's obligation set out new section 3E(6) in relation to the memorandum of understanding between PRA and FCA.

Finally, we hope our comments are of assistance to you. Please do not hesitate to contact us should you wish to discuss our response further.

Yours faithfully

Alison Robb.

Alison Robb
Group Director Strategy & Planning
(Unsigned as sent by e-mail)

ANNEX TO NATIONWIDE BUILDING SOCIETY'S RESPONSE TO 'A NEW APPROACH TO REGULATION: THE BLUEPRINT FOR REFORM'

We are the UK's third largest mortgage lender, the third largest high street savings provider and sixth largest high street financial services organisation, with around £190 billion in assets. We are the only building society that provides a viable alternative to the banks through our size and scale, product proposition, pricing structure, branch network and brand strength. As a modern, mass market mutual, we are owned by and run for the benefit of our 15 million members. We are naturally consumer focused and, though we must take a commercial approach to remain competitive, we do not compromise our mutual principles.

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

Objectives

We welcome the new section 9C and its reference to economic growth. It is important that economic growth and financial stability are priorities for the UK and we hope the inclusion of this reference will ensure the two priorities do not conflict.

Governance, accountability and transparency

In our response to *Building a Stronger* System, we called for the FPC as far as possible to be made subject to equivalent governance, accountability and transparency mechanisms as the MPC. The MPC operates within an established and effective framework which could apply equally to the FPC. We support the idea of the FPC publishing financial stability reports as an aid to transparency and we accept that market sensitivities might preclude entirely or limit significantly other disclosures. However, we believe that the proposals could go further in applying an MPC-style regime to the FPC given the equally important roles they will play in balancing monetary and financial considerations respectively. In this sense the Government should consider promoting the FPC to a full committee of the Court of the Bank of England rather than a sub committee, as is currently proposed.

Capital tools

We also asked for further information on how and when capital tools would be deployed. Variable risk weights, for example, might concern us if their application is uniform and insensitive to different operating models, asset classes and sectors. We are therefore pleased that the interim FPC will analyse the merits of macro-prudential tools potentially available to it ahead of the permanent FPC taking on its permanent macro-prudential supervisory role. We trust that this analysis will be made available not only to Treasury but as far as possible to industry, with an opportunity for industry to engage in this process and comment on the conclusions reached. Moreover, given the significance of the tools that will be at the FPC's disposal, the FPC should issue a policy statement that sets out how it will discharge its responsibilities.

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

We broadly support the proposals. We think they will lead to heightened regulatory scrutiny of payment systems; which is appropriate given the pace of development, complexity and inherent risks associated with near real time transactions and the interdependence between financial institutions. The growth in volume and value of, for example, Faster Payments requires interbank intraday settlements to operate with the utmost integrity and resilience to ensure complete, timely and accurate exchanges. This makes it highly desirable to ensure appropriate supervision of payment systems in the context of maintaining financial stability, but also in a benign environment to promote market integrity and remove practical impediments to consumer transactions.

3. Do you have any comments on:

- **the proposed crisis management arrangements; and**
- **the proposals for minor and technical changes to the Special Resolution Regime as described above and in Chapters 3 & 4?**

We agree with the minor technical amendments to the SRR, and would take the opportunity to echo the BSA's comments on the use and ultimate cost of the FSCS. Recourse to the FSCS should be minimised and the FSCS should be made accountable to a creditors' committee where it is used in relation to a failed institution. We would also take the opportunity to repeat here our plea to Government to review the FSCS fee structure. We comment further on this in our response to Q15.

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

Accountability

We believe the Treasury Select Committee (TSC) should scrutinise the Chancellor's appointments to the Boards of both regulators. The TSC has a veto on the appointment of, for example, the Chair of the Office of Budget Responsibility, but an equivalent check does not appear to have been suggested in respect of the regulators.

Impact on mutuals

We continue to believe that an explicit diversity 'have regard' or objective is appropriate as a means of recognising the benefits of different "banking models" and the diversity they introduce to the financial system. The Government's alternative to this is the proposal to require the PRA and FCA to assess the impact of new rules on mutuals (new section 138L). This is encouraging against a background of regulation that in a number of ways seems to have favoured the corporate form. However, the current drafting seems only to require the regulators to: first, assess the impact on mutuals and, then, only if it the impact is deemed significant as compared to other authorised firms, to specify how it differs. It appears to stop short of requiring the regulators to adjust their proposals commensurately to remove any resulting inequalities.

Given this, we would:

- repeat our suggestion that both regulators should be required to assess whether or not a rule is appropriate given a firm's legal structure, as well as simply the cost simply the cost of compliance. For example, developing share-like equity capital instruments to satisfy rules governing executive remuneration structures and to issue as Common Equity Tier 1 capital in anticipation of Basel III reforms has been problematic due to our non-corporate status; and
- ask the Government to impose on the regulators a requirement to justify any decision to press ahead with rules without modification in cases where the impact on mutuals is assessed as being significantly different to other authorised firms or where such a rule is simply inappropriate.

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

Our comments in answer to question 4 should be taken in the context of the increasing volume of directly-effective European law and the position we share with the BSA in relation to the UK's discretion during the implementation process. As mentioned above, the Government's efforts to recognise diversity in financial services are encouraging. However, we believe there is a case to be made for seeking to minimise the time, effort and resources that are devoted to engaging in a consultation process where the UK has no discretion in the way that it implements EU law. For this reason we advocate bringing forward in time the point at which the section 138L assessment is performed, so that it occurs with a view to informing the UK's negotiating position in advance of maximum harmonisation EU law coming into force.

Some respondents to *Building a Stronger System* suggested establishing a joint committee of domestic regulators to co-ordinate and represent the UK's interests in Europe, in order to secure a proportionate and fair deal for firms and consumers in advance of the point at which it is too late to take any meaningful action. We would support such a move and believe there could be scope to include the section 138L assessment within that committee's remit.

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

We support the FCA's strategic objectives as set out in the draft legislation, which we hope will provide consumers with the degree of protection they require and promote greater choice within the market.

We note the inclusion of new section 1C(2) and believe this is worthwhile in assisting not only the FCA but also firms in implementing a risk-based approach to product-related design and disclosure. The question then becomes by which measure will the FCA judge the inherent risk of such products and the needs of consumers with differing levels of sophistication? In any event, these factors have the potential to motivate firms to make sure consumers are given appropriate and accurate information at the right time so they are able to make an informed decision and secure the best outcome for them. Firms should then be confident that the FCA will set their behaviour against the principle set out in the draft legislation that consumers should take responsibility for their decisions.

This might be pertinent in some advice-related sales complaints, where consumers on reflection believe they have been 'mis-sold' the product rather than accepting they may have personally made a poor decision based on the information provided to them.

We believe that improving consumer outcomes should be a pivotal element of regulatory reform, and competition has a key role to play. In some areas of retail financial services, competition has not been as powerful a force as might have been expected. PPI sales is perhaps the most obvious and current example. We believe that effective competition occurs where consumers can easily compare products using clear and transparent sales literature, make informed choices and switch providers within a regulatory framework that provides a level playing field for firms irrespective of their ownership structure. A greater regulatory focus on competition has the potential to improve consumer outcomes and reduce the need for regulation.

We therefore welcome the plans to allow the FCA to exercise its powers in relation to competition. The draft Bill seems to strike an appropriate balance between ensuring that competition is at the heart of the FCA's operational model and ensuring that its remit does not cut across the existing competition law regime, which would lead only to uncertainty. Giving the FCA the power to make an advanced referral to a specialist competition regulator seems therefore to be an appropriate compromise.

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

We are broadly supportive of supervisory initiatives such as more intrusive product intervention, but we were nevertheless pleased to see the Government's acknowledgement that product intervention is a compliment to, and not a substitute for, regulation of the sales process. The FCA should aim for an early, regular and productive dialogue with firms, ultimately aiming to develop co-operate relationships with firms.

We believe that firms and consumers will benefit if the FCA is able to discuss openly with firms consumer information that it plans to collect and analyse. Complaints data supplied by the Financial Ombudsman Service (FOS) is a key example. There is real potential to prevent widespread consumer detriment, minimise costs and reduce the disruption that is generated by mass claims; and ultimately foster a culture of efficient engagement with firms.

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

This could help the FCA identify issues causing mass detriment at a much earlier stage. The effectiveness of this approach, and the extent to which we would be able to provide meaningful feedback, depends largely being given further information on a number of factors:

- to whom the FCA gives this statutory role;
- the nature of the evidence to be provided; and
- to what degree this evidence is reviewed by the FCA prior to it taking action.

The FOS, with its evidence base of complaints, does seem to be a natural choice, particularly as it is an independent body. However, the extent to which consumer groups become nominated parties may require further consideration, due to the bias nature of the role they perform and the potential for the FCA to be inundated by referrals. We note recent developments in relation to the role of Claims Management Companies and in this context believe their role needs careful consideration.

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

The proposal could act as a useful mechanism for giving firms an indication of how the FCA views certain issues and, significantly, its preferred course of action in respect of them. It could ensure complaints are handled consistently and fairly across the industry, and potentially negate the need for such complaints to be referred to the FOS. Ensuring timely decisions on referrals will also ensure the industry can manage consumers' expectations in terms of any dissatisfaction they have expressed. We would expect the time periods and actions to be set out clearly in rules and guidance in the useful way.

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

Please refer to our answer to question 6.

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

We believe the Treasury Select Committee (TSC) should scrutinise the Chancellor's appointments to the Boards of both regulators. The TSC has a veto on the appointment of, for example, the Chair of the Office of Budget Responsibility, but an equivalent check does not appear to have been suggested in respect of the regulators.

As for transparency, we broadly support the proposals and welcome any efforts to improve transparency provided they do not interfere with commercial sensitivity and confidentiality or damage the market. We had hoped that the Government would legislate to improve communication channels with firms generally (para 2.129), although in this respect we are pleased that the Government has decided to retain at least the practitioner panels.

We believe the duty to report and investigate on possible regulatory failure placed on the FCA by section 51 is crucial but that it should go further: Treasury should be obliged to lay before

Parliament any report it receives, consistent with Treasury's obligation set out in new section 3E(6) in relation to the Memorandum of Understanding ("MoU") between PRA and FCA.

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

We said in our response to *Building a Stronger system* that there should be appropriate focus on minimising the complexity and operational burdens that will be placed on dual-regulated firms. We note the Government's efforts to secure arrangements that will ensure the new authorities interact and co-ordinate effectively with each other, as well as with firms and with the European Supervisory Agencies. These mechanisms will be critical to avoid regulatory gaps, so we are pleased to read new section 3D. There must be delineation of powers and responsibilities as between the FCA and PRA, and it must be clear how decisions will be made when the FCA and PRA disagree on the treatment of a dual-regulated firm.

We would ask for a clearer commitment about how often the PRA and the FCA will review its performance, particularly in the context the effectiveness of the co-ordination mechanisms that the regulators will implement to comply with section 3D. The regulators should each year disclose the results of this assessment in a joint publication. This report should be informed by feedback received from firms via a dedicated forum set up for the same purpose. The ultimate aim should be to report on the cumulative impact on dual-regulated firms of what we hope will not feel like two layers of duplicative supervision.

We welcome the new section 3E statutory MoU as a means of explaining how the regulators intend to comply with their duty to co-ordinate. We believe this to be an important document. As currently drafted section 3E(1) seems only to require the inclusion of a general explanation. The wording of section 3E(2) – 'the memorandum *may* in particular' [emphasis added] – makes other areas discretionary; this includes applications for or the variation of permissions, information gathering and collection of fees (2)(l), among others. Section 3E(2) should therefore be combined with section 3E(1) so that the legislation specifies basic mandatory contents.

Finally, we would seek clarification on the Government's intention when using the word 'public' in new section 3E(8)(b). This provides an exception to publishing information in the MoU if the regulators believe that any aspect is a technical or operational matter not affecting the public. Like members of the public, regulated firms are affected by, and as such are necessarily interested in, such matters. We could therefore be disadvantaged if technical or operational information is not published on the basis that it is of no interest to members of the public. 'Public' should be substituted with, for example, 'market participants'.

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

We agree with the 'almost unanimous industry view that there should be a single point of contact for regulatory processes'. The Draft Bill incorporates some helpful provisions in the context of authorisation but there is room for confusion. We therefore continue to support the BSA in calling for:

(1) a common gateway for dual-regulated firms in respect of authorisations, approvals, variations, waivers, notifications etc;

(2) the integrated regulated reporting system (GABRIEL); and

(3) a single regulatory handbook.

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

We welcome the Government's position that the PRA and FCA should bear joint responsibility for the FSCS, and to make it more accountable However, we would refer here to our response to question 3 and comments on the FSCS being subject to a creditors committee.

It is important to us that the regulators are able to assess the risk posed by firms under their supervision so that levies can be set on the basis of that risk-based assessment. We would likely support any proposal that allows for a fairer contribution from financial services providers based on the risks taken with customer deposits. Our contention with the current system is that the size of our retail deposit base dictates the size of the levy we pay – with no regard to the inherently low risk nature of our business. Building societies have always raised the great majority of their funds from traditional retail sources, and in any case are required to do so by law. We will therefore pay disproportionately more relative to our balance sheet size than those banks that have chosen to neglect their retail deposit base and instead rely excessively on wholesale funding and pursue higher risk strategies – the type of strategy which ultimately contributed to the financial crisis.

We also welcome the intention to retain the FOS, which has been a successful force in providing an appropriate and independent avenue to assist with consumer protection.

Comments on impact assessment

We support the BSA's position and comments in relation to the impact assessment.

NYSE Euronext's Response to the Government White Paper Entitled "A New Approach to Regulation: The Blueprint for Reform" (CM8083)

1. NYSE Euronext

1.1 NYSE Euronext is a leading global operator of financial markets and a provider of innovative trading technologies. NYSE Euronext's exchanges in Europe (Amsterdam, Brussels, Lisbon, London and Paris) and the United States provide for the trading of cash equities, bonds, futures, options, and other Exchange-traded products. NYSE Liffe is the name of NYSE Euronext's European derivatives business and is the world's second largest derivatives business by value of trading. It includes LIFFE Administration and Management, which is a self-clearing Recognised Investment Exchange pursuant to the Financial Services and Markets Act 2000 ("FSMA").

2. Executive Summary

2.1 NYSE Euronext welcomes the further opportunity provided by publication of the White Paper and draft Financial Services Bill ("the Draft Bill") to comment on the Government's plans to reform the system of financial regulation in the UK. As was the case during the public consultations which HM Treasury initiated on this issue in February this year ("the February Consultation") and July last year ("the July Consultation"), NYSE Euronext has focussed its comments on those aspects of the reforms which have a direct impact on core financial market infrastructure, particularly Recognised Investment Exchanges ("RIEs") and Recognised Clearing Houses ("RCHs").

2.2 NYSE Euronext is pleased to note that a number of the comments that it made during the February and July Consultations have been reflected in provisions of the Draft Bill. However, in NYSE Euronext's opinion other provisions of the Draft Bill need to be amended as, in their current form, they would have the **unintended effect of**:

(a) **overlooking the interest of the Financial Conduct Authority ("FCA") in post-trade activity** where this is relevant to the maintenance of contract and market integrity;

(b) **removing the legal basis for some business which is conducted today** under the auspices of an RIE, and thus threatening the continued operation of existing services such as NYSE Liffe's successful and innovative Bclear service; and

(c) **damaging the positive relationship between the statutory regulator on the one hand and RIEs and RCHs** ("Recognised Bodies") on the other, thus undermining their existing cooperative approach to market regulation.

2.3 These issues are explained in further detail in section 3 of this paper. For ease of reference, section 3 sets out the questions from the White Paper which are relevant to those issues (in bold italics), followed by an explanation of each issue (in normal type).

3. Questions Contained in the White Paper and the Issues Raised by the Draft Bill

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

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

3.3 Questions 2 and 11 are both relevant to the issues set out in paragraph 2.2 of this paper. Each of those issues is explained further in the remainder of this section of the paper.

FCA's Interest in Post-Trade Activity

3.4 As explained in its responses to the February and July Consultations, NYSE Euronext understands the underlying rationale for the proposed "twin peaks" approach, whereby the FCA will be responsible for regulating exchanges and other trading platforms and the Bank of England will be responsible for overseeing RCHs and settlement systems. However, as NYSE Euronext stated in its previous responses, trading, clearing and settlement cannot each be regulated in complete isolation as they are each a link in the same business chain. Activity in one link can and does have an impact on activity in the others. Moreover, certain functions, such as trade allocation, could be regarded as part of the trading link or, alternatively, as part of the clearing link.

3.5 In the case of on-exchange derivatives markets, like NYSE Liffe's, where contracts are held open for months if not years, regulation of the market must encapsulate both trading activity (i.e. the flow of transactions on a daily basis) and the stock of outstanding positions. Trading takes place on the regulated market, while resultant positions are held with the CCP. Such positions can and do have an impact on future activity on the market and issues concerning them are, in many cases, the key factors which must be managed actively in respect of the maintenance of contract and market integrity. The legitimate interest that the FCA should have in relevant areas of post-trade activity must therefore be explicitly acknowledged in its objectives and remit. There is currently no such acknowledgement in Clause 1D (The Integrity Objective) of the Draft Bill.

Damage to Existing Legitimate Business

3.6 In moving to a "twin peaks" approach, the Draft Bill must avoid undermining the basis on which legitimate business is conducted today. There is a danger that technical modifications to the current FSMA regime will inadvertently remove the legal basis for some of this business. For example, as a consequence of moving from a unitary regulator to a "twin peaks" regime, Clause 25(3) of the Draft Bill would remove the FSMA provision (section 285(2)(b)) under which exchanges currently operate "cleared only" services, such as NYSE Liffe's successful and innovative Bclear service.

3.7 Consistent with the objectives of the G20, such services have the beneficial policy effect of transferring business from the Over The Counter environment into the exchange/CCP environment. It is therefore a matter of significant concern that the legal basis for the future operation of such services in the UK is unclear as a result of the Draft Bill (e.g. whether such services can continue to be operated by an RIE or whether they can only be operated by an entity which has RCH status). Clarification is needed before the Draft Bill enters the legislative process in order to avoid damaging unintended consequences.

<u>Relationship between the Statutory Regulator and RIEs/RCHs</u>

3.8 NYSE Euronext believes that the proposed amendments to the existing approach to regulating Recognised Bodies requires further scrutiny.

3.9 As HM Treasury is aware, NYSE Euronext welcomed the Government's decision not to proceed with its original plans to dismantle the tailored regime for regulating Recognised Bodies and instead to carry forward the Recognised Body regime in the Draft Bill. In its response to the February and July Consultations, NYSE Euronext observed that there has been over two decades of experience with the operation of the Recognised Body regime and that, in NYSE Euronext's view, that experience has demonstrated the following:

(a) The current regime recognises the unique position of Recognised Bodies as front-line regulators of the member firms which use their facilities. As such, the Recognised Bodies are partners in regulation with the FSA. This has provided an effective framework for the maintenance of fair and orderly markets.

(b) The regime proved effective during the financial crisis. No Recognised Body was in distress – or in receipt of government funding – during the period of financial turmoil. On the contrary, the Recognised Bodies played an important part in managing the consequences of the default of major financial institutions, such as Lehman Brothers; and their markets continued to operate effectively and in an orderly and transparent manner, whilst liquidity in many other fora dried up.

(c) The legislative framework in most jurisdictions with major financial centres distinguishes exchanges and central counterparties on the one hand from users of their facilities (e.g. investment firms and banks) on the other, and subjects them to appropriately tailored regulatory obligations. Subjecting exchanges and central counterparties in the UK to a regime designed for investment firms and banks would have run counter to those established international standards and would have raised a question mark over the continued ability of UK-based exchanges and central counterparties to provide their facilities to their many users based outside the UK.

3.10 Whilst NYSE Euronext therefore welcomes the proposal to retain the Recognised Body regime, it also notes that the Draft Bill contains a number of modifications to the regime, all of which would have the effect of increasing the formal powers which the relevant regulator (i.e. the FCA in respect of RIEs and the Bank of England in respect of RCHs) will have over Recognised Bodies. The formal powers in question would allow the FCA and the Bank of England:

(a) to exercise a power of direction over Recognised Bodies without all of the existing checks and balances (Clause 27);

(b) to fine and publicly censure Recognised Bodies (Clause 28);

(c) to have additional rule making powers in relation to Recognised Bodies (Clause 26); and

(d) to require a Recognised Body to appoint a skilled person to prepare a report on any matter in relation to which the FCA/Bank of England could require the Recognised Body to provide information to it (paragraph 12 of new Schedule 17A inserted by Schedule 6, and paragraph 4 of Schedule 11).

3.11 In NYSE Euronext's view, the Government has not sufficiently justified such changes. Most significantly, it has not been able to point to any failures with the operation of the current regime which would be addressed by the imposition of the proposed new formal powers; nor is NYSE Euronext aware of any such failures.

3.12 The proposed new powers were described in the White Paper as "technical changes" to the regime[1]. However, NYSE Euronext believes that far from being merely "technical", such changes could, depending upon how they are implemented in practice, radically alter the nature of the cooperative relationship between Recognised Bodies and the statutory regulator, whereby the statutory regulator and the Recognised Bodies are currently partners in regulation, as described in paragraph 3.9(a) above.

3.13 Changing the nature of that relationship could prove to be counterproductive if it were to undermine the ability of the statutory regulator and the Recognised Bodies to work together effectively – making use of their respective knowledge, powers and regulatory reach - in the interests of the efficacy of the regulatory system as a whole. NYSE Euronext would therefore request the Government either to justify properly the proposed new formal powers – by demonstrating that they are intended to address identified failures in the operation of the current regime – or if, as NYSE Euronext anticipates, this cannot be demonstrated, to remove the proposed powers from the Draft Bill.

4. Next Steps

4.1 NYSE Euronext has raised the concerns set out in this paper with the Joint Committee on the Draft Bill, as part of the Pre-Legislative Scrutiny Process. It would also welcome the opportunity to discuss them further with HM Treasury, the Bank of England and the FSA.

8 September 2011

[1] Paragraph 2.35, page 20 of the White Paper.

A New Approach to Financial Regulation: The Blueprint for Reform

Overview - Thank you for the opportunity to be able to comment on these proposals. We fully understand the Government's rationale for the changes being put forward. We believe there are some operational aspects, especially for entities that will be regulated both by the FPC & PRA, that need to be refined if these proposals are to meet the Government's goals and achieve the desired benefits for the country, industry and Consumers. Critical in this respect is the need for co-ordinated open and honest dialogue between the FCA & PRA with the industry. Failure in this area could lead to excessive costs for the industry with no tangible benefit for Customers.

Co-ordination – We welcome the steps proposed so that the FPC and PRA keep each other informed and co-operate as required. We believe it is possible to go further in this area which will help the industry and should reduce costs. We believe that the regulators should form a common secretarial function/gateway into the two bodies. This should cover all areas of overlap including (but not exhaustive) applications for approval, variations to permissions, appointment of approved persons, reporting of standing data and fees, etc.

Rule book (s) - We fully understand that both the FPC and PRA will want to be able to shape the rules of their specific areas of interest, be it conduct of business or prudential. However, there are numerous other rule books such as SYSC or PRIN, etc that cover the interests of both parties. It would be beneficial for all parties and reduce the costs/possibility of inadvertent breach, if the two regulators could agree a common set of generic rules ideally in one rule book.

The starting point for both regulators should be the existing FSA rule book. This will benefit all parties in the industry by saving resources and helping avoid inadvertent error. Any changes to the existing rule books should be a conscious and clearly articulated decision, following normal consultation and cost benefit protocols.

New tools – We fully understand why the government feels it is necessary to provide the new regulatory authorities with further mechanisms to address some of the recent problems facing the industry. However, we believe it is possible to achieve a lot of its goals with its existing tools. It is essential to appreciate the long term nature of financial services especially when it comes to life insurance. Therefore, any new tools/standards put in place should be "time stamped" so that that any evaluation of adherence with regulatory objectives is considered in relation the rules applicable at time the contract was put in place.

Financial Ombudsman Service (FOS) – The respective ambits of responsibilities of both the FOS and the FCA should be clearly defined. The FOS should restrict its activity to adjudicating on individual cases. Any award by the FOS should be strictly compensatory in nature using publicised and evidence based scales with no punitive element

In consideration of any case the FOS should focus on whether or not the firm in question, has in the round, attempted to deal with the complaint fairly rather than act as a conciliation service. Current practice of making small changes in final settlement, where the FOS agrees with the outcome, wastes FOS resources which could be better spent on areas of real concern. This is also one of the factors in the increase of claims management company activity. We are concerned that false expectations are being created, resulting in delays in settlement with lower net compensation being provided to parties who have suffered substantive poor treatment

Should the proposal above not be acceptable any FOS (FCA) complaint publication should clearly articulate cases where it:

- Agrees with the decision made by the firm.
- Disagrees with the fundamental decision made by the firm.
- Substantively agrees with the decision made by the firm but has made a minor change to the settlement amount.

This will allow regulatory authorities to focus on substantive areas of Customer detriment

The FCA should take responsibility for resolving any/all potential broader regulatory issues coming out of complaints. There should be a clearly articulated process to facilitate review by the FCA of any potential broader regulatory issues coming out of complaints with appropriate industry input.

Any guidance or technical note from FOS which could have wider ramifications for the industry should be subject to formal consultation along the same lines as with anything published by FCA/PRA. We have reservations about the proposals for the FOS to publish reports on their determinations owing to obligations on firms to take account of FOS decisions. Any power to publish decisions should be optional rather than mandatory and should not be adopted until the FCA has had the opportunity to fully consult the industry on the matter

The FOS should be obliged to exercise its functions in a manner consistent with the FCA's strategic and operational objectives and regulatory principles. The FCA should conduct regular reviews of the overall FOS operations, policies and procedures. We do not see that this would in anyway compromise the operational independence of FOS on individual cases.

Claims Management Companies (CMCs) – These parties are playing an increasingly influential role in financial services. There is wide spread concern about the negative impact that some CMCs are having on consumers and the industry. There is evidence that Customers are incurring significant charges as a result of using CMCs without any tangible benefit being provided. This is a useful opportunity to transfer regulation from the MoJ to FCA and applying the same robust regulatory controls on these parties as the rest of the industry. They should also contribute to FCA/FOS costs in line with the demands they create on these bodies.

Mass detriment – We do not see the merit of putting in place a formal mechanism for nominated parties to refer issues that may be causing mass detriment to the FCA. Given the objectives of the FCA they will do this without requiring external parties to alert them. We are concerned about confusion and false expectation that may be caused by this proposal. As with CMCs we believe that Customers could actually be disadvantaged by the inappropriate conjecture created.

Consumer responsibility - We welcome the reiteration that consumers should take responsibility for their decisions. We believe it would be beneficial if consumer responsibilities here could be set out in a bit more detail so that all parties can factor these into their activities.

Differential approach to protecting different categories of Consumer – We fully understand the government goals here. We look forward to the details of how the regulator intends to achieve this and what the industry needs to do going forward to support these goals.

Enforcement – We are concerned about the early publication of disciplinary action against firms. We believe this could be counter productive in achieving a timely and mutually agreeable conclusion to regulatory breaches with significant negative reputational and financial impact on the firms concerned in areas such as share price, etc. In the event of any successful challenge to disciplinary action via the Upper Tribunal the tribunal should be able express an opinion on the original decision.

Consultation – We strongly recommend that both the FCA and PRA are obliged to fully consult on any rule changes unless there is a genuine emergency. Any consultation should include full cost benefit analysis. Controls should be put in place to ensure any change in stance by either regulator is published in a formal discussion or consultation paper so that all interested parties get to consider all potential ramifications.

Resources – It is essential that both the FCA and PRA are sufficiently resourced both in terms of bodies and skills to undertake their responsibilities. This is all the more important as the authorities move to a judgement based approach.

We fully support the carve out of responsibilities for the PRA in relation to with profits. However, taking into account these responsibilities and the natural focus on banks with recent events; it is essential that there is sufficient knowledge at a senior level in the PRA of life assurance.

Timetable – This is a very ambitious agenda for the industry especially with all the other activity in train. Whilst we are clear over the overall aspirations of the government, it is often the detailed rules which are the most problematic for the industry to adopt. We request that there is a clear 12 month gap between the publication of the detailed rule books of the regulators and when the industry needs to adopt the new rules.

Grandfathering – Virtually all the regulated entities on day one will have been approved and have been supervised by the FSA. It would be a highly desirable if the FPC and PRA could adopt a joint process that would allow the automatic approval of any existing individual/organisation, only requiring further information if and where there has been any changes by the party or additional requirements by the new regulators.

PLUS | SX

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

8 September 2011

Dear Sirs,

Response to HM Treasury's Consultation and White Paper 'A new approach to financial regulation: the blueprint for reform'

PLUS MARKETS GROUP

33 Queen Street
London
EC4R 1BR

t. +44 (0) 20 7429 7800
f. +44 (0) 20 7429 7801

plusmarketsgroup.com

Introduction

1. PLUS Markets Group plc ("PLUS") the parent of PLUS Stock Exchange, a Recognised Investment Exchange, has engaged with the Government's proposals for regulatory reform since mid-2010 and is pleased to see evolving proposals at the stage of a draft Bill and the desire for a whole scale revision of regulatory approach. These proposals aim to take account of past failures as well as take account of opportunities and challenges for the new regulatory structure. Our impression is that the regulatory structure outlined in the White Paper results from the Government paying attention to responses and feedback received from participants in the financial services industry as well as from consumer groups.

2. Having previously considered and responded in detail on some of the technical and structural aspects to the Government's proposals in some detail we'd like to focus on some aspects of the substance behind the proposed new regulatory architecture, particularly the regulatory approach and ethos of the new Financial Conduct Authority (FCA).

Financial Conduct Authority

3. We said in our response to the February consultation *A new approach to financial regulation: building a stronger system* that the basis for the conduct regulator, the FCA, is likely to be on a firmer footing since the Government progressed its proposals to ensure that the activity of consumer protection isn't given undue prominence at the expense of other areas within the FCA. Indeed we're pleased to see the framework outlined in the White Paper recognising that the FCA has a greater role specifically in relation to the needs of wholesale and retail market issues and having a role in removing barriers to entry and inefficiencies in markets generally.

FCA statutory objectives – high expectations

4. It is now quite clear that the Government has high expectations of the FCA and that these expectations, reflected in its statutory objectives, are much wider than consumer protection and a remedial and firm-specific approach to supervision.

5. PLUS is supportive of the proposed single strategic objective for the FCA (which will provide the regulator with clear clarity of purpose) at clause 1B(2) of the draft Bill together with the operational objectives set out at clause 1B(3). Our remarks at this

stage relate to the expectations which the Government proposes to place on the FCA and specifically certain of its statutory objectives, namely:

- The efficiency and choice objective (operational objective)
- FCA's duty to discharge its general functions in a way which promotes competition

6. We're not sure that the FCA should or will be in a position to promote innovation and competition but are certain that choice and innovation are a product of market forces and user demand. Choice and innovation are distinct from the FCA's proposed part to play in removing barriers to entry and inefficiencies: the FCA's intervention is wholly appropriate in the pursuance of these ends. If however it is determined that the FCA should play a meaningful role in facilitating choice and innovation and actively promoting competition this expectation is far from insignificant and the FCA needs to be sufficient for the task so as to be positioned at the forefront of developments and innovation. This is tall order for any large financial institution and the FCA will seemingly be subject to high expectations which it will be expected to meet.

7. In June of this year the FSA published the 'FCA Launch Document' which showed encouraging signs in terms of recognising the magnitude of the FCA's task and that the FCA will need to be supported and resourced with skills and knowledge in line with its likely statutory objectives leading to a culture based on judgement and sound analysis. In particular the Launch Document alluded to the need for the senior level within the FCA to benefit from sound comprehension of markets and how they interact with consumer behaviour. PLUS simply seeks to draw the Government's attention to the challenges for the FCA flowing from some aspects of these statutory objectives which are not insignificant and that notwithstanding a commitment to internal culture, ethos and resourcing appropriate to the tasks assigned it, the practical challenges for the FCA in terms of resourcing-up are nevertheless considerable. The FCA will bear the brunt of these challenges during the transition from a process-driven form of supervision to a judgement-led approach, an approach which in accordance with the FCA's statutory objectives aims to fathom new products and services in an environment where product innovation is a recurring theme.

Product intervention

8. We're supportive of the FCA's operating on a pre-emptive and intrusive model of conduct regulation albeit this basis and product intervention powers also place significant responsibility on the FCA to adapt itself to a framework where it is subject to a positive duty to intervene at an early stage where it considers that a product or product feature is likely to result in significant consumer detriment. At the same time we welcome the White Paper clarifying that the power will not generally be capable of being exercised to advance the integrity objective and that the FCA will be required to consult on and publish a statement of policy governing the circumstances in which it may make temporary product intervention rules.

Rule-making

9. PLUS is keen to ensure that the FCA in approaching rule-making or other forms of intervention contemplates possible adverse effects on the UK's financial services industry's ability to complete in a global competitive environment. It is also right that FCA should be tempered by a concern not to adversely disrupt the capacity of the financial sector to contribute to economic growth. Whilst we consider that the proposed statutory objectives for the FCA are reasonable we would urge the Government to consider how best to ensure that the FCA has regard to this concern.

Cooperation

10. The regulatory framework encapsulated in the draft Bill contains useful aspects designed to ensure that the PRA and FCA cooperate in the exercise of their respective regulatory functions. Many respondents to the previous consultations have voiced doubts over the robustness of the proposed framework in the event that the PRA and FCA fail to cooperate. Given the desirability to avoid repeating past submissions PLUS seeks in this response to the White Paper to impress upon the Government that attention needs to be given to the internal cultures and resourcing of the PRA and FCA to ensure that in addition to being sufficient to discharge their responsibilities given the high expectations to be placed on both organisations, a cooperative approach should permeate from senior management to front-line staff at the PRA and FCA. A revision of the regulatory framework cannot be limited to structural change.

11. The FSA is presently subject to a duty to cooperate with other persons who have functions similar to the Authority or in relation to the prevention or detection of financial crime (section 354 of FSMA). The FSA also benefits from section 349 FSMA which permits the disclosure of information to, among others, Recognised Investment Exchanges in the discharge of their regulatory functions. Our experience is that the FSA frequently shares information with PLUS Stock Exchange upon a request for disclosure being made albeit that obtaining disclosure can be an involved process as the FSA's internal culture lends against disclosure to even those persons contemplated by section 354. We've been disappointed on a number of occasions over the absence of pro-active cooperation which has featured instances where the FSA has failed to alert PLUS in relation to an investigation or intelligence in its possession material to our regulatory functions as an RIE, particularly in relation to our primary market function. Whilst our regulatory function recognises that there exists critically sensitive categories of intelligence that cannot be shared, the FSA has very rarely been unable to make disclosure upon being formally requested to do so.

12. The solution to these set of issues requires an internal step-change to ensure that the FCA can adopt a cooperative approach. At the same time the Government may do well to consider amendments to the existing information sharing gateways particularly section 349 to provide a specific positive obligation to disclose information which will or may assist the recipient in the exercise of its regulatory responsibilities - along the lines of the proposed section 354C provision (PRA's duty to provide information to Bank of England). Such an amendment could contain exemptions to permit the non-disclosure of critically sensitive categories of intelligence.

Recognised Investment Exchanges

13. PLUS has made lengthy submissions over the course of the last year in relation to the proposals for amendments to Part XVIII FSMA to introduce "technical improvements" to the Recognised Body regime and therefore we do not propose to add substantially to what has already been said.

Technical improvements to Part XVIII

14. No rationale for the introduction of these "technical improvements" has been made out and it is less than clear as to the failures in the Recognised Body regime the Government believes it necessary to address.

15. The proposed amendments are designed to provide for "vertical" and prescriptive supervision of Recognised Bodies and risk emptying Recognition of its substance in such a way as to undermine our effectiveness and the regulatory standards of our markets. These concerns are accentuated by clause 26 of the draft Bill which, if enacted, would enable the Treasury to confer on the FCA (or PRA as the case may

be) power to make rules for the purposes of the Recognition requirements. We're uncertain as to the intended application of this measure.

Self-clearing RIEs

16. We note with interest the apparent reversal since the previous consultation of the Government's intention to preserve the ability of RIEs to clear instruments traded on the markets we operate, as it is important to recognise that this development carries a number of implications.

17. The present climate places great importance on access to the clearing facilities of central counterparties which are viewed as a means of dampening systemic risk in the financial system. Indeed it is likely that the framework introduced by the forthcoming European Market Infrastructure Regulation (EMIR) will introduce a mandatory clearing obligation in respect of certain asset classes. In this context the Government realising the significance of clearing facilities, ought to recognise that any measures which limit the number of CCPs providing clearing services within the EU are likely to be counterproductive and represent a challenge for users in terms of obtaining access to clearing facilities.

18. Users seeking access to third party clearing facilities with respect to instruments traded on RIEs without self-clearing resources must have reasonable certainty of finding an outside clearer for such a purpose. This point may appear to be an unnecessary concern, but PLUS has first hand experience of just such a problem in trying to launch a new product. The ownership and governance of clearing houses are varied across Europe but in many cases are dominated by one group, or type, of owners such as another (rival) exchange or a group of large investment or commercial banks. It is entirely possible that the type of owners of these clearing houses may see a commercial disadvantage in allowing their clearing facilities to be used in this way as this business may threaten their own market position. If however an RIE is in a position to offer self-clearing facilities this significantly reduces the likelihood of products being "frozen out" of the market for reasons not directly related to the technical or product expertise of third party clearers declining access to their central counterparty clearing facilities.

19. We recognise European regulation (particularly EMIR) is likely to intervene by introducing a new set of prescriptive requirements for CCPs in the EU and that the requirements for RCHs are likely to undergo change to align with EU requirements. At the same time it is open to RIEs wishing to offer clearing services to apply to become Recognised Clearing Houses. However aside from being mindful of the burden of accepting an onerous authorisation process, many of the Recognition requirements to which RIEs are presently subject are unlikely to be at significant variance with future requirements for RCHs (augmented by EMIR) although there will be additional requirements and binding technical standards specific to the clearing activity. We therefore propose that should the Government press ahead with removing the concept of a "self-clearing RIE" in the revised landscape, RIEs applying for a Recognition Order to become a Recognised Clearing House should benefit from an efficient process and that compliance by an RIE with the Recognition requirements applying to it as an RIE will be taken as evidence that the RIE satisfies any equivalent Recognition requirements for Recognised Clearing Houses. This approach might be placed on a statutory footing so as to avoid unnecessary regulatory duplication for all concerned.

Concluding remarks

20. We hope that our input is useful and are available should you require us to expand on any of the above.

Yours Sincerely,

Godwin

James Godwin
Director of Regulation
PLUS Stock Exchange plc

pwc

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

8 September 2011

Dear Sirs

HM Treasury white paper: A new approach to financial regulation: the blueprint for reform

PricewaterhouseCoopers LLP ('PwC' or 'we') welcome the opportunity to comment on the white paper. Our general observations on the proposals where they are relevant to our business and experience are set out in this covering letter. Where we are responding to individual questions, this is set out in the appendix to this letter.

We responded to the previous consultation paper published in February. In this letter, as well as outlining our views on any new issues raised by the white paper and draft bill, we expand upon a few points that we made previously which we believe are particularly important.

Clear governance and accountability
In our view the overarching governance framework for the Bank of England, the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA) are critical to the success of the new regulatory model. The governance and accountability arrangements for the PRA and the FCA should be consistent, and should take account of the recommendations to be made by the Treasury Committee's inquiry into the accountability of the Bank of England.

International competitiveness
We believe that both the PRA and FCA should be required to 'have regard' to the competitiveness of the UK compared to other international financial centres. While it is important that the new arrangements enhance financial stability, it is equally important that the financial services sector can help support economic growth.

Co-ordination between the UK regulators and internationally
We believe that the PRA and FCA's respective objectives should include effectively co-ordinating their activities with those of ESMA, EIOPA, the EBA and other international bodies. The FSA and other UK regulatory bodies have a strong record of constructive engagement and influence in European and international bodies and the responsibilities under the new regime should enable this to continue.

PricewaterhouseCoopers LLP, 7 More London Riverside, London SE1 2RT
T: +44 (0) 20 7583 5000, F: +44 (0) 20 7822 4652, www.pwc.co.uk

We hope you find our response to the white paper useful. If you would like to discuss or clarify any matter in this response, please contact Pat Newberry (020 7212 4659), Anne Simpson (020 7804 8123) or Laura Cox (020 7212 1579).

Yours sincerely

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

pwc

The Bank of England and Financial Policy Committee

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

We believe that the role of the Financial Policy Committee (FPC) within the Bank of England's existing governance framework and its accountability for decisions should be made clearer. The Bank will have responsibility for both regulatory and monetary policy, which may conflict from time to time. The FPC will be a committee of the Court of the Bank of England, and will be required to take account of the Bank's overall financial stability strategy which will be set by the Court, whose members are Crown appointments. It is important that the FPC is publicly accountable for its decisions and, as noted in our response to the previous consultation, it would be prudent to set out a clear governance framework for the FPC, including a framework for managing conflicts between monetary and regulatory policy decisions.

The first report of the Interim FPC contained a number of recommendations which relate largely to financial reporting. We believe that while the FPC has a significant role to play in this area, any recommendations made by it should be required to take into account the existing framework for financial reporting, that is, UK GAAP, EU-adopted IFRS and UK Company Law.

3. *Do you have any comments on*

- *the proposed crisis management arrangements; and*
- *the proposals for minor and technical changes to the Special Resolution Regime as described above and in Chapters 3 and 4?*

The proposals for co-ordinating crisis management focus on co-ordination between HM Treasury, the Bank of England and the PRA. The draft Bill gives scope for the Memorandum of Understanding (MoU) to be extended to other parties, including the FCA. We believe that it is important for the FCA to be a party to the MoU.

If the FCA is not included in the MoU, there is a risk that in a crisis, the potential implications for consumers of any decision taken during the crisis might not be not fully and effectively evaluated, resulting in consumer detriment. One of the biggest challenges of managing a crisis of any financial institution is thoroughly considering the impact of any decision taken on its customers. None of the other authorities has protecting consumers as a specific remit, and therefore they are less likely to be in a position to fully analyse the impact on customers quickly in a crisis.

Also, the roles and responsibilities of the authorities, in the event of the failure of an FCA-regulated entity, are not clearly defined. We would expect that managing a crisis relating to any FCA-regulated entity would require the direct involvement of the FCA, to ensure that knowledge gained through supervision of that entity was readily accessible and taken into account. If a FCA-regulated group failed which had PRA-regulated subsidiaries, the FCA would need to be involved to ensure that the crisis management process was managed appropriately and effectively.

It would also be prudent to require the PRA to consider involving the FCA in crisis management where it deems it appropriate. We believe that it is not possible to predict in advance all types of entities which might prove to be systemically important in the event of a crisis. Also, it is possible that the failure of certain investment firms which will be prudentially regulated by the FCA could precipitate a crisis.

The Prudential Regulation Authority (PRA)

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

We welcome the inclusion of a specific PRA insurance objective, being: 'contributing to the securing of an appropriate degree of protection for those who are or may become policyholders'. However specific reference to policyholders makes the more general PRA objectives appear somewhat unbalanced, as the legislation does not specifically refer to other types of customers (e.g. depositors). We suggest that it would be appropriate to add similar objectives for the other types of businesses the PRA will regulate (i.e., deposit-takers and investment firms), for example regarding those who are or may become depositors.

We strongly believe that both of the new regulators should be required to 'have regard' to the competitiveness of the UK as a financial centre, so that the UK continues to remain an attractive and competitive place to do business as compared with other international financial markets. We believe that the new regulators need to allow a high level of choice in the UK financial services sector and to facilitate new entrants to the market, many of whom are likely to come from abroad. In particular, increased concentration in the banking industry following the financial crisis and the consolidation of banking groups is seen by many as having reduced competition to the detriment of consumers. We encourage HM Treasury to give the PRA, as well as the FCA, an objective to promote competition internationally and within the UK where this does not conflict with their other objectives.

As well as deposit-takers and insurers, the PRA will regulate systemically important investment firms, of which there are likely to be few. Using legislation to strictly define what is a "systemically important investment firm" may reduce flexibility and increase the risk that such firms are not appropriately identified. We recommend that it should be left to the PRA and FCA to consider each investment firm on a case by case basis where there is any possibility that the firm may be a candidate for PRA supervision. If a case arises where the PRA and FCA cannot agree then the FPC should act as arbiter.

Many groups will contain both deposit-takers or insurers and non-systemically important investment firms. To simplify regulatory oversight without increasing systemic risk, we recommend that HM Treasury allows deposit-takers or insurers to guarantee the liabilities of their non-systemically important regulated subsidiaries, thus taking all the group entities out of the scope of FCA prudential regulation. The liabilities of the non-systemically important group companies will be included in consolidated supervision and would also feature on a solo-consolidated basis in the guaranteeing entity.

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

Although the white paper noted that the accountability mechanisms for the PRA broadly mirror the existing provisions for the FSA, because the PRA will be a subsidiary of the Bank of England there is a fundamental difference in the governance structures between the PRA and the FSA. Regulatory and monetary policy will be concentrated within the Bank of England's group. It would be prudent for HM Treasury to consider the processes for appointment and removal of members of the Court of the Bank of England, the Governor, and for ensuring that the Court and the Governor are appropriately accountable and that their decision-making process and outcomes are transparent and public, particularly in times of crisis. In developing the governance and accountability structures of the PRA, the Government should take account of the recommendations to be made by the Treasury Committee's inquiry into the accountability of the Bank of England.

The white paper demonstrates that the Government believes that the PRA should be free to decide what mechanisms it wants to use to engage with industry. However, we continue to believe that it would be appropriate for the PRA to retain the existing practitioner panels, particularly with respect to capital.

Financial Conduct Authority (FCA)

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

The draft Bill rebadges the FSA as the FCA. We noted that in the draft Bill, the definition of 'the Authority' (i.e., the FSA in the extant FSMA) in section 417 has been deleted but some references to 'the Authority' remain in the text. Throughout the Bill, it is important that references to the FCA and PRA are precise. In particular, as an auditing firm we note that the requirement to report matters of material interest to the regulator is to 'the Authority' and therefore ask that the text relating to the auditors' right and duty to report is clarified.

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

The purpose of and justification for the FCA's new power to issue warning notices before enforcement action is taken against a firm or indeed before the existence and/or nature of breaches has been confirmed is unclear. It seems likely that in most cases, the FCA's other powers regarding product intervention as set out in section 137C of the draft Bill would be more appropriately used to prevent the most severe cases of consumer detriment.

If the FCA issues warning notices in circumstances where it has not fully investigated the facts, it may risk unfounded reputational damage to firms, which could have a long-term detrimental impact on the firm. In some cases, such action could even undermine rather than facilitate financial stability. We suggest that the FCA's powers to issue warning notices should be limited to cases where there is immediate potential detriment to consumers or counterparties, which cannot be mitigated through the use of the FCA's product intervention powers.

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

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

15. *Do you have any comments on the proposals for the FSCS and FOS set out above and in Chapters 3 and 4?*

We broadly welcome the proposals and in particular the requirement for the FCA to publicly respond to issues which may cause mass detriment which are brought to its attention. However, we are also concerned that the current proposals could be seen as a downgrade of the role of Financial Ombudsman Service (FOS), if it had no role on mass issues other than referring them to the FCA and/or the ability of individual consumers to access FOS were eroded. The FCA's stance on particular issues should not in any way prevent individuals bringing appropriate cases to FOS based on specific facts and circumstances. Currently no procedure for review or appeal of FOS decisions exists. We believe that it would be appropriate for FOS decisions on individual cases and FCA decisions on mass issues to be able to be challenged, either through the Courts or another appropriate means of appeal.

We also recommend that HM Treasury clarifies which parties would be able to bring issues that may be causing mass detriment to the FCA's attention.

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

We welcome the inclusion of a competition objective and mandate for the FCA. However, the FCA's competition mandate appears to focus on competition within the UK market and the benefits for consumers with regards to cost and product innovation. However we continue to strongly believe that the FCA (and the PRA, as stated in our response to question 4 above) should be required to have regard to the competitiveness of the UK market *vis-à-vis* overseas markets (excluding the EEA).

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

The FSA and HM Treasury have made it clear that the FCA will be a more interventionist regulator than the FSA. Currently, the UKLA can only resort directly to enforcement action against issuers. We see introducing skilled persons appointment powers as a proportionate response to providing the FCA (in its capacity as UKLA) with the appropriate tools to conduct investigations. The s166 regime has proved to be a valuable tool in the financial services industry.

Whilst there will be a cost arising this will be borne by the entities subject to skilled person reports, rather than by the wider industry through levies on all issuers.

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

The governance and accountability structures for the FCA should be consistent with those of the PRA, and, as noted at 4 above, take account of the recommendations to be made by the Treasury Committee's inquiry into the accountability of the Bank of England.

The transparency arrangements for the FCA (and the PRA) should also allow that, in exceptional circumstances, decisions may quite properly need to be taken without full public disclosure, where such disclosure would conflict with the FCA or PRA's objectives.

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

In our response to the previous consultation, we recommended that the MoU between the FCA and PRA should take account of areas of regulation which are likely to fall within both regulators' remits, such as the existing SYSC, PRIN, APER and BIPRU books. We continue to believe that in areas where there is joint responsibility —and where the regulators will inherit identical existing rules — there should be joint rule-making. Firms will also need to consider the impact of European Regulations and European Binding Technical Standards. Under the current proposals, which leave the level of co-ordination to the regulator's discretion, dual-regulated firms and groups will need to ensure compliance with three potentially conflicting sets of rules. Since this is likely to be unduly burdensome we continue to believe that the PRA and FCA should be required to 'have regard' to consistency in their rules, set out in legislation or formally in the MoU.

In some cases, rule-making which focuses on the regulators' primary objectives could conflict, for example with regard to competition and financial stability, and in these instances the regulators will need to agree on rules which can meet both their objectives. Currently, for example, it is not clear on how consultation between PRA and FCA on with-profits business should work. With-profits business has both a consumer protection and prudential implication. We hope that more concrete proposals for dealing with this and similar issues are made public shortly.