Dear Sirs
I have heard from the Financial Services Authority that you are interested in hearing the views of regulated firms with regard to your proposed regulatory change in the financial services markets.
I have read your consultancy paper 'A new approach to financial regulation'.
I run a small mortgage brokerage firm arranging mortgages from the whole of the market on a non advised sales basis.
I am happy to see that the changes process put forward by Mr Osborne has started on schedule.
There are three points that I would like to see considered, not just in the area of mortgages but all credit arrangements.

1. All consumer borrowing should be regulated by the same body.

This means bringing in credit cards, personal loans, car leases, catalogue borrowing, store cards, buy to let mortgages, secured loans and credit clubs.
The reason I say this is because there are different regulations for these that have no real benefit to consumers and I believe this fuels over borrowing leading to financial difficulties that are often blamed on mortgage borrowing. Consumers are offered credit with almost no affordability checks and/or without regard to the level of borrowing a consumer already has. This is most common with credit cards.

2. APR should be revised to show the real cost of borrowing because

from my experience over many years, consumers do not understand APR.
Lenders quote APRs when no additional fees are payable separately but added to the loan, for example. This is not correct. It is particularly noticeable in mortgage lending. I would suggest a new rule BPR which is Borrowing Percentage Rate and should show what percentage of the loan added or separate fees are for obtaining the loan. This way borrowers can compare the actual interest rate and whether charges are competitive and make better informed decisions than by using a system that almost no one understands.

3. The current FSA Treating Customers Fairly has a nice sound to it

but consumers do not actually understand what this means. From my experience all the matters that consumers are unhappy about, for example poor service, delays in processing applications, decisions to lend that are withdrawn, the time it takes to arrange a loan or mortgage, unclear criteria and errors in documentation that cause problems are not covered by the current TCF rules. When telling clients what TCF actually stands for most are surprised and believe these rules to be a whitewash for poor consumer service.
In my view treating customers fairly should and must cover all aspects of how a transaction is managed by lenders, intermediaries and advisers.

I hope this information is of use to you.
Regards
Maurice Edgington
Director
Tricon Limited

EQUITAS

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

14 October 2010

Dear Sirs

I write in response to your request for comments on the document entitled A New Approach to Regulation: judgement, focus and stability. I am writing in my capacity as Chief Executive of the Equitas Group and with the support of the Board of the Equitas Group and the Trustees of the Equitas Trust which owns the Equitas Group.

The Equitas Group was formed in 1996 as part of the Lloyd's Reconstruction and Renewal Plan to reinsure the liabilities of Lloyd's of London syndicates allocated to the 1992 and prior years of account, other than life syndicates, and to perform the run-off of these liabilities. Details of the companies in the group, their respective roles, and a brief historical note are attached at Appendix 1. The Equitas Group carries out no new business of any kind; nor does it participate in markets or engage with retail customers. The overriding issue for regulation of the Equitas Group is whether valid claims are being and will continue to be paid.

The regulatory issue for the Equitas Group of regulated companies, in common with other runoff entities concerned with wholesale insurance business is, therefore, that of prudential regulation. None of the Equitas companies has any material business with consumers, nor, hence exposure to conduct of business regulation.

We welcome the statement in the consultative document that the framework now proposed will "support and facilitate a new more judgement-led style of prudential regulation". The Equitas Group has some unique characteristics that have been the subject of intense scrutiny by regulators over the years. For any company in run-off, particularly one as unusual as Equitas, the application of rules and legislation – whether old or new – often requires judgement and discretion on the part of regulators to ensure that unintended and unfortunate consequences do not occur.

We are therefore concerned with the proposal that the Consumer Protection and Markets Authority will have responsibility for the conduct of business regulation of all financial institutions. The wording implies that this will happen regardless of whether a firm faces significant conduct of business issues and therefore somehow that the PRA will be subordinate to the CPMA, in spite of the overarching systemic risks against which the PRA is tasked with defending.. There seems to be a clear case for applying a concept of materiality before subjecting a firm to CPMA regulation. Equitas would surely fall under any reasonable de minimis classification since it has no dealings with consumers or with wholesale markets. Indeed for any solvent companies in run-off, CPMA regulation may well be very heavy handed.

Our final concern is that the CPMA and the PRA will set fees in respect of the activities under their remit; and that the CPMA will be responsible for making rules for industry funding of FOS, FSCS and CFEB. The ombudsman, compensation schemes and consumer education are all concerned with the present and the future. Companies that are already in run-off are rooted in the past, and it would be impossible to justify raiding their resources to support these three causes.

Yours faithfully

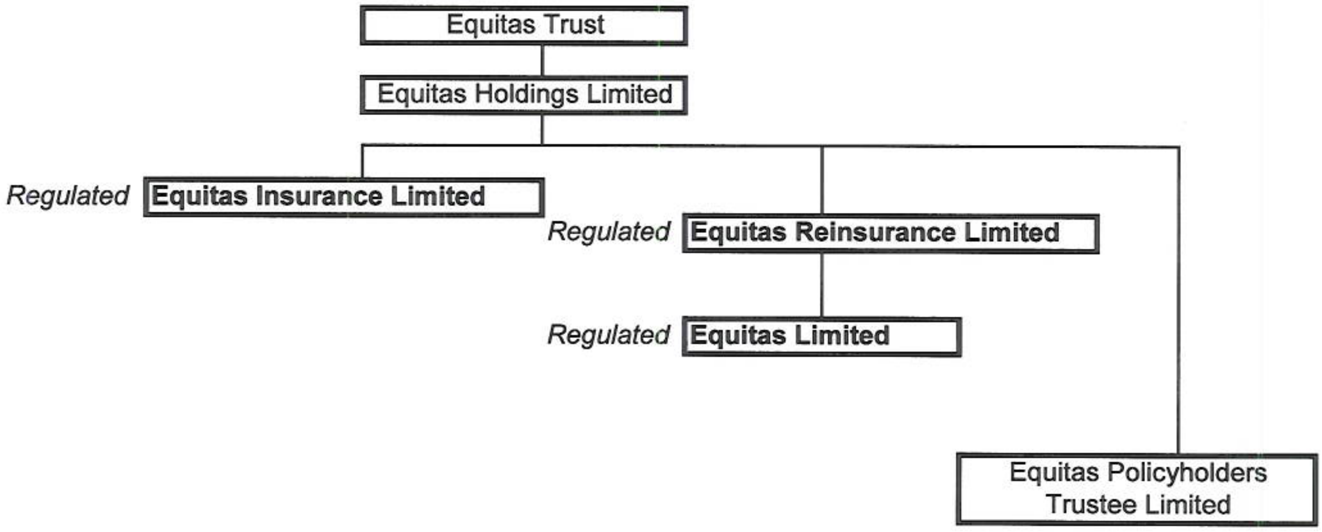
Jane Barker

Chief Executive

Appendix 1

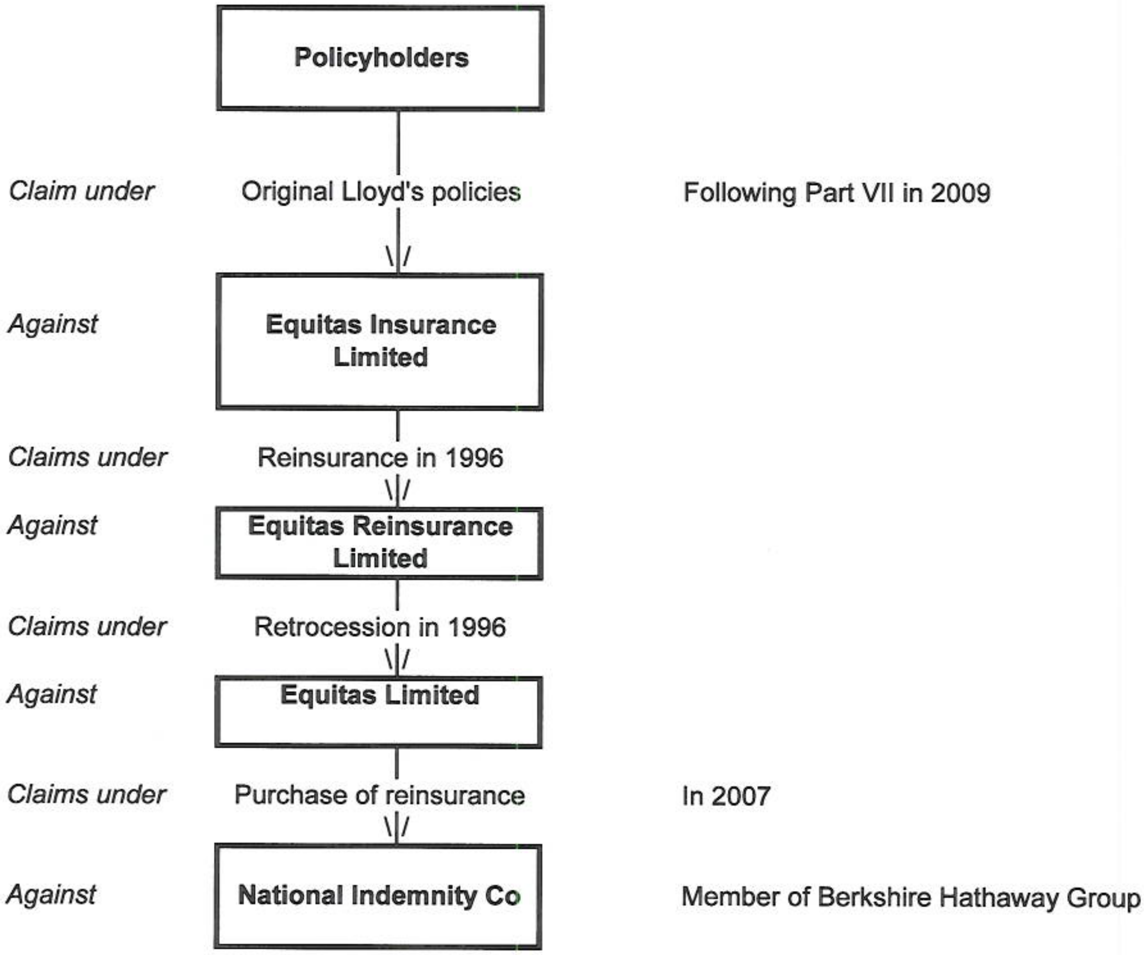
Equitas Group

Legal Structure



Equitas Group

Legal relationships associated with claims



14.10.10

Appendix 1 A Brief Historical Note

As part of the Lloyd's Reconstruction and Renewal Plan, Equitas Reinsurance Limited reinsured the 1992 and prior years' non-life business of all Names and retroceded that business to Equitas Limited in 1996. Equitas Reinsurance Limited and Equitas Limited are authorised as reinsurers and regulated under the Financial Services and Markets Act 2000 (FSMA) by the Financial Services Authority. In 2009, Equitas Insurance Limited (a new company wholly owned by the Equitas Group and regulated by the Financial Services Authority) accepted the transfer of Lloyd's Names' 1992 and prior years' business under Part VII of FSMA.

In 2007, Equitas Limited purchased $5.7 billion of reinsurance cover over and above the existing Equitas reserves from National Indemnity Company, a member of the Berkshire Hathaway group of insurance companies. At the time of the Part VII transfer in 2009, a further $1.3 billion of additional reinsurance cover was purchased. At the last balance sheet date (March 31st this year) $6.2 billion of additional reinsurance cover was available over and above the estimate of claims outstanding.

All three regulated entities have the same level of claims outstanding, with Equitas Insurance Limited holding the liability to policy holders, Equitas Reinsurance Limited having reinsured the liabilities of Equitas Insurance Limited and having retroceded those liabilities to Equitas Limited. Equitas Limited has purchased reinsurance from National Indemnity Company. All three companies are in solvent run-off and none of them has underwritten any business other than the 1992 and prior years' business of Lloyd's of London syndicates.

Even when the group was first set up in 1996, the business which Equitas took over was predominantly wholesale. Its retail business was very limited, short-tail in character, and ran off fairly quickly. Today, 18 years after this run off exercise began and the last policy was written, only long-tail business remains. None of the Equitas companies participates (or ever has participated) in wholesale financial markets.

euroclear

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London, 18 October 2010

A new approach to financial regulation

Dear Sir/Madam

This response is provided on behalf of Euroclear UK & Ireland Limited (***EUI***) which, as you will be aware, operates the CREST system, the UK's securities settlement system. EUI welcomes this opportunity to respond to the consultation regarding the proposed new approach to financial regulation set out in the July 2010 paper (the ***consultation document***).

In this response we do not address all the questions raised in the consultation document. We have focussed our response on those areas of particular interest or concern to EUI or in relation to which EUI has knowledge and experience to contribute.

Summary of key responses

In summary, EUI wishes to make the following key responses to the consultation document:

- the proposals for oversight of EUI are not clear. EUI is very concerned that they may lead to an unnecessarily burdensome and duplicative regulatory regime, with EUI subject to two overlapping, general regulators;
- we agree there are clear synergies which support regulation and oversight of clearing and settlement to sit with the Bank of England. On the basis of the proposals, we are concerned that there is no clarity on the precise regulatory objectives of both the bank and the CPMA in respect of EUI's activities. Our preference would remain a single regulatory body responsible for the oversight and regulation of EUI and all other RCHs ;

- insufficient detail is provided regarding proposals for reform of the 'recognised body' arrangements. We consider that recognised body status must be maintained for EUI, given its market infrastructure role;
- The markets division of CPMA must be established as a strong, credible and independent regulator of wholesale markets in order to be credible within ESMA. Clear mechanisms will be needed to ensure appropriate, informed representation in relation to clearing and settlement issues at ESMA.
- A single regulatory body should be responsible for the regulation of EUI both as a Recognised Body under FSMA and also as an Operator under the Uncertificated Securities Regulations. Any proposed future review of these two regimes should await the proposal from the Commission for a CSD Regulation (which is currently due in June 2011).

We set out below the consultation questions with EUI's detailed responses.

The Bank of England and Financial Policy Committee (FPC)

1 Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?

2 If you support the idea of secondary factors, what types of factors should be applied to the FPC?

3 How should these factors be formulated in legislation?

The FPC should operate with a clear primary objective. However, given the potential impact of its work in the financial services sector, this objective must be supported by a set of clear secondary factors to which the FPC should have regard. This should include a principle of proportionality and consideration of the impact of its work on competitiveness.

In order to ensure the necessary levels of co-ordination within the proposed new framework, these should include the need to have regard to actions taken by the PRA (and CPMA).

Prudential regulation authority (PRA)

4 The Government welcomes respondents' views on:

- ***whether the PRA should have regard to the primary objectives of the CPMA and FPC;***
- ***whether some or all of the principles for good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice, should be retained for the PRA;***
- ***whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and***
- ***whether there are any additional broader public interest considerations to which the PRA should have regard.***

There will inevitably be an overlap of roles and responsibilities between the PRA and CPMA, in addition to the close link between prudential oversight and conduct-related oversight. It is therefore essential that the PRA has regard to the objectives of the CPMA to ensure coordinated operation of the new arrangements.

As with CPMA, we consider that the existing principles for good regulation should apply in relation to the PRA. These establish a sound basis for a balanced approach by the regulator taking into account relevant considerations.

We do not consider that innovation or competitiveness are overriding considerations in exercising regulatory powers. Financial stability and consumer protection concerns should prevail where necessary to avoid harm. However, we do consider that the relative position of UK financial services compared to European or other international markets must be taken into account by regulators in exercising their functions. We therefore consider that the requirement to have regard to potentially adverse impacts on innovation or competitiveness should be retained.

Where it is proposed that the Bank of England (as distinct from the PRA) has a regulatory or supervisory role, the same considerations apply. This must also be subject to a clear requirement for the Bank to have regard to the objectives of the CPMA.

5 Is the model proposed – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?

The authorities should be established as independent and autonomous regulators of their respective responsibilities.

However, there will be a large degree of overlap in the activities of the PRA and CPMA, both at a policy level but also at a supervisory level. Activities will need to be closely co-ordinated, in order to avoid or reduce duplication (or underlap) and uncoordinated activity.

EUI welcomes the various proposals in relation to the interaction between the regulators. These high level principles will need to be carried through to effective detailed mechanisms.

6 Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focussed approach to supervision?

7 Are safeguards on the PRA's rule-making function required?

8 If safeguards are required, how should the current FSMA safeguards be streamlined?

EUI considers that the current mechanisms and safeguards in relation to FSA activity and rule-making must be maintained in relation to the PRA. The consultation paper does not elaborate on potential justifications for differential safeguards. We do not see on what basis prudential decision making should be subject to a lower level of accountability and scrutiny compared to existing prudential decision making by the FSA (or to non-prudential regulatory processes by CPMA).

The same concerns apply in relation to regulatory decision making by the Bank of England (as distinct from the PRA) as regulator of clearing and settlement, which should also be subject to equivalent safeguard and transparency mechanisms.

9 The Government welcomes views on the measures proposed which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.

EUI welcomes proposals which will ensure the PRA is a transparent, operationally independent and accountable.

Consumer protection and markets authority (CPMA)

10 The Government welcomes respondents' views on:

- ***whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC;***

- ***whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which;***
- ***whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and***
- ***whether there are any additional broader public interest considerations to which the CPMA should have regard.***

As we have noted above, given the overlap of roles, information and decision making, it is essential that the CPMA has regard to the objectives of the FPC and PRA (and, where distinct, the Bank of England in a regulatory capacity) in the interests of close and effective cooperation.

We also consider that the existing principles for good regulation should be retained in relation to the CPMA. These establish a sound basis for a balanced approach by the regulator taking into account relevant considerations.

Our comments above in relation to innovation and competitiveness considerations for PRA apply equally to the CPMA. We therefore consider that the requirement to have regard to potentially adverse impacts on innovation or competitiveness should be retained.

Regulators should also be obliged to take into account the impact of their actions on competitiveness within in the UK. In particular, firms carrying out similar activities should not be subject to unequal requirements which impose competitive disadvantages.

11 Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?

EUI welcomes proposals designed to ensure that the CPMA operates as a strong, transparent, accountable and independent regulator whose rules and supervision do not cause duplicate regulation for those firms also regulated by or overseen by the Bank of England. It is essential that CPMA wholesale markets division is both independent and credible, and that the CPMA is seen to have equal regard for its twin roles as both a consumer and markets regulator. As noted below, this is particularly the case given CPMA's role as the UK ESMA representative.

12 The Government welcomes views on the role and membership of the three proposed statutory panels for the CPMA.

EUI has not responded to this question.

13 The Government welcomes views on the proposed funding arrangements, in particular, the proposal that the CPMA will be the fee- and levy-collecting body for all regulatory authorities and associated bodies.

EUI agrees with the proposal for all fee and levy-collecting activity to be conducted by one body.

14 The Government welcomes views on the proposed alternative options for operating models for the FSCS.

EUI has not responded to this question.

Markets and infrastructure

15 The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.

Proposed division

The proposed division of responsibilities for markets and infrastructure is not clear from the consultation document, particularly in relation to CCPs and settlement systems. It is therefore difficult to respond without additional information being provided on the proposals. Further consultation will be required when the proposed division is more clearly elaborated.

As you will be aware, EUI is currently:

- a 'recognised clearing house' under the Financial Services and Markets Act 2000, subject to the Recognition Requirement Regulations[1] (***Recognition Requirements***) and regulation by the FSA in accordance with the REC sourcebook (***REC***);
- an 'operator' of a securities settlement system under the Uncertificated Securities Regulations[2] (***USRs***), subject to the detailed requirements of those regulations and regulation by the FSA;

[1] Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) Regulations 2001.
[2] Uncertificated Securities Regulations 2001.

- an 'inter-bank payment system' under the Banking Act 2009, subject to 14 high level principles and regulation by the Bank of England;
- a 'designated system' under the Settlement Finality Regulations[3] (***SFRs***), subject to oversight by the FSA.

This structure already entails duplication of information provision, oversight and reporting to both the Bank of England and FSA (for example with parallel 'ARROWS' and 'Expectations Letter' processes).

If settlement systems are to be subject to a single regulator (rather than a dual regulator regime), EUI agrees there are clear synergies which support oversight by the Bank of England. These include: EUI's systemic importance; the already existing payment systems oversight role of the Bank; the close technical and operational interaction between the CREST system and the Bank of England's RTGS system; the essential role played by the CREST system in the Bank's market operations; and the close relationship with the operation and oversight of CCPs.

Uncertainty on basis of regulation

The consultation document proposes a transfer (from the FSA) of the "regulation and supervision"[4] of settlement systems to the Bank of England (ie not the PRA). The document does not elaborate on what this "transfer" entails and it is therefore unclear whether this includes all aspects of current regulation by the FSA (ie Recognition Requirements, REC, USRs and SFRs roles). To be able to respond fully, this must be clarified at a further stage of consultation.

The document states the USRs and SFRs regimes "are to continue largely unchanged"[5]. Again it is not clear what this means: are there to be changes, and which authority is intended to be responsible? We note that the Bank of England indicated in discussion with RBs that USRs oversight is to pass to the Bank.

The Recognition Requirements (along with REC) and the USRs are very closely aligned and to a large degree set out mirror requirements. It is therefore essential that the Recognition Requirements and USRs are overseen by the same regulator. Given the overarching principles on which they are based and the close inter-relation between their various provisions, it is also essential that the Recognitions Requirements applicable to EUI (and the USRs requirements) are not split into separate parts overseen by separate regulators.

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[3] Financial Markets and Insolvency (Settlement Finality) Regulations 1999.
[4] Paragraph 5.4.
[5] Paragraph 5.17.

We note above, in relation to PRA, that existing processes and safeguards should be maintained to ensure an accountable and transparent regulatory process. These considerations apply equally in relation to Bank of England regulation and supervision. In particular, this must be subject to explicit cost-benefit analysis to ensure a proportionate approach is adopted which does not impose overly burdensome information requests or expectations outweighing potential systemic benefits. The Bank of England should also be required to have regard to the objectives, requirements and functioning of other regulators.

EUI would be very concerned if Bank of England regulation of settlement systems was to be other than on the basis of the clear requirements of the Recognition Requirements and USRs. We do not consider that an extension of the high-level and uncertain non-rules-based payment systems oversight approach is merited, nor would it provide improved systemic oversight. Any lack of clarity would greatly increase the regulatory uncertainty and burden for EUI.

Although not included in the consultation document, HM Treasury indicated in discussions with RBs that the Banking Act payment systems oversight regime was also subject to review at this time (although this is not indicated in the consultation paper). It is not clear to what extent there will be rationalisation of the payment systems oversight functions with the proposed new general regulatory oversight of the Bank for settlement systems. Clearly there is scope for such rationalisation where one regulator is overseeing one entity under two separate regulatory regimes. EUI welcomes such a review and supports the reduction in regulatory overlap and burden that could be achieved if such a rationalisation was carried out. Such a review, however, must be carried out in parallel with the likely regulatory changes for CCPs through EMIR (currently in co-decision) and the future CSD Regulation (due to enter co-decision in the summer of 2011).

Potential role of CPMA

Although setting out a clear objective – of regulatory oversight of settlement systems passing to the Bank - the consultation document goes on to state that the CPMA will have responsibility for "any conduct aspects of clearing houses and settlement systems"[6]. It is not clear what this means or what role is actually intended for CPMA.

Although the consultation document states that supervision of market infrastructure will follow the same general principles as for any other type of regulated entity, this is not the case. Other prudentially important regulated entities will be subject to a clear prudential-based oversight by the PRA and conduct-based oversight by the CPMA. This clear delineation of roles is not provided for CCPs and settlement system oversight. The proposal is apparently therefore that the Bank of England will be a general regulator of settlement systems, but with the CPMA also having some form of general regulator role. It is not at all clear what "conduct aspects" means in the context of EUI, which is not subject to conduct-of-business type rules given its role and the nature of its relationship with system members (and why would all relevant issues not be covered by the Bank of England in its general regulator role?). Equally, "prudential requirements" does not have clear application to EUI as it is not itself a party to market contracts and does not have credit risk on settlement. Nor is it clear how responsibilities would or could be divided between the Bank of England and the CPMA (we refer above to the necessity of keeping REC and the USRs together and in one piece).

EUI is therefore very concerned that as currently formulated the proposals will lead to entirely duplicative regulatory regimes, exacerbating the existing duplication of regulation. We see no systemic or financial stability benefits that would be met be such duplication (and no justification for this uniquely disproportionate treatment has been elaborated).

We would also note that this is in the context of a low risk market infrastructure operator which has been subject to no regulatory failings. The CREST system continued to operate highly effectively throughout the financial crises. Imposing dual regulators is therefore both unnecessary and unwarranted.

CPMA's market division

EUI is concerned that the establishment and positioning of the CPMA as "a strong consumer champion in pursuit of a single objective"[7] will be to the detriment of its additional role as regulator of wholesale markets. We are also concerned that PRA powers to override decisions of CPMA mark it out as a second-tier regulator.

The CPMA's markets division must be established as a strong, credible, informed regulator of wholesale markets. This role must clearly be of equal standing alongside consumer protection functions.

ESMA representation

With regulation and supervision of CCPs and settlement systems passing to the Bank of England, CPMA will not be primary regulator of the full end-to-end securities market process (ie trading, clearing and settlement). CPMA's knowledge and rule making power in relation to clearing and settlement will

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[6] Paragraph 5.16 first bullet. This is presumably intended to refer to CCPs and settlement systems, given EUI's status as a 'recognised clearing house'.
[7] Paragraph 4.3.

necessarily be indirect. We do not see that providing some form of duplicative but subsidiary regulator role to the CPMA in relation to CCPs and settlement systems is a solution to this issue.

EUI is very concerned that this split will negatively impact CPMA's role as UK representative to ESMA and consequently significantly reduce effective representation at EU level, at a time when ESMA will have direct rule making powers in relation to clearing and settlement. We therefore consider it essential that there are clear and robust mechanisms for ensuring that UK representation at ESMA is informed and respected. This should include clear cooperation and consultation mechanisms, and Bank of England attendance on behalf of CPMA in relation to all clearing and settlement related issues. We would welcome further elaboration and consultation on such safeguards.

16 The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.

Rationale for current arrangements

The 'recognised body' (***RB***) regime[8] was originally established:

- to recognise the distinct 'infrastructure' role of RBs as low or non-risk taking market services, in contrast with standard investment firms[9];
- to reflect the regulatory functions of RBs, setting rules, ensuring orderly and efficient operation and providing neutral oversight of the market or system which they operate. This role is the responsibility of each of the RBs because they are the entity best placed to do so based on their knowledge, experience and position. Together, the RBs are essential components of the UK regulatory framework;
- to provide a flexible framework to support the distinct and unique business models of each of the RBs;
- to allow close and detailed cooperation between RBs in the interests of the orderly operation of the financial system;
- to provide a close and continuous relationship with the FSA, with detailed oversight and information provision.

[8] Under Part 18 of the Financial Services and Markets Act 2000.
[9] Ie those authorised under Part 4 of the Financial Services and Markets Act 2000.

All of these considerations continue to apply and, contrary to the assertion of the consultation document, these factors very clearly distinguish infrastructure from large financial services industry firms. Competitive developments in certain aspects of the liquid equities markets do no negate these factors in relation to equity exchanges (and certainly do not do so in relation to other exchanges, CCPs or settlement systems).

The RB arrangements have been proven to operate very successfully over a number of years. Unlike other aspects of the financial services industry, they continued to do so throughout the financial crises.

The exempt regime provides a highly effective and cooperative framework for interaction between the regulator and the RBs. The FSA has general rule making powers in relation to information and notification requirements[10], which in any event is facilitated by the open and close supervisory relationship. The regime also includes effective 'key individual' arrangements.

Consultation proposals

The consultation document does not identify any areas of the current RB regime where shortcomings or regulatory failures have been identified. In discussions, the FSA was unable to indicate any scenarios (whether actual or hypothetical) where a regulatory failure, or sub-optimal regulatory outcome, resulted from inadequacies in the current arrangements. No specific areas of inadequate information provision were identified. The Government's actual proposals or options in relation to rationalisation have not been set out in the consultation document (we understand from subsequent discussions that the Government is actually considering abolition of the RB regime entirely). In particular, no explanation has been provided as to how rationalisation will improve financial and systemic stability or efficiency. In the absence of any such explanation, we are very concerned that any change would in fact negatively impact financial and systemic stability.

Without understanding the rationale or objectives behind abolishing or revising the existing regime, or what the rationalisation proposal actually is, it is therefore difficult to comment. Further explanation and consultation by the Government is essential for an informed assessment to be made in relation to this critical framework for financial services infrastructure.

Complexities in revising the current arrangements

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[10] Financial Services and Markets Act 2000 section 293. See also REC Chapter 3.

Additionally, EUI is concerned that the outline proposal to 'rationalise' the regime has not considered the complexities of the existing regime and would lead to a number of unforeseen consequences. These would include:

- the need to continue distinct provisions in relation to the unique role and responsibilities of current RBs, whilst carving out RBs from a number of aspects of the authorised firm regime. This may create a more complex and cumbersome authorised firm regime;
- the complexities of identifying the specific regulated activities carried out by each of the existing RBs and the complications that may result from this;
- how the existing regulatory functions of RBs would be dealt with and how statutory immunity in relation to those regulatory functions would be incorporated into the general authorised firm regime;
- how current inter-RB and RB-regulator information portals would be maintained and distinguished from other authorised firms;
- impact on RBs' rules in relation to their members;
- implications of extension of Part VII of the Companies Act 1989 to a wider range of authorised firms;
- increased rigidity and inability to cope with market developments, particularly in crises situations;
- creating a discrepancy between the regulatory regime for exchanges, CCPs and settlement systems in the UK from the arrangements in other jurisdictions (no other European country treats core market infrastructure as an investment firm); and
- impacting the perception of the role and status of RBs both in the UK and outside the UK, by directly equating their position to that of investment firms or other authorised firms.

We consider it vital that an adequate and informed consultation is conducted on these points.

We also note current European developments in relation to regulation of both CCPs and settlement system are likely to require further regulatory change within a relatively short window, possibly within a year for CCPs, and within two years for CSDs. We question the necessity or desirability of implementing two waves of change in a short period in an area where no regulatory failings have been identified.

17 The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS.

It is essential that CPMA provides a strong, knowledgeable and credible regulator of financial markets, not least to ensure effective representation of the UK at ESMA. In addition, there are clear synergies in relation to activities and functions of primary and secondary market regulation.

EUI is therefore concerned that merging the UKLA with the FRC will undermine effective market regulation and would seriously reduce the effectiveness of UK ESMA representation.

18 The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator.

EUI has not responded to this question.

Crisis management

19 Do you have any overall comments on the arrangements for crisis management?

20 What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention?

21 What are your views about changes that may be required to enhance accountability within the SRR?

The consultation paper has not made specific proposals in relation to securities settlement or payment systems functions and EUI has not responded to these questions.

Impact assessment

22 The Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm.

As noted above, although the proposals are not clear, there is a danger that EUI will be subjected to full twin regulatory regimes. EUI already has increased ongoing costs and resource contention as a result of the duplication of oversight under the FSA and Bank of England's payment systems role. An extension of this twin regulator regime would further increase EUI's ongoing compliance and management costs with no additional regulatory or systemic benefit.

Also as noted above, the proposals make no assessment of the impact of abolishing the current RB regime.

If you have any queries with regard to the contents of this response, please do not hesitate to contact us.

Yours sincerely

pp - Yannic Weber
Chief Executive Officer

HM Treasury Consultation: A new approach to financial regulation: judgement, focus and stability - July 2010

Response from European Central Counterparty Limited

Contact person:

Karl Spielmann

Vice President, Legal and Compliance, EuroCCP

Introduction

European Central Counterparty Limited ("EuroCCP") would like to thank HM Treasury for providing this opportunity for industry participants and practitioners to comment directly on the proposed changes to the regulatory structure to be employed in relation to the UK financial system outlined in the consultation document: "A new approach to financial regulation". EuroCCP is pleased to offer its views based on its experience as a Recognised Clearing House in the UK and European Markets. In this respect EuroCCP will be responding specifically to Consultation Questions 15 and 16.

Question 15

Creation of dedicated Clearing Divisions

EuroCCP recognises the advantages of separating supervision of conduct of business issues from the supervision of prudential matters. However, in the case of CCPs, EuroCCP believes it is important that both the CPMA and Bank of England (the "Bank") ensure that a Clearing Division is operated by both regulators recognising the distinct issues and responsibilities involved in regulating and supervising CCPs as opposed to other market infrastructures. EuroCCP believes that the creation of dedicated Clearing Divisions within both the CPMA and the Bank will enhance their ability to cooperate with each other on any common conduct issues by providing a very clear point of responsibility for each regulatory authority to coordinate with.

Distinct Responsibilities

EuroCCP would also welcome greater clarity and detail regarding the proposed split of responsibilities between CPMA and the Bank and how each authority will avoid duplicating the supervisory activity of the other authority.

Effective representation within ESMA

Given the role that the new European Securities and Markets Authority ("ESMA") has been allocated within the proposed Regulation on OTC derivatives, central counterparties and trade repositories (the " OTC Derivatives Regulation") in relation to certain aspects of CCP authorisation and supervision, EuroCCP believes it is vital that the interests of UK domiciled CCPs are represented effectively within ESMA. We would welcome additional details as to how this would be achieved by CPMA which will have multiple responsibilities and priorities not confined to wholesale financial market issues and how the views of the Bank on CCP issues will be represented to ESMA.

Question 16

Definition and Objectives

It is not clear what the Consultation document means exactly when it refers to "rationalisation" of the two FSMA regimes, particularly when the rationale as to why changes to one or other of the regimes are being contemplated has not been identified. For example, it is unclear how the proposals would enhance financial stability or the efficiency of the UK regulatory system which are stated as objectives of the Consultation. In turn, this makes it difficult to provide an informed and constructive response especially when the desired outcomes of the rationalisation are also unknown. EuroCCP believes a further articulation of the substance of the proposal and the rationale behind the proposal would materially assist the usefulness of consultation process.

Notwithstanding the above, EuroCCP believes that the following issues should be considered when reviewing the case for any change to one or other of the existing FSMA regimes:

i) ***Distinct Regulatory Regime***
Recognised Bodies are distinct from and perform very different functions from authorised persons under Part IV of FSMA. They have specific responsibilities to run and operate safe, fair and orderly markets which generally include rule making powers and the ability to discipline members who fail to adhere to those rules. These aspects of Recognised Bodies do not, in EuroCCP's view, lend themselves readily to an existing Part IV type authorisation. EuroCCP believes that for this reason a distinct regulatory regime should be retained for Recognised Bodies.

ii) ***Impending changes at European level***
Recognised Bodies face a number of potential regulatory changes at European level with the introduction of the proposed OTC Derivatives Regulation and the new supervisory body, ESMA, both anticipated in 2011. Both will have a material impact on the way Recognised Bodies operate and the management of compliance with these new requirements is a significant undertaking which will place increasing demands on Recognised Bodies over time. In light of impending regulatory changes at European level, EuroCCP believes there is a real danger that changes to the FSMA regulatory regime which are introduced now will either require further amendment in the immediate future or in some instances may prove redundant. EuroCCP believes that it would be undesirable to have to revisit the amended FSMA regime in such short timescales.

iii) ***Simultaneous changes at National level***
In relation to CCPs specifically, EuroCCP believes it is undesirable to introduce new regulators and an amended regulatory regime at the same time particularly when the current Part 18 regime embodied in the FSA REC Handbook is a stable and well understood body of regulation.

iv) ***Sufficiency of Part 18 FSMA***
In EuroCCP's opinion the existing Part 18 FSMA/REC regime has operated well and has not delivered any material regulatory failure either pre or post financial crisis. EuroCCP believes that the core recognition and notification requirements outlined in REC are sufficiently detailed and flexible to facilitate a cooperative and constructive relationship between regulators and Recognised Bodies. EuroCCP believes that the current level of notification requirements do enable FSA to take a very detailed view of a Recognised Body's activities and its ability to meet the recognition requirements.

As this response has made clear, EuroCCP has found the proposals contained in Consultation Questions 15 and 16 difficult to interpret as they are presented in very high level terms and lack an identifiable supporting rationale. On this basis, and given the material impact any proposals in this area will have on Recognised Bodies, EuroCCP urges HM Treasury to carry out an additional consultation where its proposals are fully and clearly articulated in order that Recognised Bodies and other interested parties can respond constructively and substantively in this critical area of UK financial regulatory reform.

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Financial Regulation Strategy
HM Treasury
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London SW1A 2HQ

Sent via email to financial.reform@hmtreasury.gsi.gov.uk

Friday 15 October 2010

To whom it may concern,

FairPensions welcomes this opportunity to respond to the consultation *'A new approach to financial regulation: judgement, focus and stability'*. FairPensions is a project of The Fairshare Educational Foundation, a registered charity (no 1117244) established to promote Responsible Investment by UK pension schemes and fund managers, and to ensure that ultimate asset owners are well served by institutional investors and other professional agents in the investment world.

FairPensions is a member organisation. Our members include organisations representing the beneficial owners of pension schemes, such as the National Federation of Occupational Pensioners, UNITE and Unison, as well as thousands of individual pension fund members.

Introductory remarks

Effective regulatory oversight of corporate governance and, one step up the chain, oversight of investor behaviour is essential to the protection of beneficiaries' assets and the long-term health of the financial system. FairPensions has a history of engagement with post-financial-crisis reviews of this issue, including the Walker Review and the FRC's consultations on the Corporate Governance Code and the Stewardship Code. All our responses are available on our website at: http://www.fairpensions.org.uk/policy.

Clearly, the objective of reorganising the regulatory architecture must be to improve its capacity both to mitigate systemic problems at an early stage and to respond to crises when they do occur. We recognise that the focus will inevitably be on bank supervision. However, the new framework's effectiveness in supervising institutional investors will also be key to its ability to deal with systemic risk and prevent another crisis. As BIS Minister Edward Davey recently remarked in a speech to the Association of British Insurers,

> *"These issues – promoting strong boards and engaged shareholders – are particularly important when considered in the context of the financial crisis. After all, the failings of the financial institutions, their management and owners, were an important factor in bringing about the crisis. And the Government recognises, of course, that significant changes are also needed to regulation. This is why the Government is consulting on the future of UK financial regulation."*

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In our view, this recognition must go beyond the proposal for a new Companies Regulator. It is important that responsibilities for supervising investment firms and occupational pension schemes are divided in a sensible and effective way, and that, in attempting to resolve the weaknesses of the tripartite model, the government does not create new gaps in supervision. In particular, the agenda of promoting active investor stewardship, including through the work of BIS and the FRC's Stewardship Code, must be supported and not undermined.

It is also vital that the voice of consumers is not drowned out by that of industry. The proposed CPMA is a welcome move in this respect. However, it is crucial that questions of consumer protection do not become siloed into the CPMA, and that the interests of ultimate asset owners are represented and reflected across the regulatory system. Risks to consumers are not limited to consumer-facing activities: poor corporate governance, conflicts of interest and inadequate risk management ultimately affect consumers just as much as high interest rates or unfair overdraft charges. Consumers with pension savings in the capital markets are particularly vulnerable, since they increasingly bear the investment risk associated with their savings, and are not subject to the same government guarantees as bank savings in the event of catastrophic losses.

In light of these general comments, we respond below to specific questions insofar as they are relevant to our remit.

Q4/10: The government welcomes respondents' views on… whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained.

We agree with the argument expressed in the consultation paper that "the case for making global competitiveness and innovation in financial services part of the responsibility of a regulator charged with ensuring the safety and soundness of risk-taking financial firms needs to be reconsidered." As the paper points out, there is a strong argument that a concern for competitiveness and supporting financial innovation contributed to the regulatory failures leading up to the financial crisis. We would go further and say that this argument is almost incontrovertible. If the government is serious about responding to the failures of recent years, it must be made clear that the regulators' responsibility is to the health of the wider economy and the protection of consumers – and not to the industry it regulates. We therefore do not believe that the requirement to have regard to potential adverse impacts on innovation or global competitiveness should be retained for either the PRA or the CPMA.

Indeed, this requirement may not itself be in the interests of genuine competitiveness. In the long term, the best way for the regulator to promote competitiveness must be to restore the trust and confidence of market participants and ultimate asset owners which has been so badly damaged by the recent crisis. This requires confidence that the regulatory approach is more robust and less conflicted than that which preceded the crash. Removing the requirement to have regard to adverse impacts on innovation and competitiveness would send a strong signal that this is the case.

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Q7: Are safeguards on the PRA's rule-making function required?
Q8: If safeguards are required, how should the current FSMA safeguards be streamlined?

In this regard we would comment only on our own experience that, within the current FSA rule-making framework, consultation processes have a tendency to become less a safeguard than an opportunity for intense industry lobbying and, potentially, for regulatory capture – thus damaging rather than enhancing the safety of the system as a whole.

This is not necessarily an argument against any safeguards or consultation – merely a factor which we would urge the government to bear in mind when designing the new mechanisms. Removing the requirement for regulators to have regard to adverse impacts on competitiveness and innovation would help to minimise this risk. It would also be advisable to explore means of ensuring that public consultations gather representations from a range of interests and views, rather than simply those of regulated firms – for example, through statutory consultees or a requirement for the PRA proactively to solicit responses from other parties with an interest or with independent expertise, such as consumers, civil society or academics. These stakeholders often have far more limited resources than regulated entities, and so find it difficult to monitor or engage with consultation processes in the absence of such support. In our experience, consultation responses tend to be overwhelmingly dominated by industry voices, with the result that strong initial proposals by the FSA are watered down or abandoned altogether.

Q12: The government welcomes views on the role and membership of the three proposed statutory panels for the CPMA.

We wish to make two brief points about the Consumer Panel. Firstly, it is important that the construction of the Consumer Panel ensures that the interests of all relevant consumers are adequately represented, reflecting the wide range of firms that will be overseen by the CPMA. In particular, the understandable focus on retail banking and mortgages must not lead to the neglect of pension fund members and insurance policy holders whose assets are entrusted to the capital markets.

Under the present system where panellists are selected through open competition, the only mechanism for guaranteeing this representation is through the panel's engagement with external organisations. This is unsatisfactory, particularly as many organisations representing the interests of ultimate asset owners are not those generally thought of as 'consumer groups', but also include trade unions or civil society organisations. Possible options for overcoming this could include

- Direct representation of consumer representative groups on the panel;
- Requirements that the panel's composition is representative of the full range of consumers affected by the activities of CPMA regulated firms;
- Replacing the present requirement in the terms of reference for the Panel to 'have regard to the interests of all groups of consumers' with a more detailed list of groups that ought, *inter alia,* to be considered (including ultimate asset owners such as pension savers); or
- A more formal process for ensuring the panel liaises with all relevant organisations.

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We have also observed an acknowledged tendency for the FSA to assume that consultation with the Consumer Panel removes the need for further engagement with consumer groups or civil society, which contributes to the industry bias in public consultations (see response to Q7&8). This is particularly concerning given that the Consumer Panel does not guarantee direct representation of consumer groups. By siloing consumer voices in this way whilst giving regulated entities multiple opportunities to air their own views, the current system may frustrate its objective – and is unlikely to be sufficient for a new body intended to be a "strong consumer champion".

We would suggest either that the role of the Consumer Panel be extended to facilitating wider consumer engagement with the work of the FSA, or that the FSA itself be required to have regard to the need to engage with consumers as per our suggestions in response to Q7&8.

We would also suggest that, given the government's objective to make the CPMA "a strong consumer champion in pursuit of a single objective", it might be appropriate to offer a justification for retaining a practitioner panel. This would help to allay any concerns about regulatory capture and improve consumer confidence in the new regulatory system.

Q17: The government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS.

We welcome in principle the idea of bringing together corporate information, corporate governance and investor stewardship in a single, powerful new companies regulator, and hope to contribute to BIS' consultation in due course.

We are aware that some concerns have been raised about the proposed transfer of the UKLA into the FRC. We remain to be convinced of these objections. In particular, we would comment that the concerns raised about whether the FRC is equipped to undertake forward-looking, proactive market supervision open up wider questions about the FRC's role and regulatory approach, which we believe merit further consideration. A strengthened, more proactive FRC would seem to be implicit in the government's proposals. Perceived inadequacies in the FRC's *present* focus and capabilities therefore would not seem to be a strong reason for rejecting reform in this area.

Our main concern, however, is that the fate of company regulation in general should not rest on the decision whether to proceed with the merger of UKLA and FRC. In our view, the proposal to create a new companies regulator is not contingent on this move, and there remains a strong case for it regardless. Moreover, the need for strengthened supervision of companies and their investors would remain even if regulatory responsibilities continued to be divided along present lines. One widespread concern that has emerged during BIS' consultation on narrative reporting is the inadequacy of enforcement of the current reporting framework. The creation of a new companies regulator would present an opportunity to enhance or replace the Financial Reporting Review Panel (FRRP), and we very much hope that the government's proposals will reflect this.

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We are also hopeful that the creation of a new body could bring renewed focus and impetus to the stewardship agenda. Our one concern is that this should not accentuate the tendency for this agenda to be subsumed into corporate governance. This tendency is reflected in the FRC's Stewardship Code, which treats stewardship activities largely as a means of enforcing the Corporate Governance Code, and implies that they arise from an obligation to investee *companies*, rather than an obligation to ultimate asset *owners* to protect and enhance the value of their pension savings or investments.

The recent failure of institutional investors to challenge poor corporate governance in financial institutions, which has prompted the current focus on investor stewardship, had devastating effects on ultimate asset owners such as pension savers. In our view, promoting greater accountability to those whose assets are at stake, and a culture of long-termism that protects their interests, must be central to the regulatory agenda. It would therefore be unfortunate if oversight of stewardship was entirely divorced from that of consumer protection in the retail investment market. Indeed, the present review provides a good opportunity to draw these connections more explicitly, and we hope this opportunity will be grasped.

We remain at your disposal and would welcome the opportunity to meet with you to discuss any or all of the above.

Yours sincerely,

Catherine Howarth
Chief Executive, FairPensions

Sirs

I respond as a Social Entrepreneur, but with long past experience in the financial services sector, with particular experience in the field of regulation, dating back to Professor Gower, the SIB - and with published articles which predicted inter alia - the endowment and pensions mis-selling episodes way back in the 1980's, and perhaps more importantly the financial crisis against which your proposed regulatory reforms are addressed by way of an article in a major newspaper.

I cannot today meet your deadline for a response in detail, however I would wish the following notes to be recognised:

1: A blog (currently work in progress) here: http://notproven.blogspot.com/ . I have chosen the subject of Bank charges and their fairness (a subject addressed in the Coalition Government's agreement), but chosen to demonstrate the clear failures in the current Regulatory regime, and which imo remains insufficiently addressed in the current consultation.

I expect when the blog is complete to open it out to social fora (it is already featuring), and the media and if my analysis proves sufficiently accurate I believe it will play a part in influencing future Government action, not just in the regulatory domain, but in wider fields such as the discussions on the future of the banking industry, by way of public reaction over the coming months.

2: I have appended below a copy of an e-mail to the Treasury Select Committee (04-10-2010) which also included a copy of an e-mail addressed to Lord Turner at the FSA, and others.

I hope it may explain further the approach I am adopting.

An acknowledgement of this e-mail would be appreciated - for our mutual records.

Mike Fenwick ...

Copy E-mail to TSC referred to above:

Dear Sirs

Yesterday, you received a copy of an e-mail which was addressed to Lord Turner, Chairman of the FSA. It is appended below for reference.

Perhaps I should explain why I have issued a copy to the Treasury Select Committee. There are two reasons, one leading to the other in sequence, and without this e-mail it may not be apparent that this is so.

Last year, during the term of the previous Committee, Lord Turner gave evidence, and in the applicable session, he was invited by the then Chairman of the Committee, John McFall to comment on the FSA position consequent upon the Supreme Court decision over the OFT Test Case related to Bank charges. A decision that addressed solely whether the OFT had the legal right to investigate such charges, not a decision over whether such charges were or were not fair - that remains an open unanswered question.

In my e-mail to Lord Turner I mention a blog I am writing, and in the opening posts on that blog, I make reference to both the questions from John McFall and the answers given by Lord Turner. The blog remains work in progress, but I believe when it is concluded it may seriously question the more or less universal belief that the Supreme Court ruling brought an end to the issue over Bank charges. I accept that it brought an end to the OFT proceeding further.

The evidence I list and the comments I make in the blog on this one specific issue over Bank charges will be completed I hope within the next week (or so) - but it will raise wider issues, issues in which I know the current Committee have an interest, namely the future of financial regulation, it is these latent issues which form the sequence to which I referred earlier..

May I stress I am no newcomer to these issues, nor to dealings with the FSA (and indeed its *predecessor the SIB), nor to dealings with the OFT. (I am happy to provide details on request).*

However, in a recent article, the Committee's current Chairman, Andrew Tyrie, MP, was quoted as saying that the past legislation in this area of financial regulation "left a vacuum of leadership". That in essence, and in parallel, will be the conclusion to my current notes in the blog - and it will I believe draw attention to Andrew Tyrie's wish that this time such legislation should be scrutinised forensically so that this time we get it right. I recognise Mr Tyrie was probably making reference to the banking crisis at the highest levels whereas my efforts are directed at helping ordinary people, at the lowest level - nonetheless, the same conclusions can be drawn.

I am well aware through Hansard of the efforts expended by Mr Tyrie during the passage of the FSMA to achieve this result. He will be unaware of my own similar efforts both in speeches and in articles to achieve the same. We both failed, and it is my assumption that neither of us wish to fail again.

I believe the comments in the blog (particularly when complete) may (in part) assist the Committee, and Mr Tyrie in ensuring that is not the outcome.

It is of course open to the Committee to dismiss this e-mail and my comments, but I hope it may choose not to do so.

However, I would appreciate it if you would be kind enough to simply acknowledge receipt of this e-mail - no comments need be made - simply for both our record purposes.

Many thanks for taking the time to read these comments..

Mike Fenwick ...

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!8th October 2010

Dear Sirs

A new approach to financial regulation

We are pleased to respond to this consultation. Fidelity Investment Managers is a global asset management company operating in twenty-one countries outside the USA. We manage over £130bn of assets.

FIM is a member of the IMA and the ABI and we would commend their responses to this consultation to you. We have not therefore prepared detailed responses to the consultation but there are two issues which we would particularly wish to bring to your attention.

International competitiveness.

We are surprised and worried at the lack of consideration of the external dimension in the paper. It is not just that the new authorities should have regard to international competitiveness it is that, particularly in Europe, they should be required to pay attention to the impact of European developments on the success of UK-based firms so long as that does not conflict with their responsibilities in the UK more narrowly.

In recent years the UK has been slow to respond to the challenge of the majority of regulation emanating from Brussels. The silence on this matter in the paper bears witness to this. It is clearly not seen as a priority whereas it should be.

A good example is the FSA attitude to the Commission's PRIPS initiative. TheFSA's prime concern is to avoid interference with RDR. That is understandable, but PRIPS has the potential to radically change the market in Europe to benefit consumers there and improve the operating environment for asset managers. We do not believe the two objectives are inimical, indeed the introduction of FSA thinking into the European forums is exactly what we seek.

Furthermore we were disturbed to see that the Markets division of the CPMA will be the lead authority representing the UK in ESMA. We would expect the Consumer Protection Division to have at least an equal role, their interventions in ESMA and with the Commission will be at least as important for our business as markets.

That leads to a second concern.

The importance of asset management - the buy side

The remarks above about representation in ESMA point to another weakness of current regulation which, it appears, is about to be repeated. That is the weakness of regulatory attention paid to the importance of the buy-side in the economy and in markets. Traditionally the markets work in the FSA has been dominated by sell-side thinking. The proposed structures and responsibilities appear to embed that in the CPMA.

Markets have two sides, each is equally important. We pay great attention to developments in markets and would wish that to be formally recognised in the structuring and objectives of the CPMA.

In addition we would wish to see the creation of the CPMA being used as an opportunity to correct another weakness in current arrangements, the lack of expertise in, and concentration on, asset management at the supervisory level.

FSA supervision has been organised on an omnibus basis with regulators overseeing a portfolio of disparate firms. There has been too little recognition of the very different business models, and therefore risks, embodied in asset managers and banks. If the CPMA is to regulate all asset managers, including those with bank or insurance company parents, they should be encouraged to develop a centre of expertise in asset management.

We would be pleased to meet with you to take further any of these matters.

Yours faithfully,

Philip Warland

Philip Warland

Head of Public Policy

The Financial Inclusion Centre

Promoting fair, inclusive financial services

HM TREASURY CONSULTATION

A NEW APPROACH TO FINANCIAL REGULATION:

JUDGMENT, FOCUS, AND STABILITY

RESPONSE BY THE FINANCIAL INCLUSION CENTRE

About the Financial Inclusion Centre

The Centre is an independent, not-for-profit research and policy innovation think-tank dedicated to promoting: fair and inclusive, efficient and competitive, well governed and accountable, secure, and properly regulated financial markets.

For queries on this consultation response, please contact Mick McAteer, mick.mcateer@inclusioncentre.org.uk

For general information on the Centre, please contact info@inclusioncentre.org.uk or visit www.inclusioncentre.org.uk

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INTRODUCTION AND SUMMARY OF PROPOSALS

The Financial Inclusion Centre welcomes the opportunity to respond to this consultation.

Our comments relate mainly to the proposals for the establishment of The Consumer Protection and Markets Authority (CPMA). We strongly support the Government's decision to create the CPMA. Moreover, we warmly welcome the consumer focused approach set out in the consultation paper. This is a great opportunity to establish a regulator which acts as a 'champion' dedicated to consumer and investor protection and market efficiency. To ensure the CPMA performs this role effectively, the Government should take this opportunity to reform the scope, objectives, and approach to financial regulation in the UK as well as redesigning the UK financial regulatory architecture.

However, we include some proposals relating to the Financial Policy Committee (FPC) and the Prudential Regulatory Authority (PRA) particularly with regards to the governance and accountability of the FPC/PRA and the relationships between the FPC/ PRA/ CPMA. These proposals are designed to avoid the real threat (and perception) that the CPMA will become the junior partner in the new regulatory system.

In terms of structure, this response is divided into two main parts. To put our response into context, the first part summarises our views on i) the need for a new approach to financial regulation, ii) the role of the CPMA, and iii) governance, accountability and transparency in the regulatory system and the relationships between CPMA/ FPC/ PRA.

The second part contains our response to the specific questions in the consultation paper.

Background

Before going onto to summarise our proposals it is useful to describe the range of different activities and functions that should be regulated to ensure the financial markets work in the interests of consumers and society.

These include matters related to financial markets such as:

- exchange functions ie. the operation of stock exchanges and markets;
- wholesale market activities such as investment banking;
- financial system stability/ macro-prudential regulation/ systemic risks;
- legal aspects – the basic legal and authorisation of market participants;
- micro-regulation – the prudential supervision of individual firms;
- the role of information intermediaries (auditors, actuaries, and credit rating agencies);
- competition and market efficiency;
- retail/ conduct of business activities – this covers how firms treat consumers, efficiency of distribution, marketing and promotion, quality of advice and information provided to consumers, the behaviour of firms and intermediaries/ advisers;
- rights to redress and protection schemes (designed to ensure consumers' losses are minimised in the event of a firm failing).

However, it cannot be assumed that if policymakers regulate (or the market itself regulates) the above activities effectively, the wider needs of society will automatically be met. Policymakers must also factor in wider economic and social policy considerations such as:

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- maintaining access to financial services;
- ensuring consumers' core financial needs are met and they are well provided for – eg. consumers should be providing for retirement, building up assets to participate in society, insured against the risk and shocks that life throws at them and so on; and
- wider economic and monetary policy.

So, any reforms to the regulatory architecture must take into account those different regulatory activities and ensure that those activities are coordinated and implemented at international, EU and UK level.

We make no comments on the decision to situate the PRA within the Bank of England rather than with the CPMA. This is a difficult question of judgment.

It would be perfectly feasible for the CPMA to operate an internal 'twin peaks' regulatory model with consumer and investor protection, and micro-prudential regulation sub-structures. This would have significant advantages not least with regards to efficiency and integrated regulation and consumer protection. However, equally, we can see the advantages of integrating macro and micro-prudential regulation for the purposes of managing financial stability and systemic risk.

Therefore, our comments are made in the assumption that the overarching regulatory architecture described in the consultation paper will be implemented.

The need for a new approach to financial market regulation

In our view, the approach to financial regulation in the UK should undergo a major transformation. This should apply to consumer and investor protection, and efficient market regulation- not just to macro and micro-prudential regulation.

Historically, financial regulators (and policymakers) adopted an approach based on creating the conditions for markets to work rather than intervening to make markets work. Moreover, regulators have tended to see themselves as arbitrating between consumers and financial services markets and providers. However, the lessons of history suggest that this 'referee' role has had limited effect at protecting consumers or promoting efficient financial markets. The sheer imbalance in power and influence between the financial services industry and consumers (and their representatives) means that theoretical approaches – for example, based around addressing information asymmetries - are always likely to have limited success in influencing market and consumer behaviour.

It is important to recognise that the financial services sector is one of, if not *the,* biggest sources of consumer detriment in the UK. The Office of Fair Trading estimated the extent of consumer detriment across the economy. This amounted to £6.6 bn per annum with professional and financial services generating 46% of total financial loss[1].

However, the OFT analysis measures 'visible' consumer detriment. An analytical note produced by Cooperatives UK and The Financial Inclusion Centre estimated that total consumer detriment attributable to financial services in 2010 is likely to be in the region of £11bn and that total

[1] http://www.oft.gov.uk/shared_oft/reports/consumer_protection/oft992.pdf

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detriment over the past 5 years is in the region of £32 bn - in other words, around £6bn per annum attributed to financial services alone[2].

The detriment we identified can be attributed to sub-optimal charging structures, lack of real competition and diversity in certain key market sectors[3], oversupply and inefficient supply and distribution chains[4] in other sectors, as well as classic misselling detriment (see below for Typology of consumer detriment).

It is important to note that these consumer detriment estimates exclude the i) huge direct and indirect costs paid by society to resolve the financial crisis and ii) public policy costs associated with financial exclusion and financial underprovision[5].

Typology of consumer detriment

Consumer detriment/ market failure in financial services can be grouped into the following broad categories:

- **Macro-prudential:** financial instability/ systemic failure;
- **Micro-prudential**: individual firm failure;
- **Consumer/ market protection**: classic misselling/ dysfunctional market behaviour/ unsuitable sales practices/ unfair treatment of consumers/ misleading marketing, advertising and promotion/ inappropriate advice/ fraudulent activities;
- **Social utility**: market inefficiency/ weak competition/ overpricing/ poor product design and quality/ lack of genuine innovation;
- **Financial underprovision**: consumers underproviding for core financial needs such as retirement, insurance against risk, asset building, and so on;
- **Restricted access/ exclusion**: consumers facing restricted access to products or services or denied access altogether;
- **Financial capability**: low levels of financial capability, financial literacy and self-determination[1].

The proposals for the FPA and PRA are intended to address the first two categories of market failure. With regards to consumer policy, regulatory resources have tended to be focused on the classic consumer protection category - this is where the FSA has focused its activities recently to good effect.

However, in our view, financial regulation and government policy in the UK has not been very effective at dealing with the other major categories of consumer detriment such as weak competition, market inefficiency and overpricing.

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[2] Analytical Note: The Case for Diversity in Financial Services – the big bill for consumer detriment. Ed Mayo Cooperatives UK, The Financial Inclusion Centre, July 2010

[3] For example, the widening of net interest margins in the banking sector much of which cannot be attributed to rebuilding balance sheets. For an analysis of the costs of widening margins, see Are banks and building societies playing fair?, The Financial Inclusion Centre, http://www.inclusioncentre.org.uk/press_releases_14.html

[4] Along the entire distribution chain - retail distribution of financial services, institutional fund management, market oversupply and so on

[5] This includes the failure of many consumers to provide for core financial needs such as retirement incomes, insurance and protection and build assets.

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The role of the CPMA, new statutory objectives

Taking into consideration the legacy of market failure in the UK financial services sector, we argue for a new approach to regulation. The new CPMA should be more of a consumer champion rather than a 'referee' and be a more proactive, interventionist regulator with a set of clear statutory objectives designed to tackle the main categories of consumer detriment/ market failure evident in financial services.

We emphasise that this issue of market efficiency and real innovation (as opposed to the illusion of choice and oversupply) deserves special attention within policymaking and regulatory circles.

It is reasonable to assume that, in the future, many households will face additional competing demands on their finite resources as the balance between public and private provision of core welfare goods is expected to shift. Consumers will be increasingly expected to utilise financial markets to provide for a decent income in retirement, insure themselves against risk and so on - in addition to meeting other financial commitments from limited resources.

Therefore, it is self-evident that we should strive to ensure that the financial services industry is as efficient as possible and genuinely innovative to ensure that UK households have access to value for money, quality, appropriate products and services.

However, improved market efficiency benefits not just those households who are commercially viable for the market, it contributes to financial inclusion – the more efficient the market is, the further it can extend its reach to lower/medium income households.

Furthermore, it is also interesting to note that the UK spends 1.7% of GPD on tax relief on pensions. Therefore, it is also incumbent on policymakers to ensure that the long term investment/ pensions industry is efficient to ensure taxpayers assets are used effectively.

The levels of underprovision/ exclusion in key financial sectors (low levels of savings, comparatively low retirement provision, underinsurance etc) suggests that i) many consumers lack the capability, confidence, propensity, trust and confidence to engage with the financial services industry and/ or ii) the financial services industry has failed to be efficient or innovative enough to extend access to consumers on lower/ medium incomes.

More generally, we are concerned that the current regulatory system is not set up to protect the interests of more vulnerable, financially excluded, lower income households. Vulnerable households are not well served by the current regulatory system at each part of the regulatory 'supply' chain. They are more likely to face barriers to fair market access in the first place; once in the market they are more likely to suffer disproportionate detriment; and they are less likely to be aware of rights to redress and to be able to get a fair outcome from the redress system.

This argues for a rebalancing of the CPMA's objectives and activities to protect the interests of more vulnerable consumers. It is important to avoid the perception and reality that the CPMA is a regulator for 'Middle England'.

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The Government proposes that the CPMA will have a primary objective of ensuring confidence in financial services and markets, with particular focus on protecting consumers and ensuring market integrity.

We support this primary objective. However, taking into consideration the nature and extent of consumer detriment/ market failure in financial services and to support the overarching objective envisaged by the Government, we argue that the new CPMA should be given the following statutory secondary objectives:

- Ensuring an appropriate degree of consumer and investor protection;
- Ensuring competitive, efficient, and innovative financial markets;
- The promotion of financial inclusion and provision;
- The promotion of financial capability (delegated to CFEB).

Governance, accountability and transparency, relationships between CPMA and FPC/ PRA

While we strongly support the general principles underpinning the establishment of the FPC and PRA, it is important that robust mechanisms are put in place to provide the necessary governance, accountability, and transparency to ensure the FPC and PRA act in the public interest.

Therefore, we propose that the FPC and PRA should be required to take into consideration the following during the policymaking and decision making process (both on an ex-ante and ex-post basis). The FPC/ PRA should be required to:

- consider of the impact of decisions and activities on the wider economy and consumer welfare (ie. in terms of access, competition, plurality and diversity, and efficiency);
- consider the impact of decisions and activities on the statutory objectives and duties of the other regulators which form the new regulatory system (clear transparent protocols are needed);
- consult as a matter of principle before implementing policy – the exception to this would be periods where a crisis management programme is underway or where a major systemic risk has been identified which requires a quick response from the FPC/ PRA;
- operate under a presumption of transparency – automatic disclosure of information should be the default position. Again the exceptions to this general principle should be events where disclosure would undermine confidence, thwart crisis management programmes or where it is proven that disclosure would genuinely prejudice commercial interests (although this needs to balanced against the overriding principle that disclosure is usually in the public/ consumer interest).

To further improve governance, representation, transparency and accountability, we make three further key recommendations. These apply to all three regulatory authorities but would obviously need specific application. The three measures are:

- a full review of the confidentiality and disclosure provisions in FSMA 2000 and the Freedom of Information Act 2000 (including the interaction with EU legislation) should be undertaken to ensure that the regulators can operate under the presumption of transparency and disclosure;

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- the Government proposes some very welcome statutory accountability and transparency measures. However, these should be supplemented by reforms to the way regulators' main boards operate. For example, FPC/ PRA/ CPMA boards should hold extended board meetings over two full days. The regulators' policies and decisions will have clear wider public interest implications. The boards must be accountable for these policies and decisions. An annual report is not sufficient. Therefore, we propose that the first day of board meetings should be conducted in a public hearing format with transparent debate and representation invited from public interest representatives and other stakeholders. We believe this would improve the performance of the board as well as improving accountability. The second day should be reserved for the main board business or confidential business and conducted as a closed session;
- furthermore, while transparency is necessary, it is not sufficient to ensure that regulatory authorities operate in the public interest. Robust governance is critical. The majority of the regulators' boards should be non-executive members. However, it is important that a number of these non-executives should be experienced public interest representatives (who understand how regulation serves the public interest) and not limited to market experts or even reputable academics. Such important regulators should not exist in an 'ivory tower'.

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RESPONSE TO SPECIFIC QUESTIONS

The Bank of England and Financial Policy Committee (FPC)

1 Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?

2 If you support the idea of secondary factors, what types of factors should be applied to the FPC?

3 How should these factors be formulated in legislation – for example, as a list of 'have regards' as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?

We support the view that the FPC's primary concern should be financial stability and effective macro-prudential regulation. However, it is self-evident that the FPC's policies and decisions could have a major impact on consumers, the wider economy and society.

Therefore, we would agree with the suggestion that the FPC's financial stability objective should be balanced with secondary factors. These balancing factors should include:

- a requirement to consider of the impact of decisions and activities on the wider economy and consumer welfare (ie. in terms of access, competition, plurality and diversity, and efficiency);
- a requirement to consider the impact of decisions and activities on the statutory objectives and duties of the PRA and CPMA;
- a general requirement to consult before implementing policy – the exception to this would be periods where a crisis management programme is underway or where a major systemic risk has been identified which requires a quick response from the FPC ;
- a presumption of transparency – again the exceptions to this general principle should be events where disclosure would undermine confidence or thwart crisis management programmes.

Given the primary consumer and investor facing role of the CPMA, it is probably more appropriate for the FPC to be required to have regard to the secondary factors.

The governance and accountability of the FPC will be critical. These balancing factors are a matter of judgment. Therefore, it is important that the membership of the FPC contains sufficient public interest representatives with the necessary skills, standing and integrity to ensure that the FPC's policies are developed and decisions made with due regard to the wider public interest.

We welcome the intention that five members of the FPC will be from outside the Bank of England. However, we would argue that it is important that a number of these external members should be experienced public interest representatives (who understand how regulation serves the public interest) and not limited to market experts or even reputable academics. Such an important regulator should not exist in an 'ivory tower'.

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We also support the statutory accountability measures set out in paras 2.52 to 2.55. However, we would supplement these with further accountability measures.

For example, we recommend that the FPC should hold extended board meetings over two full days. The FPC's policies and decisions will have clear wider public interest implications so it must be properly accountable for these policies and decisions. Six monthly financial stability reports and an annual report while important are not sufficient.

Therefore, we propose that the first day of FPC meetings should be conducted in a public hearing format with transparent debate and representation invited from public interest representatives and other stakeholders. We believe this would improve the performance of the FPC as well as improving accountability. The second day should be reserved for the main FPC business or confidential business and conducted as a closed session.

Prudential regulation authority (PRA)

4 The Government welcomes respondents' views on:

- ***whether the PRA should have regard to the primary objectives of the CPMA and FPC;***
- ***whether some or all of the principles for good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice, should be retained for the PRA;***
- ***whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and***
- ***whether there are any additional broader public interest considerations to which the PRA should have regard.***

As with our views on the FPC (see above), it is important that the PRA should be required to take into consideration the impact of its decisions on the other critical parts of the new regulatory system.

The PRA should have to take into consideration the following:

- a requirement to consider of the impact of decisions and activities on the wider economy and consumer welfare (ie. in terms of access, competition, plurality and diversity, and efficiency);
- a requirement to consider the impact of decisions and activities on the statutory objectives and duties of the PRA and CPMA;
- a general requirement to consult before implementing policy – the exception to this would be periods where a crisis management programme is underway or where a major systemic risk has been identified which requires a quick joint response from the FPC/ PRA ;
- a presumption of transparency – again the exceptions to this general principle should be events where disclosure would undermine confidence, thwart crisis management programmes, where it is proven that disclosure would genuinely prejudice commercial interests (although this needs to balanced against the overriding principle that disclosure is usually in the public/ consumer interest).

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While we support the argument that the PRA should have to consider the impact on competition, innovation and market diversity (from the perspective of consumers), we do not believe that the PRA should be concerned with the global competitiveness of the UK financial sector. We take the view that this is the job of the Government acting in the national interest, not the regulator.

The governance and accountability of the PRA will be critical. These balancing factors are a matter of judgment. Therefore, it is important that the membership of the FPC contains sufficient public interest representatives with the necessary skills, standing and integrity to ensure that the PRA's policies are developed and decisions made with due regard to the wider public interest.

5 Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?

Granting permissions, identifying significant influence functions, and approving 'key persons' is a critical, if overlooked and misunderstood, aspect of regulation. This role requires specialist skills and understanding of markets. This logically points to each regulator having responsibility for decisions within their remit.

However, on the face of it, the separated model could create an element of duplication within the wider regulatory system leading to additional costs compared to the integrated model.

But, without access to further information (on costs/ respective coverage etc), we are unclear at this stage to what extent the potential cost disadvantage of the separated model outweighs the benefits of specialisation.

6 Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focussed approach to supervision?

7 Are safeguards on the PRA's rule-making function required?

8 If safeguards are required, how should the current FSMA safeguards be streamlined?

We have no particular comments on the approach outlined in paras 3.17 to 3.23 except to say that, while we are conscious of the Government's desire to keep within the timetable outlined, the priority should be to ensure that the powers and functions are fit-for-purpose.

9 The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.

We welcome the Government's intention to ensure that the PRA is transparent, independent and accountable and support the measures outlined in paras 3.17 to 3.41.

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In particular, we welcome the intention that the majority of the board will be non-executives members free of any conflicts of interest. However, we would argue that it is important that a number of these non-executives should be experienced public interest representatives (who understand how regulation serves the public interest) and not limited to market experts or even reputable academics. Such an important regulator should not exist in an 'ivory tower'.

We also support the statutory accountability measures set out in paras 3.37 to 3.40. However, we would supplement these with further accountability measures.

For example, we recommend that the PRA board should hold extended board meetings over two full days. The PRA's policies and decisions will have clear wider public interest implications. The PRA board must be accountable for these policies and decisions. An annual report is not sufficient. Therefore, we propose that the first day of board meetings should be conducted in a public hearing format with transparent debate and representation invited from public interest representatives and other stakeholders. We believe this would improve the performance of the board as well as improving accountability. The second day should be reserved for the main board business or confidential business and conducted as a closed session.

Consumer protection and markets authority (CPMA)

10 The Government welcomes respondents' views on:

- ***whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC;***
- ***whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which;***
- ***whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and***
- ***whether there are any additional broader public interest considerations to which the CPMA should have regard.***

We strongly support the Government's decision to create the CPMA. This is a great opportunity to establish a regulator which acts as a 'champion' dedicated to consumer and investor protection and market efficiency. However, given the need to ensure the new regulatory system works effectively, we support the view that the CPMA should have regard to the primary objectives of the FPC and PRA. We would emphasise that this relationship should apply both ways. It is important not to create the impression that the CPMA is a 'junior partner' in the new regulatory system.

CPMA objectives

As we set out above, we argue for a new approach to financial market regulation (see The need for a new approach to financial market regulation, above page 3). We would argue that regulators have tended to see themselves as arbitrating between consumers and financial services markets (and the providers in the market). However, the lessons of history suggest that this 'referee' role has had limited effect at protecting consumers or promoting efficient financial markets. The sheer imbalance in power and influence between the financial services industry and consumers (and their representatives) means that theoretical approaches – for example, based around addressing

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information asymmetries - are always likely to have minimal impact on influencing market and consumer behaviour.

As we also point out above, the financial services sector is one of, if not *the,* biggest sources of consumer detriment in the UK. We estimate that total consumer detriment attributable to financial services in 2010 is likely to be in the region of £11bn – and that total detriment over the past 5 years is in the region of £32 bn[6].

This detriment is attributable to sub-optimal charging structures, lack of real competition and diversity in certain key market sectors[7], oversupply and inefficient supply and distribution chains[8] in other sectors, as well as classic misselling detriment (see above for Typology of consumer detriment, page 4).

It is important to note that these consumer detriment estimates exclude the i) huge direct and indirect costs paid by society to resolve the financial crisis and ii) public policy costs associated with financial exclusion and financial underprovision[9].

The proposals for the FPA and PRA are intended to address consumer detriment linked to macro and micro-prudential regulatory failure. With regards to consumer policy, policymakers have tended to focus regulatory resources on the classic consumer protection category - this is where the FSA has focused its activities recently to good effect.

However, in our view, financial regulation and government policy in the UK has not been very effective at dealing with the other major categories of consumer detriment such as weak competition, market inefficiency and overpricing.

The new CPMA should be more of a consumer champion rather than a referee and become a more proactive, interventionist regulator with a set of clear statutory objectives designed to tackle the main categories of consumer detriment/ market failure evident in financial services.

The Government proposes that the CPMA will have a primary objective of ensuring confidence in financial services and markets, with particular focus on protecting consumers and ensuring market integrity.

We support this primary objective. However, taking into consideration the nature and extent of consumer detriment/ market failure in financial services, the need to support the overarching objective envisaged by the Government, and the need to consider wider public interest considerations, we argue that the new CPMA should be given the following statutory secondary objectives:

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[6] Analytical Note: The Case for Diversity in Financial Services – the big bill for consumer detriment. Ed Mayo Cooperatives UK, The Financial Inclusion Centre, July 2010

[7] For example, the widening of net interest margins in the banking sector much of which cannot be attributed to rebuilding balance sheets. For an analysis of the costs of widening margins, see Are banks and building societies playing fair?, The Financial Inclusion Centre, http://www.inclusioncentre.org.uk/press_releases_14.html

[8] Along the entire distribution chain from retail distribution of financial services, institutional fund management, market oversupply and so on

[9] This includes the failure of many consumers to provide for core financial needs such as retirement incomes, insurance and protection and build assets.

- Ensuring an appropriate degree of consumer and investor protection;
- Ensuring competitive, efficient, and innovative financial markets;
- The promotion of financial inclusion and provision;
- The promotion of financial capability (delegated to CFEB).

This means that the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action would fall away as these would be covered by the secondary objectives.

With regards to principles of good regulation, we support the retention of:

- the need to use resources efficient and economically;
- the responsibilities of those who manage affairs of authorised persons;
- the principle of proportionality.

As above, the need to retain the need to minimise impacts on innovation and competition, or indeed facilitate competition, would fall away due to the secondary objectives.

Furthermore, as we outline above, we regard the promotion of the UK as a global financial centre in the national interest to be a responsibility of the Government, not the CPMA.

CPMA Scope

We support the proposals set out in 4.14 to 4.16. However, we would make two further points.

Firstly, while we appreciate that the Government intends to consult on whether to include consumer credit within the CPMA's scope at a later stage, we urge the Government to speed up the process.

There is the obvious inconsistency where the FSA (and CPMA when established) has responsibility for regulating retail banking when an account in is credit but once the account is overdrawn this transfers to the OFT.

However, perhaps more importantly, there is the need to protect the most vulnerable financial consumers. Many of the worst excesses of consumer detriment can be found in the consumer credit sector. The growth in exorbitant payday and other sub-prime lending, and the behaviour of commercial debt management companies are two obvious examples. We do not believe that the existing authorisation, licensing and monitoring regime followed by the OFT is fit-for-purpose. We are confident that the FSA/ CPMA approach based around robust authorisation processes and conduct of business rules would be more appropriate and would drive much of the worst practice out of the market.

The second point we make is a more general one relating to regulatory responsiveness and flexibility. The regulator's scope and definition of regulated activities depends primarily on government policy and legislation. This is a prescriptive approach to regulation. This approach is understandable – not least because of the need for accountability and requirements to implement EU legislation.

However, we believe this undermines the ability of regulators to respond quickly and flexibly to emerging consumer detriment and to revise regulation to keep up with market innovation.

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Therefore, we urge the Government to investigate whether it would be possible for the CPMA to operate under a much more permissive regulatory framework.

A permissive and responsive approach would be for the Government to establish the CPMA with the general discretionary power and authority to ***regulate a financial transaction, activity or relationship between a consumer and financial services provider***. Financial transaction or relationship would be broadly defined as involving a financial service provided for commercial gain. Consumer in this case would be defined as any consumer of financial services regardless of which part of the supply chain they operate (this would capture customers operating in the wholesale/ institutional markets not just retail consumers/ end-users).

Within this framework, rather than define prescriptively and precisely relatively narrow categories of products or services to fall within the scope and remit of CPMA as is the case now, it would be more effective to provide from the outset broad categories of financial activities[10] and/ or broad sectoral definitions[11] which the regulator would have the authority to regulate, supervise and enforce. These categories could then be regularly reviewed to ensure they are relevant and capture emerging consumer detriment and market failure.

This would not remove the need for consultation but properly structured would change the presumption of regulation allowing the CPMA to proactively identify and respond to emerging consumer and market detriment, and ensure the more effective exercising of the powers and functions relating to rule making, authorisation and permissions, supervision and enforcement (see para 4.18).

CPMA powers and functions,
We support the proposals relating to powers and functions outlined in para 4.18.

However, as mentioned above, the way the scope and remit of the CPMA is decided would need to be reformed to ensure that these powers and functions are exercised to maximum effect.

Moreover, we are pleased that the Government is to review the effectiveness of the FSA's existing own powers with a view to making the CPMA a more effective consumer protection authority.

If the CPMA is to become a more proactive, interventionist regulator it may well need to deploy a wider range of regulatory interventions from its 'toolkit' – for example, more explicit setting of minimum standards or product regulation. It is imperative, therefore, that the legislative and regulatory framework allows the CPMA to utilise whatever interventions it deems necessary for addressing consumer detriment/ market failure. Unless this is explicitly provided for, we fear that the financial services industry will use its powerful financial resources to attempt to legally block or hinder the CPMA's interventions.

[10] For example, the facilitating, arranging and provision of the following services: money transmission, transactional banking, deposit taking, investment services (retail, institutional, and wholesale), pensions, consumer credit, and the provision of advice, guidance and information and so on.
[11] for example, banks, insurance companies, investment companies etc

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Specifically, as a result of the proposed changes to the Office of Fair Trading, we believe that with regards to financial products and services, the CPMA should now be the lead enforcer on Unfair Terms in Consumer Contract Regulations (UTCCR) and Consumer Protection from Unfair Trading Regulations 2008 (CPRs), which implement the Unfair Commercial Practices Directive (UCPD).

11 Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?

12 The Government welcomes views on the role and membership of the three proposed statutory panels for the CPMA.

We support the governance and accountability mechanisms outlined in paras 4.30 to 4.36.

To further improve governance, representation, transparency and accountability, we make three further key recommendations. These apply to all three regulatory authorities but would obviously need specific application to the CPMA.

The three measures are:

- a full review of the confidentiality and disclosure provisions in FSMA 2000 and the Freedom of Information Act 2000 (including the interaction with EU legislation) should be undertaken to ensure that the CPMA can operate under the presumption of transparency and disclosure;
- The Government proposes some very welcome statutory accountability and transparency measures. However, these should be supplemented by reforms to the way the CPMA main board operates (compared to the existing FSA board arrangements). For example, the CPMA board should hold extended board meetings over two full days. The regulator's policies and decisions will have clear wider public interest implications. The board must be accountable for these policies and decisions. An annual report is not sufficient. Therefore, we propose that the first day of board meetings should be conducted in a public hearing format with transparent debate and representation invited from public interest representatives and other stakeholders. We believe this would improve the performance of the board as well as improving accountability. The second day should be reserved for the main board business or confidential business and conducted as a closed session;
- furthermore, while transparency is necessary, it is not sufficient to ensure that regulatory authorities operate in the public interest. Robust governance is critical. We are pleased that the majority of the CPMA board will be non-executive members. However, it is important that a number of these non-executives should be experienced public interest representatives (who understand how regulation serves the public interest) and not limited to market experts or even reputable academics. Such important regulators should not exist in an 'ivory tower'.

We support the proposals for the panels outlined in para 4.38. We believe the panel system has worked well and the basic principles underpinning the panel's operations should be continued. The

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panels should be well-resourced, include a balance of representation. The CPMA should be require do respond to the panels' annual reports as is the case now.

13 The Government welcomes views on the proposed funding arrangements, in particular, the proposal that the CPMA will be the fee- and levy-collecting body for all regulatory authorities and associated bodies.

We agree that it makes sense for the CPMA to be the fee and levy collecting body for all regulatory authorities and associated bodies.

14 The Government welcomes views on the proposed alternative options for operating models for the FSCS.

We have no comments on this question.

Markets and infrastructure

15 The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.

16 The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.

17 The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS.

18 The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator.

We have no comments on the above questions.

Crisis management

19 Do you have any overall comments on the arrangements for crisis management?

20 What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?

21 What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24?

We have no comments on the above questions.

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Impact assessment

22 Annex B contains a preliminary impact assessment for the Government's proposals. As set out in that document, the Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm. In particular, comments are sought from all types and size of deposit-taking, insurance and investment banking firms (including credit unions and friendly societies), and from groups containing such firms.

We are unable to supply any specific additional information relating to costs for financial services firms. However, we would reiterate the point made above that any impact assessment should consider the impact of any proposals on financially excluded consumers.

This marks the end of the response by The Financial Inclusion Centre.

The Financial Inclusion Centre
October 2010

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FINANCIAL INCLUSION TASKFORCE

Taskforce consultation response: A new approach to financial regulation: judgement, focus and stability.

October 2010

Introduction

1. The Financial Inclusion Taskforce is an independent body, which aims to ensure that everyone can access the financial services they need. The Taskforce was established in 2005, and is chaired by Brian Pomeroy. Taskforce members act in a voluntary capacity and call on experience gained in industry, the third sector, consumer advocacy, local government and education.

A new approach to financial regulation

2. In its recent consultation the Government said that a new Consumer Protection and Markets Authority (CPMA) would be established as the single integrated conduct regulator, taking a tougher, more proactive and more focused approach to regulating conduct in financial services and markets.

3. The Government has said that the new body will be a strong consumer champion and will ensure that the interests of consumers and participants in financial markets are placed at the heart of the conduct regulatory system and given the appropriate degree of priority.

4. The consultation document highlights that the Government will legislate to provide the CPMA with a primary objective of ensuring confidence in financial services and markets, with particular focus on protecting consumers and ensuring market integrity. The CPMA's primary objective will be balanced with a set of statutory secondary considerations (or 'have regards') that it must take into account in pursuit of its objective. The document suggested a number of factors that these considerations could include, amongst them 'promoting financial inclusion where possible, by encouraging access to suitable products and services'.

5. The consultation paper invited views from respondents on, among other things, what additional broader public interest considerations the CPMA should have regard to.

The scope of regulation under a CPMA

6. Our remit is to help the Government to encourage the use of appropriate financial services by low-income households. The Taskforce believes that regulation should start to apply before a consumer has agreed to take up a specific product. A decision not to access a product can often be the most appropriate one for a consumer. We would therefore like to see financial regulation supporting consumers in the choices they make, as well as protecting them once they have taken up a financial service.

7. For this reason the Taskforce supports the Government's proposals to establish the CPMA as a more pro-active regulator. We would like the CPMA to take be ready to take measures to protect consumers ahead of their accessing financial services, e.g. taking unsuitable products off the market before they caused consumer detriment.

8. We believe there is considerable scope for the CPMA to work in partnership with the Consumer Financial Education Body (CFEB) to support consumer decision making. Financial advice provided by CFEB should be able to show people when a product represents poor value for money for their individual circumstances.

9. The Taskforce also feels that it will be important for the CPMA to have a full overview of financial services, including products that currently fall outside the scope of banking services. For example, prepayment 'saving' schemes such as Farepak were promoted as financial services, but were not subject to statutory regulation or oversight. Prepaid cards increasingly offer transactional banking services but fall under under the e-money directive. We think that the CPMA should be able to look to the substance of how a product is marketed as well as the form, to ensure an appropriate level of regulation.

10. Finally, we would encourage the Government to ensure that the new regulatory responsibilities and boundaries are clear and do not overlap.

The CPMA and financial inclusion

11. The Taskforce believes that a secondary objective to promote financial inclusion for the CPMA would be desirable. Such an objective would also serve to extend the CPMA's remit to consumers who may not yet be accessing financial services.

12. The Government has said that it will legislate to provide the CPMA with powers to make rules governing the conduct of financial firms. Taskforce members hope that this will include rules on providing access to basic bank accounts. These rules currently fall under The Financial Services Authority's Banking Conduct of Business rules. A new secondary objective could usefully inform the CPMA's oversight of these rules, in particular being mindful of any unintended effects of regulation in increasing financial exclusion.

13. Existing rules require banks to communicate appropriate information to their customers, including information, where relevant, on basic bank accounts. The current sourcebook has been supplemented by Industry Guidance, which replicates much of the previous banking code.

14. The Taskforce believes that monitoring the way that banks offer access to bank accounts should be an important part of future compliance monitoring of the conduct of retail banking. We recommend that the CPMA should ensure that banks continue to support their branch staff to welcome all potential customers, to support customers who are new to banking and to help them to meet ID requirements.

15. The Taskforce would also like the CPMA to take a role in annual monitoring of levels of financial inclusion (e.g. using ONS survey data to identify how many people live without access to transactional banking). We would like the CPMA to hold regular consultations with key financial inclusion partners including the banks, consumer groups and the regulators to consider how conduct of business rules can promote access to banking and other appropriate financial services.

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

Dear Sirs,

A NEW APPROACH TO FINANCIAL REGULATION: JUDGEMENT, FOCUS AND STABILITY

The Financial Ombudsman Service has two observations on the proposals contained in the paper *A new approach to financial regulation: judgement, focus and stability.*

First, we welcome your statement at paragraph 4.44 that it will be important for the Financial Ombudsman Service to remain independent of the CPMA, as is currently the case with the FSA. The need for independence is underlined by the Government's intention to make the CPMA a "consumer champion".

The current arms-length governance arrangements for the Ombudsman Service have generally worked well. They have helped ensure that we remain accountable and increasingly transparent in carrying out our work, whilst securing both our independence from organisations representing the parties to the complaints we determine and our operational independence from the FSA. However, some might perceive a risk to our impartiality if the regulator becomes a "consumer champion". It will therefore be important to ensure that responsibilities of the CPMA in respect of the Ombudsman Service can be exercised in such a way that our independence and impartiality in the handling of cases are not jeopardised.

And second, we welcome your proposal that the CPMA be the levy-collecting body for all the regulatory bodies and the associated bodies, including the Financial Ombudsman Service. This will enable the continuation of the current arrangements, which have worked well, whereby the regulator collects the annual levies from FSA-authorised businesses, and the Ombudsman Service collects fees in respect of individual cases direct from those businesses who are the subject of complaints before us.

Yours faithfully,

ADRIAN DALLY
Head of Policy

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Company Secretary: Anne McArthur

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

14 October 2010

Thank you for seeking the FRC's views on the Government's proposal to merge the UK Listing Authority with the FRC. The FRC is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. The FRC and UKLA have much in common in terms of their principal objectives. Both seek to promote trust in the capital markets to encourage investment, whether through risk capital or other securities.

If the Government decides to pursue this proposal, the FRC believes it could make it work and that there would be important synergies between the FRC's operating boards and the UKLA. For example:-

- The FRC publishes the UK Corporate Governance Code while the UKLA monitors the quality of governance and financial information of companies seeking to raise capital in the market;

- The Accounting Standards Board (ASB) provides guidance on narrative reporting in annual reports whilst the UKLA provides guidance on narrative reporting in listing documents;

- The Financial Reporting Review Panel (FRRP) addresses narrative reporting in annual reports and the UKLA addresses narrative reporting in listing documents;

- The Auditing Practices Board (APB) provides guidance on the role of auditors in relation to listing documents which are then relied upon by the UKLA in assessing suitability for listing.

Success would, however, require co-operation between the CPMA, the Bank of England and the FRC/UKLA in two areas: on joint access to market monitoring and on a co-ordinated approach to representing the UK in EU discussions. We believe such co-operation is achievable, and will in any event be necessary between the Bank of England and the CPMA.

However, whilst the proposal can be made to work, we believe a much better option would be for the Government to create a UK securities regulator focussed on the wholesale markets, and to separate this from the protection of consumers throughout the whole range of financial services, which is an essentially different function. A new Securities Regulator would bring together the functions of the FRC and much of the Markets Division of the FSA. It would secure the synergies of an FRC/UKLA merger without the same boundary problems. The market monitoring issues would be reduced. The EU problem would be largely eliminated as the new body would closely match ESMA.

The FRC would oppose the merger of its functions with the CPMA given that the proposed structure of the CPMA combines consumer protection and markets responsibilities. The FRC is concerned primarily with the governance of, and reporting by, listed companies to shareholders. In the CPMA, consumer interests must dominate the agenda. A combination of these would create the same confusion of purpose as existed in the FSA before the crisis, and replicate one of the most serious regulatory weaknesses the split-up was supposed to address. The FRC strongly believes that this would be to the detriment of its work and indeed of other market-related activity.

Stephen Haddrill
Chief Executive

Financial Services Consumer Panel

AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

A new approach to financial regulation: judgement, focus and stability

The Financial Services Consumer Panel Response to CM 7874

October 2010

Index

Introduction

1) The Financial Services Consumer Panel welcomes the opportunity to contribute to the Treasury's consultation on the future of financial services regulation. This is a hugely important consultation which needs to deliver the right outcomes for consumers. We are intent on ensuring that the drivers outlined in HMT's new approach, namely judgement, focus and stability, are achievable and deliver a regulatory regime which serves consumers more effectively.

2) Given our statutory role as an adviser on consumer interest to the Financial Services Authority (FSA) we have focused our response on consumer issues. We have also taken the opportunity to gather together specific case studies[1] where the Panel has played a key role and which illustrate the points we are making. In addition, we draw useful comparisons with international work on regulatory reform in the US[2] and the Netherlands[3] to demonstrate other approaches to consumer protection and to help ensure good practice is shared.

3) We have enclosed detailed comments on the proposed Consumer Protection and Markets Authority (CPMA). We have also commented on the overall approach to consumer protection and other relevant issues that are essential to ensure that the new regulatory architecture affords consumer protection the priority it deserves.

4) It is essential that the outcome of current deliberations on the future structure of regulation delivers a regime that serves consumers better. Given the essential role of financial services in citizens' lives, and its contribution to their wellbeing, a strong and effective CPMA needs to emerge. We believe proper resourcing, increased accountability, effective governance and improved transparency will be key. So too, will be „joined-up' thinking and effective interaction and communication between the new regulatory bodies to avoid potential and actual overlaps or „underlaps' in supervision.

5) We are keen to participate actively in the current debate on the future of regulation to ensure consumer protection is enhanced and that consumers can rely on a regime which has their needs at its heart. Ultimately, it is consumers who bear the cost of regulation. It is therefore, essential to ensure the future regime serves them well and learns from the successes and weaknesses of the past.

[1] See Appendices
[2] Appendix 8 US regulatory reform
[3] Appendix 9 financial regulation in the Netherlands

Executive Summary

Judgement, focus and clarity

6) The failings of the regulatory system have been well documented. The weaknesses have been associated with the „light touch' regulatory approach that characterised the FSA from its inception and throughout much of the financial crisis. More recently, there have been welcome steps by the FSA towards a more vigorous stance on consumer protection, with earlier, more robust enforcement and intensive supervision. We believe this focus needs to continue. To be beneficial to consumers, the new Consumer Protection and Markets Authority needs a clearer remit and stronger powers than the FSA. It also requires the will and confidence to exercise judgement and actively to use the powers at its disposal to protect consumers, who are not homogenous and whose diverse interests need to be understood fully.

   We believe an effective regulator should:

   - *Have strong and experienced leadership*
   - *Have sufficient, high-quality consumer input at Board level*
   - *Be evidence based*
   - *Have and deploy actively a range of strong regulatory tools*
   - *Be fearless in the face of an industry that has long been favoured by government and which has recourse to expensive legal and lobbying activity*
   - *Have timely and effective enforcement and redress mechanisms at its disposal*
   - *Be transparent and accountable*

   We are calling for a regulator to deliver intelligent regulation, ensuring firms abide by the rules, and to uphold consumer interest with effective redress and timely and appropriate compensation for consumers.

Consumer champion

- A mandate to act as a strong consumer champion - the CPMA needs clarity of purpose and focus to act in the consumer interest, with the delivery of clearly articulated, good consumer outcomes central to its operating philosophy.

  Its primary objectives should be:

  a) to protect and uphold the interests of existing and future consumers in relation to the provision of financial services to ensure that all persons have access to financial services which are fair, transparent and competitive, and;

  b) to ensure the integrity of markets so that all persons have access to markets for financial services which are fair, transparent, efficient, stable and competitive.

  It should also have a secondary objective:

  to carry out its functions in the manner it considers is best calculated to further the principal objectives, wherever appropriate, by promoting effective competition between persons engaged in authorised activities.

- If competitive markets do not deliver efficient and fair outcomes for consumers, the CPMA, like many other industry regulators, needs to be able to act on excessive prices and charges to remedy detriments.

- These objectives also require strong leadership backed up by greater powers to crack down quickly and effectively on dubious practices, challenge business models and if necessary to ban products. The focus of the new CPMA should be on early effective intervention rather than the FSA's past concentration on the efficacy of sales processes. The CPMA should continue and extend the FSA's recently developed analysis of and challenge to business models, and should retain, and use actively, the FSA's powers.

- Given the social role played by financial services in our various communities, regard must also be paid to the public interest including the broader interests of citizens including the disadvantaged.

- The efficiency and competitiveness of wholesale markets are critical as this is where people's savings and pension funds are invested. The proportionality of costs is important as higher transaction costs in these markets mean higher charges for consumers which have an adverse impact, especially when compounded over a lifetime of savings. The CPMA needs the power to intervene to drive down these transaction costs. The Consumer Panel remains concerned that the CPMA may lack sufficient tools to do this, hence our call for the CPMA to have an effective toolkit that will enable it to act appropriately as an economic regulator.

Remedy and Redress

- Straightforward, fast access to remedy and redress are essential with greater clarity for consumers as to how they enforce their rights;

- Per-brand authorisation of banks so that consumers can easily understand who they are contracting with and the level of protection they are entitled to in the event of problems.

- Effective enforcement with fines in the same league as competition regulators so that financial services organisations fear the intervention of the regulator, and stronger powers, where necessary, to ban products and senior executives from the industry and effectively incentivise good behaviour in others;

Transparency

Transparency has many different facets and is of particular relevance both in determining the role of the CPMA and the behaviour of the industry.

- A presumption in favour of transparency would reduce the need for time consuming and expensive enforcement action.

- The CPMA should have a duty to publish as much meaningful information as possible on the performance of regulated firms so that transparency becomes a regulatory tool empowering consumers to take well-informed decisions, choose well-run businesses to do business with. It will also create a market pressure in favour of compliance and better industry behaviour;

- Transparency should also be key to the CPMA's operation, with timely publication of board minutes etc. As a regulator, the new CPMA should lead the field in terms of best practice regarding transparency, naming, faming and shaming relevant firms and giving examples of best and worst practice.

Consumer Credit and Claims Management

- Incorporation of consumer credit powers into those of the CPMA would end the fundamental divide in financial services protection. The Panel believes that extending the CPMA's role to regulating credit for CPMA authorised financial services firms would give greater clarity in the regulation of consumer financial products;

- Likewise, the Panel would like to see an extension of the CPMA's remit to the financial services aspects of claims management companies and debt management and advice firms.

Governance and accountability

- Leadership and governance will be key. We believe the majority of the Board of the CPMA should be people with experience of consumer regulation and insight into consumer interest. The mistake of the early FSA board of having too strong an industry bias must not be repeated;

- Effective accountability and reporting lines are critical, as is access to the Chancellor and the Secretary of State for Business. In addition, regular review by the Treasury Committee would increase oversight and Parliamentary accountability;

- We believe accountability to the Panels should be increased. The Panels already engage at an early stage in the formulation of FSA regulation, and enhanced requirements for early consultation and increased accountability, written into the forthcoming legislation to strengthen governance in the new structure;

- The Panel strongly believes that there mist be appropriate information sharing between CPMA and PRA supervisors to ensure that there is a joined-up approach to regulation.

- There must also be appropriate consumer representation at a senior level throughout the new regulatory structures.

Lessons learnt from the Consumer Panel's insight

7) Given our unique position as a statutory adviser to the FSA, the Consumer Panel has an unparalleled insight into the past performance of the FSA in protecting consumers. While there have been considerable strengths, and we have been impressed by the FSA's progress in recent years, there have historically been very serious weaknesses. We have compiled a study of relevant cases where the Panel has been involved and which highlight the points we are making and add weight to our call for effective change.

- In the fist four case studies with-profits[4], payment protection insurance[5], split capital trusts[6] and precipice bonds[7] the FSA took too little action, too late. With endowment mortgages[8] and self-certified mortgages[9] there was a lack of adequate regulation as well as a lack of action. Banking regulation[10] demonstrates what can happen when regulation is insufficiently joined-up;

- FSA investigations were not completed fast enough with successive ineffectual investigations resulting in escalating consumer detriment and an overburdened Financial Ombudsman Service picking up the pieces. This weak approach has been made manifest by the emergence of major mis-selling scandals;

- A lack of transparency by the FSA arising from constraints in the original Financial Services and Markets Act 2000 and a consequential inability to disclose information has left consumers in the dark, oblivious to the unacceptable treatment experienced by others;

- Enforcement has historically been insufficiently robust or frequent, particularly against large firms which were therefore under little pressure to improve compliance. The modest fines set proved no deterrent to existing behaviours or harmful practices;

- Because the FSA has not had a duty to promote effective competition amongst providers that delivers good consumer outcomes, it has not therefore pursued this approach to improving outcomes for consumers. Because of light-touch regulation and the FSA's approach to undertaking its duties, the FSA has carried out little economic and market analysis that would illuminate the underlying sources of consumer detriment;

- The FSA's concentration on sales processes rather than business models and product development detracted from an effective focus on earlier intervention;

- The wider implications, risks and lessons from past business reviews were not picked up in many cases and consequently industry behaviour did not improve.

4 See Appendix 1
5 See Appendix 2
6 See Appendix 3
7 See Appendix 4
8 See Appendix 5
9 See Appendix 6
10 See Appendix 7

MAIN RESPONSE

Chapter 2 – The Bank of England and the Financial Policy Committee

1 Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?

8) The FPC needs to have a clear primary objective relating to financial stability, but as is the case with other regulators, this has to be supplemented with secondary considerations and, in particular, the objectives of the CPMA and PRA. All the new bodies should „have-regard to each others' objectives in carrying out their work.

2 If you support the idea of secondary factors, what types of factors should be applied to the FPC?

9) In terms of the secondary factors the FPC should also have regard to the broader public interest, for example in reflecting on the needs of citizens in vital aspects such as future pensions and effective retirement provision, home ownership and the availability of consumer credit.

10) The Panel has two particular concerns, firstly that the balance of power in the regulatory mix should not be tilted too far away from consumers in favour of macro prudential regulation and secondly, that the new bodies must work effectively and constructively together.

11) However, not only must the new bodies work together effectively, they must also have appropriate relationships with the Consumer Financial Education Body (CFEB), the Financial Services Compensation Scheme (FSCS) and the Financial Ombudsman Services (FOS), to ensure that information and best practice are shared. Consideration therefore needs to be given to appropriate use of memoranda of understanding between the new bodies to facilitate good communication and the sharing of information, as in the Dutch system[11]. Lessons can also be learnt from the statutory duty the Netherlands bodies have to minimise unnecessary costs.

12) It is also important that the external members of the FPC have a sufficiently broad grasp of consumer issues and the consumer perspective so that this body does not have an overly strong industry perspective.

3 How should these factors be formulated in legislation – for example, as a list of 'have regards' as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?

13) The additional factors should be formulated in legislation as „have regards'.

14) The example of sub prime mortgages and the FSA's ongoing mortgage market review is of relevance here in that concerns are already emerging about the possibility of consumer detriment from a poorly co-ordinated approach to asset bubble management.

[11] See Appendix 9

It would be very concerning if under the new structure, it were possible for high level decisions to be taken for reasons of macro prudential stability, which had an unnecessarily negative impact on citizens because of a lack of involvement at an early stage in the process from bodies tasked with protecting their interests.

Chapter 3 – Prudential Regulation Authority

4. The Government welcomes respondents' views on:

- *whether the PRA should have regard to the primary objectives of the CPMA and FPC;*

15) Each of the new bodies should pay due regard to each others' primary objectives, at least in their „have regards'.

16) The Consumer Panel believe that the PRA must not be treated as senior to the CPMA. This would mean that consumer protection and market stability are not both accorded the importance they deserve.

- *whether some or all of the principles for good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice, should be retained for the PRA;*

17) We agree in general that the principles from section 2 of FSMA should be retained for the PRA and that with regard to competition, this should be related to promoting effective competition i.e. providing clear consumer benefit in terms of value.

- *whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained;*

18) We do not think it is the PRA's role to consider the impact on the global competitiveness of UK financial services.

- *and whether there are any additional broader public interest considerations to which the PRA should have regard.*

19) As with our view on the FPC there are broader public interest considerations to which the PRA should have regard. These include reflecting on the needs of citizens with regard to future pensions, home ownership and the availability of consumer credit

5 Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?

6 Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focussed approach to supervision?

20) We have nothing to add at this stage on Questions 5&6

7 Are safeguards on the PRA's rule-making function required?

8 If safeguards are required, how should the current FSMA safeguards be streamlined?

21) In so far as it is possible, the PRA should retain the present rule making processes of the FSA. These have been tried and tested and have evolved into a balanced approached to regulation based on principles and rules.

9 The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.

22) We welcome the proposed accountability mechanisms for the PRA, and the reference to the accountability mechanisms present in the FSA (described in 4.36 of the consultation document) which includes a reference to consultative panels. The PRA should consult with the Independent Panels, in particular the Consumer Panel, when undertaking aspects of its work which will impact on consumers.

Chapter 4 – Consumer Protection and Markets Authority

10 The Government welcomes respondents' views on:

- *whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC;*

23) Financial stability is clearly an overarching requirement which underpins consumer protection. Yet, given the proposed new regulatory landscape and the focus of the FPC, we believe the CPMA should have a primary objective of: **protecting and promoting the interests of existing and future consumers in relation to the provision of financial services**. At an operational level, misbehaving firms should not be able to escape censure by arguing that the fine or redress might impact on firm stability.

- *whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which;*

24) The CPMA objectives should be as follows:

Primary objective:

a) to protect and uphold the interests of existing and future consumers in relation to the provision of financial services to ensure that all persons have access to financial services which are fair, transparent and competitive, and;

b) to ensure the integrity of markets such that all persons have access to markets for financial services which are fair, transparent, efficient, stable and competitive.

The CPMA should have the following **secondary objective**:

to carry out its functions in the manner it considers is best calculated to further the principal objectives, wherever appropriate by promoting effective competition between persons engaged in authorised activities.

The CPMA should have the following **'have regards'** considerations to be taken into account in pursuit of the principal objectives:

a) the objectives of the FPC and PRA;

b) the need to ensure that authorised firms are able to finance the activities which are the subject of obligations on them;

c) the need for consumers in all parts of the United Kingdom to be treated fairly by the firms with which they deal and to secure value for money;

d) the need for consumers to be provided with as much information as possible concerning the performance of authorised firms;

e) the desirability of promoting public understanding of the financial system;

f) the desirability of promoting financial inclusion

g) the desirability of promoting diversity and encouraging new providers of financial services;

h) the need to use resources in the most efficient and economic way;

i) the principle that a burden or restriction which is imposed on a person should be proportionate to the benefits which are expected to result from the imposition of that burden;

j) the need to minimise the adverse effects on competition that may arise from anything done in the discharge of its function.

25) We have looked at examples from other jurisdictions and other sectors in balancing the range of objectives and „have regards' we consider appropriate for the CPMA and how best to make use of competition. Both the US Bureau of Consumer Financial Protection[12] and the Dutch authority the AFM[13] are good precedents in our view for the kind of remit the CPMA needs.

26) In terms of examples from other regulated industries, OFCOM and OFGEM in carrying out their functions have a primary duty to promote the interests of citizens and to further the interests of consumers, *where appropriate, by promoting competition*. In the case of OFGEM it is quite clear that the regulator is to carry out its functions in a way it considers best calculated to further its principle objective and this may or may not be through promoting competition.

27) While examples from sectors concerned with commodities cannot be directly compared with financial services, we think there are lessons which can be learnt due to the increasing commoditisation of some financial services. A characteristic of these other regulated industries is a combination of universal coverage and competitive supply. However, financial services and utilities are not entirely analogous and consequently, we believe it sufficient to refer to competition as a secondary, rather than a primary objective for the CPMA.

28) The CPMA should also be required to have regard to the fair treatment of consumers and for citizens to be able to secure value for money through having access to as much information as possible on the performance of regulated firms. This is the position in other regulated sectors and it is a good position for the new CPMA.

- *whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and*

[12] Appendix 8
[13] Appendix 9

29) We agree that the requirement to have regard to impacts on global competitiveness of the UK financial services sector should not be retained.

30) Consumers are also concerned about the efficiency and competitiveness of wholesale markets as this is where their savings and pension funds are invested. The proportionality of costs is important as higher transaction costs in these markets mean higher charges for consumers which have an adverse impact on savings, especially when compounded over a lifetime. The CPMA needs the power to intervene to drive down these transaction costs.

31) The Consumer Panel remains concerned that the CPMA may lack sufficient tools to carry out its role, hence our call for the CPMA to have an effective toolkit that will enable it to act as an economic regulator if appropriate.

- *whether there are any additional broader public interest considerations to which the CPMA should have regard.*

CPMA as Consumer Champion

32) As a Consumer Champion there are a number of broader public interest considerations and regulatory practices which the CPMA will need to take into account in its work.

33) It is important that the CPMA takes account of the public interest in terms of furthering the interests of citizens and consumers in promoting an economically and socially sustainable market in products and services. We have previously referred to reflecting the needs of citizens with regard to future pensions, home ownership and the availability of consumer credit. Increasingly, financial services are becoming essential to everyday life and it is crucial that all consumers including the vulnerable and disadvantaged are protected.

34) Protecting and promoting the interests of all consumers will only result from intelligent regulation of the financial services market which fully takes into account the complexity and diversity of the market. We define intelligent regulation as a system whereby regulators make balanced, proportionate judgements on firms' business models based on prudential and conduct information, rules and principles. This can be differentiated from more primitive forms of box-ticking regulation, in that supervisors use their judgement and experience based on a holistic view of the entirety of the information available. Naturally, this calls for high calibre supervisors able to hold their own when dealing with financial services companies. Intelligent regulation should result in clear, joined-up, enforceable rules which offer one-stop regulation, proactive market and firm monitoring for early risk identification and effective product scrutiny. Consequently, the Panel is concerned that splitting prudential and conduct supervision between the CPMA and PRA introduces a new risk in that regulators may no longer have the perspective of the entire regulatory landscape resulting in disjointed regulation. The risks of disjointed regulation can be seen in current banking regulation in relation to the respective roles of the FSA and OFT[14].

35) Making firms adhere to the rules involves using credible deterrence so that firms fear the reputational and financial risk of non-compliance. This will require the CPMA to have the correct leadership, so that it can take strong action, to have clarity in terms of its remit and to be able to employ greater transparency as an effective tool in the regulatory process. There also needs to be confident, high quality enforcement staff equipped with the powers to act effectively and quickly to ensure swift compliance.

[14] See Appendix 7

With-profits, PPI, precipice bonds and split caps all illustrate what can happen when a regulator does not act decisively and quickly.

36) Additionally, intelligent regulation encompasses the concept of making early challenges to business models when required and increasing product scrutiny to ensure toxic products do not get copied across the market, introducing widespread detriment which is ultimately expensive for both consumers and the industry. We strongly support powers that enhance earlier, effective market and product interventions, subject to the principles of proportionality and effectiveness. Endowment and self-certified mortgage mis-selling are examples of the type of problem caused by weak regulation which should not be allowed to recur.

37) It is also important that in undertaking its work as a consumer champion the CPMA takes account of consumers in the nations and regions of the UK. The previous FSA regime came into effect before devolution and with a separate legal jurisdiction and Parliament in Scotland as well as an Assembly in Wales the CPMA needs to take account of the increased diversity of the UK and the different public interest considerations which may apply in different areas.

Transparency

38) Greater transparency will allow consumers access to better information on which to make informed choices about financial products and services and the companies with which they do business. This would involve the CPMA in faming, naming and shaming; giving examples of best and worst practice.

39) Fewer consumers would have suffered detriment if there had been more and earlier "naming and shaming" of PPI[15] mis-sellers.

40) The CPMA should go out of its way to render this information into a form which will be easily understood by consumers, thus giving consumers the power to make informed choices and if necessary take their business elsewhere. We would also like to see clear powers to publish complaints data and the publication of Own Initiative Variation of Permissions (OIVOPs).

41) The Consumer Panel has undertaken considerable research into transparency over the last few years and in our more recent report Transparency as a Regulatory Tool[16] we have found that the FSA, although comparing well to other international comparisons, could go further. We would like to see the CPMA become a global leader in transparent reporting of firm complaints, enforcement proceedings, financial promotions and corporate Governance issues. There should be a presumption in favour of transparency to allow consumers to make sensible choices and responsible businesses to prosper.

42) To allow for greater transparency, the Panel has argued for changes to sections 349 and 391 of FSMA 2000. Section 349 should be amended to allow information which the FSA finds in the course of its work, such as complaints data, to be disclosed in pursuit of its consumer protection objective with the usual safeguards of proportionality and cost effectiveness. Our section 391 amendment would allow the publication of warning notices, the FSA's equivalent of a formal charge, in line with standard practice in law

[15] See Appendix 2
[16] Transparency as a Regulatory Tool, John Leston

enforcement. Enforcement action can take years to complete, during which time consumers can continue to suffer major detriment oblivious to the serious allegations which are being investigated. Consumers should therefore have the right to know at the earliest opportunity that a firm or an individual is under investigation so that they can take action to protect themselves

43) This view on transparency was endorsed by the Conservative White Paper[17]

> "*we will force banks to be more transparent about their retail consumer charges. Effective competition relies on consumers being able to make informed choices. Increasing transparency on charges will help consumer compare products. This approach is also being pursued by the Obama administration in the US*."

44) A logical adjunct to this is that consumers need to easily understand the level of protection they are entitled to in terms of deposit guarantees. One important improvement would be to introduce per-brand authorisation of banks. This would remove the uncertainty about the compensation available which results from the myriad brands owned by some institutions. Consumers would be under no illusions as to precisely the level of protection they have for their money in a bank. During the 2007/08 Financial Crisis the Consumer Panel lobbied for increased compensation as it was clear some consumers had underestimated the level of protection they possessed because of brand confusion.

Effective Redress and ensuring compliance

45) Effective redress can only be accomplished if firms understand their regulatory obligations to handle complaints fairly. They must learn that it will be cheaper for firms and consumers to resolve problems earlier. Likewise, timely and appropriate compensation will only occur if the regulator is both empowered and motivated to get tough with firms. This requires strong leadership and a remit to protect consumers along with effective enforcement.

46) The CPMA must compel the industry to take stronger action towards treating customers fairly. The CPMA should enforce this through analysis of business models and regulation where competition is ineffective. It should include effective powers for the CPMA to ban products and expel senior executives from the industry if appropriate.

47) The Panel is concerned about the possible creation of the new Economic and Financial Crime Agency and the risks this may pose for effective enforcement in the financial services industry. It is vital for the success of the CPMA that it has adequate enforcement powers. The new EFCA agency would fragment enforcement creating an inefficient two tier enforcement structure, with lower-level activity dealt with at the CPMA.

48) Related to this is our concern about the interaction between supervisory teams and the possibility that if PRA supervisors lead teams from both the PRA and CPMA information relevant to the CPMA may not be passed on and that information may flow only in one direction towards the PRA. Unless there is an adequate dual or reciprocal flow of information the CPMA will be left ill-informed about consumer protection and market stability issues. In the US this is accomplished by the requirement of prudential regulators to share their reports and examinations with the Bureau of Consumer Financial Protection[18]. Aligned audit processes in the CPMA and PRA are essential to

[17] From Crisis to Confidence: Plan for Sound Banking, Policy White Paper July 2009
[18] See Appendix 8

police the delivery of efficient and effective supervision. The Dutch regulator[19] the AFM has a co-operation covenant with the central bank the DNB. We think that the UK equivalent – the memorandum of understanding - should be used to ensure that the PRA and CPMA teams work closely together and that they work to minimise the impact on firms both in terms of regulatory burden and cost.

49) We also envisage that the CPMA will need an effective working relationship with CFEB given the shared subject matter of their work. Moreover, we think that better information-sharing between FOS and the CPMA will assist the CPMA in its consumer protection function as it will be able to identify issues more easily when they first arise.

Joined-up regulation of consumer credit and financial claims management

50) The CPMA should take on the consumer credit powers of the OFT in relation to firms authorised by the CMPA. This would give greater clarity in the regulation of consumer financial products. The experience of the FSA in banking regulation[20] is a cogent example of the sort of problems faced by consumers because of disjointed regulation.

51) We also take the view that the CPMA should take on the regulation of claims management companies where they are involved in financial services and that this should apply throughout the United Kingdom. There is also a case for regulating debt management companies.

52) Extension of the CPMA's powers into these two areas would give the new body a comprehensive overview of the consumer landscape and end the somewhat arbitrary and illogical division between FSA, OFT and MoJ responsibility which currently exists.

Consumer representation on the CPMA board

53) The CPMA must have sufficient consumer experience at board level. One of the early mistakes of previous regulatory reform was that the FSA board was too close to the industry which it regulated. The CPMA needs to hit the ground running with a high-calibre board which is not afraid to stand up to industry and act fearlessly in the interests of consumers.

> *11 Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?*

54) In answer to Question 11, to ensure that the CPMA is effective in meeting its objectives and that consumer financial issues are sufficiently represented at Cabinet level, the CPMA should have direct access to the Chancellor of the Exchequer and report on consumer issues in the same way as the PRA reports on prudential matters. Moreover, we want to establish the principle that the CPMA, also has a similar reporting relationship with the Secretary of State for Business and the Treasury Committee of the House of Commons.

55) Given the departure of Hector Sants to the PRA and his appointment as a Deputy Governor of the Bank it is essential for the success of the CPMA that an energetic and high calibre CEO is appointed at the earliest opportunity. The CPMA will only succeed if it has a powerful and competent Chief Executive who can manage the transition.

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[19] See Appendix 9
[20] See Appendix 7

12 The Government welcomes views on the role and membership of the three proposed statutory panels for the CPMA.

The Role of the Panels

56) We support the proposal to make the Smaller Businesses Practitioner Panel into a third statutory Panel. It is important that the CPMA continues to enjoy the input provided by the Consumer Panel, Practitioner Panel and Smaller Businesses Practitioner Panel.

57) Over the last decade the Panels have provided an increasingly useful service in assisting the FSA to formulate policy by providing cogent challenging advice. As is presently the case,[21] the CPMA should be under the same duty as the FSA to consider the representations of the Panels and provide statements[22] of reasons if it disagrees.

58) The Consumer Panel has endeavoured to deliver effective advice on behalf of consumers and we have detailed some of the work of the Consumer Panel over the last decade in the case studies supplied[23].

59) We believe the role of the Panels should be enhanced in the new regime to improve the CPMA's governance. In particular, we would like to see increased and effective Panel resourcing and a stronger obligation on the CPMA through statute to consult and take note of the Panel's recommendations and challenges.

60) Moreover, the three Panels representing consumer and practitioner interests should not only provide input to the CPMA. We believe the Panels have become an effective part of the FSA's governance structure and should be enabled to advise the FPC and PRA, to ensure that consumer and practitioner interests are adequately represented. When applicable, the FPC and PRA should have a duty to liaise with and consult the Independent Panels to ensure that there is proper scrutiny of decisions.

61) Specifically in the case of the Consumer Panel, we recommend that it has a formal duty to report to the Treasury Select Committee on a regular timetable.

13 The Government welcomes views on the proposed funding arrangements, in particular, the proposal that the CPMA will be the fee- and levy-collecting body for all regulatory authorities and associated bodies.

62) Question 13 raises some important issues regarding the funding arrangements for the new bodies. We agree that it is sensible to share support infrastructure as indirectly all costs will inevitably be borne by consumers. Consequently the Panel is very concerned that the new structure will lead to a duplication of staff and structures. In as far as it is possible, new bodies should share resources in the form of data, supervision staff, IT systems and Independent Panels. This is a problem which has been addressed in the Dutch system[24] by a "covenant" between the conduct and prudential regulators and also by a statutory duty to minimise unnecessary costs. A similar memorandum of understanding will be needed between the FPC, PRA and CPMA

63) The Consumer Panel is concerned that there is insufficient clarity as to how the bodies which are also funded by the levy, such as Financial Ombudsman Service (FOS), Financial Services Compensation Scheme (FSCS) and the Consumer Financial

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21 s11(2) FSMA 2000
22 S11(3) FSMA 2000
23 See Appendices
24 See Appendix 9

Education Body (CFEB), are resourced. We are concerned that the proposals as they stand give insufficient certainty to the issue of funding and consequently risk the independence and sustainability bodies dependent on the industry levy.

14 The Government welcomes views on the proposed alternative options for operating models for the FSCS.

64) The Consumer Panel does not have a response to Question 14.

Chapter 5 - Markets and Infrastructure

15 The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.

65) As discussed with regard to the CPMA, consumers are also concerned about the efficiency and competitiveness of wholesale markets as this is where savings and pension funds are invested and transacted. Inefficiency and a lack of competitiveness result in higher transaction costs which are borne by consumers in the form of higher charges. Charges which are higher than they need be will, over the long lifetime of many financial products, have a large impact.

66) The CPMA needs the power to intervene to drive down these transaction costs. The Consumer Panel remains concerned that the CPMA may lack sufficient tools to do this, thus our call for the CPMA to have an effective toolkit that will enable it to act as an economic regulator if appropriate.

16 The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses

67) The Consumer Panel is concerned that the rigour currently instilled in the UK system by the FSA is not lost in any rationalisation.

17 The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS.

18 The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator.

68) In response to Questions 17 and 18, the Consumer Panel is concerned about the proposed changes as the present system has worked well without the sort of failures seen in other areas of the financial or regulatory system. The proposed changes could increase regulatory complexity and do not appear to offer any significant advantage over the present arrangements.

69) There are natural synergies between the markets work of the CPMA and the work of the UKLA and a separation could weaken market regulation. We also note that the current European structure under the ESMA would be a poor fit with the proposed new UK arrangements and that this could potentially weaken the UK's voice in the European Union.

Chapter 6 - Crisis Management

19 Do you have any overall comments on the arrangements for crisis management?

70) The Consumer Panel is concerned that the CPMA is not sufficiently included in the crisis management structure. As in other areas of reform, we have called for greater regard to be given to the public interest. There is a need to take into account the broader interests of consumers with regard to the management of future crises.

71) It is important to bear in mind that during the Northern Rock crisis it was the televised scenes of customers queuing around the block that did much of the damage to the reputation of the banking system and the UK as a whole. The body charged with being the consumer champion needs to be involved throughout to ensure that that the concerns and interests of consumers are adequately taken into account.

20 What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?

72) The Consumer Panel supports the enhancement of OIVoP powers as part of a more proactive and consumer focussed regulatory process.

21 What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24?

73) The Consumer Panel has nothing to add on Question 21.

Annex B - Impact Assessment

22 Annex B contains a preliminary impact assessment for the Government's proposals. As set out in that document, the Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm. In particular, comments are sought from all types and size of deposit-taking, insurance and investment banking firms (including credit unions and friendly societies), and from groups containing such firms.

74) The Consumer Panel has no comment on Question 22.

Appendices

Appendix 1 Case Study – With-profits

The FSA acted too slowly. Consumer Panel research highlighted significant problems in the governance arrangements of with profits funds.

With-profits funds are pooled investment funds that are run by insurance companies or mutual societies. They invest in equities, bonds, gilts and property. They were formerly seen as safe investments and the funds have around 20 million investors. In recent years many of these funds were hit by stock market falls and returns were significantly reduced.

Concerns grew about the effectiveness of so-called "smoothing" mechanisms supposed to keep up bonuses in the bad years; and a lack of transparency surrounding market value adjustments designed to protect existing policyholders when investments leave the fund early.

FSA Action

The FSA has had concerns about with-profits funds for many years and has looked into them on several occasions. In the early 2000s the FSA did a good job in resolving some of the problems in the with-profits sector. In 2005 the FSA introduced rules for with-profits funds to ensure that the investors were treated fairly.

However, in June 2010 FSA With-Profits Report[25] showed that with-profits policyholders are still not being treated fairly by the FSA on its own measures despite previous warnings to the industry by the FSA.

Regulatory Shortfall

The Consumer Panel has conducted reviews and research into the With Profits Sector and held a round table on with profits funds in 2010.

Previously, in 2007 Consumer Panel research[26] showed a lack of advice available from financial advisors and poor information provided by companies to consumers. The Panel was also concerned about the inconsistent treatment of different investor groups.

In 2008[27] further research gave rise to a concern about inherited estates, with-profits committees, the permitted uses of funds and governance of funds.

The FSA has acted too slowly in working to resolve the range of problems with the funds and to provide adequate redress[28].

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[25] http://www.fsa.gov.uk/pubs/other/withprofits_report.pdf
[26] 2007/2008 Consumer Panel Annual Report p30
[27] 2008/09 Consumer Panel Annual Report pp 6,12
[28] 2009/10 Consumer Panel Annual Report p20

Appendix 2 Case Study - Payment Protection Insurance (PPI)

The FSA took too long to act. However, consistent campaigning by the Consumer Panel pressured the FSA to take stronger action on PPI.

Payment Protection Insurance (PPI) policies are designed to cover all or part of the payments on loans, mortgages and other financial products if the policy-holder was unable to work. In some cases the cost of the policy is added to the loan, substantially increasing the overall cost. In many cases the policies have not provided the protection that was claimed and some consumers were not eligible to make claims in certain circumstances – in other words, there has been large-scale mis-selling.

FSA Action

The FSA started to act against PPI misselling in 2005. In 2007 its own research showed that some firms were still failing to treat their customers fairly. In 2008 the FSA banned single premium PPI policies with unsecured loans as this was the most damaging area of PPI sales. The FSA also took regulatory action by censuring 10 firms and giving the largest ever retail fine for PPI misselling. However, the FOS was still receiving a very large number of complaints about PPI policies and it pointed out to the FSA that there appeared to be a wider regulatory failure in this area - despite high rejection rates of complaints by firms, over 80% referred to the Ombudsman were overturned in favour of consumers.

In 2009 the FSA issued proposals for more rigorous investigation of PPI complaints, but there was strong opposition from industry and this delayed progress.

In 2010 the FSA issued a deadline of 1 December 2010 for firms to comply with the new policy statement published in August 2010. The FSA is now the subject of a judicial review, so it seems there will be further delay in implementing the FSA's new requirements.

Regulatory Shortfall

The Panel has been concerned about PPI since 2007[29] and has repeatedly stated that the FSA has been slow to respond[30].

The Panel asked the FSA to carry out more enforcement action and to require firms to carry out past business reviews. The Panel supported the FSA's proposals for changes but has been disappointed with the slow progress. The Panel has also asked the FSA to tackle PPI sold with credit cards, secured loans and mortgages since these may also have been mis-sold.

The FSA has been ineffective and taken too long to address problems with PPI in spite of receiving many warnings from different sources.

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29 2007/08 Consumer Panel Annual Report p31
30 Repeated 2008/09 Consumer Panel Annual Report pp 6, 11 and 2009/10 pp 25, 26

Appendix 3 Case Study - Split Capital trusts

The FSA lacked the powers to adequately resolve the problems and was consequently slow to act.

Split Capital Trusts operate by investing client money in shares for a fixed period (normally five to ten years). There are two types of shares – income shares (that pay dividends) and capital shares (that generate capital growth only) and investors can choose between income and capital growth.

The shares were wrongly sold as being very low risk investments. Problems arose when the firms operating the funds expanded too rapidly. They also invested in each other's investment trusts, resulting in a web of cross-ownership. When the stock market fell, high-gearing and cross-holdings between trusts caused some investments to fall sharply in value and some investors lost all their capital.

FSA Action

The FSA launched a large investigation into split caps in May 2002 which resulted in firms agreeing to pay into a £144 million compensation fund on Christmas Eve 2004. Agreement was reached without admissions by two further firms in April 2005.

There was widespread discontent with this result as by some estimations investors had lost £700 million and the FSA was criticised for lack of action even though it had known about the problems earlier. The FSA had however been hampered by the fact that investment trusts were not regulated products and that the period under investigation straddled the introduction of the FSA.

Regulatory Shortfall

The Panel called on the FSA to publish more information to help consumers[31 and 32]. In particular, regarding eligibility to complain and the names of „problem' trusts[33].

The FSA was accused of complacency by the Treasury Select Committee and others and consumers suffered financial loss. The Panel demanded that the FSA name and shame problem trusts but the view of the FSA at the time was that these trusts were outside its remit.

[31] Consumer Panel 2001/02 Annual Report p59
[32] Consumer Panel 2002/03 Annual Report p7
[33] Consumer Panel 2002/03 Annual Report p30

Appendix 4 Case Study - Precipice Bonds (structured capital risk products)

The FSA took too little action, too late. The Consumer Panel consistently warned of the detriment consumers were suffering and demanded firmer, faster action.

Precipice bonds are high risk investment products. They pay a regular income over a period of up to five years but the capital may dwindle to nothing over the term of the investment. Many investors were pensioners who were persuaded to invest by advertisements promising double-digit returns but not mentioning the risks involved. It has been estimated that £7.4 billion was invested between 1997 and 2004, most of which was lost.

FSA Action

The FSA fined firms that mis-sold precipice bonds and increased its scrutiny staff from 4 to 25. Warnings were issued to consumers from December 1999 and thereafter with a series of consumer fact-sheets. Fines were imposed against a number of firms including £300,000 for Capita Trust Company Ltd (formerly Royal Sun Alliance)

Regulatory Shortfall

Members of the Treasury Select Committee raised concerns about the FSA's inaction and implicit approval of some precipice bond schemes. The Committee said that stronger action should have been taken earlier, with financial promotions obliged to disclose the risks in similar sized print to the best case scenarios highlighted for the investments.

As early as 2002[34] the Panel warned over the risk posed by the inappropriate marketing and sale of precipice bonds and the losses being suffered by consumers. The Panel thought that the FSA seem to have been wrong-footed by the widespread inappropriate sales of precipice (high income) bonds and must act faster in future.

In 2003[35] the Panel wanted the new disclosure regime to be extended to new and complex products rather than just packaged products as proposed.

[34] 2002/03 Consumer Panel Annual Report pp 7, 20, 22
[35] 2003/04 Consumer Panel Annual Report pp 14, 16

Appendix 5 Case Study - Endowment Mortgages

A lack of regulation and industry malpractice led to consumer detriment. Endowment mortgages highlight the need for comprehensive regulation and for business model reviews of both financial products and their marketing.

Endowment mortgages are (or were) interest only mortgages sold alongside an investment policy designed to pay off the mortgage capital at the end of the term. The policy was usually invested in shares or bonds and was often sold as a low risk or no risk product likely to generate a surplus at the end of the term, often with no discussion of the risks involved or alternative repayment vehicles available. However, in practice many policies failed to produce the promised returns, resulting in a shortfall of capital to pay off the mortgage.

The total extent of the shortfall is not known.

FSA Action

The FSA conducted an industry wide review of the mortgage market in 2000 and this resulted in fines for companies found guilty of mortgage endowment misselling. The FSA ensured that endowment mortgage holders received an FSA factsheet from their provider and through the ABI policy holders were also sent a standard format re-projection letter. Fact sheets on complaining were also made available. Concerns were raised at the time that the onus was on householders to prove that they had been mis-sold a product 10-15 years previously.

Regulatory Shortfall

Endowment mortgages were a subject of concern to the Consumer Panel from its inception in December 1998. As we detailed to the Treasury Committee inquiry[36] the Panel consistently pressed the FSA to act faster to investigate warnings and to investigate more thoroughly the firms which had a greater concentration of problem endowments. The Panel also called on the FSA to make sure that consumers understood the issues that affected them and their savings, and were informed of their rights, as well as the limitations of compensation.

The Panel expressed the view to the Treasury Committee that the FSA had relied too much on the reassurances of the industry[37]. The Panel called for the FSA to commission mystery shopping[38] exercises in our 1999 Annual Report.

Re-projection research commissioned by the Panel in 2000[39]revealed that over half of respondents believed that their endowment mortgage was guaranteed to pay off their mortgage. As a result of this research, which revealed some consumer confusion, the Consumer Panel also undertook a lot of work in assisting the FSA to reformat the re-projection letters sent to those with endowment mortgages to make sure consumers understood the implications of their situation.

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[36] 25th November 2003 Consumer Panel submission to the House of Commons Treasury Committee
[37] Consumer Panel 2003 Treasury Committee Submission para 45, p11
[38] Consumer Panel 1999 Annual Report pp 24, 31
[39] Consumer Panel Mortgage Endowment Reprojection Research Report, Autumn 2000

Appendix 6 Case Study – Self Certification Mortgages

Weak regulation and poor lending practices led to consumer detriment. Consumer Panel action has included encouraging providers to liaise properly with consumers and the FSA to increase regulatory pressure on firms.

The recent worldwide financial crisis was in part caused by instability from mortgage market debt as mortgages had been sold to a large number of customers who could not afford them. In the UK the significant growth in the number of self-certified mortgages contributed to this problem.

FSA Action

The FSA took over regulation of the Mortgage Market on the 31st October 2004 following the Treasury announcement of January 2000. FSA regulation replaced the voluntary mortgage code with the Mortgage Conduct of Business Rules (MCOB). These were extended to cover home purchase and reversion plans with effect from the 6 April 2007.

Regulatory Shortfall

In 2005[40] the Panel rated the FSA weak on regulation of self-certification mortgages and pointed out that the results of the FSA thematic work on self certification mortgages could hide a much bigger problem than the FSA had suggested.

The Panel also reported that the FSA and CML data indicated a worrying level of interest-only mortgage arrangements being made where the lender had no knowledge of how the capital would be repaid at the end of the term. The Panel asked the FSA to undertake thematic work.

In 2006[41] the Panel reiterated its concern over mortgage lending and mortgage advice and it encouraged the FSA to increase regulatory pressure on firms to improve the mortgage market.

The Panel also worked with the Ministry of Justice which brought out a mortgage arrears pre-action protocol in November 2008 designed to ensure that repossession was the last resort of lenders.

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[40] 2005/06 Consumer Panel Annual Report para 2.11 and 2.13
[41] 2006/07 Consumer Panel Annual Report para 2.20

Appendix 7 Case Study – Banking regulation

Disjointed regulation of the banking sector resulted in consumer detriment from poor business practices. The financial crisis and lobbying by the Consumer Panel and others eventually resulted in FSA taking over regulation of retail banking from the Banking Code standards board.

The FSA only took over retail banking conduct regulation for deposit taking in November 2009. Before the FSA took over, retail banks had regulated their conduct themselves through the Banking Code Standards Board. By 2008, it had become apparent that self-regulation was not working well and the implementation of the European Payment Services Directive provided an incentive for the FSA to take over the regulation of deposit taking. However, the OFT continued to be responsible for the regulation of credit and a modified form of self-regulation of credit has continued under the Lending Code Standards Board.

For many years banks had charged customers for unauthorised overdrafts; however, from 2006[42] the issue of the size and scale of charges became increasingly controversial with the OFT indicating that some of the charges might be illegal. A series of out-of-court settlements followed with large numbers of consumers making claims before the OFT took a test case in 2007. The case went up to the Supreme Court in 2009 with the ruling that the 1999 consumer contract regulations used by the OFT did not apply to bank charges to which customers had agreed. However, the court left open the option for the OFT to use other provisions to scrutinise bank charges.

FSA Action

The FSA has been hamstrung by not being in charge of all banking conduct of business. An example of the problems this created is that the notification of an unauthorised overdraft is regulated by the FSA, but subsequent communications come under the OFT. However, the FSA took action against poor complaint handling in banks after conducting a review which followed the publication of aggregate complaints data in September 2009.

Regulatory Shortfall

In 2008[43] the Panel expressed concern that legislation was preventing the FSA from closely supervising bank charges.

In 2009[44] the Panel reported that it was disappointed by the Supreme Court ruling on unauthorised overdraft charges. It emphasised that this made the issue unclear for consumers and also that it would result in unfairly high charges to vulnerable people. The Panel asked the FSA to clarify this area. The Panel also noted its concern about the lack of clear advice to consumers wanting to challenge bank charges. The Panel also reported that it was worried about banks using the OFT unsuccessful court action as a reason to reject claims.

The Consumer Panel remains concerned that the separation of responsibility between the FSA and the OFT with regard to consumer credit means that there is disjointed regulation. We would like to see the FSA's successor given power over consumer credit.

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[42] 2007.08 Consumer Panel Annual Report p17
[43] 2008/09 Consumer Panel Annual Report pp 3,13
[44] 2009/10 Consumer Panel Annual Report p14

Appendix 8 - US Financial Services Regulatory Reform

The US regulatory system is characterised by a proliferation of organisations regulating different sectors of the market and performing interrelated functions. This presents some complexities when both comparing the system to European models of financial services regulation and indeed in implementing regulatory reform.

The main changes enacted by the Obama administration are contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act. The long titles sets out the overall aims of the legislation:

> *To promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ''too big to fail'', to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes*

Dodd-Frank came into force on the 21 July 2010, however, many of its provisions[45] will only come into force over the next 18-months. In general terms, Dodd-Frank is consistent with the direction of reform adopted elsewhere in the world and represents the largest change in the regulatory structure in the US since the Glass-Steagall Act of 1933.

The key provisions of Dodd-Frank are:

- Financial Oversight Council (FSOC) charged with identifying and addressing systemic risks
- Consumer Financial Protection Bureau - with powers to regulate individual firms
- Enhanced powers for the Federal Reserve to impose capital, leverage and liquidity requirements on individual firms and The Volker Rule – a prohibition on banks engaging in proprietary trading
- Living wills – a liquidation process for systemically significant firms to end taxpayer bailouts
- Stronger regulation around corporate governance including remuneration
- Regulation of hedge funds, derivatives and credit rating agencies and non-bank financial institutions.

Financial Stability Oversight Council

The Financial Stability Oversight Council (FSOC) has been created to identify risks in firms and from market activities that threaten the financial system as a whole and has an information gathering arm the Office of Financial Reporting (OFR).

The reason for creating the FSOC was to deal with the perceived failure in the system as described by the Washington Post on 26th January 2009[46]:

[45] 243 rulemaking and 67 studies according to US law firm Davis Polk
[46] Neil Irwin and Binyamin Appelbaum, Washington Post Staff Writers

An abundance of federal agencies regulate the financial industry. But no agency is responsible for understanding or containing the risks affecting the financial system as a whole. In fact, none even has a complete picture of the financial markets.

The FSOC is empowered to:

- Bring non-bank financial institutions under the regulation of the Federal Reserve
- Recommend enhanced prudential standards which the Federal Reserve and others must consider, including implementing rules on firms whose size and complexity could pose risks of market stability
- Approve Federal Reserve Decisions to require firms to divest some of their holdings
- Require companies to report on certain issues
- Monitor and report on domestic and international financial regulatory proposals and report and advise congress
- Set aside any rule proposed by the Consumer Financial Protection Bureau (see below)

The FSOC must

- Report to Congress annually its activities, market stability, regulatory developments and emerging risks
- Consult with foreign regulators on proposals to impose additional standards on foreign firms

FSOC Membership

The membership of the FSOC includes the Treasury Secretary (Chair), and the heads of the Federal Reserve, SEC, Office of Comptroller of Currency (OCC), Bureau of Consumer Financial Protection, Federal Deposit Insurance Corporation (FDIC), Commodities Futures Trading Commission (CFTC), Federal Housing Finance Agency (FHFA, National Credit Union Association (NCUA) and the non-voting chairman of the OFR.

Office of Financial Reporting

The OFR is a self-funded, through fees on large banks, and largely independent organisation with the power to gather information from financial market participants and to require standardisation of financial information for reporting to the OFR and other regulators.

Significantly, its information gathering powers are broad and all data collected will be subject to the Freedom of Information Act. Although there are some complexities in the legislation and exemptions for publication of supervisory information, the OFR is required to publish, in a manner that is easily accessible to the public, databases on financial companies and financial instruments, as well as formats and standards for OFR data.

Bureau of Consumer Financial Protection (BCFP)

The creation of the BCFP is still one of the more controversial pledges of the Obama administration, as has been seen by the recent controversy over its director[47]. The BCFP is established within the Federal Reserve but will be independent with its director appointed by the President and approved by Congress. Funding will be derived from a capped percentage of the Federal Reserve's operating profit and will therefore be independent from approval or scrutiny by Congress. Penalties levied by the CFPB will be held in a separate fund and used to compensate victims.

BCFP Aims and Objectives

The BCFP[48] is tasked with:

> *The Bureau shall seek to implement and, where applicable, enforce Federal consumer financial law consistently for the purpose of ensuring that all consumers have access to markets for consumer financial products and services and that markets for consumer financial products and services are fair, transparent, and competitive.*

Five further objectives are specified[49]:

1) *consumers are provided with timely and understandable information to make responsible decisions about financial transactions;*
2) *consumers are protected from unfair, deceptive, or abusive acts and practices and from discrimination;*
3) *outdated, unnecessary, or unduly burdensome regulations are regularly identified and addressed in order to reduce unwarranted regulatory burdens;*
4) *Federal consumer financial law is enforced consistently, without regard to the status of a person as a depository institution, in order to promote fair competition; and*
5) *markets for consumer financial products and services operate transparently and efficiently to facilitate access and innovation.*

BCFP Powers

The BCFP lacks an explicit mandate to ensure stability of firms or the financial system as a whole. However, other bodies which do have this mandate have a check on the BCFP's powers.

The BCFP has exclusive rulemaking, examination and enforcement powers for depository banks with assets over $10 billion and for many non-bank financial institutions. However many firms are exempted, including those regulated by other bodies[50]. For smaller banks, the BCFP remains the rulemaking authority but will share examinations and enforcement remains with prudential regulators. However, the BCPF does have rule making powers with

[47] http://www.washingtonpost.com/wp-dyn/content/article/2010/09/17/AR2010091706597 html
[48] Chapter X, Subtitle B, s1021(a) HR 4173 pp 604 – 605 Dodd-Frank Act
[49] Chapter X, Subtitle B, s1021(b) HR 4173 p605 Dodd-Frank Act
[50] E.g. insurance firms and broker-dealers. Specific exclusions include auto dealers, accountants and retailers of non-financial goods

regard to new consumer financial protection provisions and existing Federal consumer financial protection laws and provisions currently spread amongst other federal agencies.

A member of the FSOC can stay the implementation of a BCFP rule and a 2/3 vote of the FSOC can set it aside.

Information collecting powers of the BCFP extend annual and specimen reports as well as answers in writing to specific questions. Prudential regulators also have to make their reports and examinations available to the BCFP.

A new consumer hotline is also to be created for consumers to report problems with financial products and services.

BCFP Accountability

The BCFP director is liable to testify at semi-annual Congressional hearings and the BCFP must also submit a report regarding its actions over the preceding period and plans for the upcoming period as well as report on problems faced by consumers in obtaining financial services and an analysis of the efforts of the BCFP in ensuring fair lending.   Annual audits are also provided for in the legislation and budget must be submitted to the Office of Management and Budget.

Additionally the BCFP must publish an annual report and assess each of its rules within five years and submit a report to congress on internal training and work-force development.

Appendix 9 - Financial Regulation in the Netherlands

Dutch financial services regulation is based on function-based supervisions rather than sector-based supervision due to the increasing complexity of the financial products on offer in the Dutch market from the late 1990s.

DNB Netherlands Central Bank (De Nederlandsche Bank)

The DNB is the prudential regulator in the Dutch system. It is tasked with prudential supervision of financial institutions including banks, credit institutions, pension funds and insurance companies as well as monitoring systemic risk and financial stability.

DNB aims and objectives[51]:

- Financial stability
- Monetary policy
- Secure payments
- Prudential supervision – financial institutions must be sound and reliable
- Economic adviser to the Dutch Government

DNB powers

Aside from prudential regulation the DNB is also responsible for authorising firms and for monitoring financial institutions as well as co-operating with international bodies.

DNB Accountability

Day to day management is carried out by the Governing Board of the president and three executive directors. There is also a ten member Supervisory Board which oversees DNB management and general operations including approving its budget as well as a 14 member Bank Council which serves as a sounding board for the Governing Board.

The DNB is independent of Government and maintains secrecy with regard to monetary policy and prudential supervision to protect the financial system.

AFM - Netherlands Authority for the Financial Markets (Autoriteit Financiële Markten)

The AFM is responsible for financial markets and conduct of business regulation as well as authorising all firms before they are allowed to provide certain services. It describes itself as an independent supervisory authority for the savings, borrowing, investment, pension and insurance markets and strives to:

> *…strengthen the confidence of consumers and companies in the financial markets, both national and international*[52]

Moreover, the AFM provides consumer information on its website and states that that:

> *Consumers have to be able to rely on financial enterprises acting decently and honestly*[53].

AFM aims and objectives are threefold:

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[51] http://www.dnb nl/en/about-dnb/duties/index.jsp
[52] http://www.afm.nl/en/consumer/afm.aspx
[53] http://www.afm.nl/en/consumer/vertrouwen.aspx

- making the financial markets more accessible
- promoting the smooth operation of the financial markets
- promoting confidence in the financial markets

AFM Powers

The AFM has a wide range of powers including information gathering and providing information to consumers. They can also:

- Issue an instruction or a public warning
- Withdraw permission
- Report firms to the public prosecutor
- Impose fines and penalty payments
- The AFM publishes lists[54] of firms and individuals which consumers should be wary of doing business with as well as consumer financial educational information[55]
- Financial Markets Information Line which consumers can call to complain or seek information. The AFM co-operates with the DNB on this.

AFM Accountability

The AFM falls under the jurisdiction of the Ministry of Finance and is therefore described as a “semi-governmental” agency under the Dutch system.

Co-operation between the AFM and the DNB

The AFM and the DNB have a statutory duty[56] to minimise unnecessary costs by sharing data and also have a co-operation covenant, reviewed annually, which is designed to provide a framework for co-operation. This includes agreement on:

- Respective powers and responsibilities of each supervisor
- Defines which aspects of financial institutions come under conduct as opposed to prudential regulation
- Rules for consultation and information sharing

Co-operation between the bodies includes quarterly board level meetings and issue specific working groups as well as well as joint supervisory teams for large institutions and notification procedures and consultation ahead of investigations.

[54] Only available in Dutch: http://www.afm.nl/nl/consumenten/risico/waarschuwingen_afm.aspx
[55] http://www.afm.nl/en/consumer/producten.aspx
[56] 2007 Financial Supervision Act

Appendix 10 - The Financial Services Consumer Panel

We are an independent statutory body, set up to represent the interests of consumers in the development of policy for the regulation of financial services.

We work to advise and challenge the FSA from the earliest stages of its policy development to ensure they take into account the consumer interest.

The Panel also takes a keen interest in broader issues for consumers in financial services where it believes it can help achieve beneficial change and outcomes for consumers.

Since the Panel was established in 1998, we believe the Panel has helped deliver significant, positive benefits for consumers. We support the FSA where we believe policies can help consumers and challenge the FSA forcefully when we feel consumers would be disadvantaged.

Members of the Panel are recruited through a process of open competition and encompass a broad range of relevant expertise and experience.

Further information about the Panel can be obtained from the Panel's website:
http://www.fs-cp.org.uk/

THE FINANCIAL SERVICES PRACTITIONER PANEL

RESPONSE TO HM TREASURY CONSULTATION PAPER 'A NEW APPROACH TO FINANCIAL REGULATION: JUDGEMENT, FOCUS AND STABILITY' OF JULY 2010

18 OCTOBER 2010

EXECUTIVE SUMMARY

i. This submission is from the Financial Services Practitioner Panel (The Practitioner Panel, a body set up under Financial Services and Markets Act 2000 (FSMA) as an independent Panel to the Financial Services Authority (FSA). Details of the role and remit of the Practitioner Panel are at Appendix 1.

ii. As stated in its Annual Report, the Practitioner Panel believes that an effective regulator is clearly in the interests of consumers, practitioners and the wider economy and was accordingly glad of the opportunity to engage in this consultation process. In formulating its overall position on the proposed reforms set out the HM Treasury's consultation paper 'A new approach to financial regulation: judgement, focus and stability' of July 2010, the Practitioner Panel undertook extensive consultation with a wide range of stakeholders and interested parties and we believe therefore that this response provides a uniquely broad perspective of views from across the regulated community which the Panel represents. As this response constitutes an agreed position for the Practitioner Panel as a whole, it may not necessarily fully represent the more specific views of individual members of the Practitioner Panel or the position of the firms that they represent. A separate response has been prepared by the Smaller Businesses Practitioner Panel, and so we have not covered specific issues for smaller firms in this document.

iii. This response should be read in conjunction with the Practitioner Panel's separate submission (attached at Appendix 2) to the Treasury Committee inquiry into financial regulation which sets out our thoughts and observations in relation to a broader range of matters associated with the adoption of the 'twin peaks' regulatory framework and the timing of the transition.

iv. The objectives of the regulatory authorities

We support the notion that each authority should be assigned a single clearly defined objective. This should not however be unconstrained and each authority, including the Financial Policy Committee (FPC), should be legally required to balance its decisions and actions in relation to a range of clearly defined additional factors. Our comments on the nature of these factors are set out in the following pages of this response.

We note the Government is seeking specific feedback on the extent to which these should continue to include reference to potential adverse impacts on innovation and the competitiveness of the UK financial services sector. In this regard, we are strongly of the view that competitiveness, competition and innovation are critical to consumer choice and the long term sustainability of UK financial markets and therefore each of the authorities should continue to have regard to these matters when performing their duties.

We fully support the application of the existing FSMA principles of good regulation, particularly the use of robust cost benefit analysis (which is referred to in the FSMA proportionality principle). We believe further work is required to improve the robustness of the cost benefit analysis and embed this into day-to-day operations and decision making processes. We believe the principles of this discipline are equally relevant to conduct, prudential and financial stability matters and the regulatory reforms provide an opportunity to clearly set out how these factors should be applied in practice.

The new regulatory framework should include adequate challenge of proposed measures and checks to ensure their effective ongoing usage, as well as a need for each authority to disclose how they have discharged their responsibilities in this regard.

v. Enhancement of the Bank's accountability mechanisms

We support the strengthened focus on financial stability. However, given the overall power vested in the Bank of England (the Bank) as a consequence of moving from the existing tripartite regulatory system with an integrated prudential and conduct regulator to a 'twin peaks' model with a focus on financial stability, we are concerned that the current range of accountability and transparency mechanisms proposed are less than those currently applied in the existing regulatory framework.

In order to address this matter and support the FPC and Prudential Regulatory Authority (the PRA) in their decision making processes we are advocating that a range of enhancements be made. These include first, extending the role proposed for a Practitioner Panel from the Consumer Protection and Markets Authority (the CPMA) to include matters falling within the PRA mandate (further information on this matter is set out below); and second, the establishment of a non-executive advisory group comparable to the previous Board of Banking Supervision that will provide commercial and international input, support and expertise to the FPC and broader supervisory decision making processes at the highest level. This will bring several benefits: appropriate commercial input, a forum for discussion on international issues and improved coordination of prudential, conduct and financial stability matters.

We also believe that to successfully implement the proposed reforms it will be important to ensure that the independent members of the FPC are senior, highly regarded and influential industry figures who collectively are able to represent the broader views of the financial services industry and challenge the executive members effectively.

vi. Strengthening the role and positioning of the independent panels

We believe the existing independent panels have provided valuable input, support and challenge to the FSA on a wide range of matters in the past, including the provision of industry insight and expertise on policy related matters and regulatory initiatives, emerging industry risks, as well as the FSA's performance. This input has regularly included a stress on international matters, the need for real cost benefit analysis of proposed regulatory initiatives and appropriate commercial input. We have also provided ad hoc sounding board support on the resolution of a range of other issues and are proactively engaged by the FSA on a wide range of other matters.

Consequently, we advocate that the existing roles of the independent panels are extended beyond the CPMA to act in a similar capacity for the PRA and to support the supervisory decision making processes of both authorities. We believe that the current balance of interests in the Practitioner Panel, Smaller Businesses Practitioner Panel and Consumer Panel is important and should be maintained – with the addition of the SBPP becoming a statutory panel. Therefore all the Panels should work across the regulatory structure.

A Practitioner Panel that spans both authorities will also be better placed to provide guidance, support and industry challenge on the commercial, operational and cost impacts of prudential regulatory matters (particularly any unintended and adverse impacts), the level of coordination across the authorities, as well as the representation of UK interests internationally. We also believe the Practitioner Panel's position should be strengthened through the creation of a right to raise major concerns on financial stability matters directly with the FPC.

In order to ensure the Practitioner Panel is able to discharge its broader mandate, it will be important to revisit its membership and increase the level of support it currently receives.

In summarising points (iv) and (v) above, we believe that in finalising its reforms the Government should enhance the accountability mechanisms proposed for the Bank in the following three ways:

- Extend the role proposed for the Practitioner Panel to include matters falling within the mandate of the PRA and strengthen its position through the creation of a right to raise major concerns on financial stability matters directly with the FPC;
- Establish an advisory body comparable to the previous Board of Banking Supervision to provide commercial input and support to the FPC and broader supervisory decision making processes at the highest level; and
- Ensure the 'independent' members of the FPC are strong and influential figures who collectively are able to represent the broader views of the financial services industry and challenge the executive members effectively.

vii. The role of the CPMA as a 'consumer champion'

We have a number of suggestions relating to the positioning of the CPMA within the regulatory framework. We would preface these with the observation that conduct and prudential regulation have large areas of overlap and that protecting consumers as whole will involve choices about which regulatory action to take. The first of our suggestions relates to its role as a 'consumer champion'. Whilst we recognise and support the Government's overall consumer protection aims in this regard, we are concerned that currently this term is undefined and there is a real risk that if it were to be narrowly interpreted or viewed as a lobbying or campaigning body on consumer rights, the actions of the CPMA could result in a detrimental impact on consumers and market participants alike.

A regulator such as the CPMA will have to make difficult decisions around which consumers to protect and in what way. Recent examples include the FSA's Retail Distribution Review and the increasing trend in product regulation. Whilst these initiatives have been designed to benefit consumers, there is a danger they will result in a detrimental impact on a far greater proportion of consumers and adversely impact the overall level of market competition and a wide range of firms. Consequently, we believe the CPMA should be more balanced in its outlook and play a key role in helping to maintain healthy and vibrant markets that are to the benefit of consumers and other participants. It would help in this regard if it were to take over from the current FSA the twin statutory objectives of maintaining market confidence and securing the appropriate degree of protection for consumers.

We note the Government intends to engage in a frank and open debate on this matter and makes reference to consumer responsibilities in the consultation paper. We welcome this initiative and would urge early dialogue on this matter, before the CPMA is established, with the outcomes used to clearly set out the balance required between the regulation and supervision of firms, consumer responsibilities and the role of the state.

viii. The positioning of the CPMA as a 'second tier' regulator

The second area of concern in relation to the CPMA is its positioning relative to the PRA. The consultation paper currently refers to the PRA as acting as the lead regulator over the CPMA in the event of any conflicts. We are concerned that this could inadvertently result in the CPMA being regarded as being a 'second tier' regulator which in turn could adversely impact its ability to attract and retain high calibre staff, the quality of regulation it provides, as well as its ability to effectively represent UK interests internationally.

In order to allay industry concerns in this regard, we urge the Government to ensure the early appointment of the CPMA CEO, who should be an individual of equal standing as the PRA CEO, together with the announcement of the management structures of the regulatory authorities which should include well regarded individuals within senior positions who are collectively able to represent the broader interests of the financial sector.

ix. Clarity of decision making processes and escalation mechanisms

Given the high degree of collaboration required across the authorities, we recognise and endorse the need for clearly defined mechanisms to support decisions and the resolution of conflicts. We believe that it would be inappropriate for the PRA to have an absolute right of veto over the CPMA in all instances, particularly given that in many instances 'conduct' and 'prudential' matters are inextricably linked. Examples of this include the recent ban on short selling which involved the use of 'conduct' measures that were designed to address 'prudential' concerns. Other examples are set out in the following pages of this response. We also believe the Bank's existing framework for making decisions will need to be enhanced given the difference in the nature and volume of decisions that the PRA will be required to make.

In this context, we would welcome greater clarity on the processes that will be put in place to support decisions involving multiple authorities (including overseas regulators), as well as the mechanisms that will be used to ensure the timely and effective escalation and resolution of issues and conflicts, including where ultimate authority resides for such matters.

x. The positioning and fragmentation of markets regulation

The proposed positioning and fragmentation of markets regulation through the creation of a new tripartite structure is one of the more concerning areas of the proposals, especially the proposal to merge the UKLA with the FRC. We believe the operation of this framework will create significant challenges given the real-time nature of markets supervision that will impede it effectiveness, including the ability of the authorities to intervene in a timely manner. This is particularly relevant to primary and secondary markets regulation where there is a clear need for synergy and close collaboration across the authorities involved in such activities, as well as a high degree of commonality in specialist skills and resources required by both authorities.

We can see no benefit whatsoever in the Government's proposal to merge the UKLA with the FRC and are not aware of any other major European Union country which has split its supervision of primary and secondary markets regulation across different regulators.

Given these issues, the unique and leading position of the UK in wholesale markets, the systemic importance of many firms involved in wholesale markets activity, as well as the strong correlation between 'conduct' and 'prudential' risks, we would urge the Government to reconsider its proposals in relation to markets regulation.

We believe a more effective framework would keep primary and secondary markets regulation together and involve assigning responsibility for the supervision of wholesale markets to a single authority which has greater oversight of the end-to-end transaction cycle. In this context we consider this would be better undertaken either by a single strong securities regulator (which we recognise will create an additional body and the issues that flow from this) or a separate division of the Bank.

If the current proposals are implemented as drafted, it will be absolutely vital for the Markets Division of the CPMA to be given adequate authority, decision making responsibility and 'equal' status to consumer protection.

xi. The dilution of the UK's international position

Given the increasing role played by the European Union in the regulation of UK financial markets, the limits of UK representation at this level and the significant international regulatory change agenda, it is critical that the UK has a strong and influential voice in EU policymaking.

It is, in our view, unwise that at precisely the same time as the European Union regulatory regime is reformed and three new Authorities are established, that the proposals for the UK reform could result in a mismatch in terms of the representation at this level, or even a dilution of influence.

We believe that the proposed framework for engagement at the international level needs to be strengthened to ensure more effective representation of UK interests and this should be addressed as a matter of priority. One leg of this would be to refrain from separating primary and secondary markets regulation. Another would be to allocate responsibility for all market infrastructure providers (exchanges, trading platforms and clearing houses) to a stronger markets authority. This would help preserve an authoritative voice in EU-level discussions which would directly derive from, and be reinforced by, domestic responsibilities.

CONSULTATION QUESTIONS

The Bank of England and Financial Policy Committee (FPC)

> ***1. Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?***

1.1 In order to help ensure clarity of accountability, we believe that the FPC should be assigned a single clearly defined objective. We advocate that the objective of the FPC should be to maintain financial stability. However, this should not be unconstrained. We have three main comments in this regard:

- Establish clear secondary objectives (see the following comments in this section and section 2);
- Strengthen the 'independent' checks and balances on the FPC (see the following comments in this section); and
- Establish Practitioner Panels for the PRA (see section 12).

1.2 As the FPC's actions and decisions could result in far reaching consequences for financial markets, businesses more generally, consumers and the economy as a whole, there is a need to ensure that the potential impact of its actions is fully considered in discharging its duties. Therefore we believe that this objective should be supplemented with a series of strong and clearly defined secondary factors that the FPC should be legally required to consider in performing its duties. Our views on the nature and application of these secondary factors are set out below.

1.3 Whilst we see clear benefit in the creation of the FPC to address macro-prudential risks, it is plain that when coupled with the PRA and the Bank's existing monetary policy objective, significant power will be vested in the Bank as part of the 'twin peaks' regulatory framework. In this context, we are concerned that despite the presence of 'independent' members of the FPC, which we welcome, fewer checks and balances are proposed in relation to these aspects of the new regulatory framework than currently apply to the present regulatory regime.

1.4 These concerns include the accountability mechanisms for effective external challenge and consultation with the FPC in relation to its decision making processes. Whilst we recognise that monetary policy is of the utmost importance and not in itself in any way easy, the decisions required of the Monetary Policy Committee and range of tools at its disposal, are narrower and more clearly defined than is currently envisaged for the FPC in respect of financial stability. We also believe the FPC's decisions are likely to involve a high degree of judgement and, as outlined above, could potentially result in far reaching consequences for individual firms, consumers and indeed society as a whole. We argue that this is particularly important to take into account because many of the tools which are being discussed in respect of macro-prudential regulation are relatively unproven and might have unintended adverse consequences. Therefore, we believe the current range of checks and balances set out in the consultation paper need to be strengthened to provide a greater degree of transparency, scrutiny and challenge.

1.5 As the proposals indicate the FPC will comprise of a minority of ‘independent’ members, it will be critical to ensure that these are senior highly regarded and influential figures who are also free of conflicts of interest in relation to their role on the FPC and their other business commitments. As with the MPC, membership of the FPC should be regarded as a substantial role that will require a significant time commitment of its ‘independent’ members and commensurate level of support. It will also be important to ensure that collectively the members of the FPC are able to represent the various sectors of the financial services industry effectively and we welcome the Government’s comments in paragraph 2.43 of the consultation paper in this regard.

1.6 Whilst one option would be to revisit the membership of the FPC and ensure this comprises a majority of ‘independent’ members which would bring it into line with good governance practices, we assume this has been considered and regarded as being impractical in the case of the FPC. We would welcome the Government’s views on why this is the case.

1.7 To the extent that the FPC may continue to comprise a majority of Bank executives, we would advocate that an independent advisory and consultative body, comparable to the previous Bank of England Board of Banking Supervision, be established within the new regulatory framework to provide independent commercial input, support and expertise to the FPC and broader supervisory decision making processes at the highest level. This body could also provide advice and support in a number of other key areas including:

- the general principles and policy of financial services supervision;
- the development and evolution of supervisory practice;
- the development and administration of the related supervisory legislation;
- the structure and staffing of the regulatory authorities; and
- overseeing the resolution of potential conflicts and issues within the Bank and across the regulatory authorities, as well as the representation of UK interests at the international level, particularly European Union policy fora.

To help ensure the independence of this body, it should be free to take the initiative in raising matters in these areas and have rights of access to the Chancellor.

To ensure that industry views are appropriately represented in its deliberations, this body should comprise senior and experienced individuals who collectively are able to effectively represent each sector of the financial services industry.

1.8 Our comments on role and position of the statutory panels are set out in section 12 below.

2. If you support the idea of secondary factors, what types of factors should be applied to the FPC?

2.1 Given the matters set out above and the far reaching impact of its decisions, we support the view that the FPC should be provided with a clear and transparent range of factors that it should be legally obliged to consider and balance in determining a particular course of action in relation to its primary objective.

2.2 The consultation paper highlights the need for the FPC to take into account the economic and fiscal impact of its actions on the financial services sector and the economy more widely (e.g. levels of lending to businesses and families and the competitiveness and profitability of UK firms in relation to competitors based elsewhere), as well as the statutory objectives of other regulatory authorities. We welcome these views, as well as the need to reflect these matters in the range of factors that the FPC will be obliged to consider.

2.3 We also believe the FPC should have regard to using the resources of the regulatory authorities efficiently and effectively, and ensure that the impact of its judgements on firms, consumers and the economy more broadly are proportionate to the expected benefits. Whilst we recognise the practical challenges associated with the use of devices such as cost benefit analysis in relation to prudential matters (particularly macro-prudential matters), we believe the principles of such approaches provide an essential and structured discipline that should form an integral part of the overall framework within which supervisory decisions, including those related to financial stability, are made.

2.4 In addition to considering the competitiveness of UK firms relative to firms based elsewhere in the EEA, we believe domestic competition and innovation are critical to consumer choice and the long term sustainability of UK financial markets. In his report titled 'UK international financial services – the future' of May 2009, Sir Winfried Bischoff states 'perhaps the greatest single factor in the UK's success as a trading nation has been the adherence by successive governments to the philosophy of open and competitive markets'. He also provides a wide range of examples of positive innovation and sets out a number of areas where society continues to face significant unmet needs which are likely to remain unresolved without financial services innovation. These include provision for the growing retirement needs of ageing populations, financing increasingly expensive and complex healthcare systems, as well as national debt management and improved risk management products. He also states 'a successful international financial centre needs to be at the leading edge of market developments, and like all forms of economic activity needs innovation to prosper and progress. The Government and the industry should ensure that the financial services industry can remain at the forefront in finding new solutions to emerging financial needs and markets'. We fully support these views and believe the FPC should also be required to consider the potential impact of its actions on these matters when performing its duties.

2.5 Finally, we would also advocate there should be a requirement on the FPC to explain how it has discharged these responsibilities.

3. How should these factors be formulated in legislation – for example, as a list of 'have regards' as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?

3.1 We believe that the factors set out above should be formulated in legislation as a series of strong and clearly defined factors that the FPC must 'have regard to' and balance in carrying out its primary function.

3.2 We value the importance of all of the FSMA principles of good regulation and have in the past raised concerns relating to their application. We believe the regulatory reforms provide an opportunity to clearly set out how these factors should be applied in practice, as well as the controls that will be put in place to ensure their effective ongoing usage. We are of the view that these factors should not be regarded as being of lesser importance than the primary objective. Instead they should be considered as being an integral part of how the FPC will seek to achieve its primary objective and used to determine an appropriate course of action by the FPC (and PRA and CPMA) in the event that all other required considerations are equal.

Prudential Regulatory Authority (PRA)

4. The Government welcomes respondents' views on:

- ***whether the PRA should have regard to the primary objectives of the CPMA and FPC;***
- ***whether some or all of the principles for good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice, should be retained for the PRA;***
- ***whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and***
- ***whether there are any additional broader public interest considerations to which the PRA should have regard.***

4.1 We support the Treasury's proposal to assign the PRA with a primary objective that will be supplemented by a statutory range of factors that it 'must have regard to' in carrying out its primary function.

4.2 The strong interrelationships between 'prudential' and 'conduct' issues and regulation have been widely acknowledged in the consultation paper, as has the potential impact of one authority's actions on the objectives of the others. We endorse these views and support the notion that in performing their duties each authority should 'have regard to' the primary objectives of the other. This will also help to ensure that effective cooperation and collaboration mechanisms proposed in the reforms are maintained across the differing authorities, and the risk of overlap and underlap is managed.

4.3 The existing FSMA principles of good regulation provide a useful mechanism that is designed to ensure regulators take into account the impact of their decisions and actions on a range of defined matters and avoid unintended consequences. Therefore, we believe both the PRA and CPMA should 'have regard to' the existing FSMA principles of good regulation in performing their duties.

4.4 As outlined above, we believe the competitiveness of the UK financial service industry, competition and innovation are critical to consumer choice, the long term sustainability of UK financial markets and the economy more generally. Therefore, in common with our comments in relation to the objectives of the FPC, we are strongly of the view that both the PRA and CPMA should 'have regard to' the potential impacts of their actions on these matters when performing their duties. There should also be a requirement for each authority to explain how it has discharged this responsibility in its Annual Report.

4.5 As noted above, we have previously raised concerns with the way in which all the principles have been applied in practice. A particular area of concern relates to the use of cost benefit analysis (which is referred to in the proportionality principle), where we believe further work is required to improve the robustness of the analysis performed and embed this into the day to day operations and decision making processes. Industry practitioners believe the effective use of cost benefit analysis is a vital part of a regulator's decision making. As also stated previously, we are of the view that these factors should not be regarded as being of lesser importance than the primary objective and should be considered as being an integral part of how the regulatory authorities will seek to achieve their primary objectives and used to determine a course of action in the event that all other required considerations are equal. The implementation of the proposed reforms provide an opportunity to clearly set out how these factors should be applied in practice, as well as the controls and independent checks and balances that will be put in place to ensure their effective ongoing usage.

5. Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?

5.1 In formulating this response we have assumed we should focus on the operating models proposed in the consultation document for the PRA and the CPMA rather than the broader move from a single integrated regulator to a 'twin peaks' model per se. Our views on the key issues and risks arising from the adoption of a 'twin peaks' regulatory framework have been set out in our separate response to the Treasury Select Committee inquiry (attached) into financial regulation and have not been repeated below.

5.2 In our view it is important to keep policy formation and the related supervisory activities closely integrated and we are therefore generally supportive of the idea that each authority should be responsible for policy decisions, granting or amending approvals and permissions, and undertaking supervisory and, where appropriate, enforcement activities in relation to those areas falling within their remit. However, we recognise this approach creates a number of key risks that will need to be managed effectively. These include ineffective communication, coordination and cooperation between the various regulatory bodies in relation to policy decisions and supervisory and enforcement matters, as well as increased cost, duplication and underlap. We are also aware that the heightened nature of these risks is an inevitable consequence of creating the 'twin peaks' regulatory framework.

5.3 Whilst we are cognisant that the consultation paper outlines a range of mechanisms that should help to mitigate these risks, there is currently insufficient clarity on how the overall regulatory system will be monitored and where ultimate authority resides for the resolution of conflicts between the regulatory bodies. For instance, given the PRA is being constituted as an operationally independent subsidiary of the Bank, it is unclear if the FPC has a right of veto over its decisions and the resolution of potentially differing views across the regulatory bodies such as the PRA approval of a change in ownership of a major UK financial institution that potentially had financial stability implications or the findings of the current independent commission on banking etc.

5.4 The proposals are at present insufficiently detailed to determine how effective the coordination mechanism will be in practice or how they will impact firms. We are concerned that there is a lack of clarity on how supervisory decisions involving both authorities will be made, as well as the mechanisms that will be put in place to ensure that issues and conflicts between the authorities are escalated and resolved in an effective and timely manner e.g. the granting of approvals and permissions in the event of differing views across the authorities and determining whether an approach which is primarily prudential or conduct or both is required to address matters arising from supervisory activities. If a relatively new macro-prudential regulatory initiative is implemented, it will be vital that the effects on individual firms, groups of firms and consumers are fully considered. Similarly, there is a lack of clarity on how groups and EEA passported firms will be treated within the proposed framework and the extent to which these will also apply to other agencies such as the Economic and Financial Crime Agency, the Competition Commission and the Office of Fair Trading. Given the nature and volume of decisions that will be required of the PRA, we believe that the Bank's existing framework for making decisions will need to be significantly enhanced.

5.5 The proposals are also silent on the extent to which an independent appeals process will exist within the new framework (such as that currently in operation under the stewardship of the Regulatory Decisions Committee) and, if so, how this is intended to work. We would welcome further guidance on these points, as well as the controls that will be put in place to monitor and ensure the ongoing effectiveness of the coordination mechanisms. We believe these should include clearly defined responsibilities in this regard and an independent review at least annually.

5.6 We note that the Government intends to look closely at the potential creation of a shared services capability for the new authorities and welcome this initiative given the importance of cost effective regulation. We believe the regulatory processes and systems should be harmonised wherever practicable and support the creation of gateways that enable the effective flow of information and decision making across the authorities. Whilst this will help to mitigate the additional regulatory burden the new regulatory approach will inevitably place upon firms, we remain concerned that this will be a direct consequence of the new framework.

6. Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focussed approach to supervision?

6.1 Although we do not object to a 'judgement focused approach to supervision' per se, the proposals do not set out the principles upon which the approach will be based. Judgement led regulation is acceptable so long as it is on the basis of clear and transparent principles which are applied on a consistent basis. These should also be aligned with European and global initiatives, applied to international firms operating in the UK and avoid any arbitrary application of judgement that could disadvantage UK firms.

6.2 We would be concerned that the use of predetermined thresholds to drive the point at which supervisory intervention becomes mandatory could be interpreted as rules and potentially result in dysfunctional behaviour.

6.3 We believe the transition to the new framework provides an opportunity to rebalance the work performed by supervisors in a way that does not seek to second guess management or replicate the work done in firms, and removes the potential for micro-regulation.

7. Are safeguards on the PRA's rule-making function required?

7.1 We advocate that the PRA's rule making function should be subject to the same safeguards as are proposed for the CPMA, including a statutory process, consultation with the statutory panels and wider public consultation, as well as a duty to carry out detailed market failure analysis and robust cost benefit analysis prior to their introduction.

7.2 We believe that this is an area where Practitioner Panel input has been of value in the past and used to inform the FSA's policy decisions. We also believe this is an area where the statutory panels can continue to play a mutually beneficial role within the new regulatory framework and set out further details in this regard in section 12 below.

7.3 It will be noted from earlier comments that we have in the past raised concerns with the FSA relating to their use of cost benefit analysis and believe further work is required to improve the robustness of the analysis performed and embed this into its decision making processes. These concerns are particularly acute for the FSA's policy decision making processes and we believe this matter should be addressed as part of the implementation of the new regulatory framework.

8. If safeguards are required, how should the current FSMA safeguards be streamlined?

8.1 As outlined in paragraphs 7.1 to 7.2 above, we believe the PRA's rule making function should be subject to the same safeguards as are proposed for the CPMA. As will also be noted from these paragraphs, rather than streamlining the current safeguards, we believe certain elements need to be strengthened, particularly the use of cost benefit analysis. Whilst we recognise changes in prudential regulation are increasingly determined at EU or international level, the use of cost benefit analysis will continue to be relevant in instances where, for example, the PRA may wish to implement super-equivalent practices where permissible. Additionally, the existing independent panels can provide useful input and support to the PRA in formulating its strategy and position in relation to policy decisions made at the international level. Further information in this regard is set out in section 12 below.

9. The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.

9.1 Whilst we are generally supportive of the Government's proposals in relation the PRA Board structure, in particular that it will comprise a majority of non-executive members and include the CPMA CEO, we believe that a number of improvements are required. Firstly, in order to help ensure that the functioning of the Board better represents the interests of the financial services industry as a whole, it will be important to ensure that its independent members include senior and experienced individuals from other sectors beyond banking. And secondly, to help ensure its effective operation and independence from the Bank, it will be important to ensure that the external members are able to challenge the views of its executive members effectively. Therefore, the independent members should all be senior, highly regarded and influential industry figures who are also, as far as possible, free of conflicts of interest in relation to their role on the Board and their other business commitments. Mechanisms should be put in place that will ensure potential conflicts of interest are identified and, where appropriate, managed effectively.

9.2 Whilst we do not have the details of the proposed management structure at this stage, we believe it will be similarly important to ensure that senior positions within this also include experienced individuals from other sectors beyond banking. We urge the early announcement of these positions which may help to allay industry concerns that, as a banking led regulator, there is a risk that the PRA may inappropriately seek to apply practices adopted in the banking sector to other sectors of the financial services industry. We also believe the early announcement of the proposed structure and the senior positions within this will play a key role in helping to attract and secure appropriate resource and reduce the increasing risk of staff attrition.

Consumer Protection and Markets Authority (CPMA)

10. The Government welcomes respondents' views on: • ***whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC;*** • ***whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which;*** • ***whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and*** • ***whether there are any additional broader public interest considerations to which the CPMA should have regard.***

10.1 We are supportive of the Treasury's proposal that, in common with the PRA, it will assign the CPMA with a primary objective which will be supplemented with a statutory range of considerations that it must take into account and balance in carrying out its primary function.

10.2 Whilst we recognise and support the Government's overall aims in relation to the protection of consumer interests in their purchase and use of financial products and ensuring their fair treatment, we believe the regulator should also play a role in helping to maintain healthy and vibrant markets that are to the benefit of consumers and other public interests. Consequently, we are very concerned at the notion of the CPMA being positioned as a 'consumer champion', particularly as this is an emotive and undefined term and there is a risk of it being narrowly interpreted which could result in a detrimental impact on consumers and market participants alike. We do not believe the CPMA should be positioned as a consumer lobbying or campaigning organisation. For example, actions taken by the CPMA with an undue bias towards consumer interests could restrict the availability and price of financial products, as well as market competition. A recent example of this is the FSA's Retail Distribution Review which may result in improvements for a segment of the market but may potentially have a detrimental impact on a far greater proportion of consumers. This brings out a key aspect of consumer protection which will be relevant to the CPMA: some decisions for the benefit of consumers as a whole may not benefit all consumers. The CPMA will have a difficult task of making choices in this respect.

10.3 A further example is the increasing trend in product regulation. Whilst we recognise the intention behind this initiative is designed to benefit consumers, the introduction of such regulation has not been met with a commensurate reduction in the related conduct or sales regulation. The increased regulatory burden this has placed on firms is in danger of stifling industry participants and, if left unchecked, is likely to impact market dynamism and competition as well as the price and availability of products to the detriment of consumers.

10.4 We are also mindful that it should be formally acknowledged by regulators that as it is not possible to eliminate all risks relating to financial products (e.g. the level of investment returns), the term 'consumer champion' may inadvertently be misinterpreted by consumers to give them a false level of assurance over the risks of a range of financial products. This would be an unfortunate consequence.

10.5 Consequently, we believe that it will be vital for the CPMA to ensure that the market works effectively for consumers and is balanced in its outlook, in that it gives equal weight to the interests of consumers and financial markets participants. We would therefore recommend that it takes over the interlinked objectives of the FSA maintaining market confidence and securing an appropriate degree of protection for consumers. In discharging its responsibilities it will need to seek a balance between the two objectives. In this context, we welcome the Government's intention to engage in a frank and open debate on this matter, as well as its reference to consumer responsibilities in paragraph 4.25 of the consultation paper. We would urge dialogue on this important matter takes place before the CPMA is established and the outcomes used to clearly set out the balance between the regulation and supervision of firms, consumer responsibilities and the role of the state, for example, the impact of pension provision and long term care. We also believe that it will be important for the regulatory framework to include safeguards that prevent the introduction of undue bias.

10.6 The use of consumerist language in relation to the CPMA is also unfortunate as it creates a risk the proposals may be misinterpreted and inappropriately applied to the wholesale markets sector by their Markets Division which will often be dealing with professional wholesale counterparties. In order to help set the tone of future regulation and avoid the introduction of unintended consequences, we believe the proposals should set out some broad guidelines on the expectations of wholesale market participants in relation to their purchase and use of financial products

10.7 Given the role of the CPMA in relation to UK representation on international policy fora and the potential for misinterpretation of the term 'consumer champion', we believe that consideration should be given to changing the current working title of this authority to 'Conduct and Markets Regulatory Authority' which would better represent the nature of its mandate.

10.8 As set out earlier in this response, the range of considerations that the CPMA is required to 'have regard to' should not be treated as being of lesser importance than its primary objective. Instead they should be treated as an integral part of how the CPMA will seek to achieve its primary objective and used to determine a course of action in the event that all other required considerations are equal.

10.9 For the reasons also set out earlier in this response, we believe the range of considerations that the CPMA must have regard to in carrying out its duties should include reference to the objectives of the other authorities and all the matters currently set out in the FSMA principles of good regulation, including competitiveness of the UK, competition in financial services markets and innovation. (See paragraphs 4.2 to 4.5 for further information). Our earlier comments relating to the need to more effectively embed the use of these factors into the regulators' day to day operations and decision making processes are equally relevant to the CPMA, as is the need to improve the related control environment.

11. Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?

11.1 As with the PRA Board, we are generally supportive of the Government's proposals in relation to the CPMA Board structure, in particular that it will comprise a majority of non-executive members and include the PRA CEO as an ex officio member. However, we believe that a number of improvements are required.

11.2 In common with our views on the membership of the PRA Board, we believe that it will be important to ensure that the CPMA Board's 'independent' members include senior and experienced individuals from other sectors beyond banking who are able to challenge the views of its executive members effectively. Therefore the independent members should all be senior, highly regarded and include influential industry figures who are free of conflicts of interest in relation to their role on the Board and their other business commitments. Mechanisms should be put in place that will ensure potential conflicts of interest are identified and, where appropriate, managed effectively.

11.3 We are concerned that unlike the PRA, the CEO of CPMA is yet to be appointed and the detrimental effect this may have on current staff attrition levels and the ability to attract and retain high quality talent that will transfer to the new authority. In our view this position should be given equal prominence as the PRA CEO and the appointment made as soon as possible. Given the CPMA's proposed mandate, including its role in Europe, we believe that this individual should be a highly regarded and influential figure who has strong wholesale markets knowledge and experience.

11.4 We are also somewhat concerned that the proposals suggest the PRA will act as the lead regulator in any conflicts with the CPMA. Whilst we understand the rationale for this, this position is likely to result in the CPMA being regarded as a 'second tier' regular both domestically and internationally and have a number of adverse consequences. These include a diminished ability to exercise influence in EU policymaking, additional challenges in seeking to attract and retain appropriate resource and an undesirable impact on the quality of regulation. Whilst we recognise the need for clearly defined processes for making decisions across multiple authorities and mechanisms to resolve conflicts, we are of the view that the CPMA should be positioned as being of equal standing as the PRA. This should include the appointment of individuals to other senior positions within its management structure, all of whom should be well regarded and experienced individuals and collectively represent a broad range of financial services sectors. Such a position may also help to give the CPMA greater credibility in its role at the international level.

11.5 As with the announcement of the CPMA CEO and PRA structure, we urge the early announcement of the CPMA management structure and appointment of senior positions.

11.6 Given that in many areas 'conduct' and 'prudential' risks are inextricably linked (e.g. inappropriate sales practices could have an adverse effect on the quality of a firm's assets and therefore increase its prudential risk), it is conceivable that there may be instances where a 'conduct' led approach or a combined 'conduct' and 'prudential' approach may be the way to resolve issues arising from the other authorities' supervisory duties. We believe that it would be inappropriate for the PRA to have absolute right of veto over the CPMA in such circumstances. Instead, the framework should set out clearly defined mechanisms through which such matters are escalated and resolved in a timely and effective manner, as well as an independent appeals process.

12. The Government welcomes views on the role and membership of the three proposed statutory panels for the CPMA?

12.1 We believe the existing independent panels have provided valuable input, support and challenge to the FSA on a wide range of matters in the past and welcome the Treasury's proposal to put the Smaller Businesses Practitioner Panel (SBPP) on the same statutory footing as the existing Practitioner Panel and the Financial Services Consumer Panel.

12.2 More specifically, the role performed by the Practitioner Panel has included the provision of industry insight and expertise on policy related matters and FSA initiatives, emerging industry risks, as well as the FSA's performance. We have also provided ad hoc sounding board support on the resolution of range of other issues and are proactively engaged by the FSA on a wide range of matters.

12.3 Consequently, we advocate that the existing roles of the independent panels are extended beyond that proposed in respect of the CPMA to act in a similar capacity for the PRA and support the supervisory decision making processes of both authorities. This could be achieved by proposing separate Practitioner Panels for the CPMA and PRA. However, the Government may want to consider streamlining this. Rather than creating separate Practitioner Panels within the CPMA and PRA, we believe that it would be more effective to establish a single Practitioner Panel and Smaller Businesses Practitioner Panel that span both authorities. Such an approach would better enable these panels to provide guidance, support and industry challenge on the commercial, operational and cost impacts of prudential regulatory matters (particularly any unintended and adverse impacts), the level of coordination across the authorities, as well as the representation of UK interests internationally. It also reduces the level of inefficiency that would otherwise arise from the creation of two separate panels. In doing so, the existing membership of the panels will need to be revisited to ensure they have the requisite skills and experience to discharge its revised mandate effectively. It will also be important to ensure that the panels have access to additional secretariat support, including analytical, reporting and other administrative resource.

12.4 The reforms also present an opportunity to strengthen the role of the Practitioner Panel and SBPP and clarify their mandate. Currently, the FSA is legally required under FSMA to consider representations made by the Practitioner Panel and, where it disagrees with a view expressed or proposal made in a representation, the FSA is required to provide the Practitioner Panel with an explanation in writing of its reasons for disagreeing. The same also applies to the FSA's relationship with the Consumer Panel. Neither Panel expects that formal representations under the Act will be required often. This is nonetheless an important facility: whilst the Practitioner Panel has no fear the CPMA and PRA administration would ever seek to sideline the Practitioner Panel or its views, it continues to be important to protect against such a possibility. We believe this facility should be retained within the new regulatory framework and extended to the SBPP. The panels positions should be further strengthened through the creation of a right to raise major concerns about the impact of regulation on financial stability with the FPC.

13. The Government welcomes views on the proposed funding arrangements, in particular, the proposal that the CPMA will be the fee- and levy-collecting body for all regulatory authorities and associated bodies.

13.1 We are concerned with the overall cost of funding the FSCS, the budgetary uncertainty this is creating for firms generally and the significant burden this places on smaller well run firms. In this context, we welcome the Government's current review of the FSCS funding arrangements and look forward to hearing its conclusions and proposals in due course.

13.2 We also welcome the Government's proposal to make the PRA and CPMA each responsible for setting the fees and making the rules in respect of the activities under their remit in a manner that ensures simplicity, avoids cross-subsidy between the regulators and helps to reduce the cumulative burden placed upon firms. The mechanisms used for determining fees, both individually and in aggregate, should be subject to independent oversight and review.

13.3 Similarly, we support the notion that the CPMA should be responsible for making the rules in relation to the funding of the FOS, FSCS and CFEB and act as the sole agency responsible for the collection of fees on behalf of all the regulatory authorities and associated bodies.

14. The Government welcomes views on the proposed alternative options for operating models for the FSCS.

14.1 We are of the view that the allocation of responsibility for making rules in relation to compensation and levies, and the choice of FSCS operating models are not inextricably linked and can be dealt with separately. Our comments in relation to the first of these matters are set out above. As the FSCS currently administers a range of different compensation schemes, the arrangements set out above need not result in the demise of the current cross-subsidy arrangements between different classes of levy payers.

14.2 Irrespective of where responsibility for making the rules relating to compensation and levies lies, we believe the FSCS should continue to act as the sole independent body responsible for administering consumer compensation schemes on behalf of both the CPMA and PRA. This will help to ensure consistency in the administration of compensation schemes for consumers and firms, as well as reduce overall administration costs.

14.3 Given the clear linkage with the work of the Bank in the event of a failure of a firm, we support the notion that the FSCS board should include a PRA executive. Similarly, given the close working relationship with the CPMA, the FSCS board should also include a CPMA executive. This will also help to support the escalation and resolution of issues and conflicts that could arise between the authorities, without adversely impacting the independence of the FSCS.

Markets and infrastructure

15. The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.

15.1 The proposed fragmentation and location of markets regulation is one of the concerning areas of the proposals as we believe the approach outlined will result in more bureaucratic, and balkanised, regulation of wholesale markets, dilute the UK's international position, particularly in relation to policy formulation at the European level and undermine confidence in wholesale markets and the UK's leading global position in this area.

15.2 Whilst we welcome the specific focus given to wholesale markets within the revised regulatory framework and the proposal to assign responsibility for the supervision of central counterparty clearing houses (CCPs) and settlement systems to the Bank given their systemic importance, it will result in unnecessary complexity through the creation of a new tripartite model, being:

- the Financial Reporting Council (covering primary markets);
- the Markets Division of the CPMA (covering secondary markets: exchanges, trading platform providers and other firms engaged in secondary markets trading activities); and
- the Bank (covering post trade infrastructure providers).

15.3 We believe the operation of this framework will create significant challenges in relation to the required level of coordination across the differing authorities and is likely to result in inefficiency and impede timely and effective supervisory intervention, particularly in relation to the real-time decision making that is required as part of market surveillance activities.

15.4 The positioning of the Markets Division within the CPMA is also of concern. Whilst we recognise that elements of markets supervision sit well within an overall conduct regulator and there is some synergy in relation to its interface with ESMA, we are concerned that insufficient weighting has been given to the strong correlation between conduct and prudential risks; the systemic importance of many firms involved in wholesale markets activity; and the significant difficulty of making real time decisions in an environment that requires coordination across multiple authorities. In section 11.4 above, we raise a number of concerns in relation to the positioning of the CPMA which include the impact of it being perceived as a 'second tier' regulator on its ability to attract and retain high quality talent. This observation is particularly relevant to the Markets Division where the quality of supervision provided is critically dependent on the availability of high calibre staff that have a comprehensive understanding of how the wholesale markets operate and other specialist skills and expertise. We are also concerned that positioning the Markets Division within the CPMA may result in some cross contamination of the principles and practices adopted by the Consumer Protection Authority which would be entirely inappropriate for the wholesale markets.

15.5 As the European Union is playing a dominant role in the regulation of UK financial markets (e.g. 80% of policy decisions are now made at the European Union level which also has a wider influence over national regulators and the new ESMA will be an important policy making body) and representation is restricted to one vote per territory, we believe that it is critical that the UK has a strong and influential position at this level. However, we are concerned that the lack of alignment between the UK regulatory framework (twin peaks splitting prudential and conduct) and that being established at the European Union level (sector based) coupled with the fragmentation of the UK regulatory structure will dilute the effectiveness of UK representation at this level (e.g. the ability of the CPMA to influence positions will be diminished given its restricted mandate when compared to its European counterparts, particularly in relation to the regulation of central counterparty clearing houses, settlement systems and the regulation of primary markets if the UKLA is merged with the FRC). This could undermine the UK's leading position in global financial markets. This matter is of particular concern given the European Union's regulatory change agenda over the next two to three years which coincides with the distractions that are likely to occur as the UK transitions to the new regulatory framework.

15.6 We believe the proposed framework for engagement at the international level needs to be strengthened to ensure more effective representation of UK interests and there is greater transparency on the role of HM Treasury within this. One leg of this would be to refrain from separating primary and secondary markets regulation. Another would be to allocate responsibility for all market infrastructure providers (exchanges, trading platforms and clearing houses) to a stronger markets authority. This would help preserve an authoritative voice in EU-level discussions which would directly derive from, and be reinforced by, domestic responsibilities. In order to ensure the momentum gained by the FSA in raising its profile internationally through initiatives such as the appointment of a Director dedicated to European and international issues is not lost and there is a continued focus on international engagement during the transition period, we would urge the Government to address this issue as a matter of priority.

15.7 We also have a number of concerns in relation to the proposed merging of the UKLA and the Financial Reporting Council. These are set out in section 17 below.

15.8 We note that in order to reflect the strategic importance of wholesale markets to the overall risk in the financial system, the regulation of wholesale markets is currently undertaken by the Risk Division of the FSA rather than the Supervision Directorate. Additionally, in several other European countries, markets are regulated by a separate authority.

15.9 Given the unique position of the UK in wholesale markets, their significant contribution to the City of London and the critical role that effective regulation has played in supporting London's position as a leading global financial services centre, we would urge the Government to look again at the location of markets regulation within the revised framework. We believe that a more effective framework would involve assigning responsibility for the supervision of wholesale markets to a single regulator which has greater oversight of the end-to-end transaction cycle and better served by a single strong securities regulator, or a separate division of the Bank, rather than the CPMA.

16. The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses

16.1 The consultation paper does not set out the Government's overall aims in relation to the possible rationalisation of the existing FSMA regimes for regulating exchanges, trading platforms and clearing houses, either in terms of the concerns the Government is seeking to address or the benefits sought. Consequently, it is difficult to comment on this specifically.

16.2 It is clear that there will need to be some consequential changes required to the FSMA regimes as a result of the split in regulatory oversight arising from the creation of the PRA, CPMA and the allocation of responsibilities between the CPMA, PRA and the Bank for clearing systems, central counterparty clearing houses and payment systems.

16.3 However, we understand the Government is actively considering wholesale revision of the existing FSMA Recognised Body regime by way of its abolition and re-designating all Recognised Bodies as authorised persons. We also understand that, in part, some changes are driven by a desire to increase the regulation and supervision of Recognised Bodies by (a) giving the FSA rule making powers, (b) bringing Recognised Bodies within the FSA discipline/enforcement regime, (c) applying a full Approved Persons regime to Recognised Bodies and (d) giving the FSA power to order reports on Recognised Bodies under what is currently Section 166 of FSMA. We are concerned that the consultation does not clearly set out the Government's proposals in this regard, nor the rationale and justification for these.

16.4 The justification for the Government's new approach to financial regulation is a failure in the UK regulatory framework, revealed by the financial crisis. Yet however complex a crisis this has been, it has not involved a failure in the market infrastructure. Moreover there is no evidence of any deficiencies in the regulation of the market infrastructure, still less any that had a bearing on the financial crisis. Indeed during the worst market conditions for decades, far worse than any stress test regulators could have devised, the market infrastructure in the UK proved resilient, and assumptions made about its performance in times of stress, and that of the regulatory regime that underpins it, held firm.

16.5 We therefore see no rationale for change in this area, and we do not think any proposed change would be consistent with a credible impact assessment. We would need an articulation of the perceived problems with the current regulatory regime before offering any substantial input. What we can say is that there would be significant knock-on effects on other legislation if the regime were to be dissolved, and equivalent provisions would need to be found in order to preserve any features carried over to the new regime.

16.6 Recognised Bodies perform an important function in ensuring that markets operate in a neutral, efficient and orderly manner. Recognised Bodies are a part of the frontline regulatory regime in the UK, setting standards and ensuring that market participants act in accordance with the rules of the market. The Recognised Bodies are all different, operating in different ways and covering different activities; the Recognised Body regime allows for this, recognising that these bodies need to act with a degree of autonomy. Whilst the growth of Multi-lateral Trading Facilities (MTFs) in the equity sector could be viewed as breaking down the distinction with Recognised Investment Exchanges (RIEs) (as they can be run by investment banks and take on some of the activities of an RIE), MTFs perform only a small proportion of the range of activities of an RIE and it would be inappropriate to treat Recognised Bodies as being synonymous with MTFs or investment firms. It should also be noted that the Recognised Body regime is recognised internationally and is consistent with the approach taken in MiFID and in the European and US jurisdictions. We believe the changes outlined above in relation to the existing Recognised Body regime create a real risk of unintended adverse consequences, including detrimental impact on the reputation of the Recognised Bodies as neutral, trusted bodies and less flexibility for regulatory oversight

16.7 Given the concerns outlined above, and our belief this aspect of the proposed reforms is in itself a significant undertaking (particularly the legislative change process) that will increase the regulatory burden placed on firms further without obvious benefit, we would urge the Government to consult separately and more fully on the nature of its proposals, including the issues that it is seeking to address and the benefits sought.

17. The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS.

17.1 We have outlined a number of significant concerns and likely impacts arising from the fragmentation and positioning of markets regulation (including primary markets regulation) within the proposed framework in section 15 above. These concerns would become particularly acute if the UKLA were to be merged with the FRC and, as the activities of the UKLA and FRC are fundamentally different, the benefits of this proposal are unclear. Therefore, we strongly oppose this aspect of the Government's proposed reforms.

17.2 As noted in the consultation paper, primary markets activities are a fundamental part of the City of London and are pivotal to the UK's position as a leading global financial services centre. Effective regulation of these markets has played a key role in ensuring confidence in the stability, integrity and efficient operation of these markets and we are concerned that the Government's proposals will significantly weaken this position. It is not clear to us as practitioners why the Government feels there is a need to reform markets regulation and we would welcome further guidance on the problems the reforms are seeking to address.

17.3 As part of its supervisory responsibilities the UKLA monitors the conduct of those market participants engaged in the issuance of securities and is required to make real-time decisions in relation to matters that arise from its live market surveillance, including the need to suspend or remove securities and take enforcement action. The real-time supervision and enforcement of primary markets activity undertaken by the UKLA has clear synergies with the secondary market supervision and enforcement which, under the current proposals, will be undertaken by the CPMA. Unlike the UKLA, the supervisory activity undertaken by the FRC is not real-time. The FRC review the accounts of UK companies and, of the 20,000 securities admitted to the Official List, only 6 per cent represent equity securities. A further area of synergy relates to the specialist skills and resources required for effective primary and secondary markets regulation which are largely comparable across both areas. We believe the fragmentation of this structure across the FRC and CPMA, coupled with the lack of clarity on the split of responsibilities and authorities across these bodies, will undoubtedly have an adverse effect on their ability to make timely supervisory decisions and, where necessary, intervene effectively.

17.4 As will be noted from paragraph 15.2 above, the proposals fragment the regulation of markets through the creation of a new 'tripartite' framework and are therefore inconsistent with the Government's aims in relation to the move to a 'twin peaks' approach that will avoid the problems associated with such an approach.

17.5 We have experienced a number of instances that indicate the UKLA is currently insufficiently sensitive to the highly competitive nature of global financial markets and the commercial impact of its decisions on the broader interests of UK financial markets participants. We are concerned that this position would be exacerbated through a merger with the FRC and result in a detrimental impact on its decision making as well as the position of those firms who are directly and indirectly impacted by its decisions.

17.6 We also note that no other major European Union country has split its supervision of primary and secondary markets across different regulators.

17.7 We have also previously highlighted the likely difficulty of attracting and retaining high calibre individuals in the event the authority was perceived to be a second tier regulator, as well as the detrimental effect this would have on the quality of the regulation provided. As will be noted from our earlier comments, the activities of the UKLA are fundamentally different to those performed by the FRC (which centres on company reporting, audit and corporate governance). Consequently, we believe the proposed merger of the UKLA and FRC is likely to result in particularly difficult challenges in securing appropriate resource.

17.8 The importance of having effective representation at the international (particularly European Union) level has been set out in earlier sections of this response (see paragraph 15.5), as have our concerns relating to the likely impact of the reforms on the ability to influence policy decisions taken at this level effectively and protect the UK's position. Given the highly competitive nature of primary markets and the concerns we have raised previously relating to the ability of the CPMA to represent the interests of this sector effectively at the European level, we are particularly concerned that this position may be exploited to the detriment of the UK.

17.9 For the reasons outlined above we strongly believe that the UKLA would be better positioned alongside other aspects of markets regulation.

18. ***The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator***.

18.1 As will be noted from the above, we do not support the proposed merger of the UKLA with the FRC and have raised a number of broader concerns in relation to the fragmentation of regulation more generally. Consequently, we do not support the notion of creating further fragmentation through the transfer of other aspects of financial market regulation to the FRC.

Crisis management

19. Do you have any overall comments on the arrangements for crisis management?

19.1 We recognise the need for flexibility within the crisis management arrangements and are generally supportive of the Government's overall proposals in this regard.

19.2 The consultation paper highlights how the fragmented structure of the existing tripartite system coupled with the ill defined responsibilities and powers of the authorities were proven to be ineffective in seeking to address the challenges posed by the last financial crisis. It also sets out the high-level role of the Bank and the Treasury in relation to crisis management activity and stresses the paramount importance of effective coordination between the regulatory bodies in the event of a crisis. Notwithstanding these points, we are not convinced that the measures set out in the consultation paper will prove to be more effective in the event of a future crisis. Key areas of concern in this regard relate to the creation of the 'twin peaks' regulatory framework and the fragmentation of markets regulation will require a greater need for more effective coordination and, separately, the responsibilities and powers of the various authorities likely to be involved in a crisis are insufficiently detailed, particularly those of the CPMA and FSCS which are currently undefined. We believe further clarity is required on these matters, as well as how international coordination will work in the event of a crisis and the interests of UK markets, firms and consumers protected in such circumstances.

19.3 To the extent that a body is created to oversee and coordinate the management of a crisis, it will be critical to ensure that this includes senior and influential members who have strong industry expertise and experience that can support its role in making critical decisions at a time of distress.

19.4 In our view, the FSA in response to the banking crisis has tended towards a read-across of policy proposals from different sectors with a seeming preference for a 'one-size-fits all' approach. We are concerned that this may persist or potentially increase with the new regulatory framework, particularly given the role and positioning of the PRA. We believe additional checks and balances are required within the new regulatory framework which ensures such instances do not recur.

20. What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?

20.1 Given the circumstances in which heightened powers of supervision and the use of OIVOPs are typically required, we would advocate the existing safeguards and related governance arrangements be retained, including an independent appeals process such as that currently in operation under the stewardship of the Regulatory Decisions Committee.

20.2 As will be noted from earlier comments in this response, we would be concerned that the use of predetermined thresholds to drive the point at which supervisory intervention becomes mandatory could be interpreted as rules and potentially result in dysfunctional behaviour.

21. ***What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24***?

21.1 The Panel welcomes the Government's proposal to put in place arrangements to ensure conflicts do not arise in relation to the Bank's role as lead resolution authority and the Bank's new responsibilities in relation to the PRA.

Impact assessment

22. ***Annex B contains a preliminary impact assessment for the Government's proposals. As set out in that document, the Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm. In particular, comments are sought from all types and size of deposit-taking, insurance and investment banking firms (including credit unions and friendly societies), and from groups containing such firms.***

22.1 The preliminary impact assessment considers two options in relation to the proposed reforms; 'do nothing' and 'proceed'. For the latter, the consultation paper notes that whilst there are many variants mainly relating to the allocation of particular functions between the PRA and CPMA, these have not been considered further in the preliminary impact assessment but may be re-examined in the final impact assessment. In this respect, we can see clear benefit in the establishment of the FPC to address macro-prudential risk, but believe other reforms could be achieved as an addition to the current regulatory structure which would mitigate the risks and costs inherent in the transition to the 'twin peaks' regulatory framework.

22.2 As will be noted from earlier sections of this response, we have raised concerns that the fragmentation of the regulatory framework could result in weaker domestic regulation and dilute the UK's position at the international level (particularly European Union). Ultimately this could undermine confidence in the UK's financial markets, reduce competition amongst firms and weaken the UK's leading position in global financial markets. We have also raised concerns relating to the CPMA being positioned as a 'consumer champion' and the potential impact of this being interpreted too narrowly on consumers and firms alike. Each of these areas could result in significant indirect costs. Whilst we appreciate the difficulty in accurately quantifying such costs, these matters do not appear to have been appropriately considered in the preliminary impact assessment as the assessment states in a number of areas the reforms will have no impact on competition or other economic or social impacts.

22.3 Additionally, in section 16 of this response, we raise a number of observations relating to costs and benefits associated with the possible rationalisation of the existing FSMA regimes relating to the regulation of exchanges, trading platforms and clearing houses and would welcome further clarity on these matters within the impact assessment.

22.4 The risks inherent in the proposed regulatory framework, particularly those arising from the fragmentation of regulatory responsibilities and the lack of clarity on the crisis management arrangements, may dilute its effectiveness both in supervising stable market conditions, and in preventing or tackling a crisis. The preliminary impact assessment is silent on the extent to which these matters may have been considered.

22.5 The transition to the new regulatory framework also creates a number of significant risks including the dilution of the UK's position in Europe, the continued loss of high calibre staff, as well as management stretch and distraction resulting in weaker domestic supervision. These risks are heightened given the timing of the transition coincides with a significant international regulatory change agenda and an increased need to support the economic recovery and manage the increased risks this presents. Again, the extent to which these risks have been appropriately considered in the impact assessment is unclear.

22.6 The assessment of costs in the impact assessment relating to rule changes assumes that, beyond those driven by changes in EU law, other rule changes will be the subject of cost benefit analysis before they are made, and therefore the current costs of the 'proceed' option are overstated. Whilst we welcome the suggestion that the cost benefit analysis will be undertaken before rule changes are made, we have previously raised concerns with the FSA relating to their use of this discipline and believe further work is required to improve the robustness of the analysis performed and embed this into its day to day operations and decision making processes. Consequently, until such time as this matter is adequately addressed, we are concerned that this may prove to be an inappropriate assumption.

22.7 Overall, we believe that increased costs will be an inevitable consequence of moving from a single unitary regulator to a 'twin peaks' model, not only in the transition, but also in the structure of the separate regulatory bodies, the introduction of new requirements, the high level of coordination required between the authorities and the need for firms to deal with two supervisors. Ultimately, these costs will be passed onto consumers. We also recognise that any pressure to maintain overall regulatory costs at the current levels could have a detrimental impact on the quality of regulation which is an undesirable outcome.

22.8 We note that based on preliminary estimates, transition costs are expected to amount to circa £50 million spread over a three year period. We would welcome further guidance on the breakdown of this estimate, particularly the property and other infrastructure costs, as well as the checks and balances that will be implemented in relation to the overall management of transition costs.

22.9 We would also advocate that a series of check points be used both during and after the transition period to determine the effectiveness and cost of the new regulatory framework and whether any changes are required. Practitioner insights should be used to inform the thinking of regulators and the Treasury on these points.

APPENDIX 1

ROLE AND REMIT OF THE PRACTITIONER PANEL

1. The role of the Practitioner Panel is to advise the Financial Services Authority on its policies and practices from the point of view of the regulated community. It has statutory status under the Financial Services and Markets Act 2000 (FSMA). As such, the Practitioner Panel is given access to the FSA's plans for new regulatory policies, and so is able to provide an important sounding board for the FSA before the ideas have been made public.

2. Members of the Practitioner Panel are drawn from the most senior levels of the industry, with the appointment of the Chairman being formally approved by the Treasury, to ensure independence from the FSA. The members are chosen to represent the main sectors of the financial services industry as regulated by the FSA. The Panel currently has senior practitioners from the retail and investment banks, building societies, insurance companies, investment managers, financial services markets, custodians and administrators.

3. The Chairman of the FSA's Smaller Businesses Practitioner Panel (SBPP) sits ex officio on the Practitioner Panel to ensure co-ordination, but debate on issues specifically affecting smaller firms are covered by that Panel. The SBPP is submitting separate evidence to this Inquiry.

4. The names of the members of the Practitioner Panel as at 1st October 2010 are as follows.

Panel Member	*Position*
Iain Cornish (Chairman)	Chief Executive, Yorkshire Building Society
Richard Berliand	Head of Global Cash Equities & Prime Services, JP Morgan Securities Ltd
Simon Bolam	Principal, E H Ranson & Co (Chairman, SBPP)
Russell Collins	Head of Deloitte UK Financial Services Practice
Mark Hodges	Chief Executive, Aviva UK
Simon Hogan	Managing Director, Institutional Equity Division, Morgan Stanley
Roger Liddell	Chief Executive, LCH.Clearnet Group Limited
Helena Morrissey	Chief Executive Officer, Newton Investment Management
Xavier Rolet	CEO, London Stock Exchange Group
Andrew Ross	Chief Executive, Cazenove Capital Management Limited
Malcolm Streatfield	Chief Executive, Lighthouse Group plc
Helen Weir	Group Executive Director Retail, Lloyds Banking Group plc

APPENDIX 2

FINANCIAL SERVICES PRACTITIONER PANEL

SUBMISSION TO THE TREASURY COMMITTEE INQUIRY INTO FINANCIAL REGULATION

SEPTEMBER 2010

EXECUTIVE SUMMARY

1. This submission is from the Practitioner Panel, a body set up under FSMA 2000 as an independent Panel to represent the interests of practitioners to the FSA. Details of the role and remit of the Practitioner Panel are at Appendix 1.

2. This submission answers to the questions as set out by the Committee. The key points which we would draw out from our answers are:
   a. Overall we do see clear benefit in the establishment of an FPC to address macro-prudential risks, but we believe that this could have been achieved as an addition to the current regulatory structure.
   b. The move from a single integrated regulator to a "twin peaks" model risks losing some of the good work done by the FSA since the crisis and has an inherent risk of lack of communication and coordination between the various regulatory bodies (in this case the CPMA, PRA and FPC) and potential cost, duplication, overlap or underlap.
   c. The proposals recognise the need to minimise the risks of splitting the regulator, but with insufficient detail to be assured of their effectiveness. There must be a system of coordination at every level, as changes in the conduct and prudential areas within firms are inextricably linked.
   d. There is a significant risk of increased costs, not only in the transition, but also in the structure of the separate regulatory bodies and the inevitable introduction of additional requirements such as for macro prudential regulation.
   e. None of the proposed bodies map directly onto the relevant EU bodies, on which the UK has only one vote. The scope for dilution of the UK's voice in Europe is therefore very significant.
   f. There is much power vested in the Bank of England via the FPC and PRA, and potentially with fewer checks and balances than the present regulatory regime. All the regulators must be transparent and accountable, with the appropriate consultative mechanisms. As part of this, we are advocating an increased role for the independent panels across the regulatory structure.
   g. The new regulators must all retain an objective to take account of the impact of their actions on the competitiveness and innovation in the financial services industry. We are opposed to the CPMA being positioned as a "consumer champion", as this is too emotive and ill defined as a role for a regulator.
   h. Although we do not object to a 'judgement led' approach for the PRA, the Treasury Consultation does not indicate the principles on which such judgements will be based. Judgement led regulation is only acceptable on the basis of clear and transparent principles which are applied on an equal basis.

i. The proposed tripartite approach to markets regulation, with the separation of primary markets, secondary markets and post-trading is unlike the approach in any other jurisdiction. We are not convinced that the CPMA is the best location for markets regulation. We recognise the difficulties of this decision, but believe that Markets regulation, including the UKLA, should be a standalone function, or with the PRA.
j. We await the specific proposals on enforcement, which has been an important component of the existing regime.

TREASURY COMMITTEE QUESTIONS

3. Will the Government's financial regulation proposals improve the framework for financial stability in the UK? Will they work in a crisis? Do the Government's proposals get the balance right between tackling the problems of the last crisis and preparing the UK financial system for the next one?

4. We think that the creation of the FPC has the potential to improve the effectiveness of financial services regulation in the UK. However, the FSA has progressed far since the last crisis, and other aspects of the changes introduce additional complexities which create the need for additional safeguards and coordination. This therefore may reduce the effectiveness of the regulatory framework in preventing or tackling a crisis.

5. The transition process itself creates a risk of the erosion of the effectiveness of the regulator, at a time when there is a need for the regulator to be focused on other issues. We believe the implementation risks are very significant, especially at the current time:
   a. We have already seen a significant loss of senior FSA personnel.
   b. Whilst the crisis may have lessened in intensity, the FSA is dealing with major regulatory change and supervisory issues. To overlay a protracted period of fundamental organisational upheaval raises a material risk of management distraction.
   c. We perceive there to be a considerable risk of dilution of focus on the international agenda at a time when such focus is imperative.

6. The potential problem of coordination is clearly recognised in the Treasury Consultation, but there is little detail on the effective mechanisms for ensuring coordination throughout the regulatory system. The prudential and conduct aspects of a firm's business are inextricably linked, and so it is difficult to see how the regulators will act independently of each other.

7. How do the Government's proposals dovetail with initiatives currently being undertaken at European and the global level?

8. There is recognition in the Treasury Consultation of the need to link in to initiatives at European and global level. We want the UK to be in a strong position to negotiate, both at Government level and at regulatory level. We do not want the fragmentation of the UK regulator to dilute the UK's voice. We have urged the

FSA to take a high profile role, and would not like the FSA's initiative in appointing a Director dedicated to European and International issues to be lost.

9. The new UK structure does not dovetail into European structures any better than the current system, and risks fragmentation and dilution of the UK's messages with the split of regulatory responsibilities. This is particularly pronounced in the proposed division of markets regulation which does not tally with ESMA.

10. The reference to the PRA using its 'judgement' in many parts of the consultation could conflict with European and global initiatives unless the judgement is against clear standards. International firms operating in the UK cannot be expected to conform to judgement decisions which are not based on clear policy statements and procedures, and UK firms should not be disadvantaged by any arbitrary application of judgement.

11. What costs will the regulatory structure place on consumers?

12. Consumers, through increases in fees and charges, ultimately pay for all the costs of the regulatory structure. There are potentially significant costs in the transition to the new system as a one-off cost. The new system itself is likely to cost more in regulatory fees and in the resources of firms in dealing with two regulators.

13. There may be further consumer costs if the CPMA's role as consumer champion is interpreted too narrowly. If it restricts firms from developing new products and working the market effectively, there may be less choice available, with consumers paying more for products which are less suited to their requirements. One example of this is the Retail Distribution Review, which may improve standards, but it will also reduce the availability of advice for consumers.

14. Do the Government's proposals appropriately assign roles and responsibilities between the different regulatory institutions?

15. The roles and responsibilities of the different regulatory institutions seem generally to be appropriately assigned. We have a number of specific considerations, as follows.

16. ***Location of markets.*** We have found it difficult to identify what the government is trying to achieve with the changes proposed for markets. It seems it would be better to have Markets in a stand alone regulator, or as part of the PRA, rather than the CPMA.

17. Confidence in the markets is fundamental to the strength of London and those institutions that trade there: a failure in the markets would have an immediate effect on the UK's financial stability. We note that within the FSA, the regulation of markets does not take place within the Supervision Directorate of the FSA, but is located in the Risk Division, indicating its strategic importance to overall risk in the financial system. In many other European countries, markets are regulated by a separate authority. If the current FSA Markets Division, with all its responsibilities, was transferred to a separate markets regulator, the firms affected

would only be supervised by the new regulator, so it would not cause further fragmentation for practitioners.

18. Whilst we appreciate that there are pros and cons, we also believe that the UK Listing Authority (UKLA) should stay with the rest of Markets regulation and not be moved to the FRC as suggested in the Treasury Consultation. If the UKLA moved to FRC, it would be too far away from financial services regulation, and so insufficiently aware of the competitiveness and wider pressures of the financial markets. Splitting the UKLA off from the rest of Markets would also weaken our voice in Europe.

19. ***Governance***. We are concerned about the accountability mechanisms for effective challenge and consultation in the regulatory system. Overall, there is much power vested in the Bank of England, with little external accountability, whilst its actions will have an increased impact on how firms operate and the UK economy as a whole.

20. The FPC is extremely powerful and yet does not seem to have enough external checks and balances. One option is that the FPC has a majority of independent members so that the industry and consumer viewpoint is fully taken into account, although we recognise this might not be practical. An alternative might be for an advisory and consultative body similar to the previous Bank of England Board of Banking Supervision, which gave industry input before FSMA replaced the Banking Act. Another alternative would be to establish a Practitioner Panel for the PRA, perhaps with additional powers for the Practitioner Panel, or a sub group of it, to interact with the FPC.

21. ***Independent Panels.*** The current system of the Independent Panels (Financial Services Practitioner Panel, Smaller Businesses Practitioner Panel, Financial Services Consumer Panel) providing guidance and checks and balances in the development of policy is important. It should be maintained, not only in the structure of the CPMA, but in the PRA as well, with possible input into the FPC.

22. These changes also present an opportunity to strengthen the powers of all the Panels. Currently the only onus on the FSA is to explain why they are not responding to challenges from the Panels. We would welcome more formality in the responsibility of the regulator to consider our views, with less discretion to ignore representations without evidence that the opinions have been fully taken into account. We would like all the Panels to have the right to raise major concerns about the impact of regulation on financial stability with the FPC.

23. ***Decision making and crisis management.*** We do not believe that there is enough clarity of ultimate authority and escalation of conflicts in the current proposals. For instance, if the PRA cleared a change of ownership of a major UK financial institution to a company based in a country with whom the UK had a difficult political or economic relationship, would the FPC be able to step in on financial stability grounds to stop such a takeover?

24. ***Costs and benefits of regulation.*** There is not enough reference in the Treasury consultation to the need for any new developments in regulation to be challenged

on the basis of costs versus benefits. This is an area where we have criticised the FSA for not paying enough attention to cost benefit analysis (CBA), or not always undertaking a rigorous CBA when changing procedures. We will urge that all parts of the new regulatory system must adhere to strict cost benefit analysis for implementation of new regulatory requirements.

25. ***Structure of regulators.*** At this stage, we do not have the details of the proposed structures of the PRA and CPMA, but they must have a breadth of sector representation which will be critical for ensuring appropriate resources are employed. There must be equal standing between the CPMA and the PRA, and a chief executive should be appointed to lead the CPMA as soon as possible. We are also concerned about the lack of clarity on the future of parts of the enforcement function. This is a key part of the regulatory system, and must be strong, but with appropriate appeals mechanisms.

26. ***Consumer champion role for CPMA.*** We do not believe that the CPMA's main role should be as a consumer champion and have indicated the cost implications in paragraph 13. We are particularly concerned about such an emotive and ill-defined description which may allow undue bias into the role of regulator.

27. Will there be unintended consequences of the Government's proposals for regulation on the prospects for non–bank financial institutions

28. We note that paragraph 3.34 of the Treasury Consultation refers to the PRA benefitting from the expertise, experience and credibility of the central bank, but it is unclear that this will help the regulation of companies in insurance and other sectors. It is essential that senior staff with non-banking expertise are appointed at the PRA. There should also be a consideration of specifying certain independent members of the FPC are from non-banking backgrounds to counter-balance the banking members.

29. In addition the FSA in response to the banking crisis has tended towards a read-across of policy proposals from different sectors with a seeming preference for 'one-size-fits all' approach. Once the PRA is part of the Bank of England there is a danger that this will increase with banking driven interests taking over the agenda.

30. Should the FPC have a statutory remit? If so, what should that remit be?

31. We would welcome a statutory remit for the FPC which would give it clear accountability. We advocate that the remit should be to maintain financial stability, with due regard to maintaining the competitiveness of the financial services industry in the UK.

32. We also believe that there should be some statutory challenge to the FPC's opinions on behalf of industry practitioners. There must be practitioner membership within the independent members and an external monitoring/advisory role for part of the Practitioner Panel or another independent practitioner dominated grouping.

33. How should the success of the FPC, both in and out of crisis, be measured?

34. The measure of financial stability which will guide the FPC needs to be defined. With that in place, the transparency of decisions and six monthly reports as recommended in the consultation paper should allow the success of the FPC to be measured.

35. However, the MPC is dealing with more measurable objectives and a narrower range of clearly defined tools than the FPC will have. Therefore the FPC will need to base its views on judgements and so will need a greater level of transparency, scrutiny and challenge, with publication of measures taken to avoid any crisis after an appropriate interval.

36. We would argue that the FPC should be measured on the basis of regulatory stability in addition to maintaining financial stability. It is important for the industry and for consumers that the regulatory agenda does not lurch between policy priorities, and provides a consistent and certain regulatory environment.

37. Given the international regulatory framework, what macro–prudential tools should be granted to the FPC?

38. The detail of macro-prudential tools is not within our expertise, but we would urge that any implementation of macro-prudential requirements from the FPC which impact on firms should still be subject to full consultation through the PRA and CPMA.

39. Has enough been done to mitigate the risk of conflict between the FPC and the Monetary Policy Committee (MPC)?

40. The MPC has a clear inflation target, whereas the FPC's more general objective of financial stability is less easy to measure. We would not support any proposals where the MPC's views could over-ride that of the FPC, with regulation of financial services firms potentially manipulated via the FPC to help achieve inflation targets.

41. Is the FPC appropriately structured in terms of the balance between internal and external members and the size of the Committee?

42. We are concerned about the balance of FPC membership. As well as 6 out of 11 members from the Bank of England, the chief executive of CPMA is counted as an external member. This means 7 out of 11 are officials from the regulatory structure. This committee must be seen as independent, and also in tune with current industry practices. The FPC will have such an impact on the financial services industry, that one option would be to have a majority of independent members on the FPC or a specialist advisory body (see paragraph 20).

43. Independent membership of the FPC must be seen as a substantial role which requires time commitment between meetings. Members will need to be provided with resources and back up to ensure they operate with credibility and their opinions are not ignored.

44. What characteristics, experience and qualities should the Government look for when appointing external members of the FPC?

45. There must be people with detailed knowledge of the financial services industry as external members of the Committee. Most people currently working in a regulated firm will have conflicts of interest. Instead, independent members could work alongside the industry, or be only recently retired and be well regarded and of high standing in the financial services industry.

46. There should also be members of the Committee with wider experience than that of banking to ensure that the interests of the whole financial services industry, and particularly that of other firms regulated by the PRA, are taken into account.

47. Should the PRA be the lead authority over the Consumer Protection and Markets Authority (CPMA)?

48. Although we understand the need to resolve potential conflicts, it is essential that the CPMA is seen as being as important as the PRA. If the CPMA is seen as junior, it could harm how the CPMA is regarded by firms, and the CPMA's position in EU and international negotiations. It could also damage its ability to attract the highest quality staff. We would not want this to happen. There is already an imbalance in the appointment of Hector Sants as Chief Executive of the PRA, but no appointment to the head of the CPMA – who must be a credible person of similar standing to Hector Sants.

49. One could argue that the CPMA should be the lead regulator, as under the current arrangements, all firms will be regulated by the CPMA, but a smaller number of firms will be regulated by the PRA.

50. Is it appropriate for the PRA (and CPMA) to adopt a judgements–based approach to financial regulation and supervision?

51. Any judgements-based approach must be referenced against clear principles, with consistent application across sectors, groups and firms, and with reference to the requirements in other jurisdictions. It is unclear in the Treasury Consultation what transparency and accountabilities are proposed around the adoption of a judgement-based approach.

52. We disagree with paragraph 3.9 of the Treasury Consultation that excessive concern for competitiveness was the cause of regulatory failure leading up to the recent crisis. The regulator must take account of the need for financial services firms to operate successfully in the market place.

53. We believe that PRA rule-making must be subject to similar requirements to the current FSA consultation requirements.

54. Do the reforms and the creation of the CPMA provide adequate protection for the consumer?

55. The CPMA's proposed role as 'consumer champion' is too emotive, too ill-defined, and fundamentally inappropriate for a regulator to hold. We advocate a role for the CPMA to ensure that the market works effectively for consumers. Consumers must take some responsibility for their own decisions and we welcome the reference to consumer responsibility in paragraph 4.25 of the Treasury Consultation.

56. The remit of the CPMA must also guard against any inadvertent extension of consumer protection measures into the wholesale market, where such restrictions would stifle the market.

57. At the moment the balance between product and sales regulation for the CPMA seems unclear. If greater product regulation is introduced, there should be a commensurate reduction in the regulation of sales practices.

58. To what extent will the regulatory and administrative burden increase for those firms who now have to deal with two regulators?

59. There are significant increases in the costs of the new model, both in direct regulatory fees and for firms who will have to deal with two rulebooks, two sets of requirements, and two teams of supervisors coming to visit. There may also be unnecessary duplication and potentially conflicting regulatory demands from the two bodies.

60. As overall support costs are likely to increase, with a corresponding pressure to contain costs, we would not like this to result in a reduced effectiveness of supervision.

61. Should any of the proposed bodies be given responsibility for promoting competition in the banking and financial services sector?

62. We believe it is vital that all the new proposed bodies should have to pay regard to the need to maintain competitiveness in the banking and financial services sector. It is not a regulator's role to promote competition.

63. Should any of the proposed bodies have a role in promoting the City of London?

64. We believe the regulator has a role to promote the effectiveness of the UK in its EU and international relations, but not in promoting London.

Dear HM Treasury,

I would like to submit my comments in light of the current consultation process. Modern Capital has been an FSA regulated investment advisor since January 2007 and as an investment manager since January 9th 2008 - it is therefore a relatively new firm, a firm that is growing and the comments reflect this experience of starting up a new firm in the UK.

I would like to submit:
- fees should be based on AUM to allow new firms that have limited investors and limited market impact to operate - ultimately the health of the financial services industry will be greatly influenced by new entrants (who also did not benefit from any of the bailout packages);
- firms should not be allowed to operate under other firm's FSA umbrella's or if this is the case, then with great supervision and separate filing requirement - there are currently many firm that operate with virtually zero regulatory costs whereas firms that play by the rules incur these costs. It lowers the barriers to entry, creates unfair competition and allows unregulated firms to operate.

In general the regulatory landscape, I feel, respect the challenges of starting a financial services business in the UK and at the same time the importance of competition and new entrants while ensuring that all firms are regulated to an appropriate level in the best interests of investors and other market participants.

Thank you very much,

Michael Fischer

Michael Fischer, CFA, CAIA - Modern Capital LLP - 150 Brompton Road - London SW3 1HX - UNITED KINGDOM - www.modern-capital.com

Dear Mark,

Reform of Financial Regulation

I do not have time before leaving for Italy today to draft a learned Paper on the reform of financial regulation but your Release has invited inputs by October so I endeavour to set out my main points.

I have for long been in favour of the Bank of England taking over responsibility for supervising/regulating banking and was the original proponent of this. Logically it leaves the reformed FSA as largely a retail consumer regulator but there are important largely investment management related territories which do not fall properly in either camp. The logical solution is a third leg which might be housed, together with the Consumer Protection Regulator but as I set out below needs to be independent thereof.

My main comments are as follows:

1 The large Life companies have large balance sheets and can impinge on banking safety, e.g. it was AIG, the insurer, that developed the massive credit default swap market which proved a major threat to the banking system. Logically, the Bank of England needs to oversee their balance sheets but their retail services fall to the Consumer Protection Regulator.

2 The retail services provided by banks are clearly a territory for the Consumer Protection Regulator which means that banks would also be subject to both regulatory bodies and their different regulatory focus.

3 Investment management services fall into 4 categories, (with the same firms often provided at least 3).

Large scale institutional portfolio management

Sophisticated private client portfolio management

Sophisticated institutional/HNW Funds - i.e. mostly Hedge Funds

Retail Funds

The sort of regulation required for retail Funds which is analogous to that for Retail banking services is quite different from that required for the other 3 territories.

I have already raised with you the specific - in my view mistake - of seeking to lump together sophisticated HNW private client investment management services with retail IFA services the important issues with regard to managing large institutional portfolios and institutional Funds are mostly quite different from those relevant to managing retail Funds.

I believe that putting the sophisticated side of investment management - i.e. other than retail Funds - under the control of a consumer oriented Authority would be quite inappropriate and cause problems. This area needs its own regulatory function.

4 There is the separate issue of who handles authorization of financial services businesses - including banks. It would clearly be sensible for the Bank of England to take over responsibility for bank authorization but per the above point, institutional and HNW investment management is different in kind to the provision of retail Funds and retail investment advice.

5 Stock Markets - the FSA has ended up with Stock Market rules and conduct coming under its responsibility with regard to AIM. It would not be appropriate for a consumer oriented regulator to have this responsibility - where should it go?

In my view there is much to be learnt from the pre-FSA structure of regulation which correctly separated regulation of the retail investment sector from regulation of the institutional and HNW investment sectors. The sophisticated investment management sector needs a new IMRO. The SIB also provided a home for some specialist areas which did not easily fit elsewhere.

6 There remains the territory which has been ducked for many years as to whether HP/leasing/related territories should continue to come under the BIS (previously DTI) or be transferred to the consumer protection authority?

If you are interested I would be pleased to have a brainstorming session with you and your advisers - reflecting what is now a career of over 40 years in the City, largely in the investment management industry but which has also included banking and Corporate Finance.

With kind regards.

Howard

(Dictated by Howard Flight and sent in his absence)

Dear Sirs, Plus copy for the attention of Mr George Osborne

We have just received an update from the FSA on proposals for the changes to the financial industry.

We are a small independent travel insurer and the last thing we want is a whole raft of new regulators, rules online forms etc.

Travel insurance does not need regulating. All the FSA has done is to increase costs for ourselves which we of course have to pass on to the customer. There has been no improvement or benefit to the customer / traveller at all.

Fees have gone up and it has now become a major cost. It is also environmentally unfriendly as since the FSA regulated our business we now have to send out twice the amount of paperwork, none of which the customer reads and all of which goes in the bin. When you calculate the paper, the cost of transporting that paper and the cost recycling it and then multiply it across the country the cost is enormous.

We small businesses need real help in this uncertain future not just a cosmetic shifting around of a failed regulator.

Kind regards

Malcolm Floyd
Floyds Direct travel insurance

Fraud Advisory Panel

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11 October 2010

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

BY EMAIL: financial.reform@hmtreasury.gsi.gov.uk

Dear Sirs

Response to the HM Treasury consultation paper "A new approach to financial regulation: judgement, focus and stability" (CM 7874)

1. The Fraud Advisory Panel (the 'Panel') is a registered charity and membership organisation which acts as an independent voice and supporter of the counter fraud community in the United Kingdom.

2. Established in 1998, the Panel works to encourage a truly multi-disciplinary perspective on fraud. It has over 300 corporate and individual members, drawn from the public, private and third sectors and across a variety of professions.

3. The Panel's role is to raise awareness of the immense human, social and economic damage caused by fraud and financial crime and to help individuals and organisations to develop effective strategies to prevent it.

4. The Fraud Advisory Panel welcomes the opportunity to respond to HM Treasury's consultation paper on the implementation of a new financial regulatory architecture for the United Kingdom (CM 7874).

5. However the consultation paper excludes consideration of how the Government intends to address the issue of economic crime within the financial services sector. We note that proposals to transfer responsibility for the prosecution of criminal offences currently prosecuted by the Financial Services Authority to a new Economic Crime Agency will be examined as part of a separate consultation on economic crime (para 5.26).

6. There has been much criticism of the FSA for its 'light touch' approach to regulation on matters related to the current financial crisis. However recent speeches and activity by the FSA indicate that it is placing greater emphasis on criminal prosecutions and this change in emphasis should not be lost.

7. We believe that there is still much that can be done to improve the UK's response to fraud. The current fraud prosecution landscape is confusing due to the absence of high-level strategy, a plethora of bodies with responsibility for the prosecution of fraud, problems inherent in the system of prosecution itself and the emergence of alternative sanctions applied inconsistently across the criminal justice system.

8. Earlier this year the Panel published a discussion document *Roskill Revisited: Is there a case for a unified fraud prosecution office?* which concluded that the time has come to end to the confusion and overlap caused by so many different agencies all pursuing similar goals, and called for a coherent approach to the prosecution of fraud.

9. The public needs to be convinced that the resources are in place to fight financial crime and fraud effectively and are being used for that purpose. The conventional response of the criminal justice system has been inadequate; fraud needs to be discouraged and punished.

Yours sincerely

Rosalind Wright CB QC
Chairman

Submission by Freshfields Bruckhaus Deringer in the context of HM Treasury's consultation on the new approach to financial regulation

This response relates to questions 17 and 18.
We do not support either:
(a) the creation of a Companies Regulator, nor
(b) the merger of the UKLA's functions with those of the FRC

1. Should there be a Companies Regulator?

The consultation paper does not make a case for a new Companies Regulator. We are instead promised a consultation process in due course. It seems to us that quite apart from the underlying arguments for and against such a regulator, the proposal to merge the UKLA with FRC is primarily justified by its prospective creation, and that this is rather jumping the gun.

It seems to us that to make a case for a Companies Regulator, one would need to demonstrate either (a) that there are relevant areas of UK corporate activity that are not currently being regulated and should be, and can most effectively be regulated by a new Companies Regulator, or if not (b) that there are areas that are being regulated by one or more other regulatory authorities, but that this regulation can be more effectively carried out under a single authority.

Effectiveness in this context might derive from cost efficiency, or from "joining up" multiple regulatory strands that are otherwise being applied in an inconsistent way.

We do not believe that there is any consensus that corporate governance, corporate information or institutional stewardship are areas that require greater levels of regulation (or indeed, any particular group arguing that this is the case). Pay/bonus levels are perhaps one area where many would like to see more controls. But we would rather doubt that this is a view confined to pay/bonuses paid by UK-incorporated companies. It seems to us that it would be problematic for a BIS sponsored Companies Regulator to seek to regulate all UK pay or bonuses irrespective of whether they were received by directors or employees of UK companies, or by sole traders, by partners of any type of partnership, or by directors or employees of non-UK entities.

We are sceptical about whether cost efficiencies can be achieved simply by bringing multiple regulatory teams together under one regulatory authority. We do not believe that history gives cause for optimism that such efficiency will be achieved, and that the costs of change are often very significant, both for the regulator and the regulated.

The creation of a Companies Regulator must therefore be justified on the basis that the regulation of the areas for which it would be responsible are currently not sufficiently "joined up". This would be evidenced by inconsistency in the conceptual approach adopted by the current regulatory authorities, or in their application or enforcement of the rules they have adopted. We don't believe that such evidence exists.

2. Should the functions of the UKLA be merged with those of the FRC?

This proposal seems to us to be justifiable only by reference to a perceived need for the activities of UKLA and those of FRC to be more "joined up". Given the clear difficulties of this proposal (see below) there would seem to be a need for a strong list of advantages; some clear examples of inconsistencies of approach between the rules and regulatory approach adopted by UKLA and those of FRC, and of the harm that this causes issuers or the investing community, who might be regarded as the consumers of the regulatory products of FRC and UKLA.

We are not aware of any issuer or investor complaining that the Listing Rules are inconsistent with the FRC's various regulations, or that there is a difference of approach between the two authorities that is leading to problems for investors or uncertainty or expense for issuers.

So for us the merger proposal is a solution in search of a problem.

The most significant difficulties in this proposal seem to us to be:

(a) that the influence that the UK authorities will have in the deliberations and decisions of ESMA will inevitably be diluted. If the UKLA's functions are transferred to the FRC, then the regulator that is responsible for a significant proportion of regulatory bandwidth for which ESMA is now the ultimate EU authority will not have a seat at the table; we are very sceptical that the delegation of this representation to the CPMA or some sort of shared representation (even if permitted by ESMA) will give our authorities the same weight as they currently enjoy in this context. That creates an unnecessary risk to the long term development of the UK securities markets and UK issuers. ESMA is going in our view to become an increasingly influential body, and it is most important that the UK retains the same strong voice in its deliberations that it has enjoyed in relation to CESR.

(b) that being part of a separate regulatory body will inevitably cause obstacles to communication and teamworking between the authorities responsible for primary and secondary market activity. There seems to us to be a much greater risk if inconsistencies of approach between primary and secondary regulators emerge, than if there is some inconsistency between the primary market activity regulator and the FRC. Market abuse is a particular issue in this case. The regime is a carefully integrated mix of the rules imposed by UKLA and the market rules which will in the future be applied by the CPMA. It would be extraordinary to have these two regimes managed by different regulators.

(c) the UKLA needs to provide a continuous and responsive interface with issuers and their advisers, a role which the FRC is not expected to perform. Even if the UKLA team and infrastructure would survive intact within the it is fair at least to question whether FRC is more likely to be a sensible location for this activity than the more "real-time" regulator that CPMA will be.

To summarise, we consider that this proposal has significant disadvantages, and carries serious risks, both to the UK's influence in EU and other regulatory circles, and to the attractiveness of London as a location to list securities. We see no benefit that can be expected from the proposal to compensate for these disadvantages and risks. We therefore oppose it.

Freshfields Bruckhaus Deringer
18 October 2010

A new Approach to Financial Regulation – Consultation

Response from the Funeral Planning Authority

1. This submission is a response from the Funeral Planning Authority (FPA) to the consultation on the future regulation of financial services and is concerned with the regulation of funeral plans.

2. The FPA is a self-regulatory authority established in January 2002 by the major funeral plan providers to regulate the selling of funeral plans and to protect the monies paid by planholders. The FPA seeks the continuation of the self-regulation of the funeral plan industry. The arguments for self-regulation advanced prior to the implementation in January 2002 remain valid and are strengthened by the delivery of effective self-regulation over the past eight years.

WHAT IS A FUNERAL PLAN?

3. A funeral plan is an agreement whereby a customer makes payment in full or by instalments for a funeral to be delivered at some time in the future which may be many years later. A funeral plan is not primarily an investment or financial product. It is essentially the purchase of a service to be delivered at an indeterminate time in the future. The planholder specifies the funeral wanted when the need arises. The monies paid in advance are not the property of the purchaser and the self regulation by the industry through the FPA recognises the need to protect the monies, paid for the plan, until the time of need.

4. A plan may cover the whole cost of the funeral or be a contribution towards the cost. In the latter case the planholder or the person arranging the funeral will have to make an additional payment. Any additional service or variation in the funeral plan will be payable by the person arranging the funeral.

There are offers marketed as funeral plans which are outwith the definition of a funeral plan in the RAO. The FPA does not regulate these arrangements. One such arrangement is the sale of a life policy in relation to which the policyholder executes a legal charge or assignment of the benefits of the policy in favour of a funeral director with whom there is an agreement for the provision of a funeral. The sale etc of the policy is a regulated insurance product. Another arrangement is the sale of vouchers which can be used in the purchase of a funeral - the status of these arrangements in relation to the Financial Services legislation is uncertain.

WHO SELLS FUNERAL PLANS?

5. There are 14 registered providers representing some 95% of the industry's plan sales. The FPA is currently under discussion with several businesses seeking registration but on the information available to the FPA those unregistered businesses are not at present selling a significant number of plans. The fourteen companies registered with the FPA represent the major companies in the sector. They include companies whose plans are trust-based or insurance-based: they include companies which also provide funerals (known as "integrated") and those that only sell funeral plans (therefore "non-integrated). Funeral plan providers enter into commitments with funeral directors for the performance or provision of funerals at pre-agreed prices relating to the monies which come from the maturing insurance policies and from the trust. The integrated providers necessarily have relations with their own funeral directors.

6. Funeral plans are sold by direct mail, by internet or by contact with a funeral director.

In all these cases, the provider would enter into a binding contract with a specific funeral director to perform the funeral at the time of need at an agreed price. Consequently, the security for the performance of each customer's funeral comes from:

- the secure retention of monies paid;
- the undertaking of the plan provider to provide the funeral; and
- an additional commitment from a funeral director to perform the funeral for whatever monies are available at the time of need.

Funeral plans are an important facility for funeral directors in the marketing of their services. The market for funeral services is limited by the death rate and the ability to be able to offer funeral plans is important in a competitive market place. In the past some funeral directors operated in-house arrangements for payment in advance for future funerals retaining the money received within their business possibly in a clients account or on deposit. The funeral plan industry started and filled a demand for more formal arrangements using a trust or insurance to protect the monies. There are a number of relatively small funeral plan businesses and it is likely that the costs of statutory regulation would be such as to alter the structure of the sector, limit the choice for consumers and increase the cost of plans. Funeral plans are an important facility for customers.

The FPA charges a fee on initial registration of £200 and registered providers pay an annual re-registration fee of £200 and £1.50 for each plan sold in the previous calendar year (subject to a cap at 12,000 plans). In addition registered providers will have compliance costs. The costs of direct regulation would be significantly higher, and would not be economic for providers selling a relatively small number of plans and run the risk of inhibiting entry into the market. The FPA provides a good level of protection for customers.

<u>REGULATION OF FUNERAL PLANS</u>

7. Financial Services and Markets Act 2000 included powers enabling direct regulation of funeral plans. The Regulated Activities Order 2001 (RAO) defines in Article 59 a funeral plan as:

> "*a contract (other than one excluded by article 60) under which –*
> *a) a person ("the customer") makes one or more payments to another person ("the provider"); and*
> *b) the provider undertakes to provide, or secure that another person provides, a funeral in the United Kingdom for the customer (or some other person who is living at the date when the contract is entered into) on his death;*
> *unless, at the time of entering into the contract, the customer and the provider intend or expect the funeral to occur within one month."*

Article 60 provides for the exclusion from direct regulation of funeral plans which comply with the specified criteria which are summarised below.

<u>HISTORY</u>

8. 1997 the OFT published a report on an investigation of funeral plans and this was followed in 1999 by a Treasury Consultation "Regulation of the Pre-Paid Funeral Industry." The general thrust of the report and consultation document was for the regulation of funeral plans primarily for the protection of the monies paid for a contract under which the service will be delivered at some time after the time of payment. A funeral plan is the payment in advance for a service and, for exclusion from direct regulation, the provider of a funeral plan must meet certain criteria:

- *in the case of insurance-based plans:*
  "the provider undertakes to secure that sums paid by the customer under the contract will be applied towards a contract of whole life insurance on the life of the customer (or other person for whom the funeral is to be provided), effected and carried out by an authorised person who has permission to effect and carry out such contracts of insurance, for the purpose of providing the funeral" or

- *in the case of trust-based plans:*
  "the provider undertakes to secure that sums paid by the customer under the contract will be held on trust for the purpose of providing the funeral, and that the following requirements are or will be met with respect to the trust –
  i. *the trust must be established by a written instrument;*
  ii. *more than half of the trustees must be unconnected ["unconnected" being defined] with the provider;*
  iii. *the trustees must appoint, or have appointed, an independent fund manager who is an authorised person who has permission to carry on an activity of the kind specified by article 37, and who is a person who is unconnected with the provider, to manage the assets of the trust;*
  iv. *annual accounts must be prepared, and audited by a person who is eligible for appointment as a company auditor under section 25 of the Companies Act 1989 (1), with respect to the assets and liabilities of the trust; and*
  v. *the assets and liabilities of the trust must, at least once every three years, be determined, calculated and verified by an actuary who is a Fellow of the Institute of Actuaries or of the Faculty of Actuaries."*

9. The industry response to the need for regulation proposed a self-regulatory approach. The industry trade associations, the National Association for Pre-Paid Funeral Plans and the Funeral Planning Council in support of their submission stated that the two associations had an unblemished record of protecting the delivery of funerals under funeral plans mainly arrangements based upon trust arrangements and monitoring including actuarial and accountants' reports. The FPA since January 2002 has a similar unblemished record.

THE FUNERAL PLANNING SECTOR

10. In 2002, the first year of self regulation, registered providers sold 46,340 plans which in 2009 increased to 91,335. On 30 June 2010 there were 600,115 plans outstanding. The funds held by registered providers, in respect of trust based plans, was some £600M which includes plans sold before 1 January 2002. There are 14 providers registered with the FPA of which seven sell trust-based plans. Registered providers represent some 95% of the industry and, on the information available, those providers selling trust based plans who have not registered with the FPA are not significant players in the market and are small businesses. The FPA is in discussion with a further small number of businesses seeking or likely to seek registration.

REGULATION BY THE FPA

11. Registered providers must comply with requirements of the RAO and with the FPA's Rules and Code of Practice. Compliance is monitored by the Compliance Committee whose members are independent of the Industry. Monitoring includes annual re-registration of the registered providers requiring the submission of information, including for most RP's, an annual actuarial valuation and audited accounts and current documentation (brochures, terms and conditions, contracts).

12. . The Rules provide for:

- the registration and re-registration requirements
- the appointment of the Compliance Committee
- the right of appeal against a decision
- the security of the plan funds including, for example, the terms required in the trust deed (for trust-based plan providers) and the approval of insurance arrangements (for insurance-based plan providers)
- the complaints procedure required to be provided by the plan provider
- the independent conciliation and arbitration scheme provided through the FPA which is required to be used in the event the plan provider's own arrangements do not resolve a dispute (see 15. below).

13. . The Code of Practice provides for:

- the conduct of the plan provider
- marketing and advertising
- information plan providers are required to provide to customers (including, for example, cancellation of a plan)
- the contracts and documents with which customers must be provided
- the complaints procedure
- an agreement to co-operate in the delivery of the Authority's pledge to customers in the event of the insolvency of a registered plan provider (see 14. below).

14. The need for a long stop protection is recognised in the Rules. It includes a pledge that "Registered Providers shall co-operate in the delivery of the Authority's "Pledge to Customers" by which, in the event of the insolvency of a Registered Provider, the other Registered Providers will examine ways in which the Authority might assist in arranging delivery of the funerals of customers of the insolvent Registered Provider. The extent of this cooperation will be at the discretion of the individual Registered Providers."

15. Registered Providers are required to operate their own complaints procedure but if they are unable to resolve the complaint, customers are invited to put their complaint to the FPA. The FPA endeavours, informally, to find a mutually agreeable solution but, failing that, the customer may refer the matter to the Independent Dispute Resolution Service Ltd. (a subsidiary of the Chartered Institute of Arbitrators) for conciliation and, if the customer elects to do so, to arbitration. Disputes that reach the FPA are of a greatly varying nature but, in 2009 for example, 19 were received concerning registered providers: since 2002, only two cases have been put to the IDRS for independent conciliation and/ or arbitration showing that many disputes are resolved by the FPA's intervention. The FPA also endeavours to assist in disputes between non-registered providers and their clients whenever possible but without any authority.

16. The FPA maintains a dialogue with the Financial Services Authority.

Attached:

- Rules of the FPA
- Code of Practice of the FPA

A New Approach to Financial Regulation: Judgement, Focus and Stability (CM7874)

A Response by the Futures and Options Association

OCTOBER 2010

A New Approach to Financial Regulation: Judgement, Focus and Stability

NB. All references to paragraphs in CM7874, unless otherwise indicated.

1. Introduction

1.1 The Futures and Options Association ("the FOA") is the principal European industry association for over 170 firms and organisations engaged in the carrying on of business in futures, options and other derivatives. Its international membership includes banks, financial institutions, brokers, commodity trade houses, energy and power market participants, exchanges, clearing houses, IT providers, lawyers, accountants and consultants (see Appendix 1).

1.2 As HM Treasury will be aware, the FOA has questioned the need to fragment the UK's regulatory infrastructure quite so deeply as well as the timing of introducing such significant changes for reasons set out in its original response to the Conservative Party White Paper "From Crisis to Confidence: Plan for Sound Banking". The FOA recognises that the structural changes identified in the Government's consultation paper "A new approach to financial regulation: judgement, focus and stability" (CM7874) and the findings summarised in its Introduction reflect what is now settled Government policy. The observations set out in this response are intended therefore to maximise the capability of the new infrastructure to operate in a way that delivers coherence, efficiency, effectiveness and, as it is put in CM7874, "the best value for money solution for the financial services sector".

1.3 In general terms and subject to the observations outlined later in this response, the FOA supports the general objectives:

(a) to establish a new Financial Policy Committee (FPC) as an essential step in delivering what is described in para 1.10 as a response to the need for a "dedicated focus on macro-prudential analysis and action";

(b) to co-ordinate and converge macro-prudential and economic management with the micro-prudential regulation of individual firms;

(c) to distinguish the prudential regulation of deposit-taking banks, investment banks, insurers and other systemically-important institutions from business conduct regulation and the regulation of other investment firms; and

(d) to establish a "more judgement-focused" approach to prudential regulation.

1.4 At the same time, the FOA does have a number of observations and concerns, each of which is enlarged in the ensuing sections in this response, namely:

In general terms:

(a) The risk of inter-institutional rivalries and tensions, supervisory overlap, rules overlap (particularly as regards business conduct and prudential regulation) and of a significantly increased regulatory burden on firms is high. It is important therefore that, where possible, there are "bright lines" in terms of scope, responsibilities, decision-making, information-sharing and regulatory co-operation (and it should be remembered that, while the degree of fragmentation is less, burdensome duplication was one of the key concerns that led to the unification of the SRO system and the establishment of the FSA).

The FOA would urge the Government to consider, therefore, enabling one authority (acting on behalf of the other(s)) to be responsible for the provision of certain common functions and processes, including authorisation, the removal of permissions and routine supervisory visits.

(b) The FOA is strongly supportive of the FPC, the PRA and the CMA being required to "take into full account" the secondary "factors" referred to in CM7874 (reflected in the Financial Services and Markets Act 2000 and described by the FSA as "Principles of Good Regulation"), including, particularly, the essential need for firms to be competitive and innovative. While there may be some variance in these factors, reflective of the different responsibilities of the FPC, the PRA and the CPMA, the FOA believes that, wherever possible and appropriate, the "factors" and the duty and burden of obligation should be the same, bearing in mind that, in each case, they will be sub-ordinated to the primary objectives of each of these authorities. (See further the reply to Q4 and paras 2.5, 4.8 and 4.9 in this response.)

(c) The FOA supports the view that the rule-making function should continue to be subject to statutory process, as described in para 3.22, including public consultation, the duty to carry out detailed cost-benefit / market impact analysis and oversight by the competition authorities to prevent rules becoming anti-competitive. It is equally important that changing rules, in order to incorporate *de minimis* "nice to haves" or simply "for changes' sake" should be avoided.

(d) The PRA and the CPMA should each have a high level, statutory-based practitioner panel of sufficient seniority and relevant expertise to perform roles comparable to that provided by the FSA's existing high-level Practitioner Panel.

(e) The proposal that the PRA will be the UK's representative body on the new European Supervisory Authorities for banking and insurance and that the CPMA will be the UK's representative body on the European Securities and Markets Authority presupposes a matching "bright line" of responsibility. It is likely that there will be no such match and that each body will have to act on behalf of the other.

CM7874 makes no significant reference as to how the UK will be represented on the international standard-setting bodies, such as IOSCO, apart from the reference in para 6.25 and then only in the context of "crisis management". As with the interface with the new European Supervisory Authorities, the division in responsibility between the PRA and the CPMA may call for one of those bodies to act on behalf of the other where there is a need for UK regulatory authorities to be represented on international fora.

With regard to the FPC (see Section 2 in this response):

(f) There should be a higher number of external members on the Board of the FPC, if they are to be able to effectively, as it is put in para 2.43, "challenge" the Committee's deliberations.

(g) The degree of independence of the FPC and its operational processes and its responsibilities and duties as regards co-operation and information-sharing should all be set out in a separate code of governance.

(h) The FPC should be required to take into full account not just the economic or fiscal consequences of their actions, but also the social outcomes.

With regard to the PRA (see Section 3 in this response):

(i) The scope of firms to be regulated by the PRA assessed as being in the order of 1500-2000 firms is unclear (with it being described differently in various sections of CM7874) (see para 3.1 in this response), as against the original 50-100 (or so) systemically-important institutions (depending upon how that is defined).

With regard to the CPMA (see Sections 4 and 5 in this response):

(j) It is critically important that a new interim CEO and other managing director-level appointments are made as soon as possible to ensure that there is "equivalence in arms" in the debate over the relationship between and the respective roles of the PRA and the CPMA.

(k) The ability of CPMA to accommodate regulatory differentiation between wholesale and retail business (which is founded not on any need for "light touch" regulation, but rather for proportionate regulation to reflect the fundamental differences between retail and wholesale customers and business) is questionable (see also (n) below).

(l) The FOA would urge the Government to consider renaming the CPMA as the Markets and Conduct Authority (as suggested by the London Stock Exchange) and, further, it should comprise three separate divisions, namely, "retail,", "wholesale" and "markets", each of which should have its own Managing Director and sub-Board. Such a division would accommodate the position of the many firms which are not systemically-important and are neither "retail" nor "markets".

(m) The FOA believes that there should be close co-operation and collaboration between the Markets Division of the CPMA and the Bank of England with regard to the regulation and supervision of CCPs; and supports the broad–based industry view that the UK Listing Authority should remain within the Markets Division of the CPMA.

(n) The regime for Recognised Bodies should remain separate and distinct from the regime for authorising investment firms, insofar as each of these groups has different relationships and performs essentially different functions (see further paras 5.2 and 5.3 in this response).

(o) The CPMA will be a substantive regulatory authority in its own right and should not be subordinated to the PRA, bearing in mind the number of firms that will be directly authorised and regulated by it and its critical role as the UK's sole representative body on ESMA.

(p) While consumer interests, retail investor protection and honest dealings should be a priority focus for the CPMA, describing the CPMA as a "strong consumer champion" undermines seriously its independence as a statutory based authority, particularly in the area of handling of customer complaints, consumer-related disciplinary proceedings. It also questions its ability to be even-handed in its treatment of regulated institutions (cf. the observations made with regard to the Financial Ombudsman Scheme in para 4.16 in this response). Further, it suggests that the other CPMA divisions will be subordinated into consumer responsibilities of the CPMA, underlying the concerns expressed in (l) above. (See paras 4.2 and 4.3 in this response.)

1.5 The FOA recognises that there is real value in "test-driving" some of the proposed changes by introducing them internally within the FSA and prior to implementing the enabling legislation, but there is a related question as to whether or not this process of early implementation will underline the depth and integrity of the "comprehensive" consultation promised by the Government "early in 2011" (see Section 7 in this response).

1.6 Subject to para 1.5 above, the intention of the Government to establish a "shadow" construct of the proposals for a new CPMA and PRA within the FSA is a necessary step in the process of phasing in implementation of the Government's core proposals in CM7874 and staggering the attendant costs and complexity of them. It will also provide an opportunity for a mid-term review on progress and "fitness for purpose".

Additionally, this internal restructuring within the FSA will also enable the Government to assess whether or not its objectives and the mechanisms for cooperation, coordination and direction, particularly as between the PRA and the FPC, could still be achieved without necessarily taking the next step of "externalising" those divisions. It is recognised that the Government is likely to proceed with that next step, but such an interim review would seem pragmatic and sensible and could be incorporated within the proposed 2011 consultation exercise (see Section 7 in this response).

1.7 In view of the fact that the FPC, the PRA and the CPMA and other such bodies will be acting independently in the setting of their fees, there is a concern that, cumulatively, there could be a severe and disproportionate impact on the economics of the business being undertaken by regulated firms, which will be carried over into charges and fees to customers. The FOA believes that the process should be the subject of independent oversight by the National Audit Office or, where there are no conflicts of interest issues, by HM Treasury, to avoid inter-institutional rivalry or the funding of overlapping activities and to analyse the cost-benefit of specific fees proposals.

1.8 The FOA believes that the Preliminary Impact Assessment is flawed because, firstly, it covers only the options of "do nothing" (which is not an option) or "proceed" and did not analyse the more realistic options of "do less" or even "do differently"; secondly, it did not assess the core elements of the proposed changes; and, thirdly, it assumed no substantive rules change as a result of structural change – an assumption the assessment conceded specifically as "unrealistic". Further, in justifying the benefits, it is assumed that the cost of the proposed changes will be offset by "the total expected welfare costs of another financial crisis" without any consideration of whether "do less" or "do differently" would achieve the same or similar reduction in such welfare costs (see Section 8 in this response).

2. The Bank of England and the Financial Policy Committee

2.1 It is generally recognised that the original Tripartite system was deficient, with no clear lines of responsibility for decision-making or for identifying, analysing and acting on risks to the system as a whole.

While it is difficult to predict the cause of the next crisis and whether or not the current proposals do, in fact, strike the right balance, the FOA believes that they should have a significantly better chance of catching a crisis at the "orange light" rather than the "red light" and mitigating its consequences.

The FOA supports, therefore:

(a) the Government's proposals to place the Bank of England in charge of macro-prudential regulation, abolish the Tripartite system and establish a "strong" Financial Policy Committee (FPC) within the Bank, with the power to take mitigating action as and where necessary to reduce risk to the system;

(b) the objectives of the FPC as defined in para 2.24, including converging macro-prudential/economic and micro-prudential oversight and regulation;

(c) the three broad functions of the FPC as identified in para 2.30, namely, monitoring the system to identify risks of financial stability, addressing identified vulnerabilities and imbalances and informing as to analysis and action taken;

(d) the monitoring obligations and powers to take action set out in paras 2.31 and 2.32; the lines of responsibility/co-operation set out in para 2.37 in terms of utilising micro-prudential levers to resolve macro-prudential issues as between the FPC, the PRA and the CPMA; and the proposals for ensuring close co-operation and information-sharing between those organisations, HM Treasury and the Bank of England's Court of Directors.

2.2 The FOA notes that the FPC will be accountable, internally, to the Court of Directors of the Bank of England and, externally, to the Government, parliament and the public. While the FOA is strongly supportive of the need for external, and not just internal/private accountability, it anticipates that there may be tensions insofar as the public policy objectives of, for example, the Government and the Bank of England may not be *ad idem*.

With regard to para 2.55, the FOA supports the recognition by the Government that, while full transparency is desirable in terms of process and analysis, the release of certain details or information could have a "destabilising" effect for individual firms or on the market more widely, and/or there may be other public policy or commercial confidentiality reasons as to why full disclosure may be undesirable.

2.3 With reference to para 2.39, while it is understood that the Bank of England must be fully and effectively represented on the FPC, the FOA would prefer to see a higher number of external members than the proposed number of four, particularly if those external members are expected not just to provide adequate and broad-based expertise, but, as is envisaged in para 2.43, to "challenge" effectively the Committee's deliberations. The FOA believes that the role and responsibilities of these external members are comparable to those of a non-executive director. They should be sufficiently informed and expert to ensure that the Committee lives up to its responsibilities, particularly in the context of decision-making and accountability. Such external members could include, for example, the chief economist of one of the major banks, a senior prudential regulation expert from one of the major accountancy firms and a senior, well-respected and independent economist.

The FOA notes the reference to the line of accountability of the MPC, but para 2.57 draws what appears to be a careful distinction, insofar as it states that the FPC will be clearly accountable to the Bank's governing body – the Court of Directors – implying that it may not have the same degree of independence as the MPC. It appears that comparability with the MPC is more aligned with the fact that the Court will monitor the procedures of the FPC and ensure that it is properly supported suggesting that the analogy with the MPC is more about process than accountability.

The FOA would urge the Government to consider the appropriateness of developing a separate code of governance to cover the responsibilities, accountability and processes of the FPC and defining the degree of its independence.

2.4 With regard to funding (para 2.68), the FOA notes that it is the Government's objective "to maintain the principle of fully funding these activities – including any new responsibilities – from industry contributions".

As stated later in this paper in relation to the PRA and the CPMA, the risk of each of these bodies acting independently in setting the funding to meet their own requirements poses a question over how those independently-set fees will impact cumulatively on the economics of the business undertaken by regulated firms, particularly for their customers. On this basis, while it is recognised that the "Government will work with the Bank" to determine how this will be taken forward, the FOA believes that there should be a formal process of independent oversight, undertaken either by the National Audit Office or, where there are no conflict of interest issues, by HM Treasury to avoid inter-institutional competition in terms of funding or the funding of overlapping activities and to assess, as indicated above, the cumulative impact of the industry "fully funding" all these organisations and analyse the cost-benefit of specific fee proposals.

Q1. Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?

Q2. If you support the idea of secondary factors, what types of factors should be applied to the FPC?

Q3. How should these factors be formulated in legislation – for example, as a list of "have regards" as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?

2.5 The FOA believes strongly that the FPC should, as is envisaged in CM7874, be "mindful" of "other secondary factors when determining a particular course of action", including levels of lending to business and families and the competitiveness and profitability of the UK banks in relation to foreign competitors, but:

(a) the term "mindful" is inadequate – it should be set on the same footing as the burden of observance placed upon the CPMA and the PRA, namely, as argued by the FOA, "to take into full account" (recognising that such factors will still be sub-ordinated to the overall public policy objectives assigned to the FPC);

(b) those secondary factors should include the consequences of macro-economic action on social cohesion and stability, i.e. the impact is not just economic or fiscal, but also social;

(c) the "secondary factors" should include such of the general principles of good regulation required to be taken into full account by the CPMA and the PRA (and largely as formulated in the current legislation) as may be relevant and appropriate for the FPC, including the additional factors set out in paras 4.10 and 4.12 (see the response to Q4 and paras 4.8 and 4.9 in this response).

3. Prudential Regulation Authority (PRA)

3.1 The FOA believes that while it is clear that the PRA will be responsible for the Prudential Regulation of all "deposit-taking institutions, insurers and investment banks" (para 1.14), there are a number of outstanding questions about where the perimeter of PRA authorisation is to be set, e.g.:

(a) While the primary objective placed upon the PRA is to prudentially regulate systemically important institutions, the Government's assessment that these will comprise 1500-2000 firms suggests that the remit will be significantly wider than the currently estimated 50-100 systemically important firms (depending upon how that is defined).

(b) Para 3.12 equates "investment banks" with "broker-dealers", which is inaccurate. While some investment banks undertake significant broker-dealer activities, broker-dealers do not operate as "shadow" or investment banks. In the absence of a systemic risk or business scope test, this will mean that large numbers of broker-dealers of different sizes that do not carry on investment banking activities and are not systemically important (and many of which would be small or purely domestic specialist dealers) would fall under the remit of the PRA. Presumably, this is not intended.

(c) Under direction from the FPC, the PRA (i) will be empowered to take "regulatory action with respect to all firms" (para 1.15); (ii) will have "operational responsibility for the regulation and supervision of individual firms" (para 1.16); and (iii) be able to make "significant regulatory decisions affecting firms – for example, on authorisation, supervision or enforcement of rules or sanctions" (para 1.16). Para 2.18 also refers to "the day-to-day operations of firm-specific regulation". While it is not clearly stated, these powers are presumed to apply only to those firms that are directly regulated by the PRA and not more widely.

(d) Since the CPMA will be responsible for setting and enforcing the prudential regulatory standards for firms falling within its jurisdiction and not within the scope of the PRA, this will call for close collaboration in the setting of prudential rules between the CPMA and the PRA. However, while it is recognised that there should be no anti-competitive distortions in prudential regulation, it is equally clear that prudential rules will have to be tailored to properly and fairly match the risks, products and services posed by the differentiated business models of many CPMA-regulated firms.

(e) With regard to para 3.15, the FOA notes the inclusion, within the scope of the PRA, firms which "deal in investments as principal". It is presumed that this is not a criterion for defining the scope of the PRA, but is a reference to the kind of activities carried on by PRA-regulated firms which would be prudentially regulated by the PRA. On the other hand, if dealing in investments as a principal is a scope-defining activity, then this would bring within the scope of the PRA a significant number of very differentiated firms of all types and sizes – something that is again surely not intended.

3.2 With regard to para 3.14, it is assumed that the power of the FPC to make recommendations to the Treasury to enlarge the perimeter of the PRA could include – even though this is not stated – recommendations to reduce the perimeter of its scope.

3.3 Apart from prudential regulatory policy, it does not seem appropriate for the PRA to be the "lead authority" over the CPMA because the CPMA will be responsible for the prudential and business conduct regulation of the vast majority of financial service firms in the UK, ranging from asset managers to specialist broker-dealers, exchanges and international oil and energy corporates, which are likely to be far removed from the competence and experience of the PRA.

Further, it is difficult to see how the CPMA could play an authoritative role representing the UK on ESMA if it is seem to be subordinated to the PRA.

Q4. The Government welcomes respondents' views on:

- *whether the PRA should have regard to the primary objectives of the CPMA and FPC;*
- *whether some or all of the principles for good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice, should be retained for the PRA;*
- *whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and*

- *whether there are additional broader public interest considerations to which the PRA should have regard.*

3.4 The FOA supports the primary objective of the PRA as articulated in para 3.5, and agrees that it should take precedence over all other secondary objectives or factors which may be required to be taken into account by the PRA. At the same time, in the interests of coherence and a workable collaborative arrangement, each of the authorities, including the PRA, should "take into full account" the primary objectives of their peer authorities. For these same reasons, wherever possible, each of the authorities should be required to "take into full account" the same Principles for Good Regulation as their peers to avoid conflict between them.

3.5 The FOA agrees with the secondary factors set out in para 3.7, but, in view of their subordinated nature to the primary objective, believes that the obligation could be described in terms of "taking into full account", rather than just "having regard to". This would ensure that meaningful and not just superficial consideration is given to these secondary factors.

3.6 The FOA supports:

(a) the obligation to act "proportionately and in accordance with regulatory good practice";

(b) the additional factors itemised in para 3.10;

(c) the suggestion that "wider factors" should be taken into account, but these should include not just the economic impact of the policies and regulatory issues of the PRA, but their impact on market liquidity, participation and diversity;

(d) the extension of the principles of good regulation itemised in para 4.10 and 4.11 as may be relevant and appropriate.

3.7 The FOA believes strongly that sustaining global competitiveness and innovation are key to growth and that they should both continue to be secondary factors (see Appendix 2), particularly since:

(a) it is impossible to see how the PRA (or the CPMA) could perform a more judgemental role, which involves commercial interventionism and reviewing firms' business models and strategies, without being required to take into full account the need for firms to sustain not just their international, but also their domestic, competitiveness;

(b) the financial services sector is a major contributor to UK GDP – a large percentage of which is provided by foreign-owned firms, conducting international wholesale business – and is believed to support in excess of one million jobs in London and the UK;

(c) any decision to abandon the need for the FSA to take into account the need for international firms to be competitive or innovative will send a particularly damaging message (alongside all the other UK-driven constraints) to international firms located in the UK, and also to firms that may consider relocating to the UK;

(d) HM Treasury has itself recognised the importance of facilitating competitiveness by the Treasury in the Executive Summary of its paper "Risk, Reward and Responsibility: the Financial Sector and Society" (December 2009), in which it stated that:

> *"A strong and competitive financial sector is essential to a productive economy, and financial services make a significant contribution to the UK economy in particular."*

(e) recognition of the need to facilitate competitiveness is reflected in the context of delivering on the primary objective of the FPC as set out in para 2.26 (referred to para 2.5 in this response), so it is unclear why these two factors should be questioned in relation to the PRA and the CPMA.

The FOA notes the observation in para 3.9 that one of the reasons for regulatory failure was "excessive concern for competitiveness". This level of attention, if that was the case, was a matter in the sole discretion of the FSA and was not required under the terms of the existing legislation, i.e. facilitating competitiveness was a factor and not an objective; and its "promotion" was specifically rejected at the time of the passage of the Financial Services and Markets Act (see Appendix 2).

With regard to innovation, the FOA agrees with the observation in para 3.9 that financial innovation should not be "supported at all costs", but, once again, questions the value of that statement since that level of priority was not, even remotely, required under the existing legislation (see above para in relation to competitiveness). The critical role of innovation was recognised by Sir David Walker in the Preface to his Report "A Review of Corporate Governance in UK Banks and other Financial Industry Entities" (July 2009) which noted that:

> *"…any undue hampering of the ability of bank boards to be innovative and take risks would itself bring material costs. It would check the contribution of the banks to wider economic recovery and delay restoration of investor confidence in banking as a sector capable of generating reasonable returns for shareholders."*

Q5. Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?

3.8 The FOA welcomes the recognition by the Government that there is an intrinsic functional overlap between the PRA and the CPMA and that this will require a "significant degree of co-operation and co-ordination" to avoid unnecessary regulatory duplication or conflict or the imposition of excessive and needless regulatory burdens on licensed institutions.

3.9 While the FOA believes that the PRA should be responsible for day-to-day supervision in terms of overseeing compliance with its prudential rules and requirements, it is nevertheless desirable for one authority (acting on behalf of the other or others) to be responsible for certain common functions and processes, including authorisation and the removal of permissions. Other functions, such as enforcement and investigation, should be conducted by the authority with the necessary expertise, and, where possible, on a joint basis. Further, where tenable, visits should be carried out on a joint basis with the CPMA in order to avoid imposing undue regulatory burdens and duplication on regulated firms. As an aside, duplication of visits by the sectoral SROs was a key concern of firms prior to the establishment of unified regulation under the FSA.

3.10 While the FOA supports the need for a close relationship between the FPC and the PRA, the powers of the FPC to make directions and issue recommendations seems, in some respects, to be conflicting and may need further clarification, e.g.

(a) Box 3.B states that the PRA will be required to consult the FPC in advance of any other consultative processes, where the PRA (or the CPMA) "believes there is a risk that the rule it proposes could have material adverse financial stability consequences, which, in the case of the PRA, may entail an extensive period of pre-consultation insofar as many of their significant rules will pose precisely that risk".

(b) Para 2.32 empowers the FPC to give directions to the PRA on the regulatory tools that should be deployed in pursuit of macro-prudential policy and to make recommendations where specific regulatory actions are required in order to protect financial stability.

(c) Para 2.37 states that "the PRA will be required to implement the FPC's decisions on the use of its macro-prudential tools by applying them across "all" relevant firms, posing the question as to whether this duty applies to all firms deemed "relevant" by the FPC, or whether it applies only to PRA regulated firms. No mention is made of the thousands of firms which will be prudentially regulated by the CPMA. The only reference to the CPMA in this paragraph applies to those tools that are deemed necessary and which relate only to "conduct regulation".

(d) Para 3.29 states, in part contradiction to (b) above, that the FPC, aside from the implementation of macro-prudential tools, will have "operational independence for the day-to-day regulation and supervision of firms" and that "neither the bank nor the FPC will have any formal power of direction over the PRA in relation to firm-specific decisions or other operational matters".

3.11 The FOA supports the formal process set out in Box 3.B, but would caution that this is a complex matrix of co-operation and co-ordination, which could become excessively bureaucratic and burdensome and lead to significant delays in regulatory output and protracted consensus-building, which could, in turn, impair the ability of an individual authority to take fast-track actions. It is for this reason that many of the cross-cutting functions should be assigned to one authority on a pooled-information basis.

Q6. Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focussed approach to supervision?

Q7. Are safeguards on the PRA's rule-making function required?

Q8. If safeguards are required, how should the current FSMA safeguards be streamlined?

3.12 It is stated, in para 3.1, that financial supervision in the UK relied too much on "tick-box" compliance with rules and directives. While it is true that the authorities did not monitor sufficiently closely the building-up of systemic risks in individual firms and across the system as a whole, it is worth noting that the FSA had already introduced a "more principles-based approach" and, in that sense, was already moving away from "tick-box" compliance.

3.13 The FOA supports the Government's intention to ensure that there will be a "new, more judgement-led style of prudential regulation" and increased focus on "understanding institutions' business models and strategies", but it is critical that:

- those exercising such judgements have the training and competence to do so;

- this approach and individual judgements are exercised in accordance with pre-set transparent criteria and are "cleared" internally to ensure consistency and transparency;

- the greater discretions given to the PRA in terms of investigation, etc. should be exercised fairly, consistently and in accordance with accepted notions of natural justice;

- judgements are made pursuant to the principal objective of the CPMA (or PRA) and take into full account the secondary factors, where applicable.

3.14 The FOA strongly supports the view that the rule-making function should continue to be subject to statutory processes, as is described in para 3.22, including consultation with a high-level statutory-based practitioner panel (similar to the one established under the FSMA), public consultation and the duty to carry out detailed cost-benefit / market impact analyses. The rule-making process should also include the issuance of feedback statements and oversight by the competition authorities to ensure that rules are not anti-competitive.

3.15 The FOA strongly supports the Government's expectation that the PRA will actively look "to reduce and simplify the rules and guidance contained in what is currently the FSA handbook" to delete duplicative or out-dated rules, but consistent with European law and the needs of transparency and legal certainty/predictability.

Q9. The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.

3.16 The FOA supports the primacy of external accountability of the PRA in the interest of balance and transparency, but believes that balancing the external and internal governance arrangements will be complex and may be difficult to fulfil, insofar as, for example, the Bank of England and the Government may not necessarily have the same priorities and objectives.

It is noted that neither the Bank nor the FPC will have any formal powers of direction in relation to firm-specific or other operational matters (see also para 3.10 in this response). While it is true that they would not normally be necessary in terms of securing macro-prudential/economic stability, it should not be assumed that there is necessarily a "bright line" between firm-specific / operational decisions and macro-stability decisions. Indeed, it was the apparent crossover between them that motivated the objective of converging prudential regulation/supervision with macro-stability oversight – as reflected in para 3.31!

For confirmation, the FOA agrees with many of the "transparency and accountability" proposals set out in paras 3.37 to 3.40.

3.17 Clearly, it is important that both the PRA and the CPMA are "politically independent".

3.18 With regard to para 3.41, the FOA supports the concept that the PRA must be able to set fees and levies in such a way as to be satisfied that it can meet its statutory and other public policy objectives, but it is essential to ensure that the cumulative impact of separately-set levies by the PRA, the CPMA and other organisations looking to the industry for funding, do not become so excessive as to be uneconomic or unreasonable. The FOA believes therefore that the National Audit Office (or HM Treasury, if there is no conflict of interest) should, in addition to the general audit obligations set out in para 3.39, have an independent role in overseeing the setting of those fees to ensure that they are proportionate, do not reflect undue competitive inter-institutional rivalry, are not duplicative of the roles of other authorities; and that, individually and cumulatively, they pass the appropriate cost-benefit / market impact analysis.

The FOA believes that it is not appropriate for the authorities to be "judges in their own cause" in the setting of fees and that, as a result, the NAO would have to perform this function in relation to all the other fee-raising authorities, including the CPMA and the FPC.

4. Consumer Protection and Markets Authority (CPMA)

4.1 The FOA notes and strongly supports the Government's intention that the CPMA will be "independent of Government" and that the transfer of powers from the FSA and the establishment of the CPMA should deliver, wherever possible, "the best value-for-money solution for the financial services sector".

4.2 The FOA very much supports the importance of retail consumer protection and the right of all consumers of financial services to expect to be treated honestly and fairly by their providers and to have the benefit of appropriate degrees of support and assistance "when things do go wrong" (para 4.50).

4.3 The FOA is deeply concerned over and disagrees strongly, however, with the promotion and combative description of the CPMA as a "strong consumer champion", which imports a clear bias into what should be an impartial and objective regulatory authority.

More particularly, this description:

(a) suggests that the interests and treatment of the regulated providers of financial services and products and the market infrastructure providers will be marginalised and subordinated to the overarching consumer objectives of the CPMA which is implicit in this terminology;

(b) challenges the independence and impartiality of the CPMA with regard to the investigation and hearing of complaints and disciplinary proceedings were consumers are involved;

(c) begs the question as to what degree, against whom, and in respect to what matters consumers are being championed?

(d) contradicts the assumption in para 4.3 that "there will be no in-built tensions between different objectives, and a dedicated focus on the importance of proper conduct".

As recognised in para 4.2 in this response, there is a clear need for the interests of consumers and investor protection to rightly remain at the heart of the regulatory conduct system, but this should not and does not require the CPMA to be labelled as a "strong consumer champion".

In this context, it is argued in para 4.44 that the Financial Ombudsman Service should remain independent of the CPMA to avoid impugning "its claim to impartiality and hence its legitimacy on making rulings which are binding on firms" and that it can only retain its credibility "if it does not favour or appear to favour consumers". This suggests a policy inconsistency that is disturbing. Surely, if it is unacceptable for the Financial Ombudsman Service to exhibit a bias towards consumers, the same should be said of a statutory-based regulatory authority such as the CPMA!

While the FOA notes the restriction in para 4.4 to dealings with "ordinary retail consumers", that restriction does not appear elsewhere, posing questions for the customer categorisations that are caught within the word "consumers". Even if the term "strong consumer champion" is intended to apply only to retail consumers, it is still an unacceptable description for an impartial regulatory authority and the concerns expressed above would still apply to even this more limited interpretation.

Bearing in mind the inclusion, within the scope of the CPMA, of many different wholesale markets firms, types of business and customers, the reference to consumer protection should include the words “as appropriate”.

4.4 The FOA questions the terminology used in relation to the CPMA, which distinguishes retail conduct of business and wholesale market conduct. The distinction appears to be drawn incorrectly, insofar as wholesale business can involve the provision of services which do not involve market conduct and retail conduct of business may, of course, involve execution of transactions in markets. Put another way, it would be better described as retail conduct of business and wholesale conduct of business, whether it leads to market dealings or not.

4.5 With regard to paras 4.15, 4.18 and 4.19, the FOA notes that the CPMA will be responsible for the setting of prudential rules for firms that are not prudentially regulated by the PRA and for supervising and enforcing compliance with those prudential rules.

It is essential, therefore, that:

(a) there is close co-ordination in this area between the CPMA and the PRA, to ensure consistency in rules and regular information-sharing as and where appropriate; and

(b) the CPMA is able to apply prudential rules, which are targeted and tailored to reflect the different and, in many cases, lower levels of risk posed by the broad spectrum of CPMA-regulated firms to ensure that applicable prudential rules are appropriate and proportionate.

As a passing observation, the FOA is surprised that, bearing in mind the powerful focus given by the paper on prudential regulation, there appears little or no recognition of the need for prudential regulation to be tailored according to risk.

4.6 With regard to para 4.25, the FOA is a strong supporter of the need for a frank and open debate about the question of regulatory balance as between, for example, protectionism and proportionality, investor protection and investor awareness of risk (i.e. the same risk of moral hazard arises in connection with consumer reliance on state protection / compensation as it does in terms of institutional reliance on public sector bailouts), regulatory compression, market diversity, market safety and innovation.

While it is recognised that a balanced approach, for example, to risk is difficult to achieve in the aftermath of such a severe crisis, the running of risks is critically important to the post-crisis need to deliver economic growth – a point that has been fully recognised by HM Treasury in its paper, “Risk, Reward and Responsibility: the financial sector and society” (December 2009).

> *“… taking risks is fundamental to the financial markets’ role in the economy… In the absence of risk, the many benefits that the financial sector delivers will be foregone – enterprise will not be able to flourish and our overall standards of living would be a fraction of what we enjoy today.”*

4.7 The FOA would repeat its observations made earlier in this response as regards the need for close co-ordination and co-operation between the PRA and the CPMA and the importance of avoiding a repeat of the kind of problems that arose with the original Tripartite arrangement and the continuing risk that co-operative processes and consensus-building become overly bureaucratic and protracted.

Q10. The Government welcomes respondents' views on:

- *whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC;*
- *whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which;*
- *whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and*
- *whether there are any additional broader public interest considerations to which the CPMA should have regard.*

4.8 The FOA supports the overarching objective as stated in para 4.6, but would repeat its response to Q4 in relation to the PRA as regards statutory secondary factors and considerations. It is concerned, however, that this issue is addressed in Section 3 (PRA) and Section 4 (CPMA) using different language and with a different emphasis.

4.9 In the interests of regulatory coherence and coordination, the CPMA should have to pay regard to the primary objectives of its peer authorities and the FOA would reiterate its opinion that the "factors" or principles for good regulation and the burden of their observance, wherever appropriate and relevant, should be the same for each of the authorities.

4.10 The reference in the third indent in para 4.12 to maintaining diversity applies, presumably, to services, products and providers.

Q11. Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?

4.11 The FOA supports the proposal that the Board of the CPMA should comprise mainly non-executive members (and include the CEO of the PRA), but it is important that they comprise senior expert practitioners drawn from across the full range of the CPMA's authorised firms.

Q12. The Government welcomes view on the role and membership for the three proposed statutory panels for the CPMA.

4.12 The FOA strongly supports the continuance of the three statutory panels, which have played a significant and valuable role since the formation of the FSA, and the proposal that the Small Business Practitioner Panel will be placed on a statutory footing.

Q13. The Government welcomes views on the proposed funding arrangement, in particular, the proposal that the CPMA will be the fee- and levy-collecting body for all regulatory authorities and associated bodies.

4.13 The FOA would reiterate its views stated in para 3.18 in this response about the need for independent oversight of the setting of levies by the PRA, the CPMA and other bodies to ensure that their cumulative impact does not have a disproportionate or adverse economic effect on either the providers or the consumers of financial services, bearing in mind that those levies will be reflected in the level of consumer/client commissions, charges and spreads as "pass-on" customer costs.

Q14. The Government welcomes views on the proposed alternative options for operating models for the FSCS.

4.14 The FOA prefers the alternative of the Financial Services Compensation Scheme continuing as a single scheme under the remit of the CPMA, with the PRA having a formal role in the way suggested.

Additional Points

4.15 The FOA believes it is critically important that the position of CEO and those of the FSA Managing Director positions that will become part of the CPMA are filled as soon as possible. Further, the CEO of the CPMA should have no lesser status than the CEO of the PRA and, because of the need for co-operation between the two bodies, the CEO of each of those bodies should be a member of each other's Board.

4.16 While financial inclusion is an important factor, it is not entirely clear what is meant by the CPMA "encouraging access to suitable products and services". Does it mean that this a specific obligation on the CPMA, leading to its opining on what are suitable products and services, or is this a reflection of the existing know-your-customer / suitability rules and the need for close monitoring by the CPMA?

The need for better description of this objective is driven by previous policy observations by the FSA on the societal value of products and services.

As an aside, the FOA does not accept the view that products and services have to be manifestly societally beneficial, firstly, because of the difficulties in defining what is meant by societally beneficial (e.g. to what degree, for whom and for how many) and, secondly, because the primary objective of the regulatory authorities is to ensure that they are not societally detrimental. The statutory objective of protecting investors clearly calls for societally harmful products and services to be withdrawn, but that should not apply where the impact of the relevant services and products is neutral and there is no identifiable damage to consumers (NB. Any false claims as to their benefit would be a specific breach of business conduct rules).

4.17 The FOA strongly supports many of the proposals set out for governance, transparency and accountability, but questions why they do not apply in equal measure to the PRA, e.g. the holding of annual public meetings (which could be done in association with the CPMA).

4.18 The FOA shares the Government view that the Financial Ombudsman Service, as it is put in 4.44, must "remain independent of the CPMA" to avoid impugning "its claim to impartiality, and hence its legitimacy on making rulings which are binding on firms" and that it must not be seen to "favour, or appear to favour, consumers". Being part of a "strong consumer champion" does create an unacceptable and inherent implication of bias!

4.19 With regard to the Consumer Financial Education Body, the FOA believes that it would be highly desirable for the CEO of the CPMA to sit on the Board of the CFEB, firstly, because there should, in real terms, be little conflict between the bodies, secondly, it is difficult to see how the presence of the CPMA CEO would, as anticipated in the paper, undermine the CFEB's independence and, thirdly, CPMA will have the secondary objectives (as envisaged in para 4.12) of promoting "public understanding of the financial system" and "financial inclusion, where possible, by encouraging access to suitable products and services". The presence of the CPMA CEO on the CFEB Board will ensure consistency in purpose and facilitation of the CPMA's objectives in this area, reflecting the clear linkage between the role of the CFEB and those objectives of the CPMA. This calls not just for regular communication but also co-equal cross-representation at Board level.

5. Markets and Infrastructure

Q15. The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.

Q16. The Government welcomes view on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.

5.1 The FOA welcomes and supports the Government's intention to create "within the Consumer Protection and Markets Authority (CPMA), a strong separate markets division to lead on all market conduct regulation, and to be the lead authority representing the UK in ESMA". The FOA would emphasise that, in order to be a strong markets division, that division will need to have a high degree of autonomy, possible even with its own sub-Board, if it is to be properly distinguished from the retail role and outputs of the CPMA, which – to re-emphasise the point – is reflective of its bias as a "strong consumer champion". The Markets Division and the regulation of wholesale business and the duties and obligations to be imposed on providers in relation to wholesale customers, should not be subordinated to the "consumer champion" objectives of the CPMA (see para 4.3(a) in this response).

5.2 The FOA recognises the arguments as to why CCPs should come under the regulation and supervision of the Bank of England, but increasing integration of clearing and execution within exchanges makes a powerful case against undue fragmentation of the regulation of CCPs between the Markets Division of the CPMA and the Bank of England. An unduly fragmented regulatory approach could be exacerbated by the fact that CCPs, although lead regulated by their home-state regulatory authorities, will also be the subject of regulatory colleges comprising very diverse regulatory authorities and central banks, some of which could be unduly influenced by the Eurozone v. non-Eurozone debate.

In the view of the FOA, if it is decided that the Bank of England should be responsible for the regulation of UK CCPs, it is critically important that this is done in direct association and in closer co-operation with the Markets Division of the CPMA, to the point where there is joint oversight (largely anticipated in para 5.16).

5.3 For these reasons, the FOA does not accept that infrastructure providers are indistinguishable from most large firms in the financial services industry and would be deeply concerned over any suggestion that the Recognised Body regime should be abolished. Aside from the fact that no reasons have been given for any such decision and apart from the core differences mentioned in para 5.2 in this response, the risk profiles of each group are fundamentally different. That difference is reflected by the Part VII Companies Act 1989 (i.e. the default rules) and the statutory immunity that is given to RBs in connection with their regulatory activities.

5.4 The FOA recognises and supports the examples of differentiation between wholesale market conduct regulation and other types of financial services as set out para 5.6. While it is true that there is some commonality between market conduct regulation and financial conduct regulation, based largely on the fact that both firms and exchanges are service providers, there are significant differences:

(a) the underlying relationship between a firm and its customers is fundamentally different to the relationship between a market infrastructure provider and its members/end-users;

(b) infrastructure providers are, in effect, market regulators and are required to supervise trading practice and procedures (as recognised in para 5.13);

(c) infrastructure providers do not owe fiduciary or other regulatory obligations to the users on their markets and are not counterparties to their positions.

5.5 The FOA welcomes the Government's recognition in para 5.10 of the difference between retail financial services conduct and wholesale financial markets conduct issues, but this applies also to wholesale financial <u>services</u> conduct issues.

5.6 CM7874 does not make it entirely clear as to where firms that provide purely wholesale financial markets and services and the more specialist broker-dealers would sit within the CPMA, bearing in mind that they are not "retail" and are not "market infrastructure providers".

The FOA would urge the Government to establish three separate internal divisions within the CPMA, namely, "retail", "markets" and "wholesale".

Q17. The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS.

Q18. The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator.

5.7 The FOA believes that questions relating to the future of the UK Listing Authority are best addressed by other trade associations, but, in general terms, the FOA's view is that the UKLA should remain closely linked with stock exchange regulation within the Markets Division of the CPMA and not merged with the FRC under the BIS. The reality is that the role of the UKLA overlaps significantly with the market supervisory role of the CPMA and it should be able to rely on the integrated supervisory, investigative, legal and enforcement functions of the CPMA – functions which the PRA is ill-equipped to provide.

In this context, the FOA questions whether the FRC could handle the volume of work generated by the UKLA, e.g. in 2009 the FSA approved 1700 documents and handled 18000 calls.

5.8 With regard to the proposal to establish a new Economic Crime Agency, the FOA believes that, in principle, this does make for a higher degree of rationalisation than is currently the case, insofar as there are a significant number of prosecuting authorities with powers in relation to "white collar crime". However, it is important that that CPMA does not lose its scope to sanction the broad range of market-related contraventions that continue to fall within its remit, including the criminal prosecution role that supports the ability of the FSA to have a full range of prosecution/disciplinary options open to it as regards those who manipulate or abuse markets.

6. Crisis Management

Q19. Do you have any overall comments on the arrangements for crisis management?

Q20. What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?

Q21. What are your views about the changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24?

6.1 The FOA anticipates that other organisations and trade associations will respond in more detail to the proposals set out in Section 6, but the FOA believes that they are broadly adequate, although it questions the obligation of the Government's report to the Chancellor "on developments in prudential regulation and financial stability as well as macro-prudential and significant regulatory actions by other authorities no more than every six months". No doubt there will be more frequent meetings in the event of an emergency, but at a time when the economy is fragile, it would seem sensible for these reports to be made on a quarterly basis.

7. Implementation

7.1 While the FOA notes that no questions have been posed in CM7874 relating to the programme for implementing the establishment of the new regulatory infrastructure, the FOA would emphasise its support for the Government's commitment to "carrying out a full and comprehensive consultation process, in order to provide ample opportunities for interested parties to comment on these proposals over the course of their development and refinement".

7.2 The proposal in CM7874 to establish a "shadow" internal structure within the FSA which replicates and anticipates the creation of the CPMA and the PRA will pose questions to the extent, depth and integrity of the 2011 round of "full and comprehensive" consultation in early 2011. However, it is a sensible first step that will help to stagger costs and phase in implementation, and should also provide a very real opportunity to "test drive" the proposals and for undertaking a mid-term "fitness for purpose" assessment before proceeding to the next substantive step of "externalising" the PRA and the CPMA as separate bodies.

7.3 The FOA recognises that the Government is committed to a restructuring of financial services regulation along the lines set out in CM7874, but believes such a mid-term assessment (which could also be the subject of the proposed early 2011 consultation) would also provide the Government with an opportunity to assess whether or not its objectives as set out in CM7874 can be achieved to full effect without losing the advantages and strengths of having a unified regulatory authority.

Possible advantages include:

- retaining the international influence of a single unified regulatory authority;
- solving the problems of a potential mismatch between the scope and responsibility of the European Supervisory Authorities and those of CPMA and the PRA (and internationally);
- avoiding the major costs and upheaval involved in creating a new bi-partite / multi-partite arrangement;
- preserving and further developing the significant changes introduced by the FSA to correct shortcomings, many of which have relevance to both business conduct and prudential regulation;
- reducing substantially the risk of duplication, conflict, complexity and dual regulation of PRA/regulated firms and the risk of inter-institutional rivalries.

7.4 Clearly, the underlying question is whether an independent PRA division operating within the FSA could be sufficiently detached to enable it to deliver on the

Government's proposals for improving the framework for managing financial stability in the UK, particularly in the context of providing the FPC with sufficient convergence with and "reach" into the micro-supervisory responsibilities of an internalised PRA. The FOA believes that an internalised PRA division within a regulatory authority would still achieve the objective of providing the Bank of England with oversight of micro-prudential regulation and would not detract from the power of the FPC to issue directions as appropriate.

The FOA anticipates, however, that any such mid-term review will, in line with Government policy, conclude that evolution to an external "twin peaks" approach is a necessary next step. Even so, such a review would still help to determine how best that next step can be achieved to the benefit of all the "stakeholders" in financial services regulation in line with the "value-for-money" outcome sought by the Government.

8. Preliminary Impact Assessment (Annex B)

8.1 The FOA believes this impact assessment of questionable value insofar as it adopts an "all or nothing" approach and lacks granularity to the extent that it does not look at the component parts of the changes and apply a cost-benefit analysis to those parts.

More particularly:

(a) The preliminary impact assessment assessed only two options, namely, "do nothing" (which is not really an option in the current circumstances) or "proceed". It provides no analysis of the other options of "do less" or "do differently". Even within the confines of Government "made policy", there would be some value in considering those latter two options. To put forward a "do nothing" option in preference to a "do less" or "do differently" option is clearly designed to bolster the cost-benefit analysis of the "proceed" option and therefore the assessment is of little real value.

(b) If the impact assessment, in terms of cost-benefit, is to be realistic, it should look not just at the whole, but also the core parts of the proposed changes, to ensure that each of the elements of the "proceed" option do not, in themselves, fail an impact assessment - otherwise the stated Government objective of delivering "the best value-for-money solution for the financial services sector" cannot be assured.

8.2 In view of the foregoing, the following statements should be afforded a higher level of recognition than is given to them, namely:

- "it is impossible to quantify the benefits of the proceed option in a realistic way";

- the Government's conclusion that it is "unrealistic" to assume that "no changes will be made to the rules etc. of the regulatory bodies as a result of changes to the regulatory structure".

Q22. Annex B contains a preliminary impact assessment for the Government's proposals. As set out in that document, the Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm. In particular, comments are sought from all types and size of deposit-taking, insurance and investment banking firms (including credit unions and friendly societies), and from groups containing such firms.

8.3 The FOA notes the expectation that no changes will be made to the rules "as a result to changes to the regulatory structure", but believes that it is inevitable that rule changes will be introduced and that, if they occur, this aspect of the costs of the “proceed option”, far from being “overstated”, could be materially understated.

8.4 The FOA agrees with the conclusion that “most of the approximately 20,000 firms currently regulated by the FSA will be regulated solely by the CPMA after the reforms have been implemented” and it is unlikely, therefore, that they will suffer any significant transitional costs or significant increases in on-going costs as a result of changes in the infrastructure.

For the 1500-2000 firms, or such number as may eventually be prudentially regulated by the PRA, the fact of dual regulation with the CPMA means it is likely that there will be potentially significantly increased costs, both on a set-up and an on-going basis. However, the numbers of firms affected will in large part depend upon how the term “broker-dealer” is translated. If it is only intended to apply to the few very large firms that pose a risk to the system that can be equated to that of “investment banks” and deposit-taking institutions, that is one thing. If, on the other hand, it is intended to be significantly wider than those firms, then the consequences, cost and burden of dual regulation will become more widespread and could have significant economic implications for not just a large number of small and medium-sized enterprises, but also for their customers.

8.5 The FOA anticipates that increases in cost are likely to be passed on to customers in commissions and charges and, taken together with all the other changes that have been and are being introduced, this could have a multiplying and adverse effect on the economics of trading and investment.

8.6 In terms of assessing the benefits, the FOA questions the validity of the assumption that the benefits of the “proceed option” are “likely to outweigh the costs by a significant margin” without undertaking a more granular analysis of the major aspects and elements of the “proceed option”. It should not be assumed that changes in the infrastructure (as opposed to all the other changes that are being introduced in terms of the quality, focus and priorities of regulation) can, in themselves, be justified because of the expected reduction in the total anticipated welfare losses that will accrue from a financial crisis. Firstly, this discounts significantly the mitigating impact of all the other changes that are being introduced post the crisis with this same objective in mind, i.e. there is no attempt to assess how the proposed change in the infrastructure itself will reduce those costs as opposed to the mitigating impact of all the other changes and, secondly, as para 6.5 notes, “no two crises will be the same”, so considerable care needs to be taken when making this kind of assumption.

8.7 The FOA notes the Government’s acknowledgement that the risks of underestimating the transitional and ongoing costs are “real risks”, but that any significant materialisation of those risks would be insufficient to reverse the ranking of the “proceed” and “do nothing” options. The FOA would only reiterate its view that it believes that the PRA is flawed in itself and therefore those “real risks”, if they materialised, could adversely impact, possibly significantly, the assumptions made in this Preliminary Impact Assessment.

APPENDIX 1

List of FOA Members

FOA MEMBERS

FINANCIAL INSTITUTIONS
ABN AMRO Clearing Bank N.V.
ADM Investor Services International Ltd
AMT Futures Limited
Bache Commodities Limited
Bank of America Merrill Lynch
Banca IMI S.p.A.
Barclays Capital
Berkeley Futures Ltd
BGC International
BHF Aktiengesellschaft
BNP Paribas Commodity Futures Limited
Capital Spreads
Citadel Derivatives Group (Europe) Limited
Citigroup
City Index Limited
CMC Group Plc
Commerzbank AG
Crédit Agricole CIB
Credit Suisse Securities (Europe) Limited
Deutsche Bank AG
ETX Capital
Fortis Bank Global Clearing NV - London
GDI Markets Limited
GFI Securities Limited
GFT Global Markets UK Ltd
Goldman Sachs International
HSBC Bank Plc
ICAP Securities Limited
IG Group Holdings Plc
Investec Bank (UK) Limited
JB Drax Honoré
JP Morgan Securities Ltd
Liquid Capital Markets Ltd
LMAX Limited
Louis Capital Markets UK, LLP
M & G Investment Management Ltd
Macquarie Bank Limited
Mako Global Derivatives Limited
MF Global
Marex Financial Limited
Mitsubishi UFJ Securities International Plc
Mizuho Securities USA, Inc London
Monument Securities Limited
Morgan Stanley & Co International Limited
Newedge Group (UK Branch)
Nomura International Plc
ODL Securities Limited
Rabobank International
RBS Greenwich Futures
Royal Bank of Canada
Saxo Bank A/S
S E B Futures
Schneider Trading Associates Limited
S G London
Standard Bank Plc
Standard Chartered Bank (SCB)
Starmark Trading Limited
The Bank of Nova Scotia
The Kyte Group Limited
Tullett Prebon (Securities) Ltd
UBS Limited
Wells Fargo Securities International Limited
WorldSpreads Limited

EXCHANGE/CLEARING HOUSES
APX Group
Bahrain Financial Exchange
CME Group, Inc.
Dalian Commodity Exchange
EDX London
European Energy Exchange AG
Global Board of Trade Ltd
ICE Futures Europe
LCH.Clearnet Group
MEFF RV
NYSE Liffe
Powernext SA
RTS Stock Exchange
Shanghai Futures Exchange
Singapore Exchange Limited
Singapore Mercantile Exchange
The London Metal Exchange
The South African Futures Exchange

SPECIALIST COMMODITY HOUSES
Amalgamated Metal Trading Ltd
ED & F Man Commodity Advisers Limited
Engelhard International Limited
Glencore Commodities Ltd
Koch Metals Trading Ltd
Metdist Trading Limited
Mitsui Bussan Commodities Limited
Natixis Commodity Markets Limited
Noble Clean Fuels Limited
Phibro GMBH
RBS Sempra Metals
Sucden Financial Limited
Toyota Tsusho Metals Ltd
Triland Metals Ltd
TRX Futures Ltd
Vitol SA

ENERGY COMPANIES
Accord Energy Ltd
Atel Trading AG

BP Oil International Limited
ChevronTexaco
ConocoPhillips Limited
E.ON EnergyTrading SE
EDF Energy
EDF Energy Merchants Ltd
Gaselys
International Power plc
National Grid Electricity Transmission Plc
RWE Trading GMBH
Scottish Power Energy Trading Ltd
Shell International Trading & Shipping Co Ltd
SmartestEnergy Limited
Trayport Limited

PROFESSIONAL SERVICE COMPANIES
Ashurst LLP
Baker & McKenzie
Barlow Lyde & Gilbert
Berwin Leighton Paisner LLP
BDO Stoy Hayward
Clifford Chance
Clyde & Co
CMS Cameron McKenna
Complinet
Deloitte
Denton Wilde Sapte
Eukleia Training Limited
Exchange Consulting Group Ltd
FfastFill
Fidessa Plc
Financial Technologies India
FOW Ltd
Freshfields Bruckhaus Deringer
Herbert Smith LLP
Hunton & Williams LLP
International Capital Market Association
ION Trading Group
JLT Risk Solutions Ltd
Katten Muchin Rosenman Cornish LLP
KPMG
Mpac Consultancy LLP
Norton Rose LLP
Options Industry Council
PA Consulting Group
Pekin & Pekin
R3D Systems Ltd
Reed Smith LLP
Rostron Parry Ltd
RTS Realtime Systems Ltd
Sidley Austin LLP
Simmons & Simmons
SJ Berwin & Company
Speechly Bircham LLP
SunGard Futures Systems
Swiss Futures and Options Association
Total Global Steel Ltd
Travers Smith LLP

APPENDIX 2

The “Competitiveness” Principle of Good Regulation

The “Competitiveness” Principle of Good Regulation

1. Section s2(3) of the Financial Services and Market Act (2000) (“FSMA”) sets out a number of factors (otherwise known as Principles of Good Regulation) to which the FSA must have regard in making its rules and guidance and determining the policy and principles by which it exercises its other functions. These include a factor described as “the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom”. In commenting on this criterion to the Future of Banking Commission, the Chairman of the FSA observed that the FSA’s “good regulation” focus was being undermined by the “secondary objective” of facilitating competitiveness, the burden of “industry promotion” and a “sort of race to the bottom”.

2. The FOA does not accept that any of the statutory “factors” impose a “secondary objective” on the FSA – nor should they do so. The legal position is that, while the FSA *must*, so far as is reasonably possible, act in a way “which is compatible with the regulatory objectives", i.e., maintaining market confidence, promoting public awareness, protecting consumers and reducing financial crime, it is required only to "have regard" to the factors set out in s2(3) of FSMA. In the circumstances, and bearing in mind also that competitiveness was specifically rejected as a statutory objective by the Joint Committee of the House of Commons and House of Lords on the Financial Services and Markets Bill and subsequently by the then Government, it is difficult to see how this factor can operate as an "objective", either primary or secondary, of the FSA.

3. The FOA does not accept that there is an obligation on the FSA to engage in "industry promotion". The fact is, this is not a statutory “factor” and no such duty is imposed on the FSA under s2(3) of FSMA. Some organisations argued strongly at the time that the competitiveness criterion should use the word "promote", but this was, once again, specifically rejected by the then Government. In the circumstances, it is difficult to see how the Principles of Good Regulation in s2(3) of FSMA can be construed as imposing any sort of obligation of "industry promotion" on the FSA.

4. Clearly, neither the PRA nor the CPMA should be inhibited from maximising regulatory effectiveness within the boundaries of proportionality, deliverability and affordability. This means, however, marrying up good and effective regulation with, in the case of London, good international business. This will involve taking into account not just the need to sustain diversity, entrepreneurialism and (already a specific s2(3) factor) innovation, but also the international character and competitiveness of that business. It is particularly difficult to see how the PRA or the CPMA can fulfill a more business-intrusive approach to supervision (described by Hector Sants as “judging the future decisions of firms based on business models and other analyses……” and “taking a view on management action”) without being required to take into full account the international character and competitiveness of firms regulated by them.

15 October 2010

By email to: *financial.reform@hmtreasury.gsi.gov.uk*

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

Dear Sirs

GC100 response to HM Treasury's Consultation: "A new approach to financial regulation: judgement, focus and stability"

The GC100 is the association for general counsel and company secretaries of companies in the FTSE100. There are currently more than 120 members of the group, representing some 90 companies.

The GC100 welcomes this opportunity to respond to HM Treasury's Consultation, "A new approach to financial regulation: judgement, focus and stability" (Cm 7874: July 2010), with particular reference to the proposal set out in Chapter 5 of the consultation to split off the UKLA and make it part of the FRC.

We have limited our response to questions 17 and 18 in the consultation, relating to market regulation and regulation of companies generally.

Policy objectives

We believe that the Government's central policy objectives as outlined in the consultation, namely, to enhance the UK's financial stability and to avoid regulatory failure contributing to another financial crisis, are sound.

However the consultation deals not only with the regulatory structure for banks and other financial institutions, but also with the structure of primary and secondary market regulation for equity and debt in the UK. This is quite a different issue, as the structure of UK markets affects the attractiveness of those markets for investors and therefore the capability of all companies (not just financial institutions) to raise finance competitively and efficiently, as well as being relevant to the competitiveness of the UK as a centre for investment and a market for capital raising by international companies. Strong and effective UK market regulation is a key ingredient for the continued strength and efficiency of the UK capital markets as a source of capital for business.

In addition, we do not believe that any compelling case has been made for a companies regulator or for further regulation of companies more generally. Companies and business should not be a regulated sector per se and suggestions that they should be will only damage the attractiveness and competitiveness of the UK as a location for international business.

Accordingly we believe it is of fundamental importance that any new approach to financial and market regulation should continue to have regard, amongst its objectives, to any potential adverse impacts on innovation or the competitiveness of the UK financial services sector, and the impact on London as a global financial centre, and should be structured so as to enable the UK to continue to compete effectively on the global economic stage.

Question 17: UKLA/FRC

Our firm view on the central question posed in paragraph 5.21 of the consultation is that the UKLA should remain within the CPMA markets division, and should not be merged with other regulatory functions relating to companies and corporate information, in particular those of the FRC under BIS. Our reasons are set out below.

We believe that the functions of the UKLA as a market regulator would fit better within the CPMA markets division. To separate them would mean splitting primary market regulation from secondary market regulation, which we believe is undesirable. Retaining the UKLA with the CPMA's market supervision functions on the other hand is more likely to deliver synergies and more effective market regulation.

For example, on an IPO or a rights issue (primary market equity issues) there are always a number of related secondary market activities which are relevant (such as the trading in the aftermarket, research published by underwriters on the issuer, the regulation of the underwriters' sales forces when they are marketing the new shares, the stabilisation of the share issue) and which, if the proposal is adopted, would be regulated by separate regulators. As a result, the same transaction would in practice be divided between two regulators, presumably with separate supervisory and enforcement teams, separate rules and so forth.

Once an equity issuer is admitted to trading the Listing Rules (which for this purpose includes not only the Listing Rules themselves, but also the Prospectus Rules and the Disclosure and Transparency Rules derived from various EU Directives) and other aspects of FSA obligations (specifically MAR and part VIII of FSMA) blend to provide a comprehensive regulatory approach to both primary and secondary market activity. In particular, aspects of the Listing Rules (such as the requirement for issuers to announce inside information (as defined in section 118 FSMA) to the market, to maintain insider lists and to disclose dealings/arrangements with PDMRs) are specifically designed to dovetail with and operate alongside secondary market obligations (such as the prevention and prosecution of market abuse, transaction reporting obligations etc.). To separate these aspects of primary and secondary market regulation would be a retrograde step for little tangible benefit which would be likely to increase market fragmentation and lead to confusion as well as an undesirable and artificial dual regulation for listed issuers. Market abuse enforcement would fall under the markets regulator and Listing Rules compliance would fall under the new FRC/UKLA regulator (in addition to any other regulator relevant for particular categories of issuer).

While it is of course true that historically certain of the market regulation functions of the UKLA used to be separate, being carried out by the London Stock Exchange in the 1990's, the world has moved on since then: first, following the major changes in EU regulation of markets, which integrated market regulation in a way which makes splitting primary from secondary regulation very undesirable (e.g. the scope of the market abuse directive); and secondly, through fragmentation of market activity across different exchanges and platforms, increasing complexity and making it even more important that financial and market regulators are responsible for all aspects of market regulation (primary and secondary, equity and debt, and specialist securities) rather than a patchwork of market and other bodies.

The UKLA is primarily a market regulator focused on the admission of debt and equity securities to markets and the subsequent continuing obligations of those issuers relating to the relevant securities which are admitted to trading. The corporate governance aspects of its role and rule book has been mainly limited to requiring listed equity issuers to report on certain aspects of the Combined Code in the Annual Report. As a market regulator, the UKLA is involved in real-time monitoring of issuers, in responding to events as they happen, and in implementing and enforcing the Listing Rules, which are not the primary functions of a policy development-focused body such as the FRC, and which fit much better with the role of the CPMA markets division, which also has real time responsibilities.

Indeed the overwhelming bulk of the UKLA's activity is its supervision of capital markets issuance across debt, securitised derivative and equity capital markets; governance is a relatively small part, already primarily left with FRC and its stewardship of the UK Corporate Governance Code, with the UKLA performing an indirect monitoring and enforcement role.

Finally, we believe that CPMA, as the UK's single seat representative on ESMA in Europe will be much better placed to engage and to exert influence if it represents both primary and secondary market regulation, rather than having a separate regulator with responsibility for primary market policy. It is widely accepted that there is a need for a strong UK voice in Brussels, given the increasing impact of EU regulation on UK markets, and it is our view that the CPMA markets division will carry much more authority and ability to represent the interests of the UK if it is responsible for both the listing function and secondary markets policy.

CPMA will also be much better positioned to preserve London's super-equivalent premium listing standards, and to ensure that these are not eroded by maximum harmonisation initiatives.

Questions 17 and 18: Companies Regulator

We do not support the proposal for a new companies regulator. Companies and business should not be a regulated sector per se and suggestions that they should be will only damage the competitiveness of the UK as a location for international business. Companies should, like every other type of organisation and wherever incorporated, be regulated by reference to their substantive activities, for example through health and safety and employment laws and specific sectoral regulation where necessary.

UK corporate governance has been the subject of extensive review both before and since the financial crisis. BIS already has responsibility for company law and, via the FRC, the UK Corporate Governance Code sits within that remit. Whilst corporate governance practices will continue to develop, we see no rationale or advantage in creating a new companies or governance regulator, or any substantive needs or benefits. The structure of UK corporate governance regulation does not need change for change's sake: that will create cost and bureaucracy and risk furthering the impression that the UK is no longer as business friendly a jurisdiction as it should be. It certainly will not further stability - one of the stated objectives of the consultation proposals - in business regulation.

If you have any questions arising out of our response, or if we can usefully elaborate on any aspects, please contact me or Mary Mullally, Secretary to the GC 100.

As a matter of formality, please note that the views expressed in this letter do not necessarily reflect the views of all of the individual members of the GC100 or their respective employing companies.

Yours faithfully,

John Davidson
General Counsel and Group Secretary
SABMiller plc

Chairman of the GC100

cc

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Financial Regulation Strategy
HM Treasury
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London
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20th October 2010

Response to "A new approach to financial regulation: judgement, focus and stability"

Background

Genworth Financial ("Genworth") is a leading insurance business, serving the lifestyle protection, retirement income, investment and mortgage insurance needs of over 15 million customers worldwide. We have two business lines within Europe:

- Our lifestyle protection business underwrites a range of income protection insurance ("PPI") policies helping consumers to meet their payment obligations on outstanding financial commitments, including mortgages, personal loans, and credit cards in the event of involuntary unemployment, temporary disability (due to accident or sickness), permanent disability or death;
- Our Mortgage Indemnity Insurance business provides credit risk transfer for mortgage lenders, making it possible for them to offer higher loan to value mortgages thus making home ownership more readily available, especially in the first time buyer sector of the market.

For more information, visit: http://www.genworth.co.uk

Summary of our response

Genworth recognises the scale and damage of the great financial crisis of 2008 and, along with many other businesses, has had to adapt and cope with its effects. It is understandable that the proposals to address systemic weaknesses and financial stability should be broadly drawn and we can understand the proposal to bracket insurers with the banking sector for prudential supervision due to the significance of their prudential regulation. Equally however it should be understood that insurance companies did not cause this crisis and we believe that HMT should be alert to any unintended consequences of moving prudential insurance supervision to the Prudential Regulation Authority (PRA) as a subsidiary of the Bank of England.

The very significant risk of this step is clearly that insurance regulation may be seen as a backwater within the Bank of England and PRA with a lack of focus and developed expertise. There was some flavour of this in the consultation paper itself where insurance regulation was hardly mentioned. The likely effect of this, which would be strongly detrimental to the UK public interest, is that inexperienced supervisors will tend to be conservative in their prudential expectations, loading UK insurers with excess capital leading directly to a lack of international competitiveness and to potentially inequitable redistributions between generations (as, over time, "inherited estates" will build up only to be periodically and somewhat randomly released).

Prudential requirements are increasingly international through the Solvency 2 process, however they still involve elements of judgement requiring high quality analysis at both entity and national levels.

We believe that HMT should be very robust in setting a clear expectation that the relevant departments or sections of the PRA should become a genuine centre of excellence with regards to insurance supervision, whether that be at the macro-prudential level, in dealings with individual entities or in dialogue with the new European Supervisory Authorities. Put simply, we hope and expect that the Bank of England/PRA should be set the goal to be as knowledgeable and influential in Frankfurt (where the proposed new Insurance and Occupational Pensions Authority will be based) as with the European Banking Authority in London.

We have attached our detailed response in the following pages. We have focused on those questions which do, or in our view should, focus on insurance regulation. I should also like to thank you for the extra couple of days' grace in submitting this response. Naturally if there is anything you would like to discuss in greater detail we would be happy to help.

Yours sincerely

Kelvin Baynton
Vice President Compliance, Europe

Answers to the questions posed

Prudential Regulation Authority

By way of introduction, clearly the most important consumer protection measure that can be taken in the insurance sphere is prudential, to ensure that insurance companies are financially sound and in a position to pay policyholders in the event of valid claims. These can occur over very long time frames and the management of these assets and liabilities call for considerable specialist expertise.

Q4. We do not agree with the conclusions in the paper around the inappropriateness of issues such as global competitiveness and innovation, so far as insurance regulation is concerned (and we re-iterate here that insurance companies did not cause the great financial crisis). The "light touch" approach was taken by FSA not so much because of a desire to foster international competitiveness but because of what in the banking sector proved to be a flawed belief that the markets (domestic as well as international) knew best. In practice the principles of good regulation do not act as a very strong fetter or guide on regulatory behaviour, but we do not think that any regulatory structure should ever be unfettered. Further, in an increasingly open global market the main impact of any lack of competitiveness will be regulatory arbitrage. Therefore we believe there should be some appropriate checks and balances on the PRA, primarily around the principles of good regulation. These should certainly include the desirability of innovation and UK competitiveness.

We favour a single objective for the PRA. Otherwise it may either become tied up in regulatory process or will be tempted into regulatory creep into other areas.

We believe that the PRA should be under a statutory obligation of some kind to ensure an appropriate focus on the insurance sector (and any other non-banking sectors under its supervision), and be required to report on this.

Q5. In our view the proposal in 3.16 carries the risk of much needless duplication and delay. We would much prefer clear ownership of each process with a "one stop shop" for changes and amendments. Therefore we would support an integrated model instead.

Q6. Yes, subject to our earlier, and continuing point, that to move to judgement based decisioning requires real expertise, which means a continuous and ongoing commitment to excellence in understanding and interpreting insurance business as well as banking.

Q7. As per our answer to question 4, there should always be appropriate checks and balances on regulatory behaviour. As a minimum this should normally include proper public consultation and robust cost benefit analysis.

Q8. We do not think the case has been made to streamline them.

Q9. The section on governance and oversight, and in particular the close working relationship with the Bank of England, serves to underline the importance of ensuring appropriate expertise in the insurance sector, to ensure that insurance supervision is not allowed to become a backwater. In particular we believe that the PRA should be required separately to account for this to Parliament annually, and to establish one or more consultative fora for the insurance sector.

Consumer Protection and Markets Authority

We believe firmly in the highest standards of market integrity and welcome the stated primary objective of the CPMA ("ensuring confidence in financial services and markets, with particular focus on protecting consumers and ensuring market integrity"). We do not think the working title is optimum because of the likely linkage of "protection" with "safety net" and other post hoc measures and so we would prefer to see an alternative title.

Q10. Given that the CPMA will have prudential responsibility for significant sectors of the market we do not see how it can operate effectively or appropriately if working to only one objective, therefore we would like to see it given a broader remit within its area of competency.

The CPMA should certainly have regard to the principles of good regulation (though it is worth noting that recently the FSA has shown scant regard to these, resulting in the recent application for Judicial Review by the BBA following Policy Statement 10/12).

Q11 We have found the quality of cost benefit analysis by the FSA in recent years to be very poor (e.g. see PS09/23 and the subsequent consultation in PS10/6). There appear to be no constraints or controls around this process. We would therefore like to see greater transparency, accountability and independence around this discipline, perhaps be requiring it to be undertaken by an external body. Such a body, if a standing function, could provide a shared service to each of the new regulators, including the FPC, which would ensure greater rigour.

Q13. We support a single fee-collecting body.

Q14. The important principle is to avoid cross-subsidisation.

Goldman Sachs International | Peterborough Court | 133 Fleet Street
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Authorised and regulated by the Financial Services Authority

Regulatory Coordination. For an effective supervisory framework, we note the importance of coordination between the different regulatory bodies, as they work alongside each other. Close cooperation will be key to the success of the new structure. In particular, we note:

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Grant Thornton

Our ref: SM/GMM

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Dear Sirs:

A new approach to financial regulation: judgment, focus and stability
We welcome the opportunity to respond on the above discussion paper. We support the approach taken by HM Treasury in seeking views from stakeholders, and we support initiatives to facilitate debate on the architecture of UK financial regulation.

Our response is focused on question 17 which deals with whether the United Kingdom Listing Authority ("UKLA") should be merged with the Financial Reporting Council ("FRC"), as a first step towards creating a companies regulator under Department for Business, Innovation and Skills ("BIS") as this matter has a direct impact upon our business and our clients.

It is important to recognize the importance of competitiveness to the success of City of London and the wider UK economy. The UKLA regulates primary market activities including the initial placement of investments such as shares or bonds, obtaining official listing of shares and bonds; and the related activity of disclosing information in accordance with the disclosure and transparency obligations that apply to listed issuers and their major shareholders. The degree of regulatory burden around these activities will have a direct impact upon the competitiveness of the City of London and the wider UK economy. If the balance is not right, there is a danger that non-UK financial centers become more attractive to businesses seeking funding from the capital markets.

Whichever body assumes responsibility for the activities of the UKLA, this important balance must be considered to be sacrosanct.

Providing the regulatory balance remains in the favour of City of London and UK competitiveness, in our view, either body could assume the responsibility for the UKLA as both the FRC and the proposed Consumer Protection and Markets Authority ("CPMA") have clear parallels with the activities of the UKLA. The FRC has regulatory responsibility and oversight for the financial reporting of listed companies and the CPMA will have responsibility for market conduct regulation.

If you have any questions on this response, please contact Steve Maslin (phone: 020 7728 2736; email: steve.maslin@gtuk.com) or Giles Mullins (phone: 01908 359609; email: giles.m.mullins@gtuk.com)

Yours faithfully

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The relationship between micro-macro-prudential supervision and central banking

David Green

Remarks at Conference on Financial Regulation and Supervision in the New Financial Architecture
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The nature of the involvement of a central bank in the supervision of financial firms and infrastructure providers is a matter of endless controversy. It is probably incapable of an answer that is generally applicable in all times and all places. The controversy tends to create as much heat as light because it is often intimately involved in struggles about legitimacy, political or otherwise, influence and, ultimately, power.

The debate is often confusing because it is frequently couched in terms of extremes in territory where there are no absolutes. In part this is because, while it is usually relatively clear what is meant by supervision and the tools involved are susceptible to relatively clear description, the term central bank is a relatively loose one that covers a range of disparate functions. The BIS (1) has published a taxonomy of no less than twenty separate functions which demonstrates the remarkable diversity of practice that obtains between institutions that might appear to be superficially similar in structure and objective. Rosa Lastra (2) groups central bank activities into nine broad categories of function, but emphasise their changing nature and importance.

Howard Davies and I (3) have sought a definition of the irreducible functions of a central bank, without which the title is not meaningful:

- They must have the capacity to supply ultimate settlement assets for the financial system.
- They must have the ability to act as a banker to key agents in financial intermediation. These agents may not exclusively be banks. At times this banking function may be extensive, including the provision of liquidity on an enormous scale, and a range of guarantees to different types of financial intermediary.
- They must perform as the institution that implements monetary policy, whether by setting the price of money (through the short term interest rate) or the quantity (through the supply of reserve assets to the financial system).

Notably responsibility for supervision is not one of these core functions. Indeed, in a study published in 2007 (4) no fewer than 50 out of 143 central banks surveyed had no direct responsibility for supervision.

The list of major central banks without direct supervisory responsibilities at the time of writing is quite impressive – Japan, ECB, UK, the Nordic countries, Canada, Australia, China, between them covering a significant part of the world's financial system. Interestingly a significant number of them had direct supervisory functions in the past and some of them may perhaps yet acquire them back again.

The position of the National Central Banks within the Eurosystem does not quite fit within conventional distinctions in that on some counts they are not full central banks at all because individually they neither determine nor implement monetary policy, although the Governors, in their personal capacities, do so collectively. I return to the question of the role of supervision of National Central Banks within the Eurosystem later.

It seems clear that supervision can be undertaken outside the central bank and often with considerable success. However, the reasons for doing so vary. Sometimes the reason for having supervision outside the central bank has been forgotten or is simply not a matter of serious debate – take Canada or Switzerland, despite their very different experiences during the latest crisis.

We start with the case for supervision to be undertaken within the central bank. Some of the arguments are set out usefully in the ECB's 2001 paper on "The role of central banks in prudential supervision" (4). The main arguments relate to

1. Information-based synergies running from the supervisory to the central banking function
2. Synergies running in the opposite direction
3. Assessment of systemic risk
4. Independence

1. The first is based on information-related synergies between supervision and core central banking functions. The argument here is that confidential information collected for supervisory purposes may assist in the oversight of payment systems and other market infrastructures and that prudential information is essential for the conduct of macro-prudential monitoring. It may also assist in more accurate assessment of economic activity for monetary policy purposes and will be essential in the event of a crisis in which the central bank is called upon to act.

While there is merit in these arguments, it is not evident that in systems where the central bank and supervisor are separate there needs to be any impediment to such information flows taking place any more than between separate departments within a central bank, and clearly in most jurisdictions where the functions are separate information seems generally to flow adequately. Where information flow is unsatisfactory this may more often be due to reluctance to cooperate rather than inability to do so, which can also arise between departments within a central bank.

2. Information-related synergies may also work the other way round, where a central bank's insights into financial market developments can assist with supervision. A particular advantage is seen to derive from the central bank's active involvement in markets and engagement with market participants. This brings both knowledge and expertise. It is argued that market participants may have greater willingness to speak to the central bank acting in this context precisely because contacts are outside the formal supervisory process.

This information can, of course, be passed to the supervisory agency, as it would be within a central bank, again depending on goodwill. While the direct market expertise is undoubtedly useful it will tend to be within a much more limited range of products and markets than the supervisor needs to know about so will need to be supplemented in any event.

3. The argument that a central bank needs to be directly engaged in supervision to assess risks in the system as a whole is difficult to judge. This seems to depend on mind set and mandate. Some free-standing supervisors quite clearly see the assessment of risks in the system as a whole to be integral to their micro-supervisory responsibilities, while some prominent central bank supervisors have failed to spot the building up of major systemic risks.

4. A final argument is that the independence of the central bank from political interference, where such is delivered in practice, is as important for supervision. Clearly there is a need to endow the supervisor with a degree of operational independence, including from the supervised community, and local circumstances may determine whether or not the central bank or a

separate agency is better able to achieve this. What can be problematic is where the central bank claims immunity from political scrutiny for alleged supervisory failure on the grounds of central bank independence, as has from time to time occurred.

A number of very different and not necessarily wholly consistent arguments support the case for responsibility for supervision being separate from the central bank. The main ones are:

1. Potential conflict with monetary policy objectives.
2. Differences in independence and accountability requirements.
3. Desirability of having manageable decision-making units where there is cross-sectoral regulatory consolidation.

1. The argument that there may be a potential conflict between monetary and supervisory roles and objectives runs as follows. There can on occasion be a conflict of interest which might tempt a central bank to loosen its monetary policy stance because of concerns about the financial health of the banks it itself regulates. This is more than a theoretical possibility and arguably occurred in the United States at the end of the 1980s and again in 2007-8. These episodes occurred at a time when it looked as if there was a real possibility of tension with a strict inflation objective. Arguably, even in inflation-targeting regimes, in very many jurisdictions monetary policy has been overwhelmingly directed within the most recent past at the stability of the financial system.

More narrowly, a lender of last resort that is also responsible for ongoing supervision may be tempted to intervene in support of an individual institution in part to cover up the inadequacy of its own supervision. This might mean that non-viable institutions could be inappropriately supported by the central bank, supposedly generating moral hazard in relation to other institutions and therefore potential financial instability in the future. This has been argued in relation to the Federal Reserve's actions in the recent crisis. A loss of credibility could arise from perceived regulatory failings and this may damage the central bank's reputation and therefore its authority to conduct monetary policy.

Supervisory responsibilities imply a different type of accountability and a different and closer relationship with the political authorities, which may cut across the independence a central bank needs in the conduct of monetary policy. Again, this point was argued in the US Congress in the debate leading up to the passage of the Dodd-Frank legislation.

Such arguments in favour of separating monetary policy and supervisory decision-making gained ground for some time, partly in parallel with two quite separate movements in thinking. On the one hand there was the doctrine that monetary policy should focus primarily or indeed almost entirely on inflation and consequently needed to be independent of political pressure and, on the other, that the evolution and integration of financial markets required that the separate supervisory disciplines of banking, insurance and securities supervision should be integrated in parallel.

The argument that monetary policy needs to be free from political interference once the overall objectives have been set clearly makes for a governance challenge if supervision is placed under the same governance structure. In ordinary times monetary policy can in principle be seen as exercising its impact with relative indifference as to who is affected and how: the hand can seem invisible. However, supervision by its very nature is seen as having a differential impact on different political and economic groups. Indeed, it is often intended to. This differential impact varies according to the degree of regulation that is applied to different kinds of intermediation, whether it limits the volume of a particular category of intermediation or the way it is provided. If this degree of specific impact is combined with direct support in a crisis for individual market segments the political interest is heightened further.

This debate has most recently played out with greatest clarity in the US, where supervision and monetary policy decision-making is combined in the Federal Reserve, with demands either that supervision be taken out of the Fed altogether, for a variety of motives, or for the Fed's historic independence to be diluted through greater degrees of accountability.

A different set of arguments has been in play in relation to separation of functions to maintain purity of policy in relation to inflation targeting. Here there is a growing sense that the decision to have monetary policy focus on a particular measure of inflation has led to policy mistakes in the case where the central bank has been slow to recognize the side effects on the financial system of a particular interest rate strategy, and has notably been unwilling to use the price mechanism to restrain excess credit expansion.

To the extent that there is increasing recognition that monetary policy needs to take much more careful account of its impact on the financial system as well as the real economy, the case for completely separating monetary policy and supervisory decision-making is diluted.

Similarly, debates have reopened in relation to the arguments pointing to the desirability of integrating all the supervisory functions. What are perceived as supervisory failures in some jurisdictions have been taken as failures of the integrated model. Either the effort to encompass all aspects of conduct of business and prudential supervision has been regarded as simply too big a management task or else potential conflicts of interest between prudential and conduct of business requirements have come to be seen as too difficult to manage within a single institution. Both arguments point to the need for a split in the integrated regulator and sometimes, though this is a separate argument, for banking supervision to be located/relocated within the central bank.

Neither of the cases advanced seems especially convincing and more to be attributed to particular local circumstances and, often, local politics. Thus the serious systemic crisis in banking in Switzerland has not led to any strong case being made either for the split up of FINMA or for the movement of banking supervision to the Swiss National Bank. Nor has the transparency of the twin peaks model in the Netherlands, with separate prudential and conduct of business regulators, made it any easier satisfactorily to resolve conflicts between the objectives of separate prudential and conduct of interest regulators and, indeed, there are some there who now make the case for substituting an integrated regulator in place of the twin peaks arrangements.

Analysis undertaken by the Bank of England indeed found it difficult to find any correlation at all between the performances of the different categories of supervisory model. At the extreme, the Canadian banking system had a relatively good crisis, despite the central bank never having had any responsibility for supervision, while De Nederlandsche Bank has presided over a whole string of banking problems.

Of course, there are idiosyncratic reasons for these differences too, but the record leaves us with considerable uncertainty as to whether one model is superior to another.

What is rather clearer is that, from a management structure point of view, supervision and monetary policy-making involve entirely different processes. At the risk of oversimplification, the output of monetary policy-making is delivered at the top of the management hierarchy and the output of supervision at the bottom.

Thus, although its execution can be complex, the monetary policy decision is ultimately a relatively straightforward one. It is whether or not to change interest rates and if so by how much. It may also involve deciding to change the composition of the central bank's balance sheet as well as its size. All this involves the assembly and analysis of a vast amount of date, filtering the facts and the theory at ever-higher levels of management until a decision is taken at the top.

In supervision the process is the other way round. Policy is set at the top, but supervision itself takes place in decisions taken in dialogue with a myriad supervised entities and individuals about details of capital and liquidity requirements, systems and controls, fitness and properness of individuals, treatment of customers, and so on.

Experience suggests that it is quite hard to fit these two completely different kinds of operation under the same roof. Certainly in the pre-1998 Bank of England the very different management skills and technical knowledge required meant that the monetary policy and supervisory operations were quite separate enterprises. The same is generally true of central banks that combine both functions. Thus, in the absence of either adequate cross-fertilisation of ideas or knowledge brought about by personnel transfers or without formal collective decision-making or at least information structures, the two functions may only be brought together at the top of the organization. The way they are brought together is dependent on the inclination or background of the Governor and his deputies, unless the pressure of circumstances forces a dialogue between the functions, as has been the case in the current crisis.

This state of affairs means that where precisely supervision is located may matter far less than the connections between the functions. It is certainly possible for monetary and supervisory policy to be more securely integrated when they are in separate institutions than when they are in the same. What make a difference are the arrangements for co-ordination and information-sharing, as well, perhaps, as the mindsets and backgrounds of the leadership of the functions.

Recent history suggests that mistakes have been made in both directions, i.e. through the monetary policy function losing sight of the fact that monetary policy can only be transmitted effectively through a financial system which is sound or through the supervisory function losing sight of the fact that the drivers of the behaviour of financial firms and their condition are contingent on what is happening in the real economy and in financial markets.

There is no clear correlation between such shortcomings and whether or not one agency is responsible for both functions. What is critical is the sound functioning of the relationship between, on the one hand, the central bank function (as macroeconomic policy maker and as direct participant in financial markets, especially as provider of liquidity support) and, on the other, the supervisory function. The Canadians, for instance, draw attention to the highly developed structure of their interagency coordination arrangements as well as the fact that the interdependence between supervision and the transmission of monetary policy has long been recognised.

The relationship goes in both directions. Because of the central bank's need to analyze developments in the real economy to determine the overall monetary stance and developments in the financial system in order to understand the functioning of the monetary transmission mechanism, the central bank will have insights about the development of risks for individual firms, whether arising from the evolution of the macro economy or from changing behaviour or relationships within the financial system.

Equally the supervisors of individual firms will obtain a range of intelligence not otherwise available about what each individual firm knows about what is happening in the economy and what they observe in the behaviour of other participants. This requires capacity within the supervisor to analyse such intelligence from individual firms and to generate advice back to the supervisors of individual firms and markets, as well as to provide additional information that can inform the conduct of monetary policy and macroeconomic policy more generally.

The interface between these two sets of data requires very closely related but separate and distinct roles and activities in both the monetary policy and supervisory functions. These functions tend to go by different names internationally. Very often they go under the generic if ill-defined term of "financial stability" irrespective of whether located in the central bank or the supervisor.

There is danger of overlap where the quite different analytical purposes are not made clear. One purpose is to convert information gained by central banks for monetary policy purposes into advice that can inform the actions of supervisors. The other is to convert information available to supervisors from their day-to-day supervision into advice that can inform the macroeconomic decision makers.

From the central bank side the analysis needs to be made available in ways that lead to recommendations for the supervisors to consider. A widely observed phenomenon in the recent crisis has been the extent to which the numerous financial stability reports produced by central banks have failed to give rise to supervisory response. In part this has been because risks are insufficiently prioritised or inadequately articulated. A central bank needs to give clear recommendations as to what it thinks the supervisory reaction should be. The process then requires capacity within the supervisor to convert a generalised concern about a given risk into operational guidance at the level of supervision of the individual firm.

This is the challenge for "macroprudential policy", now an extremely fashionable term. It covers a range of different concepts-analysis, supervision, regulation. At one end there is macroprudential analysis. This is a relatively straightforward concept. It must be right that policy analysis looks at the whole of the interaction between the financial system and the economy, and at the interaction within and between the different parts of the financial system. It must be right to look at how what is happening to the whole both derives from and impacts on individual firms and markets. So macroprudential analysis is essential.

At the other end is macroprudential "regulation". This is much more problematic and involves turning insights about the financial system into adjustments to the specific regulation of the individual firm. Ever since the term "macroprudential" was coined in the Bank of England in 1979 the feat of transforming macroprudential theory into practice has defeated policymakers. This does not mean that it is not worth trying. On the contrary, it remains as vital as ever to take account of the insights brought by the fullest possible analysis.

Many will be familiar with the excellent paper by the Bank of England on "The role of macroprudential policy" (Nov 2009) (5), which in turn builds on the FSA's Turner Review of a few month's earlier. The challenge remains, however, to succeed where previous attempts have failed. As the Bank puts it, the challenge is to re-orient prudential regulation towards risk across the system as a whole and to find out how instruments can be designed and deployed to mitigate those risks. The Bank examines in some detail a number of concrete ideas focussing on a regime of systemic capital charges, either applied to headline capital requirements or through applying risk weights on particular types of exposure.

However, the paper goes on to describe the challenge of making a macroprudential regime operational including the tricky degree of judgment involved, the need to make changes over time and according to circumstances, and on an internationally consistent basis, yet still have adequate transparency, accountability and predictability. These are strikingly reminiscent of the kind of factors that have bedevilled the implementation of such steps at each point macroprudential concerns have come to the fore in the past decades.

What is rather different now is that in the 80s, when the macroprudential concept was already current, monetary policy was often seen as operating in large part through the supply of credit. The concern then, as expressed by the G10 governors in 1986, was that, because of the effects of innovation, deregulation and structural change "the scope for monetary policy to operate via changes in the availability of credit is being reduced relative to the role of […] interest rates and exchange rates".

In the more recent past the thinking of some central banks had reached the point where the role of credit expansion in leading to unsustainable booms, bubbles even, was not felt to be something that it was the responsibility of monetary policy to influence. Monetary policy, it was thought, should instead focus purely on consumer prices, as evidenced in the progressive spread of inflation targeting regimes. The search for macroprudential tools is in some cases, as explained in the Bank of England paper cited, a consequence of the view that monetary policy would not be able to curb emerging financial imbalances without diluting the commitment to the inflation objective and that an attempt to curb banks' balance sheet growth through monetary policy may have been seriously destabilising for the real economy. Instead, it was concluded that macroprudential tools should be used.

The difficulty with this argument is that e.g. the surcharging of capital ratios, if that is one of the tools deployed, will only make a difference through material changes in the volume and price of credit intermediation as banks adjust. This is none other than a change in the monetary stance through a different route, so to assume that inflation and growth would remain unchanged seems wrong.

Nevertheless, it is also the case that the regulation of individual firms can be improved by macroeconomic analysis, if only by seeking to ensure that management is compelled to confront the reality of the environment in which a firm operates, even if that means a supervisor directly challenging business plans. The introductions of risk-weighted capital and of the use of models were examples of earlier attempts to systematise this, albeit imperfect in their execution and effect. It may be that a system of capital surcharges can indeed be devised to address changes in risk across the cycle and to reflect individual firms' contribution to systemic risk, but the jury is out on this – accurate forecasting of the phases of the cycle in each different region of the globe is only one of the challenges.

What is more certain is that the approach to monetary policy in inflation targeting countries needs in any event to change as Howard Davies and I explain in our recent book (4). Monetary policy can no longer ignore what is happening within the financial system, as has happened in some countries. And if it does ever become possible to devise macroprudential capital or liquidity surcharges reliant on judgment, judgment just as difficult and uncertain as that required for monetary policy decisions, the institutional framework for both monetary policy and financial supervision may need to undergo radical change.

Returning to the issue of institutional structure, it does not seem necessary for the two functions to report to the same management nor, consequently, to have the same public accountabilities. What is necessary is that both functions are publicly accountable for proper conduct of their relationship with the other. As mentioned above, getting acceptable degrees of independence for the monetary policy and supervisory functions simultaneously can be problematic if they are in the same organization. Perhaps partly for this reason there are few examples in the industrial world of collocation. Only the US currently has co-responsibility both for the formulation of monetary policy and for operational supervision of most, though not all of the banking system located within the central bank. In the euro area the national central banks, Banque de France, Banca d'Italia, and so on, are no longer responsible for monetary policy and so do not have a conflict.

In the UK the Coalition government has decided to transfer banking supervision back to the Bank of England. The proposal initially specified that "control of macroprudentional regulation" and "oversight of microprudential supervision" should be given to the Bank. From the discussion above it can be seen that this poses some challenges for mandate and accountability and it remains to be seen at the time of writing how independent the Bank of England will remain in the monetary policy field or how the dual accountability envisaged will be handled. It needs to be borne in mind that, at the time when the Bank was responsible for banking supervision pre-1998, the ultimate responsibility for monetary policy lay with the Treasury, not the Bank, so that this is not a return to the past.

The ECB has made a number of bids to take on supervisory decision-making in respect of the euro area's larger cross border banks from the national supervisors, whether National Central Banks or not. These bids, most notably during the debate preceding the adoption of the De Larosiere proposals, have so far been unsuccessful, but the creation of the European Systemic Risk Board and the provision for that body to have the same membership as the ECB General Council raises the question as to what the relationship between the ECB's monetary policy decision making role and its role in making recommendations to supervisory authorities in Member States should be. The ECB has no accountability arrangements in this field, essentially because at the time the Treaty was written, it was not expected that the ECB would assume functions in this area. An attempt to remedy this gap has been made by requiring recommendations to pass effectively via the Council. This set of relationships is still to be tested, but where the relationship between the ECB's different functions finally comes out will have wider implications for governance and accountability elsewhere.

So what can we conclude?

There are arguments both for and against the central bank being responsible for supervision and there isno overwhelming case on either side. The central bank may bring special insights and expertise, but against that there can be direct conflicts in certain narrow circumstances and the business of supervision has quite a different structure to that of monetary policy making. Where there is a case for an integrated regulator, combining it with the central bank may bring additional management and accountability complications and also concern about undue concentration of power. So, on balance, it may be better for the functions to be separate.

What is quite clear, however, is that the arrangements for liaison and for cooperation between the functions are critical and need to be in place and function properly whether supervision is inside the central bank or not.

Foot notes

(1) BIS. 2009. Issues in the Governance of Central Banks. Basel: Bank for International Settlements.

(2) Lastra, R. M. 1996. Appendix. In Central Banking and Banking Regulation, pp 249-86. Financial Markets Group. London School of Economics and Political Science.

(3) Davies, H. and Green, D, 2010. Banking on the Future: The Fall and Rise of Central Banking. Princeton University Press.

(4) European Central Bank. 2001. The Role of Central Banks in Prudential Supervision.

(5) Pringle, R. (ed.). 2007. How Countries Supervise Their Banks, Insurers and Securities Markets, 2007. London: Central Banking Publications.

(6) Bank of England. 2009. The Role of Macroprudential Policy. Discussion Paper.

Consultation
A new approach to financial regulation:
judgement, focus and stability

Response from Mr Paul Grenet

I wish to respond to the above document, with regard to proposed regulatory changes and the Financial Ombudsman Service (FOS). This response is primarily to questions 10 to 14.

The FOS has been little mentioned in the consultation document, but it is an area of financial regulation where members of the public are deeply involved. There are areas where I believe it does not meets today's standards of best practice, openness and transparency. For instance, FOS provided 166,000 decisions last year, with no appeals procedure and its Ombudsmen routinely recommend redress awards as "fair and reasonable" without actually checking the calculations.

Appeals against FOS decisions

There is no independent appeal against an FOS decision. FOS say that when a case is reviewed by an Ombudsman, this is regarded as an appeal, but this is much too cosy an arrangement. In instances where a case is passed to an Ombudsman because the Adjudicator cannot properly grasp the issues, then this cannot possibly be regarded as an appeal since only one competent person (the Ombudsman) has assessed the case and no second review has taken place of his decision.

Furthermore the quality of Ombudsmen's reviews is questionable. In her 2004 review of the FOS Professor Elaine Kempson stated:

> "In larger case files, adjudicators flag the key documents and correspondence for the ombudsmen."

This suggests to me that Ombudsmen expect and get guidance from Adjudicators about what they regard as most important. No appeal can be run on such a basis.

Contrarily, if a complaint is made about FOS "service standards", the complainant can appeal to a Casework Manager and even further, to the Independent Assessor. Last year 166,000 cases were decided by FOS. There must have been some mistakes and I can think of no other area in public affairs where decisions involving up to £100,000 (soon to be £150,000) can be taken by a single individual without the right of appeal.

The lack of appeal affects both consumers and firms, especially small firms and IFAs. An ill considered decision made by an Ombudsman without IFA qualifications, can be accepted by the claimant and be binding on the firm. With no right of appeal, an IFA can have his business, career (and life) ruined at a stroke by a decision made by a single individual..

CPMA should reconsider this situation. The lack of an appeals system requires guaranteed infallibility on the part of the Ombudsmen which is neither realistic or possible. Para 4.40 suggests that CPMA decisions will be subject to appeal, it would be strange is FOS decisions exempt from appeals.

Calculating redress

The current FOS does not generally calculate redress payment or check the calculations to establish whether a firm's offer is reasonable, so a prime reason for approaching the FOS (for an ordinary person to get the firm's calculation checked) is misplaced.

The FOS generally does *not* check a firm's calculations where they make an offer to pay redress. I cannot see any basis for this. Putting the consumer back where they would have been if the firm had not made the mistake requires a particular figure which depends on the facts of the case, not on the firm's willingness to offer redress or not. There must be a possibility that some firms may make a low offer in the knowledge that it will be waved through, indeed the whole question of how an Ombudsman can assess a firm's offer as "fair and reasonable" when he has not actually checked the figures threatens the credibility of the whole FOS process.

CPMA should address the question of how redress is checked, perhaps by making FOS set up an actuarial department to do this.

Guidelines and principles

FOS Adjudicators and Ombudsmen are not constrained by a legal framework and can make decisions taking into account pretty well anything they choose as long as they can say the result is "fair and reasonable". There is no easy way for a consumer to know the rules and guidance on which the

Adjudicator and Ombudsmen are working. In his review of the FOS, Lord Hunt recognised this and suggested a solution, the FOSBOOK, which would act as the main means of recording and promulgating details of developing practice and decisions for the benefit of both consumers *and FOS staff*. There is no sign of the FOSBOOK, as far as I know.

The last Chief Ombudsman, Mr Merricks, says guidelines are available to "help consumers and firms settle between themselves without needing to come to the ombudsman service". It follows from this that the guidelines must espouse best practice and produce a fair settlement. However it seems that FOS Ombudsmen are not required to follow them.

The FSMA . (DISP 3.8.1) states

> "In considering what is fair and reasonable in all the circumstances of the case, the Ombudsman will take into account the relevant law, regulations, *regulators' rules and guidance and standards*, *relevant codes of practice* and, where appropriate, what he considers to have been *good industry practice* at the relevant time."

This seems clear enough, but Mr Merricks says the guidance referred to is

> "guidance from the FSA and other regulators – not information published by the ombudsman service".

It is ludicrous that Adjudicators and Ombudsmen are not required to follow FOS guidelines. FOS is, after all, the principal body setting best practice in this arena. CPMA should review this policy, promote openness and transparency by publishing the guidelines in the FOSBOOK and making sure FOS staff follow its policies.

The role of Independent Assessor

At £48,000 for two days a week, this is clearly a very important position. However the authority and duties of the post are minimal. The IA is not permitted to consider the merits of the actual decision, merely FOS service standards. Last year the IA, Mr Barnes, only reviewed 165 cases (1 in 1000) and made awards (usually £50-£1000) in only 60 of these. The IA can make recommendations, but the FOS can ignore them and indeed the FOS do not have to comply with the IA's requests or recommendations at all.

The independence of the IA has also been questioned. The last IA was an ex-board member and the new IA was appointed by the FOS board assisted only by a 'public interest *observer*' who as an observer presumably took no part in selection. I doubt if the man in the street sees this as independent especially as the IA is also paid by the FOS.

The IA also makes reports to the Board, but I question the usefulness of these. Mr Barnes looked at such a small number of cases that his report can have little relevance to *overall* service standards, and no relevance at all to the FOS main business since he is not permitted to consider this. Mr Barnes was aware of this and frequently said as much in his annual reviews.

There is evidence that the FOS does not properly respect the IA's independence or authority. In one case, the Principal Ombudsman told the IA he would not accept *any* recommendation that he might make. What is the point of the Independent Assessor if he can be brushed aside like this ?

In her current role the Independent Assessor is underused and her qualities and experience are wasted. CPMA should review the role of the Independent Assessor and confirm her responsibilities and authority. She should be given the authority to issue *instructions* which FOS must follow, not *recommendations* which FOS and the Board can ignore.

Staff and qualifications

In Summer 2010 FOS staff levels have reached about 1600 with around 600 new staff joining in a single year recently and further recruitment taking place. 25% are outsourced contractors. This means a huge rate of expansion, or a huge staff turnover but whatever the reason, in 2010 there were hundreds of new staff with low experience levels and this, combined with the practice of paying Adjudicators extra to achieve workload targets must sometimes impact on quality. The Chief Ombudsman has confirmed that more cases are being passed to Ombudsmen, so it seems consumers have less confidence in the Adjudicators. I am concerned that Ombudsmen and Adjudicators may not have appropriate qualifications for the work they are doing. A recent advertisement for Ombudsmen did not require any minimum financial qualifications and the salary level offered to Adjudicators recently for a nine month fixed term is unlikely to attract the best candidates away from the attractions, salary and long term career structure of London's city and financial world.

Customer Service staff advised 760,000 FOS enquirers that their concerns did not need a formal investigation. I do not know what qualifications are required for these workers, but they appear to be offering advice to many people. Do they have appropriate qualifications to do this ?

CPMA should insist that FOS publishes *minimum standards* for staff qualifications at all levels and should make every effort to attract the best candidates as Adjudicators, perhaps with higher basic pay and no incentive payments.

FOS should be allowed to penalise firms for serious mistakes

The current system where a firm is required *only* to put a consumer back where he would have been if the mistake had not been made, is no longer acceptable. It is equivalent to telling a serial shop-lifter that as long as he puts the stolen goods back on the shelf, then no action will be taken and its OK to carry on shop-lifting. Next year FOS could be awarding some consumers £150,000 in redress but the firms will receive no criticism or penalty regardless of the seriousness of the issues.

FOS should be allowed to penalise firms if necessary, and perhaps consumers who make frivolous complaints.

Summary

I hope the Government will review the way FOS works. Just saying “the award is fair and reasonable” and “the Ombudsman’s decision is final” is no longer good enough. The public need explanations, openness and transparency from staff with qualifications and experience to match the quality of the professional staff employed by the financial firms. The Independent Assessor’s role needs a complete review. Firms’ calculations should be checked properly before approving them as reasonable, and FOS must accept that 166,000 decisions a year made by 1000 staff must include some mistakes, and introduce some form of appeals system.

Dear HMT,

I write in response to your July 2010 consultation "A New Approach to Financial Regulation" and would like to register my complete objection to the proposals you have presented to the British public, Parliament and financial institutions. For context I am a Risk Manager in the City of London and have a keen appetite for achieving the right regulatory objectives, protecting consumers' interests and, in equal measure, maintaining the competitiveness of the UK financial services industry. If the consultation achieves its aims of breaking up the Financial Services Authority (FSA), this will go along way in losing focus at the regulator (creating gaps), confusing consumers (making finance more complicated) and destroying the globally respected brand that is the FSA (a regulatory structure that has been replicated the world over).

Since December 2001, when the FSA assumed its full powers, it has worked to deliver on its four statutory objectives (1. market confidence; 2. public awareness; 3. the protection of consumers; 4. the reduction of financial crime), against a fierce political back drop of opposition presented by the Conservative Party. This opposition manifested itself in the Conservative party backed Centre for Policy Studies (CPS) paper in 2000, "Leviathan at Large - the new regulator for financial markets", by Martin McElwee and Andrew Tyrie MP http://www.cps.org.uk/cps_catalog/CPS_assets/146_ProductPreviewFile.pdf . The thrust of the paper was that a "regulatory monolith" was being created that would "over regulate" the UK, dedicating a chapter to this topic alone (The Risk of Over Regulation - Chapter 5).

"The incentive to over-regulate
(The FSA)... operates according to "a philosophy based on light touch regulation," it is biased in the direction of over-regulation. The powers of the Authority are immense, and it has significant discretionary power to make new rules (and principles) binding the markets. Its instincts will be to use them. The regulator and its senior staff are likely to be slated if a even a minor scandal occurs.

...The hand of the regulator will be heavy and could easily damage the City's global competitiveness." (p27)

So, why is this background relevant to this change consultation? Well, it fundamentlly undermines the basis proposed to justify the change/ break up of the FSA. From a prevailing pre crisis view, that "the FSA is over-regulating" the political wind has changed to suggest it was not doing enough - it was "too light touch". Further confirming another statement in the same 2000 CPS paper and the genuine backbone behind the change consultation:

"There will always be calls for more regulation. Every time something goes wrong, and particularly when it reaches the popular press, the cry goes out: "Something must be done!"

"If the FSA really were to take a light touch approach to regulation, it could reasonably be said that it was failing to meet its statutory objectives. If the regulator "fails" even once, it can expect parliamentarians to be amongst the most shrill in their calls for scapegoats. (p33)

Two years before the seeds of the crisis could, potentially, have been spotted the CPS issued a follow up to their stance titled: "The Leviathan is still at large - An Open Letter to Mr John Tiner, Chief Executive of the FSA 2005" http://www.cps.org.uk/cps_catalog/CPS_assets/457_ProductPreviewFile.pdf . Why should we trust the recommendations of this change consultation when the very "think tank" and party members driving this change have seemingly forgotten their loud recommendations made to further "loosen" the regulatory system and empower the finacial sector, so close to one of the worst finance disasters in history:

Leviathan is still at large (2005)
- concerns over the costs and burden of regulation;

Recommendations (chapter 3)

- **advocating a light touch regime**, subject to broad principles, and supported by regularly updated Guidance, adapted for the business and market needs of each market sector. This is **in contrast to the current climate of ever-more prescriptive rules**, micromanagement and combative enforcement;

- **revising the FSA's accountability to make it much less dependent on the Treasury, and more accountable to the industry that it serves**;

- addressing the **ever-increasing indirect costs of regulation** and their effects on the competitiveness of the industry both at home and abroad;

- **recognising the skills, sophistication and ability of senior management to manage their own business risks; and removing many of the prescriptive compliance burdens under which they labour;**

All of these recommendations would disgust the British public were they to be repeated now. Yet they were exactly the senitments of the party and forces now instructing "change", against all those recommendations now, just a few years before the crisis. In short, this is a politically motivated decision, the worst basis to make change and will result in the following:

- **Loss of focus at the regulator**

The global and, in particular, the European financial landscape is subject to the highest volume of regulatory changes in recent years (AIFMD, Solvency II, UCITS IV to name a few). There is a genuine and real threat that if EU Directives are over applied in Europe the balance of financial power will shift to the Far East, who have openly stated they will wait for Europe before implementing changes there. Distracting the FSA now from this fundamental task of securing the UK's competitiveness is wreckless.

This "change" process has also made it incredibly difficult for the FSA to recruit and retain good staff at a time they need them most.

- **Confusing Consumers**

Market research shows that consumer awareness and understanding of finance is improving. People do actually know who the FSA is. At a time where illegal money lenders are rife and the economy is at its most financially distressed it would be wreckless to remove the one safe harbour the British public have begun to recognise as "the financial regulator". In contrast, the Bank of England's acivities are not known by the masses and to try to explain the relevance of the CPMA and the PRA will be expensive and ultimately futile. Why waste the progress of 8 years?

- **Destroying the Globally Respected FSA Brand and Damaging the UK's Leading Financial Role**

The FSA is widely recognised as the world's leading regulator and a focal point for doing financial business in the UK. This can be seen by the sheer number of international regulatory events and information sharing initiatives the FSA partakes in. The visible respect the globe has of the FSA can be seen by the proliferation of consolidated single regulators around the world. As an inudtry, finance is the UK's leader and as the backbone to that the FSA is its global brand. HMT and the Conservative party are greatly underestimating the value of that brand.

In conclusion, the transfer of power from the FSA to the Bank of England, the CPMA and the PRA will have the net effect of loss of regulatory focus, consumer confusion and the absolute destruction of the UK's brand as being the leader in global financial regulation, via the FSA. We will see existing FSA staff move back to the Bank of England, for many this will be a return to where they came from in 2001 and a big pay day for lawyers (rewriting contracts) and consultants explaining to everyone what has just happened. The benefit to the public will be negative.

The consultation does not tackle the underlying issues within the industry of ensuring senior management are accountable for the risks wihin their firms (addressing the enforcement flaws) and getting a handle on how to manage major financial groups who operate in multi sectors (retail banking, asset management, insurance, investment banking). Trying to split these between the CPMA and PRA will be impossible and lead to duplication between the two bodies, resulting in industry strain and potential gaps.

This initiative needs to be stopped. With the economy in such dire straits we do not have the luxury to make big legislative reallocations to suit political whims. Particularly where the political whims have been proven, via the CPS papers, to be so dangerously wrong in the past.

I would appreciate your considered thought with regard to these points.

Yours sincerely,

Christopher Grix.

Dear Sir or Madam

I am responding to the consultation document 'A new approach to financial regulation: judgement, focus and stability - http://www.hm-treasury.gov.uk/consult_financial_regulation.htm

Publishing mortgage arrears figures by marital status:

The consequences of the "every choice of lifestyle" agenda which has followed from the policy "we shall not promote one type of family structure over another" of the previous government should be evaluated.

The Social Exclusion Unit named 8 indicators of deprivation, following which the ONS published statistics and indices [2001] for 7 of them, omitting 'family breakdown'.

Mortgage brokers require applicants to record their marital status whereas lenders classify borrowers as 'single', 'joint' or 'multiple'.

'Marital status' on government forms has been replaced by 'civil status'.

The combined effect of this suppression of information has meant that both the social and the economic consequences of an important change in policy cannot be easily evaluated.

Now that the banks which have suffered most from their connections with 'toxic' debt are in public ownership, someone should be finding out what made this debt 'toxic'. My belief is that some banks and building societies were much more cautious than others and were more inclined to lend to married couples rather than cohabiting couples.

David Cameron “cites research showing that almost half of cohabiting couples split up before their child’s fifth birthday, compared with one in twelve married people”.

This line of thinking is supported by an interesting paper “Mortgage Default among Rural, Low-Income Borrowers” printed in the US Journal of Housing Research in 1995 and [ironically] apparently funded by Fannie Mae.

It is quite an old paper and may not be entirely relevant. I think it is indicative that potential changes in lifestyle may not have been factored in sufficiently to lenders’ thinking. It includes:

“On average change in marital status increases the risk of default 4.5 times”.

This is supported further by other research, “Why have a rising number of Americans defaulted on their mortgage payments in recent years? When economist Darryl E. Getter of the U.S. Department of Housing and Urban Development set out to answer this question, he discovered that the problem was often not chiefly financial, but rather marital: many of the American homeowners who fall behind in their mortgage payments are experiencing the economic distress occasioned by divorce or separation from a spouse……….. Getter specifically identifies divorce/marital separation as a “variable that represents changes in economic circumstances” likely to cause a default on home mortgage payments.
Whether looking at all households or just at those with “normal and unusually high” incomes, Getter finds unusually high default rates for home mortgages among Americans who are divorced/separated ……… (Source:
Darryl E. Getter, “Contributing to the Delinquency of Borrowers,” The Journal of Consumer Affairs 37.1 [2003]: 86-100.)

This was published in 2003 and based on earlier data. The recent and rapid increase in cohabitation is not considered. I believe my contention that it is really the increase in cohabitation which precipitated the mortgage/financial/economic crisis is a reasonable one.

In “Research Into Mortgage Default and Affordable Housing: A Primer”, [2002] Charles A. Capone, Jr., Ph.D, Congressional Budget Office, Center for Home Ownership, Local Initiatives Support Corporation writes, “…..

statistical results are reported as multiplier ratios. These ratios give the relative strength of various influencing factors on incentives to default. Deviations from a value of one (1.0) tell direction and strength of effects. For example, the ratio reported for marital problems is 4.48. That means the incentive to default is 4.48 times as high for families experiencing marital problems than for those without such difficulties. This is not quite the same as saying probabilities of default will be 4.48 times as high, but it is close."

There was an interesting letter [12th August 2008], "A Myth About Fannie Mae and Freddie Mac" in the New York Times by Judith A. Kennedy, President and Chief Executive, National Association of Affordable Housing Lenders, Washington. She concludes, "Fannie Mae and Freddie Mac aren't victims; they dug their own holes".

Judith Kennedy should know what she is talking about as she has previously worked for both Fannie Mae and Freddie Mac!

UK research shows "the difference in family breakdown risk between married and cohabiting couples is sufficient that even the poorest 20% of married couples are more stable than all but the richest 20% of cohabiting couples".
Based upon this evidence - if my contention turns out to be correct - the FSA - or its successor - should be requiring the banks and other lenders to publish their mortgage arrears figures by marital status.

Yours faithfully
M N Gulliford

www.affinities.org.uk