Nationwide

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CONFIDENTIAL

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

Dear sir/madam

A NEW APPROACH TO FINANCIAL REGULATION: BUILDING A STRONGER SYSTEM

We welcome the opportunity to respond to HM Treasury's latest consultation on reforming the regulatory architecture for financial services. This letter follows our response to the July 2010 consultation document. It sets out:

- our overarching thoughts;
- our summary position on key elements of the proposed regulatory structure; and
- the regulatory 'tenets' we believe should be followed in formulating proposals for regulatory change.

In addition to this letter, we attach more detailed responses to a number of the questions. Furthermore, we endorse the Building Societies Association's ("BSA") response to the consultation and urge the Government to address the BSA's concerns, particularly regarding important practical arrangements, by providing for them in the forthcoming legislation.

Overarching thoughts

- *Financial stability*

We recognise the need for reform and believe the emphasis on financial stability is correct. It is of critical importance that the UK benefits from more effective macro-prudential supervision and a situation is avoided in the future where a single regulator is unable to balance conflicting priorities. The proposed "twin peaks" model – incorporating both the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA") and overseen by the Financial Policy Committee ("FPC") – should deal effectively with these issues.

- *Promoting effective competition*

As well as securing ongoing financial stability, these reforms represent an opportunity to re-engage with consumers and re-build trust in the financial system. We believe that dealing with the structural challenges described above should form part of a wider strategy to shape an environment that encourages effective competition, fairness, sustainable growth, and long term value for consumers.

We welcome the Government's intention to require the FCA to, whenever appropriate, exercise its general functions in a manner intended to promote competition. To us, effective competition is where consumers can easily compare products, make informed choices and switch providers within a regulatory framework that provides a level playing field for firms irrespective of their ownership structure. We believe that by focussing more closely on competition there may be potential to improve consumer outcomes and reduce the need for regulation. This could be beneficial to all market participants. As highlighted in the consultation document, there are 'potentially negative effects of excessive regulation on market efficiency and consumer choice'.

We understand the Government's desire to ensure that the pursuit of greater competition is not undertaken in a way that is incompatible with the FCA's strategic objective. In our view, a focus on promoting 'effective competition' would be fully aligned to the achievement of its strategic objective. Indeed, we would go further and recommend that consideration should be given to whether 'promoting competition' should be one of the FCA's primary objectives. In this case, it would be important to recognise the extent to which this could change the remit of the FCA to that of an economic regulator with significant new powers. This potentially has significant consequences which would need to be explored fully if its remit is to be defined in this way.

- *The treatment of mutual organisations*

Firms must able to compete on a 'level playing field' regardless of their ownership structure or the legal and regulatory framework within which they operate. We believe this is fundamental to ensuring good outcomes for consumers. We therefore welcome plans to remove from the Building Societies Act 1986 the largely anachronistic anomalies and barriers to competition, as well as the proposal to require the PRA and FCA to consider the impact of proposed rules on mutually-owned businesses as part of the Cost-Benefit Analysis ("CBA") process.

We believe an equally important consideration is the appropriateness of a proposed rule given the legal and financial structure of a business to which it could eventually apply, which would extend beyond the current proposal. We therefore urge the Government to:

- make the enhanced CBA process a statutory requirement; and
- widen the CBA proposal to require the PRA and FCA to analyse not only the extent of the costs and benefits of the proposed rule, but also evaluate whether it is appropriate to mutually-owned institutions.

Regulatory structure, approach and co-ordination

- *Macro-prudential supervision*

The FPC has significant potential to deliver a more sustainable financial services industry but also to add an additional layer of complexity and uncertainty for institutions. We require more information to assess the effectiveness of the macro-prudential tools that will be at its disposal. It is not immediately clear, for example, how and in what order the tools will be deployed. The FPC should be subject to equivalent accountability and transparency mechanisms as the Bank of England's Monetary Policy Committee, although we appreciate the need to limit the publication of market sensitive information.

- *Judgement-led prudential supervision*

We support the proposed objectives for the PRA and welcome the detail on the issue of proportionality. However, we believe this principle should be articulated in a way that includes reference to the opportunity cost of new regulation – we describe this as the "golden rule".

We also welcome the Government's intention that the PRA will supplement its rules with purposive statements to aid interpretation if this leads to greater certainty. We believe that firms should, within lawful and morally-sensible boundaries, be free to take a pragmatic approach to compliance and risk management activities. Likewise, we believe the PRA should not only be judgement-led, it should be outcomes-focussed.

We are concerned, however, about the potential negative consequences of a judgement-led approach should it involve a confrontational supervisory style and supervisors who are not familiar with the specifics of a firm's business model and culture. Supervisors will need the requisite skills and experience to perform their role effectively – and there should be mechanisms to resolve differences of opinion without firms having to resort legal action.

- *FCA as a 'consumer champion'*

We welcome the Government's recognition of the concerns raised by respondents regarding the FCA's proposed role as a 'consumer champion'. The consultation document usefully clarifies and explains how this role will be performed in practice. However, despite our natural consumer focus, we feel the continued characterisation of the FCA as a 'consumer champion' makes it desirable to include a statutory safeguard to ensure firms are treated with the requisite degree of fairness and impartiality that would be expected from line regulator as distinct from a consumer advocate organisation.

We also ask the Government to work with the industry to develop a principles-based framework to product intervention that allows for mature and productive interactions with firms during the product lifecycle. We are not against banning products as we recognise the importance of being able to tackle products that are inherently unfair to consumers. But if a power to ban products is conferred on the FCA, it should be clear to firms how and when it would be used.

- *Regulatory "underlap"*

There needs to be appropriate focus on minimising the complexity and operational burdens that will be placed on dual-regulated firms. Without strong co-ordination mechanisms, the proposed structure could easily suffer from the same regulatory "underlap" that was exposed as being present in the current Tripartite structure during the financial crisis. The Government should therefore secure arrangements that will ensure the new authorities interact effectively with each other, with regulated firms and with the European supervisory framework. This is, of course, relevant during a benign economic environment and even more so during an emergency situation.

Regulatory 'tenets'

We believe it is important to recognise that these reforms are not happening in isolation – there is a significant wave of regulatory change within Europe and the UK as a direct result of the financial crisis. In our opinion it is important that any proposal for regulatory change should:

- adhere to the "golden rule" by being a proportionate response to the problem it seeks to tackle with sufficient focus on the opportunity cost to firms;
- not confer on industry excessive responsibility for demonstrating compliance with new rules such that the amount of senior management time spent on evidencing compliance renders businesses incapable of operating efficiently;
- avoid situations where firms become subject to overlapping duplicative rules that are designed to achieve the same end; and
- be risk-based: firms that demonstrate a higher degree of prudent management in lower risk markets should be less burdened than firms exhibiting higher risk characteristics.

Next steps

Finally, we trust our response is helpful to you in taking forward the proposed reforms and would be happy to discuss it with you further.

Yours faithfully

Alison Robb
Group Director, Strategy & Planning

NATIONWIDE BUILDING SOCIETY'S RESPONSES TO HM TREASURY'S CONSULTATION 'A NEW APPROACH TO FINANCIAL REGULATION: BUILDING A STRONGER SYSTEM'.

Nationwide Building Society is the UK's third largest mortgage lender, the third largest high street savings provider and sixth largest high street financial services organisation, with around £190 billion in assets. Nationwide is the only building society that provides genuine competition to the banks through its size and scale, product proposition, pricing structure, branch network and brand strength. As a modern, mass market mutual, we are owned by and run for the benefit of our 15 million members. We are naturally consumer-focused and, although we must take a commercial approach to remain competitive, we do not compromise our mutual principles.

The answers we provide in this document are **confidential**. We list below only those questions on which we comment.

CHAPTER 2: BANK OF ENGLAND AND FINANCIAL POLICY COMMITTEE

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

Capital tools

We recognise that additional capital may be required to address cyclicality, in particular to protect against periods of stress. However, macro-prudential capital tools introduce an additional level of complexity and uncertainty into a firm's capital planning. Any decision to raise capital requirements should be pre-announced 12 months or more before the implementation date. To ensure firms hold an adequate 'management buffer' of capital, it should also be clear how the Authorities calculate any potential requirement and the maximum additional amount of capital firms could be required to hold. The form of capital firms must hold against the additional requirements should also be clear. On the basis of the new definition of Tier 1 capital under Basel III (i.e. loss absorbing), we would recommend that any requirement is met by this form of capital.

It is worth stating that the existing regulatory framework already contains provisions under Pillar 2 that require firms to hold buffers to withstand severe stress scenarios (i.e. capital planning buffer). We believe that Pillar 2 and stress-testing could deliver the regulatory objectives in a more targeted manner in addition to removing 'double counting' between the framework already in place and that proposed in the paper.

We provide below comments on the three proposed measures: countercyclical buffer, leverage ratio and the variable risk weights.

Countercyclical buffer

We believe the countercyclical buffer is a relatively blunt instrument. From the detail you provide and the Basel III reforms, there appears to be no distinction between lending to different sectors of the economy. Financial institutions target different segments of the market and the effect of cyclicality may not be experienced equally across different sectors.

Leverage limits

We do not support incorporating the leverage ratio as a Pillar 1 requirement (as is proposed under Basel III). We believe that it would impose a binding constraint of general application that is not appropriate to all business models, particularly organisations, like us, that adopt an inherently low-risk business model and originate high-quality assets. It could potentially lead to such firms holding a disproportionately high amount of capital for low-risk lending, increasing their risk profile, and/or becoming increasingly uncompetitive due to higher capital costs relative to their competitors. We also believe it could lead to the regulators not focusing on the sources of risk.

Variable risk weights

This tool would be more 'pointed' than an aggregate capital buffer as it would focus specifically on certain sectors or asset classes. However, the detail provided in the paper is limited and as such the quantitative impact on different business models is difficult to assess.

We therefore ask for more information on:

- the economic and market indicators that would be used to identify sources of systemic risk and decide minimum risk weights;
- how risk weights would be implemented in practice, for example whether via the PRA, or imposed on firms directly by the FPC such that, in effect, dual-regulated firms would become subject to another layer of supervision;
- any pre-announcement mechanism that is proposed to be used and the notice firms can expect to receive ahead of having to re-perform internal capital calculations and, potentially, issuing capital;
- how often the FPC will re-calculate and -calibrate risk weights; and
- whether the UK is in isolation in considering this tool and whether it will have national discretion to implement such measures following expected amendments to the Capital Requirements Directive on the basis that variable risk weights do not seem to feature prominently on the international reform agenda.

In addition, we would exercise caution that any change to Pillar 1 risk weights could have a multiplier effect on the regulatory capital requirements for some firms due to capital requirements being imposed in percentage terms under Pillar 2.

Liquidity tools

The consultation provides limited information on potential liquidity tools, outlining only a liquidity buffer, similar to the countercyclical capital buffer. Our comments on the capital buffer apply equally to the liquidity tools. It would be a blunt instrument that does not focus on the underlying issues related to the segments to which firms lend.

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

The FPC should as far as possible be subject to equivalent accountability and transparency mechanisms as the Bank of England's Monetary Policy Committee. We appreciate, however, that maintaining financial stability might require a certain degree of opacity and limits to be placed on the publication of market sensitive information.

CHAPTER 3: PRUDENTIAL REGULATION AUTHORITY

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

The strategic and operational objectives seem sensible. As regards the regulatory principles, we welcome in particular the comments on and inclusion of the principle of proportionality. We believe that all regulation should meet the "golden rule": that is, it should deliver a demonstrable net good – the "bad" activity that it prevents should be greater than the "good" activity that it inhibits. We believe it should be clearer that the principle of proportionality must allow for a proper assessment of the opportunity cost on those subject to regulation.

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

We support moves to include short statements of purpose alongside the rules it makes – provided that doing so will allow for greater certainty as to how the PRA will view a firm's activities and without reducing flexibility. It would be helpful to firms if these statements were of sufficient granularity to reflect the specific part of any regulatory pronouncement that resulted in the rule being made – for example, a publication of the Basel Committee on Banking Supervision or the sentiment of some other internationally agreed standard – rather than the PRA's own interpretation. We appreciate that in some cases there will be less flexibility available to firms. In these cases we welcome clear signposts such as those that might fall within the Proactive Intervention Framework.[1] In any case, we believe that firms should, within lawful and morally-sensible boundaries, be free to demonstrate creativity and take a pragmatic approach to their compliance and risk management activities. In this sense, the PRA should not only be judgement-led; it should be outcomes-focussed.

As a judgement-led regulator, we accept that supervisors will be required to reflect on and challenge statements of fact. However, a supervisor will necessarily require considerable expertise and knowledge of the firm(s) they supervise in order to discharge their supervisory duty effectively. Supervisors will have a wide power to take – sometimes unpopular – action that could have a material impact on a firm's activities. We are concerned that in the extreme it will not be possible to resolve a difference of opinion without, in effect, seeking a judicial review. We believe there should be mechanisms earlier in the process to avoid this situation: legal action is costly and will be undesirable to firms who wish to foster healthy and constructive relationships with their supervisors.

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

We note with interest the discussion about the safeguards around rule-making, in particular the duty to consult. The proposals explain, in relation to the PRA, that there will be no significant reduction to the existing requirements to consult set out in the Financial Services and Markets Act 2000 ("FSMA"). We value this statement as we believe the duty to consult serves both as an appropriate check on regulatory power and, if used effectively, a productive way of engaging with industry. We question, however, the degree of latitude that will be available to the PRA, and indeed the FCA, to consult given the trend towards increasingly prescriptive and directly applicable European regulation, so we appreciate why the Government might wish to streamline the consultation requirements when implementing EU rules. We are not against European alignment; but we believe that any streamlining of the consultation requirements – and by implication the Cost Benefit Analysis ("CBA") – will dilute the Government's efforts to recognise diversity in legal structure and develop an impartial evidence base (please see our response to Q23). We accept that waiving the consultation requirements would be legitimate in an emergency situation.

We ask the Government to legislate to require the PRA and the FCA to conduct CBA in relation to all financial regulation that applies to mutually-owned businesses irrespective of its provenance or whether UK regulators consult prior to domestic implementation.

CHAPTER 4: FINANCIAL CONDUCT AUTHORITY

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

We welcome the Government's intention to require the FCA to, whenever appropriate, exercise its general functions in a manner intended to promote competition. To us, effective competition is where consumers can easily compare products, make informed choices and switch providers within a regulatory framework that provides a level playing field for firms irrespective of their ownership structure. We believe that by focussing more closely on competition, there may be potential to improve consumer outcomes and reduce the need for regulation. This could be

[1] The PIF seems very similar to the FSA's ARROW II scorecard. We would expect any supervisory assessment or resulting intervention to remain confidential between the PRA and the firm and welcome clarification on how the Government expects the PRA to use this tool.

beneficial to all market participants. As highlighted in the consultation document, there are 'potentially negative effects of excessive regulation on market efficiency and consumer choice'.

We understand the Government's desire to ensure that the pursuit of greater competition is not undertaken in a way that is incompatible with the FCA's strategic objective. In our view, a focus on promoting 'effective competition' would be fully aligned to the achievement of its strategic objective.

We share the Government's ambitions for consumers to understand the products they need and make better financial choices. The consultation document usefully clarifies and explains how this role will be performed in practice. However, despite our natural consumer focus, we feel the continued characterisation of the FCA as a 'consumer champion' makes it desirable to include a statutory safeguard to ensure firms are treated with the requisite degree of fairness and impartiality that would be expected from line regulator as distinct from a consumer advocate organisation.

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

The FCA will need to strike a balance between *enabling* consumers and promoting competition on one hand and intervening and *restricting* product providers on the other. We are not opposed to intervention, but we believe that a micro-supervisory approach – including, for example, rigid, arbitrary and narrowly-defined restrictions on products – is likely to have a negative effect on competition and could result in consumer disengagement. We question, therefore, whether it is necessary to confer on the FCA a wide power to ban products. We believe there is merit in considering a range of alternatives as part of a wider plan to create an environment where supervisory deterrence incentivises market discipline in preference to the imposition of prescriptive and narrowly-defined rules.

The Mortgage Market Review is a specific example where there are ongoing philosophical differences between the FSA and the mortgage industry. There is a lack of agreement over the relative responsibilities of individuals and lenders and the impact this has on the efficiency and effectiveness of the market. This is a political as well as a regulatory matter. We should use this consultation process to bottom out these differences to prevent them from flowing into the new regime where they may become entrenched and harder to resolve.

We ask the Government to legislate to require the FCA to:

- *develop an intervention framework founded on a set of broad principles;*
- *provide clear guidance on when it is likely to intervene (consistent with, for example, the desire to manage firms' expectations by using the PRA's PIF);*
- *enter into mature dialogue, and where possible collaborate, with firms early and at appropriate intervals during the product lifecycle; and*
- *consult with industry on the merits of possible alternative interventions.*

(14) The Government would welcome specific comments on:

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

We support the use of transparency as a regulatory tool if it results in fair treatment. The availability of a power to require the withdrawal of misleading financial promotions could also be a useful tool. We share the BSA's concern that the power should be used only where the advertisement is misleading beyond reasonable doubt. This is in case irreversible damage to a firm's reputation is caused due to the firm being unable to appeal until after the notice has been issued. We have the same concern about the power to issue a warning notice where the FCA proposes to take enforcement action. There is a danger that this could harm a firm's reputation particularly where no disciplinary action is then taken.

CHAPTER 5: REGULATORY PROCESSES AND CO-ORDINATION

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

We welcome the Government's commitment to ensuring the new regulators co-ordinate their activities. A statutory duty to co-ordinate is crucial. The proposals acknowledge our concern that the impact of transitioning to the new environment should be minimal. We strongly support the BSA in setting out important practical measures that could be adopted to ensure effective and efficient co-ordination and interactions with firms. This includes, in particular, establishing a "common gateway" for dual-regulated firms' authorisations, approvals, variations, waivers, notifications and reports; and co-ordinating when planning supervisory programmes, gathering information and performing supervisory reviews.

There has been a wholly appropriate focus on regulatory "underlap" in relation to the Tripartite authorities during the financial crisis and in relation to the new authorities under the proposed structure. However, consideration should also be given to regulatory "overlap". Take overheating in the mortgage market, for example. The regulatory response is to tackle the problem with both conduct and prudential regulation seemingly without a proper assessment of the potentially excessive costs of a dual regime. As far as possible there should be a single rulebook within the new structure and the new regulators should be assigned sole responsibility for specific rules and dual ownership should be avoided.

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

We agree that this is an appropriate means of ensuring financial stability.

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

Please see our response to Q17.

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

Please see our response to Q17.

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

Please see our response to Q17.

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

We welcome the decision to give building societies greater flexibility within the Building Societies Act 1986, as well as the proposal to require the PRA and FCA to consider the impact of proposed rules on mutually-owned businesses as part of the CBA. Notwithstanding our opinion that promoting diversity should be part of the regulators' statutory remit, the latter is hugely encouraging against a background of financial regulation that has in many ways been drafted with publically-listed financial institutions in mind. We believe an equally important consideration is the appropriateness of a proposed rule given the legal and financial structure of a business to which it could eventually apply. We believe this would extend beyond the current proposal.

We ask the Government to:

- *make the enhanced CBA process a statutory requirement in preference to, say, modifying a voluntary code of practice on consultation that might apply to the new regulators; and*
- *widen the CBA proposal so that the PRA and FCA analyse not only the extent of the costs and benefits of the proposed rule, but also evaluate whether it is appropriate to mutually-owned financial institutions.*

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

The proposals appear sensible although we would urge the Government to ensure that fees do not rise any higher than the current FSA budget: dual-regulated firms should not have to pay twice for what is effectively the same regulatory coverage.

CHAPTER 6: COMPENSATION, DISPUTE RESOLUTION AND FINANCIAL EDUCATION

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

The proposed operating model appears complicated and at risk of appearing disjointed to an outside observer. We believe that levies should be co-ordinated, raised concurrently and that they should relate to aligned accounting periods. In our opinion this should avoid a fragmented process for receivers of levies from both PRA and FCA.

Also, where there is any cross-over in the activities of the two regulators, synergies should be explored and reflected in the fee structure, thereby avoiding the situation where firms effectively pay twice for the same regulatory coverage.

Irrespective of how the PRA and FCA interact with the FSCS, fees should reflect not only to the size of the organisation, but also the level of its inherent risk. We would prefer fee calculations to take account of the level of risk as assessed by the two bodies' respective remits.

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

We welcome efforts that lead to fair outcomes for consumers. However, consideration should be given to the unintended consequences that might result from the publication of FOS determinations. We are concerned about the way in which Claims Management Companies ("CMC") manage consumers' expectations and pursue complaints that are unfounded. The publication of FOS determinations could lead to an increase in this type of conduct. We believe that greater transparency is positive but also that the CMC community should be subject to much tighter regulation.

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

We have found the information contained in the FSCS annual plan very useful, particularly since the credit crisis. We agree strongly that annual plans should continue to be published and would welcome the opportunity to input into any consultation process.

We also welcome increased scrutiny of the FSCS by the National Audit Office. As a significant participant in the scheme – but with limited access to the operations, forecasts and results – we would appreciate the additional confidence that an independent review would provide.

CHAPTER 7: EUROPEAN AND INTERNATIONAL ISSUES

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

We would take this opportunity to ask the Government to ensure the new authorities support the UK's commitment to the wider European and international financial regulatory framework. We believe support in this context includes refraining from pursuing gold-plated regulatory solutions that impose unnecessary burdens and costs and risk having to be unwound.

- End -

Dear Sir or Madam,

Northumberland Credit Union Ltd. was founded in 2003. It has 400 members and approximately £100,000 in members' savings and other assets. It serves people throughout the county of Northumberland, but particularly in rural areas where credit union services are least likely to be available. During the year ended September 2010, NCUL made 130 loans totalling £75,000.

NCUL is run largely by volunteers. We have no comment on macro regulatory issues but as directors of a small credit union, we are concerned that the regulator should keep things simple and not expect an unrealistic level of technical sophistication in credit unions such as our own.

<u>No. 12. Relationship between the FSA and FCA</u>

We welcome the prospect of a degree of continuity between the FSA and FCA.

<u>No. 14. New powers with regard to misleading promotions</u>

We look forward to the suppression of advertisements from firms that are neither credit unions nor part of the credit union movement purporting to offer credit union loans.

<u>No. 17. Co-ordinating the activities of the PRA and FCA</u>

We would prefer it if the entire regulation of credit unions, including capital and liquidity requirements, the receipt of reports and returns and the registration of approved persons, were carried out wholly by the FCA.

If this is not acceptable, then we would ask that the existing distinction between small and large credit unions be made use of, so that only large credit unions had to deal with two regulators.

<u>No. 21. Approved Person regime</u>

The FSA's present arrangements for approved persons work reasonably well. Once one has a basic familiarity with their large and complicated website, one can find the right form with half a dozen keystrokes. We particularly value the exemption of credit unions from having to use ONA.

We hope therefore that the FCA will continue the FSA's present system, and in particular will continue to deal with all approved person applications as they relate to credit unions.

<u>No. 23. Regulation of mutuals</u>

We welcome the government's recognition that mutual societies should not be disadvantaged as a result of regulatory processes designed primarily for the private sector.

Roger Hawkins,
Director and Compliance Officer, Northumberland Credit Union Ltd.,
on behalf of the Board

NYSE Euronext's Response to HM Treasury's Consultation Document Entitled "A New Approach to Financial Regulation: Building a Stronger System (CM8012)"

1. NYSE Euronext

1.1 NYSE Euronext is a leading global operator of financial markets and a provider of innovative trading technologies. NYSE Euronext's exchanges in Europe (Amsterdam, Brussels, Lisbon, London and Paris) and the United States provide for the trading of cash equities, bonds, futures, options, and other Exchange-traded products. NYSE Liffe is the name of NYSE Euronext's European derivatives business and is the world's second largest derivatives business by value of trading. It includes LIFFE Administration and Management, which is a self-clearing Recognised Investment Exchange pursuant to the Financial Services and Markets Act 2000 ("FSMA").

2. Executive Summary

2.1 NYSE Euronext welcomes the further opportunity provided by the current consultation to comment on the Government's plans to reform the system of financial regulation in the UK. As was the case during the public consultation which HM Treasury initiated on this issue in July last year ("the July Consultation"), NYSE Euronext has focussed its comments on those aspects of the reforms which will have a direct impact on markets and infrastructure.

2.2 First, NYSE Euronext welcomes the fact that the current consultation document ("the February Consultation") addresses a number of the major concerns which NYSE Euronext highlighted in its response to the July Consultation[1]. These relate specifically to the following issues:

(a) **Recognised Body Regime:** In response to the July Consultation, NYSE Euronext argued strongly that the tailored regime for regulating exchanges and clearing houses (collectively, "Recognised Bodies") should be retained as it acknowledges the unique position of the Recognised Bodies, for example as front-line regulators rather than quasi-firms. NYSE Euronext is pleased to see that the Government has responded to those concerns by stating that the Recognised Body regime will be retained pending the outcome of the MIFID review. NYSE Euronext does note, however, that the February Consultation explains that the Government nonetheless intends to propose some changes within the current Recognised Body regime. Section 3 of this paper provides NYSE Euronext's comments on those proposed changes.

(b) **Listing:** In its response to the July Consultation NYSE Euronext advocated the case for the UK Listing Authority ("UKLA") being part of CPMA (now renamed as the Financial Conduct Authority ("FCA")), rather than it being merged with the Financial Reporting Council ("FRC") as originally suggested by the Government. NYSE Euronext argued for the UKLA to be within the FCA in order to maintain the synergies between primary and secondary markets regulation. It is pleased to see that the February

[1] NYSE Euronext response to CM7874, submitted to HM Treasury on 18 October 2010.

Consultation confirms the statement which was included in the Government's summary response of November 2010, that the UKLA will indeed come under the auspices of the FCA.

2.3 Secondly, the February Consultation acknowledges the other issues raised by NYSE Euronext in its response to the July Consultation. These issues are as follows:

(a) **Wholesale Markets Regulation:** it is essential to ensure that the proposed conduct regulator, the FCA, is able – notwithstanding any retail investor focus – to regulate conduct in wholesale financial markets in a manner which reflects the needs of the professional users of those markets, recognising that such needs often differ significantly from those of retail investors.

(b) **Co-ordination Among the New Regulators:** the Bank of England and FCA must avoid overlap and gaps in the regulatory oversight of trading, clearing and settlement systems; and must ensure that the UK is represented effectively in the crucial negotiations within ESMA which lie ahead.

2.4 The February Consultation suggests how the issues described in paragraph 2.3 could be addressed and NYSE Euronext's reactions to those suggestions are contained in sections 5 and 6 of this paper.

2.5 Finally, section 7 of this paper requests further information about the remit and composition of the proposed Markets Panel within the FCA.

3. Recognised Body Regime

3.1 NYSE Euronext welcomes the Government's decision not to proceed with any plans to dismantle the tailored regime for regulating Recognised Bodies, albeit that it notes that the Government's final decision will depend on the outcome of the MIFID review.

3.2 As the Government is aware, the regime for Recognised Bodies was established by the Conservative Administration of the 1980s, through enactment of the Financial Services Act 1986. It was carried forward, substantially unaltered, into FSMA. As such, there has been over two decades of experience with the operation of the Recognised Body regime. In NYSE Euronext's view, that experience has demonstrated the following:

(a) The structure of the current regime is correct in recognising, and continuing to recognise, the unique position of Recognised Bodies as front-line regulators of the member firms which use their facilities. As such, the Recognised Bodies are partners in regulation with the FSA (as they were with the Securities and Investments Board before it). This has provided an effective framework for the maintenance of fair and orderly markets.

(b) The regime proved effective during the financial crisis. No Recognised Body was in distress – or in receipt of government funding – during the period of financial turmoil. On the contrary, the Recognised Bodies played an important part in managing the consequences of the default of major financial institutions, such as Lehman Brothers; and their markets continued to operate effectively and in an orderly and transparent manner, whilst liquidity in many other fora dried up.

(c) The legislative framework in most jurisdictions with major financial centres distinguishes exchanges and clearing houses on the one hand from users of their facilities (e.g. investment firms and banks) on the other, and subjects them to appropriately tailored regulatory obligations. Subjecting exchanges and clearing houses in the UK to a regime designed for investment firms and banks would have run counter to those established international standards and would have raised a question mark over the continued ability of UK-based exchanges and clearing houses to provide their facilities to their many users based outside the UK.

3.3 Whilst NYSE Euronext therefore welcomes the Government's decision to retain the Recognised Body regime, it also notes that the February Consultation states that the Government is likely to propose a small number of "technical improvements" to the regime (page 79 of the February Consultation refers). These include "simplifying the procedure for issuing directions and allowing the FCA to impose penalties on an RIE". However, NYSE Euronext believes that far from being merely "technical" changes, such changes could, depending upon how they are structured, radically alter the nature of the cooperative relationship between Recognised Bodies and the statutory regulator, whereby the statutory regulator and the Recognised Bodies are currently partners in regulation, as described in paragraph 3.2 above.

3.4 Changing the nature of that relationship could prove to be counterproductive if it were to undermine the ability of the statutory regulator and the Recognised Bodies to work together effectively – making use of their respective knowledge, powers and regulatory reach - in the interests of the efficacy of the regulatory system as a whole. As such, and given the lack of detail on the proposed changes in the February Consultation, NYSE Euronext would like to discuss them with HM Treasury. It will also closely scrutinise any proposals involving them which are contained in the Government's forthcoming White Paper on regulatory reform.

4. Listing

4.1 NYSE Euronext welcomes the Government's decision to keep the UKLA within the FCA, rather than removing it and merging it with the FRC. The UKLA has an important role to play in the development of the London capital markets and, more generally, in facilitating capital formation in a robust but efficient manner. As explained in NYSE Euronext's response to the July Consultation, NYSE Euronext believes that the best way to ensure that UKLA continues to perform this role effectively is for it to remain within the FCA, thus maintaining the existing synergies between the regulation of primary and secondary markets.

5. Wholesale Markets Regulation

5.1 In response to the July Consultation, concern was expressed by NYSE Euronext and many other stakeholders that the regulation of conduct in the wholesale financial markets would be the responsibility of a body which had been given the working title of "**Consumer** Protection and Markets Authority" (emphasis added). NYSE Euronext welcomes the fact that the original working title of the conduct regulator has now been replaced by the more neutral title of "Financial Conduct Authority". The new title represents better the Government's stated intention that "as a regulator, the role of the FCA should not be confused with that of consumer advocate organisations, which themselves have a vital and distinct role to play. The FCA will be an entirely impartial regulator from whom firms and consumers can expect fair treatment" (paragraph 4.9, page 60 of the February Consultation refers).

5.2 In the July Consultation, the Government proposed that, in recognition of the differences between retail financial services and wholesale financial markets, responsibility for all market conduct regulation – including the oversight of exchanges - will be located within an operationally distinct division (i.e. the "markets division") of the conduct regulator.

5.3 In its response, NYSE Euronext noted that it is important that these distinctions are drawn clearly, not just in relation to the operational organisation of the FCA, but also in the legislation which underpins it and in its governance structure, rules, guidance and supervisory processes. Each of these must be appropriately calibrated in order to ensure that the FCA undertakes the appropriate form and style of regulatory oversight for the type of business concerned, rather than having a perspective solely focussed on the interests (notwithstanding their worthiness) of the provision of retail-oriented services.

5.4 NYSE Euronext therefore welcomes the fact that the February Consultation further endorses this approach by stating that "the FCA will also contain a strong markets regulation function, responsible for ensuring high standards of wholesale conduct by financial services firms (including imposing disciplinary measures against those found to have committed market abuse) and for regulating the listing process, recognised investment exchanges and other trading platforms. These responsibilities, which have to date been performed effectively by the relevant specialist functions within the FSA, will be largely transferred intact across to the new FCA...the objectives and functions of the FCA will be defined in a way that allows wholesale and markets regulation to be carried out as a core part of the FCA's regulatory approach, with the flexibility required to ensure that the specialist requirements of these markets are appropriately reflected and recognised" (paragraph 4.10, pages 60-61 of the February Consultation refers).

6. Co-ordination Among the New Regulators

6.1 As NYSE Euronext noted in its response to the July Consultation, the Government proposes to make the FCA responsible for regulating exchanges and other trading platforms and the Bank of England responsible for overseeing clearing houses and settlement systems. NYSE Euronext understands the underlying rationale for a bifurcated approach of this nature. However, it notes that trading, clearing and settlement cannot each be regulated in complete isolation as they are each a link in the same business chain. Activity in one link can and does have an impact on activity in the others.

6.2 For example, in the case of on-exchange derivatives markets, like NYSE Liffe's, where contracts are held open for months if not years, regulation of the market must encapsulate both trading activity (i.e. the flow of transactions on a daily basis) and open positions (i.e. the stock of outstanding transactions). Trading takes place on the regulated market, while resultant positions are held with the clearing house. Such positions can and do have an impact on future activity on the market and issues concerning them are, in many cases, the key factors which must be managed actively in respect of the maintenance of contract and market integrity. The legitimate interest that the FCA should have in relevant areas of post-trade activity must therefore be explicitly acknowledged in its remit and responsibilities.

6.3 Any regulatory structure involving more than one agency is potentially prone to a lack of coordination and the resultant development of overlap or gaps in regulatory oversight. NYSE Euronext would therefore urge the Government to ensure that an operational framework is put into place which will enable the Bank of England and the FCA to operate in a coordinated fashion in the interests of minimising the costs and promoting the effectiveness of the regulatory system.

6.4 In the February Consultation, the Government states that the FCA and PRA will have a general duty to coordinate their activities, in addition to specific requirements such as an obligation to prepare a Memorandum of Understanding between them. Whilst these initiatives are welcome, they should also extend to the Bank of England, because it is the Bank itself, rather than its subsidiary, the PRA, which will regulate clearing houses and, for the reasons explained in paragraphs 6.1 to 6.3 above, it will need to coordinate effectively with the FCA.

6.5 Moreover, in situations in which a regulated entity has more than one regulator in the UK it would seem inadequate simply to rely upon a general duty of coordination among the regulators. Where dual regulation will apply – i.e. in relation to prudentially significant firms and self-clearing Recognised Investment Exchanges – NYSE Euronext believes that the relevant regulators should have a duty to devise specific protocols for the oversight of the entity in question in order to minimise both regulatory gaps and duplication.

6.6 Furthermore, the Government has announced that the FCA will represent the UK on all matters within the European Securities and Markets Authority ("ESMA"). However, unlike the remit of the FCA, ESMA's remit will not be confined to conduct regulation, but will also include prudential regulation. Indeed, one of ESMA's first tasks will be to develop binding technical standards which will underpin the European Market Infrastructure Regulation ("EMIR"). EMIR will, amongst other things, promulgate standards for central counterparties, which at national level within the UK will be an area of regulation led by the Bank of England rather than the FCA. As such, in its response to the July Consultation NYSE Euronext expressed a concern as to how key aspects of clearing and other areas of prudential regulation can be effectively handled, in the ESMA context, by a body which does not have primary responsibility for such matters at national level.

6.7 The Government has acknowledged this issue in the February Consultation and has proposed that where the FCA is required to handle such issues in an ESMA context, it will be accompanied at the relevant ESMA meetings by a non-voting representative of the authority which has responsibility for them in a domestic UK context, i.e. the Bank of England in relation to clearing. The February Consultation document also explains that "the PRA and FCA will work closely together to ensure that the other regulator is kept fully informed of any matters due to be discussed in EU bodies that fall into their sphere of responsibility. This should mean, for example, that if a conduct-related issue is discussed in the EBA, the PRA should seek the FCA's views in advance, invite the FCA to attend the meeting as a non-voting observer and take the FCA's views into account in any vote" (paragraph 7.24, page 110 of the February Consultation refers). It is vital that these intentions are given practical effect and that they are also extended to the Bank of England.

7. User Panels

7.1 Paragraph 4.39 of the February Consultation states that the Government will "legislate for Practitioner, Smaller Business Practitioner, Markets and Consumer Panels for the FCA". With the exception of the Markets Panel, these arrangements carry forward those which are currently in place for the FSA. As the Markets Panel is new, and as the February Consultation does not provide any further information about it, NYSE Euronext would appreciate the opportunity to discuss with HM Treasury the proposed remit and composition of the Markets Panel and its relationship with the other panels.

8. Next Steps

8.1 NYSE Euronext would welcome the opportunity to discuss further the contents of its response to the February Consultation with HM Treasury, the Bank of England and the FSA and it looks forward to considering the Government's forthcoming White Paper, including a draft Bill for pre-legislative scrutiny.

14 April 2011

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Financial Regulation Strategy
HM Treasury
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14 April 2011

Dear Sirs,

A new approach to financial regulation: Building a stronger system

On behalf of Old Mutual plc, a financial conglomerate with its primary listing in London, I welcome the opportunity to respond to the above consultation. It is encouraging to note that this present consultation has responded to a number of the concerns highlighted in response to the previous consultation. The attached document therefore contains our detailed response to the questions raised, albeit there are some issues of fundamental importance which I have brought to your attention below:

1) A key element of the Prudential Regulatory Authorities (PRA) proposed supervisory approach is based on the wider use of mechanisms that support increased reliance on supervisory judgement. Combined with more limited grounds for appeal to enforcement we are concerned that this approach may result in firms being exposed to an increased risk of incurring significant costs and/or reputational damage as a result of poor regulatory judgement. In principle we are uncomfortable with the concept of regulators being able to place greater reliance on supervisory judgement, without an appropriate challenge mechanism in place to safeguard firms.

2) Proposals to give the PRA the right of veto over decisions made by the Financial Conduct Authority (FCA) gives the impression that the PRA, is seen as the lead regulator. We believe that this is an unintended consequence that could undermine the distinct powers of each regulator and give rise to confusion over regulatory decision making powers. As an alternative we would suggest that PRA concerns regarding FCA action are dealt with via an appropriate referral process rather than a right of veto.

3) Whilst supportive of the need for earlier regulatory intervention during the product lifecycle, these powers need to be applied proportionately to avoid innovation being stifled and customer choice and competition being eroded. For this approach to work it must also be supported by FCA personnel having much higher levels of product knowledge and awareness to identify potential issues. It is important that new products are not blocked as a result of a lack of understanding by the regulator rather than them posing inherent risk to customers.

4) Intuitively the proposed use of warning notices prior to the conclusion of regulatory investigations seems contrary to the objective of promoting financial stability. Use of early warning notices, later determined to be unwarranted, could result in firms suffering irrevocable reputational damage and customer detriment through an inappropriate reactive response i.e. surrender of contracts. The potential de-stabilizing effects of this approach in our view outweigh any potential benefit to customers.

5) It is vital that both regulators work closely together to ensure consistency of approach and avoid a significant increase in costs. We believe that the proposals put forward for managing the authorisation process in their current form are unworkable and are likely to result in additional cost and confusion. To avoid unnecessary duplication we would advocate the use of a separate body to manage the authorisation process on behalf of both regulators.

I trust that this letter and our detailed comments will be of assistance to you in the development of the new regime.

Yours faithfully

Philip Broadley
Group Finance Director
Old Mutual plc

Response to questions

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

In our view the effectiveness of the instruments as macro-prudential tools will be dependent on the quality of information available to FPC. Key here will be interaction with the EU and International bodies/regulators to gain broad agreement on macro-prudential developments and the appropriate response. It is important that whatever tool is used by the FPC this is consistent with what is generally felt to be appropriate in the broader EU/International context as the effectiveness of the tool will be limited if different approaches are used. This is one of the challenges for the FPC in that in meeting its financial stability objective for the UK, it needs to be intimate with international thinking and developments. With this in mind, we believe that the "relevant bodies" referred to in the second part of the Bank of England's amended financial stability objective should include appropriate "international bodies"

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

None that come to mind

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

No

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

No

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

The interconnection of strategic and operational objectives reflects a sound operating mechanism in our view. In addition, the principles capture the key areas that we feel are relevant and we note and accept the reasons for excluding innovation from this list.

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

It is difficult to comment on this question without more details of the criteria the PRA will use to determine investment firms within its prudential scope. At this point we would say that neither the permission of "dealing as principal", nor the fact that a firm is a BIPRU E730k firm of itself is sufficient to form any conclusions on systemic impact. If anything it may be better to exclude reference to a type of activity in the decision mechanism to avoid being restricted in getting the right firms in scope. A more holistic approach using metrics from a number of different areas may be more likely to deliver the right outcome.

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

This is an area of concern, as for some time industry practitioners have expressed concern at the potential for poor regulatory judgment to result in additional work and cost and in some circumstances reputational damage that is not in any way warranted by the circumstances. These concerns have not really been addressed, so the potential for the new regulator to have even greater power when exercising judgment is not a welcome development.

In relation to the limited grounds for appeal to enforcement, HMT needs to be mindful that enforcement can include individuals and smaller companies who may not have the means to proceed to a judicial review type challenge. It is important therefore that adequate safeguards are built into the system to allow proper challenge by all. The proposals here appear to only be focused on what would work for the regulator and not what is fair and proper to all those potentially affected.

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

No strong views

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

No strong views

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

The current regime is effectively carried forward to the new regime, albeit with interaction with practitioners placed on an informal footing. Going forward, it will be key to see the extent to which adequate engagement actually takes place and this will need to be closely monitored. Linking up with the FCA for consumer issues is logical.

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

Although we support the strategic and operational objectives, we do feel there is a need for additional focus on general product take-up. This will touch upon the area of financial inclusion to the extent that change to the regulatory framework makes financial inclusion worse (because for example products are no longer viable to be taken to market). It would require the FCA to consider how regulatory change impacts the take-up of financial products and in particular whether the outcome is of benefit to society. If the FCA scope is too narrow and focused predominantly on prevention, this may overlook other long term consequences of its strategy. Focus on product take-up would address this by requiring the regulator to consider the broader long terms consumer related consequences of it policies.

In examining the operational objectives, we accept that it could be argued that facilitating choice and promoting competition touch upon product take-up. We would suggest however that an approach that is described as interventionist, and concerns greater use of enforcement activity and warning notices is indicative of where the FCA will be focusing most of its attention, i.e., avoiding miss-selling and punishing those that do. We believe therefore that the FCA's functions and approach need to be more balanced on broader consumer issues and these need to be more proactively expressed in its objectives.

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

No strong views

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

We understand and support the need for regulatory intervention at an earlier stage in the product life cycle. We are also aware that at the European level there is similar focus in this area. Our concern in relation to this area is that such activities are properly focused and do not lead to product innovation being effectively stifled in the UK. This would occur if the FCA prevented product launch or development through lack of its own understanding of the product proposal rather than because of significant consumer risk inherent in a product. In this respect, it is noted that innovation is not one of the objectives or principles of the FCA and in relation to this question it could mean the regulator is ambivalent in this area. This issue could be addressed by the FCA being required to document in detail the purpose of product intervention activity, including the reason for the tools and approach used in each case. The record would be an area of focused review by the NAO including details of outcomes and whether objectives were achieved. This would lead to ongoing improvements in FCA's use of this intervention power as experience resulted in changes in approach.

One area that does need to be considered is the potential for firms to be commercially disadvantaged by flawed use of this tool. There is no easy answer to this issue, but the need for a careful and reflective use and proper internal controls is clear.

Question 14: The Government would welcome specific comments on:

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

We believe the approach to transparency and disclosure is logical as is the proposed new power in relation to financial promotions.

We do however have significant concerns in relation to the use of warning notices and question what regulatory benefit it is felt these will achieve. Our concern is derived from the potential for mistaken use of this tool leading to harm to a firm that cannot easily be undone. The subsequent issue of a discontinuance notice by the FCA should a mistake be made will have negligible impact on repairing the reputational damage caused to the firm. A further point to make is that in extreme circumstances this tool has the potential to cause significant contract cancellations reflecting a consumer's belief that warning notice indicated the firm was in financial difficulties. For banks in particular, this could potentially lead to the type of systemic issue that the PRA is seeking to avoid. In our view, if proportionality was applied to the use of this tool, we cannot see that a case could be made for its use. The FCA has other mechanisms it can use that could achieve the same protection to consumers with more reliability. We are unsure how the environment for consumers is in any way advanced by the addition of this tool to the regulatory apparatus.

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

We have no strong views in this area.

Question 16: The Government would welcome specific comments on:

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

We have no strong views in this area

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

We believe the proposals address many of the concerns expressed by respondents to the previous consultation. The key next step is to see the detailed MOU's as well as the wording used in the description of areas of coordination.

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

We understand the logic behind this proposal, but question whether this is the correct solution. The impression a PRA Veto gives is that the PRA is the lead regulator. This could undermine the distinct powers that each regulator has and lead to some regulatory confusion. We suggest that any PRA concern at FCA action should not be dealt with by a Veto, but by referral to the FPC for a judgment. The benefit of this approach is that neither regulator is seen to be superior to the other by having an additional tool in its armory.

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

We believe all three proposals are will lead to additional cost, and confusion. Our preference would be the set up of a separate body that would handle the authorisation process for both regulators. Firms would complete an application containing both prudential and conduct information and submit it to that body. The approval body would liaise with whichever regulator was required and in a coordinated manner be the portal for communication between the regulator(s) and the firm. We suggest this body is also used for permission changes, approved persons as well as all communication on levies. It would essentially be the administrator of routine activities leaving the regulators to deal with supervisory activities.

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

Please see comments above.

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

Please see answer to question 19.

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

The paper highlights the need for both PRA and FCA focus on passporting in the new regime as opposed to the current holistic focus by the FSA. What the paper does not say is how the two regulators will communicate with each other and coordinate activities as they will certainly need to do so. The likelihood of passporting firms and EU regulators being contacted by both regulators is high.

A further point to consider is the potential for regulatory arbitrage should the UK environment for product regulation be greater than that applicable to EU firms passporting into the UK.

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

No strong views.

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

We believe this is an area that needs more thought as the potential for unintended consequences or confusion is significant. The paper highlights systems and controls being common to both regulators, yet the risk of these moving in different directions for PRA and FCA regulated firms is real. The same is true for prudential rules supervised by PRA and FCA (in this instance where the rule does not concern a systemic issue). Simple coordination between the two regulators appears to be an inadequate tool to deal with this issue. In our view the solution would be a number of rules common to both regulators that cannot be varied without joint regulatory agreement, i.e., an FCA rule will always be the same as the equivalent PRA rule. This will avoid the rulebook moving apart over time.

In relation to rule waivers, we believe the same issue arises as it would be wrong if the FCA waived a prudential rule for its firms that the PRA would not given the same circumstances. This issue raises a number of considerations that cannot be addressed in a written response.

Question 25: The Government would welcome specific comments on:

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

It would be helpful if HMT provided some examples of areas where the "power of direction" would be likely. Proposals which show solo and regulatory powers derived at an EU directive level being "trumped" by the PRA veto may cause tension between the regulators and confusion for firms. It endorses a regulatory hierarchy with the PRA as preeminent regulator which we feel is unhelpful. Putting the PRA as ahead of European requirements further adds to this perception. We would hope that the likelihood of a power of direction or a PRA veto being used are negligible and that other mechanisms will be considered.

In relation to the proposed "power of direction" over unregulated parent entities, we believe this is also a case where HMT needs to say more about the circumstances in which it feels this direction will be used and in particular, what directions are envisaged. The current regime already concerns systems and control requirements in relation to unregulated holding companies and FSA is actively engaged with them and has been for some time. We believe there needs to be more transparency from HMT on what it wants from the regulatory infrastructure over and above what it has already.

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

The new coordination powers are similar to what already occurs at an EU level in relation to a change of control. We have no concern with these or the proposal on Part VII transfers.

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

We have no strong views

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

We believe there needs to be consistency of approach for fees levied by the PRA and FCA. In particular this concerns how the power to make rules is exercised. We note that the current regime will largely be replicated and that one organization will collect them. We support this approach.

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

We have no strong views

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

We believe the closer links between the FCA and FOS will provide more consistency for firms in terms of a closer correlation between FOS decisions and regulatory requirements. There will also be the benefit of earlier information passing to the FCA as trends in consumer complaints start to emerge. These are both positive developments.

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

We support these proposals

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

The comments in the paper cover all the key issues concerned with international regulatory coordination. This is an increasingly important area as decisions at the EU level in particular can have significant ramifications on UK firms. A close working relationship between the regulators so that a unified approach is given is absolutely key. In addition, there also need to be a close engagement with firms so that their views and concerns on international developments can be taken into account early enough in the international decision making process. All of this concerns a significant investment in resource at the regulator on international *issues that has not always been there. At a time of major UK change it is important that commitment is made to ongoing focus on this important area*