THE UKCARDS ASSOCIATION

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14 April 2011

Re: A New Approach to Financial Regulation: Building a Stronger System

The UK Cards Association is the leading trade association for the cards industry in the UK. The Association is the industry body of financial institutions who act as card issuers and/or acquirers in the UK card payments market. It is responsible for formulating and implementing policy on non-competitive aspects of card payments. Members of The UK Cards Association account for the majority of debit and credit cards issued in the UK, issuing in excess of 56m credit cards and 85m debit cards, and covering the whole of the plastic transactions acquiring market.

The Association promotes co-operation between industry participants in order to progress non-competitive matters of mutual interest and seeks to inform and engage with stakeholders to advance the industry for the ultimate benefit of its members' consumer and retail customers. As an Association we are committed to delivering a card industry that is focused on improved outcomes for the customer.

We welcome the opportunity to respond to this consultation and would also look to assist HMT as the new regulatory regime is developed.

In responding to this consultation document, The UK Cards Association has restricted its response to comments on the Financial Conduct Authority together with its interface with other regulators and the impact of European/international issues, as these areas will be of most direct relevance to our Members.

We recognise that the proposals for the PRA will be important to our Members, but as these are not specific to the card business, we would defer to our Members' individual submissions on the wider regulatory implications and prudential regime.

Should you require any further details or have any queries, please do not hesitate to contact me.

Yours sincerely

Jacqui Tribe
Manager, Legal, Regulatory & Schemes

Chapter 1 – Introduction

The UK Cards Association supports the proposed strategic and operational objectives as set out in this section of the consultation. In particular, we are pleased to note that the over-riding principle is one of 'protecting and enhancing confidence in the UK financial system'.

HM Treasury will be familiar with the view of the Association and its Members regarding the future of credit regulation. For the avoidance of doubt, the card industry supports the move to a single regulator. However we remain to be convinced that a move to a FSMA-style principles based regime would be of benefit to stakeholders. We would therefore promote an alternative approach which looks to build on the strong consumer credit regime that exists today (our response to the consultation Reforming the Consumer Credit Regime, refers).

We welcome recognition of the significant and ongoing activity taking place in Europe and would wish to ensure that the regulator takes due regard of such activity so as to ensure a coordinated approach to regulatory change and the avoidance of duplication of effort and resource within relatively short timeframes. Where there are issues being raised at a European, or wider, level, we would hope that the FCA would, in considering and lobbying on such subject matters, consult with industry to ensure that the key issues are effectively identified and lobbied on for the benefit of UK stakeholders.

Chapter 4 – Financial Conduct Authority

As already indicated, from a cards perspective this is the key area of The UK Cards Association's interest and therefore the one which we wish to focus our attention on.

We support the principle of a single regulator and see this as a positive move to provide a coordinated and consistent approach in consumer credit regulation.

The concept of putting appropriate consumer outcomes at the centre of the regulatory process *(para 4.9)* is one that the industry is familiar with and can support. That said, we are unclear as to the extent that this supports or justifies the FCA being a 'consumer champion' - a role which we strongly believe should not be undertaken by a body that is intended to be neutral and an 'entirely impartial regulator'. We would therefore welcome views on how these two seemingly conflicting roles can be carried out by the FCA whilst retaining the organisation's integrity.

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

We broadly support the FCA's strategic objective of protecting and enhancing confidence in the UK financial system and this is something the card industry would seek to support through its business models, transparency, and general business practice.

As the Treasury will be aware, the card industry believes that competition and consumer choice is an important feature of the UK's credit market and would wish to ensure that, while the regime and regulator may change as a result of the consultation process, this remains the case. We see the promotion of competition as a key role for the regulator and note that this has also been recognised in the interim report of the Independent Commission on Banking.

As an industry we have maintained the importance of, and need for, consumer protection. However, it is imperative that the consumer's responsibility for borrowing is not overlooked or understated. We therefore support the Treasury's view *(para 4.16)* that the regulator's role should be to secure an appropriate degree of protection where consumers face actual or potential detriment.

With regard to the regulatory principles, we are pleased to see reference to proportionality (4.09) and the concept of the responsibility of consumers for their own choices. We believe these are fundamental to an effective regulatory regime for credit if choice, competition and innovation are valued as the market moves forward.

Financial Crime

We support the proposed role of the FCA in the area of financial crime as defined within the consultation document and welcome the acknowledgement of the importance of liaison with a range of stakeholders who have an interest in this area.

Financial Fraud Action UK is the name under which the financial services industry co-ordinates its activity on fraud prevention, working in partnership with The UK Cards Association, the Fraud Control Steering Group and the Cheque and Credit Clearing Company. As an industry we would welcome the opportunity for further and ongoing dialogue with the FCA as this area of its responsibility develops.

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

We are aware of the FSA's recent consultation on product intervention and understand the need for such powers in the case of what are deemed to be high risk products. However, although the industry would not wish to see products introduced that are detrimental to consumers, there is a need to recognise the role of innovation, technological developments and creativity in further evolving the credit market which may lead to new and differently structured or focussed products being introduced. We do not believe that the role of regulation by the regulator is to inhibit such development and potentially limit the choice available to the detriment of the consumer.

We therefore welcome the proposal that the FCA should publish and consult on a set of principles governing those circumstances under which it will use the new product intervention powers to ensure that the powers are used in an appropriate and proportionate manner reserving the most extreme powers, such as the introduction of a ban, as a last resort and for the most serious cases only.

Chapter 6 – Compensation, dispute resolution and financial education

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

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

In our response to the consultation on reforming the consumer credit regime, we have indicated that there is a significant element of the work conducted by the Financial Ombudsman that is inextricably linked with what happens in the consumer credit market. We believe this to be the case both in terms of the issues that the Ombudsman sees in its case files and the ways in which the credit industry is currently seeing the Ombudsman Service being abused by the likes of Claims Management Companies where loopholes and ambiguous areas in legislation are clearly being exploited.

The UK Cards Association believes that, whilst until recently the regulatory framework within which the Financial Ombudsman Service operated was fit-for-purpose, in the current environment the regime is being abused, particularly whilst there is nothing to dis-incentivise what can only be considered 'frivolous and vexatious' claims. This is to the detriment of lenders, the regulators and, ultimately, the consumer. We therefore believe that there is a very important role that the FCA can play in ensuring a robust structure that is effective for stakeholders and is not open to abuse.

While we recognise the importance of a dispute resolution process that is operationally independent, given the above, we believe there is a strong case for establishing a more formal working relationship with the Financial Ombudsman, i.e. through the auspices of the FCA. This would maximise effectiveness and ensure coordination and a consistency of approach on matters of legal interpretation. In addition this would facilitate an effective mechanism for the timely exchange of intelligence between the appropriate 'authorities' where evidence of misuse is identified.

We support the move towards increased transparency and recognise that this is something that the Financial Ombudsman Service has already identified and is already seeking to address.

Chapter 7 – European and international issues

The UK Cards Association believes that it is important to ensure an effective interface and working relationship between the UK regulator and the new regulatory framework operating within Europe. As the largest credit market within Europe it is essential that the UK voice is effectively heard to the benefit of stakeholders. We would therefore encourage ongoing liaison between the FCA and the UK credit industry in support of lobbying activity in Europe.

As the industry body for cards we would welcome the opportunity for ongoing dialogue with the FCA not only on domestic matters but, equally as important, on European lobbying issue. We would also be pleased to present the findings of the industry's comprehensive evidence base exercise which has been used to support recent industry responses to calls for evidence.

Joint ACE Credit Union Services and UKCreditUnions Ltd response: HM Treasury CM 8012

A new approach to financial regulations – Building a Stronger System

Background

This response is submitted jointly by ACE Credit Union Services (ACE) and UKCreditUnions Limited (UKCU) who represent 110 registered credit unions and study groups across the UK; they vary in type and size, many are community-based, linked to local churches or serve their local communities; others are industrial or associational.

The two trade bodies have a combined membership of 71560 that are based across the four countries of the UK. Irrespective of their size and in addition to the four key objects set out in the Credit Union Act 1979 [S1(3)], they have a common objective in providing a safe and convenient source for all their members to deposit and borrow within a cooperative self-help environment.

Both trade associations have made their member Credit Unions aware of the consultation document through information on the member's section of our respective websites and member's meetings, i.e. annual conference.

We would, on behalf of our member Credit Unions now wish to make the following responses:

Box 2.D: Consultation question

1. **What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools?**
2. **Are there any other potential macro-prudential tools which you believe the interim FPC and the Government should consider?**

It is difficult to evaluate whether the tools set out in the consultation document, that the FPC can take to prevent a future systemic failure, are sufficiently robust to prevent such failure and whether this level of supervision will place too severe limitations on the everyday operations of financial institutions. From the point of credit unions, the systemic risks that may arise are relatively small, but the costs of funding an extra regulatory authority will be a major concern. Credit unions are already facing increasing costs on a number of items of expenditure, but are limited as to how much interest they can charge on loans to members. (However credit unions are not seeking an increase beyond the 2%.)

Box 2.F: Consultation question

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

The proposals in terms of the composition of the FPC, particularly the inclusion of non-bank members to bring in expertise and knowledge from other fields, seem to be appropriate. There is some concern about how transparent the FPC can be in balancing the information it gives to the public whilst guarding against giving information that may give rise to alarm. The consultation

document seems to imply that information which is held back will eventually be released, but it is not clear how the aim to be transparent will work in practice.

Box 2.G: Consultation question

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

The sharing of information and co-ordination between the three authorities will be key to the effectiveness of the new system. It is helpful that the consultation document has set out its views on how this will operate in practice. This could be its strength, but may not be sufficient if roles become blurred over time, or has to deal with a large scale problem in the future, where there is serious banking problem and the FPC has to challenge the financial institutions in a crisis situation. From the credit unions' point of view it is helpful to have a clear proposal that the PRA will have sole responsibility for the regulations (CREDS).

We take the view that one authority should be responsible for authorisation and removal of permission. We are concerned that if this role is spread across two authorities, it would lead to duplication of work, the possibility of conflicting opinions, confusion for firms and extra *costs.*

Box 3.C: Consultation question

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

Whilst credit unions recognise the need for regulations, apart from about 11 very large credit unions, the majority are medium to small in size and can find some of the regulations overly bureaucratic and difficult to meet. The medium/small credit unions usually have few if any employed staff and are largely reliant on volunteers. Volunteers are sometimes dissuaded to serve as directors because of the weight of regulations. There is a continual need for the regulators to ensure that the regulations applied to this group of credit unions is proportionate to the benefits and that the words which appear frequently in the regulations – that they should be "appropriate to the size and complexity" of the firm are applied in practice.

Ace and UKCU are committed to encouraging and supporting the growth of our member credit unions to provide and enhanced service to their local communities. We have had some successes in helping credit unions reach sustainability, including merging where this is appropriate.

Box 3.D: Consultation question

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

No comment

Box 3.E: Consultation 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)?

Our response to Question 5 is relevant to this question also. Whilst we recognise that credit unions are deposit takers and must take responsibility for all that this implies there is very little comparison between a bank and a small credit union with a few hundred members. There must be flexibility in how the rules are applied to credit unions to ensure that they are being managed responsibly, whilst recognising their inherent limitations.

Box 3.F: Consultation question

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

The explanation as to the separateness of the PRA seems to resolve the queries that were raised by others previously.

Box 3.G: Consultation question

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

The mechanisms in FSMA and the additional proposals set out in clauses 3.53 to 3.59 of this document would appear to ensure an appropriate level of accountability for the PRA.

Box 3.H: Consultation question

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

The FSA has operated a good scheme of consultation, although on some occasions it has felt that little account has been taken of the responses it has received. The standing consumer panels for large and small businesses have been very useful as a way of conveying the views of firms to the FSA and influencing decision making. The Bank and the FSA are holding a meeting in May to consult with all the credit unions about the change of regulator and this is greatly welcomed by the credit unions. Consultation is very important as firms subject to regulation and the wider public have much to contribute and it is good to know that consultation measures will continue on much the same basis, although we disagree with the decision not to have a standing consumer panel for the PRA and feel this would be a lost opportunity for the exchange of views.

Box 4.B: Consultation Question

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

We welcome the reforms and the decision to intervene at an earlier stage regarding products.

Box 4.D: Consultation questions

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

The FCA will have a number of functions – engaging more directly with customers and promoting confidence in the financial services; dealing with financial crime; investigating and reporting on regulatory failure; regulating wholesale markets; sharing duel regulation with the PRA for firms outside their remit. Whilst at one level these can be seen as part of the protection of service to the customers, these roles are very different and pressures and high demand in one area may be disadvantageous to another. For example, promoting business on the one hand may conflict with investigating financial crime on the other. The plans for governance and accountability seem appropriate on paper, but the diversity of tasks may make these tasks more difficult in practice.

Box 4.F: Consultation question

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

Some powers will be welcomed to provide additional protection for consumers where there is limited protection at present. However, these are strong powers which could lead to serious repercussions for service providers (and perhaps for customers). It is therefore important that there is consultation about the circumstances in which these new product intervention powers will be used.

Box 4.G: Consultation question

14. The Government would welcome specific comments on:

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

Whilst recognising the need to prevent detriment to customers, the possible threat of high fines greatly concerns credit unions as many are struggling to meet rising costs. A high fine that is appropriate for a large bank is not appropriate to a small credit union. Fines need to be more flexible and to take into account the size of the firm and the level of services it provides.
In general, when judging the performance of credit unions, run largely by volunteers, it could be useful to look at some form of grading or grouping of credit unions that moves away from the current rather crude grading of Version 1 and Version 2, as this could help both regulatory staff and credit union directors to have a clearer understanding of how the regulations, policies etc should be applied to their situation.

Box 4.H: Consultation 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?

No comment

Box 4.I: Consultation question

16. The Government would welcome specific comments on:

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

No comment

Box 5.A: Consultation question

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

Whilst the consultation paper has provided clarification about how co-ordination will take place between the two authorities, it is difficult to comment at this point until the MoU is published and we can see how this will operate in practice.

Box 5.B: Consultation 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 agree with this action as the PRA is likely to have greater knowledge about a failing firm and may be able to assist the firm in improving its stability or in the case of credit unions, transferring its engagements to another credit union, or at least move to be being able to close down in an orderly way.

Box 5.C: Consultation questions

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

We prefer the alternative approach where one authority (either the FCA or the PRA) are charged with the processing of applications for those firms for which it will be the regulating authority. This

will avoid confusion for firms and ensure that a detailed knowledge of the firm making the application prior to registration will then be available to the authority responsible for on-going regulation.

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

With regard to variation of permissions we feel that each authority should be responsible for deciding on the varying of permissions of firms it regulates and also that the present OIVoP and WoP arrangements should continue.

For credit unions it is vital that regulatory staff with sound knowledge and experience continue to be involved in authorisation and variation decisions, due to the special nature of these firms.

Box 5.D: Consultation question

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

We feel duel decision making on approved persons is a recipe for delay in decision making, confusion for firms applying for approval and will lead to duplication and extra costs. We feel that one authority should be responsible for those it regulates, but can seek advice from the other where there are any concerns or grey areas.

Box 5.E: Consultation question

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

No comment

Box 5.F: Consultation question

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

We welcome the inclusion of a section on mutuals and that it proposes to modify the consultation requirements for both the PRA and FCA regarding cost analyses and their effect on such firms.

With regard to the registration of credit unions allocating registry powers to the prudential regulator seems sensible.

Box 5.G: Consultation question

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

At what point will consultation take place with firms about proposed new rules or changes to rules? It could be helpful to firms to be aware of any disagreement between the authorities when responding to proposals.

As for approved persons, the waiver of rules should be made by the regulating authority, with consultation between the two authorities' only taking place where there is an issue of concern, to avoid duplication and confusion.

Box 5.H: Consultation 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?**

No comment

Box 5.I: Consultation questions

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?

No comment

Box 5.J: Consultation question

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

No comment

Box 5.K: Consultation question

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

It is vital that the annual fee structure relating to credit unions continues to be based on the same formula as agreed with the banks and building societies and also continues to take into account their size and ability to pay. As stated previously in this response, the majority of credit unions are small/medium in size (and are struggling to survive I think this point should be removed as it could give rise to the perceived need for more intense regulation and subsequent fees as we would be deemed a higher risk!), faced with large increases in fees for insurance, technology, auditing, accommodation costs and the annual fees paid to the FSA including FOS and FSCS. (I suggest the remaining sentences are deleted - The interest charges they can make on loans are restricted to 2%. The fees must be commensurate with their ability to pay.)

Box 6.A: Consultation question

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

The proposed arrangements appear to satisfy previous concerns raised by others by setting out which authority will be responsible for particular rules/functions of the FSCS.

Box 6.B: Consultation questions

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

It seems appropriate for the FCA to take on the functions of the FSA. Transparency is important. The FOS newsletter, in particular, is very useful to practitioners in understanding how the FOS assesses and resolves complaints.

Box 6.C: Consultation question

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

An audit by the NAO will strengthen their accountability.

Box 7.C: Consultation question

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

No comment

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April 2011

Financial Regulation Strategy
HM Treasury
1 Horse Guards Road
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Dear Sir/madam

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

This response is submitted by Unite the Union. Unite is the UK's largest trade union with 1.5 million members across the private and public sectors. The union's members work in a range of industries including financial services, manufacturing, print, media, construction, transport, local government, education, health and not for profit sectors.

Unite is the largest trade union in the finance sector representing some 150,000 workers in all grades and all occupations, not only in the major English and Scottish banks, but also in investment banks, the Bank of England, insurance companies, building societies, finance houses and business services companies.

Unite welcomes the opportunity to contribute to this consultation paper and further welcomes the acknowledgement contained that "financial firms are never again allowed to take on risks that are so significant and so poorly understood, resulting in such severe economic consequences for businesses, households and individuals." (para 1.5)

Unite is aware of the damaging consequences such unfettered risks have had on peoples' lives and on our members specifically across a wide range of industrial sectors. SMEs are struggling to access affordable finance, the public sector is facing unprecedented cost cutting measures, unemployment, at 2.5 million, is at a 17 year high, around 1 million young people are unemployed and according to the ONS, the finance sector itself lost around 100,000 jobs between Q1 2008 and Q1 2010. [1]

[1] http://www.statistics.gov.uk/statbase/TSDdownload2.asp

It is vital that the regulatory function is robust, resilient and focused and above all is independent and able to provide suitable deterrent measures and appropriate penalties to discourage risky behaviour in order that future crises, should they arise, are less likely to be as destructive across the wider economy.

In the newly proposed 'conduct-focused' environment, Unite does however remain disappointed that HM Treasury has failed to provide the opportunity to take account of the views of the workforce in contributing to the debate surrounding good or bad practice within the sector.

It became apparent from evidence provided by Unite to the FSA on Pure Protection and particularly regarding sales versus service, that employees were placed under considerable pressures to attain targets to obtain individual and group bonuses which risked some customers being sold inappropriate products.[2]

It is important to provide an environment where inappropriate behaviours can be reported to an independent authority, without compromising the integrity or position of the employee. The new approach should therefore allow for the opportunity for the employee voice to be heard at a strategic level.

Employees within the sector may have information concerning practices and procedures which may not necessarily be in the best interests of customers or wider public interests; some of which may require a sensitive and confidential approach. Unite is therefore also seeking clarification on how individuals with sensitive information, such as whistleblowers, can come forward in a safe and trusting environment in order to expose unfair or bad practice without jeopardising their career opportunities.

Consequently Unite sees a role for a workforce representative on the FCA to provide additional input from an employee perspective on issues surrounding consumer protection and conduct administration and would be happy to discuss this issue further with HM Treasury.

Yours faithfully

David Fleming
National Officer

For further information on this submission please contact:

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[2] http://www.epolitix.com/fileadmin/epolitix/stakeholders/FSA_Pure_Protection.pdf

Dear Sir/Madam,

I write today on behalf of UnLtd, The Foundation of Social Entrepreneurs, in response to the consultation on the reform of the Financial Services Authority.

UnLtd is the largest supporter of social entrepreneurs (key to the government's Big Society agenda), providing funds and business support to over 1,200 people per year.

In our work with a total of over 10,000 social entrepreneurs, it is clear that the current financial regulations and regulatory authority were structured in a way that does not consider the social investment market place.

As such, we thoroughly endorse the Bates Well Braithwaite work (led by Luke Fletcher and copied in above).

We believe that Luke has gone through a process to engage the leaders in the social investment market place and as such provides a set of sector supported recommendations.

Regards,

Jonathan Jenkins

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Please find our response to HM Treasury CM 8012

Box 2.D: Consultation question

1. **What are your views on the likely effectiveness and impact of these instruments as macro-prudential tools?**
2. **Are there any other potential macro-prudential tools which you believe the interim FPC and the Government should consider?**

It is difficult to evaluate whether the tools set out in the consultation document, that the FPC can take to prevent a future systemic failure, are sufficiently robust to prevent such failure and whether this level of supervision will place too severe limitations on the everyday operations of financial institutions. From the point of most credit unions, the systemic risks that may arise are relatively small, but the costs of funding an extra regulatory authority will be a major concern. Our credit unions is already facing increasing costs on a number of items of expenditure, but are limited as to how much interest they can charge on loans to members. We would not wish to increase the maximum interest rate beyond the 2% now in place

Box 2.F: Consultation question

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

The proposals in terms of the composition of the FPC, particularly the inclusion of non-bank members to bring in expertise and knowledge from other fields, seem to be appropriate. There is some concern about how transparent the FPC can be in balancing the information it gives to the public whilst guarding against giving information that may give rise to alarm. The consultation document seems to imply that information which is held back will eventually be released, but it is not clear how the aim to be transparent will work in practice.

Box 2.G: Consultation question

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

The sharing of information and co-ordination between the three authorities will be key to the effectiveness of the new system. It is helpful that the consultation document has set out its views on how this will operate in practice. This could be its strength, but may not be sufficient if roles become blurred over time, or has to deal with a large scale problem in the future, where there is serious banking problem and the FPC has to challenge the financial institutions in a crisis situation. From the credit unions' point of view it is helpful to have a clear proposal that the PRA will have sole responsibility for the regulations (CREDS).

We take the view that one authority should be responsible for authorisation and removal of permission. We are concerned that if this role is spread across two authorities, it would lead to duplication of work, the possibility of conflicting opinions, confusion for firms and extra *costs.*

Box 3.C: Consultation question

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

Whilst we recognise the need for regulations, we would not wish them to become overly bureaucratic and difficult to meet. We only employ three members of staff and are largely reliant on volunteers. Volunteers are sometimes dissuaded to serve as directors because of the weight of regulations. There is a continual need for the regulators to ensure that the regulations applied to credit unions is proportionate to the benefits and that the words which appear frequently in the regulations – that they should be "appropriate to the size and complexity" of the firm are applied in practice. We already have a reliance on our association (UKCU) to keep us updated in regulation changes and would like assurances that they would always be kept in the loop concerning these matters in order that the relevant information gets passed on to us.

Box 3.D: Consultation question

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

No comment

Box 3.E: Consultation 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)?

Our response to Question 5 is relevant to this question also. Whilst we recognise that credit unions are deposit takers and must take responsibility for all that this implies there is very little comparison between a bank and a small credit union with a few hundred members. There must be flexibility in how the rules are applied to credit unions to ensure that they are being managed responsibly, whilst recognising their inherent limitations.

Box 3.F: Consultation question

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

The explanation as to the separateness of the PRA seems to resolve the queries that were raised by others previously.

Box 3.G: Consultation question

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

The mechanisms in FSMA and the additional proposals set out in clauses 3.53 to 3.59 of this document would appear to ensure an appropriate level of accountability for the PRA.

Box 3.H: Consultation question

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

The FSA has operated a good scheme of consultation, although on some occasions it has felt that little account has been taken of the responses it has received. The standing consumer panels for large and small businesses have been very useful as a way of conveying the views of firms to the FSA and influencing decision making. The Bank and the FSA are holding a meeting in May to consult with all the credit unions about the change of regulator and this is greatly welcomed by the credit unions. Consultation is very important as firms subject to regulation and the wider public have much to contribute and it is good to know that consultation measures will continue on much the same basis, although we disagree with the decision not to have a standing consumer panel for the PRA and feel this would be a lost opportunity for the exchange of views.

Box 4.B: Consultation Question

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

We welcome the reforms and the decision to intervene at an earlier stage regarding products.

Box 4.D: Consultation questions

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

The FCA will have a number of functions – engaging more directly with customers and promoting confidence in the financial services; dealing with financial crime; investigating and reporting on regulatory failure; regulating wholesale markets; sharing duel regulation with the PRA for firms outside their remit. Whilst at one level these can be seen as part of the protection of service to the customers, these roles are very different and pressures and high demand in one area may be disadvantageous to another. For example, promoting business on the one hand may conflict with investigating financial crime on the other. The plans for governance and accountability seem appropriate on paper, but the diversity of tasks may make these tasks more difficult in practice.

Box 4.F: Consultation question

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

Some powers will be welcomed to provide additional protection for consumers where there is limited protection at present. However, these are strong powers which could lead to serious repercussions for service providers (and perhaps for customers). It is therefore important that there is consultation about the circumstances in which these new product intervention powers will be used.

Box 4.G: Consultation question

14. The Government would welcome specific comments on:

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

Whilst recognising the need to prevent detriment to customers, the possible threat of high fines greatly concerns credit unions as many are struggling to meet rising costs. A high fine that is

appropriate for a large bank is not appropriate to a small credit union. Fines need to be more flexible and to take into account the size of the firm and the level of services it provides.
In general, when judging the performance of credit unions, run largely by volunteers, it could be useful to look at some form of grading or grouping of credit unions that moves away from the current rather crude grading of Version 1 and Version 2, as this could help both regulatory staff and credit union directors to have a clearer understanding of how the regulations, policies etc should be applied to their situation.

Box 4.H: Consultation 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?

No comment

Box 4.I: Consultation question

16. The Government would welcome specific comments on:

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

No comment

Box 5.A: Consultation question

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

Whilst the consultation paper has provided clarification about how co-ordination will take place between the two authorities, it is difficult to comment at this point until the MoU is published and we can see how this will operate in practice.

Box 5.B: Consultation 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 agree with this action as the PRA is likely to have greater knowledge about a failing firm and may be able to assist the firm in improving its stability or in the case of credit unions, transferring its engagements to another credit union, or at least move to be being able to close down in an orderly way.

Box 5.C: Consultation questions

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

We prefer the alternative approach where one authority (either the FCA or the PRA) are charged with the processing of applications for those firms for which it will be the regulating authority. This will avoid confusion for firms and ensure that a detailed knowledge of the firm making the application prior to registration will then be available to the authority responsible for on-going regulation.

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

With regard to variation of permissions we feel that each authority should be responsible for deciding on the varying of permissions of firms it regulates and also that the present OIVoP and WoP arrangements should continue.

For credit unions it is vital that regulatory staff with sound knowledge and experience continue to be involved in authorisation and variation decisions, due to the special nature of these firms.

Box 5.D: Consultation question

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

We feel duel decision making on approved persons is a recipe for delay in decision making, confusion for firms applying for approval and will lead to duplication and extra costs. We feel that one authority should be responsible for those it regulates, but can seek advice from the other where there are any concerns or grey areas.

Box 5.E: Consultation question

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

No comment

Box 5.F: Consultation question

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

We welcome the inclusion of a section on mutuals and that it proposes to modify the consultation requirements for both the PRA and FCA regarding cost analyses and their effect on such firms.

With regard to the registration of credit unions allocating registry powers to the prudential regulator seems sensible.

Box 5.G: Consultation question

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

At what point will consultation take place with firms about proposed new rules or changes to rules? It could be helpful to us to be aware of any disagreement between the authorities when responding to proposals.

As for approved persons, the waiver of rules should be made by the regulating authority, with consultation between the two authorities' only taking place where there is an issue of concern, to avoid duplication and confusion.

Box 5.H: Consultation 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?**

No comment

Box 5.I: Consultation questions

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?

No comment

Box 5.J: Consultation question

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

No comment

Box 5.K: Consultation question

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

It is vital that the annual fee structure relating to credit unions continues to be based on the same formula as agreed with the banks and building societies and also continues to take into account their size and ability to pay. As stated previously in this response, the majority of credit unions are small/medium in size (and are struggling to survive I think this point should be removed as it could give rise to the perceived need for more intense regulation and subsequent fees as we would be deemed a higher risk!), faced with large increases in fees for insurance, technology, auditing, accommodation costs and the annual fees paid to the FSA including FOS and FSCS. (We agree with UKCU's suggestion that the remaining sentences are deleted - The interest charges they can make on loans are restricted to 2%. The fees must be commensurate with their ability to pay.)

Box 6.A: Consultation question

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

The proposed arrangements appear to satisfy previous concerns raised by others by setting out which authority will be responsible for particular rules/functions of the FSCS.

Box 6.B: Consultation questions

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

It seems appropriate for the FCA to take on the functions of the FSA. Transparency is important. The FOS newsletter, in particular, is very useful to practitioners in understanding how the FOS assesses and resolves complaints.

Box 6.C: Consultation question

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

An audit by the NAO will strengthen their accountability.

Box 7.C: Consultation question

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

No comment

A new approach to financial regulation: building a stronger system

Response by Virgin Money

Virgin Money

Virgin Money is a rapidly growing UK financial services business. Nearly three million customers have Virgin Money branded products. Our offering includes retail banking services, payment cards (credit cards and prepaid cards), savings and investment products (stakeholder pensions, cash ISAs, and simple unit trusts), general insurance products (motor, home, travel, and pet) and life insurance products.

The business was founded in 1995 and has since developed a reputation for innovation and excellent customer service. Virgin Money aims to bring simplicity, transparency and fairness to the UK retail banking market. Our objective is to provide a better, different form of banking to customers, increasing competition in the sector. Virgin Money's aim is to make 'Everyone Better Off' in the way it does business by offering good value to customers, treating employees well, making a positive contribution to society and delivering a growing profit to shareholders.

Virgin Money is supportive of the Government's proposed approach to building a fit for purpose new financial regulation structure and we appreciate the urgent priority that is being assigned to this initiative.

Before responding to the specific questions posed, there are some particular points of principle that we believe are key to the success of the planned approach.

Clarifying regulatory responsibility – We support the objective of achieving clarity regarding regulatory responsibility for financial stability. While we hope that the UK regulatory system will not again have to address as serious a threat as was posed in late 2007 and 2008, there has to be clear regulatory line of sight to ensure that, when future crises do arise, all parties understand responsibilities and are empowered to take swift and informed decisions about the urgent steps to be taken. We believe that bringing both "macro" oversight and "micro" prudential responsibility for systemically important firms under the direction of the Bank of England is a clear step towards achieving this outcome.

Appropriately skilled staff – In order for each of the FPC, the PRA and the FCA to achieve their oversight and protection of the UK economy, and to successfully undertake the decisive judgement led approach expected of them, they will require high quality staff that can understand and act on information available to them. While it is recognised that there is a need for a change of culture, experience of such changes suggests that they are difficult to implement. In particular, people have a tendency to revert to working methods which they know best therefore the intended change in culture will require staff with relevant skills, particularly in exercising judgement. We strongly believe that the importance of retaining and recruiting the appropriate quality of staff should be given a high propriety as part of the work to embed the new framework. We draw attention to this issue where relevant in several of our detailed responses.

Promotion of competition – We believe that the establishment of an objective for the FCA to promote competition will benefit consumers and focus regulatory attention on the effective oligopoly in retail markets enjoyed by the major incumbents in the banking industry. We expand on this area within the detail of our submission.

Cooperation between firms and regulator – We recognise the objective of the more intrusive response but hope that it will not lead to relationships that are less open and constructive and, hence, less likely to arrive at optimal outcomes for customers.

Cooperation between regulatory bodies – It is vital for the success of the new structure that strong relationships are maintained between the different bodies. We appreciate the recognition given to this issue within the consultation. While considerable thought has gone into the mechanisms, they will be as effective as the skills and qualities of the people undertaking the responsibilities. In addition, we believe that the PRA's veto should be exercised with great care and, as we note in our detailed responses, its use should trigger some form of public scrutiny to better understand the area of misalignment between the separate regulatory bodies.

Responses to specific questions

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

The set of tools proposed seems reasonable and pragmatic. We are particularly supportive of the recognition that provisions will be required to allow urgent amendment to secondary legislation if the situation requires it.

The key to the successful use of the toolkit is likely to be the quality of its implementation and the skill and competence of the Bank of England and PRA staff tasked with utilising it. For this reason, as emphasised in our introductory comments, we believe that the quality of staff that the new regulator has at its disposal and the training provided to them will be very important in achieving the Government's objectives in this area.

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

We can see no obvious omissions from the set of tools presented in the paper.

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

The proposal for records of meetings to be published and for the FPC to publish twice yearly financial stability reports should provide transparency of regulation and also give firms and other stakeholders a clear understanding of the FPC's view of the macro stability of the financial system at a point in time.

This in itself should provide useful direction and guidance to aid those tasked with making decisions around the prudential stewardship of firms.

The planned composition of the FPC appears to include appropriate stakeholders.

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

Settlement systems, payment systems and recognised clearing houses play an important part in the UK financial services system. It seems to us that it is sensible to align the regime applying to securities settlement systems and clearing houses with that which already applies to recognised payment systems given that the failure of all of these transmission mechanisms could compromise the financial stability of the UK.

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

The strategic objective of focusing on financial stability is clearly appropriate. Looking at the detail of the objective, it could be argued that "contributing to the promotion" of the stability of the UK Financial system could potentially be open to misinterpretation. An objective such as "ensuring" the stability of the UK financial system, while more direct, could have the impact of failing to recognise the primary responsibilities of firms and their senior management in achieving this outcome. An alternative approach could be to propose that the PRA's objective is framed in a form such as "***directing and supervising approved persons to maintain the stability of the UK financial system".***

The principles are sound and in particular recognise the responsibilities on both firms to manage their affairs prudently and on consumers for accepting an appropriate degree of responsibility for their actions.

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

The scope proposed for PRA regulation seems sensible. A distinction is rightly made between the more immediate liquidity risks presented by banks in contrast with insurers where the risks of financial instability will generally have longer term financial impacts on consumers. We support the view that insurers can present a systemic financial risk and agree that the PRA should include them within the scope of their regulation. Lloyds of London does present specific risks and is integral to the management of financial risk within the UK and wider economy so we support the view that it should also be within the scope of the PRA's oversight.

Firms dealing in investments as principal pose particular threats both to their own financial positions but also to the stability of market counterparties that they deal with. We would support the view that the PRA should have a means of proportionate oversight of firms that have that regulatory permission.

Clearly there are EC Directive based requirements that stipulate that certain financial services groups are supervised on a consolidated basis. We believe that it is important that the PRA continues to monitor both relevant groups and their constituent solo regulated firms on a consolidated basis. We believe this is important as other regulated and potentially non-regulated firms in the same group as a PRA regulated firm could have a significant impact on

the longer term financial stability of higher risk firms intended to be overseen by the PRA on a solo basis. It would seem more efficient both for the regulators and firms if, where PRA supervises a consolidated group, that it should also oversee constituent firms on a solo basis that would otherwise be prudentially supervised by the FCA.

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

It is important that the PRA has strong powers to achieve its objectives. Often in times of firm specific or macro financial stress the need to be able to act rapidly and decisively will be of paramount importance. The PRA may need to make rapid decisions in challenging conditions often with less than perfect information. Key to the regulator's ability to make effective decisions will be the quality and experience of the staff involved at all levels of the organisation. For this reason, we strongly believe that one of the most effective mitigations and controls over sub-optimal regulatory decisions will be the capability and competence of the staff available to the regulator. We strongly believe that the importance of retaining and recruiting the appropriate quality of staff should be given a high propriety as part of the work to embed the new framework.

While it is appreciated that urgent steps may need to be taken to achieve financial stability, considerations around public censure and enforcement actions against individuals and firms would not necessarily require the same degree of urgent resolution. While it is important that there is no unnecessary delay in taking actions to achieve a financial stability outcome, in the interests of fairness, we believe that an appropriate period of time should be taken to adequately investigate matters of personal and organisational culpability including a right of response before regulatory conclusions are made public.

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

The governance framework seems a significant improvement on current arrangements and should prevent the risk of regulatory underlap or a lack of cohesion between "macro" and "micro" prudential oversight.

An area that may benefit from further articulation is the relationship between the PRA and the various parts of the Bank of England that make decisions about the provision of emergency liquidity to firms.

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

The accountability mechanisms for the PRA appear transparent, rigorous and extensive. In addition to the right of audit by the National Audit Office (NAO), accountability to the Public Accounts Committee, and the Treasury powers to order independent inquiry, the requirement for a publicly available report to be laid in front of Parliament in the event of regulatory failure will be a significant measure to improve transparency in financial regulation and provide important guidance as to whether further enhancements are needed either within the governance of firms or the regulatory architecture.

The fact that reports may contain confidential information should not be used as an unnecessary barrier to relevant information being put in the public domain when there is a public interest justification. Disclosure of this type is a powerful tool, but one that should be used carefully. It seems reasonable that individuals or entities cited in the report should have the right of advance sight of statements or allegations made about them and the opportunity for any reasonable comment they wish to make to be published within or as an addendum to the report.

The relevant authorities should consider carefully any representations made that publication could be market sensitive, prejudice ongoing legal proceedings or subject individuals to excessive damage to their reputation.

Appropriate and balanced disclosures should be made if justifiable and a reasonable argument can be made that they promote the regulator's objectives or if there is a wider public interest.

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

The proposals seem appropriate and reasonable. It seems acceptable that the PRA does not have its own consumer panel providing that, where relevant issues are raised via the FCA's consumer panel, the mechanisms for communication and liaison between the two regulators are employed to ensure that the PRA is suitably advised and, where relevant, seen to respond.

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

The strategic and operational objectives appear appropriate. The FCA will have an extremely wide remit covering conduct of business, financial crime, lower risk prudential oversight, listing rules and monitoring of markets in addition to the new objective to promote competition. Given the breadth of the FCA's scope, it seems a pragmatic to acknowledge that also attempting to cover the equivalent of the FSA's objective to promote public understanding could create an unacceptable degree of stretch in organisational capability. While the FSA made significant progress on this objective, it seems more efficient for that remit to pass to the CFEB.

We look forward to more detailed proposals on the approach to be taken for the CFEB's delivery of its objectives and to better understand the Government's plans for addressing financial inclusion issues.

The Independent Commission on Banking (ICB) was asked to consider measures to improve financial stability and competition. The ICB Issues Paper pointed out that there has historically been a degree of tension between financial stability and competition. We suggested to the ICB that, after a period in which financial stability has, understandably, taken priority, there is now a need to give greater attention to competition in retail banking.

We previously expressed concern that "have regard to competition" requirements might leave competition issues subordinated to primary objectives such as financial stability (which allowed Lloyds TSB to buy HBOS without a normal competition review) or maximising value (which meant that the RBS retail banking assets were sold to the highest bidder, subject only to meeting a single market share criterion set by the EU).

We believe that the solution put forward (in paragraphs 4.20 to 4.22) seems sensible and should work in practice. The first operational objective of facilitating efficiency and choice should support the basic elements of competition, it is consistent with the strategic objective of protecting and enhancing confidence in the UK financial system and it can be applied to the other operational objectives. Indeed, it should constrain the second operational objective from leading to outcomes that are too pro-consumer, and the third operational objective from outcomes that are too risk-averse. These two unintended outcomes could reduce the commitment of providers and so could restrict, in the first case, choice and, in the second case, efficiency.

However, we note that both the TSC and the ICB have called for the FCA to promote competition by making it a primary objective. We also note Andrea Leadsom's suggestion, in her paper "Boost Bank Competition", that the FCA should establish a Financial Competition Commission, and the ICB's comments about price discrimination, for example in PCAs. We suggest that further consideration should be given to each of these proposals.

While supporting the importance of competition relative to financial stability, we suggest that consideration should be given to the following issues:

- The effectiveness of the proposed approach will, in practice, depend on the people delivering it at the FCA. As in other areas of the intended new approach to financial regulation, effective regulation of conduct by the FCA will require judgement rather than tick-box compliance. Earlier intervention, as proposed, sounds sensible, but will require proper understanding of the issues, and good judgement, possibly based on incomplete information.

- Achievement of the FCA's operational objective of efficiency and choice should be supported by simple financial products, if implemented broadly as suggested in the consultation paper. In the same way that CAT products and stakeholder pensions had positive impacts on pricing across their product markets, simple financial products, with the discipline of competition through comparison websites, should encourage efficiency and, by making it easier for new entrants, increase choice.

- Although we believe that the strategic and operational objectives proposed for the FCA are sensible and workable, we suggest that there should be a review after an initial period, and from time to time thereafter, as was proposed for micro-prudential regulation.

- We note recognition (in paragraph 4.22) that the PRA, while not responsible for competition, will be involved in "key regulatory areas potentially impacting on competition", and that the PRA will be able to veto FCA actions. This underlines the need to achieve the right balance between the potentially conflicting objectives of financial stability and competition. We look forward to the consultation paper from BIS (mentioned in paragraph 4.95) on reforms to the UK competition framework.

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

In terms of both governance and accountability, as per our responses in respect of the arrangements for the PRA at questions 8 and 9, we are supportive of the measures being put in place for the FCA with the qualification that care should be applied to the disclosure of confidential information.

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

We agree that there is a case for some controls on financial products as well as on their distribution. We agree that, in designing and pricing financial products, providers should not seek to exploit consumers' lack of understanding or difficulty in anticipating possible future outcomes. We believe that this is particularly important for consumers who are less affluent or less financially confident.

In our response to the simple financial products consultation paper, we suggested that there should be some general principles applicable across all simple financial products (including principles for product pricing), and some standard features and some comparison features for each product category. We suggested that simple financial products should offer "quality" and "reliability".

We also suggested that the availability of simple financial products, along with financial education and financial healthchecks by the CFEB, should lead to improvements in product design and pricing across the relevant product categories.

If there is to be a degree of intervention in the design and pricing of financial products, it seems sensible for it to be implemented through supervision of providers' own new product approval processes and pricing processes, rather than by approving each new product and price change. This approach would mirror supervision under Basel II of banks' own risk models used to estimate their capital requirements for various risks, rather than require banks to have a model for regulatory purposes different from the one used for internal purposes.

We have, however, some comments about some aspects of the FSA's proposed product intervention regime:

- Although not focusing on advice, the Discussion Paper reflects the FSA's traditional focus on products such as pensions, investments and mortgages which are generally sold through advisory channels, but does not recognise the growing importance of mass-market financial products sold online, including through comparison websites, without advice. We believe that the latter model, which is appropriate for simple financial products, can make important contributions to the FCA's two key measures of efficiency and choice, but noted in our response to the simple financial products consultation paper that it is necessary to guard against possible behaviours which could be used by providers to enhance their rankings on comparison websites.

- In the simple financial products consultation paper, there was recognition of the need to build trust with providers, and gain their support, by reassuring them that they will be allowed to charge fair prices rather than capped prices, and that, in relation to possible risks of mis-selling, it is recognised that it is better for many people to have a

good financial product, even if it is not the best, than no product at all. We recommend that consideration should be given to these points in the design and implementation of the FCA's approach to product intervention.

14. The Government would welcome specific comments on:
• the proposed approach to the FCA using transparency and disclosure as a regulatory tool;
• the proposed new power in relation to financial promotions; and
• the proposed new power in relation to warning notices

Transparency and disclosure are important regulatory tools. Key to their use is the meaning that consumers, the industry and commentators attach to public statements made. Communications that would not help inform consumers' choices or are open to misinterpretation will not aid the regulator in achieving its objectives. It appears sensible that, as proposed, the regulator will have discretion as to the use of these powers.

We would hope that firms that are generally considered to have strong systems and controls and maintain an open and cooperative relationship with their PRA and FCA supervisory teams should be able to avert the need for these formal tools to be utilised.

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 note (in paragraph 4.97) the proposal not to give the FCA powers relating to prohibitions on cartels and abuse of dominance, and the reasons for this. However, there is a widespread view that retail banking is an effective oligopoly, or at least a complex monopoly, and that this will ultimately have to be addressed if retail banking is to provide competition that improves efficiency, and encourages new entrants to expand consumer choice.

Paragraphs 4.92 and 4.93 discuss the important example of PPI, suggesting that an explicit competition mandate would have allowed the FCA to intervene more swiftly, and supporting the case for product intervention made in the recent FSA consultation paper.

More generally, in our response to the ICB Issues Paper, we expressed concern that, although there have been more than twenty investigations of various aspects of retail banking over the last ten years, many have taken a long time, and few of them can be said to have delivered an outcome that was obviously good for consumers. We believe that there is need for a faster and more effective approach to dealing with competition issues in retail banking. We therefore believe it sensible to consider giving the FCA powers relating to competition (as proposed in paragraph 4.94). Of the two alternatives suggested (in paragraph 4.96), we prefer Market Intervention References (MIRs) to super-complaints:

- The threat of a MIR reference by the FCA should be a powerful incentive encouraging providers to reach voluntary agreement, although it is disappointing that there has been a recent tendency for large banks with ample resources to "play the long game" - for example in PPI, insufficient funds charges and credit card interchange fees. To achieve more rapid resolutions after fairly considering the interests of both providers and consumers, we believe that it is important that the teams considering the issues have strong experience in financial services as well as proven credentials in making judgements and reaching voluntary agreements. We support the concept of a

specialist approach to competition issues in financial services, suggested by Andrea Leadsom.

- Super-complaints can encourage media comments that are not helpful to trust and confidence in financial services, especially given the ongoing popularity of "bank bashing" (whether deserved or not). They can lead to adversarial engagement which is not conducive to reaching voluntary agreements. We believe that society would benefit from more open relationships between banks and their regulators. Although the 90 day timetable is attractive, we see no reason why an equivalent deadline cannot be incorporated into an MIR process.

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

While believing that it is important that these areas are subject to strong regulatory oversight, Virgin Money has no specific comments in this area.

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

The mechanisms proposed appear effective. The key to success will be adequate implementation in practice. We would urge the regulators not to underestimate the resource burden involved in maintaining effective coordination between the two bodies.

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

It seems necessary that that there should be a final decision maker in a situation where the objectives of the two organisations potentially conflict. Given the importance of achieving financial stability within the UK financial system, which ultimately is of vital importance to consumers, it appears appropriate that the PRA should be the body with the right of veto. An alternative approach would be for both regulators to make representation to a separate body that would arbitrate an outcome. However, given the immediacy of decision making that is critical in a time of crisis, an arrangement of this type would risk delay and ultimately jeopardise the overall goal of financial stability. We would anticipate that situations where the power of veto would have to be utilised would be rare and would be indicative of a particularly problematic situation. We are concerned that financial stability considerations should not easily "trump" competition considerations, as it did in the acquisition by Lloyds TSB by HBOS.

In the interests of transparency we would recommend that, as well as being referred to in the two organisations' periodic public reports, situations where the veto is exercised should trigger an automatic scrutiny mechanism – for example either an enquiry or a NAO review so that the root cause of any misalignment can be understood and addressed.

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

In our view the key consideration is that the authorisation process should be clear, efficient and authorisations be achieved within a reasonable time period. A form of shared services model for submission of applications and requests for further information would appear sensible as would a common set of forms albeit that there may be sections that are only applicable to one of the two regulators. A model of this type would appear the most efficient for both firms and for the regulatory bodies involved. We can see no obvious merits to having a two stage authorisation process as, in practice, both prudential and conduct of business permission would be needed to undertake activity. If permission was refused or made conditional on certain actions, it would of course at that stage be important to understand which of the two bodies involved had concerns or conditions to be fulfilled for authorisation to proceed.

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

As noted in our response to Question 18, we believe that any requirement for the use of the PRA's veto should trigger some form of investigation to understand why the two regulators have failed to arrive at a common view.

From a process perspective, as expressed in our response to Question 19, in the interests of efficiency and speed, the use of some form of shared service facility where possible would appear to be of benefit to both firms and the regulators.

In the scenario of either of the regulators looking to enforce Own Initiative Variations of Permissions (OIVoP), it would be vital for the firm to have a clear and direct dialogue with the lead regulator seeking to enact the OIVoP.

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

Our response reflects the views expressed in our responses to Question 19 and Question 20 above.

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

Given the FCA's responsibilities for conduct of business and financial crime, we support the approach proposed.

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

We believe that it is right that the government promotes a level playing field where appropriate but this should not be at the expense of jeopardising the mutual ownership principles that are fundamental to differentiating these organisations in the eyes of customers.

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

The approach proposed seems reasonable.

25. The Government would welcome specific comments on
• proposals to support effective group supervision by the new authorities – including the new power of direction; and
• proposals to introduce a new power of direction over unregulated parent entities in certain circumstances?

As referred to in our response to Question 6, we believe that the PRA should individually regulate all the regulated firms within a consolidated regulatory group. This would ensure that the PRA has a complete picture of the wider financial position of firms that the higher risk entities normally subject to PRA supervision may have interdependencies with.

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

We agree that it is preferable for the PRA to approve change of control applications for dual regulated firms with appropriate consultation with the FCA. It seems entirely practical that the PRA assumes the regulatory responsibility for Part VII transfers with the courts retaining the ultimate decision as to whether to approve the business transfer.

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

The proposals appear to us to be effective and we agree that the FCA should have the power to commence proceedings against a dual regulated firm with the relevant consents of the Bank of England and the PRA. The requirement for the FCA to consult with the PRA prior to application for proceedings for FCA regulated firms that form part of a PRA regulated consolidated group also seems reasonable.

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

While there may be a variety of enhancements that could be made to current fee and levy collection processes, given the extent of the changes proposed by the transfer of responsibilities as part of the new regulatory architecture, we agree that it is appropriate not to make any significant change in this respect as part of the restructure and to replicate current arrangements. We would recommend a further reappraisal of the fee and levies model once the new structure has been established for a reasonable period.

It seems practical for the FCA to raise the FOS and CFEB levies and for FSCS levy responsibility to be allocated between the PRA and FCA in relation to the relevant sub-scheme.

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

We support the recommendation that the FSCS MoU is converted to a statutory requirement rather than remaining as best practice. We believe that each of the organisations' periodic

reports should contain issues relevant to the ongoing liaison activity and whether it has been undertaken on a basis consistent with arrangements set out in the relevant MoU.

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

We endorse the proposal that, with the heightened powers being proposed for the FCA, it should be more practical for FOS to focus on individual disputes on a case by case basis. We also agree that with the proposed new obligation on FOS to pass relevant information to FCA and the requirement for FCA to have regard to that information, combined with the new stance of earlier intervention by FCA, better outcomes should be achievable for consumers with less need for post sale redress to be sought and provided.

These proposals should allow FOS to continue to exercise its important role of arbitration of disputes on a case by case basis. In addition, the proposals should enable the FCA to provide guidance to all stakeholders on systemic issues of customer detriment based upon relevant information without the risk of their view of a fair means of achieving appropriate customer outcomes being systemically challenged at a later stage. We believe that this model should create a more empowered regulator and provide better clarity for both consumers and firms.

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

We are fully supportive of the proposal for FSCS and FOS to have a statutory obligation to publish annual plans on which they should consult as CFEB is already required to do. It is also entirely appropriate that each of the bodies is obliged to report annually on its performance in relation to the prior year's plan.

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

The approach seems sensible although we believe it is vital that the PRA and FCA devote adequate resource to coordinating their activities and agreeing common stances on issues to ensure that the UK's interests are protected on matters of European and wider international engagement.

Dear Sirs,

I submit my thoughts below as a small private investor in the UK financial industry. Normally I would write to you but, as the last day of submission is 14 April and the Spanish mail system so appalling, I have decided to email you instead.

While I disagree fundamentally with a lot of the detail in your paper, I will focus my comments on the Investor/Depositor, without whom there would be no financial industry to speak of.

I agree that the current system of financial regulation is flawed and needs to be changed as a matter of urgency. These days, small investors such as myself can invest anywhere in the world, and there is no golden rule which says that we are duty bound to invest in the UK.

It follows that a proper system of financial compensation should be put in place if the UK is to regain its pre-eminent position as global leader. Such a system should be easy to understand, transparent and timeous.

I put it to you that the proposed system does not do this. So when my investments mature, I will be forced to think long and hard about whether and where I should re-invest them.

In my particular case, I am still waiting for justice after almost a year. As I'm sure you know, justice delayed is justice denied.

I'm also reasonably certain that the 80/20 principle applies to the UK - 20% of the investors/depositors have 80% of the money,and vice versa. It follows therefore that perhaps most of your 360 000 complaints relate to small claims of under £50 000.

There is thus a case for the establishment of a small claims court to decide on such cases within say six weeks. I find it ridiculous that a small claim such as mine is clogging up the system for more than a year.

Perhaps you should also regulate, and bring in harsh penalties, against staff members (such as Ms L. Wilkins of the FSA) who tell downright lies and give misleading information? Also rules for speeding up the process; the FSCS candidly states that part 1 of their investigation will take "several months", part 2 "around six months", while part 3 is open-ended. As an old-age pensioner, I could be dead before they have completed their enquiries!! Maybe that's their plan!

Finally, can I also suggest that you look at other markets (such as Australia, New Zealand, Norway, Canada etc) and study how they re-assure investors?
I see little point in continually re-inventing the wheel.

I hope that you will give some attention to these points.

Yours sincerely,

A J Waters

CAIB (SA), AIB (Z).

Dear Sirs,

I appreciate this email will arrive just after the 14th April 2011. This is because of the limited publication of your consultation to many already authorised and regulated organisations.

However, my point is very direct and succinct.

As an authorised and regulated individual operating within a dual regulated market any eventual dual regulation is of little or no consequence to overall business costs.

Claims Management Companies (CMCs) have operated for several years with the FSA regulating certain areas of the business and the MoJ others.

I trust your offices will not hesitate to contact me should you seek to hear evidence of the facts when operating with dual regulation.

It is within my experience and knowledge that many FSA authorised companies appear to operate with a view to that getting caught is wrong rather than what they are doing is wrong.

I urge very close and stringent regulation in order to being consumer confidence to the long disrespected financial services trade.

I thank you in anticipation.

Kind regards,

Roland Waters
Crashcare Group

A new approach to financial regulation: building a stronger system

DATE: 14 April 2011

FROM: Dominic Lindley, Which?; John Holmes, Which?; Tori Henderson, Which?

EXECUTIVE SUMMARY

1. We welcome this consultation and the proposed reforms which will involve a fundamental shift in approach to consumer protection and prudential regulation. The consultation contains many commendable proposals to deliver improvements for consumers and to create a more open, transparent and accountable conduct regulator. We strongly support the presumption of transparency, an increased role in promoting effective competition and the product intervention powers. However, we continue to have concerns about the interaction between the FCA and the PRA and the ability of the decisions of the PRA to take primacy. These could be dealt with by removing the ability of the PRA to veto a decision by the FCA, giving the PRA a specific duty to promote competition and ensuring that the PRA has access to views from a Consumer Panel.

Financial Conduct Authority

2. The ultimate purpose of regulation is to ensure that markets work well for consumers. We welcome the intention to place appropriate consumer outcomes at the centre of the regulatory process and for the FCA to use early and proactive intervention to ensure that the interests of retail customers are protected. In order to achieve this aim we believe the following measures should be adopted.

- The first operational objective should read "Facilitating, efficiency, value for money and meaningful choice in the market for financial services". We have a concern that the regulator may interpret the current wording as giving them a mandate to encourage a proliferation in the number of products in the market. This would have a negative impact on consumer protection, complicate decision making and work against effective competition.

- The FCA should have a duty to promote effective competition and ensure that competition is effective at protecting and benefitting consumers. It is vital that the regulator should have the remit and tools to achieve this aim. It should have powers to make Market Investigation References to the competition authority. Designated bodies such as Which? should be given the ability to make super complaints to the FCA. The regulator should have the power to tackle unfair ancillary / default charges which distort competition such as those on

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T 020 7770 7000
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www.which.co.uk

unauthorised overdrafts.

- The concept of consumer responsibility should not be extended beyond the common law principles. We would oppose any attempts by those in the industry to argue for a responsibility to be imposed on consumers to understand long and complex disclosure documents.

- The Board should contain a number of individuals with experience and knowledge of consumer issues.

- The FCA should have the power to regulate products and to take immediate action to prohibit the sale of a particular product or to control a particular product feature.

- Proper accountability can only come alongside improved transparency, so it is very important that the legislation does not constrain the FCA. Section 348 of FSMA should be removed. We believe that there should be a presumption in favour of disclosure of information by the regulator.

- The FCA should take a stronger approach to enforcement with higher financial penalties and action against individuals. FSMA should be amended so that revenue raised from financial penalties can be used in ways which benefit consumers (such as funding increased access to debt advice and measures to improve financial capability) rather than being returned to firms.

- The FCA should tackle the root causes of consumer detriment such as remuneration structures which encourage mis-selling. It should make greater use of market testing and mystery shopping to test the actual outcomes being received by consumers.

Coordination between the FCA, PRA and FPC

3. Splitting responsibility between three different regulators does not remove the conflicts which can exist between different functions, but merely externalises them. We do not believe that the PRA should be given primacy over the FCA. To permit the PRA to prevent the FCA taking a firm-specific conduct decision sends a dangerous message to the industry that only firms which are small enough to fail without causing damage to financial stability will be forced to bear the full consequences of mistreating consumers. The PRA does not currently have a specific duty to promote competition and we believe that this raises the risks of it preserving existing banks rather than allowing them to face the consequences of their commercial decisions.

4. We strongly object to the proposal to give the PRA the responsibility for specific regulatory duties connected with Part VII applications. In our experience, Part VII transfers involving with-profits funds have led to substantial consumer detriment with policyholders losing out on billions of pounds. Transferring responsibility to the PRA would be a serious mistake which risks a further deterioration in the regulators already woeful performance.

Prudential Regulatory Authority

5. We recommend that the PRA be given a specific duty to promote effective competition. This would help ensure that its focus on not preserving existing institutions, but creating a market where individual institutions face a realistic prospect of failure. It should have an operational objective to limit and remove the implicit subsidy received by the banking sector which distorts competition and disadvantages new entrants.

6. The current supervisory approach to prudential regulation had not been effective. The significant implicit subsidy received by the banking sector has eroded market discipline, distorted competition and encouraged banks to intertwine highly leveraged investment and wholesale banking activity with essential retail banking activities and the payments system. Responsibility for prudence must lie with the banking institution, its management, shareholders and debt providers and not be delegated to regulators. Stability is not created by trying to prevent failure, but by enabling firms to fail in a controlled way. The regulator must change its approach from attempting to prevent failure in all circumstances to ensuring that banks can fail, but without significant harm to their customers, vital banking services or the economy.

7. The PRA will be making a significant number of decisions which will have dramatic implications for consumers. It is vital that the PRA establishes mechanisms to ensure that consumer interests are appropriately represented in its governance structure. We recommend that the PRA should receive input from a Consumer Panel and that the Panel should have the power to make representations to the PRA and gain a written response to its representations. The PRA should also develop a strategy for wider consultation with consumer groups.

Macro-prudential regulation (Financial Policy Committee)

8. We support the introduction of the Financial Policy Committee. The potential impact on consumers of the different macro-prudential tools should be studied by the Treasury and an assessment of the impact included in the FPC's policy statements. The FPC should ask the Consumer Panel to approve its analysis of the potential impact on consumers.

Financial Conduct Authority

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

9. We welcome the intention that the FCA will involve a "fundamental shift in approach" which will use early and proactive intervention to ensure that the interests of retail customers are protected. The ultimate purpose of regulation is to ensure that markets work in the interests of consumers so we also warmly welcome the statement that it will be a 'consumer champion' in the sense of putting appropriate consumer outcomes at the centre of the regulatory process.

10. As noted over the course of many years by Which? the FSA took an approach that was too reactive and failed to put in place the right incentives for firms, make competition work for consumers or ensure that there was a credible deterrent against poor practice. Instead of tackling the root causes of consumer detriment, the regulator sought to control the sales process. It did not focus on (or indeed do much to measure) the outcomes received by consumers. There was an emphasis on disclosure of information, rather than ensuring that consumers could understand and act on this information. Indeed, the volume of information provided can deter consumers from using it effectively. The previous approach led to a number of major problems surrounding issues like Payment Protection Insurance (PPI), endowment mortgages and bank charges. These failures cost consumers and the industry billions of pounds and damaged consumer confidence.

11. The FCA should work to ensure that market forces can work more effectively in the financial services market so that companies which treat their customers fairly and offer good value for money products gain business at the expense of firms which do not. Similarly, it must be made clear to firms, their management and shareholders that a failure to treat customers fairly will have a significant detrimental effect on the firm's reputation and bottom line. It is important that the FCA is given the mandate, powers and tools to deliver improvements for consumers by implementing a more proactive approach which tackles the root causes of consumer detriment.

Strategic and operational objectives

12. Which? strongly supports the move to elevate the importance of competition in the FCA's objectives. As set out in our previous submission, we believe the new regulator should have a duty to promote effective competition which acts to protect and benefit consumers. We believe the decision to focus on the positive outcomes of competition in framing the objectives is sensible. After all, competition in retail banking should be seen as the means to achieve better outcomes for consumers, rather than an end in

itself.

13. However we are concerned about the wording that has been chosen for the first operational objective and would strongly urge the Treasury to review whether the current drafting is appropriate. We believe the objective, as framed, may not go far enough to promote the outcomes we are seeking, and could also work against achieving better outcomes as the wording may be subject to an interpretation that could work against the best interests of consumers. Which? would propose a change to operational objective (a) so that it read "Facilitating efficiency, value for money and meaningful choice in the market for financial services".

Efficiency

14. Which? strongly believes that if the FCA is to be effective in promoting effective competition that delivers benefits for consumers, its objective to facilitate efficiency needs to include a remit to consider the value for money of financial products and services. All too often in financial services, it is difficult for consumers to assess whether they are getting a good deal as they are subjected to charges that are hidden in the small print. This makes it difficult for consumers to compare products, hindering switching. These barriers need to be addressed if the market is to become more competitive.

15. It is unclear from the current consultation document whether the Treasury intends the FCA to have the value for money remit and we would welcome clarity on this issue. We would generally define market efficiency as a situation where consumers are provided with appropriate products and services to meet their needs at the lowest possible cost. If the Treasury does not intend the FCA to consider value for money, we would welcome clarity about how the Treasury would define 'efficiency' in the context of retail financial services.

Choice

16. Which? is concerned that 'facilitating choice' can be interpreted in one of two ways. In the more positive interpretation, from the consumer perspective, it will compel the FCA to follow policies that will enable consumers to make effective choices. These could include approaches such as introducing measures to help the easy comparison of products, and looking at ways to facilitate switching. However the FCA could also interpret an objective to 'facilitate choice' as giving them a mandate to encourage a proliferation in the number of products in the market. This could result in approaches such as reducing regulatory barriers for firms to encourage innovation, or reducing protection around sales processes.

17. Which? is deeply concerned that if the FCA saw their remit as facilitating choice in the second way described, it could not only have a negative impact on consumer protection but also work against the achievement of effective competition. As noted in the OFT study, "Assessing the effectiveness of potential remedies in consumer markets", evidence from psychology suggest that people can be harmed by too much choice. Having a great variety of options complicates decisions and may result in people avoiding making choices altogether, even when there are acceptable option available ('choice avoidance').[1]

18. Which? would point to the experiences of the energy sector, where studies have concluded that the variety of choice on offer is hindering effective decision making. A study by the Centre for Competition Studies in October 2010 found that "Innovation in UK retail markets may confuse not empower consumers. Innovative tariffs and other devices may not result in genuine gains for consumers, many of whom take switching decisions which leave them worse not better off".[2] Ofgem, the energy regulator, has recently concluded that the increase in the number of tariffs available, from 180 in 2008 to more than 300 in March 2011 was hindering easy price comparison. As a result the regulator has now announced that it will take action to reduce the number of tariffs made available by energy suppliers.[3]

19. Meanwhile in the financial services sector there is already a high degree of rivalry and huge number of products on offer. However this should not be seen as evidence of effective competition that is delivering benefits to consumer. As an example, our study into savings accounts in 2010 found that there were over 1,200 savings accounts available in the UK but the number of accounts on offer wasn't leading to good outcomes for consumers – indeed many consumers hold their savings in poor value accounts, losing out on £12 billion a year.[4] This is due to the fact that a large proportion of the accounts available offer extremely poor rates of interest (half of the savings accounts available paid 0.5% interest or less and one in four paid 0.1% or less), but it is difficult for consumers to find out what interest rate their account offers, and banks are not informing customers when better accounts are available.

20. As a result we would strongly urge the Treasury to review its objective to ensure it is fit for purpose and does not act against the interest of consumers. At a minimum we propose the objective should read 'meaningful choice'. If the Parliamentary Draftsmen are unable to find a way of framing this objective in a manner that distinguishes the

[1] "Assessing the effectiveness of potential remedies in consumer markets", published by the OFT in April 2008, ref: OFT994

[2] "Innovation and Competition in Generation and Retail Power Markets", published by the Centre for Competition Studies, October 2010

[3] Press release, "Supply companies failing consumers: Ofgem proposes radical overhaul, Ofgem, 21 March 2011

[4] Press release, "The £12 billion savings scandal", Which?, 27th October 2010

desired intention of the FCA's approach, the Government needs to ensure the Explanatory Notes to the Bill include a full description of the Treasury's intent with respect to this objective.

Regulatory principles

Consumer responsibility

21. With respect to the principle of consumer responsibility, Which? would note that under the common law consumer responsibilities are already established and include the principles of reasonableness, good faith, participation, disclosure and action. As a result we would question whether this principle is necessary, but understand that many in the industry feel strongly about its inclusion. Which? would urge the Treasury to avoid any pressure that may emerge from sections of the industry who believe the regulator should designate specific actions that consumers should be responsible for undertaking. In particular we are aware of those in the industry who want to impose a responsibility on consumers to understand long and complex disclosure documents. We fully support the Treasury's analysis that "[retail] consumers…are often at a relative disadvantage when engaging with financial services, given information asymmetries, product complexity and long-term product payoffs". As a result we believe it would be wholly inappropriate to extend consumer responsibility beyond the common law principles.

Senior management responsibility

22. With respect to the principle of senior management responsibility, we believe that the Government should be clear that the interpretation of this principle means that the regulator should be prepared to take action against senior management in firms which breach regulations. For too long, senior management have managed to evade the consequences of their policies which have led to significant consumer detriment. Despite widespread mis-selling of PPI the only senior management person against whom action was taken was the chief executive of Land of Leather (a furniture retailer). No senior management from any of the retail banks have had any action taken against them. This sends a dangerous message to senior management that they can impose inappropriate sales targets for products on their frontline staff and evade the consequences. Senior management have to be clear that breaching regulations will result in serious consequences for themselves and for their firm's reputation and bottom line. The FCA should send a clear signal that it will take action against individuals, including fines and greater use of orders prohibiting the individuals from working in the financial services industry.

Openness and disclosure

23. This must be a key principle governing the approach of the new FCA. The governing principle should be the need to proactively disclose information which might influence a consumer's decision to engage in a commercial relationship with a financial services company: there should be a presumption in favour of disclosure and information should only be withheld where its release would damage the interests of consumers.

Transparency

24. We support the principle of transparency in the regulators decisions. This should also include reporting on the progress that the industry has made in implementing regulatory decisions. For example, where the regulator requires the industry to contact consumers and provide redress it should publish the instructions it has given to the firm and report on the firm's progress in providing redress to consumers. This will improve the accountability of both the firm and the regulator and increase public confidence.

Other principles which the Government has ruled out

25. Promoting financial inclusion: If the Government does not propose to include a specific regulatory principle on financial inclusion then we would welcome further details about how this will be taken into account by the FCA. We also recommend greater clarity within Government as to where responsibility for the financial inclusion agenda will reside.

26. We strongly support the removal of the need for the regulator to have regard to the international character of financial services and markets and the desirability of maintaining the competitive position of the UK and the desirability of facilitating innovation. We do not feel these are suitable objectives for a regulator tasked with consumer protection. The inclusion of "innovation" presupposes that innovation in financial services is always beneficial for consumers and markets. In actual fact, innovation of product design can frequently involve increasing complexity or products which benefit the industry not consumers. The need for regulators to have regard to "international competitiveness" creates a conflict of interest which tends to support the status quo and for regulators to be insufficiently challenging to the industry.

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

27. We welcome the intention to improve the governance and accountability of the FCA. It is essential that the mechanisms for greater transparency which we recommend below are implemented.

28. We welcome the intention to make the FCA subject to audit by the NAO. The regulator should also be accountable to the Parliamentary Ombudsman. We support the continuation of the Consumer Panel. The Consumer Panel must be properly funded and resourced. It is important to recognise the inherent imbalance in resources between those who lobby on behalf of the industry and those who lobby on behalf of consumers. The FCA should also improve its ability to engage with consumer groups and ensure that they have equal rights of access to information as individual firms and industry trade associations.

29. In addition to increased oversight by the Treasury Committee, we believe it would be beneficial if the regulator made itself more available to scrutiny. This could take the form of a monthly question time where senior figures and board members were required to take questions from key stakeholders.

Board structure

30. In the past, the fact that 10 of the 12 members of the FSA board had been currently or previously employed by the industry raised the risk that only the prevailing mindset of the industry gained credence in Board deliberations. There was a clear preference to codify existing industry practice instead of asking searching questions about whether markets were working efficiently and in the interests of customers.

31. It is clear that alternative perspectives are needed and the Board of the FCA needs to be more diverse, with an increase in consumer representation and Board members with experience and knowledge of consumer issues. It is important that all Board members are independent of the industry and should only be allowed to participate in decisions where they are free from conflicts of interest.

32. We would also like to see greater transparency around the agendas, forward plan and minutes of board meetings to provide full information about when the Board is taking key decisions - though we acknowledge that financial stability considerations may occasionally limit the amount of information which can be disclosed in advance. It would also be useful to hold at least one public board meeting a year – where individual board members would take questions from stakeholders.

Freedom of Information (FOI)

33. We deal with this issue further below but we believe that it is important that as part of the legislation the Government tackles the substantial legislative barriers to organisations making successful Freedom Of Information (FOI) requests to the regulator. This means removing section 348 of FSMA. Section 44 of the Freedom of Information Act allows an organisation to reject an FOI request if disclosure is prohibited by or under any enactment. The result is that section 348 of FSMA imposes a significant roadblock to disclosure of information. Furthermore as Section 44 is an "absolute exemption", it allows the regulator to reject FOI requests without being subject to a public interest test and limits the chances of organisations making successful appeals to the Information Commissioner's Office (ICO) or Information tribunal.

Report to the Treasury

34. We welcome the intention to set out in legislation a new requirement on the FCA to make a report to the Treasury where there has been a regulatory failure. We also welcome the provision for the Treasury to have a backstop power to be able to direct the FCA to produce a report. Without this power it is unlikely that the FCA itself will trigger the preparation of a report as it will be an acknowledgement that it has failed. The legislation should also give the Treasury the power to appoint an independent person to prepare the report and a statutory requirement for the process of compiling the report to involve consultation with consumer groups.

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

35. We believe that the FCA should embrace the role that product regulation can play in addressing conflicts of interest, disciplining markets and aligning the interests of producers with consumers. We welcome the intention for the FCA to be able to "make rules to place requirements on products or product features; mandate minimum product standards; or restrict the sale of a product to a certain class of consumers".

36. In some cases, this may require the regulator to take prompt action to prohibit the sale of a particular product or to control a particular product feature. It is very important that the regulator is able to act quickly so we strongly support the proposals for the FCA to be able to make temporary product intervention rules for a period of up to 12 months with immediate effect.

37. In many markets, competition provides an effective force in shaping the products on offer and ensuring they meet consumers' needs. However, effective competition

relies on consumers being able to make informed choices, based on an ability to understand the characteristics and costs of products and to compare competing products. This should cause firms which offer poor value and poor quality products to lose business at the expense of their competitors. However, this is frequently not the case in the financial services sector, where consumers' ability to make informed choices are hindered by a combination of their lack of financial capability, product complexity, incomplete or unclear contracts, the length of time between the purchase of a product and discovering whether it has worked and a lack of transparency in the design and marketing of financial products.

38. Product regulation could be used by the regulator to address a number of issues:

- Ensure minimum standards for key products: There are certain products, such as current accounts and protection products, that consumers need access to. We believe the regulator should ensure that any such products meet minimum standards. We would draw a parallel with motor insurance where all products on sale must meet minimum legal requirements, and consumers then have the option to add on additional 'bells and whistles'. A further example would be to using 'nudging' principles to set the default standards for some products in the interests of consumers – this could include ensuring that the default setting on current accounts does not involve the provision of an unauthorised overdraft and consumers only use unauthorised overdrafts and incur charges if they have specifically opted-in. In the US, rules have been introduced by the Federal Reserve which only allow banks to process ATM and debit card transactions which would take the consumer into an overdraft (or over their overdraft limit) if consumers have specifically opted-in. A recent survey by Consumers' Union indicated that just 22% of the consumers they surveyed had opted-in.[5] The regulator may also take steps to ensure that information disclosure is on standard terms, enabling consumers to easily compare products. It could also take steps to introduce industry-wide standards such as portable bank account numbers for current accounts.

- Minimise the toxic aspects of products and in some cases prohibiting a particular type of product or specific product (for example single premium PPI): Product regulation can play a valuable role in limiting the harm that certain products can cause at an early stage. In other areas the regulator could take action when a firm unfairly uses a variation clause in a contract to change the terms or the price paid by the consumer.

- Ensure the availability of 'vanilla' products: Experience has shown that the

[5] http://www.consumersunion.org/pub/core_financial_services/017109.html

financial services industry alone will not develop simple, good value for money products which meets consumers' needs. Instead of developing good value protection insurance products the banking industry concentrated on selling poor value PPI products. We believe the regulator should pursue the idea that providers and intermediaries should offer simple, straightforwardly priced 'vanilla' products alongside their additional product offerings.

- Benchmarking of products: The regulator should consider extending requirements such as 'RU64' to additional product categories. This will require firms to benchmark the products they offer against alternatives. It is important to be clear that RU64 does not prevent firms recommending higher charging and more complex personal pensions provided that they can explain in writing why these are "more suitable" than a simple, good value stakeholder pension.

- Preventing the bundling of products: The regulator may take steps where the design of products could encourage mis-selling. One example of this type of circumstance would be where banks offer a higher rate on a one-year deposit account provided that the consumer invests a matching amount in a longer term structured product or investment product.

- Taking action concerning complex 'ranges' of products offered by individual firms: The regulator could take action where firms design complex 'ranges' of products which while not excessively complex on their own are designed to take advantage of consumer inertia and cause confusion rather than in response to genuine consumer need. For example, one building society seems to have around 20 different issues of its instant access ISAs paying over 10 different interest rates. Lloyds banking group offers 30 different variable rate savings accounts through its Lloyds TSB brand and around 20 different variable rate savings accounts through its Halifax brand. The regulator would take action to require firms to simplify their range of products. There are precedents from other sectors to consider: OFGEM has recently concluded that the rise in the number of tariffs available from 180 in 2008 to more than 300 in March 2011 is hindering easy price comparison. Their focus group research with vulnerable customers found that some had been put off comparing prices online and switching due to the complexity of the options available.[6]

- Promoting competition: The regulator could use product regulation to promote competition by ensuring that consumers can compare products. Which? has long held concerns that the variety of different methods by which lenders

[6] http://www.ofgem.gov.uk/Markets/RetMkts/rmr/Documents1/Ofgem_vulnerable_customers_research_Final.pdf

calculate the interest charged on a credit card meant that the cost to the consumer for cards with the same APR could vary. The industry claimed that these different interest calculation methods were dimensions of competition. However we agreed with Sir John Vickers who told the Treasury Committee that if a product characteristic is "invisible to consumers then it cannot be a dimension of competition".[7] Which? launched a super-complaint to the OFT in April 2007 concerning interest calculation methods on the basis that these were not proper dimensions of competition and undermined the ability of consumers to compare products through the APR. There were no clear market incentives for credit card providers to move to more advantageous (for the consumer) methods of calculating interest payments. The result has been continued differences in interest calculation methods with the only moves towards some standardisation being the result of the European Directive which required credit card companies to only start charging interest when the transaction was posted to the account (previously some companies started charging interest from the date when the purchase was made).

14 The Government would welcome specific comments on:
• the proposed approach to the FCA using transparency and disclosure as a regulatory tool;

Regulatory transparency

39. We agree with the Government that greater regulatory transparency and disclosure will be an important tool for the FCA. We welcome the intention for the FCA to have a regulatory culture based on a presumption of transparency. In the past the approach to disclosure by the FSA has been skewed far too much towards the interests of firms. The FSA has previously stated that disclosure of information would be likely to undermine firms' willingness to engage in a dialogue with it and to provide it with information. It has not put forward any credible evidence for this view. In any case, a regulator should not be relying on the voluntary disclosure of information to undertake its job effectively. A culture of secrecy harms accountability and only benefits those firms breaking the rules.

40. Proper accountability can only come alongside improved transparency. In a competitive market, brand and reputation are valuable. Firms which fail consumers should not be shielded by the regulator from the consequence of their commercial decisions. We believe that regulatory transparency could have a powerful effect towards incentivising firms to improve their practices. It also helps the industry as it

[7] John Vickers, quoted in evidence to the Treasury Select Committee at paragraph 50 of Transparency of credit card charges, First Report of Session 2003-04, Volume 1, HC125-I.

ensures that, if scandals do arise, offenders are identified and the entire industry is not labelled as universally poor.

41. The main roadblock to greater regulatory transparency is Section 348 of FSMA that prevents the FSA from disclosing information it receives in the discharge of its regulatory duties, except in certain defined circumstances. In addition to the problems involving its interpretation by the FSA, it also places substantial barriers to organisations making Freedom Of Information (FOI) requests to the regulator. It allows the regulator to reject FOI requests without being subject to a public interest test. Which? has submitted a number of FOI requests to the FSA asking for the names of mortgage lenders which had performed poorly in the FSA's thematic work. We believed that consumers had a right to know which lenders were treating customers unfairly and that this information should also be shared with the Court judges hearing repossession requests from these lenders. The FSA rejected our request and offered a number of excuses including that it would harm the lenders brand and reputation, would undermine firm's willingness to engage in a dialogue with the FSA and to provide the FSA with information and the restrictions imposed on it by Section 348 of FSMA.[8] It was clear that the FSA believed that the commercial interests of firms which were trying unfairly to evict people from their homes and levying unfair charges were more important than the public interest and the interest of consumers in disclosing this information.

42. The FSA has also refused to disclose the instructions which it had given to firms which had been fined for mis-selling PPI, stating that as the instructions it gave to the firms would invariably involve information received from the firm, they would also not be able to disclose it due to Section 348 of FSMA.

43. Section 348 should be removed and the text of the future legislation should reflect the minimum restrictions on disclosure required by EU directives. We believe this to only consist of a requirement for the FSA not to disclose confidential information it has received from other EU regulators.

44. The actual practice of the FCA would be influenced by a clear mandate to disclose information where it might help the FCA achieve its objective of ensuring good outcomes for consumers or where it might influence a consumer's decision to engage in a commercial relationship with a financial services firm.

45. In addition to the legislative changes, Which? recommends further transparency in

[8] For further details pleas see Which? written evidence included in the Treasury Committee's Fifteenth Report of session 2008-09, 'Mortgage arrears and access to mortgage finance", (Ev 63); http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/766/766we06.htm

nine key areas.

- **Thematic work**: We believe the regulator should disclose the firm-specific results of the thematic work it undertakes. The current failure to name those firms performing poorly means that consumers are kept in the dark and firms are able to get away with not treating their customers fairly without suffering any practical penalty.

- **Conduct risk:** Individual firms should be required to publish SEC style submissions covering conduct risk issues and any investigations currently underway by the regulator into their practices. This may also be an issue which merits investigation by the markets side of the FCA. Banks frequently keep their shareholders in the dark regarding conduct risk issues. No major bank has published any information in their annual report regarding their possible liability from mis-selling of Payment Protection Insurance. This is despite the fact that the FSA estimates that, overall, the industry could face a redress and administration bill of up to £3 billion from PPI mis-selling.

- **Price data**: We would like the regulator to require firms to provide the relevant price data on their products, and use this data to publish comparison tables. This will make it easier for consumers to shop around to get the best rate and spot when they are getting a bad deal, and for organisations like Which? to warn them about products to avoid. However, section 348 continues to place a substantial roadblock in the way of the regulator disclosing price data. For example, we have concerns that a number of pension providers may be offering poor annuity rates to existing customers when it comes to convert their pension into an annuity. Ideally, we would like to obtain the names of these companies so we can issue specific warnings to consumers. However, we have been informed that participation in CFEB's comparison tables is voluntary and even if the FSA were to gather data from individual pension companies it would be prohibited from publishing it without specific permission from the individual firms.

- **Complaints data**: The FSA has moved to publish complaint numbers for individual firms which receive more than 500 complaints every six months. There is already evidence that firms are taking action in response to the publication of complaints data. Banks are reporting that they are taking action to prevent errors occurring in the first place. Other banks have set targets to reduce the number of complaints received and the proportion of occasions where the Financial Ombudsman overrules the bank's original decision in favour of the consumer. The complaints data has also allowed consumer groups to identify specific occasions where there appears to be systematic

problems in the way a firm is dealing with complaints. For example, data from the FSA showed that Capital One upheld just 1% of complaints about General insurance and Pure protection products (including PPI) in favour of the consumer in the first six months of 2010. However, the Financial Ombudsman upheld 57% of the complaints it settled in the first half of 2010 and 40% of those it settled in the second half of 2010 about Capital One in favour of the customer. These differences could indicate problems in the way Capital One is assessing complaints and allows us to send a message to consumers that they should always take their complaint to the Ombudsman if they are dissatisfied with the firm's response. We also believe that the FCA should go further and publish all of the complaints statistics it receives from all firms online. As these are already collected by the regulator electronically, there should be no additional costs for individual firms. It should also require the largest firms to publish a 'complaints digest' which would outline the causes of the most common types of complaints and what action the bank was taking to address the issues raised by customers.

- **Own-Initiative-Variation-of-Permission**: This would ensure that in a situation where the FCA has concerns about a firm and varies its permission to undertake specific activities, that this is made public. This could include restrictions such as not allowing the firm to accept new business, but can also include actions such as requiring firms to contact customers who have replied to a misleading financial promotion.

- **Usage data**: The FCA should ensure that firms make 'usage data' available to customers. This electronic information could at the request of the consumer be used (in a suitably anonymised form) to quickly and efficiently analyse whether the consumer would be better off switching and the size of any possible gains. This would have significant advantages over the greater use of 'paper-based' information. The regulator should also ensure that firms provide information to consumers about the ongoing costs of their products and bank accounts.

- **Redress schemes**: The FCA should publish the names of the firms which are subject to the scheme, list what activity the firms are undertaking, the text of all letters used in customer contact exercises, the criteria the firms are using to calculate redress, the response rates to any customer contact exercise and the amount of redress paid.

- **Misleading financial promotions (see below)**

- **Warning and enforcement notices**: **(see below)**

14 (b) The Government would welcome specific comments on:
• the proposed new power in relation to financial promotions;

46. We strongly support the proposed new power in relation to financial promotions. We have long called for the regulator to take a similar approach to the Advertising Standards Authority (ASA) and introduce a Financial Promotions Register which shows where the regulator has received complaints and where a firm has been required to withdraw or amend a misleading financial promotion. The FSA has required firms to amend or withdraw 1,321 misleading financial promotions in the past five years.[9]

47. To provide prompt disclosure of action we support the provision for the FCA to have a duty to publish details of its final decision when it gives this notice to the firm. It may take some time after a promotion is issued for it to be reported to the FCA as misleading. It is important that firms are not able to evade the publication of the notice by promising that the promotion will not be re-issued.

48. It is also important that the power is drawn widely enough for the FCA to take action against a misleading financial promotion (and to publish that it has done so) even if the firm is not directly authorised by the FCA. This might be the case if an unauthorised firm has issued a financial promotion in contravention of the prohibition in Section 21 of FSMA.

49. The FCA should also respond to complaints from consumer organisations and individual consumers and state the action which it has taken in response to their complaint (including where it has investigated and not required the firm to amend or withdraw its promotion).

50. The power to publish the fact that a firm has been required to amend or withdraw a promotion would provide a powerful incentive for firms to improve standards, impose market discipline and would help draw the attention of consumers who may have responded to the misleading promotion, and could motivate more consumers and consumer groups to report adverts they find misleading. We agree with the Government that greater visibility of the FCA's actions in relation to financial promotions will increase confidence in the FCA's ability to protect consumers and increase regulatory accountability.

51. As an example of the drawbacks of the current system, when we submit a

[9] It should be noted that these figures do not include promotions about Credit cards, Store cards and charge cards Personal loans and loan consolidation, Overdrafts and some second charge mortgages which are dealt with by the OFT and Trading Standards

complaint about a particular financial promotion to the FSA we do not receive any feedback or adjudication which says whether the FSA agreed that the promotion was misleading and whether the company was required or to amend or withdraw the promotion. The FSA will not even confirm or deny whether an investigation has taken place. We contrast this with the feedback we receive when we submit a complaint to the ASA concerning the potentially misleading health claims made in an advert for Nutella chocolate spread.[10]

Table 1: Number of Financial Promotions amended or withdrawn as a result of FSA action

Year	Number of financial promotions amended / withdrawn
2010	**262**
2009	**170**
2008	**216**
2007	**324**
2006	**349**

Source: FSA

14 (c) The Government would welcome specific comments on:
• the proposed new power in relation to warning notices.

52. We support the power to allow for the publication of the fact that a warning notice has been issued and for a summary of the notice (including the grounds on which action is being taken) to be published. In addition to the benefits of increasing visibility and giving firms greater insight we believe the publication of warning notices should facilitate a more open enforcement process including the opportunity for consumer groups and individual consumers to be involved and to provide evidence to the enforcement process. For example, if the debt advice agencies become aware through the publication of an enforcement notice that the FCA is considering taking action against a mortgage lender for treating customers in arrears unfairly they may be able to submit evidence to the FCA concerning the way the lender has been treating their clients. In other occasions it may alert us to the practice of a particular firm which we may have evidence of from our engagement with consumers or from our mystery shopping work.

53. A further example of how additional openness could lead to a more appropriate outcome relates to the FSA's thematic work into how banks were handling complaints about unauthorised overdraft charges. This found a failure to deal with complaints

[10] http://www.asa.org.uk/Complaints-and-ASA-action/Adjudications/2008/2/Ferrero-UK-Ltd/TF_ADJ_44078.aspx

fairly, consistently or in a timely manner, unfair threats to consumers by banks, unfair closure of accounts and the use of false or misleading statements.[11] Despite the fact that two firms were referred to the FSA's enforcement division for further investigation, there has been no additional information about the identity of these firms or the action which was taken against them. If the identity of those firms had been made public then it would have prompted evidence from consumers and consumer groups to the regulator about how those banks had been handling complaints.

Other supervision and enforcement issues which are not the subject of questions in the consultation document

Financial penalties

54. We recommend that the Government change the law so that the revenue gained from these financial penalties should be used in ways which benefits consumers rather than being used for the benefit of industry.[12] This will require an amendment to Schedule 1, Part III of FSMA. This change should support the intention that the FCA will take a strong approach to enforcement to ensure credible deterrence and have a willingness to impose higher fines in order to encourage better conduct across the industry.

55. It is clear that to provide an effective deterrent the levels of financial penalties will need to be significantly higher than those levied by the FSA. Examples of fines in Payment Protection Insurance (PPI) cases have shown the level of fines issued were minute in comparison to the revenues firms generated from mis-selling – in the case of the January 2008 fine for HFC Bank Limited it represented less than 0.4% of sales revenue.[13] Even after the FSA had decided to significantly increase the level of penalties it imposed for PPI mis-selling, the fine levied on Alliance and Leicester represented less than 3% of the revenue they gained from selling the product.[14] It is unsurprising that the FSA's regulatory activity in the market for Payment Protection Insurance has not had the desired outcome in ensuring that customers are treated fairly.

56. We would suggest the FCA looks at the example of other regulators who levy substantially higher fines for consumer abuses. Under the Competition Act 1998, the

[11] FSA, Dear CEO letter, Handling Complaints about Unauthorised Overdraft Charges, 27 July 2007

[12] http://conversation.which.co.uk/money/banks-benefitting-from-bad-behaviour-is-bad-news/

[13] http://www.fsa.gov.uk/pubs/final/hfc_bank.pdf

[14] http://www.fsa.gov.uk/pubs/final/alliance_leicester.pdf

OFT has the power to levy a financial penalty of up to 10% of global turnover of the business involved. OFWAT and OFGEM have similar powers. British Airways was fined £121.5 million for collusion over fuel surcharges.[15] Argos and Littlewoods were fined a total of £22 million for fixing the price of toys and games.[16] OFWAT fined Severn Water £35.8 million for mis-reporting information and providing sub-standard service.[17]

57. Shareholders will only be incentivised to put pressure on senior management to ensure customers are treated fairly when financial penalties represent a significant proportion of the revenue gained from selling a product.

Effective redress

58. In the past ten years we have seen substantial detriment caused to consumers in a number of areas including mortgage endowments and Payment Protection Insurance. The impact of these problems on consumers has been compounded by the slow response of the industry and regulators. Excessively long timescales, poor complaints handling and inadequate redress have become all too common. The FCA should adopt an effective redress system which improves the incentive for firms to treat customers fairly. Two approaches which should be adopted are:

- Past case reviews

59. We welcome the Government's decision to activate the s404 powers. The FCA must show greater willingness to utilise these powers to require firms to actively review past sales of a particular financial product where detriment has occurred. This would be a similar process to a 'product recall'. Product recalls are a practice used across a number of sectors (from food to cars and other consumer products) to deal with deficient products. In these sectors, firms will typically stress test products and institute national or local recalls in response to defects.

- Collective redress

60. The FCA and the Government should introduce an improved method of collective redress which would allow a collective claim to be made on behalf of all those consumers who are adversely affected. This could have benefits for consumers in improving access to redress while reducing the administrative cost for firms and the regulator of dealing with individual cases. We believe that the Courts should have the

[15] http://www.oft.gov.uk/news/press/2007/113-07

[16] http://www.oft.gov.uk/news/press/2003/pn_18-03

[17] http://www.ofwat.gov.uk/regulating/enforcement/prs_pn2108_svtfne020708

power to ensure that claims could be done on an opt-out basis.

Remuneration systems

61. The FCA should move from a purely reactive approach to one which seeks to tackle the root causes of consumer detriment. In our view, remuneration systems linked to sales targets create a conflict of interest between the consumer and the firm. They encourage banks to recommend courses of action which result in the sale of a product, rather than that which is most suitable for the customer. They also contribute to mis-selling. For example, advisers at Alliance and Leicester received six times as much bonus for selling a loan with PPI as they did for selling a loan without PPI.[18] We welcome the thematic work which is currently being undertaken by the FSA into incentives for frontline bank staff. The FCA should prohibit remuneration and commission systems for both frontline staff and senior management which encourage mis-selling.

Measuring consumer outcomes & conduct risk

62. A regulatory approach which is aimed at improving consumer outcomes will require the regulator to undertake more work to test the 'outcome' received by consumers. This should involve greater use of mystery shopping – a technique used effectively by Which? to test how real consumers are treated by firms. The FCA may also want to make greater use of thematic work and studies of individual product markets.

63. The FCA should preserve the FSA's Conduct risk division which is aimed at the identification of emerging risks before they crystallise and cause major consumer detriment.

64. In addition, there should be a Committee introduced with members from the FCA, OFT, FOS to share information about potential risks and the merits of dealing with the issue through a complaints-led approach or by regulatory action by the FCA. This Committee would gather evidence from consumer and industry groups and set a timetable for investigation. This proposal would enhance the current 'wider implications' process. As we outline below, we would favour a move towards a more formal process (along the lines of a super complaint process) which allows consumer bodies to raise potential issues with the FCA and for the FCA to publicly report on action taken.

[18] http://www.fsa.gov.uk/pubs/final/alliance_leicester.pdf

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?

65. Which? wants to see a market where competition works to reward banks which deliver good value products and great customer service and to punish banks which do not. Giving the FCA a duty to promote effective competition would help ensure that it takes action to promote the following market characteristics. The FCA would report on the extent to which the markets it regulates met these characteristics as part of its thematic work and market testing:

> Competition on the merits – firms genuinely compete on the basis of the quality and price of their products or services rather than exploiting consumers' behavioural biases;

> Consumers are engaged and able to compare the quality or performance of different financial products and firms;

> Prices and the quality and characteristics of products are transparent and easily comparable;

> Products do not include hidden charges or unfair contract terms;

> There are low barriers to market entry and exit (while preserving essential services for consumers)

> There are low barriers to switching (both real and perceived); and

> Consumers are able to pursue effective and speedy redress where necessary.

> Conflicts of interests between firms and their customers are removed or managed appropriately.

66. Which? considers it vital that a reinvigorated financial regulator should have both the remit and tools to make competition work for consumers and for fair dealing firms. It should have the confidence to intervene in markets to ensure firms offer good value to consumers not simply the illusion of choice or rivalry. The FCA should have considerable latitude under its conduct of business powers to implement pro-competitive measures. However, Which? agrees with the Government that more general competition powers may at time be suitable. The Government correctly identify the example of Payment Protection Insurance as one of the key failings in recent years of splitting responsibility for competition and consumer protection

between two separate agencies.[19] We agree that a specific mandate to promote effective competition would have allowed the regulator to use its regulatory tools to take targeted action at a much earlier stage. This was a key recommendation of the *Future of Banking Commission*.[20]

67. The BIS' consultation into reform of the competition regime outlines concerns that sectoral regulators have not used their competition powers sufficiently, in particular to make market investigation references.[21] These concerns were supported by the NAO and other independent commentators. Which? considers that these risks may apply to the FCA. As it develops an approach to meeting its new duties it will need to be confident that referring markets is appropriate. It should not consider reference a failure of its own regulatory over-sight. The FCA will also need to significantly build its capacity to effectively analyse competition issues, make references and develop effective, proportionate remedies.

68. Super complaint powers are available to a number of organisations which are concerned with consumers' experience of financial services. It should be sufficient to ensure that a body, such as the FCA is able to receive these complaints. However, Which? considers that super-complaints relate to market failures. It is not practicable or straight-forward to arbitrarily separate failures into 'competition' and 'consumer protection' issues so there may need to be coordination mechanisms in place between the CMA and the FCA. It is vital that the recipient of super-complaints is able to look at all aspects of a market and consider all remedies to address the concerns raised. Given these concerns, Which? recommends:

> The FCA should be able to refer markets and 'horizontal' practices (as envisaged by BIS) of the financial services industry to the competition authority for market investigation;[22]
> Where the FCA conducts 'thematic' or similar reviews (analogous to existing market studies), and no market investigation reference arises the FCA should be required to promptly publish its reasons for this.[23] It will, of course, be

[19] Please see Annex 1 for an explanation of the shortcomings of Competition Regulation under the Financial Services and Markets Act 2000. This text is based on the analysis conducted by the *Future of Banking Commission* and has been updated to include further examples. Please see Annex 2 for details of failings in relation to PPI

[20] For further information please see Chapter 3 of the Future of Banking Commission report, http://commission.bnbb.org/banking/sites/all/themes/whichfobtheme/pdf/commission_report.pdf

[21] Paragraph 7.11, *A competition regime for growth: a consultation on options for reform*, March 2011, BIS.

[22] Paragraph 3.8 of BIS' consultation proposes to extend powers of investigation to practices that affect competition but arise across a number of markets.

[23] This should explain why issues are better dealt with through conduct of business rules or why an issue does not satisfy the legal test for a market investigation reference (currently section 131 of the Enterprise Act 2002).

required to consult on why it is making a market investigation reference when the occasion arises;

- The FCA, in its annual report, should review and report on its efforts to promote effective competition in the markets it regulates, the extent to which it has used any of its tools available including market investigation references and supply any other relevant information to allow scrutiny of its performance;
- The FCA board should invite and resource a suitably qualified, independent person to review its performance at the end of the business year in respect of how it has met its competition objective and exercised relevant powers. This person should report to the board with proposals to improve its practices for the forthcoming business year. This report should be published;
- There should be free and open information disclosure between the FCA and the competition authority, such that information gained under the FCA's statutory powers for any of its objectives can be supplied for the purposes of competition enforcement or investigation without seeking permission or making redaction;
- The FCA should not exercise powers under the Competition Act 1998 but, instead, should be required to facilitate any investigation by a competition authority. In addition, it should act to enable consumers and regulated firms to raise concerns of abuse by dominant firms or anti-competitive agreements.
- Subject to the reform of the competition and consumer landscapes following BIS' consultation, the FCA should be a recipient body for super complaints. The FCA consumer panel may apply for designation and existing designated qualifying bodies including Which? would be able to make super complaints as the need arises.
- The Government should repeal section 164 (The Competition Act 1998) of the Financial Services and Markets Act 2000. This section means that the Competition Act 1998 does not apply to agreements or conduct that is 'encouraged' by the regulating provisions of the FSA but which may otherwise infringe competition law. Section 164 grants financial services firms a false sense of comfort that they are not fully bound by normal competition rules affecting every other firm in the UK economy. In particular, this is because section 164 does not exempt regulated firms from EC competition law. The modernisation of competition law, where Articles 81 and 82 EC are now directly applicable by the OFT, and the international nature of most financial services makes this section largely irrelevant. Further, where a firm has an objective justification for its conduct or an agreement, domestic competition law may consider this as a mitigating factor, either finding no abuse or waiving a penalty. Obligations imposed on firms by regulators are likely to be considered an objective justification, presuming the regulations directly explain the conduct or agreement considered to infringe competition law. Banks do not warrant special treatment that insulates them from the normal scrutiny of competition law.

Competition and consumer protection powers in relation to unfair charges

69. The price and 'value for money' which consumers receive from financial products and services is a key component of the overall outcome. Excessive ancillary / default charges can lead to a substantial risk of weakening of effective competition between firms, in particular a reduction in direct price competition where apparently low 'headline' prices mask the true costs once ancillary / default charges are accounted for. Discovering the 'true' price raises consumers' search (and perhaps switching) costs, especially if price structures are frequently altered. This will distort consumer decisions leading to inefficient economic outcomes.[24]

70. A regulator with a clear competition mandate would ensure that consumers can be confident that once they have entered into a contract, they will not be subjected to any unexpected charges or, if they are, such charges are fair and proportionate. The loss of the Supreme Court case on unauthorised overdraft charges has exposed significant gaps in the ability of regulators to tackle unfair charges so we believe the FCA should be given the authority and powers to challenge these charges and assess whether they are fair and proportionate. We also note that the ICB concluded that the FCA would be the natural body to pursue a review of unauthorised overdraft charges.[25]

71. We outlined a possible approach in our submission to the European Consumer Rights Directive, our submission to BIS and our response to the Treasury Committee's inquiry into Competition and Banking.[26] Our submission to the TSC presents evidence based on market analysis of the changes made to unauthorised overdraft charges by the major banks since the Supreme court case.

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 comments to make on these issues.

[24] For example, see the Which? March 2011 super complaint on credit card surcharges: http://www.which.co.uk/documents/pdf/payment-method-surcharges---which---super-complaint-249225.pdf

[25] Independent Commission on Banking, Interim Report, para 5.29

[26] http://www.which.co.uk/documents/pdf/consumer-rights-directive-allowing-contingent-or-ancillary-charges-to-be-assessed-for-fairness-bis---which---consultation-response-226521.pdf ; http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/612/612we25.htm

Regulatory processes and coordination

Interaction / Coordination between the FCA, PRA and FPC

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

72. There will need to be formal information exchange between the regulators. Wherever possible we believe that any instructions, views and recommendations expressed between the regulators should be made public.

73. If the Government adopts our recommendations on the role of prudential regulation then there will also need to be a coordinated approach between the FCA, PRA and competition authorities for breaking up / ring-fencing / restructuring any banks which pose a systemic risk or harm competition. Under the new regime there would be two possible reasons for restructuring or breaking up a bank. For example, the competition authorities may have concerns about the dominant market share of one individual bank in the mortgage market. The prudential regulator could have similar concerns regarding the dominant position of that bank on the basis that it would make it impossible for the bank to fail without causing significant damage to the economy.

74. The FCA will also need to provide input to the PRA on the preparation of 'living wills' to ensure that these cover how customers will be treated and provide sufficient protection for customers' interests.

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?

75. We strongly object to the PRA being able to veto an FCA decision which would lead to a firm or group of firms failing. The PRA will always have a strong interest in overruling a decision by the FCA as it is always likely to believe that preventing the failure of a firm is likely to be compatible with its strategic objective of contributing to the promotion of the stability of the UK financial system. The PRA also does not have an objective or statutory duty to promote effective competition. This means that it may have a preference for the maintenance of the position of existing banks despite these banks seriously failing consumers and the economy as a whole. A regulator with a proper duty to promote competition would always have a preference for firms which make mistakes or breach regulations to be allowed to fail, rather than being supported by allowing it to evade the consequences of its actions. It is recognised as essential

for effective competition that market discipline must be made to apply to banks.[27]

76. It was clear from our discussions with a consumer group from a country that already operates this model that splitting responsibility between different regulators does not remove the conflicts which can exist between different functions, but merely externalises them. There should be coordination arrangements but we still do not believe that the PRA should be given primacy over the FCA. We believe that the Treasury should examine the case of DSB bank in the Netherlands as an example of the problems which can occur if a Prudential regulator is given the overriding power over a bank.

77. If a firm-specific conduct decision would impact financial stability by leading to a failure of a bank then the PRA has clearly not been undertaking its remit effectively. It will always be in the interests of the PRA to prevent its effectiveness from being tested by allowing the failure of the firm.

78. In the current environment we also do not believe that a decision to prevent the FCA from taking a firm-specific decision which would lead to the failure of the firm would or should ultimately lead to the continued existence of that firm. If a firm has broken the regulations and/or common law and consumers have suffered financial detriment then it will not be possible for the PRA to extinguish the legal liability of the firm. To permit the PRA to overrule the FCA also sends a dangerous message to the industry that only firms which are small enough to fail without causing damage to financial stability will be forced to bear the full consequences of mistreating consumers. The concept of 'too big to fail' risks becoming extended to 'too big to be forced to treat your customers fairly'. It is perverse to create a situation where there is a regulator which is focused on the outcomes for consumers and then to allow it to be over-ruled by a regulator with little experience of consumer issues, no consumer-focused governance and no duty to promote competition. This approach can only strengthen the moral hazard that led to the catastrophic failings in the banking industry which the regulatory reforms aim to prevent. There is currently no proposal for the PRA to establish a Consumer Panel and this increases the risks of inappropriate decisions being taken which do not give sufficient weight to consumers' interests.

79. We believe that the Government should publish some scenarios showing the circumstances which it believes might lead to the PRA overruling the FCA in a firm-specific conduct decision. We do not believe that the requirement for the notification of the veto to be laid before parliament and to be included in its annual report provide appropriate safeguards. It is likely that the same conditions which mean that the PRA

[27] Future of Banking Commission, Chapters 2 & 3

feels it appropriate to exercise the veto will prevent disclosure of the veto at the time it is exercised. However, if the Government proceeds with its proposals then we would support a requirement which includes a trigger for a report to be made to the Treasury by an 'independent person' about the circumstances surrounding the exercise of the veto, including a substantive analysis of what went wrong and what lessons can be learnt and including the disclosure of confidential information when that would be in the public interest. This would be similar to the requirement discussed in paragraphs 4.43-4.44. Since such a situation is likely to result from a disagreement between the PRA and the FCA it is important that the report is prepared by an 'independent person' rather than being the responsibility of one or other of the individual regulators.

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

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

80. The PRA and FCA will need to work closely together in making their respective decisions about the granting, amending or withdrawing permissions for particular activities. For example, permission to be active in the mortgage market could include activities which would be of interest to the PRA (mortgage lending) and the FCA (advising and arranging mortgage contracts). We do not have any strong preference between the different models for granting authorisation. It is important that the FCA is able to prevent the authorisation of a firm where it has concerns about the protection for consumers.

81. The supply chain for financial services is complex and it is possible for a firm designing a product to have no contact with consumers (by distributing the product through third parties). We would like clarification about where the regulation of the product design phase would be located if the firm was not regulated by the FCA.

82. We support the ability of regulators to use OIVoP and VVoP powers. However, we are concerned about the lack of transparency which currently surrounds the exercise of these powers. In some occasions there is no indication that the FSA is considering exercising the OIVoP or VVoP powers until they are actually exercised. Whilst we acknowledge that in certain circumstances the regulator will need to act quickly to vary a firm's permission in most circumstances we would expect the written warning of the regulators decision to the firm to be made public.

83. We also have concerns about the PRA veto in this area. In particular where this allows a firm to remain authorised where the FCA has significant concerns about the way the firm is treating consumers. In particular, where the PRA insists that a firm

retains its authorisation and this results in additional consumers using the firm for their business and subsequently suffering losses. We would like clarification of the legal position concerning whether those consumers would have any rights of action against the PRA.

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

84. We welcome the intention that both authorities will have the power to ban an approved person working in a dual-regulated firm. We are concerned that the PRA lead on approval of 'Significant influence functions' such as Chief Executive Officer may result in the downgrading of the consideration of consumer issues. We would prefer a situation where both regulators have to give consent for an individual in a significant influence function. If the Government proceeds with the current proposal then the fact that the FCA has not given its approval (and been overruled by the PRA) should be recorded. We note that in the case of DSB bank in the Netherlands the Dutch central bank was criticised for approving leadership of the bank who had "insufficient awareness of the client's interests".

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

85. We would welcome clarification from the Government as to what action the PRA would take if it had concerns about the UK branch of an overseas firm. In particular whether it would have a duty to publicly disclose this information.

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

86. We support the requirement for the PRA and the FCA to provide an analysis of the extent to which the costs and benefits of a proposed rule affect mutually-owned institutions differently to other ownership models. We would also support transferring the registration of those societies which do not undertake financial services business to outside the FCA to avoid the misleading impression that these firms are subject to conduct and prudential scrutiny on the same basis as regulated firms.

87. Mutuals are particularly disadvantaged by the distorting nature of the too big to fail subsidy for larger banks and we would expect the PRA to take these factors into account when setting the regulatory framework.

88. We wish to see further details of the minor amendments to legislation affecting building societies before coming to a view on their appropriateness.

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

89. We agree that it is important that the PRA and FCA consult each other prior to making rules. Wherever possible those views should be made public. To reduce the burden on organisations responding to consultations wherever possible the FCA and PRA could undertake joint consultations (similar to those undertaken by bodies such as the Bank of England/FSA and HM Treasury/BIS).

90. We are also concerned about the ability of the PRA to veto a rule by the FCA for the reasons expressed in our answer to question 18. If the PRA does veto a rule then this should be made public immediately.

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?

91. We support the publication of all powers of direction issued by the regulators to the other authority.

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?

92. We strongly object to the proposal to give the PRA responsibility for specific regulatory duties connected with Part VII applications. Our experience of Part VII transfers in the with-profits fund sector has been that these do not take sufficient account of the interests of policyholders. With-profits policyholders at AXA and Aviva lost out on billions of pounds worth of value because of Part VII transfers which were rubber stamped by the FSA with clearly inadequate consideration of policyholders' interests. There is a significant risk that giving ultimate responsibility to the PRA will lead to a further worsening in the regulators already woeful performance.

93. The proposal also does not seem to appreciate the role of the regulator in relation to Part VII transfers. The regulator should have a significant role in ensuring that policyholders are treated fairly during the process and providing comment to the Court in relation to the Part VII transfer and is entitled to be heard by the Court under section 110(a) of FSMA. The role of the regulator is also specified in COBS 20.2 in relation to a Part VII transfer which includes a 'reattribution' of an inherited estate of a with-profits fund. The regulator is also required to approve the appointment of a

'Policyholder advocate' as part of the process.

94. The regulator is also involved in nominating or approving the appointment of an 'independent expert' who is required to prepare an objective report on the Part VII transfer. However, this does not produce sufficient protection for policyholders' interests as 'independent experts' have typically had little success in altering the terms of the scheme and in our experience do not comment on factors which are vital to the overall fairness of the scheme to policyholders such as the firm's assumptions regarding the level of new business.

95. The ability for the PRA and FCA to apply to the Court for an independent actuary's report to be carried out after the transfer has been approved provides absolutely no protection for policyholders' interests.

96. We believe there is a need for a fundamental review of Part VII of FSMA and the Conduct of Business rules governing these issues. Transferring these responsibilities to the PRA – a regulator which will have no specific objective in relation to the protection of consumers would be a serious mistake.

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

97. Any decisions regarding the voluntary winding up of a life insurer should be made by both the FCA and PRA.

98. We are concerned about the ability of the PRA to veto a decision by the FCA to initiate insolvency proceedings for the reasons expressed in our answer to question 18.

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

99. As noted above we believe that any revenue from fines and penalties levied by both the PRA and FCA should be used in ways which benefit consumers rather than being offset against the regulators fees and levies. We support the proposal for the FCA to be responsible for raising the levy in relation to CFEB and the FOS.

Compensation, dispute resolution and financial education

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

100. We continue to believe that it would be advantageous for the FCA to make all of the rules relating to the levies for the FSCS. Given the PRAs lack of consumer focused objectives and governance it may not be the most appropriate body to make rules regarding the FSCS. We support the decision that a single organisation should continue to administer all claims for compensation.

101. The FCA should be responsible for ensuring that firms make the limits of the compensation scheme clear to consumers. The FCA should also prevent the misleading promotion of products which claim to provide a guarantee of capital, but which are not covered by the Compensation Scheme.

102. The PRA will also need to work with the FSCS on 'living wills' and reforms to resolution procedures to ensure that depositors rank above bondholders. There will also need to be a close working relationship between the PRA and the FSCS as prompt/instant payment of compensation will be important in ensuring the continuity of essential banking services. For example for current accounts, it is unacceptable for consumers to receive a cheque within seven days and then be expected to open another current account. A seamless transition of banking services is required.

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

103. The existence of an effective consumer redress system is vital to ensuring confidence in the financial system and to facilitate the smooth running of the industry. Which? as an organisation has redress for consumers as a core principle. We support alternative dispute resolution systems as a cost-effective alternative for both consumers and firms. Which? believes that the FOS is effective at providing a method of dispute resolution which is fair to both consumers and firms. The FOS ensures a level playing field between firms and consumers and provides an effective alternative to the court system. It is important that the reforms to regulation do not downgrade the role of the FOS. We would oppose the introduction of any fee for consumers to access FOS or extra appeals processes for firms.

104. We support the requirement for FOS to pass to the FCA any information which could be important in helping to promote better consumer outcomes – this information

should also be published by the FOS. We also support the requirement on the FCA to have regard to the information it receive from FOS.

105. We support the provision to allow the FOS to publish determinations. We would also favour more detailed breakdown of the FOS complaints statistics and a requirement for the FOS to report systematic problems in the way an individual firm is handling complaints to the FCA and for the FCA to be required to report back on what regulatory action it has taken against the firm and whether it has required the firm to review complaints which it unfairly rejected but where the consumer did not refer the complaint to the FOS. We believe that this should take place where for individual firms the FOS is finding a high percentage of complaints in favour of the consumer.

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

106. We have no objection to the FOS, FSCS and CFEB being made accountable to the NAO.

European and international issues

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

107. We support the establishment of a statutory MoU between the Treasury, Bank of England, the PRA and the FCA on overall international coordination within the UK's system for financial regulation. This should specifically cover how the UK will ensure that consumer protection and competition issues are addressed by the international and European financial regulatory bodies in which the UK authorities are represented.

108. In relation to the debates being undertaken at an international level, we continue to be concerned about the absence of the consumer voice. In partnership with 'Consumers International' – a global federation of consumer groups – Which? is campaigning for this to be changed. We believe that the Government should support the proposals outlined by Consumers International to strengthen the international coordination arrangements in the area of consumer protection.[28]

[28] Safe, fair and competitive markets in financial services: recommendations for the G20 on the enhancement of consumer protection in financial services, Consumers International, March 2011

Prudential Regulatory Authority

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

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

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)?

Problems with the current approach to prudential regulation

109. Which? is concerned with the current approach to regulation of banks and the legacy of the Government's intervention during the financial crises. These have significant effects on the prospects for competition in retail (and likely SME) banking by creating:

- Distortionary subsidies, direct through state aid bailouts and indirect by reducing funding costs, to the largest market incumbents thereby strengthening their market power; and
- No effective regime to enable market exit by failing banks (whether due to poor management or dissatisfied customers) while preserving financial stability of the economy as a whole.

110. These concerns relate to the public policy for regulation of banks and the role of UKFI in managing taxpayers' stake in those banks that relied upon state aid to avoid failure. Further reform should also be taken in the overall approach to regulating banks: too often regulators are held accountable for banks' decisions that create instability or put consumers at risk and those same banks remain in business regardless.

Regulation – implicit subsidy

111. Which? established a Commission into the Future of Banking early in 2010, and received evidence from key players amongst banks, regulators and government. Evidence to the Commission made it clear that the banking industry enjoys a significant public subsidy, in the form of tax payers' funds used to protect failing banks from insolvency. Lord Myners noted that "the banking industry, because it's been

underwritten implicitly against failure, without paying a premium, has enjoyed a huge subsidy". This was evident in the approach to bank failure during the crises but also marked a long-standing trend, when dealing with risks to financial stability, of preserving the status-quo by state aid or by merger.

112. This subsidy arguably distorts decision making by banks, fostering riskier behaviour than would otherwise be acceptable, while enabling those banks to raise funds more cheaply. For those banks requiring taxpayer support, it has been necessary to support the whole bank, not just the assets and liabilities linked to essential banking activities such as the payment transmission system or securing customers' deposits. Mervyn King noted to the Future of Banking Commission: "Ultimately the heart of the problem does come down in my view to the inherent riskiness of the structure of banking that we've got, and the difficulty of making credible the threat not to bail out the system, which is what is underpinning the implicit subsidy and creating cheap funding for large banks taking risky decisions."

113. It has been argued that the value of this subsidy, which distorts the cost of capital for banks, has increased over the course of the financial crisis as the implicit subsidy became explicit support, and is greater for larger than smaller banks. For example, Andy Haldane of the Bank of England estimates that the subsidy for the biggest 5 banks in the UK amounted to £50 billion for the period 2007-09, representing about 90 per cent of the total implicit subsidy available to the banking industry. In its submission to the Future of Banking Commission Virgin Money estimated private equity investors demanded a 10 – 13 per cent higher cost of capital from new entrants than from the largest incumbents: effectively double the cost facing the largest banks.

114. This subsidy results in a significant moral hazard. It fundamentally erodes the ability of small or new entrant banks to become serious challengers to the large, established incumbents. As a result market discipline, the key mechanism of competitive markets, is made ineffectual: good banks are unable to drive out the bad, while big banks remain big. By encouraging high and excessive leverage, the implicit subsidy actually increases the likelihood of taxpayers being forced to step in and support the banking sector. It also encourages banks to intertwine highly leveraged investment and wholesale banking activities with essential retail banking activities and the payments system.

Powers, function and approach of the PRA

115. Whilst we accept the criticism of the previous regulatory approach to prudential regulation, expecting a move to a more judgement-focused approach with regulators exercising judgements about the safety and soundness of firms through

greater supervision to lead to greater outcomes poses two particular problems. Firstly, because the increasing trend to put reliance on the regulator's supervision of compliance with international capital adequacy standards, such as those set by the Basel Committee on Banking Supervision, has created perverse incentives for banks to game the rules. Secondly, judgement-based supervisory regulation can all too easily turn into 'shadow management' and there is a limit to how effective this approach can be to regulating individual firms. Supervisory regulators will always be outnumbered by market participants who retain an informational advantage. It is important that the new judgement-led approach recognises these issues.

116. In his evidence to the Future of Banking Commission, Mervyn King cited the example of Citibank, which still faced near collapse during the crisis despite high calibre management and very close supervision by 'dozens' of regulators embedded within the firm. He note that "I cannot believe that any regulator in the world could honestly pretend that they would do better than what happened [at Citibank], and I think we have to recognise that sometimes things happen which are almost impossible to anticipate, hard to calibrate in advance in terms of how much capital you need to put aside, or how much cash you need to bank, in order to be sure that you won't get into trouble … Having a system that's robust with respect to that seems to me of fundamental importance, and as I understand it, that is exactly what regulators in other industries supplying utilities would encourage us to do".

117. Which? agrees that the lessons of other regulated industries have not been applied to financial services. In other industries, regulators strive to establish the pre-conditions for effective competition. It has always been recognised that for effective competition to be possible, the regulator has to ensure there are specific arrangements in place which allow firms to fail while ensuring the continuity of essential services. For example, in the Water Industry when Enron acquired Wessex Water, OFWAT imposed conditions including requiring the Board to act as if it was an independent company and prohibited cross-default operations.[29] Their primary objective was not to protect Enron's shareholders, but to ensure that customers would continue to receive an essential service and that the creditors of Enron corporation should have no recourse to the assets of the Water company. The result was that when a combination of fraud and incompetence caused Enron to collapse, the ring-fencing provisions ensured that Wessex Water was able to continue to function and essential services were maintained.

118. The prudential regulator must change its approach from attempting to prevent failure to ensuring banks can fail, but without significant harm to vital banking services

[29] For details of the ring-fencing provisions imposed see OFWAT, The Proposed Acquisition of Wessex Water Limited by YTL Power International Berhad, April 2002

or the economy. Stability is not created by preventing failure, but by enabling firms to fail in a controlled way. The PRA would be the guardian of the 'living wills' which banks would be required to produce. It would also be responsible for policing the ring-fencing of retail activities which was recommended by the Future of Banking Commission and any final proposals from the Independent Commission on Banking on the separation/ring-fencing of retail banking and restrictions on a bank's ability to transfer capital between the retail and non-retail subsidiaries.

119. Ensuring that banks face a realistic prospect of failure would help improve the accuracy of the pricing of equity and debt to individual banks and help ensure that these more accurately reflect the risks of a specific bank. Responsibility for prudence must lie with the banking institution, its management and debt providers and not be delegated to regulators.

120. The PRA would take pre-emptive steps to:

1) Protect ordinary depositors and retail customers
2) Ensure the continuity of all essential retail banking services
3) In the case of any institution that is too big or otherwise too significant to fail, intervene to restructure that institution such that its failure would no longer present a systemic risk

Specific comments on the strategic and operational objectives and regulatory principles

121. The PRA should have a specific duty to promote competition. This would help support its focus on not preserving the status quo or existing institutions, but creating a market with the realistic prospect of failure. This is vital to allow market discipline to drive firms to make informed and balanced commercial decisions that affect their solvency. It would also ensure that the PRA does not impose excessive barriers on new entrants, by making them carry higher levels of capital or liquidity than existing banks. It should also have an operational objective to limit and remove the extent of the implicit subsidy received by the banking sector, which distorts competition and disadvantages new entrants.[30]

122. We would favour objective 4 to be drafted as "Promoting the safety and soundness of PRA authorised persons includes seeking in relation to each PRA authorised person, to ensure that the failure of that person can occur with minimal adverse effects on the UK financial system."

[30] Future of Banking Commission report, page 17

123. The PRA should will need to work with the FCA to ensure that 'living wills' and the arrangements for the provision of essential banking services offers sufficient protection for customers' interests. We have expressed concern above about the interpretation of the 'consumer responsibility' principle in a way which seeks to impose unreasonable obligations on consumers. Whilst this principle would clearly be more relevant to the FCA, the risk of the PRA wrongly applying the consumer responsibility principle is clearly greater due to its inexperience in these areas and its lack of a consumer panel.

124. We support the openness and disclosure principle. It is important that the PRA is not subject to excessive restrictions on its disclosure of information. Indeed, an approach which involves the active disclosure of supervisory information to the markets would be essential to help markets price risk for individual firms.

125. We support the proposal that the PRA will not need to "have regard" to the competitiveness of the UK as a location or the need to promote innovation.

Prudential regulation of insurance companies

126. We note that whilst no major UK insurance companies collapsed or required government support due to the financial crisis the position would have changed if the Government had not provided systemic support to the banking system. The continuing fall-out from the problems at Equitable Life demonstrates the substantial consumer detriment which can arise from a failure of prudential regulation. It is important that prudential regulation of insurance companies maintains a focus on protecting consumers. It is also important that the implementation of the new framework does not distract from the vital improvements needed in the regulation of with-profits funds.

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

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

127. The accountability and governance structures largely reflect the role of the PRA as a subsidiary of the Bank of England. It is important that all members of the PRA board are independent and free from conflicts of interest. We welcome the intention to make the PRA subject to audit by the National Audit Office.

128. As stated in the previous sections we are also concerned by the ability for the PRA to veto a decision by the FCA and the implications that such decisions might

have for both consumer protection and competition. In situations where the PRA does veto a decision by the FCA the Government should appoint an 'independent person' to conduct an inquiry and produce a substantive analysis of what went wrong. As these situations will necessarily involve disagreements between the regulators it is essential that this inquiry is conducted by an 'independent person' rather than a representative from one of the individual regulators.

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

129. The PRA will make a significant number of decisions which will have dramatic implications for consumers. These will include its decisions on prudential matters, arrangements concerning resolution arrangements (living wills) including how customers will be treated as part of these arrangements. It will also be responsible for making rules in relation to the FSCS for deposit and insurance business. The PRA will also have the ability to overrule the FCA which could have significant negative implications for both consumers and competition. For example, the PRA may veto a requirement for a firm to pay proper redress to consumers.

130. We therefore strongly disagree with the Government's proposal to not retain the consumer panel for the PRA. We believe that the requirements for the regulator to establish a consumer panel should apply to both the PRA and the FCA. If the Government feels that there may be unnecessary duplication from establishing two consumer panels then the same consumer panel could provide input to both the PRA and the FCA. The PRA should be required to have regard to the representations made by the consumer panel and to give the panel a written statement expressing the reasons why it disagrees with any representation made by the consumer panel.

131. The PRA should also implement a strategy for wider consultation with consumer groups and the general public as part of its processes. This is likely to be a significant change from the current culture and approach of the Bank of England. The PRA should be subject to the requirement to hold an annual public meeting.

Macro-prudential regulation

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

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

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

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

132. We support the introduction of the FPC to address systemic risk and to implement macro-prudential regulation. Consumers and small businesses have been damaged by a move from 'feast to famine' in the availability of credit. The purpose of systemic risk regulation should be to oversee liquidity and capital standards at the macro level. It should be concerned with the inter-dependence of banks and their exposure to common economy wide shocks that may affect key sectors such as commercial and domestic property. Its role should be to act counter-cyclically, to smooth the credit cycle and to 'take the punch bowl away' when credit growth led asset price bubbles grow unsustainably and threaten to lead to instability. This is not an easy task and the framework should ensure that the FPC has the credibility and expertise to challenge the prevailing consensus and to take appropriate action. We also believe that it would be advantageous for some of the external members of the FPC to have expertise and knowledge of consumer issues.

133. However, we express a note of scepticism about the potential effectiveness of macro-prudential regulation to prevent a financial crisis, not least because of the risks of regulators becoming victims of 'flawed intellectual models' and the incentive for banks to find their way round any targets and rules. Increasing the role of macro-prudential regulation also raises questions about the fundamental purpose of banks and bankers. Bankers acting rationally should restrict credit to sectors of the economy (such as commercial property) which become over-valued.

134. Which? does not have the expertise to evaluate the effectiveness of the different macro-prudential tools proposed, so we have concentrated on their potential impact on consumers. We believe that the potential impact on consumers should be studied by the Treasury before it sets out the precise macro-prudential available to the FPC in secondary legislation. It is also very important that the FPC's policy statement concerning how it plans to employ the tools specifically includes statements

concerning how these tools will affect consumers. In relation to these factors we see considerable merit in asking the consumer panel of the FCA/PRA to report to the FPC on these issues.

135. The potential impact on consumers could fall into two different categories:

136. Loan-to-Value limits for residential mortgages: When these are changed they will inevitably lead to a number of consumers being stranded with their existing mortgage provider. For example, if a consumer has just taken out a 95% LTV mortgage and the FPC decides to limit the maximum LTV to 90% then that consumer will be unable to move to a different lender (and unless their mortgage is fully portable, to a different house). It is also likely that a reduction in the maximum LTV would lead to house price falls which would further exacerbate the position of that consumer. Unless mortgage contracts are tightly defined, banks will be able to exploit these captive customers by increasing their margins. There will also need to be consultation about how customers should be treated if they are part-way through the house purchasing process and already have a mortgage agreement in place, but have not yet drawn down the funds.

137. Other capital requirement changes: It is likely that banks will use any changes to capital requirements or risk weights to alter the price paid by existing customers. For example, many terms and conditions will allow banks to vary the contract in response to decisions by “regulators”. How any changes to price will be applied and the discretion which firms may use to apply these changes are likely to be relatively opaque to consumers (unlike clear contractual terms which could exist for changes in interest rates to follow a clearly defined and transparent reference rate such as a product where the interest rate tracks the Bank of England base rate). We have concerns that firms may seek to apply these changes unfairly or to exercise unfair contract terms. There will also be conflicting messages for consumers if the MPC is lowering the base rate at the same time as the FPC is increasing capital requirements for particular types of consumer lending. The exact terms of contracts are likely to be issues for the FCA, but how firms may exercise their discretion may also have systemic impacts if, for example, all banks are confident that they will be able to react to any changes in capital requirements by immediately passing on the costs to existing customers by increasing rates.

Annex 1

Shortcomings of Competition Regulation under the Financial Services and Markets Act 2000

Competition regulation under FSMA is, at best, wholly inadequate and, at worst, detrimental to the competitive landscape in the financial sector. The ambit of the FSA is currently centred on the maintenance of market confidence, raising public awareness, the protection of consumers and the reduction of financial crime. While the FSA also has, among its primary duties set out in FSMA, the requirement to have regard to 'the desirability of facilitating competition between those who are subject to any form of regulation by the Authority', FSMA does not give the FSA concurrent competition powers with the OFT, which would allow it to either (a) directly apply competition law or (b) refer markets to the Competition Commission, as is the case for the regulators of other industries. It is clear that the FSA's approach is to avoid putting up further barriers against competition, rather than proactively seeking to improve the degree of effective competition in the industry. Indeed, in some sectors of the market such as with-profits funds, the FSA actually applies different rules to existing firms, compared to any recent or potential new entrants.[31] The inadequate focus on appreciating the benefits which competition can bring can also lead to codifying existing industry practice instead of driving improvements for consumers. For example, instead of improving the ability of customers to switch cash ISAs, the FSA simply required that the banks provide a "prompt and efficient service" and referenced existing industry guidance.

Indeed, in its composition, FSMA gives the impression to market participants in the financial sector that they have a degree of immunity from UK competition law since agreements or conduct by a dominant firm, which would usually breach competition rules, are not subject to enforcement if 'encouraged by any of the Authority's regulating provisions'. This provision of FSMA effectively puts the maintenance of effective competitive markets in the financial sector subordinate to FSA regulation, albeit that European competition law can be applied regardless of this exclusion. Competition law considerations were further disregarded when, in the course of the financial crises, the public interest test for merger regulations was widened to include 'financial stability', allowing the Secretary of State to rule in the case of bank mergers, rather than the OFT or the Competition Commission.

The OFT has some specific responsibilities under FSMA 2000, necessary to compensate for the lack of competition objectives in the FSA's mandate. Section 160 of FSMA requires the OFT to keep the regulating provisions and practices of the FSA

[31] COBS 20.2.20

under review, and report any significantly adverse effects to the Competition Commission: a process known as 'competition scrutiny'. There have been no occasions under current legislation where the OFT has exercised this power. So, while the OFT may be suited to 'repairing' or conducting investigations into previous competitive markets, it is not up to the proactive task of regulating vigilantly to make markets in the financial sector more competitive.

This special treatment of the financial services industry sends a clear message to both the regulator and industry that the 'normal' rules of competition do not apply.

Annex 2

Payment Protection Insurance mis-selling

The mis-selling of Payment Protection Insurance (PPI) is an example of how a poorly functioning market, and a failure to intervene at an early stage to fix it, can disadvantage customers. PPI is designed to cover your debt repayments if you can't work – for example, you become ill or have an accident, or you are made redundant. It is sold alongside loans, mortgages, credit cards and store cards. In the past decade, PPI has been subject to widespread mis-selling, and this has resulted in millions of consumers holding expensive insurance they would never be able to claim on.

PPI offers a clear example of a poorly functioning competitive market, as the sale of this product involved: (a) lack of adequate disclosure to customers about the product they were buying, and the resulting asymmetry of information between provider and customer; (b) inappropriate default settings, where it was left to the customer to opt out of buying the product when purchasing another financial product; (c) the existence of inappropriate commission structures, which focused the rewards for salespeople on selling PPI, rather than serving the customer well; and (d) accounting practices which allowed firms to book an upfront profit from selling single premium PPI policies.

The resolution of the problems in PPI has taken a long time. Which? first raised concerns about the mis-selling of PPI in 2002. An initial 'supercomplaint' by Citizens Advice was made in September 2005 to the Office of Fair Trading (OFT). The OFT followed up this complaint with a market study, launched in April 2006, which subsequently led to a market investigation reference, in February 2007, to the Competition Commission (CC). In 2009, the CC ruled it would be banning the sale of PPI alongside credit products, stipulating that lenders and credit card providers would have to wait at least seven days before approaching a customer about the sale of PPI. Following an unsuccessful appeal by the banking industry, the CC provisionally confirmed this ruling in May 2010, and published its final remedies in July 2010, almost five years after the issue was first raised by Citizens Advice.

In 2005, the FSA conducted a series of mystery shopping and supervision exercises and in September 2005 called on firms to take "urgent action" to ensure that their selling practices for PPI were compliant with regulatory requirements. However, firms did not respond to the FSA's regulatory action and continued to mis-sell PPI. The FSA responded by conducting further rounds of mystery shopping and eventually conducting enforcement action and levying fines. However, these fines were such a low proportion of the revenue gained by banks from selling PPI they failed to have the desired effect. Despite, widespread mis-selling, no senior management in financial

services organisations had enforcement action taken against them. The only senior management individual to have enforcement action taken against them for mis-selling unsecured loan PPI was the chief executive of a furniture retailer (Land of Leather).[32] Eventually, at the start of 2009, the FSA eventually secured "agreement" from the industry to stop selling single premium PPI on personal loans. The problems for consumers have been compounded by the failure of firms to deal with complaints fairly. Consumers have faced unreasonable delays and the Financial Ombudsman is upholding over 90% of complaints received about some firms. This indicates that many firms are dismissing valid complaints and hoping that consumers do not go to the Ombudsman. The FSA is currently consulting on an approach to require firms to review previously rejected complaints. The FSA announced in September 2009 that several banking groups had agreed to undertake a voluntary review. However, almost a year later, Lloyds TSB disclosed that it had yet to start its review of past sales.[33] The British Bankers Association has now applied for a judicial review of the FSA's rules regarding the handling of PPI complaints.[34] This will lead to further delays for consumers.

[32] http://www.fsa.gov.uk/pages/Library/Communication/PR/2008/039.shtml

[33] http://www.lloydsbankinggroup.com/media/pdfs/investors/2010/2010_LBG_Interim_Results.pdf, page 122

[34] http://www.bba.org.uk/media/article/bba-statement-on-ppi

Annex 3

Future of Banking Commission conclusions on Consumer Protection Regulation

The regulator responsible for consumer protection regulation should have both: (a) an explicit mandate to promote effective competition in markets in the financial sector; and (b) the necessary powers to regulate the sector to achieve this, including the ability to apply specific licence conditions to banks and exercise competition and consumer protection legislation. These powers will be concurrent with the competition powers of the OFT, and will enable the regulator to both enforce competition law and make market investigation references to the Competition Commission.

The aim of consumer protection regulation is to promote the conditions under which effective competition can flourish as far as possible, and where not, the regulator will be able to take direct action. In order best to promote the interests of the consumer, the regulator will encourage financial firms to compete:

1 On the merit of the quality and price of their products and services; and
2 To gain a competitive advantage by investment in innovation, technology, operational efficiency, superior products, superior service, due diligence, human capital, and offering better information to customers.

The regulator would step in whenever there is a sign of market failure. Market failures include: (a) poor quality information being disclosed to consumers when they are deciding whether to purchase products; (b) information asymmetry between the provider and the consumer; or (c) providers taking advantage of typical consumer behaviour such as the tendency evident in retail customers to select the default option offered, and reluctance to switch products because of inertia. Any sign of market failure indicates that competition is probably not effective, and the regulator should then take action to counteract the failure.

We are in favour of exploring further a number of specific measures that could be taken by a regulator with a dedicated remit for consumer protection:

1 **Ensure customers can easily transfer products and accounts**. This will significantly reduce barriers to entry for new market entrants, and may help tackle consumer inertia. The regulator could consider the introduction of a portable bank account number for personal accounts.

2 **Ensure customers with overdrafts are not overcharged.** This will ensure customers are treated fairly and reduce barriers for new market entrants.

3 **Set 'default' settings on services, products and accounts in the customer's best interest**. As Cass Sunstein and Richard Thaler point out persuasively in Nudge, customers tend to elect the default setting that they are offered, rather than make a decision about what they actually want. The consumer protection regulator would have the power to set default settings on services, products or accounts in the customer's best interest.

4 **Allow customers to choose to 'opt-in' to unauthorised overdrafts**. Customers who do not opt in may have some payments refused. Customers would therefore be made aware of the potential cost and inconvenience of these refusals resulting from not having an overdraft facility.

5 **Ensure banks do not take advantage of existing customers**. In the retail savings market, for example, consumer inertia often leads to a reluctance to switch accounts and providers. Currently, some providers take advantage of this inertia, by only offering their best deals to new customers, and denying existing customers access to newer versions of their existing products, which may have more favourable terms.

6 **Act to prevent obscure charges or unfair, asymmetrical contract terms where these are present in financial products and services.**

7 **Ensure full and transparent disclosure on all products**. For example, any fund, such as a with-profits fund, should have full annual reports showing how the funds have performed, and how much money has been spent on commissions and management fees. Generally, it should be assumed that information should be placed in the public domain unless there are strong reasons for it not to be disclosed.

8 **Consider introducing standard products for some basic services which all retail providers have to provide, and a common form in plain English to explain the key terms so that customers can easily compare products provided by different providers on the same basis**. Additional comparative information can also be supplied on customers' use of banking products–for example, through provision of an annual summary of charges, interest forgone and average balances in standardised format.

9 **Empower customers to seek compensation via a collective redress process**. The regulator should allow simple and effective collective redress to empower retail and SME customers who have suffered widespread failures of financial products or sales processes to seek compensation when serious and systemic harm has arisen. This process would allow representative bodies to act on behalf of many customers adversely affected by the same or similar issues, with examples being financial products or services which are (a) mis-sold, (b) sold under misleading pretences or

(c) subject to unfair terms. The Commission advocates that the process should be on an 'opt-out' basis, which would allow representative bodies to take action on behalf of all consumers affected. Previous cases such as Payment Protection Insurance and mortgage endowment mis-selling would have qualified for collective actions.

10 **Promote bank retail depositors to rank ahead of all other creditors, including bondholders**. This will facilitate governments allowing institutions to fail, reducing the risk to taxpayers and forcing management to face the full consequences of their risk-taking.

11 **Ensure consumer deposit accounts clearly highlight whether or not they are covered by the Financial Services Compensation Scheme (FSCS).** This will prevent market entrants like Icesave marketing less securely protected accounts to customers who are not fully aware of the extent of their rights. It is intended, however, that the reform of the liquidation preference, mentioned above, will reduce the likelihood that the insurance provided by the FSCS is called upon.

12 **Prohibit those commission structures which incentivise mis-selling**.

13 **Firewall conflicts of interest, and if the conflicts are intractable, force structural change to address the problem**. Particular attention would be paid to conflicts of interest between the financial institution and its customers.

14th April 2011

Financial Regulation Strategy
HM Treasury
1 Horse Guards Road
London SW1A 2HQ
financial.reform@hmtreasury.gsi.gov.uk

Dear Sirs

WMBA and LEBA Response to HM Treasury Consultation Paper
A New Approach to Financial Regulation: Building a Stronger System

The Wholesale Markets Brokers' Association and the London Energy Brokers' Association (WMBA & LEBA ["WMBA"]) are the European Industry Associations for the wholesale intermediation of Over-the-Counter (OTC) markets in financial, energy, commodity and emissions markets and their traded derivatives. Our members are Limited Activity firms that act solely as intermediaries in the said wholesale financial markets. As Interdealer Brokers (IDBs), the WMBA members' principal client base is made up of global banks and primary dealers. The replies below to the questions in the paper should be seen in the context of WMBA members acting exclusively as intermediaries, and not as own account traders. (Please see www.wmba.org.uk and www.leba.org.uk for information about the associations, its members and products.) For this reason, some of the questions in the Consultation Paper are not entirely relevant to WMBA members' activities even though they are to most of their clients. Further, some answers take into account industry views and experience.

Operating as the hub of the global financial market infrastructure, IDBs are MiFID compliant and highly regulated intermediaries by virtue of their regulatory authorisation and from being subject to supervision under CAD as Limited Activity firms. Our members are neutral, independent, and multi-lateral and provide free, fair and open access to their trading venues for all suitably authorised and regulated market participants. IDBs do not take positions in the markets in which they operate and their collective service as the gateway to the global financial marketplace creates price discovery and significant liquidity. All transactions, whether executed via voice, hybrid or fully electronic means, are immediately captured at the point of trade, are subject to straight-through-processing, and are made available for transparent and timely transaction reporting to the relevant regulators.

WMBA welcomes the new approach to financial regulation outlined in the Treasury document "building a stronger system", and welcomes the opportunity to comment on it. Our response is made from the viewpoint of Limited Licence/Limited Activity firms operating in the wholesale markets and who form a major grouping in the City's financial services sector, notably one in which London retains a dominant and strong leadership role across the globe.

In short, we note that the role and function of wholesale market intermediation will be supervised from the FCA. Therefore, we are pleased to note that ***the Government also recognises that there are wholesale and markets activities which do not directly form part of the transaction chain of products and services sold to retail customers. The scale and importance of these activities makes it imperative that they are effectively, and proportionately, regulated in a way which recognises the particular characteristics of participants in these markets.***

It remains the principal and fundamental role of the UK Financial Services industry to serve as a wholesale and professional business-to-business marketplace with a global hinterland. It remains essential therefore that with the establishment of the FCA, our member firms are not supervised in a retail supervision orientated environment. Therefore, we are pleased to see the creation of a ***specialist markets function*** which ***will also contain regulation of recognised investment exchanges, multilateral trading facilities, and other trading platforms***.

Further, we also consider it correct that the FCA represent the UK at ESMA since it is this set of market intermediaries who will require direct representation within ESMA. However, in anticipation of the June White Paper, we would ask the following questions in respect of the trading platforms which our members operate:

1. What will be the ongoing supervision arrangements for Limited Activity and Limited Licence intermediaries for whom the ARROW process does not proportionately, nor directly, address their business models and in an environment where the ARROW methodology would appear to be less favoured going forward?

2. Will there be a distinct category within the ***specialist markets function*** for the regulation and supervision of Wholesale intermediary firms acting under Limited Activity and Limited Licence permissions?

3. Can the UK authorities ensure that the Limited Activity and Limited Licence categories of authorising permissions be maintained inside CRD_4 and CRD_5, such that imposition of regulatory capital does become applied to intermediaries who take no principal risk?

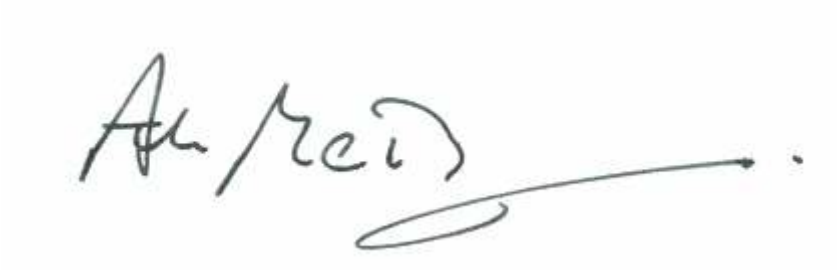
4. With respect to Fees and Levies, we note the vastly disproportionate burden of the FSA fee's that fall onto our member firms within Fee Blocks 12 and 13 in relation to either the amount of risks that they pose or the degree of supervision that they require. Indeed we are of the opinion that, because of the diversified nature of firms within these fee blocks, WMBA/LEBA members are being asked to contribute to the additional cost of regulating the retail sector in which they do not participate.

5. We would suggest that, with the advent of the new regulatory structure, to ensure a justifiable and proportional allocation of future funding costs, a review is undertaken of fee blocks A12 and A13 (or the potential new amalgamated fee block) with a view to splitting costs between firms acting purely in the professional markets and those dealing with retail counterparts. For simplicity, these costs could be allocated based on the client types within the permissions regime.

6. Also with respect to Fees and Levies, we note the periodic fees that were first imposed in 2009/10 with the intention of recovering the £8.8m development and implementation costs of the SABRE II monitoring system for security derivatives. The FSA have subsequently released figures under the Freedom of Information Act that the final costs for this development could be as much as £15m. The costs were to be recovered over 4 years and based on the number of contracts a firm executed on Regulated Investment Exchanges during the previous 12 months. As a result of the allocation policy which is grossly unfair on WMBA members who carry out high volume low margin business in exchange traded derivatives and despite numerous requests by WMBA for a review, five WMBA members have contributed approximately 20% per annum of these costs.

Should you have any queries or are able to give any further details on the revised regulatory structure for wholesale market intermediaries, please do not hesitate to contact us.

Yours faithfully



Alexander McDonald
Chief Executive Officer

Member Firms

- BGC Partners
- EBS Group Ltd
- GFI Group Inc.
- ICAP plc
- Martin Brokers (UK) Ltd
- Reuters Transaction Services Ltd
- Sterling International Brokers Ltd
- Tradition (UK) Ltd
- Tullett Prebon Ltd
- Vantage Capital Markets
- Evolution Markets Ltd.
- GFI Group, Inc
- ICAP Energy Ltd
- PVM Oil Associates Ltd
- Spectron Group Ltd
- Tradition Financial Services Ltd
- Tullett Prebon Energy Ltd

FOR PUBLICATION

WITHERS LLP'S RESPONSE TO THE HM TREASURY CONSULTATION PAPER CM8012: A NEW APPROACH TO FINANCIAL REGULATION: BUILDING A STRONGER SYSTEM (FEBRUARY 2011)

1. This response is submitted on behalf of Withers LLP.

2. We are responding to the following questions of CM8012 as follows:

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

3. Further detail is required about how the new regulator is to be accountable and/or transparent for the judgments it makes. The proposal that limited grounds should be equivalent to those raised on a judicial review would mean that the Courts would have to be prepared and resourced to hear such public law applications. It also begs the question whether the Administrative Court as opposed to the Upper Tribunal is the more appropriate forum for such hearings.

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

4. It is welcome that the legislation will define a trigger for when a report must be produced because a report under the FSMA section 14 power has yet to be produced despite a number of regulatory failures. That trigger should be independent of the discretion of the regulator(s) to be credible. There should also be provision for an independent assessment and review of any report produced by the regulator(s) because they ought not to be the judge and jury of their own mistakes. They must be held properly to account for the mistakes and damage they may have caused.

5. The existing complaints procedure in relation to the FSA is not sufficiently robust. The Complaints Commissioner has no power to require the FSA to do anything (please see attached a copy of his latest adjudication which commences with him setting out the standard template as to what he can not do). Further, an important safeguard was removed when the FSA was removed from the jurisdiction of the Parliamentary Ombudsman when FSMA came into force on 1 December 2001. An independent person should be given sufficient powers to provide credible oversight of the new regulators and to be able to hold the new regulators properly to account. The pre FSMA power of the Parliamentary Ombudsman to investigate whether the regulators as public bodies have committed mal-administration should be reinstated. It is a flaw of the existing FSMA regime that there is no such independent body with sufficient powers to investigate the actions of the FSA and to hold it to account. Clearly it is a concern that the Minister responsible for the FSA has admitted that with the current system there is a "democratic deficit"[1].

[1] Mark Hoban MP before the Treasury Select Committee on 30 November 2010

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

6. The Government's emphasis on the need for openness, clarity and transparency of the new regulators is welcome. The new regulators ought to be subject to an equivalent disclosure requirement as the firms and the individuals that they regulate to be open and co-operative and to disclose anything relating to the regulators of which the regulated firms and individuals would reasonably expect notice (Principle 11 of PRIN and Principle 4 of APER). There is at present a double standard that the FSA has sought to exploit since it has become more intensive, intrusive and litigious in its approach ie there is one express rule/standard for the regulated and another unspecified rule/standard for the regulator that is in any event unenforceable. There should be an equivalent requirement to ensure that the new regulators are transparent and can be held to account for their actions.

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

7. For the FCA to achieve its single strategic objective to protect and enhance confidence in the UK financial system, it is vital that the FCA is seen as accountable and transparent in its dealings. In carrying out its operational objectives, it must be accountable. There is insufficient accountability and transparency within the current regulatory structure. The FSA is able to ride roughshod should it choose to do so. Without sufficient accountability and transparency built into the new regulatory system, the FCA could exercise those operational objectives in a way that destroys firms and the individuals that work and or invest in and through those firms (see for example our response to question 14 and the recent outcome of the FSA investigation into Gartmore which resulted in the take over of Gartmore at a much diminished share price despite there being no FSA finding of wrong doing against Gartmore or any individual involved). This could diminish the competitiveness of the UK financial services industry and the wider economy.

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

8. As noted above, the existing arrangements for investigation of complaints against the FSA is not sufficiently robust. The new Complaints Commissioner (or a body such as the Parliamentary Ombudsman) should be given express powers to direct the FCA to do what they consider appropriately in all the circumstances and make findings adverse to the FCA that can be independently enforced.

9. Likewise it is again welcome that the Government is proposing to define a trigger that a report must be produced. However, it is inconsistent with the concept of the FCA being properly accountable that the FCA rather than an independent body such as the Parliamentary

Ombudsman should determine when that trigger has been met. There should also be provision for an independent body such as the Parliamentary Ombudsman to assess and review the report produced by the FCA. Clarity is also required as to what the Treasury might do with such a report produced by the FCA.

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

10. Our concern is whether the FCA staff will have sufficient experience and understanding to exercise the appropriate judgment on a forward-looking basis. It is a common criticism[2] of existing FSA staff that they are too junior, lacking in experience and industry knowledge with a very high staff turn over. Hence industry experience to date would indicate that this experience and understanding is not currently present.

Question 14: The Government would welcome specific comments on:

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

11. As noted above, transparency should be a mutual concept with the new regulators subject to the same transparency and accountability obligations as regulated firms and individuals. There is also the question of inequality of arms should the new regulators publish wrongly information about a firm or an individual. The new regulators at the least should be under an obligation to give the same level of publicity to their retraction of that wrongful publication as their original publication of the warning notice. There should also be an independent body to over see that the new regulators observe this obligation properly. This could be their Complaints Commissioners provided they have powers to compel the new regulators to take appropriate action when they have failed to do so. The Complaints Commissioners should also be given an adequate budget and resources to publicise their actions against the new regulators in particular cases. This would ensure confidence in accountability and transparency of the regulatory system and process.

12. We support the proposals to direct withdrawal of financial promotions. The FCA should also make available its reasoning why certain financial promotions are unacceptable. This would provide a precedent bank as to what is a clear, fair and not misleading financial promotion and what is not. That precedent bank should be available as a binding authority to hold the FCA to

[2] See for example the comments of the Governor of the Bank of England before the Treasury Select Committee on 1 March 2011

account for the consistency and predictability of its approach. Otherwise this is a highly subjective test.

13. The early publication of enforcement action should not be implemented in any individual cases where there is no ongoing possibility of consumer detriment. Otherwise this proposal is contrary to Article 6 of the European Convention on Human Rights ('**ECHR**') (the right to a fair trial) and Article 8 of the ECHR (the right to respect for private and family life). It is also potentially defamatory as well as unnecessary given that the findings of the tribunal will be publicly available and can ultimately be republished by the FCA to aid consumer protection.

14. It would be unjust and unlawful under both Article 6 and Article 8 ECHR for the FCA to take from individuals (or for that matter firms) their good name until there has been a judicial process of independent third party review of that decision.

15. Article 6 ECHR provides that:

(1) In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgement shall be pronounced publicly by the press and public may be excluded from all or part of the trial in the interest of morals, public order or national security in a democratic society, where the interests of juveniles or the protection of the private life of the parties so require, or the extent strictly necessary in the opinion of the court in special circumstances where publicity would prejudice the interests of justice.

(2) Everyone charged with a criminal offence shall be presumed innocent until proved guilty according to law.

(3) Everyone charged with a criminal offence has the following minimum rights:
(a) to be informed promptly, in a language which he understands and in detail, of the nature and cause of the accusation against him;
(b) to have adequate time and the facilities for the preparation of his defence;
(c) to defend himself in person or through legal assistance of his own choosing or, if he has not sufficient means to pay for legal assistance, to be given it free when the interests of justice so require; (d) to examine or have examined witnesses against him and to obtain the attendance and examination of witnesses on his behalf under the same conditions as witnesses against him;
(e) to have the free assistance of an interpreter if he cannot understand or speak the language used in court.

16. Article 8 ECHR provides that:

(1) Everyone has the right to respect for his private and family life, his home and his correspondence.

(2) There shall be no interference by a public authority with the exercise of this right except such as is in accordance with the law and is necessary in a democratic society in the interests of national security, public safety or the economic well-being of the country, for the prevention of disorder or crime, for the protection of health or morals, or for the protection of the rights and freedoms of others.

17. Warning notices are by their very nature given at the very outset of any action being taken by the FSA, long before a decision is reached, if indeed a decision is reached at all. On occasions, warning notices do not lead to a decision but are simply discontinued. The FSA's own statistics indicate that one in five of all FSA warning notices issued to end of 2010 did not result in a decision notice.[3] In other words, some 20% of all FSA warning notices had they been publicised under this proposal would have been wrongly publicised.

18. Receipt of a warning notice will often be the first that an individual will know that the FSA is considering taking action against them and the grounds on which it proposes to do so. Those grounds could be ill conceived and based on inaccurate and/or misunderstood information that the subject would not have been given an opportunity to correct. The FSA itself acknowledges that preliminary investigation reports serve a very useful purpose[4] and allow the person concerned to confirm that the facts are complete and accurate and/or provide further comment[5]. However, the FSA has stated that there is no statutory requirement to provide such preliminary investigation reports for correction and/or comment and it is not bound to do so. At the very least the FCA should be statutorily required to give a prospective subject of a warning preliminary investigation report a preliminary investigation report and a reasonable period of at least 28 days to correct and comment on that preliminary investigation report. The FCA should then be under another statutory obligation to consider the corrections and comments it receives on its preliminary investigation report and to set out in the body of any warning notice subsequently issued, the corrections and comments it has received and why it disagrees with them. This would provide a public cross reference point should the subject of the warning notice then prove the FCA mistaken in the subsequent Enforcement proceedings. The FCA should also be required to publicise its errors in the warning notice issued in these circumstances.

19. Whilst the Financial Services Act 2010 has allowed the FSA to publish Decision Notices in relation to Warning Notices issued after 12 October 2010, it remains to be seen whether that

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[3] Based on the statistics published by the RDC, available at http://www.fsa.gov.uk/pages/about/who/pdf/rdc_stats.pdf , between December 2001 and December 2010 the FSA issued 1,167 warning notices (an average of 117 per year). Over the same period it issued 931 decision notices.

[4] Paragraph 4.31 of the FSA's Enforcement Guide

[5] Paragraph 4.32 of the FSA's Enforcement Guide

existing legislation is compliant with the Human Rights Act 1998. The individual has yet to have a fair and public hearing by an independent and impartial tribunal. To publish a Decision Notice before that individual has been allowed to exercise his right of referral to such a tribunal would appear to constitute a breach of that person's rights under Article 6(1).

20. Furthermore, the fundamental legal principle of 'equality of arms' provides that 'a person is entitled to a reasonable opportunity to present his case under conditions which do not place him at a substantial disadvantage to his opponent.' Legal aid is not available to persons who refer their decision notices to the tribunal other than in market abuse cases.

21. By publishing either a warning notice or a decision notice, the FSA may have the effect of causing financial detriment to the individual subject to the warning notice (who may lose their employment and/or financial livelihood as a result of the allegations being made public). This could mean that the individual would not be able to afford otherwise the legal costs of making the referral to the tribunal and could be an incentive for the FSA to expedite publication to avoid an effective challenge to its own internal administrative decision making process. This may have the effect that people are put in the position where they cannot afford otherwise to challenge decisions made by the FSA. This ought to be seen as a breach of their Article 6(1) rights and at the very least is repugnant to the principle of equality of arms.

22. Consequently we do not consider that there are any circumstances in which it would be acceptable to publish a warning notice in relation to an individual. Indeed, we do not consider that there are any circumstances other than a flagrant disregard for the general prohibition (s19 Financial Services and Markets Act 2000 (**'FSMA'**)) and the financial promotions restriction (s21 FSMA) in which it would be proportionate, fair and compliant with Articles 6 and 8 of the ECHR that a decision notice in relation to an individual should be published if that individual decides to refer the FSA's decision notice to the tribunal. To reflect the fundamental tenets of natural justice, no man is to be a judge in his own cause and no man is to be condemned unheard.

It is vulnerable to judicial review

23. The FSA is also still obliged to make the balancing judgment in section 391(6) FSMA:

"But [the FSA] may not publish information under this section if publication of it would, in its opinion, be unfair to the person with respect to whom the action was taken or prejudicial to the interests of consumers."

24. HM Treasury's proposed approach (ie the expectation that the regulator will publish the fact that a warning notice has been issued unless doing so would not be compatible with its operational or strategic objectives) appears to ignore this statutory duty on the FSA to undertake that balancing judgment in each case. Instead there would be an automatic presumption (described as a discretion rather than a duty) to publish in the interests of consumers, whether or not that was in

fact the case (see paragraphs 50 to 52 below) and without taking into any consideration the fairness to the person, the subject of the warning notice.

25. The FSA can not resile from this statutory duty to make such a balancing judgment. If the FSA adopts an automatic process by which warning notices are automatically published, this could be said to ultra vires and its decision could be subject to judicial review (*Associated Provincial Picture Houses v Wednesbury Corporation [1948] 1 KB 223*).

26. Schedule 1 Paragraph 19(1) of FSMA 2000 seeks to exclude the FSA and its agents from liability in damages for an action or omission in discharge of the Authority's functions. However, there is an exception in Schedule 1 Paragraph 19(3) which specifically disapplies Paragraph 19(1) if the act or omission is shown to have been in bad faith or if its application would prevent an award of damages made in respect of an act or omission unlawful per section 6(1) of the Human Rights Act 1998 (**'HRA'**).

27. Section 6(1) HRA 1998 states that it is unlawful for a public authority to act in any way which is incompatible with a convention right. However, section 6(2) HRA states that subsection 1 will not apply if (a) as the result of one or more provisions of primary legislation, the authority could not have acted differently; or if (b) in the case of one or more provisions of, or made under, primary legislation which cannot be read or given effect in a way which is compatible with the Convention rights, the authority was acting so as to give effect to or enforce those provisions.

28. All UK law must be interpreted, so far as it is possible to do so, in a way that is compatible with HRA rights. The amendment to s391 appears to create a loophole in primary legislation which would allow the FSA to perform an act (publish its warning notices prior to the independent Tribunal's hearing) which is inconsistent with a Convention right (the Article 6 ECHR right to a fair trial). Of course, the HRA maintains parliamentary sovereignty and Parliament can decide whether or not to amend the law. However, this provision of primary legislation does appear to be inconsistent with the HRA.

29. As a consequence, the court will have the discretion to grant traditional 'judicial review' relief reviewing the lawfulness of a decision made by a public authority. If the court concludes that a decision is unlawful it can declare that the public authority acted unlawfully, cancel the decision or prevent a public authority from acting in a certain way. In most situations if a decision is found to be unlawful the court will remit the issue back to the public authority to make the decision again. This could have the effect of undoing the amendment to s391.

30. The court would also be able to award compensation to the extent the court considers it necessary, just and appropriate and to make a declaration of incompatibility, stating that that the law (rather than the decision made under the law) is in breach of human rights. Parliament will then take steps to remove the incompatibility.

Warning notices may be defamatory publications

31. Given the likely seriousness of the allegations contained in a warning notice - ie that it will tend to injure a person's reputation in business and convey an imputation as to their knowledge, judgment, capability and conduct - the routine publication of decision notices prior to the findings of an independent tribunal would be likely to give rise to defamation proceedings against the FSA/FCA by the subject keen to protect their name and reputation. From a practical perspective for the FSA/FCA, it should note that not only is it wrong to put the subject in the position whereby (s)he has no option but to engage in proceedings to salvage and defend a reputation damaged by an unproven yet serious allegation, but once proceedings are commenced, the balance of proof will be shifted to the FSA/FCA, who will then have to defend the content of the warning notice.

32. There is existing case law against public authorities in breach of Article 8 ECHR rights and associated libel actions that the public authorities should not be allowed the qualified principle defence where publication was ill considered and indiscriminate (*Clift v Slough BC [2009] EWHC 1550 (QB)* and *Wood v Chief Constable of the West Midlands [2004] EWCA Civ 1638).*

Justification for each warning notice and the balancing act

33. The FSA's justification that greater transparency would increase the impact of regulators' enforcement work by highlighting potential issues to consumers (see paragraphs 50 to 52 where there are circumstances where it would not be in the interests of consumers) and signalling to firms what behaviours the regulator considers unacceptable, can be no justification when applied to an individual. That individual would need to be associated with a FSA Authorised firm to perform any function in relation to regulated activities in the UK. Hence the exception we propose in relation to the general prohibition and the financial promotions restriction.

34. We do not believe that the system in place before 12 October 2010 under which the FSA could only publish final notices required reform. Nor are we able to recall any specific instances in the last 10 years where consumer protection may have benefitted from publishing a warning notice before an individual has exercised their right to have their case heard by the independent tribunal under a judicial process rather than an administrative process. For its own convenience, the internal FSA administrative process does not have the safeguards of a judicial process. The appropriate balance is already struck by allowing the subject of that internal FSA administrative process to refer any FSA decision to the independent tribunal before any irreversible action is taken.

35. This ought to be maintained as a fundamental principle of English justice. This is even more so if the warning notice contains any allegation of criminal misconduct – as to do otherwise would be

to breach Article 6(2) ECHR – that an individual accused of a criminal offence shall be presumed innocent until proven to be guilty in a court of law.

36. The FSA may be seen to base their policy on the presumption that the tribunal will uphold their decision. This could damage public confidence in the independence of the tribunal. Indeed, publishing a warning notice before the tribunal has had the opportunity to review the facts and test the evidence could be tantamount to the FSA prejudging the outcome of the tribunal hearing.

37. If, on the other hand, the tribunal upheld the individual's referral at decision notice stage[6], the individual may well consider an action for defamation and the protection from liability afforded to the FSA in paragraph 19 of Schedule 1 FSMA should not apply in these circumstances.

38. Further, we think the approach would not be justified when applied to a FSA Authorised firm. If there is a genuine risk of immediate harm to consumers then the FSA/FCA ought to issue a Supervisory Notice against the FSA Authorised firm and not a Warning Notice.

39. In the event of immediate consumer harm concerns then the FSA/FCA should seek to act quickly in issuing a Supervisory Notice. This in turn ought to give the FSA Authorised firm an expedited right of recourse to the independent Tribunal.

40. In such instances, we propose that the balance of interests requires the FSA Authorised firm as quick as possible recourse to the independent Tribunal to correct any misconceptions the FSA may have in taking that Supervisory action. The working practices of the Tribunal and the FSA (and the Tribunal rules) ought to be overhauled to ensure that the process is expedited as quickly as possible.

Proportionality

41. Under s2(3)(c) FSMA, the FSA is under an obligation to apply burdens and restrictions proportionately. Unless there is an exceptional risk of immediate harm to consumers which a reasonable person would regard as requiring the FSA to make immediately public its warning notice, it would not be proportionate for the FSA to publish a warning notice.

42. If HM Treasury is concerned with the visibility of the actions it is taking to protect consumers' interest, the proper approach should be to seek to streamline the process, including strict case management requirements that apply to the FSA investigation team as well as to the subject of the investigation. The safeguards which were originally built-into FSMA to prevent reputations being irreparably destroyed before the subject has had the opportunity to make representations

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[6] See for example *Paul Davidson and Ashley Tatham v FSA (Upper Tribunal Case No 31 Decision), Ravi Manchandra v FSA (Upper Tribunal Case No 034 Decision), Barket Financial Management Ltd and Bashir Ahmed v FSA (Upper Tribunal Case Reference No 65 Decision), Stephen Robert Allen v FSA (Upper Tribunal Case Reference No 70 Decision)*

to an independent body should not be ignored. The current delays in bringing regulatory proceedings to a conclusion are often the fault of the FSA investigation team because they are not subject to any deadlines to complete their work. This in itself is invidious to the subjects of their investigations.

43. The rationale of early visibility is not (unless the circumstances are exceptional) proportionate to the risk of causing irreparable damage to an innocent person's or company's reputation before they have had the opportunity to make representations to the Tribunal. The proper course of conduct should be that the subject should be presumed to be innocent of the alleged misconduct until they have either admitted the facts in the FSA's warning notice or the decision of the FSA has been upheld by the independent tribunal.

44. By contrast, in the context of a criminal investigation, if the police were to publish a statement to the effect that a named individual had committed an offence, before the evidence against that person had been assessed by an independent court, the police would, quite rightly, be liable in defamation. The Government's proposals if implemented would therefore require an equivalent balancing legal liability for the FSA/FCA.

45. Where the subject of an FSA warning notice is accused in an FSA warning notice of a lack of honesty or integrity, or a wont of competency, that individual should similarly be entitled to protect their reputation and be awarded damages if it transpires that the FSA did not have reasonable grounds for publishing that information.

Fairness

46. The FSA freely admits that the there can be a 'long delay' between the FSA issuing a warning notice and the outcome of the referral to the tribunal. This process can take many months or even years. In all but the most serious circumstances (where there is an immediate risk to consumers which we recommend should be dealt with instead through the Supervisory Notice procedure as we suggest is amended) it is unfair and would be unlawful that throughout the whole time of that 'long delay' the individual subject to the warning notice should have the allegations against him/her made public (with the consequent damage to his/her personal reputation and finances), when the independent tribunal may finally hold that the allegations are unfounded.

47. In that instance, as we have identified above, fairness dictates that person should be compensated for the FSA's wrongdoing and the FSA held properly to account. How the FSA could undo the damage it has done (if at all) would be a complicated matter. In other words, Pandora's box is best kept shut until the independent tribunal had reviewed the fairness of the FSA's decision.

Market confidence

48. If the Tribunal overturns the decision of the FSA, after it has been published, that would actually be contrary to the FSA's objective of market confidence – the confidence of consumers and participants in the judgment of the FSA would be damaged by the publicity that the FSA had erroneously made allegations against a participant.

49. An unexpected side-effect of the proposals may be that participants who had suffered loss to their reputation and financial damage through the publication of warning notices may (in the absence of any process for redress) consider that they have no option but to litigate for libel with all the attendant publicity that that will entail. Media speculation and/or criticism of the FSA's heavy-handed approach might of itself serve to undermine confidence in the UK financial services industry.

50. Another side-effect will be the impact on third parties. If the FSA publishes a warning notice concerning an FSA authorised firm, consumers investing in that firm may be inclined or even compelled (by virtue of the terms on which they have invested, for example under the terms of a trust mandate) to break their contracts with that firm and withdraw their investments on the assumption that the firm is guilty of wrongdoing. In doing so they would be likely to incur financial penalties for breach of their contracts, or even be subject to lengthy and expensive litigation.

51. If the firm is subsequently exonerated by the tribunal, so that no final notice is issued at least in the form previously published by the FSA, to whom should the consumers have recourse for the financial loss they have suffered? They would not, in those circumstances, be able to claim against the firm itself, nor would they be eligible for compensation under the Financial Services Compensation Scheme (unless the effect of the FSA publishing the warning notice had been to make the firm insolvent and in default (though that default decision would have to be reviewed itself in the light of the Tribunal decision)) or the Financial Ombudsman Service.

52. Their only potential recourse would be to bring a claim against the FSA. Consumers in these cases would have to argue that the FSA's statutory immunity in Schedule 1 Para. 19 FSMA does not apply in these circumstances. In these circumstances, it would not be fair for consumers to have to overcome the current high threshold set by the FSA's statutory immunity. We respectfully suggest therefore that the FSA's statutory immunity would require amendment to re-balance fairness to consumers as well as the subjects of warning notices if there are instances of premature publication.

Financial Services Bill Committee Report

53. In a similar vein in the context of decision notices, we note from the parliamentary record that it was first proposed that the right to publish decision notices as well as final notices would be included in the Financial Services and Markets Bill in 1999. However that was amended following

concerns voiced in the scrutiny committee (which were similar to the concerns raised in this response), with the result that the FSA was prohibited from publishing all but final notices in s.391 FSMA.

54. The Financial Services Bill Committee Report (House of Commons Library, Research Paper 10/04) discussed the issues which are pertinent to this consultation paper response. That paper identifies the need to balance the principle of 'innocent until proved guilty' against the interest of consumer protection (see pages 15 to 16 of that Report). That balancing principle appears to have been lost in the FSA's proposed approach. We would draw the FSA's attention to the following statements made in that Report:

Mark Hoban MP:

The issue is important for consumer protection; consumers should know which firms are under investigation. It is also important to help change the culture of the financial services sector and to have much more public disclosure of information. I also acknowledge that it is not a straightforward issue. We need to think very carefully about the impact legislation might have on a business. We need to think about what is the right step in a process where it may be possible to publish more information than is currently the case, but a process that is entirely private until the conclusions of the financial markets tribunal could potentially be to the detriment of consumers.

The Economic Secretary to the Treasury, Ian Pearson MP:

I recognise that section 391 does not require the FSA to disclose the fact that someone is subject to investigation, it simply gives the option of doing so… Parliament was clear at the time that publication should happen only at the end of the process, after the firm has had a chance to make representations and the option of referring the matter to the tribunal. The Government's position is that that is reasonable, given—again—that UK law is based on the principle that people are assumed to be innocent until found guilty….

[The Treasury Committee] felt that the balance between disclosure to the public and the need to protect firms before they had been found guilty of wrongdoing was tilted too far towards the needs of industry. In its response to the Treasury Committee report, the FSA made the point about fairness to those accused of wrongdoing but who had not yet had the chance to defend themselves, as I mentioned. In addition, the FSA helpfully responded that it can and sometimes does publicise whether it is investigating a particular case. It tends to do that only in exceptional cases—for example, where it is desirable to do so to maintain confidence in the financial system or to protect consumers or investors. On the important issue of consumer protection, I think hon. Members would expect the FSA to have the ability to publicise whether it is investigating a particular case. Given the fact that that can happen, the FSA stated, and I agree, that the current

framework allows a balance to be struck between achieving its objectives—in particular, consumer protection—and fairness to firms and individuals. It is a question of striking the appropriate balance…

55. The Treasury Committee and the FSA itself identified a need 'to strike a balance' between the interests of consumers and the right of people not to be publicly accused of wrongdoing before they have had the opportunity to defend themselves. This need to balance these conflicting and important issues is not reflected in the Government's proposal.

56. The concerns expressed by Parliament could be simply met if the FSA publicised whether it was investigating a particular case. It has the right to do that and has done so in certain cases. We see no reason why the FSA does not have sufficient and proportionate powers therefore already to publicise it is investigating a particular case.

Our recommended approach

57. The correct and lawful approach is that the FSA should not publish a warning notice in respect of an individual except where there is flagrant disregard for the general prohibition and financial promotions restriction such that there is an immediate threat of harm to consumers which justifies the publication. In other words, the publication of the warning notice is justified on the basis that consumers need to be put on notice of unauthorised regulated activities that are still ongoing and that are a current rather than a past threat to consumers.

58. We would recommend that the FSA issue Supervisory Notices instead of Warning Notices against FSA Authorised firms where there are immediate consumer protection concerns and the FSA Authorised firm be permitted to refer that FSA Supervisory Notice to the independent tribunal on a far more expedited basis than appears currently possible.

59. Those who have been issued with a warning notice that was published before it was reviewed by the independent tribunal ought to be compensated for the damage to their reputation and earnings by that FSA action if that FSA action is overturned in any way by the independent tribunal. The Government should also consider the need to compensate any third parties who might have taken irreversible decisions as a consequence of a prematurely published FSA decision notice (see paragraph 52 above).

60. Further, there should be a requirement on the FSA to publish a full retraction or clarification where the Tribunal's findings are at odds with the allegations contained in the warning notice. This would also give rise to a claim for general and compensatory damages.

61. The potential complexity of such arrangements of redress (and the need for primary legislation) only serves to emphasis our primary submissions that there should be no question of publishing decision notices unless there is an immediate and present threat to consumers.

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

62. Our preference is that the FCA should be given overall responsibility for processing of the application and there should be one statutory clock for the determination of the application. It is important that one regulator should be responsible and accountable for any delays in the process.

63. The two regulators ought to be required to work together to maintain the competitiveness of the UK financial services industry. We are concerned that the proposals might add extra layers of complexity and delay into the authorisation process and make alternative financial centres particularly in the EEA more attractive authorisation venues and places to establish business to the detriment of the wider UK economy. Once authorised elsewhere in the EEA, those firms have the right to exercise their passport into the UK to provide services and/or branches in any event.

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

64. Where either regulator exercises its OIVoP power or seeks that one of its firms makes a VVoP, it is important that the firm concerned should have the right to refer that decision to the Tribunal on an expedited basis. Else as is said in the consultation paper, the removal of a key decision could well make a firm's business model unviable, bringing about its failure. Either regulator's judgment in this regard therefore must be subject to the right of referral to an urgent and expedited independent review and to be accountable.

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

65. It is not clear whether the split between the PRA and the FCA would be as clear cut as is suggested in relation to Significant Influence Functions. There appears otherwise to be an asymmetry between firms regulated solely by the FCA whose senior management can be held personally to account for the firm's interface with customers and those firms also regulated by the PRA, whose senior management appears can not. That the senior management of retail banks are not properly accountable for their institutions dealing with their customers is already a matter of grave public concern.

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

66. There is no specific mention of the Freedom of Information Act 2005 ("FoIA"). Whilst we welcome the FOS being made subject to FoIA, the FSCS remains outside its scope. For the sake of consistence and accountability, the FSCS should also be made subject to FoIA.

Further confidential information

67. Further information about our practical experience with dealing the current regulatory regime and its lack of accountability and transparency can be provided on a confidential basis if HM Treasury requires.

Withers LPP

14 April 2011

A New Approach to Financial Regulation: Building a Stronger System

Zurich Financial Services Group (Zurich) is an insurance-based financial services provider with a global network of subsidiaries and offices in North America and Europe as well as in Asia-Pacific, Latin America and other markets. Founded in 1872, the Group is headquartered in Zurich, Switzerland. It employs approximately 60,000 people serving customers in more than 170 countries.

We welcome the opportunity to contribute to this consultation. We welcome the Treasury's commitment to influencing European regulation, and welcome positive steps that have already been made in this area, including the establishment of the Insurance Forum.

We also welcome many of the key decisions that have been made in creating the new regulator, including the decision to give the PRA a veto power on issues which could lead to the disorderly failure of a firm or wider financial instability.

We appreciate the decision to raise the issue FOS transparency and accountability in this consultation. The key issue here is to design a mechanism that will replace the Issues with Wider Implications process, which can allow firms to raise wider issues without needing to seek the prior approval of the FOS itself. This issue has been outstanding since it was raised by Lord Hunt's review of the Ombudsman in 2008, and needs to be addressed in order to avoid a more litigious and confrontational regulatory environment in future.

Our detail comments are set out below. Please feel free to contact us if you have any comments or questions.

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

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

The tools set out appear proportionate and relevant.

On the issue of loan to value, in the retail market the regulators could consider imposing higher training requirements on mortgage advisers who are allowed to recommend loans with very high value-to-loan ratios. This would help to ensure that consumers who purchased these loans would be guided by advisers who were even more aware of the risks involved, which would in turn act as another check on consumers taking on unsustainable levels of debt.

We agree with the Treasury's aim to engage effectively in EU regulatory processes, and we welcome the efforts the Treasury has made to engage with practitioners in the UK on EU issues, especially during the Solvency II project.

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

We think these mechanisms are appropriate, especially given that many of the members of the FPC are accountable to Parliament and other public bodies through the organisations that are involved with the FPC.

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

We do not have any comments to make on this subject.

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

We think these standards are appropriate, and welcome the decision to retain the spirit of the 'have regards' from the existing regulatory system.

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

We think that the scope is appropriate, and we welcome the statement that 'effective supervision of insurance firms for soundness and stability by the PRA may be achievable through a less intensive supervisory approach than would need to be the case for a bank'.

The PRA's supervision on insurance companies should focus first on ensuring that insurance companies have not taken on non-insurance risks. Where insurance companies are able to establish that they are engaged purely in traditional insurance business, the approach should be much less intensive.

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)?

Given the Government's emphasis on transparency and accountability across all its functions, and not just financial regulation, we would question the desirability to reduce the grounds on which appeals can be made. The UK goes further than many regulatory regimes around the world in making individuals responsible for their conduct through the approved persons regime, and the UK authorities should ensure that there is a strong governance structure around the way in which practitioners are treated.

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

This framework appears to be appropriate.

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

We agree with the proposed mechanisms.

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

We agree with the proposals, and welcome the decision not to change significantly the PRA's duty to consult and quantify the costs and benefits of regulation.

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

We agree with the proposed objectives and principles.

We also agree that responsibility for financial inclusion should rest with Government rather than a regulator. In this spirit, we would like to see the Treasury more engaged on regulatory issues that have an impact on financial inclusion in future. For example, the

Treasury has done relatively little to ensure that consumer access to advice has been properly addressed during the Retail Distribution Review, and it has been left to the Treasury Select Committee to emphasise the importance of this issue relatively late in the Review.

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

We agree with the proposed arrangements, and welcome the commitment to transparency. In this spirit, the FCA should commit to publishing the training material and guidance given to its supervisors, to give firms reassurance that they are being treated in a way that is consistent with their peers.

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

We understand the desirability to restrict the sale of products that are not fit for purpose as early as possible.

We believe that the Treating Customers Fairly initiative already achieves this for the vast majority of firms and products, and we think that the product intervention power should be introduced in a way that:

- Makes it clear that it is a last resort, only to be used when other regulatory approaches have been unsuccessful
- Ensures that it is used in a consistent and proportionate way. In line with our answer to question 12, when implementing this power the FCA should commit to publishing the training material and guidance given to its supervisors, to give firms reassurance that they are being treated in a way that is consistent with their peers.

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 agree with efforts to increase transparency. We would urge the Treasury and the regulators to respect the fundamental rights of practitioners to be punished only after an appropriate process has taken place.

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 think that the FCA should work closely with competition regulators, but we do not think that it is desirable for different regulatory organisations to hold overlapping powers. The analysis in the consultation paper is relatively brief, and it is not clear what the benefits of concurrently held powers would be.

16 The Government would welcomes specific comments on:

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

We have no comments on these proposals.

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

We agree with the mechanisms and processes.

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 strongly welcome the proposal to give the PRA a veto power where there is a risk of the disorderly closure of a firm.

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

We agree with the second approach, where one regulator is responsible for processing the application, but both regulators have the right to interact directly with the applicant and refuse an application. Having one regulator processing the application will reduce bureaucracy and duplication.

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

We agree with the proposals.

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

Some roles within firms will have both a prudential and conduct element. In order to reduce confusion and bureaucracy, there should be a single point of contact for firms that are regulated by both the PRA and FCA to provide a definitive judgement about which regulator should lead the process for approved person authorisation.

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

We agree with the approach set out. We agree that the PRA should work closely with home state regulators, and believe that regulatory colleges form a good structure, within which duplication and overlap of activity can be minimised.

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

We recognise the benefits of grass-roots efforts to meet a community's financial needs, but as a general principle, we do not think the regulatory system should favour one ownership structure over another. Many mutuals are extremely well-run firms, but there have also been problems with some mutuals in the past, most notably Equitable Life.

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

We agree with the proposed process.

25 The Government would welcome specific comments on
• proposals to support effective group supervision by the new authorities – including the new power of direction; and
• proposals to introduce a new power of direction over unregulated parent entities in certain circumstances?

We agree that groups should be regulated with reference to the risks posed by a group as a whole. This should also apply to the benefits delivered by a well-diversified set of risks across a group.

We agree with the proposals on group supervision, provided measures to regulated groups respect responsibilities for supervision set out in EU law.

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

We agree with the proposals.

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

We agree with the proposals.

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

We broadly agree with the proposed approach. It is possible that organisations such as CFEB could grow to a very considerable size, and we are concerned that its levy could become very significant. We would ask whether there should be a limit to the CFEB levy, beyond which parliamentary approval would be required, given that such a levy is in effect a tax on financial services.

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

We agree with the proposals as far as they go. The previous consultation raised the possibility that cross-sectoral subsidies between systemically significant and non-significant firms may be ended, which we supported. The final decision on this issue does not seem to have been articulated in this consultation.

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

We welcome the decision to raise this issue in this consultation, and we welcome the proposals on increased transparency.

There is one issue that has not been addressed in this consultation, and that has apparently also not been addressed in the recent decision to replace the Issues with Wider Implications process with a coordination committee consisting of the FOS, FSA and Ministry of Justice.

This issue is the lack of opportunities for firms to raise concerns over FOS decisions that carry significant consequences when applied to similar complaints. These decisions may not always be anticipated by the coordination committee, because they may relate to business written over the last 20-30 years, and they may relate to issues such as the way in which compensation is calculated or the way in which marketing material is interpreted that the coordination committee has no way of forecasting when issues first emerge.

In these situations, it is important that firms should be able to apply for a thorough examination of the issue and its implications by the FCA or the Tribunal. This application should not be conditional on the permission of the FOS, and when the FCA or the Tribunal make their decision, it should be binding on the FOS.

This issue has been raised on a number of occasions, including Lord Hunt's review of the FOS in 2008, and it has never been resolved. Ignoring it runs the risk of increasing the number of issues that go to judicial review, and increased use of this 'nuclear option' would create a more litigious and confrontational regulatory environment that would have negative implications for both consumers and regulated firms.

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

We agree with the proposals; we look forward to further information on how the National Audit Office's new role will continue after the NAO is abolished.

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

We agree with the proposed arrangements, and welcome the steps the Treasury has taken to consult with firms on European issues, including the creation of the Insurance Forum.