

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

This response is submitted jointly by ACE Credit Union Services (ACE) and UKCreditUnions Limited (UKCU) who represent 105 registered credit unions and study groups across the UK; they vary in type and size, some 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 72451 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.

### **1. Background Information about credit unions**

The FSA was established in 1998, but only took over responsibility for regulation credit unions in 2002. This was a major upheaval for credit unions which had previously been regulated by the registrar of friendly societies. Whilst there was great concern about the changes, there have been a number of advantages for credit unions:

- The FSA has provided very specific regulations and guidance so that credit unions are clear what is expected of them.
- Many of the existing staff from the Registry, who understood the philosophy and how credit unions operate continued to work with the credit unions and were able to extend their knowledge and experience to new colleagues who had previously not worked with credit unions.
- The FSA has held two meetings a year with the credit union movement's four trade associations – ABCUL, ACE, SLCU and UKCU, plus the development organisation NACUW. These meetings have been productive and working relationships have been friendly and helpful. The FSA has listened to the concerns of the trade bodies that represent the credit union movement and have taken them into consideration. Over the eight years the small firms' staff has developed a greater understanding of how credit unions work and the difficulties they face.
- Alongside Government officials and elected members, the FSA has worked hard to reduce the impact on credit unions of European Directives, some of which could have been potentially very damaging if they had been fully applied to credit unions. Only Poland and Ireland have a similar system of credit unions, so much time and effort has been necessary at the EU to prevent directives aimed at the banks harming the very much smaller credit unions.

- Although there are a few very large credit unions (about 11) that have thousands of members, some of which are around the size of small building societies, the large majority of the credit unions range from small with perhaps 200- 300 members to an average of about 2000 – 3000 with a few with up to around 10,000 members. Most of the largest credit unions are affiliated to ABCUL who understandably reflect the strength of this group of credit unions in demanding many new 'permissions' to meet the demands of their members. Because ABCUL has such a strong voice due to its larger membership, often the views of the small to medium sized credit unions are not heard. The other three trade bodies tend to represent the small to medium size credit unions which are not always in agreement with the drive towards more and more services being provided by credit unions. Many credit unions focus on the need to serve their local communities and rely on volunteers. They recognise the need for regulation, but do not need and cannot afford high regulatory costs that are too cumbersome and expensive.
- **Financial support from the Government** – credit unions have benefited from the Growth Fund, but these funds have been granted on the premise that credit unions need to focus on the financially excluded. Credit unions have always been keen to serve those on low incomes to provide access to savings schemes and loans often unobtainable from banks and building societies. The feedback from our members is that many community-based credit unions that work in partnership with their local authorities and other agencies are already being told that there will be cutbacks affecting their work with the financially excluded groups within their local communities. Credit unions know how expensive credit alternatives are, with doorstep lenders, some firms that provide furniture and household items at very high interest charges, pay day loans, and loan sharks charging exorbitant interest charges. However, credit unions cannot survive if they focus solely on the poor and need a balanced membership which includes members in work or on reasonable levels of income to provide the income to run and develop the credit union. There have been a number of credit union closures due to their moving away from having a balanced membership and focussing mainly on the financially excluded, and from giving immediate loans to those who little understanding of how to manage their limited finances.

## 2. **Transfer of responsibility from the FSA to the Bank and the setting up of the FPC and PRA**

- Credit union members too have suffered from the crisis brought about by the banking system both in the UK and abroad and wish to see a system developed which will be able to anticipate future problems and protect their funds. The question is - will a further change with all the disruption and expense involved really provide the security people seek?
- The financial difficulties had clearly developed over a lengthy period before the banks were facing serious problems and had to be supported with huge amounts of money by the public. The public are now paying the price for poor financial management with serious cuts to services. While the FSA may have failed to register these financial problems at an early stage and did not take steps to try to correct it, the same failures can be laid at the banking industry's door.
- The aims of setting up the FSA in 1998 were similar to those expressed in this report and were to provide an independent regulatory service. During the growing financial crisis the FSA did draw attention to the Northern Rock situation, but perhaps like 7/11 and the bombing of the twin towers in the USA, even when the potential risk is recognised, it may not be possible to change the course of such shattering events quickly enough to avert a crisis.

- There are many questions about the powers that the FSA have and whether greater co-ordination between the Bank, the Treasury and the FSA could have averted the financial crisis. Whilst the report stresses the independence of the committees who will monitor the financial situation, there are concerns about the Bank having a major role in preventing such financial problems arising again.
- It is recognised that there needs to be great coordination between key players but to change the system at this point is going to cost extra money; take up time whilst legislation goes through Parliament; may be rushed through with insufficient attention to guarding against future faults in the system and cause delays and confusion; staff will have to be recruited and given training, although this may be reduced if the existing staff at the FSA are going to be transferred. Whilst all this change is going on, the country remains in a worrying financial situation and there is a danger that new problems will arise and not be identified and swiftly dealt with.
- The main tools that the report is proposing appear to be based on having more money in the system to cushion future problems. The industry, and particularly credit unions, will find it difficult to find the extra funds and this could lead to closures and or extra costs for customers.
- There does not appear to have been consultation with the public about whether the FSA should have continued to act as an independent regulator, with the measures such setting up of the Financial Policy Committee and similar protective measures to ensure there is much greater co-ordination between key parties in the UK and linking with the international banking scene.
- The provision of financial education should be provided by the education system, as it is not a direct duty of the regulator. Much more financial capability training needs to be provided if financial exclusion is to be reduced.

### **3. Credit Unions**

Credit unions are concerned about the transfer of regulation from the FSA to the Prudential Regulation Authority for the following reasons:

- Will the regulatory staff have the experience and knowledge of credit unions to be able to understand that the majority of credit unions are small to medium organisations and that over regulation and excessive costs is likely to bring about closures and a loss of important services to local communities? Also that some of the European Directives aimed at the banking sector cannot be applied to credit unions because they often have not taken into consideration the impact they will have on credit unions and are in effect a steam hammer to crack a nut.
- Will the existing regulations (CRED – soon to be CREDS) continue to operate? The credit unions have faced great uncertainty over the last two years due to delays in LRO changes to the 1979 Credit Union Act and consequent changes to CRED and the credit unions' rules. Much work and time has been spent in consultations between the Treasury, the FSA and the trade associations and their member credit unions. This will be a wasted effort if whole scale changes are made, although it is recognise that regulations do change gradually over a period of time.
- Costs are a major concern. Until this year, credit unions were not required to contribute to the running of the FSCS, but this year, and for the immediate future they had to make a contribution to the funds. Many

credit unions have been shocked at the amounts that they have had to pay. Their funds are limited. On the one hand they are facing rising costs in terms of premises, staffing (where employed), fuel, insurance, FSA fees, computer charges and audit fees. On the other, they are limited to charging low rates of interest on loans and facing the same rise in bad debt and bankruptcy that all financial services have experienced. Grants which have been available in the past are gradually reducing and the Growth Fund ceases at the 31 March 2011.

- There is concern that, when credit unions are regulated by the Bank, they will be treated as any other deposit takers and that the regulations will be overly bureaucratic and inappropriate.

We anticipate that there will need to be discussions about the proposed changes and would welcome the opportunity to participate fully in that exercise.

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Dear Sirs

**RESPONSE TO THE HM TREASURY CONSULTATION PAPER: A NEW APPROACH TO FINANCIAL REGULATION: JUDGEMENT, FOCUS AND STABILITY**

Thank you for inviting comments on the proposal to reform the structure of financial regulation in the UK. ACE welcomes the opportunity to respond to the consultation paper and supports the review of financial regulation in the UK in light of the financial crisis. We have set out in this letter ACE's response to each of the consultation questions posed in the consultation paper.

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**GENERAL COMMENTS**

The consultation paper makes very little reference to the insurance industry. It is our concern that the regulation under the new approach is being structured with the banking industry in mind and does not take account of and will be unsuitable for the insurance industry which has responded well to the financial crisis. This has the potential to have a negative impact on innovation and competitiveness of the UK insurance market. In our view, the general insurance industry is already tightly regulated and this is being enhanced with the implementation of Solvency II. We believe that there is no need to reinforce insurance regulation further.

We are also concerned that changes proposed in the consultation paper are likely to prove administratively burdensome and result in costly implementations as well as ongoing costs to the insurance industry. The insurance industry is currently the subject of substantial regulatory change through Solvency II. This is coupled with the CEIOPS review of and proposed revisions to the Insurance Mediation Directive. This

will also certainly have administrative and cost implications for the insurance industry.

If the new regime is adopted it must be appropriate for and proportionate to the risks posed by the relevant industry and must not punish the insurance industry for the financial crisis caused by the banks. The structure of the new regime and the handover from the old regime to the new must be designed around the substantial changes which are already taking place in relation to insurance regulation. The handover must run seamlessly with the current regulatory changes so as not to inflict an unmanageable burden upon the insurance industry in the UK and to give the insurance industry the time to adapt to the new regime.

## **RESPONSE TO CONSULTATION QUESTIONS**

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

In our view the FPC's objective should be supplemented with secondary factors. For example the impact of macro-prudential decisions on competitiveness (see response to question 2 below).

**Question 2: If you support the idea of secondary factors, what type of factors should be applied to the FPC.**

In our view when implementing macro prudential policy the FPC must have regard to its effect on the competitiveness and profitability of the UK insurance market.

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

The legislation must provide specific and clear legislative objectives within which the regulators must operate. The legislation must also ensure that there remains an overarching requirement for proportionality and reasonableness with regards to regulation. It must also be appropriate for and proportionate to the risk posed by the relevant industry/regulated entities. The insurance industry must not be penalised for the risks posed by the Banks.

**Question 4 (a): The Government welcomes respondents' views on whether the PRA should have regard to the primary objectives of the CPMA and FPC.**

In our view, if the twin peak system is adopted, all the constituent bodies should have regard for each others' primary objectives and any new legislation must provide specific and clear objectives within which the regulators must operate.

It is vital that processes and procedures are implemented to ensure that there is co-operation and co-ordination between the constituent bodies and that the approach to

regulation (both in terms of legislating and enforcing) is consistent and clear and that duplications are kept to a minimum.

We are concerned that the PRA and the CPMA will not be consistent in their approach to regulation and that these bodies will not be sufficiently co-ordinated to deal efficiently with overlap or underlap between their remits. Any lack of co-ordination or differences in approach between the two regulators could lead to delay and uncertainty in decisions on and compliance with the new regulatory regime.

**Question 4(b): The Government welcomes respondents' views on whether some or all of the principles for good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice, should be retained by the PRA and whether specifically the requirements to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained for the PRA.**

The principles of good regulation have worked well for the insurance industry. In our view the following principles of good regulation (set out in section 2 (3) of FSMA) should be retained by the PRA:

- *Use resources in the most efficient and economic way.*
- *Have regard to the responsibilities of those who manage the affairs of authorized persons.*
- *Burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits which are expected to result from the imposition of that burden or restriction.*
- *Have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector.*

**Question 4(c): The Government welcomes respondents' views on whether specifically the requirements to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained.**

In our view, the new regulator should be aware of impacts of its regulation on innovation and competitiveness on the UK system. The UK is the predominant global market for insurance (as well as banking). This position must be retained. Regulation must be reasonable and proportionate especially when directed towards industries (such as the insurance industry) which have responded well under the current system of regulation.

We are concerned that the new approach to regulation will be structured with the banking industry in mind and that this will have a detrimental effect on the competitiveness of the UK insurance industry and will lead to unnecessary over regulation of the insurance industry.

**Question 4 (d): The Government welcomes respondents' views on whether there are any additional broader public interest considerations to which the PRA should have regard.**

The accountability of the PRA to the Government and the public is vital to ensure transparency. The measures proposed seem uncontroversial.

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

It is our view that an integrated model for granting permissions to undertake regulated activity and approving persons is preferable because this would minimise the risk of uncertainty and inconsistency.

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

We do not propose to answer this question.

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

Yes, rule making must be controlled in order to prevent over-legislation, especially towards the insurance industry, which has responded well under the current regulatory system.

Over-active rule changing is counter-productive and can impose significant bars on the ability of regulated firms to trade and/or compete against firms regulated in competing jurisdictions.

A formal consultation process must be established in order to allow the financial services industry a voice in the formulation of legislation within this area.

**Question 8: If safeguards are required, how should the current FSMA safeguards be streamlined.**

We do not propose to answer this question.

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

In order for the PRA to work effectively it must be strongly linked to the Bank of England to ensure that it has access to the Bank of England's central talent pool.

It is proposed that the PRA will have an executive committee to take significant supervisory and regulatory decisions, as well as a non-executive board. We are



concerned about how the two boards will work together and, in particular, what they will do when there is disagreement between them - will there be a process to deal with this situation and who will mediate in the event of disputes? Questions may arise as to the transparency of dealings between the two boards.

We are also concerned about how well the insurance industry will be represented within the executive committee and non- executive board of the PRA.

**Question 10 (a) : The Government welcomes respondent's views on whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC.**

In our view, if the twin peak system is adopted, all the constituent bodies should have regard for each others' primary objectives.

It is vital to ensure that there is co-operation and co-ordination between the various bodies and that the approach to regulation (both in terms of legislating and enforcing) is consistent and clear. We are concerned that the PRA and the CPMA will not be consistent in their approach to regulation and will not be sufficiently co-ordinated to deal efficiently with overlap or underlap between their remits. Any lack of co-ordination or differences in approach between the two regulators could lead to delay in decisions on regulatory issues. It will also lead to uncertainty and a potential increase in costs to authorised firms as they attempt to manage twin peak regulation.

It is vital that the CPMA has the expertise to be able to regulate both retail and commercial aspect of the financial services industry. In its approach to regulation it has to be able to distinguish between these significantly differences areas and the types of products that are offered. The CPMA must also have the expertise to understand the intricacies of the insurance industry.

We are concerned is that the CPMA will not understand insurance industry, especially the commercial/wholesale aspects of the industry. This in turn could lead to unnecessary and expensive overregulation.

**Question 10 (b): The Government welcomes respondents' views on whether some or all of the principles for good regulation currently set out in section 2 of the FSMA should be retained for the CPMA, and if so, which.**

The principles of good regulation have worked well for the insurance industry. In our view the following principles of good regulation (set out in section 2 (3) of FSMA) should not be retained by the CPMA:

- *Use resources in the most efficient and economic way.*
- *Have regard to the responsibilities of those who manage the affairs of authorized persons.*
- *Burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits which are expected to result from the imposition of that burden or restriction.*
- *Have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector.*

**Question 10 (c): The Government welcomes respondents' views on whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained.**

In our view, the new regulator should be aware of impacts of its regulation on innovation and competitiveness on the UK system. The UK is the predominant global market for insurance (as well as banking). This position must be retained. Regulation must be reasonable and proportionate especially when directed towards industries (such as the insurance industry) which have responded well under the current system of regulation.

**Question 10 (d): The Government welcomes respondents' views on whether there are any additional broader public interest considerations to which the CPMA should have regard.**

In terms of broader public interest considerations, we believe that the CPMA should also have regard to promoting financial inclusion, by encouraging access by consumers to products and services and improving consumers financial literacy.

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

The accountability mechanisms that are proposed for the CPMA for annual reports and meetings, a complaints mechanism and a system for appeals, all seem uncontroversial.

It is proposed that the CPMA will have an executive board to take significant supervisory and regulatory decisions, as well as a non-executive board.

We are concerned about how the two boards will work together and, in particular, what they will do when there is disagreement between them - will there be a process to deal with this situation and who will mediate in the event of disputes? We are also concerned about how well the insurance industry will be represented within the executive committee and non- executive board of the CPMA.

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

We would wish to see that the insurance sector is properly represented on the panels with the correct mix between wholesale, retail and international.

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

We agree that it makes sense for a single body to collect fees and levies and see no issue with this being the CPMA.

Fees and levies should be fair and proportionate to the risk posed by the industry in which the regulated entity operates. It is our concern that the insurance industry will subsidise the banking industry.

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

Splitting the FSCS into two schemes is likely to result in fragmentation, uncertainty and additional cost.

**Questions 15 to 18**

This chapter deals specifically with the banking industry. We look forward to responding to questions on the Lloyd's market when they are raised in future consultations.

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

We agree that firms should take responsibility for their own recovery if they are at risk.

We do not accept that additional powers of intervention are required. Used properly the current powers provide the regulators with all that is required to ensure the stability of the financial system.

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

In our view mandatory intervention should only be imposed in the most extreme cases. The legislation and rules governing this area should be clear and the regulator's approach to mandatory intervention should be consistent.

Any powers of the regulator should be subject to judicial review and there should be appropriate channels in place (e.g. appeal tribunal) to allow for appeals by authorised entities in relation to enforcement actions.

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

The SRR is not relevant to the insurance industry.

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

Including the Corporation of Lloyd's, insurers will be authorised by and will report to three regulators. In our view, this is likely to be administratively burdensome and costly, particularly at the start as the industry adjusts to the new regime. It would be better to have handover made under the existing conduct of business and prudential

rules and for proposed changes to these adopted after handover. This will alleviate the burden of being regulated by three entities any the confusion which could arise and the burden of having to adopt to different rules all at the same time. Any new rules should be introduced in clear and defined stages to allow businesses time to adapt. Such changes should also be timed with current proposed changed in Europe including Solvency II and changes to the Insurance Mediation Directive.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Ken Underhill', written in a cursive style.

**Kenneth Underhill**  
**General Counsel**  
**ACE European Group**

# ADDLESHAW GODDARD

Our reference John Ahern

18 October 2010

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Dear Sirs

## **Response to Consultation Paper Cm 7874 - A new approach to financial regulation: judgement, focus and stability**

We set out below Addleshaw Goddard's response to consultation paper Cm 7874 on the new approach to financial regulation.

Our overall observation is that the role of regulation should always be consistent with ensuring that the UK retains its deserved reputation as a leading financial services centre. This reputation is achieved by striking an intelligent balance between protecting investors and reducing barriers to business. It is, therefore, extremely important that regulators are not given a unidimensional consumer protection objective, as this is likely to hinder the "intelligent balancing" process and, ultimately, reduce consumer choice and diminish the UK's current standing.

The creation of new regulatory bodies will entail dual regulation in certain areas and the impact of this needs to be considered carefully when it comes to implementing detailed rules. We would welcome further information on this in due course. It is also important that the market understands how any disputes between the new authorities will be treated. To ensure full involvement in the international and European debates on the structure and regulation of the industry, proper allocation of coordination roles must be carried out between the new bodies.

We have not responded to every question on the consultation paper.

### **The Bank of England and Financial Policy Committee (FPC)**

1, 2 & 3: We feel that the FPC should also "have regard" to a wide range of other considerations, as proposed in the paper. This makes it clear that the primary obligation is one of ensuring stability, but that other factors should balance how far this objective should be pursued in relatively stable conditions.

### **Prudential regulation authority (PRA)**

4: As above, our view is that it is desirable for the PRA to have regard to a wide range of secondary objectives. This should help promote a consistency between the regulators that financial services businesses are subject to. This appears to be a natural result of the requirement that is to be placed upon each of the bodies to consult with each other: this will only be meaningful if each must have

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regard to the others' primary objectives. In particular, we think it is important to have regard to potential adverse impacts on innovation and the competitiveness of the UK financial services sector.

5: We believe that each authority should be responsible for granting authorisation to those firms that they will regulate. However, for businesses operating around the perimeter of what each regulator covers, it would be prudent to ensure that the authorisation processes are as similar as possible.

6: We feel that the approach outlined regarding the transfer of key functions is sufficient. It is important to ensure that the rules and guidance are expressed clearly and are disclosed to firms within a rulebook, rather than firms being regulated on basis of high level principles, that can be interpreted retrospectively. This is against a backdrop of firms being expected to interpret rules in light of speeches and occasional papers that are not incorporated within the Handbook in the form of guidance.

7 & 8: Our view is that safeguards on the PRA's rule making function are required and necessary. The statutory processes regarding consultation and cost-benefit analysis allow the market to comment on proposals from a different viewpoint. This is essential for maintaining a fairly regulated but competitive market. It is understood that a materiality threshold must be met in order to justify formal consultation. We note the proposition to reduce and simplify the existing rules and guidance. In our experience, the reduction in size of the Conduct of Business Sourcebook that resulted from the implementation of MIFID made the existing rules more difficult to understand. The industry welcomes capturing guidance within the rules as a method of explaining how those rules should operate in practice. It is not the volume of the material, but rather the expression, that causes compliance difficulties.

9: The measures proposed in relation to the PRA's transparency, operational independence and accountability seem sensible.

#### **Consumer protection and markets authority (CPMA)**

10: Our view on this area is the same as that outlined above in section 4 relating to the PRA.

11: We feel that the proposed accountability mechanisms for the CPMA are sufficient.

12: We encourage the use of practitioner panels to ensure a rounded debate.

13: The proposal to simplify funding arrangements and use the CPMA as a central fee and levy collecting body is sensible. We would welcome streamlining of this nature as long as the CPMA has the authority and skills to carry out the role effectively.

Regarding the proposal to consult on the merits of transferring responsibility for consumer credit from the OFT to the new CPMA, we can see the potential benefits this would bring to parts of the industry (those jointly regulated by the FSA and the OFT such as banks and building societies) but we have two main concerns arising out of this.

Firstly, we question how appropriate the proposed regime will be to regulate the pure consumer credit businesses who are not also deposit takers, for example, the motor dealership offering finance as an aside, the small pay day lender, the debt management businesses, all of whom have to be licensed presently by the OFT but who would under the proposed new regime potentially have to apply to be authorised. Thought will need to be given to the appropriateness of the regime to this sector.

Secondly, the paper talks about 'an opportunity to look again at the manner in which consumer credit is regulated'. Given that the consumer credit industry is still grappling with the implementation of the Consumer Credit Directive and the significant changes and costs to business that this initiative brought about so soon after the changes introduced by the Consumer Credit Act 2006, we have serious concerns that there may be yet further changes. The new rules should be given time to bed in and the industry allowed to draw breath. We are encouraged by the acknowledgment that any consultation on this would progress to a longer timetable to the regulatory reform work set out in the paper before us but we would be concerned that the government should not underestimate the work involved should the decision be taken to blend what are two very different regulatory regimes: the consumer credit regime is very prescriptive and based upon precise legislation/regulation. The

conduct rules are not precise, they are rules based. Any blending would have to be the subject of extensive consultation and dialogue.

### **Crisis Management**

19: The general proposals for crisis management, including the development of recovery and resolution plans, are welcomed.

20: The further powers of heightened supervision proposed for the PRA and CPMA need careful consideration to balance the necessity of regulator intervention with the ability of a firm to manage itself and its risk comprehensively. Clarity on the own initiative variation of permission powers would be useful, however mandatory intervention could be seen as a step too far when discretionary intervention could be introduced.

Yours faithfully

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# HM Treasury – A new approach to financial regulation

18 October 2010



# A new approach to financial regulation

## Introduction

AEGON UK is part of the AEGON Group, one of the largest life insurance and pension companies in the world. In the UK we have pensions, life insurance, asset management and advice businesses. AEGON UK has assets under management of £51.7 billion, including all revenue-generating investments, and employs around 4,000 staff. The AEGON Group has assets of around €409 billion (£334 billion).

## Key Points

AEGON supports the development of a regulatory structure which provides a clear framework within which firms can operate, which gives consumers confidence in the financial system and which allows the UK to operate competitively within the international environment. The main points we would like to make in response to this consultation are:

- The current regulatory environment is extremely complex, creating dangers for firms, consumers and the overall financial system, in the form of potential for confusion, overlap and gaps in the system. Whereas there is no one ideal regulatory system, the proposals have the potential to make this worse, rather than better, and particular questions need to be answered to ensure this is avoided. We outline our interpretation of the new regulatory structure in Appendix 1.
- We have reservations about the role of the CPMA as a consumer champion, and see it as having a more neutral role, balancing the needs of all its customers. If it is to be a consumer champion, it is clearly not appropriate for it to be responsible for the Financial Ombudsman Service (FOS), which has the role of an independent arbitrator.
- The new regulators should coordinate their work with other bodies, particularly the Department of Work and Pensions (DWP), to ensure coherence and consistency, avoid confusing customers and minimising the need to make multiple changes to systems, processes and outputs at additional cost.
- There needs to be a more robust framework for interaction with the new EU regulatory structure, and with other international bodies such as the G20.
- We suggest there is a role for continuing the use of the existing sector teams, putting them on a statutory footing as a link between the CPMA and the PRA.

## General comments

1. What matters to AEGON is that we are able to give the best possible service to our customers and to build our business on that basis. Regulation is an important driver of that. We appreciate that there is no perfect system of regulation but we look for one which will:
  - Secure a framework for effective competition
  - Protect consumers and engender trust and confidence in financial services; and
  - Ensure that the UK remains internationally competitive
2. Overall, we believe that the single structure of the FSA represents a relatively efficient and logical way of organising regulation. We understand the Government has made a political commitment to change, but for the new system to be an improvement, we would seek reassurance that particular issues are being addressed, in particular:
  - Overlap currently exists between certain aspects of prudential and conduct of business regulation, for example, where judgement is required in assumption setting for solvency purposes. Such assumptions need to be consistent with TCF (and hence COBS), but the outcome could be that two separate bodies will be forming separate judgements on essentially the same issue.
  - We are particularly concerned about the potential risk, particularly during any transition period, that issues may fall between the CPMA and the PRA, or the PRA and the FPC, and urge the regulators to develop robust communication structures to make sure this is avoided. We suggest a continuing role for the sector teams, possibly on a statutory basis, as a potential link between the CPMA and the PRA, as they bring together prudential and conduct questions and build expertise in particular types of business.
  - A structure which is split into separate prudential and conduct of business arms risks a loss of knowledge in the regulators about individual companies as a whole. Under the current FSA system supervisory teams have the opportunity to consider the whole company, looking at both prudential and conduct of business issues, and we are concerned that this overview will be lost. This is particularly concerning bearing in mind the holistic approach to risk underpinning Solvency II.
3. Additionally, we highlight the need for the new regulators to coordinate their work with other bodies, particularly the DWP, to ensure that any changes to regulations are carried out in a coherent and consistent manner, in order to minimise the need to change systems, processes and outputs and avoid confusion to the customer. We believe the CPMA should publish a statement explaining how each new proposal fits with wider policies (such as promoting saving) and with other bodies.
4. There is a need for clear recognition of the differences between different types of financial institution. For example, moves to a new prudential regime in the UK should recognise that the insurance sector is already taking steps across the EU, through the Solvency II process, to ensure more effective risk and capital management and consumer protection.

## A new approach to financial regulation

5. Our interpretation of the new regulatory structure in Appendix 1 outlines the potential for extreme complexity in the new regulatory system. We do not believe a complex system is in itself necessarily a problem. But we do believe there are specific points which need to be addressed if the concerns which the new regime was designed to solve are not to re-occur. In particular:
  - How does the new system relate to the non-UK environment – in particular, the new European regulatory system, which will be in place next year?
  - For example, if the CPMA is to provide the UK's representative on the European Securities and Markets Authority (ESMA), and the PRA the representatives on the European Insurance and Occupational Pensions Authority (EIOPA) and the European Banking Authority (EBA), will there be a formal process in place to ensure that the people in these posts ensure that relevant information is exchanged? And will their remit extend to considering the UK financial system as a whole, rather than discrete sectors?
  - Lines of communication with the DWP and the rest of the regulatory environment are not clear. We have long argued that the FSA, the DWP and the Pensions Regulator need to ensure that any changes to regulations are carried out in a coherent and consistent manner, in order to minimise the need to change systems, processes and outputs and avoid confusion to the customer.
  - In a world overwhelmingly composed of DC pensions we would like to see a separate re-examination of the boundary between the tPR and other regulators, with all options, including merger, on the table. Part of this re-examination should include discussion of whether tPR should be a member of EIOPA, the successor to CEIOPS.
6. Both PRA and CPMA will have rule-making powers. Prudential rules could affect conduct issues and might necessitate changes in conduct rules (for example, in the case of with-profits products). Will this slow the rule-making process?
7. The proposed structure is an opportunity to tackle current inefficiencies where regulations are not introduced coherently, leading to additional costs which ultimately impact on the value we can offer to our customers. We would particularly stress the resources required to comply with regulation, especially in terms of compliance and regulatory staff, IT systems work, product development, literature and disclosure resource, training and reporting costs. The insurance industry currently faces unprecedented regulatory change. Solvency II, the implementation of pensions reform, changes to the pensions tax system, changes to disclosure requirements from a raft of different regulation changes, and the Retail Distribution Review all require resource, often from the same areas.

## Answers to specific questions

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

The FPC needs to consider secondary factors. Given the consultation paper sets out the failings of the existing tripartite arrangement and the fault lines in the system as a whole, there can be little justification for the FPC not having regard to secondary factors that must be taken into account in order to achieve reasoned, balanced outcomes that best serve both the sector and wider economy.

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

The factors we would expect the FPC to take into account directly are those objectives of the BOE, PRA and CPMA.

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

Formulation of the factors should be as best enables the FPC to achieve balance, which feels more likely to be through a set of secondary statutory objectives (ie the BOE, PRA and CPMA's objectives).

### **4. The Government welcomes respondents' views on:**

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

As with question 1 above, to introduce one element of a three part system that does not pay due regard to the primary objectives of the others can only prove unstable. This question mirrors question 10. We expand in our answer to question 10 on how we see the different parties interfacing.

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

We prefer an integrated model with one authority for approvals and permissions. This would be simpler to control and less bureaucratic than a less integrated approach through two authorities. This is also supported by the view that the PRA's decision will always be final, effectively making the question redundant for firms regulated through both authorities.

## A new approach to financial regulation

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

Yes, we believe that the approach is sufficient for this outcome. However, a judgement-focussed approach to supervision by the PRA has the potential to add uncertainty regarding the regulator's expectations of firms, at least initially. The expectations of each regulator and where 'the bar has been set' should be clear - principles need to be supported by guidelines or rules to become operational.

Coordinating and sharing of information between the two authorities will also be key in minimising duplication and overlap. As already mentioned, we would view any loss of joined-up thinking as a detrimental development.

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

We strongly support the continuation of current consultation practices which should continue to act as a useful mechanism for parties to provide feedback and input to the rule-making process. For example, they enable initial planning, and any practical issues can be raised, as well as consideration of the implications on processes and controls.

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

Given the impact and importance of the power the PRA will have, it is questionable whether the FSMA safeguards should be streamlined. Robust consultation (see also comments on Q7) is essential.

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

The measures appear resilient but the real test will only come when putting them into practice.

### **10. The Government welcomes respondents' views on:**

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

We agree with the proposals in the first three bullets. Our concern, however, relates to how these principles and practices are implemented. For example, the principles from section 2 of the FSMA were in place before the crisis, but their existence was not sufficient to prevent it.

We agree with the statement that the FOS "should not be part of a consumer champion" and believe that its governance should be reviewed once the new regulatory structure is in place.

## A new approach to financial regulation

We have significant concerns about the effective cooperation that will be necessary between the PRA and the CPMA for this new structure to work. We believe that duplication of effort is highly likely, for example if both bodies are responsible for approving controlled functions and firms. We have concerns about requiring different approval/permissions depending on which regulator is relevant for a particular activity, for example a company which includes adviser functions as well as operating as a product provider.

Both bodies will have rule-making powers. We have concerns about how the consultation process will work, noting that it has yet to be decided for PRA. In some cases prudential rules, for example, will affect conduct issues and might necessitate changes in conduct rules. The converse will also apply. We believe that this could make the process of introducing new rules longer and more inefficient.

As with questions 1 and 4 above, to introduce one element of the three-part system that does not pay due regard to the primary objectives of the other 2 can only prove unstable. However, the CPMA should also have regard to other enforcers (eg the Office of Fair Trading) and the fair and reasonable outcome objectives of Ombudsmen (FOS and the Pensions Ombudsman).

Assuming the CPMA will be the authority responsible for establishing large-scale redress schemes, given its focus on consumer protection, we have concerns with both the PRA and CPMA having rule-making powers as firms may be subject to a conflicting requirements particularly in the early phase of their establishment.

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

Similar to our response to 10 above we agree with the proposals, but our concern is with their working in practice.

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

Membership of these bodies should include a wide range of knowledge and experience and not be dominated by representatives with familiarity of one particular sector.

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

We have no particular view on this.

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

One of the issues that the crisis highlighted was the lack of consumer understanding of compensation arrangements. We believe that this change in regulatory structure represents an opportunity to clarify and simplify the system so that consumers have a better understanding of compensation arrangements with greater equality between compensation arrangements across different product types.

We are not in favour of two separate compensation schemes as we believe this will be confusing for consumers.

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

No comment

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

No comment

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

No comment

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

No comment

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

No comment

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

No comment

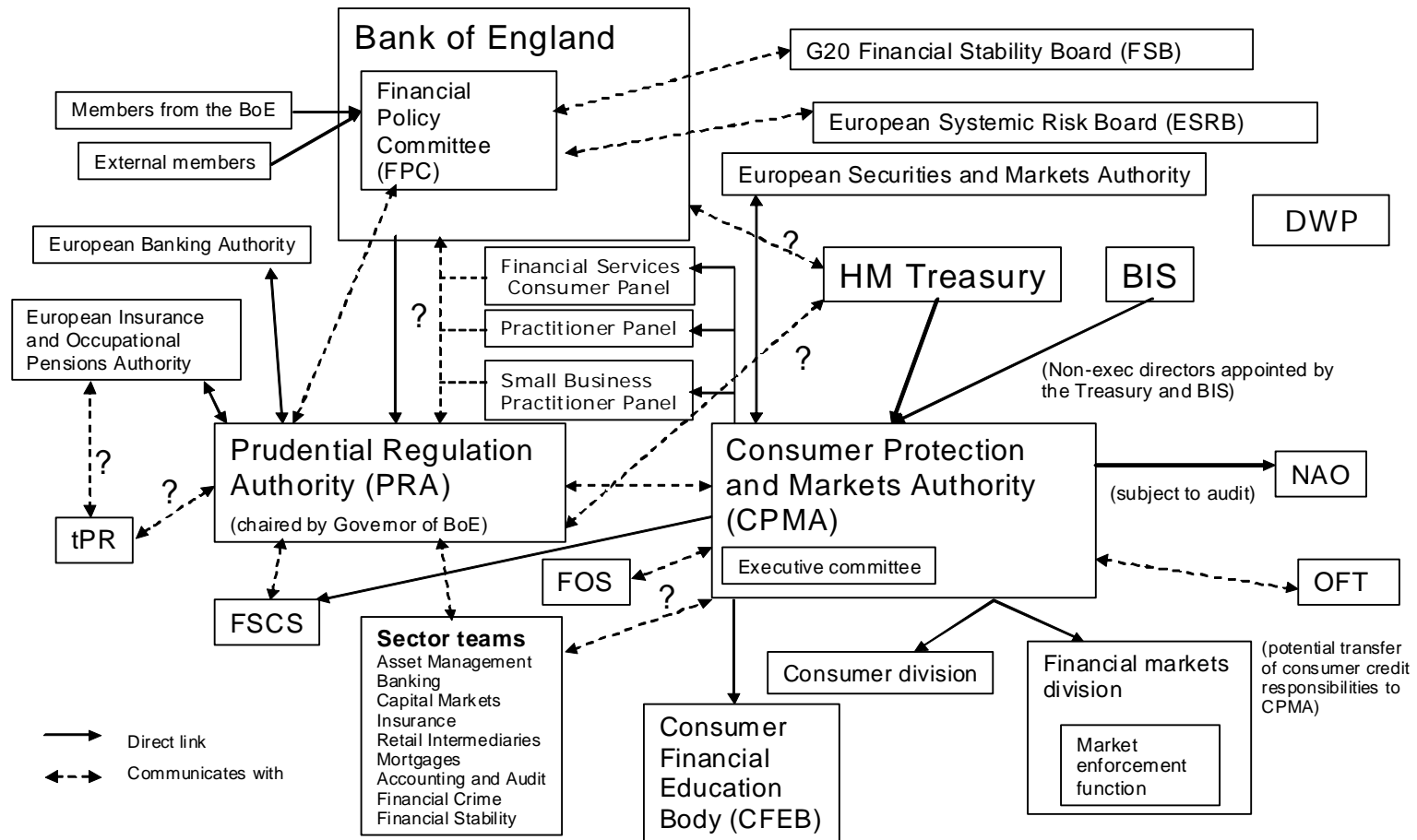
**21. What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24?**

No comment

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

No comment.

# New regulatory structure





Age UK is the new force combining

**AGE** and **HELPTHEAGED** WE WILL  
*Concern*



## Consultation response

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

18 October 2010

Ref: 2710

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Her Majesty's Treasury (HMT) presents the Government's plans to replace the existing financial regulatory framework and to give the Bank of England control of macro-prudential regulation and oversight of micro-prudential regulation. Consumer protection and market regulation will be the responsibility of a separate authority. The three bodies responsible for regulation will be:

- A new Financial Policy Committee (FPC) in the Bank of England, with primary responsibility for maintaining financial stability
- A new Prudential Regulation Authority (PRA), set up as a subsidiary of the Bank of England, with responsibility for prudential regulation of all deposit-taking institutions, insurers and investment banks
- A dedicated consumer protection and markets authority (CPMA), which will take on all of the Financial Services Authority's (FSA) responsibilities for conduct of business regulation and supervision of all firms, as well as arms-length oversight of the Financial Ombudsman Service, the Consumer Financial Education Body, and the Financial Services Compensation Scheme.

The consultation seeks responses on the proposed overhaul, including plans for the transition and timeline.

# Key points and recommendations

- Consumer protection is necessary for a strong financial services sector. While we understand the Government's approach to prudential stability and the importance of the industry to the UK, a strong focus on consumer protection will strengthen, rather than weaken stability and international competitiveness. A focus on consumer protection is particularly important following the abolition of Consumer Focus and the reduction in the Office of Fair Trading's role in consumer protection.
- Confidence in the market and consumer protection are completely different objectives and sometimes incompatible. The primary objective of the CPMA should be to 'protect the consumer from unfair market practice', not to improve confidence. CPMA should be able to take early action to close down 'toxic' products'.
- We do not think it is necessary for regulatory bodies to have regard to 'innovation' and 'international competitiveness' – while there is a strong consumer interest in fostering competition and encouraging new entrants to the market, these will be adequately covered by general requirements relating to competition and proportionality.
- CPMA should, however, have regard to the need to enable financial inclusion, the desirability of greater transparency and accountability, and the need to reduce the risk of financial abuse.
- In particular, more must be done to improve consumer protection in UK retail banking. Currently, we have lost some of the benefits of the non-statutory Banking Code, without yet seeing the full advantages of statutory regulation. The role of industry guidance in the new structure should be reviewed.
- Coordination between the regulators will be key, as will absolute clarity on responsibility and power. The objectives of stability and consumer protection must be kept in balance, and in order to achieve this the three regulators should be required to 'have regard' to the other bodies' statutory objectives.
- We recommend that HMT uses some significant past financial services events (such as the collapse of Equitable Life) to model how the new authorities would work together, especially in terms of interaction of objectives and powers.
- A smooth transition to the new regulatory system is critical for consumers, and we welcome the Government's pragmatic approach of rolling the FSA into CPMA and maintaining existing relationships with other key stakeholders such as the Financial Ombudsman Service and the Consumer Financial Education Body. The CPMA Consumer Panel has an important role to play in representing consumers, and should also have a role in advising the PRA.

# 1. Introduction

Age UK welcomes the reform of financial regulation as an opportunity to strengthen the role of the consumer in the financial services marketplace. Much has been written about the recent financial crisis and this is not the place to analyse the entire debate, but focusing on the regulatory response, we note that the FSA did warn markets about potential risks. The major failing was lack of decisive action across regulatory bodies. This consultation understandably focuses on structure, however the culture and style of regulation will be critical in the success of any new system.

Although we recognise that crises and major events rarely repeat themselves precisely, we recommend that HMT uses some significant past financial services events to model how the new authorities would work together, especially in terms of interaction of objectives and powers. For example, it would be interesting to run the collapse of Equitable Life through the proposed system. This would be a useful tool in future more specific consultations.

This response focuses on how the proposals would affect older consumers of financial services. People over 50 are a core market for the financial services industry and UK demographics predict that their importance will grow. Analysis of the FSA's Baseline Survey of Financial Capability shows that those aged 50+:

- Make up a clear majority of the owners of many savings and investment products and are over-represented in terms of ownership of household insurance.
- Hold their own in terms of share of life assurance and several banking products but are under-represented among holders of many credit products.
- Continue to hold a significant number of financial products well into retirement.
- Continue to be active purchasers of investment products.<sup>i</sup>

Despite this, older consumers are frequently poorly served by the industry. For example, the practice of 'downgrading' savings accounts, so that interest rates are no longer competitive, is likely particularly to affect longer-term savers with poor access to sources of information about interest rates.

Consumer protection contributes to, rather than takes away from financial stability. Throughout the consultation references suggest that consumer protection may be subordinated to market stability. Given the recent announcement of the abolition of Consumer Focus and major changes in the enforcement of consumer protection law, it is all the more important that the new system prioritises consumer protection. We note that the coalition agreement stated that: (a) *We will introduce stronger consumer protections, including measures to end unfair bank and financial transaction charges.* (b) *We will take forward measures to enhance customer service in the private and public sectors.*

Conversely, prudential regulation may have a major – if not always direct - impact on consumer protection (so, for example, changes to annuity rates arising from the Solvency II regime may increase sales of higher-risk drawdown products). So it is important that prudential regulators also consider the impact of their policies on consumer protection.

We also challenge the notion that the regulator must be gentle with firms in order to keep them competitive internationally. Rules protecting UK consumers would apply to all firms marketing to UK consumers and need not bite on UK firms' international operations. Where the new structures refer to the need for competition they must be very clear what this means.

Note that our comments below are restricted to those questions contained in chapters 2, 3 and 4 of the consultation paper. We are not in a position to comment on markets and infrastructure or crisis management.

## 2. The Bank of England and Financial Policy Committee

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

The FPC should reciprocate the obligations owed to it by the other two regulatory bodies, by 'having regard' to their statutory objectives. This is necessary for meaningful cooperation between the authorities and to ensure a balance between the objectives of financial stability and consumer protection

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

As above, the FPC should have regard to the objectives of PRA and CPMA.

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

The requirements on the FSA to 'have regard to' other objectives have worked well and so we suggest the 'have regards' formulation is preferable.

## 3. Prudential regulation authority (PRA)

### **4. The Government welcomes respondents' views on:**

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

We agree that each authority should have regard to the primary objectives of the other, for reasons given under question 1 above.

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

Aside from competition and innovation principles (discussed below), we agree that the principles of good regulation should be retained.

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

Currently, four of the factors to which FSA is required to have regard relate to competition. We question whether all four are necessary. In particular, the requirements to have regard to innovation and international competitiveness could fetter the regulators' power to co-operate with international regulators or act on so-called 'toxic products'. There is a strong consumer interest in fostering competition and facilitating new entrants to the market, but we believe that this could be covered by general requirements relating to competition and proportionality.

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

We do not think there are any additional broader public interest considerations to which the PRA should have regard.

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

We do not have the expertise to prefer one model.

Referring to Box 3.B, Coordination between authorities, we suggest that HMT run some examples through the proposed procedures to test in particular who has ultimate authority for each of the required decisions.

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

We are not in a position to comment.

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

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

PRA will rightly have power and responsibility to make rules critical to the operation of the financial services industry, affecting a wide range of stakeholders. It is therefore essential that safeguards are in place.

The FSA has improved its stakeholder consultation process and this is an appropriate safeguard. Procedures should take into account the fact that there is a significant power imbalance between stakeholders, and that even

matters that appear wholly prudential may in fact have a significant effect on consumers. Major financial services firms will be in regular contact with decision makers and will have the resources to ensure their interests are well represented. Consumers, especially disadvantaged consumers, need to be equally well represented. We therefore believe that the CPMA consumer panel should also have a role in advising the PRA.

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

We are not in a position to comment in detail. However, we note that in the past the Bank of England has not had – or perhaps needed to have – the same consultative mechanisms as the FSA. We believe that there should be a step change in the Bank of England’s approach to consultation, subject to clear protocols for where processes need to be kept confidential for reasons of financial stability.

## 4. Consumer protection and markets authority (CPMA)

Age UK strongly disagrees with the wording of the proposed primary objective of ensuring confidence in financial services and markets. It is the business of firms to ensure that consumers can be confident in them. The business of CPMA is to protect consumers and ensure market integrity. In order to do this CPMA must be able to take measures which may reduce confidence in firms which place consumers at risk. As an alternative wording for the primary objective, we suggest that CPMA should ‘protect the consumer from unfair market practice’. To give the CPMA teeth, we suggest that the regulatory regime should be strengthened in the following ways:

- CPMA must be able to close down toxic products quickly, for example by using an RU64-style process (requiring firms to show that there is no more suitable product for the customer than the product subject to the RU64 process).
- We strongly welcome the commencement order made on 11 October, which gives FSA the power to make consumer redress schemes. This power must be carried across to the CPMA. However, the courts should also have the power to allow collective proceedings on an opt-out basis. This would greatly improve the CPMA’s effectiveness and accountability, because it would give the courts the discretion to act if CPMA refuses to do so.

We note that the Government intends to consult on the merits of transferring responsibility for the regulation of consumer credit from the Office of Fair Trading (OFT) to the CPMA. In doing so, we hope that the Government will take into account the very different style of regulation between the two agencies. The OFT’s monitoring and enforcement functions are largely delegated to local trading standards, whereas the FSA is very centralised. Although there are advantages in having one body dealing with all credit regulation, there are also many advantages in a de-centralised system with a local footprint, for example the ability to deal effectively with local loan-

sharks and scams. Whatever the outcome of the Government's consultation, we believe that some measure of local oversight is important, and hope that the strengths of both systems can be combined. For example, financial services regulation might be strengthened by a measure of local monitoring to pick up unregulated mortgage brokers and investment firms.

We hope that the Government will also consider the CPMA's role in relation to confirming industry guidance. In our experience, the regulation of retail banking conduct of business is not yet working well. Although we welcomed the FSA's decision to make rules in this area, we have lost some of the strengths of the Banking Code – in particular, a clear, definitive statement of consumer rights set out in one document that can be used by consumers and consumer advisers. Detailed and transparent guidance is required to underpin any higher-level statutory regulation. The role of industry guidance in the new structure should be reviewed.

#### **10. The Government welcomes respondents' views on:**

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

CPMA must have complete competence within its field, subject to the requirement to 'have regard' to the objectives of the FPC and PRA. Discussions with FPC and PRA must be private and FPC and PRA must not seek to arbitrate between CPMA and firms. Some worked examples would be extremely helpful here to clarify situations in which FPC might require CPMA to abstain from taking action to protect consumers.

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

Aside from competition and innovation principles (discussed below), we agree that the principles of good regulation should be retained.

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

The 'innovation' and 'international competitiveness' should not be retained. As stated above, having four competition requirements is excessive and inappropriate for an organisation which should be focussed on consumer protection. For example, CPMA must be free to take early action against 'toxic' products. Also, it is unclear what actions CPMA would be taking which would have an adverse effect on competition whether within the UK or internationally. CPMA rules should apply to all firms operating in the UK and need not affect UK firms operating outside the UK. It is therefore unclear how the international character of financial services will be especially relevant.

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

Yes. CPMA should also have regard to:



- the need to enable financial inclusion.
- The desirability of greater transparency and accountability
- The need to reduce the risk of financial abuse.

#### *Financial inclusion*

There are many examples of financial exclusion that particularly affect older people. There are still many travel and motor insurance products with upper age limits. One in 20 households aged 85-plus still has no transactional bank account. And as financial services become increasingly technologically driven, even older people with financial products may find them increasingly difficult to use effectively. For example, many older people have current accounts that they find difficult to access because of poor health or transport difficulties. They would benefit greatly by being able to access them through post offices, but there are still three major banks (Santander, HSBC and RBS) that do not allow this.

There are at least two ways of giving the CPMA a greater role in facilitating financial inclusion. The CPMA could be given a socio-economic equality duty similar to that required of public bodies in the Equality Act 2010. Alternatively, it could achieve by a rule such as ‘a regulated institution must have regard to a financial inclusion code of practice’.

#### *Improving transparency and accountability*

The CPMA should also have a role in enabling the public to act as responsible consumers, by ensuring not just disclosure but more transparency from firms so that consumers are able to protect themselves. FSA’s decision to publish complaints by firm is a first step in this direction, but it needs to go further. For example, the CPMA should be able to give details of specific financial promotions that it has asked firms to withdraw. CPMA should also be able to report back to complainants on the outcome of their investigation, in order to encourage whistle-blowing

#### *The need to reduce the risk of financial abuse*

The CPMA should have a clear role in reducing the risk of financial abuse. There is an overlap with the FSA’s financial crime objective, but this should be made explicit. We receive many reports of financial abuse going unchecked, because responsibility for dealing with it falls between many different bodies. There is a clear link with financial services – for example, many people are open to abuse because they are reliant on family and ‘friends’ to manage their financial affairs for them. We believe that there is an urgent need for a financial abuse taskforce, led by the CPMA.

#### *Other public interest considerations*

We are pleased that under the Financial Services Act 2010 the FSA was given a duty to have regard to information provided by CFEB and a duty to have regard to public awareness of financial services. These requirements should be preserved. However, we are aware that there has been discussion of the desirability of giving the CPMA a requirement to have regard to increasing savings. While increasing saving is certainly important, we believe that it would be a more appropriate function for a separate body, such as CFEB or a dedicated taskforce, than for CPMA. Saving may not be appropriate for every consumer, and giving this responsibility to the CPMA risks causing confusion between the role of the CPMA and CFEB.

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

We strongly support proposals to have a majority of non-executives on the Board. There is some lack of clarity in the consultation over the stakeholder groups from which these non-executives should be drawn, but it is essential that the voices of consumers are strongly represented.

We also believe that there is a need for greater transparency about individual firms except where it would result in systemic risk. It should be easier for the CPMA to name particular firms where appropriate, so that - for example – specific financial promotions that have firms have agreed to withdraw can be used as example of poor practice. CPMA should also be able and willing to report publicly on the outcome of particular investigations that go beyond a certain point, even where these do not proceed to full enforcement action.

Also see our general comments on the role of the CPMA, and the desirability of giving the courts the discretion to allow collective proceedings as a way of increasing CPMA's accountability.

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

We are pleased that the CPMA will continue to have the existing practitioner and consumer panels, supplemented by a statutory small business panel. The consumer panel is particularly essential in redressing the imbalance of power between firms and consumers, as very few other consumer bodies are able to cover financial services in such detail.

We believe that the powers of the Consumer Panel should include the right to:

- Set its own agenda, including matters beyond the strict regulatory perimeter – although in practice it will often be responding to Board initiatives/approaches
- carry out its own research, with its own research budget (this is essential given the diversity of consumer experience)
- make public statements and publish its own material (this can be subject to a 'no surprises' policy)
- make formal public recommendations, to which the CPMA Board will be required to make a formal public response
- choose its own chairman, so that it is truly independent (subject to confirmation by Parliament)

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

We agree that CPMA should be the main fee- and levy-raising body. In particular, it must have the ability to raise levies to fund money guidance and debt advice (including levying firms it does not itself authorise where appropriate, for example consumer credit if responsibility for credit regulation stays with the OFT). If one body is required to raise funding on behalf of

another body, there should be a clear and transparent procedure for agreement on the allocation of budget between the bodies.

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

We are not in a position to comment.

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<sup>i</sup> An Inclusive Approach to Financial Products, Beyond Financial Inclusion: involving older people by Age Concern, Annex 1

## A new approach to financial regulation: judgment, focus and stability

### Comments and responses to questions

William A. Allen, Cass Business School<sup>1</sup>

Q1. Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?

Q2 If you support the idea of secondary factors, what types of factors should be applied to the FPC?

Q3 How should these factors be formulated in legislation – for example, as a list of ‘have regards’ as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?

A1 - 3. It is not straightforward even to define financial stability. My own attempt is set out in ‘Defining and achieving financial stability’, by G. E. Wood and myself, *Journal of Financial Stability* 2006 (pp 152 – 172). There are trade-offs between financial stability and a wide range of other desirable policy objectives<sup>2</sup>. I think it would be impossible to identify a single, clear, unconstrained objective for the FPC. Moreover, on democratic grounds, I do not think that the Bank of England should be empowered to decide by itself how the various trade-offs should be struck.

I believe that it is unwise to separate the financial stability and macro-prudential policy decision making process of the central bank from the monetary policy decision-making process. In conditions such as those which prevailed from the early 1980s until 2007, when market liquidity is ample and there appear to be no major solvency issues among financial institutions, financial stability concerns fade into the background and the central bank tends to concentrate on ‘monetary policy’, which can be interpreted as no more than making decisions about the level of short-term interest rates. However such happy conditions are historically quite unusual, and more often central banks have had to be actively concerned about the functioning of financial markets. For example for many years after the two world wars the Bank of England was very anxious about the overhang of government debt, and in the 1930s (and more recently) there have been serious problems with an overhang of private debts.

Financial stability concerns can and should affect monetary policy decisions, and vice versa. I think it is a mistake to set up a Financial Policy Committee which is separate from the Monetary Policy Committee.

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<sup>1</sup> I worked for the Bank of England from 1972 to 2004.

<sup>2</sup> For example competition. There was a long period of financial stability in the UK from the end of the second world war until the early 1970s, characterised by cartelisation of the financial industry. When the financial industry became more competitive in the 1970s, after the abolition of credit controls, it also became less stable.

It would be better to expand the role of the Monetary Policy Committee, change its membership to reflect its wider role, and change its name.

An additional drawback of having two committees responsible for dealing with two inter-related sets of issues is that the people who are members of both committees are in a very strong position vis-à-vis the others, who are in danger of being marginalized. In those circumstances, it might become difficult to persuade people to join.

It has been suggested that a multi-purpose committee would suffer from the drawback that, owing to the need for secrecy in monetary policy decisions, it would be unable to co-opt additional expert members in case of need. I do not think this argument has any force. For one thing, there may be a need for secrecy in financial stability matters, too. For another thing, a multi-purpose committee could perfectly well get expert advice whenever it needed it, just as the Monetary Policy Committee does.

What would be the objective of such a wider committee? I think that it could be defined as follows:

1. To use the policy instruments under the control of the Bank of England in pursuit of price stability (currently defined by reference to the inflation target) and financial stability (ideally as defined by Allen and Wood). Those policy instruments include not only short-term interest rates but also liquidity facilities provided to commercial banks, such as the Special Liquidity Scheme.
2. Where necessary (but not otherwise) to make recommendations to other branches of the government about policies that might have a bearing on price stability or financial stability. For example the Bank of England might make recommendations about public debt management, which might affect either price or financial stability, or about insolvency law, which might affect financial stability. It might even make recommendations about fiscal policy if it thought that the fiscal policy being pursued or planned was a threat to price or financial stability. The recommendations would not be binding on the branches of government to which they were addressed.
3. To maintain continuous oversight of financial market infrastructure, such as clearing and settlement systems, and ensure that the risks that they entail are fully understood.

It is highly relevant that the Federal Reserve, which has been by far the most effective of the world's central banks in managing the recent crisis, draws no sharp distinction between monetary policy and financial stability in its organisational structure. The Federal Open Market Committee is responsible for much more than just short-term interest rates.

If the decision to have two separate committees is irrevocable, then I suggest that, as a second-best measure, there should be as much cross-membership as possible.

The list of macro-prudential policy instruments set out in box 2C include several (variable risk weights, leverage limits, collateral requirements, quantitative credit controls and reserve requirements) which have either not been tried before, or which have been tried and have subsequently been abandoned in the light of experience. There is no sound theory underlying the application of any of them and the Bank of England is in danger of undermining its own credibility if it starts using policy instruments that neither it nor anyone else really understands. It would be like brain surgery with a penknife. In fact the Basel 3 proposals for a Liquidity Coverage Ratio represent a very severe constraint on the ability of banks to expand credit<sup>3</sup> and I am very doubtful that anything else is needed. I do not think that the armoury of box 2C will do any good at all; it is much more likely to do harm.

Q4 The Government welcomes respondents' views on:

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

A4 I think that the PRA certainly should have regard to the primary objectives of the CPMA and FPC.

Regulation is a major barrier to the entry of new firms into the financial industry and thus a serious inhibitor of competition. This was the case even before the recent intensification of regulation, and it is even worse now. Ultimately competition is more effective than regulation in protecting consumers' interests. The PRA should certainly be required to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action, and should also be required to eliminate unnecessary regulatory obstacles to new entrants into the financial industry.

Q5 Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?

A5 I'm not sufficiently familiar with the issues to express a view. However, from the viewpoint of regulated firms, it would clearly be simpler for the functions of authorisation and removal of

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<sup>3</sup> See 'Is the cure worse than the disease' by Bill Allen, Ka Kei Chan, Alistair Milne and Steve Thomas, <http://www.cass.city.ac.uk/cbr/activities/AllenChanMilneThomasVersion5.pdf>.

permissions to be managed by a single authority, and I think that there should be a strong prejudice in favour of that solution.

Q6 Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focussed approach to supervision?

A6 No comment.

Q7 Are safeguards on the PRA's rule-making function required?

A7 The problem with subjecting rule-making processes to statutory processes is that it makes it much harder to change the rules. Rules are often drawn up in response to a particular episode, but then circumstances change and the rule becomes outdated and needs to be amended. The easier it is to make such amendments, the more economical and efficient the regulatory process will be. I think that the drawbacks of subjecting rule-making processes to statutory processes outweigh the admitted advantages.

Q8 If safeguards are required, how should the current FSMA safeguards be streamlined?

A8 N/A.

Q9 The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.

A9 The proposed decision-making body of the PRA seems rather narrow to me. The three permanent members, who will occupy the top positions in the Bank of England hierarchy, will be in a majority and are likely to dominate it to a possibly undesirable degree. It would be a good idea to have some permanent members who are outside the hierarchy.

Q10 The Government welcomes respondents' views on:

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

A10 The worst thing that a financial firm can do to its customers is to default on its financial obligations to them. And inhibiting competition, even if it is done with good intentions, damages consumers' interests. Therefore the CPMA certainly should have regard to the stability of firms and the financial system as a whole. It should also have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action, and above all should be required, like the PRA to eliminate unnecessary regulatory obstacles to new entrants into the industry.

Q11 Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?

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

A11 – 12. The problem with conduct of business regulation is that too many people have unrealistic expectations of what it can do for them. It is easy for the costs to get out of hand without it achieving much. The government should make some commitment to financial firms (who will have to pay for it) about what the maximum cost will be.

Q13 The Government welcomes views on the proposed funding arrangements, in particular, the proposal that the CPMA will be the fee- and levy-collecting body for all regulatory authorities and associated bodies.

A13 No comment.

Q14 The Government welcomes views on the proposed alternative options for operating models for the FSCS.

A14 No comment.

Q15 The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.

A15 I can see the logic of combining the regulation of retail and wholesale market conduct in a single organization. The fact that the organization will need to deal with wholesale market issues might prevent it becoming a narrow-minded retail consumer advocate. Many observers have concluded that central counterparties are a better medium for trading than bilateral OTC contracts, but central counterparties are certainly and inescapably 'too big to fail' and there needs to be extensive contingency planning for managing a crisis in one of them.

Q16 The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.

A16.No comment.

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



A17 The listing rules are quite rightly rather black and white. There isn't much scope for judgment about whether you meet them or not. I can't see any point in merging the UKLA into any other body.

Q18 The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator.

A18. No comment.

Q19 Do you have any overall comments on the arrangements for crisis management?

A19 Yes. I think that the Bank of England should publish its contingency plans for providing emergency liquidity assistance to banks in a crisis. The reasons are set out in 'Is the cure worse than the disease' by Bill Allen, Ka Kei Chan, Alistair Milne and Steve Thomas<sup>4</sup>. If banks wanted to eliminate completely the risk that they would be unable to repay all their deposits when requested to do so by their customers, they would need to hold banknotes equivalent to 100% of their demand deposit liabilities. It is normally thought desirable that they should hold a much smaller amount of banknotes and devote larger amounts to commercial loans which support the economy. However, if they are to be able to assess the amount of liquid assets that they need, out of prudence, to hold, logically they need to know how the central bank will behave in its 'lender of last resort' role.

Traditionally central banks have been extremely coy about these matters, preferring 'constructive ambiguity'. After the recent crisis, any ambiguity has gone. Nor is there a valid moral hazard argument against publishing contingency plans.

Q20 What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?

A20 I think that Prompt Corrective Action has been a success in the USA and think it should be seriously considered in this country.

Q21 What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24?

A21 Prompt Corrective Action would reduce the risk of any conflict.

Q22 Annex B contains a preliminary impact assessment for the Government's proposals. As set out in that document, the Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm. In particular, comments are sought from all types and size of

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<sup>4</sup> <http://www.cass.city.ac.uk/cbr/activities/AllenChanMilneThomasVersion5.pdf> .

deposit-taking, insurance and investment banking firms (including credit unions and friendly societies), and from groups containing such firms.

A22 The impact assessment is largely content-free and shows how the requirement to produce such assessments adds to costs while making no contribution to decision-making.

Dear Sir

## **The New Approach to Financial Regulation**

Allianz Insurance plc is one of the top 10 general insurance companies in the UK with over 18 million policyholders. It is the principal UK subsidiary of Allianz SE, Europe's largest insurer and the world's largest property and casualty insurer.

Allianz Insurance plc supports the aims of high quality regulation and understands the drivers for the changes to the structure of financial services regulation proposed in this consultation paper.

We fully support ABI's response to this consultation paper but would also like to take this opportunity to emphasise our concerns in relation to a number of specific aspects.

1. To ensure the continuance of an appropriate degree of regulation, prudential regulation of insurance must be given equal status to that of banks
2. The PRA must be required to retain the current FSMA safeguards to ensure due process
3. The proposals do not adequately recognise the influence of EU developments on UK regulatory rules and practice
4. Both the PRA and the CPMA should be required to take account of the competitiveness of the UK financial services industry
5. The proposals do not give sufficient explanation as to how the regulatory authorities will work together to ensure there are no inefficiencies and duplications in the proposed regime – thus risking increased and unnecessary cost to the industry
6. It is inappropriate for the CPMA to position itself as a consumer champion if it is to be a credible regulator.

Yours faithfully

Andrew Torrance  
Chief Executive



**AngloAmerican**

TJP/BS

5<sup>th</sup> October 2010

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Dear Sirs

I refer to the paper entitled "*A new approach to financial regulation: judgement, focus and stability*" published in July 2010 and in particular, question 17 thereof as to whether it will be beneficial to merge the UKLA with the FRC or whether the UKLA should be part of the CPMA markets division.

The FRC's principal focus is on policy development, whereas there will be clear overlap between the UKLA and the market supervisory functions of the CPMA. The UKLA's focus on securities rather than companies clearly makes a merger with the CPMA more logical than with the FRC.

I understand that the CPMA will be the only UK representative at the new European Securities and Markets Authority (ESMA). If responsibility for primary markets is removed (by merging the UKLA and the FRC) this will have the effect that the UK would only be represented directly on secondary markets and thus the strength of our representation on ESMA would be weakened. It is vital that the UK continues to attract international issuers and, if the UKLA's representation at ESMA is effectively removed, London's ability to maintain its listing rules may be compromised.

I also believe that, *inter alia*, there is a risk that a merger of the UKLA with the FRC could weaken the UKLA and affect the ability of issuers to raise capital in the UK by limiting the UK's ability to defend what is a competitive listing regime compared to Europe.

Yours faithfully

Sir John Parker

**Member of the Anglo American plc group**

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## Association for Financial Markets in Europe Response

### HM Treasury's Consultative Document

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

## 1. Introduction

The Association for Financial Markets in Europe (AFME)<sup>1</sup> welcomes the opportunity to respond to HM Treasury's Consultative Document "A new approach to financial regulation: judgement, focus and stability."

AFME recognises the failures of, and the Governments' commitment to reforming, the UK tripartite system and believes, in principle, that the model set out in the HM Treasury consultation document (conduc) should deliver effective regulation for both consumers and markets. We welcome, in particular, the establishment of a body with specific responsibility for macro-prudential regulation and the focus on judgement-led regulation.

However, for a regime with multiple, judgement-led, regulatory authorities to function effectively, the precise design of the framework will be crucial to its success. The new framework, as set out in the conduc, raises a number of questions and practical concerns and greater clarity is needed in some areas to understand fully the proposals. We believe, therefore, that significant further thought will need to be given to resolving the potential problems proposed by the new structure; AFME stands ready to work with HM Treasury to help "ensure we get the detailed design right."<sup>2</sup> We are grateful to the HM Treasury Financial Regulation Strategy Team for meeting with AFME members to receive feedback on the proposals and to help clarify our understanding in relation to specific areas of the conduc.

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

<sup>2</sup> Speech by The Financial Secretary to the Treasury, Mark Hoban MP, at the London Stock Exchange, 26 July 2010

## 2. Executive summary

We set out in Section 4 below our responses to the questions raised in the condoc and our further thoughts on wider aspects of the new framework, with particular focus on their potential impact on firms, markets and wholesale financial services business in London.

In sum, our main areas of concern are around ensuring:

- the new regulatory authorities have appropriate objectives, roles and responsibilities and are subject to the right levels of accountability and transparency;
- the current, robust regulation of markets and the expertise of the Financial Services Authority's (FSA's) Markets Division are not diluted in the new framework (including by the proposed fragmentation of primary and secondary market regulation);
- the framework delivers clear, efficient and effective regulation (e.g. by ensuring the scope of the Prudential Regulatory Authority (PRA) and the Consumer Protection and Markets Authority (CPMA) dovetail in legislation and in practice and by creating a shared services function to perform regulatory processes and provide IT, data warehousing, HR and finance on behalf of the PRA and CPMA);
- the continued effectiveness of International and Europe engagement – both at policy formation and the negotiation stages – and a strong, credible and coherent representation for the UK.

With respect to the last bullet point, and as an over-arching comment, we are conscious of the need for the UK reforms to be considered in the context of the reforms taking place at both an European Union (EU) and an international level. It is crucial that the UK maintains a strong, credible and coherent voice in the EU and internationally (e.g. on the International Organisation of Securities Commissions (IOSCO) and the Basel Committee on Banking Supervision) and continues to help shape regulatory developments e.g. in negotiation of directives, setting technical standards and in seconding policy experts to the new European Supervisory Authorities (ESA).

The new UK framework will clearly not mirror the ESAs: for example, under the proposals both the Bank and the CPMA will have responsibility for regulating market infrastructure but only the CPMA will have a seat on ESMA. The optimum interaction of the UK regulatory structure with the new EU bodies – both at a strategic and operational level – needs to be resolved at an early stage in the development of the new framework to ensure that the UK – and in particular the CPMA Markets Division – has sufficient heft and influence.

The FSA's International Division provides currently: *“a centre of excellence for international stakeholder management and analysis....delivered by enhancing our support for representatives on key international committees, strengthening our relationships with key stakeholders required to deliver FSA international strategy and improving our development, implementation and co-ordination of policy.”*<sup>3</sup> It will be crucial to ensure that the work of this division is not diluted and that a similar, operational-level, support function is available to manage the UK's international and EU engagement and to co-ordinate within the UK regulatory framework e.g. by ensuring that the right policy experts are involved on committees and working groups and that delegations, particularly to ESMA meetings, include appropriate (albeit non-voting) experts from regulatory authorities that do not formally represent the UK.

Finally, whilst we appreciate that the transitional arrangements will largely be a matter for the FSA, given the time it will take for the new UK financial regulatory structure to be put into place, strenuous efforts will be needed to retain high quality staff and ensure the continuity of expertise within current FSA divisions. For the CPMA, the appointment of high calibre individuals to the Chief Executive and Managing Director posts must be an early priority, if, amongst other things, the CPMA is not to be seen as having a lesser role than the PRA..

We are aware, from reviewing the FSA's (now publically available) written evidence to the Treasury Committee inquiry into financial regulation, that the FSA has identified and is taking steps to mitigate risks associated with transitioning the regulator to the new structure. We assume that HM Treasury will be monitoring these significant risks and any impact on UK financial services (e.g. the FSA's expected reduction its ability to influence developments at an EU level due to pressures on senior management time). We also note that the FSA will use lessons learnt from moving to a shadow operating structure in early 2011 to “modify operational aspects of the new approach before its formal launch in 2012.” We assume that to the extent that changes are needed to primary or secondary legislation, HM Treasury will be involved in the feedback loop.

### 3. General Comments

AFME believes that key principles for a new regulatory framework should include:

- clarity;
- efficiency; and

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<sup>3</sup> FSA website

- effectiveness.

**Clarity:** it will be important to ensure that firms and groups which are regulated by both the PRA and CPMA have clarity and certainty with respect to the requirements they are subject to and how their duties should be discharged. Conversely, individual regulatory authorities will need to have a clear and complete overview of jointly regulated firms and groups. We believe that to deliver clarity, it will be essential for firms to have a lead regulator, to ensure one point of responsibility and one conduit for notifications etc. For example where a firm is under a duty to notify its regulators, it should be able to submit a notification to its lead regulator, for example, the PRA, and, by so doing, discharge its responsibility to notify its other regulator (for example, the CPMA). In addition, the application of the PRA and CPMA rulebooks must dovetail for jointly regulated firms; in this regard, we believe that high level, over-arching standards such as the Threshold Conditions (COND) and the Senior Management Systems and Controls (SYSC) and also areas of the FSA Handbook such as regulatory processes and the Client Assets Sourcebook should be maintained as a common rulebook.

As discussed in Section 1 above, clarity is also needed in respect of the UK's EU and international engagement.

**Efficiency:** the precise detail of the legal framework, the detailed operating procedures put in place by the regulators and the degree to which co-ordination can be achieved are key to ensuring an efficient system and we look forward to reviewing the draft legislation early next year. As a guiding principle, however, firms should not be faced with unnecessarily complex or duplicative regulatory or administrative processes e.g. applications for authorisation and approval determined by two regulators, uncoordinated supervisory visits, duplicative reporting requirements. The framework, therefore, needs to strike an appropriate balance between co-ordination and independence of regulatory bodies.

To facilitate co-ordination:

- the FPC, PRA and CPMA should be required to recognise each others objectives unless to do so would be prejudicial to their own objectives;
- a shared services function should be established to provide a common 'back office' for both the PRA and CPMA and, in particular, perform regulatory processes and provide IT, data warehousing, HR and finance for both authorities'; and
- there should be high-level co-ordination of policy setting and operational level co-ordination of policy interpretations.

**Effectiveness:** around the world a number of different regulatory models failed to detect, prevent and/or manage the crises; we, therefore, need a regulatory system that is effective. Effectiveness, however, depends not just on getting the precise



design of the framework right but also on having high calibre senior management to direct the new bodies; appropriately skilled and experienced staff to identify risks, make sound decisions concerning firms; and on the quality of the data on which regulators base their judgments. It is vital that the new regulatory bodies are given the flexibility to recruit and/or retain the right staff and that there is a standardised framework for data, including its collection and warehousing.

## 4. Detailed comments

### 4.1. The Bank of England and Financial Policy Committee (FPC)

AFME welcomes the creation of a body with specific responsibility for macro-prudential regulation and agrees that it is most appropriate to establish the FPC within the Bank of England (the Bank), thereby leveraging from the Bank's existing analytical and economics capabilities and financial stability experience.

#### *Membership, accountability and transparency*

The model chosen, with macro and micro-prudential regulation being brought within the overall responsibility of the Bank, will, inevitably result in a concentration of power within the Bank. Our concern is not the concentration per se but whether there are sufficient checks and balances; in particular, transparency and proper accountability to Government and Parliament.

Given that the Governor of the Bank will also chair the Monetary Policy Committee (MPC), the FPC and the Prudential Regulatory Authority and be responsible for the Special Resolution Unit (SRU) within the Bank, we have concerns, in principle, over the perceived independence of the Governor. Given the demanding nature of the Governor's role going forward, the Bank's senior management team will clearly be critical in providing support for the additional responsibilities. We believe that further consideration should be given to the responsibilities of the Governor and, notwithstanding the check provided by the majority of non-executive directors on the PRA Board (c.f. paragraph 3.32 of the condoc), any measures that could be come into effect when a conflict is perceived between specific roles.

We believe that the accountabilities for the FPC and PRA outlined in the condoc – particularly the Governor's proposed six-monthly briefing of the Chancellor – are less onerous than might otherwise be desirable given the power to be vested in the Bank. In designing checks and balances, however, it will be important not to constrain the ability of the Bank to carry out its duties. Possible solutions may include:

- increasing the number of external members of the FPC;

- creation of an independent advisory group of relevant experts;
- increasing the frequency of meetings with the Chancellor to quarterly (in line with the production of statistical data) and involving the CEO of the PRA (and possibly the CPMA) when macro-prudential tools have been used;
- an annual letter from the Government to the FPC framing financial stability in the context of current economic growth objectives; and
- MPC-style letters from the FPC to the Chancellor when a macro-prudential tool is used, which state the intended outcome and hence can be used to measure effectiveness. As the FPC will not, as we understand it, use macro-prudential tools in relation to individual firms, these letters could be published to mitigate market rumour.

Paragraph 2.43 of the condoc states that: “it will be important to ensure that the external members of the FPC are able to provide sufficient levels of expertise and challenge to the Committee’s deliberations – this will not only include experience of banking, but also other financial sectors such as insurance and investment banking and, of course, macroeconomic expertise.” As proposed currently, 5 out of the 11 members of the FPC are considered external but since this figure includes the CEO of the CPMA, the number of wholly independent external members is arguably 4 (the same as the MPC, which has 9 members in total). We believe, therefore, that external involvement on the FPC should be enhanced by increasing the number of external members and by allowing the FPC to establish a non-executive advisory group of relevant experts (as proposed for the PRA in paragraph 3.35 of the condoc).

### *Functions*

We look forward to further detail, in due course, with respect to how the FPC will work with the PRA (and the CPMA) in the exercise of its macro-prudential tools: for example, will the FPC set ranges and require the PRA to take action or specify the use of a tool; how will macro-prudential regulation be linked to micro-prudential regulation?

We note, incidentally, that although the condoc refers to the FPC’s macro-prudential (counter-cyclical) tools, the tools will actually be applied by PRA at a micro-prudential level. Given that many of the macro-prudential tools are new and their effects at a macro-level are not well understood, it will be important to consider not just the likely effects of a particular tool but also, if used in combination, what effect the tools will have when working together. We wonder, therefore, whether a fixed list of tools enshrined in secondary legislation is appropriate at this stage.

Finally, as markets and financial stability risks are global – and issues of concern to the FPC may not be within their (or the PRA’s) control – there is a need for strong linkages to the new European System Risk Board (ESRB), third country regulators such as the Federal Reserve and the US Financial Oversight Council and international bodies such as the International Monetary Fund and the Financial Stability Board. We await with interest, details of how the FPC will operate both at a global and a domestic level.

**Q1. Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?**

In discussing the objectives of the FPC, we are mindful that financial stability is a far broader concept than macro-prudential regulation and it is interesting to note that EU and International bodies differ in respect of whether their primary responsibility is financial stability or macro-prudential regulation as a contributor to financial stability. AFME’s newly formed Macro-Prudential Working Group would be pleased to meet with HM Treasury to discuss the FPC’s financial stability and macro-prudential roles and macro-economic tools in more detail.

Turning to Q1, we are concerned that a single, unconstrained, objective for financial stability, which, in itself, is difficult to quantify and measure, could lead the FPC to take a narrow and overly risk adverse approach to stability which might impact negatively on economic growth and other social factors. In particular, it will be important for the FPC to assess, before using its macro-prudential tools, the likely impacts of the tools on wider socio-economic factors, which could, in turn, impact negatively on financial stability. We note in this regard that the mission and objectives of the new European Systemic Risk Board (ESRB) is to:

“...be responsible for the macro-prudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability in the EU that arise from developments within the financial system and taking into account macro-economic developments, so as to avoid periods of widespread financial distress, and contribute to a smooth functioning on the internal market and thereby ensure a *sustainable contribution of the financial sector to economic growth* [our emphasis].”<sup>4</sup>

Paragraph 2.2.4 of the condoc, however, states that: “Within the Bank’s overall financial stability remit, the objective of the FPC will be to protect financial stability by:

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<sup>4</sup> Article 3 of the Proposal for a regulation of the European Parliament and Council on European Union macro-prudential oversight of the financial system and establishing a European System Risk Board (dated 14 September 2010)

- improving the resilience of the financial system by identifying and addressing aggregate risks and vulnerabilities across the system; and
- enhancing macroeconomic stability by addressing imbalances through the financial system, e.g. by damping the credit cycle”

Given the importance of balancing financial stability with economic growth and other macro-economic factors (including but not limited to international competitiveness), we consider that the FPC should have a single over-arching objective that reflects the multifaceted nature of its roles and responsibilities, even if the inter-relationships are complex. We believe that this objective should be comparable to that of the ESRB.

It will be important to amplify the FPC’s objective (c/f sections 3 to 6 of the Financial Services and Markets Act (FSMA)), so that the FPC’s performance can be more easily accountable to Parliament. For example, by reference to the scope of the risks the FPC is responsible for identifying, monitoring and addressing.

**Q2. If you support the idea of secondary factors, what types of factors should be applied to the FPC?**

As discussed above, we believe that the FPC should have a single over-arching objective, which is comparable that of the ESRB.

However, to seek to ensure cohesion within the regulatory framework, the FPC’s macro-prudential objective should be linked formally to the PRA’s (and arguably the CPMA’s) micro-prudential regulatory objectives. As is also discussed in response to Q4 below, we believe that each regulatory body should be required to recognise the other’s objectives (and at an operational level, decisions), unless to do so would conflict with their own objectives (see also our responses to Q4 and Q10 below, which also refer).

In addition, given the global nature of the UK’s markets and while recognising that this forms an intrinsic part of a macro-prudential regulator’s role, the FPC could have, as a secondary objective, cooperation and information sharing (in the aggregate) with relevant international and EU bodies such as the ESRB.

**Q3. How should these factors be formulated in legislation – for example, as a list of ‘have regards’ as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?**

We believe that factors not included in the over-arching primary objective should be enshrined in legislation as secondary statutory objectives rather than a list of factors to which the FPC is required to “have regard” but may then give insufficient weight. We believe that secondary objectives would provide

more accountability to Parliament, since it is difficult, ex post, to demonstrate whether or not a regulatory authority had ‘regard’ to a factor.

However, we believe that there should be a formal over-ride which provides that, in the event of a conflict between objectives or when taking urgent action to prevent or manage a crisis, primacy is given to the primary objective.

## **4.2. The Prudential regulation authority (PRA)**

AFME welcomes the establishment of the PRA and supports a more judgement-led approach to regulation. However, the success of more judgement-led regulation will ultimately rest on the quality and competence of the staff that take individual, firm-specific decisions and the checks and balances that exist to deliver proportional and fair outcomes. In particular, as discussed in our response to Q6, to ensure consistency and fairness, the PRA will need to have streamlined and clearly articulated procedures, which are transparent, provide reasons for a decision and give firms wishing to discuss and possibly challenge a decision a fair hearing.

### ***Objectives***

As discussed in response to Q1 above, the PRA, CPMA and FPC should have clear objectives - where possible auditable and accountable to Parliament - that reflect fully the multifaceted nature of their roles, even if the inter-relationships are complex. In particular, as growth in the financial markets will aid economic recovery and offer better choice and availability to consumers, we believe strongly that the new authorities should have, as one of their primary objectives, due regard to the UK’s competitiveness as an international financial centre and how it may be enhanced by effective regulation.

As HM Treasury recognises, it is also vital that the scope and objectives of the PRA and the CPMA are designed so as to avoid regulatory overlap and regulatory “underlap”. We comment further in respect of Q4 below on the proposed objectives of the authorities; in our view though, it is essential that the each authority is required to recognise the other’s objectives (and, at an operational level, decisions) unless to do so would conflict with their own objectives.

### ***Scope***

We note that the PRA will be responsible for “all firms who are subject to significant prudential regulation.” However, we believe that the current proposal, under which the PRA would be responsible for the “authorisation, regulation and day-to-day supervision” of specific regulated activities – namely, “taking deposits”, dealing in investments as principal and effecting and

carrying our contracts of insurance – will result in significant, unintended consequences, including:

- increasing the number (and types) of firms to be regulated by the PRA: for example, by bringing within scope any firm with a Part IV permission that includes dealing in investments as principal, regardless of whether the firm undertakes that activity or, if they do so, the scale of the business;
- adding unnecessary complexity to the vital gate keeping, authorisation and approvals (approved persons) processes by dividing the authorisation of wholesale firms' trading activities and the approval of individuals to perform certain controlled functions – for example, a significant influence function that involves the supervision of a trading desk that deal in equities as agent and in listed equity derivatives as principal - between the PRA and the CPMA; and,
- causing wholesale firms' trading-related systems and controls to be subject to regulation and supervision by both the PRA and the CPMA.

We concur that reference to specific activities, rather than types of firm, forms a sensible starting point from which to define the PRA's scope (i.e. by determining which firms are, in principle, subject to prudential regulation by the PRA as opposed to the CPMA). However, it will be important to narrow the definition of the PRA's scope to enable it to focus its resources on those firms that actually have complex prudential regulatory requirements, the supervision of which requires the exercise of judgement.

In relation to investment firms, HM Treasury might wish to consider:

- using the Markets in Financial Instruments Directive (MiFID) investment activity of “dealing on own account” - instead of the Regulated Activities Order regulated activity of “dealing in investments as principal” - to define the scope of the PRA. As HM Treasury will be aware, “dealing on own account” (Section A, Annex I to MiFID), has a narrower definition than dealing in investments as principal. In particular, dealing on own account does not include the significant number of derivative brokers that are required by exchange rules to trade on a ‘matched’ basis and whose Part IV permission to deal in investments as principal contains a “matched principal basis only” limitation (defined in the FSA Register as “Unable to hold financial instruments for own account unless it meets the “matched principal exemption conditions” in the FSA's Glossary of defined expressions used in the FSA's Handbook.”) The following extract from the FSA's Perimeter Guidance Manual (PER 13.3) refers:

***“Q16. What is dealing on own account? (A3 and article 4.1(6))***

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

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

*Dealing on own account may be relevant to firms with a dealing in investments as principal permission in relation to MiFID financial instruments, but only where they trade financial instruments on a regular basis for their own account, as part of their MiFID business. ..."*

- applying a secondary test such as excluding from PRA regulation 'limited activity' firms as defined under BIPRU 1.1.11R (i.e. a CAD investment firm which deals on own account only for the purpose of fulfilling or executing a client order or to in order to gain entrance to a clearing and settlement system or a recognised investment exchange when acting in an agency capacity or executing a client order)

### **Co-ordination with the CPMA**

As HM Treasury is aware, some misunderstandings have arisen with respect to whether giving responsibility to the PRA for the "authorisation, regulation and day-to-day supervision" of specific regulated activities – particularly dealing in investments as principal - means that the CPMA will have no role in respect of these activities. As we understand it, the CPMA will regulate the conduct of a firm when dealing in investments as principal (and carrying on all other regulated activities) while the PRA will have prudential regulatory oversight over dealing in investments as principal (and the other regulated activities within its scope), due to the risk it poses to a firm's safety and soundness.

Although the PRA will be a micro-prudential regulator and the CPMA a business conduct regulator, as discussed above, given the interrelationship between prudential risk and business conduct risk (which often cannot be separately distinguished), there will be no bright line between the regulators' scope for jointly regulated firms, particularly in areas such as systems and controls where the same set of controls may have both safety and soundness and conduct implications. We believe, therefore, that firms (and groups) that are regulated by the PRA and the CPMA should have a lead regulator, whose systems and controls requirements should take precedence.

In addition, if the PRA is to be given responsibility for authorisation of dealing in investments as principal and the approvals of approved persons whose controlled functions relate to this regulated activity, we believe strongly – as discussed in response to Q5 below - that a shared services function should process applications for authorisation, approval (of approved persons) and carry out other regulatory processes on behalf of the authorities.

It will also be important to have a carefully drafted Memorandum of Understanding (MOU) between the authorities, setting out agreements on, amongst other things, co-ordination of supervision and enforcement, policy formation and consistency of interpretations/decisions. AFME would be pleased to contribute towards the drafting and/or review of the MOU. A practical operating framework will also be needed to ensure that the new framework delivers, amongst other things:

- efficient, shared, processes for authorisation, approval and other regulatory processes;
- co-ordinated and consistent supervision;
- timely and appropriate exchange of information through information gateways;
- co-ordinated reporting and data requirements (including an overarching data integrity and standards programme and data warehousing that facilitates supervisory analysis without placing disproportionate burdens on firms); and
- clarity with respect to respective enforcement functions (and no risk of double jeopardy).

To provide for co-ordination between the PRA and the CPMA, HM Treasury should consider, to the extent it has not done so already, effective mechanism used in other ‘twin peaks’ regulatory systems such France and the Netherlands (see Annex 1 to this response, which gives an overview of the approach, in principle, to regulatory coordination in the Netherlands). We also believe that HM Treasury should establish a strong coordinating mechanism and method of resolving conflicts (c.f. the Joint Committee of the European Supervisory Authorities which will “settle cross sectoral disagreements that may arise between one or more competent authorities...”<sup>5</sup>).

### ***Enforcement***

We note from paragraph 3.20 of the condoc that the PRA will be given responsibility for enforcement of compliance with its rules, which we support. However, whilst the condoc makes reference to the CPMA’s enforcement tools, there is no similar discussion in relation to the PRA. To ensure consistency, both the PRA and the CPMA should have the same enforcement powers and

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5 Article 11a of the above



toolkits and operate under the same procedures in relation to enforcement of their regulatory own requirements. Clarity is also needed in respect of responsibility for enforcing FSMA offences including ‘unauthorized dealing’ (breach of the ‘general prohibition’ in section 19 of FSMA).

**Q4. The Government welcomes respondents’ views on:**

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

To seek to ensure cohesion within the regulatory framework, we believe that both the PRA and the CPMA should be required, formally to recognise the other’s objectives (and, at an operational level, decisions), unless to do so would conflict with their own objectives.

In addition, since all the authorities should have financial stability as an objective, the PRA and CPMA could also be required formally to recognise the primary financial stability objectives of the FPC. We also believe that the micro-prudential objectives of the PRA and CPMA should be linked to the FPC’s macro-prudential objectives, given that the PRA and the CPMA will be implementing the FPC’s decisions.

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

We see no reason why the PRA should not be subject to the principles of good regulation, as currently set out in section 2 of FSMA: namely:

- efficiency and economy;
- role of management;
- proportionality; innovation;
- international character; and
- competition

We believe that these principles should be enshrined in legislation as primary objectives rather than factors to which the PRA should “have regard”. However, given that the PRA may be required to give effect to decisions *in extremis*, the principles could be subject to an emergency override.

With respect to competition (section 2(3)(f) of FSMA) we believe that an important debate needs to take place on the respective roles of financial services regulators and the Office of Fair Trading (OFT) [or a merged OFT and Competition Commission]; the important role of the latter in

scrutinising the rules of financial services regulators, under section 160 of FSMA, should continue.

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

Before responding to this question, it is important to consider the wider meaning of the requirements and not equate ‘innovation’ with ‘risk’ and ‘competitiveness’ with ‘light touch regulation’.

Section 2(3)(d) of FSMA refers to: “the desirability of facilitating innovation in connection with regulated activities.” This is one of three “pro-competition” principles that were introduced following the interim findings of the Cruickshank Report on “Competition in UK Banking<sup>6</sup>. For the FSA, as their website explains: “This involves, for example allowing scope, where appropriate, for different means of compliance so as not to unduly restrict market participants from launching new financial products and services.” In short, effectively regulated innovation creates greater choice for consumers.

Section 2(3)(e) of FSMA refers to: “the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom.” To comply with this requirement the FSA, as their website explains: “...take into account the international aspects of much financial business and the competitive position of the UK. This involves co-operating with overseas regulators, both to agree international standards and to monitor global firms and markets effectively.” In short, competitiveness and the international nature of financial markets are intrinsically linked and rather than reducing standards to attract new entrants, this principle should focus a regulator on creating a regulatory regime that is consistent for globally active firms and attractive (to new entrants and new capital) because of its effective and proportionate regulation.

It is also of note that recital 9aa of the Proposal for a regulation of the European Parliament and the Council establishing a European Banking Authority (dated 14 September 2010) states that: “The authority should take due account of the impact of its activities on competition and innovation within the internal market, the Union’s global competitiveness, financial inclusion and the Union’s new strategy for jobs and growth.”

In sum, we believe it is important for the UK economy that international competitiveness, innovation and economic growth should be included as

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<sup>6</sup> See Government response dated August 2000

objectives for both the PRA and the CPMA; there should also be consistency with the ESAs in this regard.

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

We have no comments on this question at this stage.

**Q5. Is the model proposed in paragraph 3.16 - with each authority responsible for all decisions within their remit subject to financial stability considerations - appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?**

Given the difficulties, as discussed above, in creating a bright line between the scope of the PRA and the CPMA for jointly regulated firms, we believe that the model proposed in paragraph 3.16 of the condoc will be subject to significant operational difficulties. In particular, in the capital markets, the model would result in both the PRA and the CPMA determining applications for Part IV permission and applications for approval for individuals to perform significant influence functions that involve the supervision of agency and principal business.

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

We also believe that, instead of creating duplicate and potentially divergent technical units in the PRA and CPMA, 'centres of excellence' should be established for the regulatory system as a whole. For example, given that client assets (including their protection and speedy return to customers) must continue to be a key focus in the new framework, the FSA's new Client Assets Sector team should not be fragmented across the PRA and CPMA; instead we believe that it should form part of the PRA but act as a centre of excellence (i.e. resource) for the CPMA, thereby providing a single source of interpretation (for a single set of rules) and expertise.

**Q6. Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focussed approach to supervision?**

We welcome the statement, in paragraph 3.17 of the condoc, that the Government goal “is that the legal framework for the PRA should underpin a more informed and judgemental approach to regulation.” We see this as an expression of the risk-based type of regulator that the FSA was seeking to become and believe that the proposals could deliver, if the PRA has sufficiently experienced supervisors to understand and appropriately challenge firms, an effective check against a firm becoming an unacceptable risk to the financial system.

With the exception of functions relating to regulatory processes, which we discuss in Q5 above, the measure set out in the condoc appear sensible and we look forward to further detail. However, ultimately, the success or failure of a more-judgement led regulator will depend on the quality of its staff (who need to be as good, if not better than the firms they regulate) and on the quality of the data on which they base their judgments. The PRA and the CPMA must, therefore, have the flexibility – both in terms of remuneration and career opportunities – to recruit (and retain) high calibre individuals from the industry and consideration should be given to a standardised framework for data and its collection and warehousing.

The PRA will also need arrangements to ensure that its firm-specific decisions are subject to review and challenge internally, to ensure that all appropriate factors have been considered (e.g. to provide for a specialist review of evidence, checks for consistency with peers) and stated procedures have been followed. These supervisory processes need to be open and transparent and, ordinarily (unless the PRA has reasonable grounds to suspect fraud or has other serious concerns with respect to management), provide for an informed dialogue between firms and their supervisors at an early opportunity. Where decision are significant, we would expect that the formal checks and balances within the FSMA with respect to, amongst other things, supervisory, warning and decision notes, would apply.

There should also be a formal mechanism for firms wishing to challenge the decisions of supervisors. As a first stage, we would envisage an RDC type committee, with senior practitioner and possibly academic involvement followed by the existing right of appeal to the Financial Services and Markets Tribunal

**Q7. Are safeguards on the PRA’s rule-making function required?**

We see no reason why all the FSMA mechanisms around the rule-making process – notably the section 155 of FSMA requirement to consult and perform a cost-benefit analysis – should not apply to the PRA in relation to its rule-

making function. We regard these mechanisms as of fundamental importance and welcome the statement in paragraph 4.20 of the condoc that they are to apply to the CPMA; we regard these safeguards as of equal (and, arguably, greater) importance to a judgement-led regulator which will be proceeding in the context of a framework of prudential rules.

**Q8. If safeguards are required, how should the current FSMA safeguards be streamlined?**

We believe that FSMA (for example section 155(7) of FSMA) currently provides the FSA with flexibility to make rules in extremis. The only other area where we believe there could be streamlining is in relation to the copy-out of (directly applicable) EU Regulations, where an exception from the duty to perform a cost-benefit analysis could be provided; perhaps requiring instead an impact assessment?

**Q9. The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.**

We welcome the Government's:

- intention to "legislate to make the PRA subject to audit by the National Audit Office (NAO)" (paragraph 3.39 of the condoc);
- expectation that the PRA representatives will agree to appear before the Treasury Select Committee (paragraph 3.40 of the condoc); and
- proposal that CPMA will be responsible for collecting all levies.

We note that the PRA will "as a starting point...be required to produce an annual report which the Treasury will lay before Parliament." We believe that this annual report should be accompanied by a business plan (c.f. the FSA's Business Plan) for the forthcoming year, which will allow Parliament an opportunity to look at past performance and planned future work. The business plan should, in our view, include a detailed work programme, detailing non-routine work streams, which has been previously been consulted upon, and be linked to a Financial Risk Outlook (produced by the FPC with sector-specific input from the PRA and CPMA).

We also note from paragraph 3.37 of the condoc that "the Government will seek to supplement this basic requirement [an annual report] with further practical accountability mechanisms which will reflect the significant public responsibilities with which the Bank is being provided." We look forward to further details.

However, we believe that the PRA should be subject to the same accountability mechanisms as proposed for the CPMA (paragraph 4.36 of the condoc), including the extension of the FSMA consultative panels to the PRA. We also believe that the scope of the Complaints Commissioner should be extended to the PRA.

Being a judgement-led regulator (as discussed in our response to Q6), it will also be critical for the PRA to embed transparency, accountability and consistency at lower levels of decision making and interaction with firms.

### **4.3. Consumer protection and markets authority (CPMA)**

#### ***Objectives***

As discussed in relation to the PRA, given its multiple roles, the CPMA will need a set of primary objectives – rather than a single objective - to reflect the multifaceted, and possibly competing, nature of its responsibilities. Our response to Q1 below refers.

#### ***Structure***

The structure of the CPMA will clearly need to reflect the wide range of non-prudential functions undertaken currently by the FSA, including the regulation of retail and wholesale firms. We agree that, as stated in paragraph 5.10 of the condoc, given “the differences between retail financial services conduct and wholesale markets conduct issues, responsibility for all market conduct regulation will be located within an operationally distinct division of the CPMA.”

In January 2002, the external facing structure of the FSA comprised a:

- *Consumer, Investments and Insurance Directorate*, which included a Consumer Division (with a dedicated Consumer Protection Department);
- *Deposit Takers and Markets Directorate*, which included ‘Markets and Exchanges’ and ‘Major Financial Groups’; and a
- *Regulatory Processes & Risk Directorate*.

The CPMA should, in our view, comprise two (or possibly more) divisions – a Consumer Division and a Markets Division – each of which is headed by high calibre deputy CEO who (as is the case with the FSA’s Managing Directors) is a member of the main CPMA Board. Wholesale investment firms should be supervised by the Markets Division and retail firms by the Consumer Division. We believe that such an “operationally distinct” structure – with an

independent and strong Markets Division – is necessary to ensure that an appropriately balanced, risk-focused and proportionate approach is taken re the supervision of retail and wholesale firms.

### **Enforcement**

We welcome the statement, in paragraph 4.26 of the condoc, that the CPMA will have a separate market enforcement function within the Markets Division although clearly this will need to form part of the CPMA's wider enforcement capability. We await the forthcoming consultation on a proposed Economic Crime Agency; however, at this stage we believe that ensuring credible and effective enforcement within the CPMA is more important than moving powers to a new agency. In particular, any proposals adversely affecting the CPMA's ability to pursue market abuse investigation using either criminal or civil powers will need careful consideration.

### **Consumer protection**

As a trade association representing the wholesale capital markets, AFME will not be commenting in detail on consumer protection. However, we do wish to highlight a number of issues.

Firstly, there is general concern that the CPMA's "strong consumer champion" role (paragraph 4.3 of the condoc) will not sit comfortable with the role of a regulator; the latter needing to be neutral in its dealings with regulated firms and consumers and the former suggesting a body which will fight for consumer rights or act as a consumer advocate. We consider that reference in paragraph 1.21 of the condoc, to the CPMA protecting consumers "through a strong consumer division" is more a more helpful description of the CPMA's consumer protection role.

Secondly, we would note that the FSA's consumer protection objective, as set out in section 5 of FSMA, sets realistic expectations with respect to the FSA's responsibilities and the responsibilities of consumers; this is important to avoid challenge to the regulator:

*"A number of complainants in their submissions to the Commissioner have tried to rely upon a limited construction of the statutory objectives or aims of the FSA as contained in FSMA. The most common construction argued relates to "consumers". For example this relates to "helping retail consumers achieve a fair deal". A number of consumers have tried to argue, erroneously in the Commissioner's view, that this relates to consumers in the singular sense, that is, if as an individual, they have suffered a loss then logically the FSA has failed its statutory objectives. This is not the case. Sometimes the FSA is approached by a firm who submits a plan of action to the FSA that it proposes to take due to, for example, difficult market conditions. This might relate to a large population of different class of consumers and changes in the firm's treatment of such consumers which may lead to an unavoidable loss to some consumers. The FSA will then make its position clear bearing in mind its statutory aims and objectives and as a result of this some classes of consumers may suffer loss.*

*However the FSA has not failed in its aims or objectives as it has made its decision based on its appraisal of the situation as a whole in relation to the different classes of consumer. Losses possibly suffered by one class of consumer is probably a better situation than losses inevitably being suffered by all classes of consumer.”* Complaints Commissioner – 2009/10 report

We believe that the CPMA’s consumer objective should reflect section 5 of FSMA (protection of consumers).

### **Passporting**

The CPMA, as the conduct regulator, will, we assume, be responsible for inward and outward passporting under the EU single market directives; its duties including receiving notifications from incoming EEA firms wishing to establish branches in, or provide services into, the UK under a single market directive. We also assume that the passporting unit would be located in a Markets Division with the range of functions that we propose above. We look forward to further detail with respect to passporting in the next consultation.

### **Q10. The Government welcomes respondents’ views on:**

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

We note that the objective of the European Securities and Markets Authority (ESMA) will be to:

*“protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the Union economy, its citizens and businesses.”<sup>7</sup>*

Given the CPMA’s role as the UK markets authority, we believe that the CPMA should, as a minimum, be required to recognise the FPC’s financial stability statutory objective; arguably, though, the CPMA should have its own, markets focus, financial stability objective. In addition, as discussed in response to Q4, we believe that both the PRA and the CPMA should be required, formally to recognise the other’s objectives (and, at an operational level, decisions), unless to do so would conflict with their own objectives.

We look forward to greater detail on how the FPC will work with the CPMA e.g. on issues that involve the stability of markets.

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<sup>7</sup> Article 1(4) of the Proposal for a regulation of the European Parliament and the Council establishing a European Securities and Markets Authority dated 14 September 2010



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

See our response to Q4 above; we believe that the principles of good regulation are an important discipline for regulators and assist consumers by avoiding disproportionate and costly regulation.

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

Yes; see our response to Q4 above.

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

We have no comments on this question at this stage.

**Q11. Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?**

We welcome the more detailed accountability mechanisms proposed for the CPMA in paragraph 4.36 of the condoc and believe that all accountability mechanisms set out in FSMA should be retained in their entirety.

In addition, as discussed in relation to the PRA, we believe that the annual report should contain a work programme for the forthcoming year, which has been previously been consulted upon, and be linked to a Financial Risk Outlook (produced by the FPC with sector-specific input from the PRA and CPMA).

We also welcome the Government's:

- intention to "legislate to make the CPMA subject to audit by the National Audit Office (NAO)" (paragraph 4.37 of the condoc); and
- expectation that the CPMA representatives will agree to appear before the Treasury Select Committee (paragraph 4.39 of the condoc).

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

We welcome and support fully the statements that the CPMA will "retain the two current panels required under FSMA, the Consumer Panel and the Practitioner Panel" and that the "Small Business Practitioner Panel will also be placed on a statutory footing." However, as discussed in relation to the PRA, we believe that the remit of the panels (in particular the Practitioners Panel)

should be extended to the PRA so that the panels have an over-arching view of financial regulation; thereby helping to ensure a consistency of approach.

In terms of membership, we believe that consideration should be given as to how the panels could draw more fully upon specialist input in technical areas (for example by the creation of specialist advisory groups – such as a wholesale advisory group - which could be called upon when necessary) and how the nature of their interaction with the regulatory authorities could be enhanced.

**Q13. The Government welcomes views on the proposed funding arrangements, in particular, the proposal that the CPMA will be the fee- and levy-collecting body for all regulatory authorities and associated bodies.**

We support the proposed funding arrangements. We would not, however, wish to see the costs to firms escalate purely as a result of the establishment of additional regulatory bodies; as discussed in response to Q5, we believe that a "shared services" operating model should be developed (covering IT and other support functions) so as to achieve economies of scale.

We would ask that both the PRA and the CPMA use a common methodology to calculate their fees – to avoid larger firms having to submit different sets of data - as well as a common mechanism for collection. This could be achieved, for example, by the shared services function operating a single budgetary process for both the PRA and the CPMA, which is subject to oversight from the NAO.

**Q14. The Government welcomes views on the proposed alternative options for operating models for the FSCS.**

Any 'alternative options' for the FSCS must be considered in the light of the EU proposals for an investors' compensation scheme and a deposit guarantee scheme. That said, we continue to believe that there should be one UK scheme with mechanisms to avoid cross subsidy.

#### **4.4. Markets and infrastructure**

We welcome the statement, in paragraph 5.1 of the condoc, that: "A key imperative for the new structure...will be a stable and credible framework for market regulation which promotes confidence in the stability, integrity and efficiency of financial markets in the UK." We also welcome HM Treasury's commitment to the CPMA having a strong Markets Division.

It is, however, crucial that the current, robust regulation of markets and the expertise of the FSA's Markets Division are not diluted in the new framework

and that, given the changes to EU supervisory arrangements, it is vital that the CPMA has the maximum expertise, authority, resources, and breadth of competence to enable it to exert the necessary influence in respect of directive negotiations etc. Our detailed feedback in respect of the proposals that would fragment market regulation are set out below, however, as an over-arching comment, it will be crucial to have effective co-ordination of EU and International liaison and engagement at an operational level.

**Q15. The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.**

There is a case, which we recognise, for clearing houses being regulated by the Bank; not least because the failure of the major clearing house would, like the failure of a payment system, have catastrophic consequences. However, given the market trend towards vertically integrated exchanges, we are concerned that the CPMA, who will regulate the exchange and trading platforms, may not have a complete ‘front to back’ overview of the operations of a vertically integrated market infrastructure provider. The CPMA will also need prompt and full access to information on firms’ open positions from clearing houses, in the event of a crisis in the financial markets.

Since close co-operation and free flow of information between the CPMA and the Bank will be vital – particularly given the development of an EU regime for the central clearing of OTC derivatives - we suggest that HM Treasury consider a European model, in which clearing houses are supervised by college made up of central banks and markets authorities (e.g. the Commission Bancaire and the AMF).

It will also be important to ensure that the UK’s representation on ESMA in respect of market infrastructure issue – particularly given the developments in the regulation of OTC derivatives – is not diluted, by ensuring effective co-ordination and communication between the Bank and the CPMA Markets Division.

**Q16. The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.**

We look forward to receiving, in due course, further and better particulars on the rationalisation that HM Treasury has in contemplation. In the meantime, we see no benefit in ‘rationalisation’ of the Part 18 FSMA recognition regime with the Part 4 FSMA authorisation regime since, particularly given their different risk profile and quasi-regulatory role, we do not believe that recognised bodies should be regulated in the same way as authorised firms.

As HM Treasury will be aware, recognised bodies (i.e. recognised investment exchanges and recognised clearing houses) perform important regulatory functions, which help to ensure neutral, efficient and orderly markets, and have a critical role in respect of maintaining confidence in the UK markets. We believe that the recognition regime should remain separate and distinct from the authorisation regime as the recognition requirements enshrine vital requirements to help maintain high standards of market regulation and consumer protection and the UK's reputation as an international centre for capital-raising.

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

**We are strongly of the opinion that supervision and enforcement of the primary and secondary markets should not be fragmented.** We are unaware of either any market participants who support this proposal or of any EU or major international jurisdiction that separate primary and secondary market regulation.

As the FSA website explains: *"The FSA, when it acts as the competent authority under Part VI of FSMA, is referred to as the UK Listing Authority or UKLA. In this role, the FSA is a securities regulator, focused on the companies which issue the securities traded in financial markets.*

*By making and enforcing the Disclosure and Transparency Rules, the Listing Rules and the Prospectus Rules, we aim to protect investors and foster appropriate standards of transparency, conduct, shareholder rights and due diligence"*

The regulation of primary and secondary markets is inextricably linked such that a dividing line cannot easily be drawn between regulatory issues that arise in the primary market, in relation to a listing, and those that relate to the secondary market (i.e. the subsequent dealings in the new listing). The need for regulation throughout the lifecycle of a security listed in the UK should be seen as an unbroken continuum from pre-listing vetting, ensuring accurate information is provided to investors, through to established trading in the secondary market; dislocating primary and secondary market regulation will create fault lines that could impact on the supervision of markets, the protection of investors and the fight against financial crime.

The Market Abuse Directive, for example, is implemented in the UK in the FSA's Code of Market Conduct and the UKLA's Disclosure and Transparency Rules and a number of the FSA market abuse enforcement cases also involve

listing.<sup>8</sup> Under the article 11 of Directive, however, a Member State may only “designate a single administrative authority competent to ensure that the provisions adopted pursuant to this Directive are applied.”

In relation to leaks inquiries: “Where the UKLA is obliged by an issuer’s non-disclosure to invoke our powers to require an announcement or to suspend an issuer’s securities, we may make ex post enquiries as to whether all parties have been sufficiently open and cooperative in their dealings with us to that point and whether there have been any breaches of the FSA’s rules.”<sup>9</sup>

The UKLA, as a securities regulator, also has a significant volume of work; for example, it approves prospectuses and listing particulars in respect of listed issuers or issuers who have had securities admitted to trading on a UK regulated market or companies who have made applicable offers of securities to the public in the UK. In January 2010 alone, 93 approved documents are listed on the FSA website. The UKLA also receives notifications of prospectuses that have been approved by a non-UK EU competent authority and passported, under the Prospectus Directive, for the purpose of admitting securities to trading on a UK regulated market.

More detailed considerations in respect of this proposal are included as Annex II to this response.

**In sum, moving the UKLA to the Financial Reporting Council (FRC) will create a fault line in the regulation of markets and by so doing will risk impeding market regulation and, in particular, the fight against market abuse. The separation of primary and secondary market regulation would also risk diluting the UK’s voice at ESMA.** If the UKLA were to be merged with the FRC, it would have to be represented by the (voting) CPMA member; hence the CPMA member might be viewed, by other EU member states (who do not divide primary and secondary market regulation), as a messenger rather than the expert, **which could impact on the negotiation of key directives such as the Transparency Directive.** Moreover, at a higher European level, the proposal to merge the UKLA into the FRC would result in the UK’s financial markets being represented by two ministers in Europe (one from the Treasury and one from Department for Business Innovation and Skills). This would, again, be at odds with the approach of other member states and could weaken the UK’s voice in Europe further.

**Q18. The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator.**

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<sup>8</sup> For example, the 2004 FSA enforcement action against Shell Transport and Trading Company (“STT”), Royal Dutch Petroleum Company (“RDP”) and the Royal Dutch/Shell Group of Companies (“Shell”) for “committing market abuse and breaching the listing rules.”

<sup>9</sup> LIST: Issue No. 23 – December 2009

See our response to Q17 above.

#### **4.5. Crisis management**

As an over-arching comment, we believe that greater clarity and detail is needed with respect to the proposals for crisis management. AFME continues to contribute to HM Treasury's work on resolution regimes for investment banks and looks forward to providing more detailed input on this important topic as part of the second and more detailed consultation phase.

#### **Q19. Do you have any overall comments on the arrangements for crisis management?**

We support the development of clear and effective arrangements for crisis management, which take account of the lessons learnt from recent events. We look forward to further detail on the proposed arrangements in due course.

In the meantime, we note from paragraph 6.10 of the condoc that "the Chancellor will be accountable to Parliament for the authorities' crisis management strategy." We assume, therefore, that HM Treasury will be informed whenever there is a 'crisis' and will play an appropriately involved role in management (from monitoring to hands-on engagement), regardless of whether or not there might be a decision affecting public funds or international obligations.

In addition, whilst, the failure of a small firm with a large retail customer base may not be defined as a crisis and will not require recourse to public support, we assume that, given the impact on individuals, the Government would wish to, at the least, be kept apprised, for example, with respect to the payment of compensation by the Financial Services Compensation Scheme (FSCS).

We would also make the following observations:

- whilst responsibility for resolution falls to the Bank, as the CPMA supervises exchanges and trading platforms we were surprised to note that the CPMA does not have a crisis management role. We believe that the CPMA should have an active role both in CCP resolution and in respect of the market consequences of a failed investment firm (e.g. in relation to overseeing transfers of open positions);
- as the Governor chairs the PRA, there could be a perceived conflict when the PRA places a firm in the Special Resolution Regime, as the Special Resolution Unit also falls within the Governor's responsibilities. We believe that this warrants further consideration;

- there appears to be an emphasis on the failure of banks, however, as a future crisis is unlikely to be the same, the arrangements need to ensure that there is a broad range of tools available;
- whilst the Bank will need strong information barriers to avoid conflicts, if the Bank makes a capital injection into a market participant, to what extent could they/should they inform the Markets Division of the CPMA in advance? Again, we believe this warrants further consideration.

**Q20. What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?**

We support enhanced clarity about “own initiative variation of permission” (OIVOP) powers and the circumstances in which they might be used by the PRA and CPMA but would not wish to see these powers being used as a routine alternative to enforcement action.

However, changing the trigger points at which a regulator is able to take action before a firm breaches the threshold conditions or mandatory intervention would warrant a detailed review. We look forward to further details of HM Treasury’s proposals (including the rationale for enhancing OIVOP powers) in due course.

**Q21. What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24?**

Paragraph 6.21 of the condoc states that: “The Government will look at proposals to strengthen the accountability and effectiveness of the authorities in exercising their powers under the SRR, taking account of the regulatory authorities’ new roles”. This is an important issue which warrants careful consideration. Whilst we support the basic premise that the authorities should be accountable, it will be important to ensure that accountability, and the possibility of legal challenge, will not discourage the authorities to use such tools when it is necessary.

In addition, we believe that the position of directors in crisis management situations remains unclear. Our concern is that in a distress situation, a conflict could arise between the objectives of the regulatory bodies responsible for financial stability and protecting depositors and those of the individual directors as senior managers or officers of the company. Such a conflict could give rise to considerable corporate governance concerns as senior management are generally required as a matter of corporate law to act in the interests of the institution while it is solvent, and in the interests of creditors on and following insolvency.

The implementation of wind-down plans necessarily must take effect pre-failure. Powers to force directors to take particular action (such as implementing resolution plans) may place them in conflict with their duties to act in the best interests of the company - particularly where the actions are for the benefit of the financial system as a whole rather than the company. As the law stands today, that conflict could ultimately carry legal liability for the senior management of the institution if their implementation is successfully challenged by shareholders or creditors following a failure of the institution. Similar concerns arise where crisis management powers are used to disincentivise, or prevent, a board from filing for insolvency.

We would recommend that the review of accountability includes considering statutory reforms that prevent directors from being held personally liable in these situations.

#### **4.6. Impact assessment**

**Q22. Annex B contains a preliminary impact assessment for the Government's proposals. As set out in that document, the Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm. In particular, comments are sought from all types and size of deposit-taking, insurance and investment banking firms (including credit unions and friendly societies), and from groups containing such firms.**

Members are still considering the preliminary impact assessment. However, given the number of areas in which further and better particulars will be necessary before the real impact can be assessed (e.g. clarity on the number of firms that will be regulated by the PRA), we anticipate providing more detailed input at the next stage of the consultation process.



## Regulatory cooperation in the Netherlands: an overview

As HM Treasury may be aware, in the Netherlands the Authority for the Financial Markets (AFM) is responsible for the supervision of conduct of the financial markets while the Dutch Central Bank (DNB) is responsible for the prudential supervision of financial enterprises. Both bodies have responsibility for authorisations. The Netherlands' "one-stop-shop principle" and regulatory cooperation is explained as follows:

*The division of tasks between DNB and AFM does not affect the circumstance that both supervisory bodies are active within the same financial sector. Partly in order to prevent an overlap between the two bodies' exercise of their supervisory tasks and to promote an efficient and decisive supervisory system, the Wft [The Financial Supervision Act] provides that, to the extent possible, a single supervisory authority will have decision-making power (one-stop-shop). This means that decisions on applications by financial undertakings for a licence or a waiver may authorisation or exemption may be taken by one supervisory authority.*

*The financial supervisors set up the (Meldpunt Toezicht Overlap) in April 2003. Supervised institutions can submit complaints to the Bureau about overlaps in operational supervision by these supervisory authorities. On a number of issues the Wft imposes an obligation on DNB and AFM to cooperate (see Sections 1:46 to 1:50 Wft). In addition, DNB and AFM have entered into a new covenant. The Wft also contains rules for cooperation between DNB or AFM and foreign supervisory authorities or the European Commission."*

*[Extract from: [www.dnb.nl/openboek/extern/id/en/all/41-155123.html](http://www.dnb.nl/openboek/extern/id/en/all/41-155123.html)]*

Section 1:46 (1) of the Wft provides that "The supervisors shall collaborate closely with a view to laying down generally binding regulations and policy rules, in order to ensure that these are equivalent wherever possible insofar as they relate to matters that are both subject to prudential supervision and supervision of conduct." These matters include over-arching requirements such as "controlled and sound operations", properness and expertise.

There is also a detailed "covenant" in place between the AFM and DNB, which covers cooperation in data gathering, supervisory visits etc:

*"To supplement and elaborate this statutory cooperation, further agreements have been made in the covenant to avoid potential overlap and to ensure that the supervision is carried out efficiently and effectively. Where possible and worthwhile, the supervisors thus make use of the information and expertise available to them (taking account of the relevant statutory provisions on confidentiality) and of the infrastructure available to them for requesting information and data from supervised financial undertakings, pension funds and accountancy organisations. Where necessary and possible, DNB and AFM also cooperate in relation to the formulation of regulations and policy."*

*[Extract from: [www.dnb.nl/openboek/extern/id/en/all/41-158314.html](http://www.dnb.nl/openboek/extern/id/en/all/41-158314.html)]*

With respect to applications for authorisation, the AFM handles applications for investment firms while the Dutch Central Bank handles applications for insurers and credit institutions. Input is then co-ordinated under Section 1:48 of the Wft which provides that:

- *“If the Dutch Central Bank, in processing an application...is required to assess whether the applicant meets the requirements laid down by or pursuant to Part 4, Conduct of Business Supervision of Financial Enterprises, it shall request the opinion of the Authority for the Financial Markets before rendering a decision on such an application.”*
- *“If the Authority for the Financial Markets, in processing an application ... is required to assess whether the applicant meets the requirements laid down by or pursuant to Part 3, Prudential Supervision of Financial Enterprises, it shall request the opinion of the Dutch Central Bank before rendering a decision on such an application.”*

We believe that HM Treasury should, to the extent it has not done so already, consider in detail the strengths and weaknesses of similar “twin peaks” regulatory models and assess whether any existing ‘good practice’ around regulatory cooperation and coordination should be built into the UK framework.

**Question 17: more detailed consideration****1 Operational and deal specific reasons for keeping the UKLA within the CPMA****1.1 Operational matters:**

- a) The UKLA's function of monitoring listed companies plays an essential role in linking primary markets' regulation with the market abuse responsibilities that are being transferred to the CPMA. Since both the CPMA and the UKLA will be closely involved with the monitoring of inside information, the UKLA should be kept within the CPMA Markets Division so that information can be easily and effectively shared on a timely basis;
- b) Separation of the UKLA and the CPMA is not effective from an investor protection point of view. As securities are fungible, they can be bought on either the primary or the secondary market. CPMA would, therefore, need to be able to regulate both the primary and secondary markets in order to deliver satisfactory investor protection;
- c) Given that the CPMA will be the market regulator, it is logical for the UKLA to sit within the CPMA in order that the CPMA has a definitive overview of both primary and secondary market activity;
- d) The inter-conditionality between admission to trading on a regulated market and admission to listing represents another case for keeping the UKLA with the CPMA. The CPMA would be required to ensure that the admission to trading requirements are satisfied by the exchanges it supervises, and the regulatory linkage between this requirement and the conduct of the listing regime clearly makes the CPMA the logical home for the UKLA;
- e) The CPMA, as market regulator, would need to also be responsible for primary markets in order to effectively ensure orderly markets. There could be circumstances, for instance, where the regulator would need to suspend trading and/or listing, for example; and
- f) There are close links between financial promotion regulation and the prospectus and public offer regimes, and between the Undertakings for Collective Investment in Transferable Securities ("UCITS") and listing regimes, and both UCITS and financial promotion will be CPMA responsibilities.

## 1.2 Deal specific issues in relation to splitting the regulation of primary and secondary markets:

- a) **IPOs** - An initial public offering provides the clearest example of a significant risk of “underlap” and a loss of logical synergies if the primary and secondary element of regulation were to be split. Were the UKLA to be merged with the FRC, then the regulation/approval of the prospectus and the listing application would be undertaken by the FRC, whereas all secondary aspects (such as stabilisation and the monitoring of insider dealing) would be within the remit of the CPMA. Numerous of these secondary considerations are so inextricably linked to the consideration of the initial listing that there is no good argument for not keeping the primary and secondary regulation under one regulatory roof. Were the regulator that was responsible for the listing not to pass on information that could have an effect on the secondary market, an adverse impact could be had on the market. Similarly, the ongoing requirements in respect of the secondary market for any security which is proposed to be listed should inspire and have an influence on the disclosure in the initial listing document.
- b) **Rights Issues** – Similar issues arise on a rights issue. Arguably, however, rights issues provide an even clearer example of where joined-up regulation is required. There can be no sensible argument made for having one regulator vetting a rights issue prospectus and the trading of the nil paid rights, independent of the regulator that monitors the already listed shares of the issuer to which the rights relate. Indeed, the issues surrounding the recent proliferation of short selling of the shares of issuers conducting rights issues and the regulatory issues that this often presents further makes the case for having the primary and secondary regulation under the umbrella of one authority.
- c) **Issues of exchangeables/convertibles** – A transaction involving the new listing of an instrument that relates to an already publicly traded security is another important area where having one regulatory body focussed on primary and secondary matters is essential to ensuring an orderly and secure market, particularly in respect of insider trading. If inside information in relation to either the instrument to be admitted or the (already listed) underlying security were being acted on, under a scenario where primary and secondary market responsibilities are split, there is a serious risk of insufficient or untimely information sharing. In such a situation, it would be unlikely that one regulator would know about the activities being monitored by the other.

## 2 Key differences between the UKLA and the FRC

It is important to consider the different culture and roles of the UKLA and FRC. The FRC is not a “real-time” regulator. Its experience to date has primarily focused on setting standards in respect of reporting and audit functions and the rule writing for the regulation of UK corporate governance. Much of this rule writing is carried out by various policy committees and boards. This should be contrasted with “real time” and more flexible UKLA operations.

The UKLA has a long track record of operational experience and it applies and interprets rules in relation to complex facts and delivers responses/makes rulings in time pressured situations. The UKLA is, therefore, reactive, dynamic and astute and there is a concern that the UKLA would lose its dynamism and responsive approach to complicated listing and market issues if it were merged with the FRC.

It is important to note that the large majority of companies listed in London are not UK companies; these non UK listed companies would, therefore, not fall within the scope of a ‘companies regulator’. Indeed, approximately only six per cent of the securities listed on the Official List are issued by UK corporates. Moreover, a number of issuers whose securities are listed in London are not corporates but supranational and other such quasi-corporate entities, which, similarly, do not fall within the FRC’s remit. This evidence clearly negates any benefits that may be realised by having listing and market responsibilities being brought under the auspices of the company regulator and reinforces the argument for keeping primary and secondary regulation under the control of one body; and a body that is more experienced in assessing complex matters in respect of diverse securities rather than simple rule making in respect of audit, reporting and governance functions of UK corporates.

Another key consideration for the future of market regulation will be the nature of penalties imposed for misconduct; a question which illustrates the significant differences between the remit of the FRC and the UKLA. The primary recourse for the FRC (via the Financial Reporting Review Panel) is via the UK justice system (for example, a court imposed re-statement of accounts). The UKLA, on the other hand, is able not only to impose sizeable and meaningful fines but also suspend a company’s listing in real-time. Whatever the future of the UKLA, these capabilities will clearly need to be retained but arguably the most effective approach would be for the UKLA to continue to have the ability to exercise such functions from within the CPMA, thereby benefiting from the CPMA’s enforcement capability.

Finally, the UKLA is responsible for approving any regulated firm’s application to act as a sponsor under the listing and disclosure rules. The UKLA must also carry out an ongoing oversight of sponsor activities. In doing so, it must consider the competence and experience of the regulated firms in

many areas which will also fall under the scope of the CPMA in the new framework. The UKLA currently has full access to the FSA regarding any regulated firm, including FSA's assessments of the legal and compliance functions in the firm, its conflicts policy and practice, the quality of its control functions, and the quality of its senior management. Ultimately the UKLA must decide whether it is comfortable accepting the required representations from a sponsor with respect to the any issuer's compliance with the listing rules, its available working capital, the quality of its control and management processes, and its board's understanding of its duties under the listing and disclosure regimes. The current integrated structure of the FSA facilitates the UKLA's evaluation of a sponsor firm's competence and support depth as well as its duty to maintain a continuing review of a sponsor firm's competence. To re-position UKLA would, therefore, fracture the oversight of regulated firms acting as sponsors.

### **3 Risk to the UK's representation in Europe**

The majority of regulation relating to the listing of securities originates from the European Union. The transformation of the Committee of European Securities Regulators ("CESR") into a European agency - the European Securities and Markets Authority ("ESMA") - is likely to increase the influence and authority Europe has over domestic regulators. Whilst CESR has been primarily concerned with policy questions, it is expected that ESMA may become increasingly interested in involving itself in supervisory and operational matters.

ESMA, as is the case currently with CESR, will only permit one regulatory body per member state to represent the regulatory interests of that member state at a European level. Were the UKLA to be merged into the FRC and a split between primary and secondary market regulation created between two bodies, one of the resultant bodies would not have its own voice in Europe. Whilst one body could, through close consultation, represent the interests of both or a delegation to an ESMA meeting (or an ESMA working party) could include (non-voting) representatives from another regulator, this would be a cumbersome solution that risks being inefficient and difficult to operate effectively in practice. Moreover, the UK's ability to uphold its position in Europe and protect its unique listing regime is primarily due to the well established heavyweight presence that the UKLA brings to the table at CESR.

So far as we are aware, no other European member state currently splits the regulation of its primary and secondary markets. Were this to happen in the UK, other European member representatives at ESMA may view the relevant UK (voting) representative at ESMA as having a compromised and diluted role. This would clearly result in such representative carrying less weight

that his fellow member state representatives. Moreover, at a higher European level, the proposal to merge the UKLA into the FRC would result in the UK's financial markets being represented by two ministers in Europe (one from the Treasury and one from Department for Business Innovation and Skills). This would, again, be at odds with the approach of other member states and could weaken the UK's voice in Europe further.

The complexities of the UK markets and the wider range of issuers and buyers can often mean that the UK's markets can be misunderstood at a European level. The UK needs a strong voice in Europe to protect its interests and preserve the flexibility and unique nature of its markets which are acknowledged as being the key to the success of London as an international market. With its importance to the economy as a whole, there is also a strong need to preserve the UK's position as one of the most respected and preferred financial markets in the world. In particular, the UK's unique premium listing standard is highly regarded around the world and, together with subsequent regulation of admitted securities, crucial to the attractiveness to companies of listing in the UK; it is important that this (higher) standard is protected. There is a risk that the effectiveness of the UK's representation may be diluted if a combined regulator with responsibility for primary and secondary markets cannot represent formally the UK at ESMA.

#### **4 Conclusion**

For the reasons highlighted above, the only way to ensure effective and integrated regulation is for the UKLA function to form part of the CPMA Markets Division and not be merged with the FRC. A decision to move the UKLA to within the control of the FRC could, as discussed above, lead to regulatory "underlap" with a heightened risk of key regulatory matters falling between the gaps whilst also reducing the UK's regulatory robustness both domestically and within Europe.

# **A new approach to financial regulation – judgment, focus and stability**

**Response to HM Treasury from the Association of  
British Credit Unions Ltd (ABCUL)**



## Introduction

We welcome the opportunity to respond to this consultation. ABCUL is the main trade association for credit unions in Britain. The Association represents approximately 70% of credit unions in England, Scotland and Wales who in turn represent about 85% of credit union membership. Credit unions are not-for-profit, financial co-operatives owned and controlled by their members. They provide safe-savings and affordable loans facilities. Increasingly credit unions offer more sophisticated products such as current accounts, ISAs, Child Trust Funds and mortgages.

At the end of March 2010, credit unions in Great Britain were providing financial services to 761,708 adult members and held £599 million in deposits with £474 million out on loan to members. There were also 107,077 young people saving with credit unions.<sup>1</sup>

The Credit Unions Act 1979 sets down in statute the objects of a credit union;

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

The Coalition Government has committed to “*bring forward detailed proposals to foster diversity in financial services, promote mutuals and create a more competitive banking industry*”.

Over the past decade or more credit unions in Britain have developed significantly towards emulating the successes of their international counterparts. According to the World Council of Credit Unions (WOCCU) there are 49,330 credit unions operating in 97 countries and with \$1.4 trillion dollars in assets – in Ireland more than 50% of people belong to their credit union whilst in the US and Canada it is around 45%.<sup>2</sup>

The credit union business model is a simple one. With limited exceptions – notably the DWP Growth Fund with which over 100 credit unions have delivered 300,000 affordable loans in low income communities using money from the Financial Inclusion Fund – the money that credit unions lend out to members comes from members' savings. Savings that are not lent out to members are invested in a limited range of options and are not placed at risk.

The latest information available to us (from 2007) shows that 150 credit unions that are ABCUL members (out of 330) did not employ any staff. Only 25 credit unions employed 5 or more full time staff. This demonstrates the small size of credit unions and the need to ensure that regulation does not result in a disproportionate burden on their operations.

ABCUL recognises the need for good governance and management in credit unions and works with its members in a number of ways to raise standards of governance and ensure that credit unions are well run, sustainable and effective financial co-operatives. As well as a range of training and information services, we have launched a Code of Governance for Credit Unions and introduced the PEARLS financial monitoring system.

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<sup>1</sup> Figures from unaudited quarterly returns provided to the Financial Services Authority

<sup>2</sup> See: [www.woccu.org](http://www.woccu.org)

We have always been supportive of FSA regulation and the raising of standards for credit unions, but given the size and development stage of the sector, have always stressed the need for proportionate regulation which does not place undue burdens on credit unions.

Our response is informed by responses to a survey of our members, which vary in size from 200 to over 20,000 members. An online and postal survey was carried out during August 2010 to which 64 credit unions responded, representing over 20% of our membership and the diversity of our membership.

We have concentrated our response on sections of the consultation relating to the PRA and the CPMA. Concerns from our members about the impact on their operations and costs of dealing with two regulators are outlined in our response to the impact assessment.

## Consultation questions

### Prudential regulation authority (PRA)

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

In order to avoid unnecessary conflicting activities or judgements, it is essential that the PRA should have regard to the primary objectives of the CPMA and FPC. All efforts should be made to ensure that all of the new bodies set up to replace the FSA are working to the same agenda.

The principles for good regulation currently set out in section 2 of FSMA should also be retained in the PRA. Resources should always be used in the most efficient and economic way. Credit unions would struggle to resource a large hike in fees and should not be disadvantaged because a new regime is more expensive to run.

Proportionality is key to effective credit union regulation and the PRA should continue to have regard to this principle in its work. Credit unions have not put financial stability at risk and should not face extra burdens as a result of these reforms.

The PRA should also have regard to the important issues of competition in financial services and consumer choice within the UK. The business models and governance structures of credit unions and other mutual financial services providers are recognised as benefitting individuals and society. Ensuring that this is recognised in the work of the PRA and that mutual financial service providers are not disadvantaged by the changes to new regulation is essential for the benefit of consumers.

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

The process should be as streamlined and efficient as possible, both to reduce cost inefficiencies, ensure that the bodies making the decisions have all the information available to them, and reduce the burden on firms, especially those with limited resources, such as credit unions. An integrated model would therefore appear to be the best approach.

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

We understand that a risk based approach will mean that the regulation of the vast majority of credit unions will continue to be largely desk based. It is essential that proportionality is central to the regulation of credit unions, though we would support prompt action where problems are identified to ensure that action can be taken to ensure credit union can come back into compliance, or mergers can take place before a failing credit union has reached a stage where no other credit union would be willing to accept a transfer of engagements.

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

It is essential that the PRA consults on changes to rules and that practitioner panels and stakeholders continue to be able to comment on proposals. We very much value the opportunity to comment on FSA consultations for a number of reasons:

- As a small part of the financial services landscape, credit unions can inadvertently be caught up in new regulations which have been designed to tackle problems of which they have played no part in causing. It is essential that we are able to respond to consultations to ensure that the needs and unique characteristics of credit unions are considered as rules are developed
- The consultation process is also an essential way in which the sector can be forewarned of changes to regulation which will affect it in the future. ABCUL uses the consultation process to educate our members about possible changes: We issue a briefing when a consultation paper is published and seek feedback on the proposals, and we inform members of our response at the end of the consultation period. These two stages would be missing if consultation was not part of the PRA's rule making process and it would mean that credit unions would be less informed and would have less time to digest the changes and think about the implications for their resources and operations.
- As a small sector, credit unions are not represented on the board of the FSA and it is only through participation in practitioner panels and through the consultation process that our voice can be heard. While we would argue for more representation on the board of the PRA, we accept that this may not happen, so the current opportunities to comment on proposals must not be lost or watered down.

Of those who had made up their mind, a large majority of respondents to our survey on this consultation paper (88%) thought that the PRA should be required to carry out a Cost Benefit Analysis and consult with practitioner panels and the general public before making rules.

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

Clear and timely communications should not fall victim to any streamlining of the process and small sectors, such as the credit union sector, should not be disadvantaged by any reduction in the time or opportunities made available to feed into the policy making process.

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

It does appear that the proposed structure will ensure that the PRA will have the benefit of the experience of senior staff from the Bank of England. But this will not ensure that credit unions needs and unique business model will be understood at a senior level within the Authority. Thought should be given to ensuring that the PRA board has within it a sufficient level of understanding of all the firms that it is tasked with regulating.

72% of respondents to an ABCUL survey on the issue were concerned that the new regulators would not understand credit unions as well as current staff. Representation at a senior level of the PRA of individuals with an understanding of credit unions and the wider mutual sector would contribute to greater confidence in the new regulatory structure.

## Consumer protection and markets authority (CPMA)

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

Our response to these issues echoes our comments on the PRA in our answer to question 4. It is essential that all of the new bodies involved in the new regulatory structures have regard to the same primary objectives. It should also be made very clear to firms and to the public what the responsibilities of each body are. As with the PRA, the principles for good regulation currently set out in section 2 of FSMA should also be retained for the CPMA. Resources should always be used in the most efficient and economic way.

Having regard to proportionality is essential for effective credit union regulation and the CPMA should continue to have regard to this principle in its work. Credit unions should not be disadvantaged because a new regime is more expensive to run.

The CPMA should also have regard to the important issues of competition in financial services and consumer choice within the UK. The business models and governance structures of credit unions and other mutual financial services providers are recognised as benefitting individuals and society. Ensuring that this is recognised in the work of the CPMA and that mutual financial service providers are not disadvantaged by the changes to new regulation is essential for the benefit of consumers.

We agree with the proposed 'have regards' relating to the potential impact on consumer and business lending, promoting public understanding, maintaining diversity and promoting financial inclusion. These suggested public interest considerations, especially those which relate to ensuring mutuality will be an important factor in the effectiveness of the CPMA and its ability to meet the needs of all consumers.

This also represents a great opportunity to ensure that social goals and Government commitments are at the core of the operations of the CPMA. The Coalition Agreement commits the Government to "*foster diversity in financial services, promote mutuals and create a more competitive banking industry*". Having a built in requirement to promote diversity in the financial services industry and require the CPMA to ensure that rules do not disadvantage mutually owned financial services providers will be of benefit to the aims of the Government as well as to consumers.

Promoting diversity by ensuring that the unique needs of financial mutuals are taken into account in the work of the CPMA, and promoting financial inclusion are essential in ensuring that all consumers can benefit from the work of the new agency. This will become particularly important if, as expected, Consumer Focus and the Office of Fair Trading cease to exist. One way in which this could happen will be ensuring that the make up of the boards of the agencies have representation from mutual and consumer experts, not just individuals from the commercial financial services sector.

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

As we said in our response to question 9 above, 72% of respondents to an ABCUL survey on the issue were concerned that the new regulators would not understand credit unions as well as current staff. It will be important for the CPMA board to be representative of all the sectors it works with. It is essential that the unique business model of credit unions and the mutual difference more generally is well understood at senior levels within the CPMA.

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

We welcome the proposal to put the Small Business Practitioners Panel on a statutory footing; representation from the credit union sector should continue on this panel, and opportunities for the wider credit union sector to feed back on policy proposals should be protected. Thought should be given to having more than one credit union representative on the Panel, to ensure that the needs of different types of credit unions are reflected.

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

Care should be taken to ensure that administrative functions such as this are carried out in the most efficient way possible. It would therefore make sense for the CPMA to be responsible for collecting fees and levies.

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

A single scheme for funding the Financial Services Compensation Scheme should continue, as should cross-subsidy across the classes. This is likely to be a simpler and more cost effective system and is more likely to be able to cope with any future crisis and ensure that consumers receive compensation in the most efficient way possible. We would be concerned about proposals which would place a higher financial burden on credit unions. It would make sense for the CPMA, as the responsible body for the FSCS to have responsibility for the levy raising function. **Crisis management**

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

Credit unions are not currently included within the Special Resolution Regime, as failure within the sector would not, given its current size, represent a threat to financial stability. Many credit union sectors around the world do have in place a Stabilisation Fund, which puts in place procedures and standards to ensure the safety of credit unions, and which has the resources to intervene in struggling credit unions. This is complementary to, and does not replace, deposit protection. A recent research report, carried out by Paul Jones of Liverpool John Moores University, recommended that:

- The FSA should focus their attention on credit unions identified as weak financial institutions and support interventions and remedies to avoid default. This is seen as a much more effective intervention than raising compliance thresholds for all.

- The Government should work with the FSA, FSCS, ABCUL and the sector to consider strengthening of the credit union sector through the development of a credit union stabilisation agency.

We would be happy to provide further details on this work should that be required and would welcome the opportunity to discuss the findings of this report.

## Impact assessment

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

The majority of credit union expressed concern about the effects that these changes will have on their resources.

**91%** of credit unions were concerned that FSA fees may increase.

**87%** were concerned that the internal costs of dealing with regulation may increase

**83%** were concerned that time taken to deal with regulation may increase

**72%** were also concerned that regulators in the new bodies may not have understand credit unions as well as current staff.

Credit unions, operating as they do on tight margins and with limited resources, are understandably concerned about a second major overhaul of their regulation within one decade. Credit unions are generally comfortable with the current regulatory regime and do not wish to avoid appropriate and proportionate regulation. There is concern, however, that moves to a new regime will place pressure on credit unions at a time when they and their members are struggling to cope with a challenging economic environment which has inevitably brought challenges to credit unions.

While there have been instances of credit union failures in recent years – and the sector is doing much to improve credit union governance and operations to improve the safety and sustainability of credit unions – they were not involved in the culture in the banking sector that led to the situation that these reforms aim to prevent in the future.

Most credit unions operate with no or few staff. Any moves which will increase the administrative requirements of being regulated, because of the necessity to monitor developments from, and report to two different agencies will bring cost and resources burdens upon credit unions. In small organisations with finite resources, this is likely to have the effect of:

- Reducing the dividend that can be paid on members' savings – which may reducing savings levels and reduce in turn the amount of affordable credit that will be made available.
- Reducing the amount of time that staff and volunteers can devote to membership service – including dealing with delinquency and bad debt.

- There is also a risk that, despite efforts within the sector to bring in new volunteers to improve the mix of skills involved in credit union governance, that volunteers in smaller credit unions may see a further change to regulation as a step too far and leave the sector altogether.

Burdens placed on credit unions in the transition period to a new regulatory regime can be lessened to some degree through timely and clear communications from the regulatory body. In the last major change to regulation, credit unions were, on the whole, appreciative of the efforts that the FSA took to communicate the changes to credit unions, and the time that was taken to allow credit unions to familiarise themselves with the new regime. But the view that FSA staff did not, at the beginning of the regime, have enough knowledge and experience of credit unions was also raised.

It is essential that regulatory bodies have regard to the good practice learned from the communication and education efforts that the FSA put in place to prepare credit unions for transition in 2002. Efforts should also be taken to ensure that experienced and knowledgeable staff are in place at the new regulatory authorities to ensure the smoothest possible transition.



## Conclusion

Credit unions have a simple business model which is not affected by the vagaries of international financial markets. Credit unions have not been responsible for risky and short term business practices which have severely damaged the economy in recent years. As financial mutuals, credit unions have democratic internal checks and balances built in to their business models. Proportionate and effective regulation, which recognises the volunteer led nature of credit unions and effectively uses financial information to spot early signs of trouble, need not place a financial or resources burden on credit unions. The FSA has been reasonably successful in reaching this balance and this should continue under a new regime.

There is often a risk in the design of new systems that the needs of smaller sectors are not fully considered or considered last, often leading to unnecessary burdens. It is essential that the new regime recognises the unique position of credit unions as not-for-profit, volunteer-led organisations providing inclusive financial services to a wide range of people, including those on low incomes.

If it would be helpful for us to provide any further detail on any of the issues raised in this response, we would be very happy to do so.

**ABCUL, October 2010**



## A New Approach to Financial Regulation

### The ABI's Response to HM Treasury's consultation paper

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#### Introduction

1. The ABI is the voice of insurance, representing the general insurance, investment and long-term savings industry. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK. The ABI's role is to:
  - Be the voice of the UK insurance industry, leading debate and speaking up for insurers.
  - Represent the UK insurance industry to government, regulators and policy makers in the UK, EU and internationally, driving effective public policy and regulation.
  - Advocate high standards of customer service within the industry and provide useful information to the public about insurance.
  - Promote the benefits of insurance to the government, regulators, policy makers and the public.
2. The ABI welcomes the opportunity to respond to *„A new approach to financial regulation: judgement, focus and stability’*.

#### Summary

3. The ABI is committed to working closely with Government and the regulatory authorities to make their proposals work. The main points we have in connection with the proposals are:
  - Co-operation between the regulatory authorities at all levels is essential in order to avoid overlaps and inefficiencies in the proposed regime.
  - Both PRA and CPMA should be required to take account of the competitiveness of the financial services industry.
  - The overall costs of regulation should be proportionate and the regulatory authorities should be required to use their resources efficiently.
  - The proposals do not sufficiently take account of the importance of the EU as the source of most legislation and rules relating to financial regulation.

Nor do the proposals make clear how the UK authorities will ensure a joined-up approach in their dealing with the European Supervisory Authorities.

- Prudential regulation of insurance must be given equality of status with that of banks within PRA to ensure that high-quality regulation continues.
  - While the CPMA should seek positive outcomes for consumers, as a regulator it should adopt an evidence based approach taking account of the views of all stakeholders.
  - There needs to be a strong markets division within CPMA with control over as many of the issues affecting the financial markets as possible. This will encourage coherence of supervision.
  - The PRA must retain the FSMA safeguards and abide by the better regulation principles in order to ensure due process.
  - The forthcoming changes to the legislative framework offer a timely opportunity to reassess the role and governance of the Financial Ombudsman Service (FOS), in particular how cases with wider implications are dealt with.
4. These points, and others, are explained in greater detail in our comments which are set out below and in the attached annex.

## **Overall comments**

### Introduction

5. The ABI believes in high quality regulation and we understand the drivers for regulatory change in financial services. We are, therefore, committed to making the Government's proposed reforms work. However, we are extremely concerned at much of the detail in the consultation.
6. The major outcomes we would hope to see from a revised regulatory structure are:
- Improved financial stability;
  - Consumers' and investors' needs being put at the centre of the new regulatory structure;
  - A regulatory system that does not stand in the way of continued, positive innovation in the financial system;
  - High standards of consultation and open working with the financial services industry;

- Close co-operation at all levels between all the regulatory bodies in the new structure; and
  - In relation to insurance specific points:
    - i. Insurers play a key role as long-term investors in the UK economy. This should not be stifled by inappropriate read across to insurers of new regulatory requirements put in place as a result of the banking crisis;
    - ii. regulatory changes should not disrupt the UK's competitive and world-leading insurance markets – competition ensures that consumers receive choice and good value from insurers; and
    - iii. Effective regulation needs to reflect the risks and business models of different activities. It would be inappropriate for regulatory requirements designed for systemically important banks to be imposed on insurers.
    - iv. Insurance regulation needs to be properly resourced and given equal status with banking, particularly within the PRA.
7. There is no ideal regulatory structure and we believe that the Government's proposed 'twin peaks' model with separate prudential and conduct regulators, which has already been adopted in a number of countries, is a model which can work. Whatever structure is adopted the ABI is committed to working closely with Government and the regulatory authorities to make it work. However, in the nature of things most of our comments set out below are suggestions for improvements, or warnings about dangers to avoid, but these should all be taken in the spirit of constructive suggestions designed to ensure that we get the best regulatory structure possible.

### Overall

8. *Inefficient Regulatory Structures* - We believe that there is a potential for considerable inefficiencies, additional cost and overlapping jurisdictions to arise between the various bodies as a result of the complex mechanisms proposed to ensure co-ordination. We recognise that these arrangements are intended to ensure that the weaknesses identified in the Tripartite arrangements do not occur under the proposed new regime. However, as they stand we have a number of concerns with these proposals:
- They set up bureaucratic solutions to avoid overlap (joint membership of Boards and formal liaison arrangements) while tolerating overlap at operational level (for example proposing that PRA and CPMA will operate separate regimes for authorisations and permissions). In practice efficient joint working will require the PRA and CPMA to work together at all levels, not just at that of the most senior management, so that the two regulators

can take an integrated approach to supervision of firms (for example by ensuring that firms are not required to implement multiple rule changes at the same time). Without it, firms could easily receive two conflicting or contradictory sets of instructions from the respective regulators.

- They appear to operate largely in a top-down manner with the FPC having an ability to direct the PRA and CPMA to undertake certain actions (and a requirement on CPMA to consult with PRA in certain situations) but little provision for FPC to take account of the views of the other bodies (or for the consumer and market implications of PRA decisions to be taken into account). We suggest that the objectives of each of the bodies should have regard for the work of the others. Otherwise there is a risk of the structure becoming fragmented, when the stated aim of the reforms is to tackle some of the disconnections that arose from the Tripartite regime.

We believe that a possible way to alleviate some of these concerns would be for certain functions, including authorisations and approvals, to be carried out jointly. We suggest that an appropriate model for undertaking such joint work might be for a joint „service organisation’ to undertake these roles which would report equally to both PRA and CPMA and would help ensure the necessary co-ordination between the regulatory bodies. Such a „service organisation’ could also undertake other joint administrative roles such as fee collection and approval for passporting firms. The aim should be to minimise administrative costs during and after the transition to a new regime.

9. *Role of the EU* - The proposals do not sufficiently recognise the influence of EU developments on UK regulatory rules and practice – in effect almost all the relevant requirements for both prudential and conduct of business regulation are now set at EU level. This will increase further given that the new EU supervisory authorities will set binding technical standards. In practice this will severely limit the discretion of the UK authorities and, in particular, is likely to limit the extent to which the PRA can operate its proposed ‚judgement’ based approach to regulation given the trend in Europe towards more detailed rules and consistency of approach across regulators, both in terms of the rules themselves and the supervision of those rules. We are also concerned that the proposals will result in a fragmentation of UK representation in Europe - the PRA will represent the UK in the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA), and CPMA will have this role for the European Securities and Markets Authority (ESMA). While this can work we would urge that consideration is given to practical engagement on how, for example, conduct of business matters in EIOPA will be dealt with. There will be a need for close liaison between the authorities to ensure that the correct UK representatives are involved in the work of the EU bodies.
10. *Timing* – The consultation paper proposes that the new regulatory structures will be in place by 2012. We understand the Government’s desire to make these changes quickly but it is a very challenging timetable and there must be considerable risks and difficulties in meeting it - revising the current Financial Services and Markets Act, especially the large amount of supporting secondary legislation, will be a

considerable task. We would be grateful for additional clarification of the timetable and stand ready to assist with this process.

11. *Shadow organisations* - We understand that the FSA and the Bank of England are already in the process of reorganising their internal structures to shadow the proposed new organisations. There are clearly benefits in the FSA and Bank seeking to move to the new structures in order to ensure a smooth transition to the new regime. For example, the arrangements should help to identify any teething issues that need to be resolved prior to introducing legislation. However, such reorganisations could pre-empt the Parliamentary legislative process in such a way that it would be difficult and expensive to undertake further changes in the event that Parliamentary scrutiny results in significant changes to the proposals. We suggest that while the FSA and the Bank should begin planning for the new structures that they hold off substantive reorganisations at least until after the Government's legislation has received a second reading in the House of Commons. Once finalised, the arrangements should be implemented quickly, so as not to undermine 'business as usual' work.
12. *Distraction from ongoing work* – There are currently a substantial number of major regulatory developments underway (such as Solvency II and implementation of the Retail Distribution Review) and we are concerned that undertaking a major reorganisation of the regulatory structure at the same time will distract the authorities from focusing on implementation of these developments. In particular we are concerned that the Treasury and FSA may not ensure that the best outcome is achieved for the UK in the negotiations on how to implement Solvency II. The FSA and the Government should set up specialist teams to ensure that the new structures can be implemented without distracting from ongoing work. At the very least, there should be a clear process to monitor the implementation of the most sensitive projects being inherited from the FSA.

#### Financial Stability

13. The ABI supports the Government's intention to create a Financial Policy Committee in the Bank of England to be responsible for financial stability and macro-prudential regulation. The FPC may have to take decisions, such as limiting the amount of credit available, which could have significant political and societal implications. We are concerned that the proposed structure has insufficient political oversight (with the Treasury being limited to an observer role) and that it may have insufficient non-central banking expertise (as it will be dominated by Bank of England executives).

#### PRA

14. We are extremely concerned that the Government is considering removing the safeguards, such as requirements to consult and mechanisms to appeal regulatory decisions, currently within FSMA and we believe that these should be retained for the PRA. The consultation paper provides no justification or explanation as to why the Government believes that such safeguards might not be required – particularly

given that it is intended to maintain the safeguards in respect of the CPMA. These safeguards are needed to ensure that the regulatory authorities have undertaken due process in setting rules and making regulatory decisions and to ensure that the industry and other stakeholders (including consumers) are able to contribute to this process. There is also a need for a formal process through a complaints mechanism and the Upper Tribunal for firms to complain about failures in the way the regulator has acted or to appeal regulatory decisions which they believe are incorrect. The move to a new regulatory structure based in the Bank should not represent a retreat from the relatively open and consultative approach of the FSA.

15. The Government's consultation paper proposes that the PRA will not have a duty to take account of the competitiveness of the industry in setting its rules. We do not agree with this and strongly support the retention of the need for the PRA to take account of the competitiveness of the industry in undertaking its regulatory responsibilities. The UK financial services industry is a world leader and this provides substantial benefits to the wider economy through creating many skilled jobs, its impact on the balance of payments and on tax receipts. A strong regulatory environment is a competitive advantage for UK firms but it is essential that regulation does not damage the UK's attraction as a centre for financial services or add costs for consumers.
16. The emphasis in the consultation paper is, understandably, on the close links between the PRA and the senior management of the Bank of England but while this will clearly be beneficial to the supervision of banks it is unclear that this will provide commensurate benefits for insurance regulation. We believe that to ensure high quality insurance supervision it is essential for this to have equal status within the PRA as banking supervision. We think that this is best done by having a head of insurance supervision on a par with the head of banking supervision, ensuring that a number of the non-executive directors of PRA are chosen for their insurance expertise and sufficient training for insurance supervisors to maintain and improve their professional skills and provide a career path for specialist insurance supervisors. In addition the PRA must ensure that it employs a sufficient number of actuaries and experts on insurance risk in its policy teams.
17. Regulation of firms should be proportionate to the risks they pose to regulatory objectives. We believe that insurers, due to the nature of their business, do not normally give rise to systemic risk and this should be taken into account in how the PRA regulates insurance business. It would be inappropriate for regulatory requirements designed for systemically important banks to be imposed on insurers.
18. It is unclear to us how group supervision arrangements will operate in the new structure. Many insurers have significant fund management divisions and under the proposals these will be prudentially regulated by CPMA rather than PRA. We agree that the CPMA should be responsible for the prudential supervision of fund managers at entity level but to avoid potentially unclear and inconsistent requirements arising at group level we suggest that the PRA should be the lead supervisor for prudential supervision of insurance led groups. Similarly where an

asset management group has an ancillary insurance business lead supervision should be with CPMA.

### CPMA

19. The Government states that the CPMA should act as a „consumer champion’. We agree the CMPA should have a clear primary objective which focuses on promoting and protecting the interests of consumers. However, the legislation needs to be framed to reflect the distinction between advocacy and independent regulation. . The CPMA should I take an evidence based approach to policy-making and supervision taking account of the views of all stakeholders. Whilst the CPMA should strive to achieve good consumer outcomes, it should also recognise that there must be a proper balance between consumer protection and consumer responsibility. The CPMA should expect firms to provide consumers with information that allows them to make informed decisions. But it must also accept that consumers have the freedom to choose and will not make the right decision on every occasion.
20. Currently the Government proposes that the CPMA will not have a duty to take account of the competitiveness of the industry or of the desirability of facilitating innovation and competition in setting its rules. Although CPMA will need to identify and address any competition weaknesses in financial services markets, it should understand the benefits that competition can deliver to consumers and seek where possible to facilitate effective competition. We note that other key consumer regulators in the UK – such as Ofgem and the Legal Services Board – have objectives to promote and protect the interests of consumers *where appropriate through promoting effective competition*. This makes sense – competition helps ensure prices are low and products/services are of a good quality. So we propose that CPMA should be subject to a similar primary objective. The CPMA should also be required to have regard to the benefits of UK competitiveness and innovation as the FSA currently is.

The Government has indicated it will examine how consumer protection is enshrined in FSMA and update or strengthen the regime. We would welcome an open debate on the purpose and objectives of conduct regulation to ensure the CPMA is clear about the outcomes it will be measured against. It is important to recognise that consumers have an interest in not only being „protected’ from sub-optimal products but also in accessing products that meet their financial needs. For example, we propose CPMA should be required to take account of broader Government objectives such as promotion of saving and preventing excessive household debt. This could be achieved by introducing a legislative option for Government to issue guidance to CPMA on these matters.

21. An important issue which is not addressed in the consultation is the extent to which product regulation will be a tool at the disposal of the CPMA. The FSA has



traditionally been sceptical about the merits of product regulation, but more recently it has indicated that it may form part of its new Retail Conduct Strategy. We would not support new requirements on providers to get approval from the regulator before launching products as this would unduly limit consumer choice and competition. In addition, experience in recent years with stakeholder products shows that product regulation is unlikely to deliver good customer outcomes unless it is accompanied by a streamlined sales regime. But we suggest it is important for Government to lead a debate on this issue and set out a clear strategic framework for CPMA.

22. The forthcoming changes to the legislative framework offer a timely opportunity to reassess the role and governance of the Financial Ombudsman Service (FOS). We support the core function of FOS – to provide an independent, informal and accessible service for resolving individual customer complaints. So we favour retention of FOS’s clear mission statement in FSMA – “a scheme in which certain disputes may be resolved quickly and with minimum formality by an independent person”.
23. However, it should be recognised that the complaint profile of the FOS has changed markedly since its inception. Over one half of all complaints referred to the FOS have related to just six topics. Problems have sometimes arisen where FOS decisions have much wider implications for the industry because they impact upon large volumes of similar cases. Such cases require consultation with all the key stakeholders and analysis of the costs and benefits of a particular approach to all complaints of that type. This form of quasi-regulatory analysis cannot be satisfactorily conducted by FOS as a non-regulator.
24. We propose the CPMA would be better placed to conduct such an assessment and to give binding guidance to the FOS on its approach to similar cases. There are a number of different approaches to defining the precise process for handling of such cases (for example they might be referred to the Financial Services and Markets Tribunal). But at this stage we recommend the Government should review the handling of complaints with wider-implications and include the issue within its reform of the legislative framework. It should also take this opportunity to examine the high-level governance of the FOS to assess if it is in line with best practice for other similar statutory bodies.
25. Although the consultation paper refers to CPMA as a single focused regulator for retail conduct issues, we note that other regulators will continue to have important roles in regulating retail financial services markets. To that end, we welcome the prospect of a consultation later in the autumn on transferring the Office of Fair Trading’s (OFT) regulatory responsibilities for consumer credit to the CPMA. However, we propose the Government should go further and seek views on the merits of transferring the OFT’s competition and consumer protection powers over financials service markets to the CPMA. In recent years the OFT and the FSA have conducted overlapping but not fully coordinated investigations into the same financial services market – such as payment protection insurance. An integrated

consumer regulator might be better placed to take a coherent approach to analysing the market and identifying appropriate regulatory interventions. The recently announced plan to consult on reform of competition and consumer bodies in the New Year provides a vehicle to seek views about the implications for financial services regulation.

26. Meanwhile, The Pensions Regulator (TPR) is another body with a remit to protect the interests of pension scheme members (in their case occupational pensions). Insurers sometimes find that the responsibilities and activities of TPR and FSA overlap. That said, TPR has a quite distinctive set of relationships with employers and will have an important role in the introduction of auto-enrolment in 2012. So we suggest the Government should also explore the advantages and disadvantages of integrating TPR within CPMA and consult with the relevant stakeholders.

### Market Regulation

27. We welcome the Government's recognition in the consultation of the economic and strategic significance of the wholesale financial markets to the UK. Unfortunately the Government's proposals for the regulatory structure divide responsibility for the financial markets unworkably between the Bank, PRA, CPMA and FRC. This division of responsibility creates a significant risk of regulatory fragmentation and incoherence, representing a serious threat to the competitiveness of the UK's wholesale financial market, and to the ability of the financial markets to finance the economic recovery.
28. To make the best of the structure under consideration, two things need to be done:
- (i) The CPMA needs to have the full authority to regulate the wholesale markets, with control over as many of the issues affecting the financial markets as possible. This will encourage coherence of supervision, and ensure that the UK's voice is respected in ESMA. CPMA should be responsible for wholesale market conduct, but also for the following areas:
- The market regulation of financial institutions dealing in investments as principal;
  - The regulation of settlement systems and central counterparties bodies;
  - The UK Listing Authority; and
  - Integral supervision of fund managers with small insurance arms.
- (ii) The statutory objectives and senior management structure of the CPMA must reflect the significance to the UK economy of wholesale market regulation:
- There are significant risks in brigading together regulation of the wholesale markets with retail regulation. The White Paper rightly recognises the different nature of wholesale markets. However, the underlying regulatory issues are also very different. Wholesale markets are complex, involving several professional parties, very different from the straightforward consumer/supplier relationship usually found in the

retail market. Market efficiency is the key issue, rather than protection of particular parties in the markets.

- There is a risk that the CPMA will develop a culture which is dominated by consumer protection issues, and that this will affect the markets division where the issues are very different. An operationally distinct division within CPMA is not enough. The different approach to the wholesale markets needs to be reflected robustly in the statutory objectives of the CPMA, and in the management structure of the CPMA – which we would suggest should reflect these differences by, for example, having separate management structures for the two activities including in areas such as enforcement.

### Financial Crime

29. Financial crime occurs in many different guises, including insider dealing, boiler room scams, money laundering, bribery and fraud. It impacts upon individuals, financial institutions and society at large, whether that be through imposing unnecessary costs on customers, conferring an unfair advantage on a firm, or facilitating serious organised crime.
30. While the consultation makes reference to possible wider reforms to the approach to tackling economic crime, no detail is provided about what these wider reforms might look like. Specific mention is made of the FSA's existing prosecution powers, but of course financial crime regulation is about more than bringing prosecutions; rather there is a broad objective to reduce the extent to which it is possible for a financial business to be used for a purpose connected with financial crime.
31. As we currently understand the Government's proposals, there is potential for financial crime regulation to be highly fragmented, with market integrity activity (e.g. boiler room scams, insider dealing) being regulated by the CPMA while financial crime affecting an insurer's profit and loss account (e.g. fraud) would be regulated by the PRA. Further, with the CPMA responsible for the prudential regulation of brokers, there may be an argument for insurance fraud affecting brokers to be regulated by the CPMA while insurance fraud affecting insurers is regulated by the PRA. It is important that that such fragmentation does not lead to inefficiencies and ineffectiveness to the detriment of those that the regulation is designed to protect.

## Questions for Consultation

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### ***The Bank of England and Financial Policy Committee (FPC)***

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

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

We believe that the FPC's central objective relating to financial stability needs to be supplemented with secondary factors. This is necessary to ensure that the FPC properly takes account of the impact of its decisions both in the wider economy and in relation to the regulated entities that might be affected by macro-prudential judgements.

The factors identified in paragraph 2.28 of the consultation appear to be the appropriate ones to be taken into account. In particular (and given the lack of political oversight over the work of the FPC) there is a need to take account of the possible societal impacts of FPC decisions which may, for example, reduce the amount of credit available to some groups of citizens.

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

There is a danger that formulating these factors as secondary objectives could constrain the ability of the FPC to carry out its main objective. However, simply formulating these factors a list of „have regards' might not result in sufficient weight being placed on these issues.

We believe, therefore, that an appropriate approach would be for the FPC to have a positive legal duty to show that its decisions are consistent with the objectives of the PRA and CPMA (and with wider Government policy positions where appropriate) or to explain why any decision inconsistent with these objectives is justified.

### ***Prudential regulation authority (PRA)***

*4 The Government welcomes respondents' views on:*

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

- *whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and*
- *whether there are any additional broader public interest considerations to which the PRA should have regard.*

We agree that the PRA should have regard to the primary objectives of both the FPC and CPMA. Given that the Government intends that the FPC will have a power to direct the PRA to take certain actions it therefore seems clear that there will be a need for the PRA to have regard to the FPC's objectives so as to enable it to operate in accordance with the FPC's policy intent. In the case of the CPMA it is clear that actions taken by the PRA to improve prudential standards could lead to consumer detriment (if for example additional capital requirements resulted in a reduction in returns on certain investments) and it is, therefore, appropriate for the PRA to take account of this in reaching its decisions.

We believe that it is essential that the PRA continues to be bound by the principles of good regulation. Indeed we find it difficult to understand why the consultation paper even raises the possibility that it might not be appropriate for the PRA to have regard to principles such as using its resources in the most efficient and economic way, taking account of the responsibilities of those managing regulated firms and ensuring that any regulatory burden imposed is proportionate to the benefits expected. Adherence to such principles should be expected from any public body – successive governments have emphasised the importance of regulators acting in accordance with the principles of good regulation.

The UK financial services industry is a world leader. A strong regulatory environment can be a source of competitive advantage but it is essential that regulation does not damage the UK's attraction as a centre for financial services or add to the costs for consumers. We, therefore, strongly support the retention of the need for the PRA to take account of the competitiveness of the industry in undertaking its regulatory responsibilities.

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

We are concerned that the proposals as drafted could result in considerable overlap and duplication between the CPMA and PRA in carrying out their functions. For example the situation described in paragraph 3.16 of the PRA and CPMA separately undertaking approval of persons applying to hold significant influence functions appears to be a case in point – it simply does not make sense for the same individual to be subject to two separate approval processes.

The very fact that the two regulators espouse different approaches could itself give rise to inconsistency in decision making for some aspects; whereby appointments and approvals sanctioned under the PRA's judgement based approach could be at variance with the CPMA's pre-emptive one. Furthermore, dual responsibilities in relation to approved persons could make an already lengthy process, unacceptably longer.

We, therefore, believe that it would make sense for certain functions including authorisations and approvals to be carried out jointly. We believe that the most appropriate model for undertaking such joint work might be for a joint 'service organisation' to undertake these roles which would report equally to both PRA and CPMA. Such a 'service organisation' could also undertake other joint administrative roles such as the fee collection and approval of passporting applications (see also our response to question 13).

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

The ABI welcomes the proposal to move to a more risk-based approach to regulation. However, we believe that a more judgementally focused approach will need to be carefully thought through to ensure that there is consistency in decision making and that proper due process and legal certainty is achieved. It would not be acceptable for a more judgemental approach to result in inconsistent regulation between firms or the imposition of short notice and retrospective changes in regulatory requirements.

We note the intention in paragraph 3.24 for the PRA to reduce the current FSA handbook. This would clearly be welcome. However, any such effort to make substantive reductions will need to take account of the fact that most prudential requirements on firms derive from EU directives and it will remain a requirement on the PRA to show that it has properly implemented the directives and is regulating in accordance with their requirements. It should also be noted that under the new European system of regulation the EU supervisory authorities will issue binding standards which will have to be adopted by national regulators.

This means that in practice most prudential regulatory requirements will be at the EU level and the ability of the PRA to adopt a different approach will be severely constrained. We are not convinced, on the evidence of the consultation paper, that the primacy of Europe in this area has been fully recognised, or the importance of the UK authorities engaging fully at the EU level.

We agree with the proposed key functions of the PRA as set out in paragraph 3.20 of the paper.

We can see the attractions of using FSMA as the basis for the new authorities' powers and doing so is the method most likely to reduce the legislative timetable needed. However, it is not clear to us that FSMA will lend itself to being readily split between prudential and conduct issues. It will also be essential to recast the large body of secondary legislation which supports the current FSMA framework. The Government will need to bear this in mind in assessing a realistic timetable for moving to the new structures.

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

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

It is essential that the full range of safeguards currently within FSMA should be retained for the PRA. The consultation paper provides no justification or explanation as to why the Government is considering whether the existing statutory processes around the rule-making process are required in respect of the PRA – particularly given, as paragraph 4.36 makes clear, that it is intended to maintain the safeguards in respect of the CPMA.

These safeguards are needed to ensure that the regulatory authorities have undertaken due process in setting rules and making regulatory decisions and to ensure that the industry and other stakeholders (including consumers) are able to contribute to this process. There is also a need for a formal process through a complaints mechanism and the Upper Tribunal for firms to complain about failures in the way the regulator has acted or to appeal regulatory decisions which they believe are incorrect.

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

In general the proposals in paragraphs 3.28 to 3.41 would appear to ensure that the PRA is transparent, operationally independent and accountable.

However, we are concerned about the lack of detail about the proposed internal organisation of PRA. There is no mention of the way that insurance regulation will be structured to ensure that this is undertaken and managed by suitably qualified staff. The emphasis in the consultation paper is, understandably, on the close links between the PRA and the senior management of the Bank of England but while this will clearly be beneficial to the supervision of banks it is unclear that this will provide commensurate benefits for insurance regulation.

We believe that to ensure high quality insurance supervision that it is essential for this to have equal status within the PRA as banking supervision. This might best be done by having a head of insurance supervision on a par with the head of banking supervision, ensuring that a number of the non-executive directors of PRA are chosen for their insurance expertise and sufficient training for insurance supervisors to maintain and improve their professional skills and provide a career path for specialist insurance supervisors. In addition the PRA must ensure that it employs a sufficient number of actuaries and experts on insurance risk in its policy teams.

### ***Consumer protection and markets authority (CPMA)***

*10 The Government welcomes respondents' views on:*

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

Shaping the statutory objectives and duties for the CPMA is important because it will determine the mission and culture of the new regulator. The Government should draw on best practice, both from financial services regulators abroad and other consumer regulators in the UK.

The CPMA should have clear primary objectives which focus on promoting and protecting the interests of consumers, and on ensuring the integrity of the financial markets (we deal with this issue in greater detail in the answer to question 15).. However, we are concerned by the absence of reference to „competition’ in the Government’s proposal. Although CPMA will need to identify and address any competition weaknesses in financial services markets, it should understand the benefits that competition can deliver to consumers and seek where possible to facilitate effective competition. We note that other key consumer regulators in the UK – such as Ofgem and the Legal Services Board – have objectives to promote and protect the interests of consumers *where appropriate through promoting effective competition*. So we propose that CPMA should be subject to a similar primary objective. We agree that the CPMA’s role in „ensuring confidence’ should be referenced, as should „market integrity’, given the CPMA’s responsibility for wholesale markets.

There are further lessons to be learned from the statutory frameworks of other UK regulators. For example, OFCOM must have regard to the desirability of promoting and facilitating the development and use of effective forms of self-regulation. While self-regulation is not appropriate in all circumstances, the OFT and others have recognised that it can offer some advantages over statutory regulation, notably its flexibility and responsiveness in the face of change. The legislation should encourage the CPMA to make use of this option where it can deliver good outcomes for consumers.

We also propose that CPMA should be required to take a risk-based approach to all aspects of its regulation. While we understand the rationale for the FSA’s adoption of an „early intervention’ strategy to address conduct risks before they are fully crystallised, regulators should continually analyse markets and focus their activities on areas where there is greatest risk of consumer detriment. For example, experience suggests that consumer risks are more likely to arise in the context of sales of retail investment products than the motor insurance market.

Below we respond to each of the specific issues raised in Question 10. The ABI believes:

- CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC. The success of the new regulatory framework will rely on proper coordination between the activities of the different regulators. CPMA should not pursue actions that pose a significant risk to financial stability, so we strongly support the proposed requirement for the CPMA to consult with the PRA before it takes any decision that could present a risk to financial stability.
- All of the principles of good regulation that apply to the FSA through Section 2 of FSMA should be retained for the CPMA. Most of the regulators in the UK are subject to statutory requirements to take account of good regulatory principles. The CPMA will have extensive regulatory powers over a key sector of the UK



economy, so it is in the interests of UK consumers and businesses alike for it to exercise those powers in line with good regulatory practice. We are surprised, for example, that the Government would question the need to encourage the CPMA to use its resources in an efficient and economic way.

- We consider it particularly important to require CPMA to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector. Innovation in the market place can deliver considerable benefits to consumers. For example, the growth of comparison websites is a technological and market innovation which has increased competition in financial services markets and made it easier for consumers to compare alternative options. So we are concerned at the suggestion that the CPMA should not be required to have regard to the benefits that innovation can deliver. Similarly CPMA, with its extensive powers of intervention into UK retail and wholesale markets, needs to be alert to the impact it is having on competitiveness. The UK financial services sector is of huge importance to the UK economy and the CPMA should give weight to the implications in terms of jobs, growth and taxation and so on of different regulatory actions.
- We consider that one of the weaknesses of UK financial services regulation in recent years has been an imbalance whereby regulation of credit products has been considerably lighter than regulation of savings/investment products. This was despite the Government having a broader public policy objective of promoting saving, particularly for retirement. So we think there are lessons to learn from the legislative requirements on utility regulators Ofgem and Ofwat. They are required to have regard to guidance issued by Government in relation to their contribution towards the attainment of social and environmental policies. In a similar way, we propose HMT should have powers to provide guidance to CPMA about its contribution to social/economic goals such as promotion of saving and preventing excessive household debt.

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

We support the proposed accountability mechanisms, and in particular we welcome the proposal to make CPMA subject to audit by the National Audit Office. The requirements on FSA to conduct cost-benefit analysis prior to introducing new rules and the public consultation requirements are an important part of its accountability, so we welcome the proposal to make CPMA subject to the same requirements. Further, we believe there would be a more holistic analysis of the implications of policy making if CBAs were obliged to include reference to related regulatory initiatives (for example, from HM Treasury) and clearly set out any implications for the PRA. While the production of business plans and reports on an annual basis is important, we believe the CPMA should take a more strategic approach than the FSA and provide more clarity about its strategic priorities, market reviews and general business planning over a three to five year period. We also suggest the CPMA should be required to conduct *ex post* impact assessments to determine whether its regulatory interventions have achieved the stated intentions and learn lessons for the future.

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

We agree the proposed statutory panels representing consumers, practitioners and small business practitioners could play an important role in scrutinising the regulatory activities of CPMA. However, it is important to recognise that the activities of the PRA will have a major impact upon practitioners (and indeed consumers) so we would expect the statutory framework of the panels to reflect this. We also suggest a clearer case needs to be made as to why two different panels are needed to represent practitioners.

The membership of the practitioner panels should represent all parts of the financial services sector, as the interests of insurers can be quite different from investment banks for example. In principle, currently the Panels have an opportunity to discuss with the FSA plans for new regulatory policies before the proposals are made public. In this regard the Panels provide an important sounding board for the FSA from the full industry point of view, at a different level to the more detailed debate with industry on the impact of changes at sector level. To be effective, each of the panels needs sufficient resource to conduct research and analysis, and to develop its own independent policy-making function. We support the intention of the Financial Services Practitioner Panel to widen its membership so that it has access to a greater pool of executive resource to engage with regulators at any given time. It is equally important that the Panels strengthen their links – both between the panels themselves and with industry – particularly through early engagement with trade associations. A dedicated section within the annual reports of the regulators would help to raise the profile of the Panels. In addition, the senior management of both CPMA and PRA should be required to take due account of recommendations and input from the panels, and make clear their reasoning when deciding to take a different course.

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

We agree that a single body should be responsible for collecting the fees and levies for all regulatory authorities and associated bodies. As set out in our response to question 5 above we believe that this might best be undertaken by a joint service organisation which carries out a number of administrative functions for both the PRA and the CPMA.

We urge the Government to use this opportunity to consult with stakeholders about the statutory framework for the associated bodies. For example, as outlined above, we believe the time is right to review the legislative requirements in relation to the Financial Ombudsman Service (FOS).

The ABI supported the establishment of the Consumer Financial Education Body (CFEB) and we agree that it should be operationally independent of the CPMA. However, while we accept that it is appropriate to wait for a few years before conducting a full review of CFEB's operating model, backstop accountability to CPMA on budget and plans is important and we will be seeking more clarity regarding the consumer outcomes that CFEB is expected to achieve.

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

We believe that it makes most sense for the FSCS to continue as a unified body but without the current cross-subsidy arrangements. Given the FSCS's responsibilities it will need to work closely with both PRA and CPMA.

The ABI remains strongly opposed to the general pool arrangements introduced in 2007 which provides for cross-subsidy between different sectors. We do not believe that it is appropriate for firms (and ultimately their customers) in other sectors to become responsible for failures elsewhere given the major differences between the business models and risk profiles of each sector.

We, therefore, favour the retention of the FSCS in its current form - although this is dependent upon the outcome of the current FSA review of the FSCS and the likelihood that there will be an EU directive on insurance guarantee schemes in the next few years - but with the removal of the general pool arrangements. FSCS should remain operationally independent of both the PRA and the CPMA.

### ***Markets and infrastructure***

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

We welcome the Government's recognition of the economic and strategic significance of the wholesale financial markets to the UK. Unfortunately the Government's proposals for regulatory structure divide responsibility for the financial markets unworkably between the Bank, PRA, CPMA and FRC. This division of responsibility creates a significant risk of regulatory fragmentation and incoherence, representing a serious threat to the competitiveness of the UK's wholesale financial market, and to the ability of the financial markets to finance the economic recovery.

A more appropriate structure would have been to establish a Markets Authority under the oversight of the Bank, on a level with the CPMA and the PRA. However, if the preferred approach is to maintain the main planks of the White Paper structure, then to make the best of the structure under consideration, two things need to be done:

- (i) Regulation of the financial markets must as far as possible be brought together in the CPMA, responsible for wholesale market conduct, but also for:
  - The market regulation of financial institutions dealing in investments as principal (see para 3.15 on the PRA). Under the proposals in the White Paper, the prudential regulation of investment banks and other market-makers and traders in investments would fall to the PRA, while the prudential regulation of asset managers and other participants in the financial markets, and the regulation of conduct in those markets would fall to the CPMA. In these circumstances, maintaining a consistent approach to prudential regulation will represent a serious operational

challenge. Much greater clarity is needed over the articulation of decision-taking that affects financial institutions dealing in investments as principal, and the wider impact of those decision in the markets. Further, in view of the explicitly superior status in the White Paper of the PRA to the CPMA, great care will be needed to ensure that investment banks' de facto regulatory capture becomes institutionalised. It would be greatly preferable if prudential regulation were focused on the end users of the financial markets – investors and issuers;

- The regulation of settlement systems and central counterparties bodies (see below Question 16);
- The UK Listing Authority (see below Question 17)
- Integral supervision of fund managers with ancillary insurance arms.

(ii) The statutory objectives and senior management structure of the CPMA must reflect the significance to the UK economy of wholesale market regulation:

- There are significant risks in brigading together regulation of the wholesale markets with retail regulation. The White Paper rightly recognises the different nature of wholesale markets. However, the underlying regulatory issues are also very different. Wholesale markets are complex, involving several professional parties, very different from the straightforward consumer/supplier relationship usually found in the retail market. Market efficiency is the key issue, rather than protection of particular parties in the markets.
- There is a risk that the CPMA will take on a consumer protection attitude, and that this will affect the markets division. An operationally distinct division within CPMA is not enough. The different approach to the wholesale markets needs to be reflected robustly in the statutory objectives of the CPMA, and in the management structure of the CPMA by appointing one of the top two posts at the CPMA explicitly as the financial markets champion. A structurally distinct approach will be needed right down the CPMA, so that market issues are considered separately from retail issues, as opposed to an integrated structure in which consideration of all conduct or enforcement issues is considered inappropriately in one place, regardless of the different approaches needed

We welcome the Governments' recognition of the key role of the British regulatory authorities in exercising influence in the new EU authorities. The new binding standards-making power to be handed to the new EU authorities will change irrevocably the regulatory role of the British regulators. In future, negotiating in Europe will have a much greater impact on the market than writing British regulations. The structure and skills of the UK authorities need to reflect that. It should also be a priority for the British regulators to second good staff to the EU authorities.

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

There is a clear operational link between the regulation of market infrastructure and the regulation of market conduct. We see no logic in the proposal for the Bank to

oversee in isolation CCPs and settlement systems. This will lead to regulatory confusion, with institutions central to the orderly functioning of the financial markets regulated separately from the markets themselves. The PRA should keep a close eye on the balance sheet of CCPs, but all other matters should fall to the CPMA.

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

The work of the UKLA is important to our members as institutional investors because its work on disclosure and transparency underpins both the quality and the integrity of the investment market. This is relevant at the point of securities' initial admission to listing, and to the continuing obligations of issuers - wherever those issuers are incorporated - choosing to access the UK's capital markets. High standards in these respects are critical to the long-term interests of the savers and pensioners on whose behalf ABI members invest.

We take the view that the CPMA is the right location for the UKLA, for the following reasons:

- These additional responsibilities would pose a risk to the focus of the FRC's work on corporate governance
- Moving the UKLA to the FRC would further fragment the regulation of the wholesale financial markets. We are looking to pull together in a markets division of the CPMA as many as possible of the regulatory functions relating to the capital markets
- The separation of regulation of the primary markets in the UKLA from regulation of the secondary markets in the CPMA would be particularly awkward to co-ordinate on a day-today basis
- Only 6% of the listed bodies overseen by the UKLA are UK corporates
- The deliberative, Board-based decision-making of the FRC is very different from the real time decisions on, for example, market suspension required by the UKLA
- The FRC will not be a member of the EU authority ESMA that will in future set the rules in this area – that will be CPMA, - and could not therefore attend the top level ESMA decision-taking meetings.

However, in keeping with the spirit of the Business Secretary's forthcoming review of corporate governance and economic short-termism, we believe that the UKLA should be more visible when operating within the CPMA than it has in the FSA. The UKLA should also continue the progress made in recent years to ensure that appropriate quality of admission to listing criteria, and standards of investor protection, are maintained.

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

There is little detail in the White Paper on the purpose and tasks of such a regulator, and in the absence of this detail we find it difficult to comment. We would oppose any attempt to alter the independent status of the Takeover Panel. A link with

Companies House would be inappropriate. Investors have consistently opposed the creation of a body such as the SEC in this jurisdiction. On the other hand, we value the work of the FRC on corporate governance, and would not wish to see this called into question by efforts to find a larger home for the FRC. We applaud the Government's desire to reduce the number of quangos, but this should not be an overriding objective when the existing arrangements work.

### ***Crisis management***

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

The proposed arrangements appear to be satisfactory in principle. However, the paper gives little detail about how these would operate in practice – paragraph 6.7 makes clear that the Treasury and Bank need to develop contingency plan. We recommend, therefore, that the Government and Bank consult further on the proposed arrangements when these have been fully developed.

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

We believe that the Government should look at the need for these new powers in the context of different sectors. For example, we remain unconvinced of the need for additional resolution powers in respect of insurers given that insurance failures are spread over a long period of time and can, therefore, be dealt with adequately by existing insolvency requirements. We also believe that in the case of insurers the supervisory authorities can already intervene long before threshold conditions are breached (the third bullet of paragraph 6.17).

In respect of the proposals in paragraph 6.17 we agree that there is merit in making clearer the scope of the OIVOP powers and the circumstances in which they might be used. However, making intervention mandatory at certain trigger points could reduce supervisory flexibility and more consideration is needed of such a proposal.

The mechanics of how an OIVOP would operate in practice are not wholly clear. But we would be concerned if the regulators used an OIVOP, for example, to send a message of deterrence to the wider market, even where the individual firm concerned had agreed to take effective corrective action.

More fundamentally, the subsequent publication of a supervisory notice would amount to public censure as the notice would be publicly critical of a firm's conduct. This would not be comparable to the current practice of amending a firm's permissions on the FSA's public register. Public censure requires due process involving a warning notice, representations to the Regulatory Decisions Committee, a decision notice (which can be referred to the Financial Services and Markets Tribunal) and a published final notice. The publication of warning and decision notices is prohibited by the FSMA.

In short, we believe there is a danger that an extension of the use of OiVOPS could blur the line between supervision and enforcement, amount to public censure in all but name and deprive firms of their right to due process.

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

We have no comments on these proposals.

### ***Impact assessment***

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

We believe that the costs of moving to the new system will be considerable. We also believe that there is a considerable risk that the ongoing costs of the new regime will be higher than the existing regulatory regime.

It is stated in the impact assessment that the Government is considering whether to extend "supervisory powers to cover unregulated holding companies and unregulated entities within the Group structure of financial institutions such as banks and insurers". This proposal requires further thought and any changes need to be proportionate. To adequately supervise a Group's unregulated entities the PRA would need to significantly increase resources. Under the current regulatory structure supervisors can request any information that is required on an unregulated holding company or an unregulated entity. The FSA also already considers any potential for contagion risk from these entities on the regulated firm.



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

6 October 2010

Dear Sirs

### **A NEW APPROACH TO FINANCIAL REGULATION**

I write to convey the comments of the Association of Chartered Certified Accountants (ACCA) on the consultation document on the above.

ACCA is the world's largest global accountancy body, with over 140,000 qualified members and over 400,000 students around the world. Our members work in public practice, industry, the public sector and financial services.

Over the past two years ACCA has published a number of policy documents on the financial crisis and its aftermath. These include our publication of last year, *The Future of Financial Regulation*, which incorporated a set of principles which we believe should be central to any effective regulatory system. This work influences our response to this current document.

We do not propose to comment on all of the detailed issues raised by the document. We confine our response to a number of what we see as the main issues of principle.

At the outset, we would make two over-riding points which strike us as being central to the radical overhaul of the UK's current regulatory regime which is being proposed.

First of all, we welcome the proposed creation of the Financial Policy Committee (FPC). As the document rightly says, a macro-prudential regulator of this kind was badly lacking in the run-up to the financial crisis, with the result that debt bubbles, trade imbalances, over-leveraged business models and failures in risk and



governance built up. We trust the FPC will work effectively with its counterparts in the EU and globally.

Secondly, while we understand that the remedial action being taken now must be seen in the context of the international response to the financial crisis, we have made the point, in *The Future of Future Regulation*, that effective regulation of the financial sector does not necessarily mean more prescription and more intrusive supervision. We would hope that, under the new regime, the regulatory pendulum will not continue to swing between light-touch and heavy-touch but will focus instead on ensuring that core regulatory outcomes are identified and achieved.

We have reservations about some other elements of the regulatory overhaul being proposed.

#### **(i) The new regulatory structure**

The key proposal being made is to introduce two new regulatory bodies, the Prudential Regulation Authority (PRA) and the Consumer Protection and Markets Authority (CPMA), under the Bank of England to replace the current single regulator, the Financial Services Authority (FSA).

The assertion is made consistently throughout the document that a 'single monolithic' regulator, the FSA, was unable to cope with the range of issues it was expected to face given that its client base ranged from large investment banks to small high-street operations. We would agree that proper targeting and risk-based assessment was an issue although this challenge is equally faced by regulators in many fields.

But we are not persuaded by the argument that 'prudential and conduct of business regulation require different approaches and cultures and combining them in the same organisation is difficult'. We would agree that the FSA can be criticised for its failings in the run up to the crisis, and it struggled in the early months of the crisis. In the past two years, however, it has become a much tougher and more effective regulator and its programme of controls regarding persons with significant influence functions has been in our view impressive.

Asserting a problem is not the same as demonstrating it, and we do not believe that the document has put forward persuasive evidence of the failure of the FSA to combine effectively prudential and business conduct supervision.

There is no reason why, in our view, effective supervision of prudential rules such as compliance with capital adequacy requirements cannot be consistent with the taking of a wider view of a company's overall business approach and ethics. The two are more likely to be complementary – ACCA research has shown that businesses which place greater store by governance and ethical standards are more likely to be well-run in other aspects (ref CFO 2007 survey – see ACCA's *Risk and Reward* paper). An integrated regulatory approach covering both conduct of business issues and prudential compliance appears to us to be the more cohesive and effective approach.

Our concern is that, on a practical level, having two regulators supervising the same businesses from different angles is likely to cause problems for regulated entities which outweigh the theoretical advantages ascribed to the proposed new approach. On pages 26-28 this problem is conceded – the document says it will need 'a significant degree of co-operation and co-ordination by the authorities to ensure that they avoid duplicating efforts or cutting across each other's work. The need for such co-ordination will be particularly acute where action taken by one authority directly or indirectly interacts with the other'.

Given that the two bodies will be setting out their own objectives from scratch, and recruiting considerable numbers of new staff, there is the possibility of considerable overlap, at least in the initial stages. The document goes on to say that the acknowledged problem could be 'managed through supervisory colleges' – this seems a rather bureaucratic approach.

The splitting of the FSA into two entities can also be said to run counter to the logic of, for example, bringing the Inland Revenue and Customs & Excise together to form HMRC in 2005. The point of that very ambitious merger was to save costs and to minimise burdens on businesses which, it was generally agreed, were being overloaded with tax investigations from both bodies, often asking similar questions of the same staff. We can foresee a similar situation in reverse, where an institution has undergone one visit from PRA only to face another one from CPMA shortly afterwards.

In our paper *The Future of Financial Regulation*, we argue that the basis of effective regulation is that both sides – the regulator and the entity being regulated – should understand what regulation is trying to achieve and see the benefits of the system. We are not convinced the regime being proposed here will meet that test, and given that it is made clear that the industry will continue to meet the costs of these new regulators, this buy-in is particularly important.

## **(ii) The approach to regulation**

Another reason given for the proposed overhaul is that 'one of the reasons for regulatory failure leading up to the crisis was an excessive concern for competitiveness leading to a generalised acceptance of a "light-touch" orthodoxy, and that lack of sufficient consideration or understanding of the impact of complex new financial transactions and products was facilitated by the view that financial innovation should be supported at all costs.'

It seems to us rather harsh to blame the regulator for adopting this approach when it was being strongly promoted by the government of the day as the way forward, and a key reason for the UK's success in financial services. In a booming pre-credit crunch economy could the FSA realistically have been expected to tell the Government that it intended to introduce a heavier-handed policy?

If, however, integral to the new framework is that the regulator will be independent of government pressure to follow particular regulatory practices at different points in time then we would agree that this must be a good thing. As the document rightly points out, since 2009 the FSA "implemented a more intrusive and pro-active approach to the regulation of its firms" once problems became apparent. If the new regulators are to succeed in their task of anticipating future and breaking issues, rather than being focused on 'fighting the last war', they will need to be sure of freedom from political interference. A clear statement to that effect would be beneficial.

## **(iii) The FSA's remit to combat financial crime**

The FSA currently has a specific remit to fight financial crime. In 5.26 the paper mentions that the government is considering transferring responsibility for prosecuting criminal offences to another new agency. We would suggest that it would be beneficial if the Bank of England, as the new regulatory power, also had the specific objective of combating economic crime. Such a fundamental responsibility should be clarified and not sub-contracted out as that would run counter to the logic of centralising power in the Bank's hands.

## **(iv) The transfer of market regulation to the FRC**

Lastly, we would like to comment on the mooted (para 5.21) creation of a powerful companies regulator, akin to the US Securities & Exchange Commission, by merging the existing Financial Reporting Council with the UK Listing Authority (currently part of the FSA). ACCA is aware that there are a number of different views on the matter, with the Stock Exchange (among others) opposing this development.

In ACCA's view, there could be clear advantages to such a move if the new regulator were given additional powers in the field of, for example, corporate governance. Currently the FRC has limited tools to deal with any companies which fail to adequately 'comply or explain' with the UK Code on Corporate Governance. More teeth for the regulator here might help ensure that the revised Code was being adhered to, given the importance of governance failures in the creation of the financial crisis (see ACCA's paper *Corporate Governance and the Credit Crunch*). In this regard, ACCA also notes that the FRC itself has set out a number of synergies relating to standards in accounting and auditing in relation to listings. ACCA notes these synergies. And while this outcome could, however, also be achieved through a stronger, more independent UK Listing Authority, on balance we see the benefits as outweighing the potential disadvantages. Through combining the work of FRC and UKLA, it could offer a natural focus for enhanced accountability and good governance within UK capital markets. We believe this is appropriate to the needs of the UK economy in the wake of financial crisis and a desire to encourage stewardship and more responsibility among business and investors alike.

If the FRC did become responsible for market regulation, we do have concerns as to the likely impact of that development on the regulation of non-listed entities, and on the accountancy and actuarial sectors. Inevitably most of the focus of the new companies regulator would be on the listed sector and there would be a danger of regulation of those other, important sectors, losing focus. However, ACCA is of the view that now *is* the right time more clearly to regulate according to the scale and complexity of business concerns. The banking crisis has demonstrated clearly that governance of a large financial services operation with multiple subsidiaries and complex products requires a different approach – from board to regulators – than smaller entities. As we argue in our paper *Restating the value of audit*, we believe that consideration should be given to a stratification of audit in relation to scale and complexity.

For these reasons, ACCA believes the idea of bringing together the FRC and UKLA merits serious consideration.

Our comments on specific consultation questions are as follows:

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

As mentioned above, ACCA supports the creation of the FPC and believes the lack of a single body with clear responsibilities for monitoring macro-economic and financial developments was largely responsible for the build-up of dangerous debt and credit bubbles. The tripartite system, as has been well-documented, failed due to the lack of clarity of responsibility between the various bodies involved.

Given this backdrop, we would be in favour of a clear objective relating to financial stability. It would be sufficient, we believe, to have some reference to 'having due regard to the requirements of other bodies in the new regulatory framework'. It is essential that the effectiveness of the FPC is not stymied by being subject to too many structural constraints.

**4. Should the PRA have regard to the primary objectives of the CPMA and FPC?**

The issues outlined in question 4 illustrate clearly the reasons why splitting the current regulator into two would create problems. To keep a cohesive approach to regulation, the PRA will be obliged to have regard to the primary objective of the CPMA (and FPC) but this begs the question of why it would not be simpler to retain one integrated regulator.

As for the current principles of good regulation, we agree that it should not be part of a regulator's specific role to encourage innovation and relative UK competitiveness. (although it should do nothing to damage those – the whole point of effective regulation is to let good businesses succeed within an agreed regulatory framework). The danger, as the document points out, is that this can easily lead to a 'light-touch' regime, where regulation becomes weaker rather than targeted. Having said that, we do believe it is harsh to blame the existing regulator for its role in the lead up to the crisis, given that the government of the day was heavily promoting the regulator's approach.

On the issue of whether each regulator should be responsible for all decisions within their remit on issues like authorisations and permissions or whether an integrated model would be preferable – once again, this simply calls into question the logic of the entire exercise. If there are two regulators, they will both have to take on such a role for their area of responsibility and try their best to co-ordinate. We do not believe that this would inspire confidence.

**10. Should the CPMA have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC?**

Again, we find it hard to see how one regulator can be tasked with 'ensuring market integrity' when another has the task of checking whether major individual firms are not in danger of collapsing and causing collateral damage in the market by serious over-leveraging for example. But given the proposed structural overhaul, then the CPMA would have to have regard to the objectives of both PRA and FPC.

Most of the current FSMA principles of good regulation seem to us to be worth carrying through to the CPMA. As discussed above, protecting innovation and the relative international competitiveness of the UK should not be explicit goals of a regulator. But promoting fair competition and upholding diversity by for example ensuring that mutuals are not disadvantaged relative to other institutions seems to us a fair objective.

The accountability mechanisms as outlined for the CPMA seem appropriate. Ditto the funding arrangements.

**17. Do you agree with the proposed merger of the UKLA with the FRC, as a first step towards creating a companies regulator under BIS?**

As stated above, we can see arguments for and against this suggestion. Inevitably most of the focus of the new companies regulator would be on the listed sector and there would be a danger of regulation of those other, important sectors, losing focus. However, ACCA believes that now is the right time more clearly to regulate according to the scale and complexity of business concerns. The banking crisis has demonstrated clearly that governance of a large financial services operation with multiple subsidiaries and complex products requires a different approach – from board to regulators – than smaller entities. As we argue in our paper *Restating the value of audit*, we believe that consideration should be given to a stratification of audit in relation to scale and complexity.

For these reasons, ACCA believes the idea of bringing together the FRC and UKLA merits serious consideration.

A decision to transfer powers to the FRC would, of course, have to be taken on the basis that the FRC would be able to satisfy compliance with the IOSCO principles, especially those which provide that

- The responsibilities of the regulator should be clear and objectively stated.
- The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.

To conclude, our principal comment on the proposals is that we consider that the scheduled transfer of powers from the FSA to the Bank could be achieved through the adoption of an integrated approach to the regulation of institutions. We believe that duplication of resources and functions must be avoided and the compliance obligations of entities rationalised in the interests of good and effective regulation.

I hope these comments will be of help.

Yours faithfully



J P Davies  
Head of Business Law

## The Association of Corporate Treasurers

Comments in response to  
***A new approach to financial regulation:  
judgement, focus and stability***  
HM Treasury  
July 2010

18th October 2010

### The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the back of these comments and on our website [www.treasurers.org](http://www.treasurers.org).

Contact details are also at the back of these comments.

We canvas the opinion of our members through seminars and conferences, our monthly e-newsletter to members and others, *The Treasurer magazine*, topic-specific working groups and our Policy and Technical Committee.

### General

The ACT welcomes the opportunity to comment on this matter.

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## Response

We welcome the fact that you are addressing the structure of financial regulation in the UK. The recent financial crisis highlighted significant failings within the existing tripartite regulatory framework, notably the failure to monitor and analyse overall financial market exposures at a macro level. This lack of attention to aggregate and systemic risk has had a knock on impact to the management of financial risks within corporates. Since the crisis Corporate Treasurers have faced a number of challenges including but not limited to: lack of available funding, increased volatility in the markets and a changed attitude to risk – arguably an overreaction.

The ACT has responded to your consultation as our members, working in non-financial companies, are active users and in many ways dependent on the finance sector and financial markets.

Overall, we regret the proposed further fragmentation of UK financial regulation into three bodies, FPC, PRA and CPMA. We believe fragmentation can lead to problems similar to those the US faced during the financial crisis with its multiplicity of regulators. The relationship between the players and the role of HM Treasury above the regulators will be very important for smooth working of the UK regulatory system and its interrelation with the European level system.

### **The Bank of England and Financial Policy Committee (FPC) consultation questions:**

*Q1. Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?*

Refer general comment below Q3.

*Q2. If you support the idea of secondary factors, what types of factors should be applied to the FPC?*

Refer general comment below Q3.

*Q3. How should these factors be formulated in legislation – for example, as a list of ‘have regards’ as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?*

We have not responded to all of the above consultation questions but provide the following comments:

- We agree with the sentiment that the FPC’s objectives need to be the objectives of the whole financial regulatory system.
- We believe the primary focus of the FPC should be at the macro level and that the FPC should be responsible for working internationally with national regulators. However our view is that the objectives of the FPC should be clarified and broadened to be not purely focused on financial stability but also promoting and fine tuning the real economy and finance sector. The quiet markets of financial stability must not turn into the silence of the grave.

- For clarity of objectives and to foster cooperation there should be a statutory obligation to take into account the objectives of the other bodies (PRA and CPMA).

#### **Prudential regulation authority (PRA):**

Q4. *The Government welcomes respondents' views on:*

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

The objectives of the PRA need to be such that at a minimum it will facilitate the work of the other bodies (FPC and CPMA). Directly responsible for supervision at the micro (individual firm) level it needs to do that in a way which enables, or at least does not make more difficult, the work of those responsible for meso (industry) level and macro (whole economy) levels.

We believe it is important that all authorities consider the impact of their actions on the competitiveness of the UK economy as a whole, including the finance sector and financial markets, and not merely "have regard to ....the competitiveness of the UK financial services sector".

Q5. *Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?*

Refer general comment below Q9.

Q6. *Is the approach outlined in paragraphs 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focussed approach to supervision?*

Refer general comment below Q9.

Q7. *Are safeguard on the PRA's rule-making function required?*

Refer general comment below Q9.

Q8. *If safeguards are required, how should the current FSMA safeguards be streamlined?*

Refer general comment below Q9.

*Q9. The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRSA is transparent, operationally independent and accountable.*

We have not responded to all of the above consultation questions but provide the following comments:

Multiple front line agencies present a number of practical issues, including sharing of knowledge, duplication of effort etc. You have identified and propose that they “will work together” and have outlined a governance structure, a knowledge gateway and defined roles which should assist with this. However whilst there may be close cooperation there is a risk that a financial services regulator with split roles doesn’t have the same degree of credibility or status that a single integrated financial services regulator would.

You have proposed the following international roles:

- Within the Bank of England, the Financial Policy Committee (FPC) will be responsible for working internationally with national regulators;
- As the prudential regulator, the Prudential Regulatory Authority (PRA) will represent the UK on the new European supervisory authorities for banking and insurance; and
- The markets division of the Consumer Protection & Markets Authority (CPMA) will represent the UK at the new European Securities & Markets Authority (ESMA).

With only the CPMA representing the UK on the ESMA board, there is a real risk that any European market ruling which has a macro-prudential impact will not be authoritatively represented by the UK and will leave us with a weak voice in Europe. This will reduce the strength of the UK as a financial centre which will have a negative impact on the whole financial services industry and its contribution to the UK economy. The timing of this financial regulation restructure is unfortunate. As ESMA comes into being early next year, there is a risk that the UK’s perceived voice in the regulatory field will carry diminished weight when the Authority’s implementing rules and habits are being formed for the first time. We note that a partial solution to this problem has been found by appointing individuals to positions in both the central bank and the market regulator.

#### **Consumer protection and market authority (CPMA):**

*Q10. The Government welcomes respondents’ views on:*

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

The consultation document states “the Government considers that the case for regulators being responsible for the innovation and global competitiveness of the industries they regulate may, in particular, need to be reconsidered in the light of lessons learned from the financial crisis.” The argument being that one of the precursors to the crisis was that product innovation and global competitiveness took precedence. There is a risk that the UK financial markets become so heavily regulated and that UK competitiveness is ignored. The longer term detrimental impact could be that London ceases to be the financial capital of Europe.

The CPMA will regulate all conduct, including retail and market conduct. Retail and market regulation are very different and when combined in the one body can cause the following issues:

- We believe that the impact of the mass media and impact on individuals is likely to make the “Consumer Protection” side more politically visible than the Market division and in some ways is seen to be the senior party and prime focus within the CPMA. We therefore would see advantage if at the outset full statutory authority is provided for the Market regulation division to give it sufficient power and robustness so that it is in a position to carry out its role and not become subordinate to the possibly higher profile Consumer Protection division; and
- There is the potential for a conflict of interest between the two divisions and a resolution mechanism to deal with this that recognises the importance of both needs to be in place.

We agree that the CPMA should have regard to broader public interest considerations since too high a level of consumer protection can stifle the economy. There is also the question of defining “what is a consumer?” Small businesses, such as a sole proprietor are more akin to an individual consumer and may require more regulatory protection, whereas a large business, such as a FTSE 100 company, does not and would find it unduly restrictive. Even a small business (or a private investor of substance) may need access to financial services normally deemed unsuitable for retail access. There is a balance which requires defining of where to draw the line.

*Q11. Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?*

The accountability mechanisms proposed for the CPMA are: production of an annual report; annual public meetings; consultative panels (see below for details); maintain a complaints mechanism (with appeals in the Upper Tribunal); and reviews and enquiries. We make no detailed comment other than to point out that the new authorities will be subject to ad hoc scrutiny from the Treasury Select Committee, and that this forms a welcome additional strand to accountability.

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

The three proposed statutory panels are the Consumer panel, Practitioner panel and the Small Business Practitioner Panel. We believe that these panels do provide a useful feedback mechanism from the markets and should be retained.

*Q13. The Government welcomes views on the proposed funding arrangements, in particular, the proposal that the CPMA will be the fee and levy collecting body for all regulatory authorities and associated bodies.*

No comment

*Q14. The Government welcomes views on the proposed alternative options for operating models for the FSCS.*

No comment

**Markets and infrastructure:**

*Q15. The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.*

No comment

*Q16. The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.*

The proposal is to rationalise the regulation of trading platforms and CCPs (regulated under FSMA).

At present the Bank of England oversees the Foreign exchange markets through the FX Joint Steering Committee and the NIPS Code. We are unclear as to where this responsibility would sit in the future. London is the global centre of the FX markets and for our members working in non financial companies the FX markets are used extensively for risk management. Some continuation of the present regime, even if brought under the CPMA needs consideration.

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

We are happy to see that the government has kept an open mind to this matter; however we would be dismayed if the proposal to merge the UK Listing Authority (UKLA) with the Financial Reporting Council (FRC) occurred. Whilst both entities are engaged in governance of corporate reporting, the nature of these disclosures is quite different. The UKLA regulates corporate disclosures that are current and forward looking in nature and part of marketing securities. The FRC is responsible for disclosures that report historical performance on an accountability basis, some information from which will be incorporated in the disclosures falling under the UKLA. The risks associated with each of these activities are quite different, both in their compilation and use by the markets.

Furthermore the UKLA would effectively become the primary markets regulator for securities so it is odd to separate primary markets supervision from secondary markets supervision which would sit within the CPMA. Ongoing market conduct, market abuse, and transparency are applicable to primary and secondary markets, so we would question separating regulation between the FRC and CPMA.

No other European country separates primary regulation from secondary. We presume that this is because there is an integrated securities market and therefore supervision must be closely integrated. A separated structure risks the UK's interface with and its reputation in European regulation.

*Q18. The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator.*

No comment

**Crisis management:**

*Q19. Do you have any overall comments on the arrangements for crisis management?*

In managing a crisis we believe the overriding interest should be at the macro level and not about individual banks. We thus support the *primus inter pares* role of the FPC.

*Q20. What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?*

No comment

*Q21. What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24?*

No comment

**Impact assessment:**

*Q22. The Government welcomes comments on the assumptions made about transitional and ongoing costs for all types of firms.*

No comment

## The Association of Corporate Treasurers

The ACT is the international body for finance professionals working in treasury, risk and corporate finance. Through the ACT we come together as practitioners, technical experts and educators in a range of disciplines that underpin the financial security and prosperity of an organisation.

The ACT defines and promotes best practice in treasury and makes representations to government, regulators and standard setters.

We are also the world's leading examining body for international treasury, providing the widest scope of benchmark qualifications and continuing development through training, conferences and publications, including *The Treasurer* magazine and the annual *Treasurer's Handbook*, and online.

Our 4,000 members work widely in companies of all sizes through industry, commerce professional service firms.

Further information is available on our website (below).

Our policy with regards to policy and technical matters is available at <http://www.treasurers.org/technical/manifesto>

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The Association of Corporate Treasurers is a company limited by guarantee in England under No. 1445322 at the above address



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

15 October 2010

## **AFM Response to consultation on a new approach to regulation**

1. I am writing in response to this consultation paper, on behalf of the Association of Financial Mutuals. The objectives we seek from our response are to:
  - Comment on the proposals to deliver a new approach to regulation;
  - Highlight the vital need for the new regulatory system to better cater for a range of business models, in order to secure meaningful benefits within a new regulatory regime.
2. The Association of Financial Mutuals (AFM) was established on 1 January 2010, as a result of a merger between the Association of Mutual Insurers and the Association of Friendly Societies. Financial Mutuals are member-owned organisations, and the nature of their ownership, and the consequently lower prices, higher returns or better service that typically result, make mutuals accessible and attractive to consumers.
3. AFM currently has 57 members and represents mutual insurers and friendly societies in the UK. Between them, these organisations manage the savings, protection and healthcare needs of 20 million people, and have total funds under management of over £80 billion.
4. We accept the general premise for the consultation and the policy objective for reform, as:

*“The tripartite system of financial regulation failed to ensure financial stability - in particular by failing to identify the risk posed by the rapid and unsustainable increase in debt in the economy. This resulted in considerable economic costs in lost output and in a substantial deterioration in public finances...The policy objective is to reform the regulatory system for financial services to avoid a repeat of the financial crisis.”*



5. We broadly agree with this overview and with the analysis that supports it. Much has been written about the causes of the financial crisis and how it was allowed to have such a devastating effect. Ineffective regulation and the bonus culture were cited as primary reasons, to which we would add the increasing lack of diversity in the financial market. As The Economist wrote earlier this year, *“Just as an ecosystem benefits from diversity, so the world is better off with a multitude of corporate forms.”*
6. Recently AFM, along with the Building Societies Association sponsored work by the Kellogg College, University of Oxford to consider how the coalition might effectively deliver on its commitment to support mutuality within financial services. Amongst the conclusions reached by Professor Michie were that financial regulation was currently biased toward the proprietary business model, and that the development of legislation to create new regulators provided the opportunity to incorporate a statutory commitment to recognise the value of diversity.
7. The report also made a series of recommendations on the way the various agencies proposed in this consultation might demonstrate a commitment to a diversified financial services market, and these are summarised in an Annex to this paper. We conclude that a vital element in reform of financial regulation is that diversity must be facilitated by the legislation; as Professor Michie states, there is an: *“urgent need to translate positive words into substantive actions”*.
8. We agreed that a vital element of regulatory reform is better regulation in general, and better regulatory recognition of the mutual model in particular.
9. Our responses to the specific questions raised in the consultation are attached.
10. We would be pleased to discuss further any of the items raised by our response.

Yours sincerely,

*Martin Shaw*

Chief Executive  
Association of Financial Mutuals

## Annex: Extract from report: “Promoting Corporate Diversity in the financial services sector”<sup>1</sup>

Within the new regulatory framework, there needs to be a clear responsibility in the regulator’s charter to promote diversity of ownership. In the past, the objection to taking this step is that it would require legislation. But now there is going to be legislation in any case, and there is going to be a new regulator, so this is the moment to ensure that the regulator is given proper responsibility towards fostering diversity and promoting mutuals. So, firstly, the regulator must have a responsibility and a requirement to demonstrate that they are taking diversity into account.

Secondly, the regulator needs to have somebody within the organisation who is at a senior level defined as a head of mutuals policy. (There is not anyone who has that particular remit currently and, therefore, there is no particular incentive for anyone in the organisation to think beyond the standard plc model.)

Thirdly, regulation needs to be proportionate. Regulation and the demands it makes represents a powerful competitive advantage for large incumbent players because they can absorb that cost. The resource costs and the monetary costs impact more heavily on smaller players, constituting a barrier to entry – you have to comply with regulation before you have done your first deal – and it stops the smaller people thriving in a way that would provide meaningful competition to the big incumbents. On the whole that disadvantages mutuals, and it is certainly a barrier to greater diversity. Ironically, it actually favours the ‘Too Important to Fail’ banks that are part of the problem. There is a precedent with the rules relating to credit unions which much more effectively enable new organisations to be developed, and we recommend that this approach is translated to other forms of mutual, to remove the barriers to entry and early survival.

Fourthly, on the Prudential Regulatory Authority (PRA) and Consumer Protection and Markets Authority (CPMA):

- i. the White Paper makes it clear that the new consumer protection markets authority is responsible for the ‘promoting mutuals and fostering diversity’ agenda: this needs to be written into new Prudential Regulatory Authority objectives as well;
- ii. there should be a commitment in the PRA and the CPMA to take due account of diverse business structures; and
- iii. there needs to be a mutuals’ policy function in both the CPMA and the PRA: these bodies need somebody on the inside who understands the difference at the grass roots of producing policy in diverse sectors – people who don’t automatically assume that the plc model is the only model; a counterweight is needed to that

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<sup>1</sup> Extract from report commissioned by AFM and BSA, produced by Professor Jonathan Michie, Kellogg College, University of Oxford, September 2010

general assumption that this is how banking and insurance is organised.

Fifthly, on the Bank of England:

- i. given the immense extra powers that the Bank of England now has, it is urgent that its accountability improves concomitantly;
- ii. it is also vital that the Bank be required to explain decisions in relation to mutuals on each regulatory rule: what the impact on mutuals is, in the context of the commitment to promote mutuals; and
- iii. the Bank should also be required to report on diversity in the sector, producing an annual review of diversity and how its actions have maintained it; this would utilise the measurement of diversity referred to in Section 7.1 above, which should be the responsibility of the PRA rather than the Treasury.

Thus, good, strong and transparent regulation is required that takes account of the particular structures within the mutual sector. To achieve this would require a mutuals policies function within the PRA and CMA, with them reporting on the success of their efforts to promote diversity, and also commenting on the impact on diversity and on mutuals of each individual significant regulatory proposal.

## Responses to specific consultation questions

### The Bank of England and Financial Policy Committee (FPC)

- 1 Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?
- 2 If you support the idea of secondary factors, what types of factors should be applied to the FPC?
- 3 How should these factors be formulated in legislation – for example, as a list of ‘have regards’ as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?

We believe the FPC should maintain a single, clear, unconstrained objective. To introduce an extensive series of secondary factors would be to run the risk of duplication and misaligned priorities between different agencies, and to dilute the primary and vital role of the FPC.

We agree that the FPC should itself be made up of a combination of Bank of England executives, supplemented by external members. However we think there is a risk in presuming the former will form the main part. Specifically this is because it risks creating lack of proper accountability in the FPC.

We would be keen to ensure that there is at least one representative from the mutual sector present on the FPC, to enable the Committee to effectively take account of business model diversity. This would enable the FPC to undertake one of the recommendations in Professor Michie’s paper on diversity in the financial services sector, that within the regular reports of the Committee is a report on diversity in financial services (see Annex above).

We envisage this should be one of the secondary factors for the FPC, and that these should be formalised in legislation, and also taken into account the monitoring, reporting and actions summarised in paragraphs 2.31 to 2.33.

### Prudential regulation authority (PRA)

- 4 The Government welcomes respondents’ views on:
  - whether the PRA should have regard to the primary objectives of the CPMA and FPC;
  - whether some or all of the principles for good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice, should be retained for the PRA;
  - whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and
  - whether there are any additional broader public interest considerations to which the PRA should have regard.
- 5 Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?
- 6 Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focused approach to supervision?
- 7 Are safeguards on the PRA’s rule-making function required?
- 8 If safeguards are required, how should the current FSMA safeguards be streamlined?
- 9 The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.

We agree with the contention in the report that a major failing of the current regulatory system has been a lack of attention to understanding firms' business models and strategies. Whilst the context within the consultation was in relation to the financial crisis, this failure is just as acute in the unbridled bias towards the proprietary business model within the Financial Services Authority. This has resulted in severe problems for the mutual sector- for example in capital problems and FS Compensation Scheme costs for building societies, and in the treatment of with profits in mutual insurers. This approach risks terminal harm to the mutual sector, and stems from a disregard and misunderstanding of the mutual business model.

Similarly there has been a focus within the FSA on "one size fits all" regulation. Since the financial crisis, much attention has been given within FSA to creating new corporate governance and remuneration rules for large banks. Much of this is being transferred into non-banks and to much smaller organisations in an unsympathetic manner, creating disproportionately higher costs for small firms.

We therefore strongly recommend that the proposal that "in future supervisors should focus more on understanding institutions' business models and strategies" (paragraph 3.3) is formalised into the PRA's supporting objectives (referred to in paragraph 3.7 as "secondary factors"), and that as part of these formal secondary objectives it is also made clear that this includes to "foster diversity" as this echoes the government's own commitment. This appears to sit within either the second or third category listed in paragraph 3.7. Such an approach would mirror that envisaged for CPMA, as provided in paragraph 4.12.

We also suggest that as well as including such a requirement in the legislation, that the consultation process demonstrates that diversity was taken into account, and that this can be best facilitated by appointing a Head of Mutuals Policy.

We agree with the nature of the objectives posed in Question 4 therefore. Specifically we do not consider that there is an unmanageable tension between the PRA primary objective and the responsibility to have regard to potential adverse impacts on innovation and competitiveness. Other UK regulators appear to manage this balance adequately, and given the importance to the UK economy of the financial services sector it would risk public harm for the PRA not to have regard to the impact of its policies on the sector.

In respect of Question 5, there is a risk that giving two authorities' responsibility for authorisations and permissions could cause problems. For example, paragraph 3.16 suggests both PRA and CPMA will be responsible for approving persons to undertake significant influence functions. This creates the risk that one authority will approve whilst the other rejects. Dual responsibility is also likely to extend the approval process, and already within FSA the time taken to approve individuals is often unacceptably long. We conclude that this responsibility should sit with one regulator only- that with primary responsibility for supervising a firm.

With regard to questions 6 to 8, we believe another key function should be to explicitly expect that PRA seeks to understand individual organisations' business model and form, and strategies.

We are concerned that the paper appears to suggest that the current FSMA requirements for FSA to issue a consultation with a detailed cost-benefit analysis might be removed for PRA. The consultation process is a vital strength of regulation in this country. As a trade body, we find it necessary to respond to a significant number of consultations, to highlight the often unintended consequences of proposals. Effective consultation should give confidence amongst consumers and firms that regulation is working properly. Indeed we would encourage government to strengthen the consultation and CBA requirements on regulators- to avoid the growing tendency of FSA to issue “Dear CEO letters” that circumvent proper consultation, and to ensure the benefits of new proposals are better understood and truly weighed up against the costs, and to require pre-implementation review that encourages assessment of whether new rules have had the intended effect.

We agree with the governance issues covered in the paragraphs leading up to Question 9. However, whilst accepting that PRA and CPMA should have separate powers to raise a levy from firms according to its duties and who is lead regulator, we consider that the total cost of the new regulatory bodies should not, on a business as usual basis, exceed that of the FSA- which itself has seen enormous increases in levies over the last ten years.

### Consumer protection and markets authority (CPMA)

10 The Government welcomes respondents’ views on:

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

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

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

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

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

Before the advent of the Financial Services Authority, members of AFM were accustomed to meeting the regulatory demands of two or more authorities- for example, friendly societies were regulated by both the Friendly Societies Commission and the Securities and Investments Board.

Having a second regulator with a clear but different set of objectives is not therefore in itself a new concept. Indeed in many parts of the world it is the norm to have prudential and consumer regulation separate. For example ASIC in Australia and FCAC in Canada have for many years provided a distinctive brand of consumer protection working

alongside prudential regulators (alongside which the CFPA in the US is modeled). This appears to work well in terms of removing the ambiguity of roles, though there are potential risks, including:

- The consumer regulator needs to have its own clear remit and authority, and not be seen as the weaker partner;
- To this end, the CPMA should not be seen as the “consumer champion” as suggested in paragraph 4.44, but as a serious and integral part of the regulatory landscape;
- The risk that staff from FSA migrate to what is perceived to be the most progressive regulator (in other countries the prudential regulator is often cast in this light);
- The two bodies need to ensure their work is streamlined and avoids duplication/overlap- for example to avoid two sets of supervisors turning up at a firm at the same time, or else contradictory rules pull firms in different directions;
- The possibility of underlap still exists, where there are grey areas between rules, into which decisions made by the Financial Ombudsman Service continue to become “quasi-regulatory” -in countries such as those mentioned earlier, this is often resolved by having the arbitrator as part of the consumer agency;
- Memoranda of Understanding and information gateways need to be supported by IT systems that enable firms to submit data once.

It should also be noted that over time, with the greater influence of EU Directives, the FSA has become much more of an implementer of policy than a developer. Both PRA and CPMA will find themselves in the same position of seeing significant parts of the rulebook being articulated in Brussels, with their role being to translate to the UK market. There is a risk as well therefore that having two UK regulators reduces the UK ability to influence EU policy, or else that the work of implementing it is duplicated.

As per our response to Question 4, we agree with the objectives posed in Question 10. With regard to the responsibility for having regard to the potential adverse impacts on innovation or competitiveness, were CPMA purely responsible for consumer protection regulation it would be possible to question this. However, as their proposed remit is much broader and covers supervisory duties for firms that are not supervised by PRA, as well as a role in market integrity, it is impractical to assume they are not bound by similar responsibilities.

We are content that factors CPMA should have regard to include “the need to maintain diversity in the financial services sector (for example, by... ensuring that its rules do not disadvantage mutually owned financial institutions” (paragraph 4.12). As we discussed in the context of PRA, we think that this should be included in the relevant statute, be operationalised by requiring CPMA to appoint a Head of Mutuals Policy, and by needing to provide evidence that diversity was considered within its consultation process.

We are content with the accountability mechanisms proposed in paragraph 4.36, and the rule-making process earlier.

We agree with the formation of three consultative panels (Question 12), and are pleased that the Smaller Business Practitioner Panel will gain a statutory footing. With regard to the membership of the Panels, we would like to see clearer responsibilities and regular

turnover of appointees (in corporate governance for example, NEDs seek re-election every year, in part to prove that they continue to offer an independent view, but also to verify they have added value to the Board and attended sufficient volume of meetings). We would also like to see a wider group of firms invited to join the Practitioner Panel- no mutual insurer has sat on this Panel for many years (if at all).

The role of the Consumer Panel has been the most challenging within FSA, and the extent of their responsibilities need to be sufficient broad to attract the right membership, but also properly targeted to avoid them developing too consumerist a role where this is not compatible with their responsibilities. Equally CPMA needs to be more transparent in its dealings with the Consumer Panel.

Specifically, we would like to see that where policy proposals are put before the Board of PRA or CPMA, there is a specific requirement that papers clearly identify areas of disagreement from any of the panels.

We agree that CPMA is the most appropriate authority for collecting all regulatory fees, and that this is preferential to individual organisations levying separately.

On Question 14, it is important that Compensation Scheme arrangements are fair to both firms and consumers. On balance we conclude that this is most likely where one agency retains responsibility. However in addition to the commentary in the paper, the deposit-taker arrangements being discussed in Europe will complicate the issue further, and it is important that the form of pre-funding explored there is not translated into other sectors where there is no apparent need.

There is a risk that the opportunity to consider the efficiency of regulation more generally has been missed, and given the infrequency with which the primary legislation is likely to be reviewed this may be regrettable. In this context, we reiterate two points made earlier.

Firstly we question the automatic presumption that the FOS should remain separate from the CPMA. Consumer agencies in other parts of the world comfortably have complaint handling arms, and this informs regulatory processes more effectively. We think this would have a number of other advantages, as it would:

- avoid the concern that the Ombudsman acts in a quasi-regulatory way, in contradiction to the stated rulebook;
- improve the effectiveness of the wider implications process, which is failing to highlight and resolve problems of a wider nature in its current form;
- better understand what obligations there are to FOS in the Cabinet Offices' work on the costs of the compensation culture;
- resolve the problems whereby the two agencies issue their own complaints reporting at different times and with different approaches; and
- significantly reduce the overhead costs of the two organisations and the burden on industry, and probably offset some or all of the costs created elsewhere in the new system.

The current proposed model for CPMA is though more complex than overseas comparators, with the consumer protection/ small firm supervision/ markets



responsibilities held in one agency. Unless revised, this would probably rule drawing FOS into the CMPA, in the same way that its role as “consumer champion” is invalid.

Secondly there is a growing concern that between FSA and FOS regulation is increasingly providing ambiguous and unclear standards. The British Bankers Association recently launched a judicial review against FSA and FOS who it believes is applying new standards to old sales (in relation to Payment Protection Insurance).

We share that concern with regards to FSA’s approach to imposing a position on mutual insurers with a with-profits fund („Project Chrysalis”) that does not accord with previous industry practice or indeed the regulatory approach. This is part of our argument that FSA is failing to take account of the mutual model, and hence our call that FRC, PRA and CMPA are formally required to take proper account of diversity, as well as our call for PRA and CMPA to each appoint a Head of Mutuals Policy.

## Markets and infrastructure

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

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

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

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

Most AFM members are not directly involved in the issues discussed in Chapter 5. We do however support the main proposals in relation to the division of responsibilities. We can also see merit in bringing together UKLA and FRC, as this will help to deliver higher standards of corporate governance and stewardship.

## Crisis management

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

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

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

The recent financial crisis demonstrated failings in the regulatory regime, but has also provided the demand and the resources needed to put in place significant new powers for HM Treasury, Bank of England and FSA. In particular it was apparent that FSA adopted new powers quickly and effectively as required and consulted retrospectively if the temporary powers needed to become permanent.

The table on “Transition from peacetime to crisis” draws on those experiences and appears to provide a much better integrated approach to dealing with escalating crises in the future. It is only when we have the opportunity to consider a crisis with hindsight that

we understand what the optimum powers and arrangements would have been, and it is therefore important that crisis arrangements retain a degree of flexibility- as inferred in paragraph 6.17.

## Impact assessment

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

The impact assessment in the consultation paper considers the two options of do nothing (ie retain the current model of regulation), or proceed with the proposed new model. The assessment assumes the increase in costs for firms is not significant, and that the benefits of avoiding or mitigating the impact of future crises outweigh this many times.

We think this is a very narrow analysis and fails to capture the greater potential benefit of getting regulation to work more effectively in the public interest.

Over the last ten years members of AFM have seen their regulatory levies increase significantly. We have however seen regulatory attention and intervention increase, so it is possible to measure the value of regulation at this level in a relatively proportionate way. We are keen to see the link retained between the risks a firm poses to good regulation, the resulting level and cost of regulating that firm, and the levy that firm pays.

By far the greater cost though is the impact of complying with regulation. If compliance creates an efficient transfer of value from firm to consumer, ie where that regulation is effective in supervising firms and in protecting consumers, the result is likely to be that regulation is operating beneficially.

We are concerned however that as regards the mutual sector, that efficient transfer of value has been missing. Mutuals did not start the financial crisis, benefited little or at all from public funds and posed little or no new risks to their consumers. But regulation, whilst it has adapted to recognise a new way of thinking about the systemic risks posed by banks, has failed to understand the different risks posed by mutuals and the different business model employed. Some examples include:

- Mutual insurers that operate with profits funds are being treated by FSA in accord with the way it supervises proprietary insurers. This is beginning to have profound effects on the potential viability of some mutual insurers;
- Small mutual insurers and friendly societies are seeking rules written for large banks being crudely translated to their firms, with the effect that they suffer hugely disproportionate costs as a result;
- Building society levies to the compensation scheme reflects the costs of failures in banks not mutuals;
- Mutual insurers and building societies have no access to external capital, and FSA sees that as a shortcoming of the business model rather than helping to facilitate new forms of capital;

- Certain forms of income protection provided by (Holloway) friendly societies, whose customers benefit from a small return of excess premiums at the end of the contract, are regulated as an investment product and therefore suffer a material disadvantage compared with similar, but less advantageous policies provided by proprietary models.

AFM therefore considers that the potential benefits of a new regulatory system can be broader, so long as the new regime enables regulation to better embrace the public interest. Amongst the public interests providing in the Government's Coalition Agreement is:

“We want the banking system to serve business, not the other way round. We will bring forward detailed proposals to foster diversity in financial services, promote mutuals and create a more competitive banking industry.” (HM Government, 2010, p. 9)

Our response has therefore considered how the benefits of new regulation might be wider, by incorporating the recommendation in Annex A.

As regards the specific costs of transition and on an ongoing basis, the impact assessment broadly indicates that larger members of AFM will see higher transitional costs settled down to broadly comparable ongoing costs. Smaller mutuals will see lower start up costs but greater ongoing costs.

It is difficult to comment on that given the absence of detail, though in 2009/10 FSA accepted that socially useful organisations, such as small credit unions and friendly societies should be treated as a special case in its review of the minimum levy. We would encourage this exemption to be carried over in the future.

As mentioned above, whilst the levy raised by the regulators may not be greatly different from that by FSA (and indeed we would argue they should be the same), the likelihood is that by creating a new agency with a different remit, the CPMA will undoubtedly want to explore its new role. This would mean creating new rules and new requirements on firms that will increase its compliance costs. These internal costs will always outweigh the fee paid to the regulator and an increase here will therefore have a disproportionately higher impact on firms. We would like to see the National Audit Office work cover this aspect of regulatory efficiency.



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

**Association of Foreign Banks:  
Response to HM Treasury on “A new approach to financial regulation”**

The Association of Foreign Banks (AFB) represents over 175 foreign banks doing business in London through branches, subsidiaries and representative offices. AFB provides a forum for the sharing of information on industry issues for the mutual benefit of foreign banks operating in and out of the UK and makes representations to industry, government, regulatory bodies and other financial services organisations to ensure the attainment of good international practice. The foreign banks concerned engage in a wide range of banking and investment business activity in the UK primarily in the wholesale banking markets. They make a significant contribution to London's standing as a major global financial centre. Member banks range from the largest with several thousand staff to the smallest with ten or less staff.

We enclose the Association's responses to the detailed questions posed in the consultation paper. In addition, we would like to take the opportunity to make some more general comments on the proposed new structure.

We agree with the objectives of the proposals to give the Bank of England the ultimate oversight of both macro- and micro-prudential regulation, and to vest the operational responsibility for prudential regulation with the new subsidiary, the Prudential Regulation Authority (PRA). We also agree with the analysis that, in hindsight, the focus of the FSA's supervisory activities was not on the most fundamental aspects of supervision and can be said to have concentrated excessively on “tick-box” compliance with individual rules. We agree with the proposed changes in the focus of supervision and welcome the efforts to improve the quality of regulatory resources.

The consultative paper expresses the view that combining prudential and conduct of business regulation in the same organization is difficult as the two “require different approaches and cultures”, and therefore it is proposed by the HM Treasury that conduct of business would be supervised by a separate body in the future, the Consumer Protection and Markets Authority (CPMA). In our opinion, an organisational split may however not be the optimal solution to past or future regulatory problems, and the necessary reforms of the substance and quality of regulation could be achieved without such a profound structural change.

From the point of view of our membership, organising the two sides of regulation, prudential and conduct of business, as divisions of the same organisation would be a clearer and more efficient alternative. Having both the prudential and conduct of business aspects of their operations supervised under the same roof is beneficial in a number of ways. The tone of regulation is set from the top of an organisation, and therefore consistency and application of philosophy can more easily be established within one organisation. We believe that there is a risk that splitting the regulatory structure will increase regulatory complexity. It may result in both a regulatory “overlap” and “underlap” particularly in the area of systems and controls, which may heighten operational risks.

According to the proposed structure, many banks may need to have separate contact points within the two regulators, and authorisation of approved persons in significant influence functions would be decided by different entities depending on their role. We believe that, in many cases, prudential and conduct of business regulatory concerns are the same and should be amalgamated (e.g. vetting the significant influence functions), and that having a consolidated view of both aspects will lead to better regulation. Communication channels with the home state regulators of our member banks would also become less clear under the proposed structure.

There are several areas of supervision where the PRA and CPMA would need to work together on a very practical level, which would seem to be easier and more seamless under the umbrella of a single organisation than by way of Memoranda of Understanding and colleges of supervisors. In particular the new system will rely on the effective and practical implementation of the theory of the Memorandum of Understanding by individuals in both organisations. This approach proved to be difficult to operate before N2.

We believe that our membership would have preferred the structure to be simplified so that all regulated entities would continue to have a single regulatory body responsible for their business.

We are also concerned that the proposed structure may add to the regulatory burden and related cost on businesses operating in the UK at a time when recovery is still fragile. Whilst we understand the Government’s objective of ensuring better protection of consumers, it is important to note that a large number of foreign banks focus mainly on the wholesale markets, where regulatory requirements should be proportionate to avoid a negative effect on the competitive position of the City of London.

The structure and scope of regulation in the financial markets is evolving very rapidly on an international basis. In future, European regulations will be promulgated across Europe by the European Authorities; it is essential therefore that the UK Government retains its position of influence in Europe, so that its experience of regulation is used to raise regulatory standards to the optimum level. To ensure this, we believe that the UK regulatory structure should, where possible, mirror the structure of regulation in Europe. Thus UK members of the European bodies would be appointed by the comparable UK regulatory authority and have the appropriate expertise. In this way the UK is more likely to influence the international debate.

It is proposed by the Treasury that the regulation of the wholesale markets be split between several regulators. The Clearing and Settlement of these markets will be with the Bank of England, transaction oversight will be with the CPMA, whilst the primary market regulation and the UK Listing Authority may reside within the Financing Reporting Council. In our view the UK Listing Authority should be part of the CPMA, which should be the UK’s voice in ESMA. Our member banks frequently locate in the UK to take advantage of the depth and quality of the wholesale markets. Fragmenting the regulators could fragment the markets and hence the adversely impact on the attractiveness of the UK as the optimum location to do business.

Finally, we would like to comment that if the Government decides to adopt the structure outlined in the HM Treasury paper, we hope that the concerns we have raised above will be addressed when determining the details of the relative powers of and division of responsibilities between the regulators. In particular, efforts should be made with respect to minimising the adverse effects of the complexity of the new structure, including avoiding unnecessary bureaucracy and increased regulatory burden as well as protecting the relative position of the UK in the international context. We also hope that the current regulatory uncertainty is resolved as soon as practicable in order to support a stable regulatory environment.

We detail our answers to the specific questions below.

**Association of Foreign Banks**  
**15 October 2010**

## Consultation questions

### The Bank of England and Financial Policy Committee (FPC)

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

The AFB believes it would be useful to have secondary factors for inclusion with the primary objectives.

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

We consider that the secondary factors should include at least:

- The international competitiveness of the UK financial markets and the contribution they make to the economic and fiscal position of the UK Economy over the long term
- The economic and fiscal impact of the FPC macro-prudential decisions
- The statutory objectives of the PRA and CPMA and
- the potential aggregate impact of regulatory actions on the relative position of the City of London

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

No preference

### Prudential regulation authority (PRA)

**4 The Government welcomes respondents’ views on:**

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

The PRA should take account of the primary objectives of the CPMA and the FPC and this requirement should also be mirrored by the other organisations thus ensuring consistency and prevention of duplication of regulatory effort.

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

The AFB believes that all of the principles relating to good regulation should be retained as a safeguard for the regulated community which is interlinked with the secondary factor of “public interest”.

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

A specific requirement to have regard to any adverse potential impact on innovation or competitiveness should be retained as the AFB believes this has been one of the strong points of the UK markets.

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

The long term benefit to the UK economy of maintaining the attractiveness of the City of London to international firms should be retained. The AFB continues to believe that the long term contribution to the UK economy of the City of London has outweighed and will continue to outweigh the huge cost of the 2008 crisis largely arising outside their remit. It is unclear from the proposed new regulatory structure if there is any Governmental organisation that has responsibility for maintaining this benefit.

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

The AFB would prefer an integrated model with one source of rules and one point of contact to deal with. A clear hierarchy of responsibility with overall responsibility clearly vested in one organisation would ensure that there is no “overlap” or “underlap” of coverage. The processes outlined in Box3.B, to counter the impact of creating regulatory silos, demonstrates the advantages of a more integrated model.

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

Yes

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

Safeguards are needed to ensure that business activity is not unnecessarily restrained, constrained, interrupted, made less profitable or, in the extreme, driven off shore to other financial centres.

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

In the first place, the AFB believes that references to the regulatory good practice as detailed in paragraph 3.10 should be encoded in the legislation. Secondly we believe that the current framework that the FSA has followed for open consultation on the detailed rules and guidance has added significant value to the current FSA rule book in terms of clarity and applicability. There is a large pool of expertise available for consultation in the banking community and financial markets and this should continue to be exploited.

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

No views (the proposals seem fairly comprehensive)



## **Consumer protection and markets authority (CPMA)**

**10 The Government welcomes respondents' views on:**

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

Yes, please see the answer to Q4 above

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

Please see the answer to Q4 above

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

Please see the answer to Q4 above

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

Please see the answer to Q4 above

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

Yes (but please see the comments relating to the broader public interest and international competitiveness)

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

We support the continued existence of the two panels and of the creation of the new Small Business Practitioner Panel

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

The AFB supports the view that one fee collecting body is preferable.

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

The AFB supports the principle of no cross subsidies and would prefer a single organisation to continue to administer all compensation schemes.

## **Markets and infrastructure**

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

Please see the general observations above. The AFB believes that responsibilities for markets and infrastructure should be retained with one regulatory unit and failure to do so will create artificial dividing lines between the regulators. In our view, several of the markets are of systemic importance. Many of the participants are professional counterparties who need little conduct of business regulation. The primary markets market activity, regulated by the UK Listing Authority, should not be aggregated with financial reporting bodies. With all the new European legislation being proposed in this area it is important that the UK structure mirrors that of the European authorities as far as possible.

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

It would be sensible to await the final European legislation in this area and then implement it without gold plating.

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

The current role of the UKLA to regulate primary markets goes beyond that of financial reporting and therefore this activity would seem to lie more naturally with the CPMA.

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

The AFB believes that raising the corporate governance bar for all companies is generally good. However, we are also concerned that there should be no conflict with existing regulatory requirements that Banks currently have to comply with.

## **Crisis management**

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

There is a lack of clarity on the tools currently available to the Treasury to carry out their duties in a crisis and we agree with the intent of the Government to explore this area further.

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

The AFB believes that it is best to leave the regulators with discretionary powers as one size fits all may be inappropriate.

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

No view

## **Impact assessment**

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

The AFB believes that the worst case scenario of there being a potential significant long term cost to the UK economy, as a result of the City no longer being an attractive place for international firms to do business, has not been quantified and that it should be.

**Association of Foreign Banks  
15 October 2010**



## **AIFA's Response to HM Treasury's Paper: A New Approach to Financial Regulation**

**OCTOBER 2010**

### About AIFA

The Association of Independent Financial Advisers (AIFA) is the representative body for the IFA profession. There are approximately 16,000 adviser firms that employ 128,000 people, and turnover is estimated at £6.5 billion (including £4.5 billion from life policies, £1 billion from fund management and £1 billion from mortgages and general insurance). Around 20% of the UK population regularly use an IFA, with c45% consulting one from time to time.

Membership is voluntary and on a corporate basis. IFAs currently account for around 70% of all financial services transactions in the UK (measured by value). As such, IFAs represent a leading force in the maintenance of a competitive and dynamic retail financial services market.

### About IFAs

In every year for the last five, consumer trust and confidence in the IFA profession has grown. Research by Nottingham University shows that IFAs are the most trusted part of retail financial services (by a considerable margin) and that, in the midst of the banking crisis demand for independent advice increased – and the level of confidence in IFAs increased.

IFAs are regularly cited as offering low-cost barriers to entry into new markets, and the European Commission last year commented positively on the role of intermediaries as a force for driving competition (to the advantage of consumers) in financial services.

The UK has experienced the worst banking crisis in a century. The financial services industry has emerged with a tarred reputation from this period: yet no IFA firm posed a systemic risk, or contributed to the failures in this turmoil.

IFAs will be regulated by the CPMA under the proposed structure. However, clearly the decisions made by the FPC will impact IFAs, and a number of IFA firms in AIFA's membership are part of a wider banking, insurance or mutual group and therefore will form part of a group regulated by the PRA. In our response we have focused predominantly on the CPMA, as this is the area with most interaction with members and

consumers, but we have also addressed the necessary interaction between the three regulatory bodies.

## Introduction

AIFA supports cost effective, proportionate regulation. In any well regulated market, participants and consumers will all benefit from enhanced levels of trust and confidence. To achieve this, AIFA welcomes the debate on the purpose of regulation, and hopes that revised regulatory structures will result in a better consumer outcome.

The opportunity to develop a regulatory regime, which facilitates the provision of independent, impartial advice to consumers, is vital. At a time where consumer responsibility and the need for self-provision are so high on the political agenda, AIFA feels it is appropriate for the regulatory structure to encourage better access to more consumers. The overriding purpose of regulation must be to produce better outcomes for more consumers.

While regulatory architecture is the subject of much discussion, for member firms stability and certainty are of more value, and for consumers, the purpose of regulation is of utmost importance. Constant regulatory flux deters financial investment in firms and weakens consumer trust in the sector. We therefore wish to see a stable regulatory regime with a structure that:

- Enables better outcomes for more consumers; we must facilitate more access to advice for consumers, particularly at this stage in the economic cycle and with the savings and protection gaps at such high levels
- Changes less, with fewer “new ideas” and more consistency of delivery
- Results in stronger personal accountability within regulators for initiatives and the success of such initiatives
- Ensures all proposals are subject to greater scrutiny and cost benefit analysis before announcement
- Recognises that UK consumers have borne the costs of change – but seen the savings gap grow, levels of personal debt increase, and numbers of advisers fall; regulation must be cost effective for all
- Seeks to work with the sector; recognising the good in firms rather than assuming or pre-judging the worst
- Is cognisant of the European dimension upon which so much of our regulation is now dependent.

## **Reflections on legislative proposals**

### Re-allocation of responsibilities

AIFA recognises the rationale for the proposed re-allocation of responsibilities between the newly formed statutory bodies and the FPC. However we have some concerns when considering the bigger picture of the new regulatory architecture, the interactions and accountability mechanisms.

If the regulatory landscape is to be separated out as proposed by the Government, it is crucial there be close and continuous co-operation between the new regulatory bodies. The objectives of the individual regulators also need to be clear and fit logically together. History has shown us that failures happen when there are gaps in regulatory oversight, when regulators fail to co-operate or when they fail properly to fulfil their obligations. To achieve this, AIFA believes that each of the three regulatory bodies should formally benefit from each other's objectives as specified secondary objectives, rather than just as „have regards to'. We also question whether the interaction of MoUs and Chief Executive Board presence is in itself sufficient for cross-body cooperation; AIFA believes that the college of supervisors approach holds merit.

The consultation paper estimates that most of the 20,000 firms regulated by FSA now will be regulated solely by CPMA after the transition, with about 1500-2000 firms likely to be regulated by PRA while also subject to conduct of business regulation by CPMA.

AIFA is concerned by this potential “double regulation” of those companies which fall under both PRA and CPMA, for example institutions which have an IFA arm. Although the two bodies aim to regulate different areas of business – prudential requirements and conduct of business – it is inevitable that these will affect each other and influence the running of a business.

While aspects of regulatory responsibility can be split amongst bodies, AIFA supports the notion of a shared services organisation for certain operational services. Whilst the paper comments on the collection of fees as one area where CPMA could manage the activity for all bodies, it could be argued that areas such as enforcement, authorisations and data collection should be addressed cross-bodies. Whether this „services department' can be integral to one agency, or should be a separate structure is debatable.

### Financial Policy Committee

AIFA believes that the FPC has the potential to exert significant influence on the markets, either through own initiatives or via the CPMA and PRA.

By example, the Consultation Paper highlights the ability of the FPC to „dampen credit cycles' in the event that it feels a systemic risk is building in the sector. The provision of mortgages to retail consumers could also be impacted at a micro-prudential level by PRA actions; it could also be impacted by the work of the CPMA through such activity as the MMR.

While each of these bodies could have justifiable and appropriate needs for their own actions, it is clear that coordination is necessary to secure good consumer outcomes. Whilst this may well be led by the FPC in such a case, AIFA are concerned that the checks and balances applied to CPMA do not appear to be echoed across the piece. AIFA questions whether formal engagement with consumers and practitioners should be equivalent across all three bodies in order to provide the necessary checks and balances.

### Consumer protection and markets authority (CPMA)

AIFA supports the need to revise the UK regulatory regime, in order to restore trust and confidence in the wider financial system.

However, we must ensure that the CPMA is focused on those aspects of the financial services industry that pose the greatest risk – a continuation of the „follow the money’ approach being undertaken by FSA at present and not just „point of sale’ regulation. We support, therefore, the continuation of FSA’s Retail Conduct of Business Strategy.

AIFA does not expect that reform of regulatory structures will subsequently require a complete re-write of the rulebook; there were no fundamental failures with many of FSA’s existing rules. Where further thought is necessary is the mismatch in the implementation of the rules, including the disconnect between FSA’s stated principles and their measures of success, combined with poor supervision. AIFA feels this was the primary cause of many of the issues we see today.

Going forward we would argue that there are six principles of a good regulatory structure:

- It protects consumers – and is understood to have that role. However whilst protecting consumers from unscrupulous market participants, regulation should also openly recognise that consumers should be required to take a reasonable degree of responsibility for themselves and their decisions. The issue of Consumer Responsibility is very high on the agenda of our new Government, and should also feature in financial services.
- It recognises the international dynamic at play in any market – and seeks to ensure the UK remains a leading player, for the benefit of consumers
- It works in a cost effective, proportionate and accountable way. Retrospective action cannot be tolerated as it undermines both business confidence and consumer trust: even the best of firms cannot attract investment in a market built of shifting regulatory sands nor will consumers have confidence in an industry which is forever the subject of reform.
- It recognises that people need help in making financial decisions given the information asymmetry they are faced with. The long-term nature of many financial products, their complexity, and the importance of financial assets to individual well-being, mean that customers perceive high levels of risk when making purchase decisions. They typically lack specialist knowledge and may have difficulty in judging product performance. The costs of making a mistake are considerable. Faced with such risk and uncertainty, many customers are dependent on advice and products of an appropriate type and quality - and must trust them to do so. It is therefore crucial that regulation helps to nurture the provision of financial advice whilst also ensuring that advisers are competent to give that advice.
- There exists a cultural alignment and mutual respect between the regulator and the regulated – it is important that the industry isn’t afraid of the regulator and both should work closely together throughout the whole process without fear.
- It secures a framework within which effective competition can thrive. It encourages innovation, entrepreneurial flair, and balances the conflicts of smaller and larger market participants.

## Statutory Objectives

CPMA has a primary objective of “ensuring confidence in financial services and markets, with particular focus on protecting consumers and ensuring market integrity”. However we clearly have to question if having one single statutory objective for a regulator governing more than 20,000 firms is broad enough, particularly in light of the potential addition of close to 100,000 consumer credit firms in the event of OFT’s consumer credit regulation also transferring to the CPMA.

Whilst consumer protection and market stability are crucial roles for regulation, we also believe it is equally important that the CPMA focus on overseeing social policy issues, such as the savings, pension and protection gaps.

It is AIFA’s view that reform of the regulatory architecture will only be effective if there is absolute clarity of public policy outcome. CPMA needs to take responsibility for this clarity. It is essential that the public policy drivers are exposed, discussed, and presented as the key issues that need to be addressed.

As we see it the public policy agenda recognises that, as a nation we are under-saved, under-protected and under-pensioned. Yet, we are over indebted.

These problems reflect a range of factors:

- There has been a significant reduction in the number of advisers and direct sales forces to raise awareness and encourage take up of both savings and protection products with outlets such as banks diverting resources to credit products which have been more profitable (especially given the lower regulatory standards applied to their sale).
- Further, over the course of the last two decades there has been a decrease in consumer trust in the life and pensions industry, driven by “mis-selling” debacles and uncertain, and changing, government policy.
- Regulation has increased the cost of manufacturing and delivery of investment products. This, combined with government intervention (such as price caps on stakeholder products), has impacted the market in a way that makes it unprofitable for both providers and distributors to service small savers and investors on a mass scale.
- As a nation we have, over the course of the last decade, moved away from a position of valuing the role of savings and have become over-borrowed. The public developed a “love affair” with easy-access credit which was fuelled by clever marketing, especially for credit cards and personal loans, that captured the public’s imagination (and capitalised on a societal shift away from thrift to consumerism).
- The development of a regulatory system which has, through uneven application of its powers, delivered a retail financial services market which enabled far easier access to credit than any form of protection or investment.

The consequences of these trends are now clear to see. This wider public policy agenda therefore needs to be addressed in terms of helping consumers re-engage with their long term financial well-being and making more, and better, provision for themselves. We need to see the next decade become focused on the „enfranchisement of savings’



and a return to thrift and prudence – but regulation has a role to play in facilitating this journey. We also need to see consumers take on increased responsibility for their own financial future, as this will ultimately help yield the optimum outcomes for them.

It is therefore AIFA's view that additional statutory objectives in this area would clearly benefit consumers.

### Consumer responsibility

AIFA has strongly supported Mark Hoban's comments in recent weeks on consumer responsibility, but are concerned that the term consumer champion for the CPMA detracts from this important objective. We must be clear about the responsibility of all market participants in financial transactions.

Indeed we consider the wider issue of consumer responsibility to be an important factor within the regulatory architecture debate. AIFA's consumer research into this area suggests that consumers are more willing to accept responsibility for their decisions if their confidence in firms increases. This plays well into the Government's desire to build trust in the market. AIFA would like to see consumers embrace their responsibilities without in any way minimising the responsibilities that firms, the regulator and other agencies owe to them.

Consumer responsibility is not just about the “entry” level decisions people take (whether to engage or not) but also carries on into their interaction with the financial decisions they have taken. No one would buy a car and not have it regularly serviced, and so it is with financial services products: on-going engagement will yield better results than neglect.

General consumer protection laws and the industry regulator offer protection from rogue and fraudulent bodies and consumers' rights are widely championed. With rights, however, come attendant responsibilities and the change in the regulatory landscape provides a timely opportunity to define these more clearly in order to help consumers achieve optimum outcomes.

Tying closely in to this theme of consumer responsibility is the issue of the sector's lack of a long stop. Bringing financial services into line with the Statute of Limitations and introducing a 15-year long-stop would also encourage consumers to take more responsibility for their financial well-being. There is currently no need for consumers to check annual statements or to ensure that they have not been given wrong advice if there is no limit to the time-frame within which they can lodge a complaint. The absence of a long-stop implies that little or no responsibility at all lies with the consumer.

The introduction of a 15 year long-stop is fundamental to bringing financial services into line with other consumer-focussed industries and lifting the clouds of confusion as to where responsibilities lie. Indeed AIFA research shows consumers are in favour of such a move to. 75% of clients believe that there should be some time limit for IFAs to be legally responsible for advice given, of which 32% believe that the responsibility should end when the relationship between the client and the IFA ends.

Similarly YouGov research shows 73% of consumers believe that there should be a time limit for advisers to be legally responsible for advice, of which 23% believe that the time limit should end when the relationship between the IFA and client ends.

### Accountability and Transparency

AIFA welcomed last year's announcement of a greater role for the National Audit Office (NAO) and Public Accounts Committee in reviewing the Financial Services Authority. This is an important step in achieving greater transparency and accountability, and the necessary checks and balances on the regulator.

NAO audit will also allow for further parliamentary scrutiny as it will enable the NAO to investigate and report on aspects of the economy, efficiency and effectiveness of the CPMA's performance. Additionally AIFA is calling for the publication of Board minutes as a means of deepening accountability and transparency.

We also support the further proposed mechanisms to be set out in statute, notably:

- a requirement to produce an annual report to be laid before Parliament by the Treasury;
- a requirement to hold annual public meetings;
- a duty to establish consultative panels;
- a duty to maintain a complaints mechanism similar to that required of FSA
- decisions to be subject to appeals in the Upper Tribunal, and where appropriate reviews and inquiries

With specific regard to the "consultative panels" – namely the Practitioner Panel, the Smaller Business Practitioner Panel and the Consumer Panel – we fully support the important role they play, and especially welcome the proposed new statutory footing of the Small Business Practitioner Panel.

These panels play an important role in scrutinising the regulator's policies and we therefore question whether the panels in fact deserve even stronger powers to better fulfil this role in influencing and holding the regulator to account.

In terms of membership we would like to see the Panels continue to be made up of diverse representatives from across the industry to ensure a range of viewpoints are brought to the table. We also wish to see these Panels engage more deeply with the industry to ensure they fully understand the effects of the regulator's policies on the industry and in turn, consumers.

We also believe there is a wider role for the Treasury Select Committee to play in scrutinising the entire regulatory architecture.

### Governance of CPMA

We welcome the recent advertisement for a CEO Designate of the CPMA, and wish this had been commenced sooner. Whilst Hector Sants clearly has a „today role' at FSA there will come a point – which could even be now given the internal structures being put

in place – where we would worry that he was genuinely conflicted. An appointed CEO of the CPMA will add balance to this.

### Financial Services Compensation Scheme

AIFA support the work of the FSCS, and regard it as an essential consumer protection which benefits the wider financial services community. The proposed changes to the Financial Services Compensation Scheme are an interesting development given the current review of the funding model of the scheme. There are also three separate European directives/initiatives that impact on this area, and we are therefore seeking further clarification from the Treasury on how they see these strands interacting with their proposals.

While SMEs paying for bank defaults is entirely inappropriate, we believe cross subsidisation of providers in cases of product failings remains crucial in providing a safety net for consumers.

### Financial Ombudsman Service

AIFA has previously called for a review of the FOS. AIFA supports the role of an ADR scheme in the market, as we feel it offers a fair consumer check and balance. IFAs account for less than 2% of complaints at the FOS, unlike the four largest banks who account for over 50% of complaints.

AIFA feel that FOS operates in a quasi-judicial manner, as confirmed by Natalie Ceeney in her Treasury Select Committee evidence in October 2010. This admission only serves to highlight the need for a review of FOS – a quasi-judicial body, operating without the right of appeal is not an appropriate safe guard.

AIFA feels that greater consideration should be given to the use of FOS as a feedback mechanism to the regulatory structure, and whether there is merit, from a basis of economy of scale and resource sharing, in having an ADR service inbuilt into a regulatory. Whilst impartiality could be questioned, at present FOS does not share the confidence of the industry, nor have sufficient power in the eyes of some consumer groups, so this change could be of benefit to all. We would welcome further discussion on the re-focusing of the FOS back to a genuine ADR body better integrated into the regulatory structure.

### Cost / funding

The Consultation paper proposes that the CPMA, as the organisation with direct contact with all firms has responsibility for fee collection. However, we feel this could be taken further, by the establishment of a Common Services Department which would deal with issues such as fee collection, permissions, data collection, I.T., for all the regulatory bodies. The establishment of this Department would avoid duplication of costs in the aforementioned areas, whilst also ensuring simplicity for firms.

We are very concerned by overall cost - £50m as a transitional budget is potentially insufficient, yet still a considerable further sum to the industry. Whilst many other Government funded regulators are facing substantial cost pressure, the industry funded FSA is not and this needs to be considered carefully. IFA firms are already facing a barrage of costs due to regulatory changes in 2012, and we therefore call on Treasury to carefully consider all aspects of the costs of any changes, as well appropriate weighting towards different parts of the financial services sector; the cost of the RDR alone is equivalent to over £35,000 per „adviser’ in the UK.

AIFA would also like to continue the debate relating to the cost allocation model within the CPMA structure. AIFA has engaged heavily with FSA over recent months on this issue, including substantial work with external consultants. We feel that there are more appropriate allocation methods for the cost of regulation, and would welcome the opportunity to consider this further in light of the revised regulatory structures when they are confirmed.

#### European and international dynamics

AIFA supports enhanced co-operation between regulators at a European and international level. There has been some support for a more formal context for this co-operation, particularly for prudential matters, amongst our membership.

AIFA continues to believe that European regulatory powers are not sufficiently addressed within the architecture, and that lead regulators may not be most appropriate.

Of most concern is the split between PRA and CPMA of the three new European Authorities. It is proposed that CPMA will lead on ESMA related issues, whilst PRA will lead on EBA and EIOPA areas.

Whilst work such as Basel III and Solvency II are addressed by EBA and EIOPA respectively, and therefore appropriately sit with the PRA, there are much wider streams of work which fit less well. IMD and the associated work of the PRIPs initiative is also part of EIOPA’s work. However, whilst PRIPs will impact the conduct of business practices of all firms engaged in providing „investment’ advice in the UK to retail clients, the lead UK authority would be the PRA, not the CPMA. To have the prudential regulator as the lead authority on conduct of business related activity would seem wholly inappropriate.

We also feel there is much to be lost at a European level in coming years, as highlighted by Sharon Bowles’ letter to Vince Cable. It is crucial that the UK is best placed to achieve positive engagement in Europe in coming years, and clearly the PRA is not always necessarily the correct body for all interactions at EBA and EIOPA. We believe this area of the proposals needs further consideration.

## CONSULTATION QUESTIONS

### **The Bank of England and Financial Policy Committee (FPC)**

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

If the regulatory landscape is to be separated as proposed by the Government, it is crucial there be close and continuous co-operation between the new regulatory bodies. The objectives of the individual regulators also need to be clear but also relate to each other. History has shown us that failures happen when there are gaps in regulatory oversight, when regulators fail to co-operate or when they fail properly to fulfil their obligations.

To fulfil this, AIFA believes that each of the three regulatory bodies should formally benefit from each other's objectives as specified secondary objectives. We also question whether the interaction of MoUs and Chief Executive Board presence is in itself sufficient for cross-body cooperation. AIFA instead believes that the college of supervisors approach holds merit.

AIFA also believes that given the impact of any of the three bodies on consumer outcomes that each body should benefit from consumer and practitioner input.

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

As with the CPMA and PRA, we believe the FPC should have a secondary objective relating to oversight of social policy issues, specifically closing the savings, pension and protection gaps. This wider public policy agenda therefore needs to be addressed in terms of helping consumers re-engage with their long term financial well-being and making more, and better, provision for themselves.

We need to see the next decade become focused on the „enfranchisement of savings’ and a return to thrift and prudence – but regulation has a clear role to play in facilitating this journey. We also need to see consumers take on increased responsibility for their own financial future, as this will ultimately help yield the optimum outcomes for them.

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

We do not believe that „have regards to’ is strong enough when it comes to formulating these factors in legislation. We therefore call for them to be enshrined as statutory objectives.

## **Prudential regulation authority (PRA)**

### **4 The Government welcomes respondents' views on:**

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

We believe all three regulatory bodies should have regards to the objectives of each other, to ensure they are working in the same direction and towards common goals. We also agree that the principles for good regulation set out in section 2 of FMSA should be retained. These are good, solid principles which still hold value in regulation.

We agree that unconstrained requirements to have regards to the innovation and competitiveness of the UK financial services sector poses risks. However, we believe it is important to consider not just industry competitiveness, but more importantly consumer competitiveness. If the UK's competitiveness is affected, this will create a disparity which could lead to less-optimal product fulfilment from cross border, to the detriment of consumers.

As with the CPMA and FPC, we believe the PRA should have a secondary objective relating to oversight of social policy issues, specifically closing the savings, pension and protection gaps.

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

As we stated earlier in our response, we believe there is much merit in a college of supervisors to ensure integration between the three regulatory bodies.

It is also vital there are the appropriate checks and balances to hold the bodies to account. AIFA therefore supports permanent NAO and Public Accounts Committee involvement as a first-step in the necessary checks and balances on the regulator.

NAO audit will also allow for further parliamentary scrutiny as it will enable the NAO to investigate and report on aspects of the economy, efficiency and effectiveness of the CPMA's performance. We also believe there is a wider role for the Treasury Select Committee to play in scrutinising the entire regulatory architecture.

Additionally AIFA is calling for an independent and external audit of the new structure, as a means of deepening accountability and transparency.

We also support the further proposed mechanisms to be set out in statute, notably:

- a requirement to produce an annual report to be laid before Parliament by the Treasury;
- a requirement to hold annual public meetings;
- a duty to establish consultative panels;
- a duty to maintain a complaints mechanism similar to that required of FSA
- decisions to be subject to appeals in the Upper Tribunal, and where appropriate reviews and inquiries

We fully support the important role the Practitioner Panel, the Smaller Business Practitioner Panel and the Consumer Panel play, and especially welcome the proposed new statutory footing of the Small Business Practitioner Panel.

With regards to responsibility for authorisation and removal of permissions, AIFA believes that a common services department or organisation may produce economies of scale. The paper considers this when it discusses CPMA fee-collection, but this could extend further to authorisations or data collection. Clearly, however, any such department or organisation would need to adopt the standards/principles of which ever regulatory body's work it was undertaking.

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

We have no comment

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

We continue to welcome the role of the NAO, and PAC for all regulatory bodies. Because of the obvious and direct impact any organisation could have on retail consumers, we also believe that the use of Panels such as the Consumer Panel is valuable for all bodies. We also believe that there is a role for the Treasury Select Committee in this space, as a further check and balance.

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

We have no comment

**9 The Government welcomes views on the measures proposed in paragraphs 3.2 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.**

We have no comment

**Consumer protection and markets authority (CPMA)**

**10 The Government welcomes respondents' views on:**

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

Please refer to our answer to question four.

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

Please refer to our answer to question five.

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

We fully support the important role the Practitioner Panel, the Smaller Business Practitioner Panel and the Consumer Panel play, and especially welcome the proposed new statutory footing of the Small Business Practitioner Panel. These panels play an important role in scrutinising the regulator's policies and we therefore question whether the panels in fact deserve even stronger powers to better fulfil this role in influencing and holding the regulator to account.

In terms of membership we would like to see the Panels continue to be made up of diverse representatives from across the industry to ensure a range of viewpoints are brought to the table. We also wish to see these Panels engage more deeply with the industry to ensure they fully understand the effects of the regulator's policies on the industry and in turn, consumers.



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

The Consultation paper proposes that the CPMA, as the organisation with direct contact with all firms has responsibility for fee collection. However, we feel this could be taken further, by the establishment of a Common Services Department which would deal with issues such as fee collection, permissions, data collection, I.T., for all the regulatory bodies. The establishment of this Department would avoid duplication of costs in the aforementioned areas, whilst also ensuring simplicity for firms.

Whether this „services department’ can be integral to one agency, or should be a separate structure is debatable.

AIFA would also welcome further debate on the cost allocation models adopted within regulators. AIFA has conducted significant work in this area with FSA and would welcome an industry wide discussion on the most fair and appropriate method of cost allocation within the regulators.

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

Paragraph 4.45 indicates that the FSCS’s core business is compensating the more frequent failures of small firms such as IFAs. Whilst numerically there are more IFAs in the FSCS than banks, all previous data suggests the overall cost and value of such claims is very small. We would welcome the opportunity to view any new data which contradicts this.

When considering the scope of IFAs in the FSCS there are a number of issues to consider. The lack of a statute of limitations means that aside from bankruptcy, financial hardship or death, an individual IFA cannot enter the FSCS. It is fair to observe that many retire and stop trading, but this doesn’t mean they automatically end up in default and therefore the FSCS.

Secondly, the level of complaints against IFAs is very small – less than 2% of the FOS workload. Even if a business stopped trading, it would take a successful complaint before the FSCS would have to even consider whether it needed to compensate a consumer.

In recent years there are four key „core activities’ of the FSCS. These are bailing out depositors, payments relating to small stock-brokers and boiler room firms, payments relating to the failed product provider Keydata and lately single premium PPI claims for general insurance intermediaries. These are not IFA activities.

AIFA are aware of the three EU directives/papers currently under consideration, and feel that this debate needs to consider a wider agenda. We do not support pre-funding, particularly given the other costs being incurred by firms in these difficult times. However, the principle of the FSCS remains sounds and we support the last resort-backstop provided by the scheme.

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

## **Association of Investment Companies submission**

The Association of Investment Companies (AIC) is pleased to respond to HM Treasury's request for views. The AIC represents some 350 investment companies. These are closed-ended corporate vehicles which invest in a diversified portfolio of assets to secure an investment return for their shareholders.

Our members include UK-domiciled investment trusts, Venture Capital Trusts and non-UK (primarily Channel Island) investment companies. Investment companies are not directly regulated under the FSMA. As companies they are regulated by: company law (for UK companies the Companies Act 2006, for non-UK investment companies the relevant law from their local jurisdiction) and by accounting rules (UK GAAP and IFRS).

Where our members trade their shares on listed markets, which is the case for the majority of the sector, they also have to comply with the listing, disclosure and transparency rules. In the UK context these are created and overseen by the FSA in its role as the UKLA, but they are mainly derived from European Law, notably the CARD, Prospectus Directive and Transparency Directive. Other investment companies trade their shares on exchange-regulated markets, such as AIM.

The regulatory context for the investment company sector is changing. We anticipate that all investment companies will fall within the scope of the Alternative Investment Fund Management (AIFM) Directive. In due course they will therefore be subject to the oversight of the UK's designated competent authority, as required by the Directive.

### **Establishing an effective regulatory regime**

In making its recommendations the AIC has been guided by a number of key principles. These have included the need to:

- **Minimise complexity:** The new arrangements should seek to limit the lines of regulatory oversight and reporting. That is, regulation of the investment company sector should be in as few hands as possible. This will reduce scope for regulatory gaps and for problems to arise with coordinating separate elements of regulatory oversight.
- **Delivering regulatory coherence:** The reformed regime should seek to pool similar regulatory functions in the hands of the same regulator. This would include, for example, making the same body responsible for regulation of primary and secondary market issues.

- **‘Future proofing’ arrangements:** The broader regulatory environment is changing and the new framework must be able to deal with evolving regulatory demands. This would include engaging with the recently created pan-European supervisory authorities, such as ESMA, and the need to assume regulatory competence for the AIFM Directive.

## **Position of the UKLA**

The most significant issue for the investment company sector is the position of the UKLA. Our **recommendation** is that it should be located within the CPMA and not made the responsibility of the Financial Reporting Council (FRC). The AIC strongly supports the FRC in its role in setting accounting standards, overseeing the corporate governance framework and regulating audit practice. However, we do not agree that it is best placed to assume the responsibilities of the UKLA. Our reasoning for this position is set out below.

- Making the UKLA part of the CPMA will create a regulator with a coordinated and clear remit for regulating market activity. Its regulatory reach will cover both issuers and market infrastructure providers. This will allow ‘end to end’ oversight by one regulator and reduce the scope for regulatory gaps. A single markets regulator will allow intelligence about practice in one area to be quickly shared between regulatory functions and enhance the ability of the authority to deliver orderly and fair markets. Separating these two functions by giving the FRC responsibility for the UKLA will compromise effective regulation and reduce the scope for regulatory efficiencies to be secured.
- We anticipate that the FSA teams dealing with market issues will be transferred to the CPMA. The CPMA will therefore have specialist expertise in market issues and how they interact with the listing, disclosure and transparency rules. While it might be possible to allocate some of these resources to the FRC this is likely to be inefficient and expensive as it will dilute the expertise currently residing with the FSA and require the relevant skills to be duplicated. This is likely to lead to a less satisfactory regulatory outcome and not be cost effective.
- The FRC’s current role is focused on UK companies. In contrast, the UKLA oversees rules which apply to overseas companies and non-corporate vehicles (including, for example, open-ended unit trusts and limited partnerships, both of which can list). These broader policy responsibilities are outside the FRC’s core competency.
- In addition to the listing rules, the UKLA also administers the disclosure and transparency rules. While these regulations create obligations for the issuers of listed securities, they also regulate purchasers of those securities. For example, they require the disclosure of major shareholdings. Many of the entities which are required to disclose are regulated parties which already have a relationship with the CPMA. These relationships create the basis for a more effective regulatory relationship.

In contrast, the FRC will not have a broader relationship with these shareholders.

- The consultation paper moots the creation of a UK companies regulator (which could be facilitated by allocating the responsibilities of the UKLA to the FRC). This does not create a justification for locating the UKLA within the FRC. The case for, and remit of, a 'companies regulator' has not been made. Creating such a regulator would be a major shift in the regulation of UK companies. It is a move which deserves full and proper consideration. The current framework of company law is well established and relies on a network of legal obligations to creditors, shareholders and regulatory authorities. The Companies Act 2006 was the product of a lengthy review of current rules and sits within the overall context of the EU's company law directives. The creation of a companies regulator should not be contemplated without a clear justification and until the implications of its role are properly understood. Such a proposal should not be taken forward until there has been full feedback from the business and investor community. A decision of this nature should not be pre-empted by the merging of the UKLA with the FRC, particularly when the CPMA offers a better regulatory fit for the UKLA's existing functions.
- Investment companies, and other funds which may also list, market their shares/units to retail investors. Indeed, Venture Capital Trusts are almost exclusively bought by such private investors. This creates a natural overlap with the anticipated obligations of the CPMA. Also, impending consumer regulation from Europe on Packaged Retail Investment Products (PRIPs) will surely fall within the CPMA's remit. These measures are intended to create new obligations for pre-sale disclosure to private investors. These obligations will overlap with existing pre-sale disclosures, such as prospectuses. The UKLA has oversight of, and signs off, investment company prospectuses. Giving the CPMA responsibility for both PRIPs and the UKLA's role in approving prospectuses creates a strong regulatory logic. This will not be delivered by making the FRC responsible for the UKLA.
- Many of the regulations affecting UK markets and listed securities arise in Europe. Concentrating market issues (that is, regulation of the infrastructure and securities listed on them) in one authority will give the UK a stronger and more authoritative voice. Splitting the UKLA from the CPMA will compromise this. Of course, the FRC should also have a clear voice in Europe, particularly on governance and accounting agendas. However, the Department of Business, Innovation and Skills already acts as a strong sponsor for the FRC's views on these issues. We are also confident that the FRC would be able to work with the CPMA as appropriate. It will be easier for the FRC to have a strong policymaking role via these routes than for effective regulatory oversight to be delivered if the UKLA's functions are split from the oversight of market infrastructure.

## **Delivering the regulatory role set out in the AIFM Directive**

Changes in the regulatory landscape should take account of impending regulatory developments. Critical from the AIC's perspective is the forthcoming introduction of the AIFM Directive, which will create a new regulatory framework for investment companies. The AIC **recommends** that the CPMA is identified as the competent authority for the AIFM Directive. Key reasons include:

- We anticipate (and recommend) that the CMPA will assume the responsibilities of the UKLA. This will mean that investment companies have one primary regulator to deal with in relation to the two most significant pillars of regulatory supervision – the AIFM Directive rules and the listing and disclosure and transparency rules. This is particularly significant as a number of issues, such as disclosure to investors, are covered by both rulebooks. Of course, other regulatory mechanisms, such as company law and accounting rules, also govern investment companies. However, these requirements are not specific to the financial services sector and reside within a different, more general, regulatory framework.
- The CPMA will be responsible for regulating many Alternative Investment Fund Managers through other regulatory obligations, such as MiFID, as well as the AIFM Directive. It will create regulatory coherence for the CMPA to have oversight of both sets of regulatory requirements.

## **Maintaining a strong presence in European regulatory debates**

The volume of European legislation affecting financial services and capital markets is arguably higher than it has ever been. We anticipate that the current level of political attention devoted to this agenda will be maintained for the foreseeable future. The reorganisation of the UK's regulatory structures must not be allowed to distract from the essential task of representing the UK interests in relevant policymaking forums. There is a risk that the attention of senior officials and ministers will be focussed inwards on restructuring issues rather than outwards on responding to changes in the broader policy environment (or, indeed, on the ongoing supervision of financial institutions).

The AIC **recommends** that HM Treasury should prioritise ensuring that sufficient resources are devoted to relevant European policy debates during the planning and transitional period for changing the UK's regulatory arrangements. It should provide public reassurance that systems are in place to ensure problems of this nature will not be allowed to arise.

## **Timetable**

We note the intention to bring forward legislation in mid-2011. It is clear that regulatory restructuring is a priority for HM Treasury. However, there are significant issues to be resolved before the new regime is put in place. Also, the regulatory structure should be designed for the long term (the FSA lasted little more than ten years). The AIC would be cautious about legislating in

haste if this risked not fully considering all the ramifications of reform or left open the possibility that adjustments might need to be made to the regime at a future date. Our preference would be for a longer period of consultation and reflection if this were more likely to create a longer lasting and more stable regulatory settlement.

The AIC therefore **recommends** that the timetable for implementation be reviewed once consultation responses have been received and a fuller idea of the issues to be resolved has been established. We are confident that this will be well received by all stakeholders whose concern will be for a robust policy settlement rather than a swift resolution.

### **Comments on consultation questions**

The AIC's views on selected questions is set out below.

#### **Q. 4 The Government welcomes respondents' views on:**

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

Yes.

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

The AIC recognises that there is some debate over whether or not the PRA should adopt all the principles of regulation applied to the FSA, notably those relating to international competitiveness and innovation. However, the AIC is very supportive of adopting those principles which relate purely to good regulatory practice. Most significant of these is the need to ensure that regulatory burdens are proportionate to the benefits which are expected to result.

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

Yes, the model proposed is appropriate. Each regulator should be fully responsible for decisions within their remit. This will provide a clear line of regulatory accountability. An integrated model should not be adopted.

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

Yes.

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

Yes. Safeguards such as a requirement to consult with a practitioner panel and a duty to carry out a cost-benefit analysis are important mechanisms which should be maintained.

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

The current range of safeguards are appropriate.

**Q. 10 The Government welcomes respondents' views on:**

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

Yes.

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

Yes, a number of the FSA's principles of good regulation should be adopted by the CPMA. Particularly important is a need to ensure proportionate regulation. Also desirable is an obligation to facilitate competition between regulated parties. Whether or not the CPMA should support the competitive position of the UK is a more difficult issue.

There should be some scope for the regulatory environment to recognise that if the UK fails to attract business then these entities will not fall within the regulatory ambit of the UK authorities. This will reduce the impact of the UK's regulatory approach. Also, securing the UK's competitiveness need not mean a 'race to the bottom' for regulatory standards. Indeed, the AIC has previously argued for rules which go beyond the minimum required by Europe as higher standards can enhance market confidence and support the UK's competitive position. This suggests that some reference to the UK's international competitiveness would be appropriate, but it will be important to carefully frame this obligation to protect against the risks identified by the consultation (notably that the CMPA might become too 'light touch' a result of such a requirement).

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

See comments above.



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

The AIC supports the accountability mechanisms highlighted in the consultation paper. In particular, this would include the duty to establish consultative panels, including a Consumer Panel and Practitioner Panel. The CPMA should also be obliged to follow other principles of good regulation. This would include, for example, a clear framework for consultation and an obligation to provide cost benefit analysis as part of its policy development process.

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

The proposed panels should have a formal role in consulting with the CPMA on major policy initiatives. Where they identify and pursue issues, the CPMA should be obliged to respond publicly to their recommendations (which themselves should be made public).

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

The AIC supports creating a strong markets division within the CPMA to lead market conduct regulation and oversight of market infrastructure providers. It has no strong view on giving the Bank oversight of CCPs and settlement systems. The AIC also agrees that the CPMA should be the lead authority representing the UK in ESMA. Having one key point of contact will be important to maintaining a strong presence in critical European policy debates.

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

The AIC does not support merging the UKLA with the FRC. It recommends that the UKLA should be part of the CPMA (the policy arguments for this are explored in our introductory comments).

The AIC also queries the need and potential role of a 'companies regulator'. We recommend that, before any substantive moves are to be taken to create such a body, a full consultation on the role and objectives of such a regulator is undertaken. The possibility of creating such a regulator should not provide the grounds for pre-emptively placing the UKLA within the auspices of the FRC.

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

In the absence of any clear view as to what role a companies regulator would play, it is not possible to make a positive recommendation on this question. The case for a regulator has not been made and any policy in this area should be subject to full consultation before any action is taken.

**October 2010**



**ASSOCIATION OF LLOYD'S MEMBERS**

15 September 2010

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

Dear Sirs,

The Association of Lloyd's Members ("ALM") is a representative body for the providers of third party capital to Lloyd's and is a recognised market association. While membership of the ALM is voluntary, our membership comprises the majority of such providers. Third party capital is that provided by independent individuals, partnerships or companies that participate in a portfolio of Lloyd's syndicates managed by others. This contrasts with dedicated capital where the manager of the syndicate and the provider of the capital are part of the same corporate group. Third party capital provides some £3billion of capacity to the Lloyd's market, which is the cornerstone of the City of London's leading position in the global insurance industry. While smaller in scale than dedicated capital, it produces consistently superior returns and provides an important element of flexibility to this very important business.

At this stage we do not wish to make a detailed submission about policy and structure in the consultation document. We would like simply to comment on matters that have a direct impact on our members and their relationship with Lloyd's and its regulator. We acknowledge that third party Lloyd's members are unusual in that we both trade as part of a regulated entity, but also that, owing to significant inequalities in information and power, we require protection of our investor and minority rights. Because of the mutuality of the Lloyd's market, we also have a profound interest in its proper prudential regulation; it was third party capital that funded R&R to the extent of £3billion in the mid 1990s and other substantial deficits since then, predominantly arising from the failure of dedicated members.

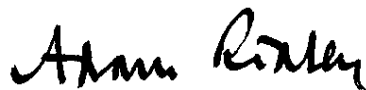
..../2

The ALM has benefited from consistently good relations with the FSA, and trusts that these will continue under the new structure. Nevertheless, we understand the Government's policy that financial stability and prudential regulation should be part of an integrated regulatory structure; and that prudential regulation and consumer protection should be undertaken by separate bodies. Lloyd's would appear to fall into both camps. In such circumstances, it is clearly important that one supervisory body should be the lead authority and given the distribution of Lloyd's business we believe the PRA would be a natural lead authority, although the CPMA would have important interests as well. That said, should there be intractable differences between the two authorities, it would seem wise that the FPC should have the final decision.

**The importance of consultation with market interests**

At this point in the reforms, we have one other extremely important concern about the process by which the development of the new regulatory structure will be undertaken. The ALM took an active part in the extensive consultation process that took the FSMA 2000 from legislation to an operational structure. We believe that input from market participants, including our own association, contributed significantly to the development of a successful *modus operandi* being achieved. Ensuring effective consultation in the present reform remains particularly sensitive in Lloyd's' case, where the potential for conflict of interest is greater than in other financial institutions. It is evident from Para. 5.25 of the consultation document that a similar procedure will be required to determine the precise way in which the two authorities will supervise Lloyd's and its members. The ALM would like to underline at this early stage that it looks forward to participating in the process. We are again ready to make a full contribution to the debate.

Yours faithfully,



**SIR ADAM RIDLEY**

for and on behalf of Dr Paul Kelly

18<sup>th</sup> October 2010

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Dear Sir/Madam

## **A NEW APPROACH TO FINANCIAL REGULATION**

The Association of Private Client Investment Managers and Stockbrokers (APCIMS)<sup>1</sup> welcomes the opportunity to respond to the HM Treasury consultation paper (CP) and to explain what the Government's proposals are likely to mean both for the firms operating in its constituency and for the hundreds of thousands of private investors who use their services. APCIMS concedes that the recent crisis has demonstrated the lack of focus, consistency and communication that lies at the heart of the tripartite system and we welcome proposals for enhanced regulatory measures aimed at those institutions whose business, scale and/or complexity gives rise to systemic risk. We do, however, believe that regulatory reform on the scale proposed carries its own dangers and, in this covering letter, we would like to outline some of our high-level concerns about the new regulatory structure envisaged in the CP.

### **In summary .....**

If regulatory reform is to deliver the looked-for benefits, APCIMS believes –

- that the new authorities' arrangements for engaging and interacting with European and other international regulatory bodies must be clarified at an early stage;
- that there must be a coordinated and consistent approach to regulation across the new authorities;
- that FSMA-style accountability mechanisms must apply to both the CPMA and the PRA;
- that the respective scopes of the PRA and CPMA must be established in such a way as to impose dual regulation only upon those firms whose business genuinely gives rise to systemic risk;
- that the integrity of UK market regulation must not be undermined by the consumer and political pressures arising from the CPMA's consumer protection role;
- that the CPMA's credibility, both domestically and internationally, relies on it operating as a strong independent regulator and not as a consumer champion;
- that CPMA regulation must differentiate between the various business models operating in the retail market and must not mirror the "one size fits all" approach that characterises FSA regulation;
- that the Government's desire to minimise uncertainty for firms during the transition to a new regulatory regime must not undermine the effectiveness of the consultation process; and
- that the importance of controlling regulatory costs must be recognised, not only during the transition to the new regulatory structure but also on an on-going basis.

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<sup>1</sup> APCIMS represents firms acting on behalf of investors. Member firms deal primarily in stocks and shares as well as other financial instruments for individuals, trusts and charities and offer a range of services from execution-only trading through to full portfolio management. Our member firms operate on more than 500 sites in the UK, Ireland, Isle of Man and Channel Islands, employing 30,000 staff. Around £400 billion of the country's wealth is under the management of our members.

## **International engagement**

Given the direct application of European requirements to UK firms and the impetus which the recent crisis has given to globally-coordinated regulatory initiatives, APCIMS is disappointed that the CP is relatively silent on how the Government foresees the new regulatory agencies operating in an international context and co-ordinating with the various European and international structures that have ever-increasing influence upon and authority over domestic businesses. While there are a number of general references to the FPC, PRA and CPMA working with organisations such as the FSB, BCBS, ESRB and ESMA, it is important that there be clarity at an early stage about how these relationships will be structured, maintained and managed and about how the UK agencies will seek to influence the policy objectives and development of such bodies with a view to safeguarding the best interests of domestic consumers and businesses.

## **Co-ordination and consistency across the regulatory system**

The CP states that the most obvious failing of the current UK regulatory system is that *no single institution has the responsibility, authority or powers to monitor the system as a whole, identify potentially destabilising trends and respond to them with concerted action*. We are, therefore, surprised that the CP does not do more to make clear how the FPC (the most obviously senior of the three new regulatory entities) will fulfil this role. While the document outlines the new regime's *crisis management strategy* and the general means by which the FPC will influence the activities of the other agencies, it does not identify which organisation will be responsible, on a day-to-day operational basis, for ensuring the overall cohesion and consistency of UK financial regulation policy or for "knocking heads together" in the event of regulatory "turf wars" or inconsistencies between different bodies' policies/priorities. Many APCIMS members consider that the FSA struggles at times to deliver a co-ordinated and consistent approach to regulation across its own internal divisions and functions – given this, we believe that mechanisms aimed not only at ensuring effective coordination across the new authorities but also at determining which body takes ultimate responsibility are of enormous importance.

## **Accountability mechanisms**

We welcome the clear statements in the CP that the CPMA's rule-making function will be subject to statutory processes of consultation and cost-benefit analysis and that other accountability mechanisms will apply to the CPMA's general operation. While APCIMS has concerns about how effectively some of these mechanisms have operated under FSMA, we believe that they are an essential part of any regulatory structure, enabling regulators to benefit from the practical knowledge and experience of firms, consumers and other parties and helping to foster better relations between regulator and regulated. Given this, we are concerned by the suggestion that the Government is considering whether such mechanisms are actually required for the PRA. Although the CP goes to some lengths to stress the PRA's operational independence and to outline the measures aimed at ensuring its accountability to Government, Parliament and public, we believe it is essential that mechanisms are put in place to allow for effective input by the firms which will both be subject to PRA regulation and fund its operation.

## **PRA and CPMA scope**

In its early remarks about how FSA-regulated firms will fit into the proposed PRA/CPMA environment, the CP is deceptively straightforward with the PRA *responsible for prudential regulation of all deposit-taking institutions, insurers and investment banks* and the CPMA having *responsibility for the conduct of business regulation of all financial institutions* and the *prudential regulatory framework for all financial institutions not regulated prudentially by the PRA*. However, subsequent references coupling *broker dealers* with *investment banks* and to the PRA overseeing the regulated activity of *dealing in investments as principal* muddy the waters and open up the possibility that many firms whose

activities are not systemically significant (including a large proportion of those in APCIMS' membership) may end up bearing the significant costs of dual regulation. APCIMS believes that determining the respective scopes of the PRA and CPMA by dividing the existing "regulated activities" between them is an overly simplistic approach which will need to be reconsidered if the PRA's *significant prudential regulation* is only to apply to those firms whose activities, size and structure are genuinely likely to give rise to systemic effects.

### **Integrity of market regulation**

APCIMS welcomes the Government's recognition of the crucial importance of market activities to the UK's financial system and global position and the consequent need for *a stable and credible framework for market regulation which promotes confidence in the stability, integrity and efficiency of financial markets in the UK*. While the decision for this function to be undertaken by the CPMA can undoubtedly be made to work, we believe that this will require the adoption of formal mechanisms aimed both at augmenting the operational autonomy of the Markets Division within the CPMA (for example, a dedicated sub-Board and Practitioner Panel) and at ensuring that market regulation is not overtaken by the consumer and political pressures that seem likely to influence the CPMA in its stated role as *a strong consumer champion in pursuit of a single objective*.

### **CPMA: strong consumer champion**

While it is absolutely right that the CPMA's primary objective should focus on regulating the conduct of firms with a view to protecting consumers, the idea of a regulator acting as *a strong consumer champion* does not sit well with general democratic expectations about the objectivity, independence and impartiality of bodies placed in positions of regulatory authority. Indeed, we find it hard to understand why the argument which the CP makes for the independence of the FOS (namely that *its legitimacy in making rulings which are binding on firms is only credible if it does not favour, or appear to favour consumers*) should not be even more pertinent to the CPMA in its role as a regulator.

Whatever name the currently-provisional "CPMA" ends up bearing, it is important that the legislation establishing the organisation, its objectives and its structure recognises the interlocking and mutually-dependent rights, duties and responsibilities of those who provide and those who use financial services. FSMA section 5 refers to the extent of consumer protection being modulated by reference to *the general principle that consumers should take responsibility for their decisions*. APCIMS firmly believes that whatever statute replaces FSMA must also adopt this principle if it is to recognise the importance of striking an appropriate balance between the rights and responsibilities of the various parties to a financial transaction.

### **CPMA: regulating for different sectors**

While it makes sense for all activity which involves the provision of financial services to private individuals to be regulated by a single body, APCIMS firmly believes that the single most important aspect of the CPMA's consumer-focussed activity is how regulation differentiates between, and is applied appropriately and proportionately to, the wide variety of business models operating in the retail market.

Consequently, we consider it essential that the CPMA takes a thorough-going sector-specific approach to its retail regulatory duties, assessing each sector from a position of deep understanding and knowledge and applying regulatory requirements in a way which reflects the risks inherent in each sector's business accurately and proportionately. The FSA's undifferentiated, "one size fits all" approach to delivering retail regulation, as shown in initiatives like Treating Customers Fairly and the Retail Distribution Review, has resulted in frequent

criticism from APCIMS firms that, not only does the FSA not understand their business models, but that regulation is placing the continued existence of such models under threat.

APCIMS believes that the CPMA could be an effective and beneficial aspect of the new regulatory environment so long as the promise of *a focused and specialised approach to all aspects of conduct regulation* is achieved. We have strong views about how the CPMA could most effectively pursue a sector-specific approach to regulation and would very much welcome an opportunity to discuss these with HM Treasury or provide additional information on this issue at an appropriate point in the consultative process.

### **The timetable for regulatory reform**

The implementation timetable outlined in Chapter 7 of the CP is an extremely ambitious one. While the objective of minimising uncertainty for regulated firms is laudable, we believe that the consultation process offers an exciting opportunity to remedy many of the ills of the current regime and to ensure that the legitimate concerns of all those likely to be impacted are taken into account. Consequently, while noting the Government's commitment to *a full and comprehensive consultation process*, we are concerned that the transitional measures outlined in the CP may undermine that process. The fact that the FSA will introduce a *shadow internal structure* from Q1 2011 and that an interim FPC will be established by autumn 2010 indicates the pursuit of pre-determined outcomes and raises questions about whether the views of respondents will ultimately have any meaningful influence over the proposals.

### **Controlling costs**

The CP states that, during transition to the new regime, regard will be had to a number of principles including the need to minimise transitional costs for firms. We believe that this principal must apply not only to transition but also to the operation of the new regulatory system on an on-going basis. Recent years have seen significant increases in regulatory expenditure and firms are rightly concerned about how costs will be controlled in a multi-regulator environment; indeed, we believe that sustained efforts will be needed to ensure that arrangements aimed at securing operational coordination between the FPC, PRA and CPMA do not simply translate into additional bureaucracy and increased regulatory overheads. The CP states that most FSA-regulated firms will be regulated solely by the CPMA in future and we believe that this should, assuming a sensible resolution of PRA/CPMA scope issues, include virtually all APCIMS members. Notwithstanding the CP's assurance that *these firms are unlikely to suffer any significant transitional costs or significant increases in ongoing costs as a result of the reforms*, we believe that great vigilance will need to be exercised if firms (and ultimately consumers) are not to be burdened with considerable additional costs both during and after the transitional period.

In the appendix to this letter, APCIMS responds to the questions listed in the CP and provides comments on other issues raised. APCIMS is keen to contribute as fully and effectively as possible to HM Treasury's on-going consultation work and would be happy to provide any further information required about its member firms or about how the future regulatory structure is likely to impact upon them and their clients.

Yours faithfully



Sarah McGuffick  
**Regulatory Consultant**



APCIMS' RESPONSE TO HM TREASURY CONSULTATION QUESTIONS

THE BANK OF ENGLAND AND THE FINANCIAL POLICY COMMITTEE (FPC)

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

While there is something initially attractive about the FPC being given a clear and succinctly defined remit, we believe that the proposed primary objective outlined in 2.24 is too blunt a mission statement for a body with such wide-ranging and significant powers. Consequently, we support the inclusion in legislation of secondary factors that the FPC must take into account in fulfilling its macro-prudential role.

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

We believe that, in pursuing its primary objective, the FPC should be obliged to consider and appropriately balance issues of the following type -

- the wider societal impacts of its use of certain macro-prudential tools (e.g. overall access to the housing market and the general availability of credit);
- the wider economic impacts of its use of certain macro-prudential tools (e.g. the ability of UK firms to export their products/services and to compete more generally with their peers overseas);
- the statutory objectives of the PRA and CPMA; and
- the extent to which its activities will require direct regulatory action by the PRA/CPMA

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

APCIMS believes that the secondary factors identified as being relevant to the FPC's wider role should take the form of secondary statutory objectives. From its experience of FSA policy development and consultation practices, it is APCIMS' view that, in pursuing an increasingly rigid and mechanistic approach to the FSMA section 2(2) regulatory objectives, the FSA has largely ignored the “have regard” factors listed in FSMA section 2(3), making use of them only when a reference to proportionality, innovation or competitiveness has been expedient for its own purposes. Consequently, if a regulator (whether the FPC, PRA or CPMA) is to be required to assess and balance other factors when pursuing its primary objective, that duty should be imposed in a way that cannot be side-stepped or satisfied by the use of barely-considered boilerplate language but which necessitates informed and reasoned judgements. For this reason, we believe that forms of words of the “have regard to”, “be mindful of”, “obliged to consider” variety are inadequate and that secondary factors should have the formal status of statutory objectives, albeit clearly subservient to the organisation's primary objective.

As mentioned above, we believe that the FSA has pursued an overly rigid, tick-box approach to pursuing its statutory objectives and that this inflexibility is one of the major reasons why the FSA failed to identify the market developments giving rise to the crisis or to respond to them in a timely and effective manner. Consequently, we believe that future legislation must place an emphasis on the importance of regulators balancing pursuit of their primary objectives with a

need for detailed and careful consideration of their secondary objectives and on the need for the way in which an organisation pursues its various objectives to be sufficiently risk-reflective to take account of what is happening in the wider economic environment. Obviously, there may be very exceptional situations where the ability of a regulator to take immediate action in pursuit of its primary objective without the constraints routinely imposed by consideration of its secondary objectives is of paramount importance. Is it not possible that the Chapter 6 crisis management strategy could provide a mechanism for determining the circumstances in which consideration of secondary objectives might be temporarily jettisoned in order to allow an authority to focus all its energies on achieving its primary purpose?

#### PRUDENTIAL REGULATION AUTHORITY (PRA)

#### **4. The Government welcomes respondents' views on:**

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

For the reasons outlined above in response to Q3, APCIMS believes that the PRA's primary objective should be supported by a range of subordinate factors with the legal status of secondary statutory objectives. Amongst these secondary statutory objectives, we consider that –

- the PRA should be required to have regard to the primary objectives of both the FPC and CPMA – as the CP indicates, a cross-referral mechanism of this type will *facilitate close cooperation and coordination between the three organisations* albeit at a very high level and will assist in maintaining the due balance between their primary objectives which is essential for the UK's overall economic well-being.
- all of the principles for good regulation currently listed in FSMA section 2(3) should be retained for the PRA. More specifically –
  - we see no reason why any regulatory body (whether in the financial services sector or elsewhere) should be free to exercise its authority without regard to criteria of the type found in FSMA section 2(3) (a) to (c). It is indeed a matter of good regulatory practice that a regulator should use its resources in the most efficient and economic way and that the burdens imposed on a person by way of regulation should be proportionate to the benefits expected to result and we can think of no reason why the Government should even question whether these requirements should extend to the PRA.
  - we also see no justification for the PRA not having regard to the desirability of facilitating financial innovation, of facilitating competition between regulated firms and of maintaining the competitive position of the UK. The CP refers to the UK financial system as *one of the most open, globalised and successful in the world* and implicitly recognises the importance to the country as a whole of maintaining the UK's position as a world leader in financial services – if this is to continue to be the case, the Government and all of the authorities within the new regulatory structure must ensure that, in pursuing their response to the financial crisis and in coordinating policy approaches with EU and global authorities, they do not act in ways which reduce the overall attractiveness of the UK as an international financial centre.

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

As per the comments in our covering letter, we believe that more work is required not only to clarify the respective scopes of the PRA and CPMA but also to determine whether these scopes are best defined by reference to the existing range of “regulated activities”, virtually all of which may have both prudential and conduct impacts. It seems to us that any attempt to impose a crude prudential/non-prudential divide onto a RAO framework that was never developed for this purpose is likely to result in operational overlaps and inconsistencies and also to overlook the fact that what is most important for systemic purposes is not which regulated activities a firm has permission to undertake as the extent to which it makes use of them. So, for example, while many APCIMS firms hold permission to deal as principal, they tend to do so only occasionally, in small size and so as to facilitate client business, not with the objective of running in-house positions across wide-ranging principal trading books in the way that investment banks do.

More generally, the idea that a firm should pass through two wholly separate authorisation and permission regimes in respect of its prudential and non-prudential activities is nonsensical as is the idea that its staff (who may well be the same for activities on either side of the prudential/non-prudential divide) should go through two separate approved persons processes. As well as having to fund two authorisation/approval regimes *and associated systems, controls and processes* through regulatory levies, firms would also face the possibility of their business being unnecessarily constrained in instances where the PRA/CPMA were unable to reach a swift decision on an issue of mutual concern. APCIMS believes that, rather than these processes being made the responsibility of one authority, there could be benefits to a joint service company operating between the PRA and CPMA to cover not only all activities relating to the authorisation of firms, granting of permissions and approval of individuals but also a wider range of administrative functions (see our response to Q13 below).

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

The CP refers to the Government putting in place a legal framework for the PRA that underpins *a new, more judgement-led style of prudential regulation* in which *supervisors should focus more on understanding institutions’ business models and strategies, with greater discretion to investigate and tackle risks and vulnerabilities within individual firms*. This begs the question of how legislation which is necessarily drafted at a reasonably high level, setting out the required functions and powers of a regulator, can ever be specific enough to determine the way in which regulation is actually applied by supervisory staff in their day-to-day interaction with firms. It is altogether too simplistic to suppose that Government legislation *to divide the powers and functions set out in FSMA into separate standalone prudential and conduct regulation frameworks* will establish a legal framework underpinning *a more informed and judgemental approach to regulation*. The latter will rely on the regulatory authorities being able to develop regulatory strategies and models that are based on a clear understanding of both firms’ business and the markets they operate in and to recruit and train staff who are able to reach informed, reasoned and consistent regulatory judgements. Given that it is the view of many firms (including those within the APCIMS community) that this is something that the FSA has singularly failed to achieve, it would be useful to understand how the PRA’s more risk-based, judgement-focussed approach to supervision is expected to manifest itself and what controls will be put in place to ensure both the quality and consistency of supervisory judgements.

7. ***Are safeguards on the PRA's rule-making function required?***
8. ***If safeguards are required, how should the current FSMA safeguards be streamlined?***

APCIMS believes that the PRA's rule-making powers should be subject to the full range of statutory disciplines currently provided for in FSMA. In relation to the CPMA, paragraph 4.20 refers to the rule-making function being subject to *statutory processes, including consultation with statutory panels ... wider public consultation ... the duty to carry out detailed market failure analysis and cost-benefit analysis prior to the introduction of any new rules*. We see absolutely no reason, given *the quasi-legislative rule-making function of the PRA, including the power to raise levies from firms*, why PRA rule-making should not be subject to the same processes. We firmly believe that regulation benefits from and is strengthened by the knowledge, experience and technical expertise of those involved in providing and using financial services. If regulatory authorities are left free to choose whether, when and how they engage with the industries they regulate, the result is likely to be that regulatory policy will be driven by media-generated scares and political imperatives, without due regard for appropriateness or proportionality.

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

As per the comments in our covering letter, we believe that the operation of the PRA should be subject to the same range of accountability mechanisms as proposed for the CPMA in 4.36. Consultative panels, complaints mechanisms, arrangements for appeals of regulatory decisions and the potential for statutory reviews and inquiries are all important in ensuring that a regulator is both subject to on-going challenge in the way it carries out its activities and in a position to learn from regulatory failings either on its own part or on the part of its regulated firms.

#### ***Additional comments on PRA issues***

Besides our responses to Qs 4 to 9 above, APCIMS would like to offer a number of additional comments on the CP's contents in this area as follows -

- Box 3B sets out the formal processes through which PRA/CPMA coordination is to be achieved and for which the Government intends to legislate. While effective cooperation between the authorities is essential to ensuring that regulated firms are not unnecessarily burdened by operational duplications and inconsistencies, we have some concerns about the proposals in Box 3B -
  - beyond the fact that some of the proposed mechanisms (e.g. supervisory colleges and information gateways) will take considerable time to establish and embed, we also query whether such a wide variety of interacting mechanisms may end up being bureaucratic and duplicative as well as encouraging "turf wars" over which body assumes which responsibilities. Referring to the comments in our covering letter, we believe that it needs to be clear from the outset not only what coordination arrangements will be put in place but also which body will be ultimately responsible for their effectiveness and how individual authorities will be held to account as regards their performance in this area. Accountability is key.
  - in combination with 4.29, the last bullet in Box 3B seems to indicate that the CPMA is already regarded as a subordinate regulator to the PRA. Given both the breadth of the CPMA's remit and its responsibility for all matters pertaining to market regulation, we believe that the proposed requirement for the CPMA to consult the PRA and take its advice in relation to firm-specific financial stability issues should also operate in reverse so that the PRA is obliged to consult the CPMA about firm-specific prudential issues that may have wider impacts on the operation of markets and the activities of other market participants under the CPMA's aegis.

- 3.24 states that *the Government generally expects that, as part of its new judgement-based approach, the PRA will seek to reduce and simplify the rules and guidance contained in what is currently the FSA handbook*. We query how this expectation sits vis-à-vis the admittedly *unrealistic assumption* in the Preliminary Impact Assessment that *no changes will be made to the rules etc. of the regulatory bodies*. We would also note, in relation to both the PRA and the CPMA, that even “simplifications” of regulatory provisions may entail change and therefore costs for regulated firms; this being the case, they must be subject to the standard processes of consultation and cost-benefit analysis that currently apply to all other amendments to formal rules.

## CONSUMER PROTECTION AND MARKETS AUTHORITY (CPMA)

### **10. The Government welcomes respondents’ views on:**

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

As per our response to Q4 above, APCIMS believes that the CPMA’s primary objective should be supported by a range of secondary considerations with the legal status of secondary statutory objectives. In particular, we believe that –

- the CPMA should be required to have regard to the primary objectives of both the FPC and PRA.
- in line with our earlier comments on the PRA, all of the principles for good regulation currently listed in FSMA section 2(3) should be retained for the CPMA. While we agree that the UK’s regulatory authorities should not be considered *responsible for the innovation and global competitiveness of the industries they regulate*, we believe that they should certainly be required to consider these issues in carrying out their statutory duties. The activities of regulators are capable of having major and lasting impacts not only upon firms’ day-to-day business but also upon their long-term planning about where they base their operations, where they employ the bulk of their staff and which markets they access. These issues are of vital importance to the UK’s continued prominence as a financial centre and the idea that the problems emanating from the recent financial crisis can best be addressed by downplaying the significance of innovation and competition issues is, we believe, extremely short-sighted.
- certain of the “public interest” factors identified in 4.12 may not be necessary or appropriate to the CPMA’s role. In particular, we would suggest that -
  - *promoting public understanding of the financial system* is now the task of the Consumer Financial Education Body (CFEB) and that, while the CPMA and CFEB will have to collaborate closely on consumer protection and education issues, the CPMA should not effectively be required to duplicate the CFEB’s role.
  - *promoting financial inclusion .... by encouraging access to suitable products and services* is also a more appropriate task for the CFEB than for the CPMA given that previous regulatory efforts aimed at bolstering the supply of “suitable” mass-market consumer products (e.g. via the stakeholder product and basic advice regimes) have met with limited success.

- including consumer-facing public interest factors amongst the CPMA’s objectives may end up imposing unintended constraints on its market-related activities given that the CPMA will be the regulator not only of *retail conduct of business* but also of *market conduct where firms and others (particularly corporate client of financial services firms) participate in dealings in wholesale financial markets*.
- the CPMA should be required to have regard in some way to how any regulatory failure on its part impacts upon the interests of both consumers and firms. While we believe that a “zero failure” regulatory regime is neither a practicable nor particularly desirable objective, there is a view commonly held amongst APCIMS firms that the very sizeable amounts that they have recently had to pay in FSCS levies have derived in part from the FSA’s failure to monitor, investigate and act sufficiently quickly against the activities of certain firms. As with other organisations, it is inevitable that regulators will sometimes fail to perform to the expected standards – however, where this is the case, the legitimate concerns of the regulated firms that end up bearing the costs of such failures might be assuaged to some extent if there were a meaningful process for identifying and addressing the causes of such failings with a view to preventing their recurrence.

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

The accountability mechanisms outlined in 4.36 together with the statutory processes applying to the CPMA’s rule-making functions outlined in 4.20 are fairly much a mirror-image of the current statutory disciplines applicable to the FSA under FSMA. While, as listed, they appear to provide a suitably wide-ranging set of safeguards vis-à-vis the CPMA’s role, the most important issue from a practical perspective is ensuring that they are rigorously and effectively applied.

With this in mind, we would like to draw attention to the concern felt by many in the industry about the inadequate way in which certain of the existing statutory mechanisms are deployed. While FSMA currently makes provision for consultation and cost-benefit analysis, many stakeholders remain unconvinced about either the commitment with which the FSA pursues these processes or the extent to which their outcomes actually influence FSA activity. It is a common view amongst regulated firms that –

- FSA consultation papers too often give the impression of documents issued solely to obtain a tick against statutory requirements – in instances where the FSA has already decided its future approach, consultation questions restricted to only the most anodyne aspects of the proposals or clearly framed with a view to eliciting only positive responses (e.g. along the lines of “Do you agree that the proposed requirement for ABC will have the positive effect identified in XYZ?”) make it clear that consultees’ responses disagreeing with FSA proposals will be largely disregarded.
- FSA cost-benefit analyses are often so lacking in specificity and so light on supporting evidence that they engender no confidence at all. Even in instances where very considerable costs are identified, these are too often “justified” on the basis of benefits which are both nebulous and uncertain – for example, in seeking to justify the very significant costs arising from the RDR initiative, the FSA opined that *many consumers are expected to be significantly better off under our proposals because these would improve the quality of advice, reduce the incidence of mis-selling, and lead to increased persistency* without any attempt to quantify such benefits or any recognition that its proposals might not in fact have their desired effect.
- the FSA has in a number of instances effectively side-stepped its statutory responsibilities by significantly re-engineering its policy and supervisory approach to an area without changing Handbook requirements. To give a retail market example, the FSA’s TCF initiative has resulted in firms having to meet a wide range of detailed, costly and high-

impact regulatory expectations even though no rules have been added to the Handbook and no consultation or cost-benefit process has been gone through. We are not saying that the TCF initiative is without merit but it is certainly the case that it has been developed outside of the statutory disciplines in accordance with which the FSA is supposed to wield its powers.

In providing these examples, APCIMS is not seeking to downgrade the importance of consultation and cost-benefit analysis as accountability mechanisms. On the contrary, we believe that they are essential to the effective and co-operative functioning of any regulatory system and that, in future, greater efforts must be made to ensure that they have a meaningful impact on regulatory outcomes and that they are not conducted simply for form's sake as often seems to be the case at present. Having said this, we do recognise that there may be exceptional circumstances where consultation is neither practicable (e.g. where the Chapter 6 *crisis management strategy* comes into effect) or appropriate (e.g. where the FSA is implementing European legislation on a pure "copy-out" basis without any additions or refinements of its own).

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

We welcome the decision to retain the Consumer Panel and Practitioner Panel as currently required under FSMA and to give a statutory basis to the Small Business Practitioner Panel. As is currently the case, we would see the remit of each of the Panels being to represent the interests of their relevant constituencies and to provide input to the CPMA aimed at helping it to meet its own objectives, however framed.

While it is self-evident that each of the Panels should aim to include within its membership a wide range of individuals with a view to covering as many different elements of their respective constituencies as possible, it may be that some of the Panels should "reserve seats" for specific bodies or sectors that are of particular significance for the whole constituency. Just as FSMA section 9 currently requires the Practitioner Panel to include persons representing recognised investment exchanges and clearing houses, should the Consumer Panel, for example, have a reserved seat for the CFEb or for more general consumer advisory services like the Citizens Advice Bureau?

The issue of whether the CPMA Practitioner Panel should, as per its FSA predecessor, have specific RIE representation also begs the question of whether a single Practitioner Panel will be able to operate effectively across the two distinct areas of the CPMA, one focusing on firms' conduct in dealing with retail consumers and the other on market conduct. Further to the comments in our covering letter regarding the need for formal measures aimed at augmenting the operational autonomy of the CPMA Markets Division, APCIMS believes that the CPMA should, in fact, have two Practitioner Panels, reflecting the operational divide between retail and market conduct regulation. While there would undoubtedly be some types of firms with an interest in both (e.g. retail stockbrokers providing investment advice to individual clients but also trading in the markets as exchange members), a divide would help to ensure that the Practitioner Panels provided more detailed and focused input to the CPMA.

As regards how input provided by the Panels is taken into account by the CPMA, we wonder whether legislation needs to provide a more effective mechanism for the Panels to formally lodge notice of concerns or misgivings about the way in which the CPMA operates. We understand that the current FSMA mechanism - whereby the statutory Panels can make formal representations to which the FSA must have regard and to which the FSA must respond in writing if it disagrees with the views expressed or proposals made therein - has never been used. Given the number of occasions upon which the Panels have expressed significant concerns about FSA strategy, policy and proposals, this is somewhat surprising and seems to suggest that

formal representations of the kind provided for under FSMA sections 9 to 11 are considered altogether too “nuclear” an option to ever be exercised.

More generally and beyond the formal operation of the Panels, we would like to mention the benefits that might flow from enhanced practitioner involvement across the CPMA’s activities. As well as assisting the organisation as a whole to a more informed and nuanced understanding of how different types of firms and markets operate, practitioner involvement can also be beneficial in terms of delivering practical, “hands on” training for regulatory staff and in providing the regulator with early warnings about questionable activities or behaviour on the part of regulated individuals or firms.

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

While it would certainly make more sense in administrative terms for only one body to be responsible for collecting all regulatory fees, we query whether this task should be loaded onto the CPMA given its already extensive remit. In our response to Q5 above, we suggested that a joint service company might operate between the PRA and CPMA to cover authorisation and approval processes and to act as an administrative hub, providing common and streamlined resources for functions such as IT and finance. Such an entity could also provide a central solution to the task of collecting regulatory fees and levies across the range of bodies mentioned in 4.42. Beyond acting as a collecting agent, it is possible that such an entity could also add value by overseeing budgetary processes for all the bodies using its services and by ensuring that inconsistent and duplicative costs are kept to a minimum.

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

On the basis that its member firms have historically paid disproportionate FSCS levies to finance compensation bills arising from failures in other industry sectors (e.g. pensions mis-selling and mortgage endowments), APCIMS has generally argued for cross-subsidisation to be kept to a minimum and for funding groups to be narrowly-defined. Given this, we would tend to support the 4.47 option so long as greater efforts were made to define funding groups in a way which genuinely reflected the nature of and risks inherent in firms’ business models – as we state in our covering letter, one of the most important aspects of the regulatory reform programme for the APCIMS community is that the CPMA’s promised *focused and specialised approach* results in regulation that differentiates between, and is applied appropriately and proportionately to, the wide variety of business models operating in the retail market. As regards the 4.46 option, it seems to us that the idea of separate PRA and CPMA compensation schemes is inherently problematic in respect of dual-regulated firms - if such a firm fails, it seems very likely that the prudential and conduct-related causes of its failure will be virtually impossible to disentangle with any degree of speed or precision and that there will, therefore, be a great deal of uncertainty about how compensation costs should fall upon the PRA and CPMA schemes respectively.

More generally, we believe that the relative merits of the options presented in 4.46 and 4.47 are extremely difficult to assess in an environment where there are major changes, both in progress and in prospect, to the way in which the FSCS operates. As well as the FSCS going through large-scale operational changes with a view to its being able to deliver faster payout in the event of deposit failures, we are aware that the FSA is working on a major review of the FSCS funding model at the present time and that there is also work being undertaken in Europe which may result in significant restructuring of redress arrangements (e.g. by requiring pre-funding mechanisms). Given this, we believe that any decision on the legislative provisions covering



compensation arrangements must not only take full account of the FSA funding model review but must also incorporate sufficient flexibility to accommodate future European requirements.

Finally, as referred to in our response to Q10, we believe that greater efforts must be made to ensure that regulatory arrangements for supervision, investigation and enforcement are such as to ensure that those firms whose activities are most likely to result in claims for redress are identified and acted against in an effective and timely manner. There is currently a concern amongst APCIMS members that the very significant compensation levies they face for the failure of firms like Pacific Continental Securities and Keydata Investment Services are too readily accepted as the price that the industry has to pay for the FSA's repeated failure to act speedily and decisively on long-held regulatory concerns.

### ***Additional comments on CPMA issues***

Besides our responses to Qs 10 to 14 above, APCIMS would like to offer a number of additional comments on the CP's contents in this area as follows -

- 4.15 outlines the CPMA's prudential role in respect of firms not prudentially regulated by the PRA, indicating that it will *write the prudential regulatory framework for those firms*. On this point -
  - we are concerned that "write" should not mean "re-write" – unlike many of the retail product advisers within the CPMA's remit, APCIMS firms are subject to the CRD, holding significant regulatory capital and being subject to detailed systems and controls and risk management requirements. Given that the regulatory framework covering our member firms' prudential requirements is clearly established by European directive, there should be no question of their being impacted by the prudential requirements that the CPMA imposes on its non-CRD firms.
  - it is essential that the high-level identification of the PRA as the prudential regulator does not result in it automatically assuming all of the FSA's current policy and supervisory expertise, both as regards prudential matters generally and the operation of the CRD specifically. The process of implementing both the CRD and subsequent changes to it has been a significant task for our firms and has involved APCIMS in ongoing dialogue with FSA staff in a bid to ensure that requirements designed to address concerns in the banking sector are applied appropriately and proportionately to smaller scale investment firms conducting agency business. Consequently, we consider it imperative that the CPMA retains at least some of the knowledge which FSA staff have developed over the last few years about how CRD prudential requirements can best be applied to our sector.
  - we query how prudential issues falling within the CPMA's remit will be catered for in the representative arrangements between UK and European regulatory bodies. The CP refers to the PRA representing the UK on the new supervisory authority for banking but says nothing about how the PRA and CPMA will coordinate in order to ensure that the prudential interests of those firms regulated solely by the latter are taken into account – it is essential that this issue is resolved if investment firms are not to be burdened by inappropriate bank-centric regulation.
- 4.25 refers to the establishment of the CPMA offering *a key opportunity for a frank and open debate about achieving the appropriate balance between the regulation and supervision of firms, consumer responsibilities, consumer financial capability and the role of the state* - this is a debate that we would very much welcome. The fact that the FSA's recent work in this area (launched via DP08/5) proved inconclusive in its search for a consensus on the appropriate balance of responsibility between consumers and firms indicates that this is an area that requires the direct participation of Government if there is to be any chance of reaching practicable conclusions on the mutual rights and responsibilities of the parties to financial transactions.

- 4.56 states that the Government intends to consult on the merits of transferring responsibility for consumer credit from the OFT to the CPMA – given that *the FSA and OFT regulate approximately 29,000 and 99,000 firms respectively and 16,000 of these are jointly regulated*, we believe there must be a danger that credit regulation would completely overwhelm all other CPMA-regulated activities. One compromise solution to rationalising the current system might be for the CPMA to assume responsibility for the consumer credit activities only of those firms subject to its regulation for other financial services purposes, leaving all other firms licensed in respect of consumer credit but not otherwise engaged in financial business to the care of the OFT.

Finally, while we welcome indications that the CPMA will adopt *a focused and specialised approach to all aspects of conduct regulation*, we are concerned by the suggestion in 4.24 that *it will adopt the FSA's new Retail Conduct of Business Strategy* which is outlined (a) by reference to initiatives that focus almost entirely on the market for retail products and (b) by examples of *distinctive characteristics of retail financial services* that also relate to such products. As per the comments in our covering letter, it is a view generally held amongst APCIMS member firms that the FSA does not understand their business models and that, by seeking to apply to their tailor-made investment services regulatory requirements that have been drafted with mass-market sales of financial products in mind, the FSA ends up imposing requirements which are not fit for purpose, being both costly and burdensome for firms and of little benefit to their customers. In re-engineering the regulatory structure and establishing the CPMA, we believe it is vital that the very significant differences between the many types of firms operating in the retail space are reflected in (a) organisational arrangements that result in policy, supervisory and enforcement activities being carried out in a risk-based fashion via a number of sector-specific divisions, (b) appropriately targeted and nuanced regulatory requirements and (c) regulatory personnel who have in-depth knowledge, experience and understanding of the specific sector in which they are working. As previously noted, we have given these organisational issues considerable thought and would welcome the chance to discuss them with HM Treasury staff.

## MARKETS AND INFRASTRUCTURE

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

At first glance, the proposal for the CPMA to assume responsibility for regulating *exchanges and other trading platform providers* and for the Bank to oversee *CCPs and settlement systems* seems a sensible divide given their overall responsibilities for markets and payment systems, although exactly how the CPMA will look after *conduct aspects of clearing houses and settlement systems* is unclear. Also, we are aware of concerns about (a) how this divide would impact upon exchanges that have their own integrated clearing and settlement systems and (b) the potential pitfalls, in terms of regulatory inconsistencies or omissions, of regulating CCPs separately from the market operations of which they are an integral element. It may be that, rather than pursuing a clear regulatory divide between markets and payments, it would be better for CCPs and settlement systems to remain under the CPMA's remit with the Bank exercising such influence as it needs to through the FPC's powers to monitor CPMA activities and to give directions and make recommendations to the CPMA.

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

On the basis that the CP provides no clear indication of the way in which the FSMA Part 4 and Part 18 regimes (dealing with the authorisation of investment firms and the recognition of investment exchanges and clearing houses respectively) might be rationalised, it is difficult to provide any meaningful response to this question. As a matter of principle, we do not believe

that it would be reasonable for this extremely high-level question to be used as the basis for any policy decision that is not subject to a great deal more detailed consideration and consultation.

We are aware of, and sympathetic to, concerns voiced by both the London Stock Exchange and the PLUS Markets Group about the possibility of the Part 18 recognised body regime being abolished with the result that such bodies would thereafter be regulated in the same way as investment firms. As well as failing to take account of the significant regulatory functions that such bodies perform and of the fact that they are providers of market facilities and infrastructure rather than market participants per se, such a move would represent a major change to the UK's current market structure and would need to be justified by detailed analysis of both current market operation and the relative advantages and disadvantages of alternative regimes.

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

Given that the Government recognises *the important role played by the UKLA in making London a leading global venue for companies – in all sectors – to access capital markets*, we are surprised by the proposal that the Listing Authority should be merged with the FRC. The UKLA is generally recognised as one of the more effective elements of the UK regulatory structure, benefitting from its position within the FSA where it operates alongside and in close cooperation with the market supervision and enforcement divisions. Conversely, the FRC, far from being a market-orientated regulator or even the *powerful companies regulator* referred to in the CP, has a wide-ranging remit covering, as its website indicates, promoting high standards of corporate governance, setting standards for corporate reporting and actuarial practice, monitoring and enforcing accounting and auditing standards, overseeing the regulatory activities of the professional accountancy bodies and operating disciplinary arrangements for public interest cases involving accountants and actuaries. APCIMS sees absolutely no reason for thinking that the primary market activities of the UKLA could be more effectively carried out in this environment than they could within the CPMA's Markets Division whose primary focus will be on *the promotion of market efficiency and integrity*.

APCIMS is aware of, and fully supports, the arguments that the London Stock Exchange has advanced in support of the UKLA being situated within the Markets Division of the CPMA. We also believe that certain inconsistencies that would result from the UKLA being merged with the FRC need to be considered – for example, why should a companies regulator assume UKLA's responsibilities vis-à-vis the listing of securities when AIM's primary market activities would continue to be covered by the CPMA's Markets Division as part of its oversight of the LSE? Similarly, why should a companies regulator assume responsibility for UKLA activities revolving around the listing of non-corporate securities such as securitised derivatives, warrants, options and GDRs?

In the CP, the Government recognises *the synergies that exist between the UKLA and other markets functions that would remain within the markets division of the CPMA, especially market surveillance*. We would contend that, even without concerns about maintaining the UK's competitive position as the international listing venue of choice and ensuring that the CPMA is able to speak on all UK market issues (whether retail or wholesale, primary or secondary) in its representative role within ESMA, these synergies would be sufficient to keep the UKLA firmly rooted within the overall market regulation structure provided by the CPMA.

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

APCIMS is not aware of any aspects of financial market regulation, as currently carried out by the FSA, that would not most appropriately fall under the remit of the CPMA's Markets Division. As per our comments on Q16 above, it is difficult to provide any meaningful comment to this question without having a clearer understanding of how the Government views the role of *the potential new companies regulator*.

***Additional comments on markets and infrastructure issues***

Besides our responses to Qs 15 to 18 above, APCIMS would like to offer a number of additional comments on the CP's contents in this area as follows -

- as per the comments in our covering letter, we believe that, given the importance of maintaining the UK's current pre-eminence in a wide range of wholesale market activities and ensuring that consumer regulation issues do not end up monopolising a disproportionate share of the CPMA's resources, consideration should be given to additional arrangements aimed at augmenting the operational autonomy of the Markets Division within the CPMA. For example, we would suggest the creation of (a) a dedicated sub-Board whose sole focus would be on market structure, operation and conduct issues, (b) a Markets Division Practitioner Panel as per our comments in response to Q12 above and (c) of more wide-ranging user panels (featuring experts from academia, firms, exchanges, rating agencies, data providers etc) which could provide practical input to the development of regulatory policy on markets on an on-going or ad hoc basis.
- the CP seems to equate *market conduct regulation* squarely with wholesale business with 5.6 and 5.10 in particular highlighting the ways in which activities subject to such regulation are distinct from investment business undertaken for retail consumers. Given that APCIMS firms' business is largely predicated upon providing direct access to exchange-traded investments for retail clients, it is essential that the future regulatory structure recognises (a) that market conduct regulation has both wholesale and retail implications, (b) that existing requirements (e.g. exchange rules and the FSA's COBS 11 and MAR provisions) bite on the activities of firms acting for retail investors and (c) more generally, that direct share ownership has important economic benefits, providing companies with essential sources of capital and enabling individuals to share in the possibility of corporate growth. As well as safeguarding the interests of consumers, the CPMA will need to have regard to the distinct regulatory characteristics of, on the one hand, firms undertaking retail market activities and, on the other, firms undertaking wholesale market activities.
- while we understand that the establishment of a new Economic Crime Agency will be the subject of a separate consultation, we would like to put on record our view that the investigation/prosecution of criminal activities that are specifically market-related (i.e. insider trading and market abuse) should remain with the CPMA. We do, however, believe that there is a case for reviewing and consolidating the activities of the wide range of agencies (SFO, FPS, NFA, City of London police etc) that are currently involved in the regulation of financial crime and that a single agency that sets standards for the prevention, detection, investigation and prosecution of such crime across the board is more likely to result in positive outcomes than the current disparate arrangements.

## CRISIS MANAGEMENT

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

Given the clear systemic focus of the crisis management arrangements outlined in the CP and the fact that they have been developed in response to the underlying causes of the recent crisis focused upon banking activities, there is little in Chapter 6 that appears to be of direct relevance to APCIMS-type firms. The one point we would query is why Table 6A does not outline the *transition from peacetime to crisis* for the CPMA given (a) the potentially systemic impact of the wholesale market activities within its remit and (b) the importance of the role it would presumably need to play in ensuring effective communication with consumers during times of crisis.

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

The last review of the FSA's OIVOP powers, undertaken via CP08/10 and allowing for increased use of such powers together with enhanced publicity about their use, gave rise to significant concerns amongst industry groups and law firms about the adequacy of the checks and balances to which the FSA is subject in wielding its enforcement powers. Given this, we believe that any move to further enhance these powers should be the subject of a distinct consultation exercise based upon detailed analysis of how the current powers operate and of the relative costs and benefits of any changes rather than simply being one of innumerable elements of the wider regulatory reform programme. We are also unsure that *making intervention mandatory at a specified threshold* is consistent with the CP's statements about the PRA pursuing a more judgement-led style of prudential regulation or the CPMA taking a more focused and specialised approach to conduct regulation – these approaches will require informed and nuanced regulatory decisions to be made in relation to individual firms and are unlikely to be consistent with broadly-defined trigger points applying across entire sectors.

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

On the basis that the SRR regime establishing the regulatory approach to failing banks and building societies is of limited direct relevance to APCIMS member firms, we offer no comments on this question.

## IMPACT ASSESSMENT

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

We comment in our covering letter on the need to minimise not only the transitional costs associated with implementing the revamped regulatory structure but also the on-going costs arising from its operation. We also comment in our response to Q11 above on the importance of cost-benefit analysis as a form of operational discipline on regulatory bodies and on the need for such analysis to be more thorough, robust and intellectually credible than it has been hitherto.

We recognise that the Preliminary Impact Assessment is drafted, by necessity, at a very high level and that its lack of concrete evidence for the costs and benefits likely to result from the CP's proposals reflects the very wide-ranging possibilities for regulatory reform canvassed therein. However, given that the potentially significant costs of regulatory restructuring will fall upon firms and ultimately upon consumers, subsequent stages of the consultation process dealing with aspects of the regulatory programme in a more practical and final form, will have to do a much better job of identifying and evidencing relative costs and benefits. All-embracing statements that *it is impossible to quantify the benefits of the proceed option in a realistic way* or that *the Government considers that the margin of benefits over costs is such that it is most unlikely that the implementation costs could increase by the amount necessary to reverse the ranking of the proceed and do nothing options* are unlikely to be considered adequate when a major restructuring of the country's entire financial services regulatory structure is at issue.



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**Robin Spencer**  
Chief Risk Officer

14 October 2010

Dear Sirs

**Aviva's response to: 'A new approach to financial regulation: judgement, focus and stability'**

Aviva is pleased to respond to this consultation and we are supportive of reforms to the UK system of financial supervision and regulation, in the light of the recent financial crisis.

We feel there is particular benefit in the proposal to have a Financial Policy Committee dedicated to identifying and responding to emerging risks in the economy.

As the UK's largest insurer with a large asset management business and operations across Europe, we have a keen interest in how the UK system of supervision and regulation interacts with the emerging EU architecture. We consider that the current proposals need further discussion to ensure that the right outcomes are achieved for customers, the financial services sectors and the wider economy.

We set out in the attached appendix our concerns about how the new regulatory architecture will work in practice, together with proposals and our response to the consultation questions.

In summary our key concerns are:

- Ensuring active and focused engagement in key European negotiations;
- Achieving appropriate prudential supervision for insurers within the PRA;
- Achieving oversight and a holistic view of large, diverse non-banking firms;
- Ensuring the FPC, PRA and CPMA work effectively together;
- Ensuring appropriate representation on the Financial Policy Committee (FPC); and
- Managing risks in the transition period between now and the implementation of the new structure in the UK.



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In addition we believe that strong and consistent regulation of markets will be difficult to achieve if there is separation of the regulation of the primary markets in the UKLA from the regulation of secondary markets in the CPMA. Such a separation would make market regulation difficult to coordinate and also mean that the CPMA would have a less authoritative position in the new European Securities and Markets Authority given the reduced scope of its market responsibilities.

We welcome the opportunity to discuss our response with you further.

Yours faithfully

A handwritten signature in red ink, appearing to be "R. Spencer", written over a horizontal line.

Robin Spencer  
Chief Risk Officer

Enc



## APPENDIX – AVIVA'S RESPONSE TO HM TREASURY CONSULTATION: 'A NEW APPROACH TO FINANCIAL REGULATION'

### ISSUES OF CONCERN TO AVIVA

Aviva has identified the following broad concerns with the proposed reforms:

#### Remaining active and focused in key European negotiations

1. The planned new EU supervisory architecture - and its interactions with the UK regulatory framework - is very important for large businesses like Aviva.
2. The new European Supervisory Authorities (ESAs) are due to come into operation from 1 January 2011. There is a risk that at this most critical phase, the UK will be preoccupied by internal reorganisation.
3. EU level discussions on insurance and asset management must remain focused, and receive appropriate attention by senior officials, throughout the transitional period, so that a strong UK voice continues to be heard.
4. For example, Solvency II is the most important piece of modernising insurance legislation in a generation, and the final Implementing Measures are still under discussion. Full and active engagement in such crucial EU negotiations is going to be critical to get the best outcome for our millions of customers.
5. **Aviva's proposal:** *During the transitional period, we would urge the FSA to prioritise active engagement in those European negotiations of vital importance to both the insurance and asset management industry. We further recommend that a dedicated team is put in place to oversee this engagement.*

#### Achieving appropriate prudential supervision for insurers within the PRA

6. Historically, the purpose of the prudential regulation of insurance companies has been the protection of customers. This reflects the role of insurers as providers of retail consumer products, and the fact they are *participants* in the financial system - rather than *drivers* of it.
7. Under the new proposals, insurers will be prudentially regulated within the PRA alongside banks and investment banks. These are fundamentally very different businesses.
8. It is important that careful consideration is given to 'getting it right' when it comes to the prudential supervision of insurance firms.
9. **Aviva's proposals:** *(1) The primary objective of the Prudential Regulatory Authority should incorporate a requirement that the PRA pays adequate attention to the fundamentally different rationale for the prudential regulation of insurance companies. (2) The prudential supervision of banking and insurance within the PRA should both be separately recognised within the internal management structures, to ensure that they are of equal prominence.*

### **Achieving oversight and a holistic view of large, diverse non-banking firms**

10. As a large insurance group that includes an asset management business, we do have a concern that under the Government's proposals, no single body will be charged with taking a holistic view of the whole Aviva group.
11. Under the proposed new structure, supervisors would have to gain such an overview *despite* the fact that substantial businesses within the Aviva group would be subject to prudential supervision by different regulatory bodies: the insurance business by the Prudential Regulatory Authority (PRA), and Aviva Investors (our asset management business) by the Consumer Protection & Markets Authority (CPMA).
12. **Aviva's proposal:** *Group supervision should be recognised within the proposed reforms so that a lead supervisor can take a balanced view of groups.*

### **Ensuring the FPC, PRA and CPMA work effectively together**

13. As a large, diverse financial organisation, we are used to dealing with multiple regulators. As such we are more interested in the *effectiveness* of the proposed new financial architecture, rather than its *structure*.
14. It is clear though, that there will need to be considerable cross-consultation and co-ordination between the PRA, CPMA and the FPC in the effective discharge of their responsibilities. Much of the success of the Government's proposals will depend on getting the detailed implementation right, including how liaison will happen in practice between these three bodies.
15. It is important that regulation continues to strike the right balance between:
  - Delivering against the regulator's objectives;
  - Supporting important access to products and services that consumers need;
  - Promoting a culture of saving and personal provision;
  - Attracting capital from investors into the sector.
16. There are significant differences between retail and wholesale markets and it will be important that the priorities of the CPMA are not dominated by thinking rooted in consumer protection.
17. The existing FSMA principles for better regulation should be maintained and there will need to be appropriate checks and balances to allow for transparent scrutiny of the performance of the different regulatory bodies in the delivery of their objectives. This should include formal external reporting to industry representatives, as well as appropriate consultation on policy development.
18. **Aviva's proposals:** (1) *The CPMA should be led by someone of equivalent standing to the CEO of the PRA, and who should be publicly recognised as such. This will avoid the CPMA being perceived as a junior regulator in the new UK regulatory system.* (2) *In order to create*

*the right balance, we would recommend a broader primary objective for the CPMA of not only ensuring the financial system protects its consumers, but also of promoting saving.*

*(3) The existing Better Regulation principles, statutory consultative Panels and consultation processes should be maintained for both PRA and CPMA.*

### **Ensuring appropriate representation on the Financial Policy Committee (FPC)**

19. The UK financial services market is one of the most competitive and diverse in the world, including a number of global banking, insurance and asset management businesses.
20. Financial stability mechanisms, whilst naturally banking-focused, nonetheless need to properly take into account the fundamental differences in business models of these diverse firms, their relationships with consumers, and their varying roles in the real economy.
21. **Aviva's proposal:** *The membership of the FPC needs to ensure there is appropriate and authoritative representation covering buy side market participants (insurers and asset managers) in addition to sell side.*

### **Managing risks in the transitional period between now and the implementation of the new structure in the UK**

22. The transitional period between the current and proposed new structure of financial regulation in the UK must be very carefully managed, to ensure there continues to be consistently high standards in the way the UK financial services industry is regulated.
23. **Aviva's proposal:** *We recommend a transitional plan is developed by the FSA, in conjunction with stakeholders, to demonstrate how key regulatory proposals and legislative requirements will be managed over the transitional period, and approved as soon as possible. This should include how controls over the quality of supervisory decisions and policy formulation will be maintained.*

## **AVIVA'S RESPONSE TO THE CONSULTATION QUESTIONS**

### **The Bank of England and Financial Policy Committee (FPC)**

**Q1: Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?**

In our view that the FPC should not have a single primary objective. Rather, each of the FPC's objectives should have equal weight so that the decisions that the FPC make are balanced and fair.

The FPC's objectives should not be divided between primary and secondary factors – each should be regarded with equal weight.

The FPC's objectives should include explicit consideration of the impact of their macro-prudential decisions on both the buy and sell side of the financial services industry, for example in the design and implementation of capital instruments, to address perceived financial stability problems in the banking sector, consideration should be given to whether there is likely to be a market for such instruments among buy side firms. Aviva would also like to see the FPC consider the economic and fiscal impact of their macro-prudential decisions

**Q2: If you support the idea of secondary factors, what types of factors should be applied to the FPC?**

Please see our answer to question 1 above.

**Q3: How should these factors be formulated in legislation – for example, as a list of 'have regards' as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?**

These factors should be formulated as statutory objectives, against which the FPC must balance its decisions.

### **Prudential regulation authority (PRA)**

**Q4: The Government welcomes respondents' views on:**

• **Whether the PRA should have regard to the primary objectives of the CPMA and FPC;**

The objectives of the PRA should not only have regard to the objectives of the FPC and CPMA but also of the purpose of prudential regulations for each of the sectors for which it will have responsibility.

Currently the proposed primary objective of the PRA focuses on financial stability which is entirely appropriate for its supervision of banks and investment banks, but provides it with no direction or purpose for the supervision of the insurance sector given that this does not pose a systemic risk to the financial system.

Therefore to meet the objective of properly focused regulators set out in the Government's impact assessment, if the PRA is to regulate the insurance sector, it should have a balanced range of objectives that include the purpose of its prudential supervision for both the banking and insurance sectors that it will supervise.

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

All of the current principles for good regulation should be retained for the PRA. If the Bank of England through the PRA is to supervise certain aspects of the financial services industry then it should follow good regulatory practice.

There is no valid justification for not continuing with all current principles of good regulation as set out in FSMA.

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

In our opinion these requirements should be retained.

The financial services sector plays an important role in the UK economy and the PRA should have regard to innovation within it, and its global competitiveness in the policy decisions it takes.

The FPC is being created to fill the perceived gap under the former regulatory approach where there was insufficient focus on the system as a whole. This will provide the check and balance required.

• **Whether there are any additional broader public interest considerations to which the PRA should have regard.**

The PRA should have regard for the need to promote a culture of saving and personal provision and supporting access to products and services that consumers need. It should have a regard for broader public policy. These points are elaborated in our answer to question 10.

**Q5: Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?**

An integrated model where PRA and CPMA can utilise common functionality, with oversight and decisions directed from their respective senior management, would be desirable as it would offer an opportunity to both the regulatory authorities and industry to reduce the risks of increased costs and inefficiencies that alternative arrangements could present.

Therefore the PRA and CPMA should as far as reasonably possible have shared services in place, particularly in relation to the granting/removing of regulatory permissions, levying of fees, enforcement proceedings and the maintenance of the single rule book.

It is important that the PRA and CPMA can effectively coordinate the implementation of rules derived from European Directives such as the CRD that will impact firms that they each regulate, to avoid inconsistent transpositions, interpretations and enforcement.

In those areas where shared services are not practicable the authorities should have transparent mechanisms for working together to minimise duplication and inefficiency. This should involve representation of PRA and CPMA on decision making bodies that impact firms subject to joint supervision – this should extend to the supervision teams for major groups.

**Q6: Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focused approach to supervision?**

FSMA forms an adequate basis for the legal framework underpinning the more informed and judgemental approach to regulation intended for the PRA. The FSA has already commenced its intensive supervisory approach under FSMA. This involves making judgements on decisions taken by firms and demonstrates that the existing FSMA framework is sufficient.

In determining which FSMA powers should be provided to each of the new regulatory authorities, regard should be paid to those functions that would be more efficiently discharged as shared services between the two authorities to avoid duplication and inefficiencies. We see those functions as principally those of granting/removing of regulatory permissions, levying of fees, enforcement proceedings and the maintenance of the single rule book.

**Q7: Are safeguards on the PRA's rule-making function required?**

In respect of rule making the current statutory processes and safeguards including consultation should be maintained. In addition these should be enhanced by paying regard to the objectives of the new European supervisory structure to be implemented next year, by specifying that the rule making should not exceed the requirements of EU law. A final safeguard of due process before the courts must also remain.

**Q8: If safeguards are required, how should the current FSMA safeguards be streamlined?**

We do not feel that there would be any justification for streamlining the current FSMA safeguards. These enable vital checks and balances to ensure that policy is subject to scrutiny prior to implementation and mitigates the risk of poorly conceived or poorly drafted rules being put into force.

**Q9: The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.**

The current mechanisms applied to the FSA as set out in paragraph 4.36 should be applied to both the PRA and CPMA. We see no rational reason why the PRA should be less accountable than the CPMA under the proposed new structure.

We agree with the proposal that the PRA and CPMA should be subject to audit by the National Audit Office. The focus on such audits should include the cost benefit of the regulatory approach.

### **Consumer protection and markets authority (CPMA)**

**Q10: The Government welcomes respondents' views on:**

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

The objectives of the CPMA should not only have regard to the objectives of the FPC and PRA but also of the purpose of its conduct and prudential regulation for each of the sectors that it will have responsibility for.

Currently the proposed primary objective of the CPMA focuses on protecting customers and ensuring market integrity. There are significant differences between retail and wholesale markets and it will be important that the priorities of the CPMA are not solely dominated by thinking rooted in consumer protection.

To meet the objective of properly focused regulators set out in the Government's impact assessment, the CPMA should have a balanced range of objectives that provide the purpose, for both its prudential and conduct supervision of firms, in the retail and wholesale markets. The objectives should emphasise creating opportunities to promote saving and personal provision and supporting access to products and services that consumers need. The current situation with the public deficit and the Government's desire to roll back the State means that there is a corresponding need for the Government to encourage individuals to take more personal responsibility. Clear advocacy for the role of insurance and the customer solutions and opportunities it provides would assist the Government in this regard.

We are concerned that the positioning of the CPMA may create the perception that it will be a state sponsored 'consumer champion'. Whilst consumer protection in the conventional regulatory sense must be an important part of the CPMA's role, it must also have a role in the protection of consumers from their own inertia. Therefore, the CPMA should have a regard for broader public policy, for example known issues with the savings and protection gaps, and pension deficits.

It is also important that the CPMA does not apply current and/or future standards to business that has been in place for a number of years to ensure that the stability of firms and the financial system is not undermined by retrospective judgements.

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

All of the current principles for good regulation should be retained for the CPMA.

There is no valid justification for not continuing with all current principles of good regulation as set out in FSMA.

We are particularly concerned that the Government is considering whether regulators should continue to have regard to the innovation and global competitiveness of the industries they regulate in the discharging of their general functions. Innovation and competitiveness within the industry have an important role in delivering benefits to customers in terms of costs and products, and it is important that customers are not disadvantaged.

It is also important that the principle that the authorities use their resources in the most efficient and economic way be maintained. This should be a principle that the Government should pay regard to in establishing the new regulatory structure to ensure that costs for the industry are minimised during the current period of financial austerity.

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

We feel that there is benefit in retaining the requirement to have regard to potential adverse impacts on innovation and the competitiveness of the UK financial services sector.

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

As noted above the CPMA should have regard to promoting a culture of saving and personal provision and supporting access to products and services that consumers need. Focus should be placed on market intermediaries who facilitate access for consumers to achieve this culture.

It must also have a role in the protection of consumers from their own inertia. Therefore the CPMA should have a regard for broader public policy.

**Q11: Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?**

Aviva would like to see the current accountability mechanisms provided under FSMA maintained for the CPMA, and we welcome the proposal that the CPMA will be subject to audit by the National Audit Office. As noted in our answer to Question 9 the focus on such audits should include the cost benefit of the regulatory approach.

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

The statutory panels should have a membership that is representative of the industry as a whole including a balance of buy and sell side representatives. It is important that there is a transparent process for the views of the statutory panels to be appropriately considered by the FPC, PRA and CPMA.

**Q13: The Government welcomes views on the proposed funding arrangements, in particular, the proposal that the CPMA will be the fee- and levy-collecting body for all regulatory authorities and associated bodies.**

As noted in our answer to Question 5, we are in favour of an integrated model where the PRA and CPMA can utilise common functionality that offers the opportunity to both the regulatory authorities and industry to reduce the risks of increased costs and inefficiencies that alternative arrangements could present. We therefore agree with the proposal that a single authority should be responsible for the collection of fees.

There should, however, be clear transparency over the basis on which the fees are levied including a consultation process.



**Q14: The Government welcomes views on the proposed alternative options for operating models for the FSCS.**

We favour the FSCS remaining a single scheme with the cross subsidy between different classes of levy payer being ended. This can be achieved through revision to the existing rules and is not a factor that should necessarily be linked to the possibility of separate schemes reflecting the different roles of the PRA and CPMA. If separate schemes were to be pursued, which we do not favour, this would still leave a potential cross subsidy issue in that insurers and banks would presumably be covered under whatever arrangements were put in place by the PRA.

Government also needs to consider that the European Commission is currently consulting on changes to guarantee schemes relating to depositors, investors and insurance policy holders that may have a bearing on the functioning of the FSCS in the future. As such this may not be the appropriate juncture to discuss alternative operating models for the FSCS.

**Markets and infrastructure****Q15: The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.**

Our principle concern is that the statutory objectives of the CPMA pay due regard to the significant differences between retail and wholesale markets and it will be important that the priorities of the CPMA are not dominated by thinking solely rooted in customer protection.

The division of market responsibilities between the Bank of England, CPMA and Financial Reporting Council creates a significant risk of regulatory fragmentation and incoherence. We believe that market regulation should be the responsibility of a single authority to ensure consistent market regulation.

Today London is the most global platform where supply and demand for capital of all natures meet; the attractiveness of this platform is such that issuers and investors from all over the world are content to transact on this platform, generating considerable revenues, jobs and tax resources for the country. Good regulation is part of its attractiveness; but the balance of factors is subtle and can be easily unsettled leading to companies, clients and talents leaving in a very tough competition between market centres. Therefore maintaining the competitiveness of London as a global market centre should be among the objectives of the CPMA.

**Q16: The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.**

There is a clear operational link between the regulation of market infrastructure and the regulation of market conduct and we believe the current FSMA regimes for regulating exchanges, trading platforms and clearing houses should be maintained.

In order for the UK to maintain cohesive engagement in the development of market policy in Europe, all market regulation should be the responsibility of a single regulator so that it can engage with the new European Securities and Markets Authority (ESMA) in an authoritative manner and to provide a consistent basis for rules governing all markets.

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

As noted above, for the UK to be able to engage with the ESMA in an authoritative manner, then the regulator representing the UK should have responsibility for all market regulation. Therefore, we do not believe that merging the UKLA with the FRC will enhance the UK's influence in Europe on market matters.

In line with the response by the ABI, we support the view that the CPMA is the right location for the UKLA for the following reasons:

- These additional responsibilities would pose a risk to the focus of the FRC's work on corporate governance;
- Moving the UKLA to the FRC would further fragment the regulation of the wholesale financial markets. The markets division of the CPMA should pull together as many as possible of the regulatory functions relating to the capital markets;
- The separation of regulation of the primary markets in the UKLA from regulation of the secondary markets in the CPMA would be particularly awkward to co-ordinate on a day-to-day basis;
- Only 6% of the listed bodies overseen by the UKLA are UK corporate;
- The deliberative, Board-based decision-making of the FRC is very different from the real time decisions on, for example, market suspension required by the UKLA; and
- The FRC will not be a member of the EU authority ESMA that will in future set the rules in this area – that will be CPMA - and could not therefore attend the top level ESMA decision-taking meetings.

**Q18: The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies' regulator.**

We have no comments on this question.

**Crisis management**

**Q19: Do you have any overall comments on the arrangements for crisis management?**

The arrangements as drafted appear to focus exclusively on the banking sector, indeed the CPMA is not mentioned at all in the Authorities listed in Table 6.A. That said, the arrangements would not be appropriate for other sectors where Government intervention is not a necessary component in resolution.

It is noted in paragraph 6.14 on page 49 that the PRA will be given responsibility for making rules about approving recovery and resolution plans. It is important that the PRA recognise the different characteristics of the sectors that it regulates in this regard and does not impose inappropriate standards designed for banks on insurance companies and asset managers.

**Q20: What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?**

Substantial powers are currently provided to the FSA under the FSMA and no further powers should be required by the new supervisory authorities.

The proposal to provide enhanced clarity over the OIVOP powers and the circumstances in which they might be used would be welcomed. However, we do not believe there is any justification to change the existing OIVOP powers.

We do not agree that mandatory intervention at specified thresholds is appropriate or consistent with the stated aims of a new, more judgement-led style of prudential regulation, as it would remove supervisory judgement from the process.

**Q21: What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24?**

We have no comments on this question as the special resolution regime is only applicable to the banking sector.

**Impact assessment**

**Q22: Annex B contains a preliminary impact assessment for the Government's proposals. As set out in that document, the Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm. In particular, comments are sought from all types and size of deposit-taking, insurance and investment banking firms (including credit unions and friendly societies), and from groups containing such firms.**

The objectives that Government have documented in their impact assessment include replacing the FSA with two properly focused regulators, yet the policy options do not include assessment of the different variants of allocations of functions between the PRA, CPMA and other bodies that might help ensure that this objective is met. The consultation process would have been more valuable if it had openly looked to ensure that the optimum structure to replace the FSA is pursued.

The impact assessment indicates that there are no non-monetised costs associated with the proposed reforms. This fails to recognise the impact that there will be to staff morale and turnover within the FSA during the transitional period, and the affect this will have on their ability to participate and influence international reforms, and carry on with the supervision of financial services whilst also restructuring itself internally to align with the new model.

It is also noted in the impact assessment that it may be reasonable to assume that the effect on ongoing costs for most PRA regulated firms will be minimal, although there is likely to be significant transitional costs in setting up systems to deal with both regulators. It is not possible for firms to estimate the likely increase in costs until it is clear what functions the new regulatory bodies will share and what functions they will duplicate. The Government should ensure that the new regulatory bodies work effectively together to minimise duplication and the associated costs that this would impose on industry during a period of financial austerity.



## HMT Consultation Paper: A new approach to financial regulation –AXA UK Group response

Questions	Response
<b>General comments:</b>	<p>We would welcome clarity as to the role, responsibilities and powers of the Treasury within the new regulatory regime. We feel that it is important that the Treasury play a part in this new regulatory process particularly to provide some balance of power.</p> <p>We feel that the timescales set out in the proposals are very ambitious based on previous experience and are concerned as to whether there is sufficient time to ensure that the industry is appropriately supervised whilst the changes pass through Parliament. For instance, the FSMA took three years for the legislation to be passed and a further 18 months for the secondary legislation and practical arrangements to be put into place. This is particularly pertinent as there are a number of key EU driven initiatives which will impact the industry and will demand resource of the regulator and firms alike to implement and contribute to their development including: Solvency II , Basel III, Alternative Investment Fund Managers Directive, Insurance Guarantee Scheme, Insurance Mediation Directive.</p> <p>As London and the UK plays a central role in the global financial markets we feel it is imperative that any regulatory change considers the international competitiveness of the UK financial services market. However the proposals in the consultation paper do not clearly set out the EU and international dimension.</p> <p>We are concerned that as the UK focuses on establishing its new domestic regulatory approach, there is the risk that any EU and global regulatory changes will be overlooked. We feel that it is essential that the UK has appropriate representation on the new EU supervisory bodies. This is particularly important in view of the fact that the new EU supervisory committees can make binding regulations.</p> <p>As a suggestion, it may be appropriate to create a central international division to represent the UK on the new EU supervisory committees and other international fora. This international division could also ensure that the existing memorandum of understanding currently between the FSA and other international regulatory bodies continues with the appropriate new regulator.</p> <p>We note that there are further consultations scheduled in respect of the market abuse regime and proposed economic crime agency. We feel that there is a danger that the new regulatory approach will become complicated and fragmented the more that additional consultations and bodies are involved.</p>

Questions	Response
	<p>Overall the proposal for the FPC to carry out the Bank of England’s financial stability remit appears to be sensible. However these proposals do not clearly set out the accountability measures that will be included within the legislation.</p> <p>The five principles of good regulation should apply to the FPC. We note that the FPC will be formed as a committee of the BoE, as such the governance and accountability mechanisms for the FPC should be clearly set out in legislation.</p> <p>We are concerned that the FPC may be too focused on banks and will not provide sufficient consideration to other financial sectors such as insurance and investment management. Any decisions made by the FPC to respond to potential risks identified should be supported by policy, accountability measures and take note of EU directives and other international developments. The experience of the committee members should be balanced and the governance structure should allow for challenge by all members. This is key in view of the EU developments in light of the fact that the European Systemic Risk Board (ESRB) has a strong banking focus.</p> <p>Any changes to the BoE’s stability objective should be the subject of a consultation process.</p>
<p><b>The Bank of England and Financial Policy Committee</b></p>	
<p><b>1.</b> Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?</p>	<p><b>1.</b> The FPC should have its objectives supported by secondary factors. An „unconstrained’ objective would be inappropriate. The regulatory objective of the FPC should be formulated in the proposed primary legislation as is currently the case for the FSA in section 2 of the FSMA.</p>
<p><b>2</b> If you support the idea of secondary factors, what types of factors should be applied to the FPC?</p>	<p><b>2.</b> Yes we support the idea of secondary factors for the FPC and these should include all of those factors provided by section 3 of FSMA, and the principles of good regulation, namely:</p> <ul style="list-style-type: none"> <li>▪ The efficient use of resources.</li> <li>▪ Role of management</li> <li>▪ Proportionality</li> </ul>

Questions	Response
	<ul style="list-style-type: none"> <li>▪ Innovation.</li> <li>▪ International character of financial services and markets.</li> <li>▪ The impact on competition both domestically and internationally</li> </ul> <p>The FPC should also be required to consider the impact of any decision on the policies and rules of the PRA and CPMA.</p>
<p><b>3</b> How should these factors be formulated in legislation – for example, as a list of ‚have regards’ as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?</p>	<p><b>3.</b> The factors should be formulated as a set of secondary statutory objectives which the FPC must ‚take into account’ and not just ‚have regard to’ as set out in section 2 (3) in the FSMA.</p>
<p><b>Prudential Regulation Authority</b></p>	
<p><b>4.</b> The Government welcomes respondents’ views on:</p> <ul style="list-style-type: none"> <li>• whether the PRA should have regard to the primary objectives of the CPMA and FPC?</li> <li>• whether some or all of the principles for good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice, should be retained for the PRA?</li> <li>• whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial</li> </ul>	<p><b>4.</b> Yes the PRA must have regard to the primary objectives of the CPMA and FPC.</p> <p>Yes all of the principles of good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice should be retained. The PRA must consider these principles rather than ‚have regard to’ as currently set out in section 2(3) of FSMA.</p> <p>All of the principles of good regulation should apply to the PRA which must include global competitiveness and innovation. It is essential that the PRA considers the impact of its decisions both globally and domestically.</p> <p><b>The PRA should be required to consider the impact of any of its proposals on the wider economy. It is essential that the PRA applies different prudential requirements on the firms it regulates and regulation designed for the banking sector is not applied to insurers and other sectors.</b></p> <p>The primary legislation should include the same safeguards as outlined in FSMA section 155 in respect of the PRA’s rule – making powers. In particular the PRA should be required to consult and produce meaningful cost benefit analysis and impact assessment when introducing or amending rules. There should also be a mechanism to appeal decisions</p>

Questions	Response
<p>services sector of regulatory action should be retained? and</p> <ul style="list-style-type: none"> <li>• whether there are any additional broader public interest considerations to which the PRA should have regard.</li> </ul>	<p>of the PRA. Firms should also be given the opportunity to apply for waiver or modification of the rules where compliance would be unduly burdensome or would not achieve the rule’s purpose and anyone whose interests are protected by the rule would not be put at undue risk.</p>
<p><b>5.</b> Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?</p>	<p><b>5.</b> This proposed approach could lead to considerable inefficiencies, additional costs and overlapping jurisdictions between the PRA and CPMA. There is a potential for the two regulators to reach different conclusions regarding the approval of a firm and/or individuals. We are concerned that the proposed dual registration may cause confusion to consumers and it is essential that the proposals for registration meet the registration requirements of Article 3 of the IMD.</p> <p>Furthermore, the proposals do not address complex groups which have a number of financial services firms within its structure which may be prudentially regulated by different authorities.</p> <p>We feel therefore that it may be more appropriate to have one centralised body which undertakes the following activities on behalf of both the PRA and CPMA:</p> <ul style="list-style-type: none"> <li>▪ Authorisation of firms and individuals.</li> <li>▪ Collection of all fees and levies.</li> <li>▪ Supervisory activities.</li> <li>▪ Enforcement activities.</li> </ul> <p>We feel that this will help ensure coordination of activities and better independent oversight of firms.</p>
<p><b>6.</b> Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focussed approach to supervision?</p>	<p><b>6.</b> We note the Government’s regulatory approach for the PRA is to become more “judgement” based focus. We are concerned that this gives rise to the possibility that the PRA will seek to intervene in the running of financial services firms without due process and which may result in a lack of consistency in regulatory decisions across the UK. We feel that it is important to continue to ensure consistency in regulatory approach and to stress that any changes in such regulatory approach must take into account the requirements of Solvency II, the Capital Adequacy Directive, Banking Consolidation Directive and for UCITS firms Article 5a of the UCITS Directive.</p>
<p><b>7.</b> Are safeguards on the PRA’s rule-</p>	<p><b>7.</b> Yes it is essential that the PRA’s rule-making powers are subject to safeguards. We believe that the same</p>



Questions	Response
making function required?	safeguards and accountability measures which currently apply to the FSA could be mirrored.
<p><b>8</b> If safeguards are required, how should the current FSMA safeguards be streamlined?</p>	<p><b>8.</b> We believe that the rulemaking provisions as set out in the following sections of the FSMA should apply to the PRA:</p> <ul style="list-style-type: none"> <li>▪ Sections 64 - 70 – Statements and codes procedures</li> <li>▪ Sections 104 – 117 – The process in respect of business transfers.</li> <li>▪ Sections 138 – 158 – The rule and guidance making process.</li> </ul> <p>We do not see the need for any modification of these provisions since they include the appropriate safeguards and accountability measures. It is essential that any changes in rules must be the subject of meaningful cost benefit analysis as set out in section 155 (2).</p> <p>We also believe that the competition scrutiny provisions within the FSMA sections 159 to 164 equally apply to the PRA.</p> <p>The FSMA also includes appropriate safeguards regarding approval and withdrawal of authorisation and supervision which should also be included for the PRA. We therefore believe that the following sections of the FSMA regarding authorisation and supervision must be retained:</p> <ul style="list-style-type: none"> <li>▪ Sections 44 – 48 – variation and cancellation of permissions</li> <li>▪ Sections 53 – own initiative power procedures.</li> <li>▪ Section 57, 58 – Prohibition process and the right to refer to the Tribunal.</li> <li>▪ Sections 61, 62, 63 – Determination of applications and the right to refer to the Tribunal.</li> <li>▪ Section 66, 67 – Disciplinary powers and the right to refer to the Tribunal.</li> <li>▪ Sections 165 – 178 – Information gathering and investigation process should be retained without any changes.</li> </ul> <p>The proposed primary legislation must also ensure that there is a Tribunal of some description to which both firms and individuals may refer decisions made by the PRA and CPMA. Therefore we suggest that Part IX of the FSMA is retained.</p> <p>Any proposed legislation must consider all EU and International developments and not impact the competitiveness of the UK financial market since this will ultimately impact the UK economy.</p>

Questions	Response
	<p>The UK must be seen as a competitive market for UK and overseas firms alike and any changes in legislation must consider this and the associated costs of capital.</p> <p>It is therefore essential that any Primary Legislation sets out the process for cross border activities both outgoing and incoming and sets out how incoming firms will be approved and supervised.</p>
<p><b>9.</b> The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.</p>	<p><b>9.</b> We are concerned that these proposals provide the BoE with considerable powers with minimal political oversight. We therefore recommend that this is addressed by requiring both the Governor and the Deputy Governors to appear before the Treasury Select Committee at least annually.</p> <p>Any decisions made by the PRA must be approved by its Board which should include non-executive directors except where a conflict of interest may arise.</p> <p>The Government should consider legislating for a committee to be set up similar to that of the FSA's Regulatory Decisions Committee which reviews enforcement, authorisation and supervisory decisions that are of material significance for the firms and individuals concerned. The PRA board should appoint a chairman (potentially the existing RDC Chair) and members should be drawn from practitioners and non-practitioners.</p> <p>All of the accountability measures currently established with respect to the FSA, should be put in place for the PRA, as set out in paragraph 4.36 of the consultation paper. This is essential in view of the significant economic control being given to the BoE.</p> <p>The PRA should be required to maintain a complaints scheme for the investigation of complaints against it arising in connection with the exercise of or failure to exercise any of its functions under the primary legislation. Therefore Schedule 1 of FSMA should be retained for the PRA. In addition, we feel that the PRA should be required to appoint an independent person as Complaints Commissioner to be responsible for the conduct of investigations in accordance with the complaints scheme.</p> <p>We also note that these proposals do not set out the internal organisation structure of the PRA and acknowledge that this is the detail to be agreed at a later date. However, we are concerned that insurance firms may be subject to regulation designed for the banking industry. As such we feel it appropriate for the PRA to be structured on a divisional basis so that banking and insurance firms are dealt with separately. We feel that this will help ensure appropriate decisions are made with respect to minimum capital requirements and other prudential requirements.</p>
<p><b>Consumer protection and markets</b></p>	

Questions	Response
<b>authority (CPMA)</b>	
<p><b>10.</b> The Government welcomes respondents' views on:</p> <ul style="list-style-type: none"> <li>• whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC?</li> <li>• whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which?</li> <li>• whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained?</li> <li>• whether there are any additional broader public interest considerations to which the CPMA should have regard.</li> </ul>	<p><b>10.</b> Please refer to our responses in relation to the PRA. These equally apply to the CPMA.</p> <p>We note that the CPMA is referred to as a “customer champion.” We feel that this is not appropriate given its role as a regulatory authority. The CPMA should secure the appropriate degree of protection for consumers balanced by the necessary measures to regulate the financial services firms. In securing the level of protection the measures set out in section 5 (2) of FSMA would be appropriate. The CPMA will have oversight of the independent consumer financial education body (CFEB) and it should be this body that acts as a consumer champion.</p> <p>If the CPMA’s rule making process follows that of the FSA then both consumers and other consumer champions will be able to respond to any proposals to ensure that the consumer is appropriately represented.</p> <p>We believe that the CPMA should continue the work of the FSA with regards to ensuring all firms have the appropriate systems and controls in place to ensure consumers are treated fairly.</p>
<p><b>11.</b> Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?</p>	<p><b>11.</b> We feel that the process for making decisions on significant regulatory or supervisory action relating to individual firms requires further clarity and believe that for decisions relating to rule changes must be approved by the board of the CPMA which should include non-executive directors except where a conflict of interest may arise.</p> <p>The Government may also wish to consider legislating for a committee to be set up similar to that of the FSA’s Regulatory Decisions Committee which reviews enforcement, authorisation and supervisory decisions that are of material significance for the firms and individuals concerned. The CPMA board should appoint the RDC chairman and members, who ought to be drawn from practitioners and non-practitioners.</p>

Questions	Response
	<p>All of the accountability measures currently established with respect to the FSA should be put in place for the CPMA, as set out in paragraph 4.36 of this paper.</p> <p>The CPMA should be required to maintain a complaints scheme for the investigation of complaints arising in connection with the exercise of or failure to exercise any of its functions similar to that under the FSMA. Therefore Schedule 1 of FSMA should be retained for the CPMA. In addition the CPMA should be required to appoint an independent person as Complaints Commissioner (this could be same Complaints Commissioner used by the PRA) to be responsible for the conduct of investigations in accordance with the complaints scheme.</p> <p>It may be appropriate for the legislation to establish one RDC and Complaints Commissioner for both the PRA and CPMA.</p> <p>It is noted that these proposals do not set out the internal organisation structure of the CPMA and would welcome clarity on this when available.</p>
<p><b>12.</b> The Government welcomes views on the role and membership of the three proposed statutory panels for the CPMA.</p>	<p><b>12.</b> The role, membership and creation of these practitioner panels should follow the process as set out in sections 7, 8, 9, 10 and 11 of the FSMA 2000.</p> <p>The Small Practitioner Panel should be set up as outlined in section 9 of the FSMA and consist of senior practitioners from smaller firms across the regulated community.</p>
<p><b>13.</b> The Government welcomes views on the proposed funding arrangements, in particular, the proposal that the CPMA will be the fee- and levy-collecting body for all regulatory authorities and associated bodies.</p>	<p><b>13.</b> Yes we agree it is sensible for one organisation to collect fees and levies associated for all regulatory authorities and associated bodies.</p> <p>However any changes to fees and levies should be the subject of a consultation process as per that process set out in Sections 138 – 158, the FSMA – The rule and guidance making process.</p> <p>We do not see the need for any modification of these provisions since they include the appropriate safeguards and accountability measures. It is essential that any changes in rules must be the subject of meaningful cost benefit analysis as set out in section 155 (2).</p>
<p><b>14.</b> The Government welcomes views on the proposed alternative options for operating models for the FSCS.</p>	<p><b>14.</b> As the FSA, together with the industry, has been carrying out a review of the FSCS we feel that the Government should consider the work already completed by this review when considering the operating model for the FSCS. We understand that the FSA will be in a position to publish its proposals on the reform of the FSCS at the end November 2010. Therefore to minimise costs to both the regulator and the industry these proposals should be considered and</p>

Questions	Response
	<p>adapted to reflect these proposed changes to the FSCS. We believe that the areas that should be reviewed are as follows:</p> <ul style="list-style-type: none"> <li>▪ Cross subsidy arrangements should be removed.</li> <li>▪ Recognition that each class of regulated firm is different and should be viewed separately from the deposit class.</li> <li>▪ Pre-funding proposals should be viewed in the light of other regulatory reforms such as Solvency II.</li> <li>▪ The FSCS should remain a single scheme under the remit of the CPMA and work closely with the PRA.</li> </ul> <p>The Government should also consider any European proposals specifically those outlined in the EU White Paper on Insurance Guarantee Schemes. We are in favour of a minimum harmonisation of this directive across Europe. The Government should also ensure a regulatory body responds to these proposals taking into consideration the need to retain the competitiveness of the UK financial services market.</p>
<b>Markets and infrastructure</b>	
<p><b>15.</b> The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.</p>	<p><b>15.</b> We are concerned that these proposals will result in fragmentation of market regulation. We believe that there is a need for a strong market regulator which brings together wholesale market regulation in one body with a clear remit to promote the interests of the UK wholesale market.</p>
<p><b>16.</b> The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.</p>	<p><b>16.</b> Yes we agree that there is merit in rationalising the regimes in the FSMA under parts 4 and 18.</p>
<p><b>17.</b> The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step</p>	<p><b>17.</b> It is unclear as to whether the proposed Companies Regulatory Authority would sit above UKLA and FRC who would continue to operate separately or whether UKLA and FRC will also be merged. We would be interested to understand further detail on this particularly as the FRC is currently an independent body, while UKLA is part of the</p>

Questions	Response
towards creating a companies regulator under BIS.	<p>FSA. In addition, the UKLA and FRC perform quite distinct functions so it is not clear whether or not a merger would result in any advantages or benefits.</p> <p>If UKLA is to be merged with another body, we feel that it would be better suited to becoming a part of the CPMA because UKLA is principally focused on ensuring the flow of information between companies to investors. We believe that there are distinct benefits to UKLA merging with CPMA, the main one of which would be to avoid there being two separate bodies dealing with market regulation. (This would reduce the chances of the adoption/implementation of different policies on a variety of matters, some of which may overlap or otherwise be related.) Furthermore, separate operation of UKLA and CPMA could risk multiple disciplinary actions for those companies in the event that conduct amounted to a breach under both sets of regulation.</p>
<p><b>18.</b> The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator.</p>	<p><b>18.</b> We are concerned that all of the proposals set out in this paper will result in a number of regulators and the fragmentation of the regulatory system. The risk is that this will lead to duplication, overlapping responsibilities, numerous fees and may result in operational weaknesses and avoidable complexities. It is essential that the legislation includes a clear and appropriate apportionment of the responsibilities amongst the regulators together with appropriate accountability measures.</p>
<b>Crisis management</b>	
<p><b>19.</b> Do you have any overall comments on the arrangements for crisis management?</p>	<p><b>19.</b> We agree that there is a need to ensure firms have in place appropriate recovery and resolution plans, however we are concerned that to set out specific trigger points and detail for all firms in the industry would be disproportionate to the risks posed and appears to be an over extension of the banking regime. In particular, to specify additional detail and have specific trigger points would reduce the flexibility of firms' ability to manage their businesses and take their own decisions and actions in the event of a crisis. As such we feel that this should be a high level requirement only.</p> <p>A firm's systems and controls must be designed and maintained to ensure that its senior management is able to make and implement integrated business planning and risk management decisions on the basis of information that it has about the risks that the individual firm faces and its own financial resources.</p>
<p><b>20.</b> What further powers of heightened</p>	<p><b>20.</b> We believe that the current use of OIVOPs as set out in the FSA Enforcement Guide provides sufficient powers of</p>

Questions	Response
<p>supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?</p>	<p>intervention and does not require any enhancement. However we do not support the current OIVOP power which permits the FSA to use its OIVOP powers even where the firm has already agreed to take action in response to an issue.</p> <p>We welcome the proposal to provide further clarity on the circumstances in which OIVOPS will be used.</p> <p>Any proposal to introduce a „prompt corrective action’ regime must bring with it appropriate accountability and appeals measures.</p> <p>We do not see the need for any powers in respect of unregulated entities such as holding companies of a failing firm. In many cases a holding company structure is put in place for administrative reasons and the individuals who ought to be held responsible for the actions of the regulated entity would sit at that regulated entity level or, if the current Approved Persons regime were to continue, would hold a significant influence function CF00.</p> <p>We are interested in further discussion relating to such powers together with the rationale should the Government believe that these measures are necessary.</p>
<p><b>21.</b> What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24?</p>	<p><b>21.</b> We welcome the proposals to strengthen the accountability and effectiveness of the authorities when exercising their powers under the special resolution regime.</p>
<p><b>Impact assessment</b></p>	
<p><b>22.</b> Annex B contains a preliminary impact assessment for the Government’s proposals. As set out in that document, the Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm. In particular, comments are sought from all types and size of deposit-taking, insurance and</p>	<p><b>22.</b> We feel that the paper has underestimated the cost of implementation particularly in view of the ambitious timescales for the legislation.</p> <p>This consultation paper proposes that Royal Assent will be obtained in 2012 for the legislation. However, we note that the FSMA primary legislation took three years to receive Royal Assent and a further 18 months for the secondary legislation and practical implementation by both firms and the FSA.</p> <p>It is also noted that the Insurance Mediation Directive took over two years to implement and did not involve the complexities of the proposals outlined in this paper.</p> <p>In terms of specific costs to the AXA UK Group of regulated firms we are unable to estimate until further clarity on the</p>

<b>Questions</b>	<b>Response</b>
investment banking firms (including credit unions and friendly societies), and from groups containing such firms.	practical aspects of the regulatory regime are known.



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Hello

We are FSA authorised but we are not an insurance broker, financial institution or insurer. Our company cold calls other companies in a telemarketing capacity for insurance companies.

We do not take money; put anyone on cover or anything of that nature. It has always been ambiguous as to whether we ever needed to be FSA authorised, but it attracts business - however it is very expensive as we are not even in the insurance, mortgage or finance industry.

Would we need any kind of authorisation when the FSA has gone?

Thanks

Anne

Anne Bagnall

Managing Director

Phonetic Ltd

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15 October 2010

Dear Sirs

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

We welcome the opportunity to respond to the important matters raised in the above Consultation Paper on behalf of Baillie Gifford & Co.

Baillie Gifford & Co is an independent fund management firm based in Edinburgh with over £60bn under management and advice. The firm is a private partnership under the laws of Scotland and includes a group of companies which are regulated by the FSA in the UK.

We have had the opportunity to review the responses submitted by our trade bodies, the Investment Management Association and the Association of British Insurers and are broadly supportive of HM Treasury's intended approach and wish only to make the following specific point:-

**Scope of the Prudential Regulation Authority, (PRA) (Consultation question 5)**

We note the intention that the PRA will be responsible for the authorisation, regulation and day to day supervision of all firms who are subject to significant prudential regulation. It is intended that this will include firms conducting the regulated activity of carrying out contracts of insurance.


We urge the Government to take a proportionate view in deciding the scope of the PRA. Baillie Gifford's sole business is investment management and for these activities we will be authorised and regulated by the Consumer Protection and Markets Authority (CPMA) under the proposed model. However, we also provide pooled pension funds through our subsidiary Baillie Gifford Life Limited (BGL). This enables us to provide our investment management capabilities to UK pension schemes through unit linked life funds offered by BGL, (no direct retail customers). BGL therefore has the activity of carrying out contracts of insurance included in its Part IV Permission, however limited to its management of pooled pension funds. As an "investment only" insurer, with effectively no insurance risk, we are of the

*Authorised and regulated  
by the Financial  
Services Authority*

view that BGL should be solely supervised by the CPMA, along with the rest of the Group, rather than by the entity charged with supervising firms subject to significant prudential regulation.

We trust that the above comments are helpful, and please contact us should you require clarification of any particular point.

Yours faithfully

A handwritten signature in black ink, appearing to read 'G. Laybourn', with a long horizontal flourish extending to the right.

***Graham Laybourn***  
***Head of Regulatory Risk***

Barclays Bank plc

HM Treasury Consultation

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

Response from Barclays  
October 2010

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# 1. Policy Framework for Financial Services Regulation

## Introduction

1.1 Barclays welcomes the opportunity to respond to HM Treasury's Consultative Document 'A new approach to financial services regulation: judgement, focus and stability' published in July. As a major global bank based in the UK, Barclays has a keen interest in ensuring that the financial services regulatory regime is sound and effective.

1.2 Much has been learnt from the recent financial crisis, not least by the industry which has strengthened its capital and liquidity, reduced leverage and improved risk management practices. The Government is right, however, to note that regulatory failures contributed to the crisis. There is now an opportunity to improve and strengthen the regulatory regime.

1.3 We recognise the desire to reform the current system quickly in the wake of the crisis. Set against this is the need to ensure that change delivers longer term improvements, and that these benefits are durable as markets change into the future. The next crisis will not be identical to the last and the system must be able to flex with changing market dynamics and endure. Regulatory change is costly and, as we have seen, regulatory failure costlier still.

1.4 Before reviewing regulatory structure, policy makers should take a step back and consider the Government's wider public policy goals for UK financial services, the policy approach to the regulation of private markets, and the rightful roles of Government and Parliament within the regulatory framework.

## Wider Public Policy Goals for Financial Services

1.5 A transparent overarching policy framework for financial services is essential if clear and appropriate statutory objectives for regulators are to be set. The Consultative Document would benefit from a clear articulation of this framework.

1.6 For financial services we understand the Government's public policy goals to be, first, to ensure that the financial services sector plays its full role in supporting sustainable economic growth and job creation in the UK; and second, to regulate the financial services sector without damage to the objective above in a way that achieves:

- a reasonable and appropriate degree of financial stability and resilience of the financial system;
- safe and sound firms that are resilient to stress, within a non-zero failure regime;
- fair, orderly and resilient markets;
- appropriate consumer protection and consumer confidence;
- an open and competitive market place for financial services, including a fair and level playing field between the UK and competitor markets.

**It would be helpful if the Government could confirm that these are its policy goals.**

1.7 The financial system is global, and any UK regulatory regime needs to be consistent with developing FSB / G20 standards and priorities. Achieving the objectives above will be impossible without international co-operation between regulators and supervisors, especially in the context of supervising international financial institutions. Colleges, crisis management groups and other forms of international supervisory co-operation are key and must be made fully operational.

1.8 It is also important to remember that the EU is the primary source for most financial services policy and makes EU wide law governing the regulation of the single financial market. The European dimension will become even more important as the new pan European regulatory institutions become fully operational (the ESA's and the ESRB). UK regulatory policy for financial services needs to be as much about engaging, negotiating with and influencing European bodies and policy makers as it is about domestic regulatory policy. There will be less scope for unilateral rule-making and the exercise of unfettered regulatory judgement in future as the new EU regime develops.

1.9 The regulatory reform agenda is moving forward at significant pace. At such a time, it is essential that the UK is effectively represented at all levels, and speaks with one voice. The FSA has made good progress recently in building credibility in European and international fora. It is essential that this strong UK voice is not lost during the transition and thereafter.

### **The European and international dimensions of regulatory policy needs to be fully built in to the new framework.**

## Regulatory Philosophy

1.10 The Coalition Government's framework agreement recognises the need for all regulation to be effective and proportionate. The Government has set up a Regulatory Policy Committee to ensure that new regulation is based on strong evidence of costs and benefits. The Government should ensure a consistent 'better regulation' approach is built into the new financial services regulatory regime.

1.11 As a general principle the regulation of private markets should only be pursued to achieve important policy goals in the public interest which would not be achieved by private markets alone. Regulation distorts the normal functioning of competitive markets. Market failures or potential failures need to be demonstrated and analysed and the consequences of intervention carefully assessed before new measures are imposed.

1.12 All regulation should be proportionate, risk based and transparent. Where regulatory powers are exercised whether by rule making, the exercise of judgement and discretion or by other means, the policy framework within which they are being applied and the process for decision taking should be open and transparent. Those affected should have the opportunity to be consulted about both policy framework and process, and able to make representations before decisions are made. It is crucial that decisions based on judgement are supported by in-depth and strategic risk analysis together with a solid understanding of the firms' business model. We support a balance in favour of judgement based supervision, together with an increased focus on business models and risk based supervision over a regime too heavily focused on "tick box" compliance with rules and directives.

1.13 The regulatory body should be accountable, feeding back to stakeholders the reasons for its decisions. There should be rights of appeal to an independent body by those adversely affected if a decision is taken in a way that does not accord with the body's statutory remit or stated policies.

1.14 As far as possible, action by regulators should be consistent and predictable. This helps foster effective and efficient markets, builds confidence and reduces costs and uncertainty for the market. The regulatory process should also be efficient with minimum duplication between regulatory bodies and clear timetables for decision-making.

1.15 Regulators should emphasise the primary responsibility of management to run their own organisations, but hold them to account for doing so in a prudent and compliant manner. Regulators should also recognise, to an appropriate degree, the principle that customers should seek to protect themselves, while accepting that not all customers can do so in all situations or in relation to all products. Regulators should be sensitive to the moral hazard that regulation can create in both the behaviours of the regulated firm and of their customers, and seek to minimise this.

1.16 The authorities must be able to take swift action in an emergency and recognise that often there will not be time to apply normal process disciplines. The processes to be followed in a crisis should be understood in advance and any rules made or other measures taken should be subject to review once normality has returned.

1.17 The authorities must be sufficiently prepared to manage crises as these will inevitably occur, no matter how sound the regulatory system. This will require having high quality staff and procedures. It will often involve cooperation and collaboration with authorities in other jurisdictions. The guiding principle should be that no firm should be assumed of being incapable of being resolved and there should be no presumption that taxpayer money will be made available, although it must remain an option that taxpayers' money could be used if the circumstances required it.

**These principles of good regulation should apply to all relevant bodies including the Financial Policy Committee (FPC), the Prudential Regulation Authority (PRA), the Consumer Protection and Markets Authority (CPMA) and the Financial Ombudsman Service (FOS) as well as the Treasury.**

## The Role of Parliament, Government and the Treasury

1.18 Financial services policy is of critical importance to the UK, not just because of the size and importance of the sector to the economy overall but also because of the fundamental role that financial services plays in enabling and supporting growth and employment in the real economy.

1.19 Elected Parliaments play a crucial role in scrutinising government policy and ensuring it is delivering to its stated objectives in the interest of citizens. The Treasury Select Committee plays a useful and important role in this regard, but major policy developments and changes to the UK's regulatory framework must remain subject to full debate and consideration in both Houses of Parliament in order to ensure appropriate scrutiny and democratic legitimacy.

1.20 Independent regulatory bodies must operate within a framework of law established by Parliament, subject to an overarching policy mandate set by the Treasury and subject to the scrutiny of Parliament. This enables regulatory and supervisory bodies to operate independently and set appropriate policy and rules within an overarching accountability framework to the Treasury and Parliament.

1.21 Treasury Ministers must continue to be responsible and accountable for setting overall financial services policy on behalf of Government. Treasury Ministers' responsibility currently includes *'financial services policy including banking and financial services reform and regulation, financial stability, city and UK financial services competitiveness, and wholesale and retail markets in the UK, Europe and internationally.'*

1.22 The Treasury website states: *'The Treasury's financial services objective is to secure an innovative, fair dealing, competitive and efficient market in financial services, while striking the right balance with regulation in the public interest.'* This confirms the important role the Treasury itself plays in balancing regulatory policy in the best overall interests of the UK. Treasury Ministers are ultimately accountable for sustainable economic growth, the macro economy, jobs and the success and competitiveness of the UK and must therefore retain a role in the new financial services regulatory policy framework.

1.23 In addition, only Treasury Ministers can represent the UK in high level policy negotiations with the EU, the US, other key markets and within international fora such as the G20 and G7. A key policy objective here should be to ensure that the international and EU regulatory regime is appropriate for the UK's significant financial markets and that a consistent regulatory approach is being followed.

1.24 The Treasury should, therefore, have clear responsibility within the new regulatory framework for:



- promoting macro economic stability including appropriate financial stability;
- providing an economic and fiscal environment that promotes sustainable GDP growth;
- fostering a successful and competitive financial services sector that contributes fully to sustainable economic growth;
- promoting UK interests in negotiations with the EU and international partners with respect to financial services regulation;
- ultimate decision-making in terms of major economic or financial services crises;
- setting, monitoring and reviewing the framework within which the regulatory bodies operate;
- setting the detailed remit for operationally independent regulatory bodies, and monitoring and reviewing their performance against it.

**The Government should confirm the Treasury's important role within the financial services regulatory framework.**

## 2. Bank of England and Financial Policy Committee

### Relationships between the Bank of England, FPC and Treasury

2.1 The Consultative Document proposes fundamental changes to the remit of the Bank of England (the Bank), significantly broadening its scope and powers. Whilst Barclays understands the reasons why such reform is proposed, we believe that particular care should be taken in setting the statutory remit and accountability framework for the Bank and its constituent parts going forward.

2.2 The Bank will in future be responsible for monetary policy, financial stability, macro prudential policy, and micro prudential policy and supervision of banks, building societies and insurers. In addition the Bank acquired powers as resolution authority for failing banks and other financial institutions under the Banking Act 2009. The consolidation of such wide ranging powers into a single entity will shift the balance between the Bank and the Treasury and needs to be underpinned by a suitable accountability framework. Robust governance structures within the new Bank and its constituent parts will also be needed.

2.3 The Bank's independence from Government in its monetary policy role is often quoted as a precedent for further reform. The 1998 Bank of England Act set the following statutory framework for the Bank with regard to monetary policy and gave the Treasury powers of direction over the Bank in the discharge of its new role:

*Cl.11 In relation to monetary policy, the objectives of the Bank of England shall be-*

- (a) to maintain price stability, and*
- (b) subject to that, to support the economic policy of Her Majesty's Government, including its objectives for growth and employment'*

*Cl.12 (1) The Treasury may by notice in writing to the bank specify for the purposes of section (11)*

- (a) what price stability is to be taken to consist of, or*
- (b) what the economic policy of Her Majesty's Government is to be taken to be.*

2.4 The Treasury discharges its responsibilities under the '98 Act by means of open letters from the Chancellor to the Governor which specify what price stability is taken to consist of and the Government's economic policy objectives for the period ahead. The letters confirm the Government's target for monetary policy and require the Governor to write an open letter to the Chancellor should inflation move away from target by more than 1%.

2.5 We consider that a similar accountability framework should apply to the FPC in its discharge of the Government's financial stability objective. Within the statutory framework for the FPC set by Parliament the Chancellor should write formally to the Governor, as appropriate, setting out what financial stability should be taken to consist of and the Government's economic policy objectives which the FPC must have regard to. Such letters should be published.

2.6 This suggests that a similar statutory framework could be set for the FPC in relation to financial stability as for the Bank regarding monetary policy. Legislation could be drafted as follows:

*A In relation to financial stability, the objectives of the Financial Policy Committee shall be-*

- (a) to maintain appropriate financial stability, and*
- (b) subject to that, to support the economic policy of Her Majesty's Government, including its objectives for growth and employment*

*B The Treasury may by notice in writing to the FPC specify for the purposes of section A*

*(a) what appropriate financial stability is to be taken to consist of, or*

*(b) what the economic policy of Her Majesty's Government is to be taken to be.*

2.7 Such a framework would give clear accountability for financial stability to the FPC whilst enabling the Chancellor to set out a broad context such as the Government's risk tolerance in terms of financial stability and the Government's macro economic policy objectives which the FPC would need to take into account. It would provide a flexible framework that incorporates the legitimate role of Government in the overall economic policy framework whilst protecting the independence of FPC decision making. A simple framework of this kind for the FPC would negate the need for formal 'have regard to's' or secondary objectives in statute.

**The statutory framework for the FPC should enable the Treasury to provide guidance on the broad framework whilst protecting FPC independence of decision making.**

## Constitution and Governance

2.8 The Consultative Document proposes that the FPC be a Committee of the Bank's Court of Directors. We believe a preferable model would be to constitute the FPC along similar lines to the Monetary Policy Committee as set out in the Bank of England Act 1998.

2.9 We would like to see more balanced representation on the FPC Board. Under the proposed constitution there would be 6 Bank of England Executives, a Treasury representative, the CPMA CEO and three external members. In our view external representation should be strengthened so it comprises at least half the total membership. It should include individuals with up-to-date senior level practitioner experience as well as independent economic, banking, and insurance experts. In order for the Board to remain of manageable size total numbers should not increase; rather some of the seats taken by the authorities should be relinquished, with senior executives attending meetings but without voting rights. All FPC appointments should be made in accordance with best practice guidelines for public appointments and ratified by Parliament. We would expect the FPC to have access to the full range of the Bank's intelligence and resource, including its network of regional agents who are in touch with local business communities.

2.10 Under the proposed reforms, the Governor would ultimately be responsible for a very wide span of policy. The Governor would chair the MPC, chair the FPC, chair the PRA, and sit on the PRA's executive committee. We question both feasibility and desirability of vesting so much power in a single individual, regardless of their abilities, and believe the proposals create significant key person and governance risk.

2.11 We understand the Government's desire for effective coordination between different parts of the regulatory system. We are concerned however about the concentration risks that would arise from the same small group of senior executives (the Governor, the Deputy Governor for Financial Stability, the Deputy Governor for Prudential Regulation and the CEO of the CPMA) sitting on the Boards or executive committees of the main regulatory bodies. This could give rise to potential conflicts of interest (eg in the triggering of 'bail ins' or special resolution) and also cloud the accountability of different parts of the regulatory system.

2.12 Policy coordination should be achieved by other means: for example through regular briefings, information exchange, executive meetings at working and senior level, and through formal mechanisms such as the proposed duty for the PRA and CPMA to consult the FPC before taking significant decisions that affect stability, and the proposed requirement that the PRA briefs the FPC prior to meetings.

**The Government should ensure sufficient independent expert representation on the FPC, and ensure clear accountability of different parts of the regulatory system by avoiding inappropriate cross membership on governing Boards.**

## Accountability

2.13 The Consultative Document rightly raises the importance of strong accountability mechanisms for the Bank and its bodies going forward. Paragraph 2.66 of the Paper states that the Government agrees with the IMF's recommendation that:

*'If a central bank is given a stronger role in financial stability, including a stronger influence on the financial regulation of individual institutions, as well as a more clearly defined role in their resolution, these powers need to be complemented by robust mechanisms that ensure transparency and a high degree of accountability of the central bank's actions in safeguarding financial stability.'*

Barclays welcomes Government's recognition of the crucial need for strong accountability mechanisms.

2.14 The MPC type statutory framework in paragraph 2.6, including the publication of open letters between the Chancellor and the Governor, would be helpful in this regard. It would impose a duty on the FPC to support Government economic policy, including regard for jobs and growth, in the discharge of its financial stability responsibilities, and allow the Treasury to specify factors to be taken into account in defining financial stability. But other mechanisms are also needed in view of the scale and importance of the FPC's remit and powers.

2.15 We therefore recommend that the following mechanisms be built into the new system:

- a requirement for the FPC to report regularly to the Treasury and thence to Parliament
- a duty for the FPC to consult the Treasury on its proposed macro-prudential policy framework and tools, and a requirement to take account of any Treasury representations
- a duty for the FPC to consult publicly on its proposed use of its power and tools, consider responses and provide feedback on the reasons for policy decisions
- a requirement for FPC members to appear before the appropriate Parliamentary Committees on request

**A number of additional measures need to be built into the accountability framework for the FPC beyond those suggested in the Consultative Document**

## Macro- prudential tools

2.16 Macro-prudential policy is still at a relatively early stage and policy development is currently active both at European level, amongst the international community and within the Basel Committee. A number of proposals are either at an early stage of analysis and consideration or are being consulted upon.

2.17 While we can see the merit of setting out macro-prudential tools in secondary legislation because of the flexibility that will bring, there will need to be full public consultation both about the powers and tools for macro-prudential policy and about how the FPC intends to apply them. The UK's approach will need to be compatible with that of the EU and other jurisdictions. We look forward to fully engaging with the Government and the FPC on these matters in due course.

## Europe and International Issues

2.18 The Consultative Document proposes to give the FPC significant powers and tools to address systemic risk in the UK financial system, with knock on implications for the real economy. It says little however on how this regime would fit with the European regulatory system for financial stability or with wider international efforts to address global systemic risk factors.

2.19 The European Union is establishing a European Systemic Risk Board to oversee systemic risk and make recommendations for action to banking supervisors and others across all member states. We would like to understand better how the FPC's work will fit and coordinate with that of the ESRB.

2.20 The EU is also establishing European Supervisory Authorities who will make harmonised technical rules about the application of prudential regulation and other matters across Europe. It is intended that these rules will be binding and remove national discretions in the areas that they regulate. It is not clear how the discretion and judgement envisaged for the FPC (and PRA) in the application of its prudential tools will fit with the new more harmonised – and legally binding - European supervisory approach.

2.21 Many of the macro-prudential tools proposed for the FPC will be subject to cross-border negotiations and international accords, and also the subject of European Regulations and/or Directives. Recently we have seen a trend towards increased use of EU Regulations (which are directly applicable without the need for implementing legislation). Both PRA and FPC representation at relevant meetings is necessary. The development of tools such as variable risk weights or addressing pro-cyclicality should not be in advance of international agreement, as this could lead to an un-level playing field.

**The FPC's work needs to coordinate fully with that of the European Systemic Risk Board, and with developing international systems for macro-prudential supervision.**

## 3 Prudential Regulation Authority

### Introduction

3.1 The Consultative Document proposes that prudential regulation and supervision of all banks and deposit takers, investment banks and insurers be undertaken by a new body, the PRA. Prudential regulation of other financial institutions would be carried out by the CPMA.

3.2 The PRA will not be independent in the same way that the FSA currently is. Instead it will be a subsidiary of the Bank, subject to direction by the FPC on regulatory tools to be used in the application of macro-prudential policy, and required to consult the FPC in advance on any rules that may have material stability implications. This should lead to greater policy coherence with respect to promoting appropriate financial stability.

3.3 The Government's intent is for a more judgement-led style of prudential regulation. Whilst this is to be welcomed it will only be achieved if the PRA has the requisite human resources, talent and culture to supervise in this way. It must be able to recruit and retain appropriate talent.

3.4 The PRA will need to operate within the developing EU regulatory regime which, as we have already discussed, may leave less scope for the application of supervisory discretion at national level.

### Statutory Remit of the PRA

3.5 The Consultative Document proposes that the primary statutory objective of the PRA should be:

*'to promote the stable and prudent operation of the financial system through the regulation of individual financial firms, in a way which minimises the disruption to the public and to the financial markets caused by any firms which do fail'.*

3.6 Barclays believes that the PRA's statutory remit should be broader and more balanced. Prudence and stability must be subject to the test of proportionality in order to avoid over-application of the precautionary principle. This could itself pose dangers for the UK economy which needs the private sector to take on risk in a controlled way, and banks need to support this risk-taking with controlled risk-taking of their own. This will have to be accommodated by the regulatory system which will need its own risk tolerance and an acknowledgment that the UK does not operate a zero failure regime.

**The UK authorities in general and the PRA in particular will need to think through their approach to risk and their risk tolerance very carefully, balancing the need for stability and the need for an appropriate degree of controlled risk-taking by the financial sector as a whole and by individual firms within it.**

3.7 We suggest the PRA's statutory remit be framed as follows:

*To promote appropriate financial stability through the effective regulation and supervision of financial institutions and activities, having regard to the impact of regulation on competition and support for economic growth, and the impact on the public and on financial markets of any firms which fail.*

3.8 We believe that the FSMA 'have regard to's' should be largely retained and applied to the PRA as well as the CPMA. The FSMA process disciplines are required in order to ensure proper checks on the exercise of regulatory power. An appropriate set of factors the PRA should have regard to are:

- The principle that restrictions imposed on the industry or on a firm should be proportional to the benefits to be derived from them

- The need to use resources in the most efficient and economic way
- The need to promote effective competition
- The responsibility of those who manage the affairs of authorised persons
- The economic impact of its decisions on consumers and businesses
- The desirability of facilitating access to financial services that meet the changing needs of consumers
- The desirability of a viable, privately funded financial sector
- The desirability of international competitive equality
- The statutory objectives of the FPC and the CPMA
- The desirability of the United Kingdom playing a full part in developing and shaping international rules and standards.

3.9 An international market that lacks consistent application of regulatory standards will lead to market distortions, arbitrage and the potential build up of systemic risk elsewhere that could impact the UK. It is therefore important that the regulator has regard to the need for competitive equality and a level playing field.

**The PRA's statutory remit should reflect the need to promote an appropriate degree of financial stability and have regard to a full range of FSMA type factors in discharging its responsibilities.**

## Governance and Accountability

3.10 In its decision taking, reporting and rulings, the PRA should state how it has taken the above 'have regard to' considerations into account in the pursuit of its statutory objective.

3.11 The regulatory principles set out in paragraphs 1.10 -1.17 should apply to the PRA as micro-prudential regulator. The PRA must be transparent in the exercise of its discretionary and rule making powers and consult interested parties in advance on its proposed policy approach, and be subject to the same process disciplines as the FSA is currently required to observe and the UK has strived to apply to EU policymaking. The PRA will – as the CPMA and the FSA – act in a quasi legislative capacity in its rule-making (the rules will be subject to enforcement as clearly stated in paragraphs 3.25 and 3.26 of the Consultative Document). Barclays does not understand why the PRA should be subject to any less onerous requirements than applied to these bodies. Nor does Barclays believe that observance of proper disciplines in policy and rule-making is any way incompatible with the exercise of supervisory judgement. Rights of appeal to an upper/independent tribunal should be built into the framework.

3.12 We agree that the PRA Board should have a majority of non executives and that the appointments to the PRA Board should be in the hands of the Treasury. It should be possible for current practitioners to be appointed to the Board, although clearly they will need to withdraw if matters related to their firm are discussed. Careful consideration should be given to the desirability of the Governor chairing the PRA Board for the reasons set out in paragraphs 2.10-12. The PRA executive should be accountable to the PRA Board for decisions and actions taken.

3.13 It is important that the PRA should be able to access confidential advice and have a confidential sounding board for its proposals and actions. The PRA should be required, as the FSA currently is, to consult and to draw on advice from one or more panels composed both of practitioners and representatives of the wider public interest. Such panels might be focused on the PRA or shared with the CPMA.

3.14 Whilst it is important that significant decisions affecting regulated firms are taken properly with due regard to all policy considerations, we do not consider it necessary for Government to legislate to constitute an executive decision

making Committee, nor do we support the proposed membership of that Committee as set out in paragraph 2.11 above. The volume of supervisory decisions that are required on a daily basis mean that such a committee could become a significant bottleneck and place considerable strain on its membership. It is arguable that there should be more, not less, delegation of decision making.

3.15 We note the proposed constitution of the PRA as a subsidiary but consider the PRA should be accountable to Parliament through Treasury Ministers in relation to its performance against objectives rather than to the Court of the Bank. The PRA should be subject to audit by the NAO in terms of value for money, economy and efficiency in terms of utilisation of levy payers funds.

3.16 The PRA should be required to advise the Treasury directly on regulatory perimeter issues in relation to its statutory remit.

### Supervisory approach

3.17 Much of the supervisory focus to date has been on 'tick-box' compliance with rules and Directives, as the Consultative Document describes. We would expect that a regulatory framework based on judgement would rely less on such an approach and more on a understanding of the firm's own internal business model and strategy.

3.18 A significant amount of firm-specific information is currently provided to the FSA as supervisor. The sheer quantity of information supplied creates a challenge to the regulator in terms of understanding the significance of information provided by firms. We believe such issues may be better addressed by improved discussion and information sharing with supervisors on a bilateral basis. We welcome recent efforts by the FSA to deal with these challenges and hope this process can continue under the new framework.

3.19 We support the proposal that FSMA is the model for the PRA's legal framework and that the powers and functions will be split into specific standalone handbooks. There must be utmost clarity regarding how the existing provisions of FSMA and the elements of the FSA handbook are transposed into the new handbooks. We note the desire to reduce and simplify the current volume of FSA rules and guidance consistent with a more judgement based approach. However, firms (and indeed their counterparties) must have certainty and clarity regarding prudential and conduct requirements. The transposition of FSMA could provide an opportunity for certain areas of legislation to be updated (for example in the area of market supervision).

### Coordination with CPMA

3.20 We note the proposed coordination measures set out in Box 3B of the Consultative Document. The Government needs to take care to ensure that the gravitas and weight of the CPMA and the PRA are reasonably balanced in order for both regulators to be able to discharge their responsibilities properly. We therefore suggest that there should be a symmetrical requirement on both the PRA and CPMA to consult each other on their respective rule-making and policy frameworks. We are not convinced that a UK college of supervisors is required.

3.21 Under the proposed framework, complex groups will be supervised by the PRA for prudential matters and the CPMA for conduct and market issues. It will be essential that there is effective joined-up coordination at working level between the various supervisors involved with an institution. This working level coordination needs to be in addition to the coordinating mechanisms suggested in Box 3.B.

3.22 We note the Government's intent to specify which regulated activities will be subject to authorisation, regulation and day to day supervision by the PRA. A number of activities such as deposit taking will be regulated by both the PRA



and the CPMA and the respective responsibilities of both bodies will need to be clearly specified and a consistent approach adopted.

3.23 The division of responsibility for enforcement activity between the PRA and CPMA could run the risk of a fragmentation of approaches and potential conflict between the bodies involved. It is critical that the right mechanisms for cooperation and coordination are established, and that firms are not subject to overlapping regulatory regimes and a disproportionate regulatory burden.

## European and International Regulatory Engagement

3.24 The PRA will need to adopt a culture and way of working that enables it to effectively engage and influence external stakeholders in addition to regulating UK firms. Throughout the transition process, the FSA must remain highly engaged in the development of the new EU architecture, particularly in relation to the powers which ESRB and the ESAs will have to impose decisions on firms or their regulators.

3.25 The PRA will need to actively participate in (and lead for UK firms) international and European supervisory colleges to ensure effective regulation and supervision of cross border firms. The PRA will need to be an active member of the European Banking Authority and the European Insurance Authority and effectively contribute to policy and technical rule making at European level. The workload here could be considerable. The PRA will also need to input data and intelligence into the European Systemic Risk Board and participate, as micro-prudential supervisor, in their deliberations.

3.26 In addition the PRA will need to participate actively in EU policy developments led by the Commission and Parliament and contribute expertise to European regulatory developments and policy making in an effective way. They will also need to engage with international supervisors in order to progress the G20 reform agenda and other matters. All this suggests an intensive European and international workload that will need to be effectively resourced.

**We recommend the establishment of a well resourced European Policy Division within the PRA to carry out this growing and important workload.**

## 4. Consumer Protection and Markets Authority

### Introduction

4.1 The Consultative Document proposes the creation of a single integrated conduct regulator, the CPMA. In principle Barclays welcomes the focus and clarity that this change should bring and would want the CPMA to be a strong and autonomous conduct and markets regulator in its own right. The CPMA will also be responsible for the prudential regulation of all firms not prudentially supervised by the PRA. It will need to coordinate closely with the PRA in both retail conduct and its markets functions.

4.2 Effective regulation requires the balancing of a number of policy objectives which may be in conflict with each other. The tension between conflicting objectives can either be internalised within a single body or externalised by allocating different objectives to separate bodies and then establishing a process to resolve potential conflicts. Either approach can be made to work.

4.3 We are concerned that the Consultative Document describes the CPMA as a 'strong consumer champion in pursuit of a single objective' and states that there would be no internal tensions. This suggests the single minded pursuit of consumer protection regardless of the potential impact on product cost and availability and on innovation and competition in the market. Our understanding is that the Government seeks a more balanced regime in retail markets, and is also concerned with achieving efficient, fair and orderly wholesale markets. We also note that the Government is keen to promote a more competitive market place for financial services in the UK and suggest that this objective should be reflected in the CPMA's remit.

4.4 A widespread concern about the UK financial services market is the degree of uncertainty about the regulatory environment, particularly with respect to retail markets. Reviews and new initiatives are launched on a regular basis by Government, Select Committees, regulators, competition authorities and others. This suggests that the regulatory regime to date has not been particularly effective at delivering the sort of outcomes for consumers that society seems to want. We look forward to working with Government and regulators to reach a better regulatory settlement where there can be more certainty for the industry and where private firms can compete fairly for business whilst still delivering good outcomes for consumers.

4.5 We note that under the proposed regime the CPMA would be subordinate to the FPC in a number of respects. For example Chapter 2 of the Consultative Document states that the FPC would monitor the CPMA's activities, make recommendations to the Treasury on the CPMA's regulatory perimeter, and have a power of direction over the CPMA to require specific tools to be used in the interests of financial stability. Whilst we largely accept this framework we believe the CPMA should be able to advise Government on relevant regulatory perimeter issues in its own right.

4.6 It will be important that the CPMA is seen to be powerful and authoritative in its own right if it is to attract and retain the requisite talent to be an effective and credible regulator. It should not be viewed as a poor relation to the Bank or PRA. There should be a symmetrical requirement on both the PRA and CPMA to consult each other on their respective rulemaking and policy frameworks as set out in para 3.21 and 3.22.

**The CPMA should have independence and authority in its own right if it is to be seen as a credible and effective regulator**

### Statutory Remit of the CPMA

4.7 In view of the CPMA's proposed responsibilities for all retail conduct of business, market conduct where firms and others participate in dealings in wholesale markets, and prudential supervision of all non-PRA supervised firms we recommend statutory objectives along the following lines:

- To promote confidence in financial services and markets through appropriate consumer protection and the promotion of fair and orderly markets;
- To promote effective competition in financial services and markets; and
- To support the safety and soundness of the financial system through the prudential supervision of certain financial institutions

4.8 We consider that the CPMA's objectives must be qualified by a number of factors that should be set out in statute including:

- The principle that restrictions imposed on the industry or on a firm must be proportional to the benefits to be derived from them
- The need to use resources in the most efficient and economic way
- The responsibility of those who manage the affairs of authorised persons
- The desirability of a sustainably profitable financial sector
- The desirability of facilitating access to financial services and products that meet the changing needs of consumers
- The principle that consumers should bear appropriate responsibility for their own decisions
- The desirability of a plurality of business models
- The international character of financial services and markets and the desirability of a level playing field
- The statutory objectives of the FPC and the PRA
- The desirability of the United Kingdom playing a full part in developing and shaping international rules and standards.

4.9 In its decisions, reporting and rulings, the CPMA should state how it has taken the above factors into account and sought to procure the objectives implicit in them.

**The statutory remit of the CPMA should reflect all of its responsibilities, and the FSA's process disciplines should apply to the CPMA in full.**

## Accountability and Governance

4.10 In view of the need to balance the overall regulatory regime and ensure the independence and appropriate stature of the CPMA, we believe that the CPMA should be directly accountable to Parliament through Treasury Ministers in much the same way that the FSA is at present.

4.11 We support the Government's intent to carry forward the FSMA accountability processes and apply them to the CPMA and believe they should be as rigorous as those under FSMA. These disciplines should also apply to the PRA in order to ensure proper checks on the exercise of regulatory power

4.12 We fully accept the importance of proper coordination between the activities of the CPMA and PRA regarding the effective and efficient regulation of individual firms. We largely support the proposed coordination processes set out in Box 3B of the Consultative Document. It is right that there should be MoUs and information gateways between the authorities and that they should each have statutory duties to have regard to each other's objectives. We do not, however, agree that the PRA should be able to take final decisions on proposed CPMA rule making, nor that the CPMA should have to consult the FPC in advance of any consultative processes with practitioners, consumers or other stakeholders other than in exceptional circumstances where there are major stability risks. If coordination mechanisms are working properly, such steps should not be necessary.

4.13 We agree that the CPMA Board should be governed by a majority of non- executives. Our preference would be that they are appointed by the Treasury which has clear lead responsibility for financial services policy in the UK. Whilst it is true that BIS has responsibility for general consumers, business, and better regulation, it could also be argued that DWP has responsibility for pensions and the Ministry of Justice/Home Office for fraud and security. Ultimate Ministerial accountability for financial services regulation needs to be clear and unambiguous. CPMA non- executive directors should all be responsible for ensuring that the CPMA discharges its statutory responsibilities effectively in line with good corporate governance practice and should not be appointed to represent particular interests.

4.14 It is not clear to us why Government needs to legislate to create an Executive Committee of the Board to take significant decisions. How the CPMA decides to organise its affairs and ensure effective decision making is for the CPMA Board to determine. The role of a Board is to set broad policy and strategy, oversee performance and ensure effective risk management, not take decisions on specific cases unless they are of high significance in policy, precedent or risk terms. The normal way of managing business would be for individual Board members who have a conflict of interest not to participate in discussions or decision taking on the matter in question.

4.15 Barclays agrees with the proposal to retain the Practitioner and Consumer Panels and put the Small Business Panel on a similar statutory basis. As noted above in relation to the PRA, it is important that the CPMA should be able to access confidential advice and have a confidential sounding board for its proposals and actions. The CPMA should be required as the FSA currently is, to consult and to draw on advice from one or more panels composed both of practitioners, consumers and possibly also representatives of the wider public interest. Such panels might be focused on the CPMA or shared with the PRA.

## Scope and Regulatory Approach

4.16 We welcome the opportunity afforded by the creation of the CPMA to update and improve the current FSMA/FSA consumer protection regime. It is important that both consumers and financial service providers can operate with more confidence and certainty than has been possible in the past. We are puzzled that the Consultative Document states the CPMA will adopt the FSA's new retail strategy as we would have thought that was a matter for the new CPMA Board. We look forward to engaging with Government, regulators and other stakeholders on how the development of a more proactive, interventionist regime could deliver better outcomes for consumers.

4.17 We look forward to the forthcoming BIS/Treasury consultation on simplification of the consumer credit regulatory regime. The current regime adds costs and lacks clarity for both providers and consumers. We see significant benefits in transferring responsibility for unsecured consumer credit regulation from OFT to the new CPMA because it would enable more coherent regulation of retail financial services for consumers. Consolidating consumer credit regulation under one regulator would lead to better, more integrated protection for consumers as well as simpler compliance for lenders. The CPMA should have as an early objective the removal of unnecessary regulatory burdens and duplications.

4.18 The Consultative Document rightly notes the important role of consumer financial education as part of the overall consumer protection framework. We note the Government's intention to review the CFEB within 3-5 years of its creation.

## Financial Ombudsman Service

4.19 We are surprised that the Government have not taken the opportunity to review the role of FOS within the overall regulatory framework for financial services. When FSMA was enacted the FSA was given clear new consumer protection powers and the new 'one stop shop' Ombudsman service was intended as an absolute backstop protection for consumers when things went wrong.

4.20 Since its establishment the FOS has grown from an office with just over 300 employees and a budget of less than £3 million in 2000 to one with over 1000 employees and a budget of £92 million in 2009. Ombudsman rulings have become a *de facto* form of retail regulation but without any of the checks and balances put in place by Parliament for the FSA, which the Government intends to roll forward for the CPMA.

4.21 We consider that the FOS should become a subsidiary of the CPMA in the new regime in order to deliver more clarity, certainty and regulatory coherence. The Ombudsman would then fall within the same overall statutory framework as the CPMA and this would help deliver greater coherence. In reaching decisions the Ombudsman should be required to have regard to all relevant regulatory policy and guidance in force at the relevant time. The Ombudsman should be required by statute to refer all cases on generic issues above a specified minimum threshold to the CPMA for action under the CPMA's proposed powers to specify redress schemes.

4.22 On the question of the Ombudsman's independence, what is critical here is the independence of the Ombudsman from either industry or consumer influence. It is impartiality rather than independence of decision making that is required. The concept of Ombudsman independence that took hold when FSMA was drafted derives from the pre-FSMA era when most financial services Ombudsmen were part of self regulatory industry sponsored regimes. Regulators such as the FSA or the proposed CPMA themselves enjoy statutory independence, so making the Ombudsman part of that regime should be a logical and helpful further development.

## FSCS

4.23 We can see the operational and policy merit of retaining a single compensation scheme and suggest it is constituted as a subsidiary of the CPMA in view of the CPMA's consumer protection responsibilities. However, the effective operation of the deposit protection part of the FSCS is important to both market confidence and financial stability. We therefore suggest that coordination of FSCS operations between the CPMA, PRA and the Bank be an additional part of the agreed crisis management process between the authorities.

**We support the transfer of consumer credit regulation to the CPMA but consider that the Financial Ombudsman Service should become a CPMA subsidiary**

## European Issues

4.24 The CPMA will need to lead technical policy discussions in Europe on behalf of the UK on retail conduct of business issues and also act as lead authority in terms of the UK's relationship with ESMA. It will be important to ensure that the UK appoints sufficient numbers of skilled officials into ESMA and other European supervisory bodies.

4.25 We therefore suggest that a separate European and International Division be established within the CPMA to ensure the requisite focus on European and other international developments of importance to UK markets.

## 5. Markets and Infrastructure

5.1 Market regulation requires both the ability to take a strategic overview of wholesale markets together with the capacity for detailed real time knowledge of market developments and market structure. The skills, knowledge, focus and culture of a skilled markets regulator will be distinctive from those of an effective consumer regulator. Whilst the market's function can coexist alongside the consumer function in a single regulatory body it is important that it retains its own integrity and is not viewed as having secondary importance; otherwise it could be 'crowded out' by high profile consumer issues.

5.2 A coherent markets authority function should ideally encompass the following:

- Monitoring and investigating market abuse, market manipulation and insider dealing
- Licensing and supervision of market infrastructure including exchanges, clearing and settlement systems and related functions
- Approval of prospectuses for listing and monitoring and enforcing listed companies' obligations with regard to market information
- Liaising with the Takeover and Mergers Panel to help ensure clean markets during bids.

5.3 Barclays welcomes the Government's recognition of the importance of a stable and credible framework for market regulation which promotes confidence in the stability, integrity and efficiency of financial markets in the U.K. Barclays therefore supports the Government's intention to establish a strong markets division within the new CPMA to lead on all market conduct regulation. This should enable the markets function to have the degree of autonomy, style of working and culture it needs to do its job effectively.

### Market Conduct

5.4 Barclays agrees with the basis of distinction, identified by the Government, between wholesale market activities and activities relating to retail consumers. The typical size of transactions entered into in the wholesale markets and the relative sophistication of the parties to those transactions differentiate the wholesale and retail markets. In recognition of that distinction, specific focus on the effective regulation of orderly markets and the regulation of appropriate standards of market behaviour is already a central feature of the regulation of Recognised entities under the FSMA Part XVIII regime in the UK and a central theme of the FSA's Code of Market Conduct. The creation of an operationally distinct division within the CPMA, dedicated to the regulation of wholesale market conduct, is therefore an important and welcome proposal. As ESMA is mandated to develop a range of technical standards relating to the regulation of European financial markets, numerous proposals for which have already been adopted by the European Commission, so the establishment of a CPMA Division with the dedicated expertise required to participate in wholesale initiatives in ESMA increases in importance.

### Regulation of Infrastructure Provision

5.5 As volumes of the OTC derivatives markets increasingly migrate into recognised clearing houses and other central counterparty clearing venues, so the systemic significance of those clearing houses increases. Accordingly, the prudential regulatory framework applicable to infrastructure providers such as central counterparty clearers is rightly identified as an important basis of the regulation of such concentrated hubs of counterparty risk.

5.6 The Government's recognition of the systemic significance of central counterparty clearers is echoed in the proposal for a regulation on OTC derivatives, central counterparties and trade repositories, adopted by the European Commission on 15<sup>th</sup> September 2010. The potential systemic risk impact derived from the pro-cyclical effects of varying collateral practices together and the potential concentration of credit risk in central counterparty clearers requires the adoption of a robust framework of prudential regulatory oversight for such clearing venues. Barclays therefore supports the Government's proposal that primary regulatory responsibility for the oversight of CCPs ought to sit with the Bank of England.

5.7 Barclays also supports the Government's proposal for the bifurcation of responsibility for the regulatory oversight of market infrastructure providers between the CPMA and the Bank of England in the manner proposed. However, we would underline the importance of the establishment of a clear and consistent basis of interaction between the CPMA and the Bank of England in relation to market infrastructure oversight, having regard to the following:

(i) There have been various examples in the market of operators of exchange trading facilities simultaneously providing central counterparty clearing services. This model of vertical integration of trading and clearing has been present in the London market for exchange traded futures and options since the early 1990s<sup>1</sup>. Recent developments in the market indicate that an increased number of vertically integrated clearing models are likely to emerge over the coming years. While the Government recognises the existence of firms which operate both trading and clearing functions, it will be important in the interests of establishing a transparent framework of regulation that respective roles of the CPMA and the Bank of England are clearly defined in relation to such entities.

(ii) There is currently no pan-European framework directly governing the regulation of central counterparty clearing houses. As the European Commission develops its proposals for the regulation of CCPs under its proposed regulation on OTC derivatives, central counterparties and trade repositories, so various regulatory technical standards relating to CCPs margining methodologies and other aspect of prudential regulation will be devised by ESMA. On the basis that the UK's primary representation in ESMA will be the CPMA, the Government should consider further the role of the Bank of England in formulating ESMA prudential regulatory standards and how that should be reconciled with the proposed role of the CPMA.

## The "Recognised" entity regime

5.8 The Government has proposed a possible rationalisation of FSMA regimes for regulating exchanges, trading platforms and clearing houses.

5.9 Barclays agrees that the combined effects of de-mutualisation, increased use of electronic trading platforms and increased fragmentation in the market for execution venues has altered the contextual framework within which Recognised entities now operate. Nonetheless, we would emphasis that certain characteristics of the regulation of the Recognised entities contribute to the mitigation of various systemic risks associated with trading with or through such entities. They are set out below. The focus of any such rationalisation might therefore focus on:

(i) Reducing the regulatory distortion in the framework of oversight for entities Recognised under Part XVIII and entities which are Authorised under Part IV where those entities provide functionally similar roles;

(ii) The basis upon which the risk reducing aspects of the Recognised entity regime might inform the development of regulatory technical standards in ESMA relating to the evolving regime for pan-European CCPs and other infrastructure providers.

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<sup>1</sup> OMLX, The London Securities and Derivatives Exchange, was a Recognised Investment Exchange with fully integrated central counterparty clearing from the early 1990's. NYSE LIFFE has also recently changed the basis of its clearing arrangements towards a more integrated model.



5.10 An Investment Exchange is not defined under FSMA. A Recognised Investment Exchange is an exchange in respect of which a "Recognition" order is in force under section 285(1) of the FSMA. As a consequence, the concept of a Recognised Investment Exchange is best defined by the criteria which it is required to satisfy in order to achieve recognition rather than by reference to a core underlying functional characteristic relating to the exchange's activity. It is these criteria which distinguish Recognised entities from Authorised entities and which form the basis in regulation between the two types of entity. A rationalisation of that regulatory framework would be a positive development but Barclays recommends that consideration should be given to preserving the positive attributes of the Recognised entity regime, a number of which are as follows:

(i) The Default Rules regime and the provisions of the Companies Act 1989 Part VII. The Default Rules regime provides a degree of mitigation of systemic risk that can derive from the successful challenge as to the validity of a transaction by an insolvency practitioner, following a counterparty default. The regime applies to Recognised entities but not to entities Authorised under Part IV. Furthermore, the regime goes beyond the powers conferred under the Settlement Finality Directive. A rationalisation which removed the powers conferred under Part VII would remove a useful tool in the mitigation of the systemic risk applicable to central counterparty clearers in particular. Those tools are a helpful supplement to conventional prudential risk mitigants deriving from capital and margin regulation.

(ii) The limitations on the scope of "exemption" under the Recognition regime is significant. Exemption in respect of the general prohibition under the FSMA only applies to activities carried out by the Recognised Investment Exchange (or Recognised Clearing House, as the case may be) for the purposes of or in connection with, the provision of exchange (or clearing) services. The effect of that limitation is that the recognised entity is not permitted to engage in other activities which fall to be regulated under FSMA and which might cause it to generate additional risk. Unlike an authorised entity, if a Recognised entity purports to carry on regulated activities in respect of which it is not exempt, it does not benefit from the provisions of Section 20 of the FSMA which regulates authorised entities engaging in regulated activities for which they do not have the required "permission". Instead the entity would potentially be subject to the penalties contemplated by Sections 23 and 26 of FSMA. This is a useful mechanism in constraining Recognised entities from the undertaking of additional risk activities.

(iii) Recognised entities continue to play an important role in the supervision of market conduct. The proximity of exchange market surveillance teams to the underlying markets that they regulate places exchange operators in a strong position to apply and enforce rules relating to aspects of market conduct. The FSMA Recognition Requirements for Investment Exchanges and Clearing Houses Regulations 2001 require such rules to be in place for a Recognised entity. It is notable that the quasi-regulatory role which is performed by Recognised entities is acknowledged in the statutory limitation of liability in damages for a recognised entity under Section 291 of the FSMA "....for anything done or omitted in the discharge of the recognised bodies regulatory functions unless it is shown that the act or omission was in bad faith." While the capacity of a Recognised body to make regulatory provisions in connection with its business is subject to limitations (for example, subject to the Investment Exchanges and Clearing Houses Act 2006) the supervisory role in respect of market conduct performed by the Recognised entities is a useful role in monitoring and influencing market behaviours.

5.11 We do not agree with the suggestion that the UKLA's functions should be merged with the Financial Reporting Council. We see listing authority functions as a key element of effective market regulation and believe more synergies would be gained from retention of the listing function within the Markets Division of the CPMA. We would also be

concerned about further loss of responsibilities from the division, which would make it less powerful and effective as a markets conduct regulator and as an advocate with the ESMA.

**Barclays supports the establishment of a strong Markets Division within the CPMA but believes that some of the more technical aspects of the proposals require further consideration. We do not support the transfer of the Listing Authority functions to the FRC.**

## 6. Crisis Management

### Crisis Management Framework

6.1 Barclays agrees that the effective coordination of actions between the authorities is of paramount importance in a crisis, and welcomes recognition that the Treasury has a key role to play. The Treasury's role needs to be wider than just the control of decisions involving the use of public funds because of the wider public interest in the effective management and resolution of a crisis. The Treasury already sits on the crisis management groups of major UK banks in recognition of this.

6.2 We support the need for a flexible framework but believe that the lead authority and decision maker must be clear at every stage of the process.

6.3 We agree that the Governor as Chair of the FPC should be required to report to the Chancellor every six months on developments in financial stability. However in our view it is the PRA's CEO, not the Governor, who should report to the Treasury on similar lines with respect to prudential regulation every six months, and the CPMA's CEO with respect to consumer and market issues.

6.4 On macro-prudential decision taking we believe the FPC should be required to notify the Treasury of their intent to take a decision regarding the use of macro-prudential tools in advance to allow the Treasury the opportunity to weigh up wider factors and make representations. The FPC should be required to take account of any such representations made in their decision making.

6.5 The Governor should be required to notify the Chancellor of potential significant risks to financial stability, whether idiosyncratic or systemic. This should not be restricted to potential calls on public funds.

6.6 We welcome recognition that the Chancellor will be accountable to Parliament for the authorities' crisis management strategy. He should also be accountable for effective crisis management leadership. We look forward to learning more about the Government's plans for full accountability of crisis management actions taken.

### Contingency Plans

6.7 One of the key learnings from the recent crisis is the need for the authorities to themselves develop contingency plans for crisis management. This will require close coordination not only between UK authorities themselves and also with supervisors, central banks and Finance Ministries in other key jurisdictions. Such advance planning is vital if effective real time decisions are to be taken in the next crisis.

6.8 The UK authorities need to put sufficient time and resource into supervisory colleges and crisis management groups for cross border firms in order to ensure that the UK's interests are properly protected. This should be seen as a core responsibility of relevant bodies in the new regime.

### Heightened Supervision Powers

6.9 It is envisaged that the PRA will take on the FSA's current powers to make rules about Recovery and Resolution Plans. It is important that further policy development in this area takes place within an agreed international framework. At present the UK is moving ahead of other jurisdictions.

6.10 We note that the Government will consider the recommendations of the Independent Banking Commission in considering whether the PRA should have wider powers to intervene, for example, to change the structure of banking groups to make them more resolvable. We would have major concerns about the granting of any such powers without the strongest evidence that they were necessary in order to meet Government's policy objectives for the banking sector as set out in section I of this response.

6.11 We do not at present see a need to reinforce the regulators' DIVOP powers as these are sufficiently flexible. Section 45 of FSMA already contains significant powers for the FSA to vary permissions, and it is hard to see what additional clarity might be brought to DIVOPs. The FSA now – and the PRA and CPMA in the future – have very wide powers over the regulated population, and DIVOPs have found their place especially in conjunction with other restrictions on regulated activity.

6.12 Any use of DIVOPs as an enforcement tool should be subject to the safeguards of the full enforcement process. In respect of the specific points raised in paragraphs 6.17 and 6.18 of the Consultative Document we would observe:

- Creating a mandatory mechanism for the use of DIVOPs by reference to specified thresholds is inconsistent with the greater use of judgement, especially in relation to prudential regulation. It presupposes that action at these trigger points will always be appropriate for all types of institution.
- DIVOPs are exercisable before a breach of the threshold conditions, and in a wide variety of circumstances NOT linked to the threshold conditions. Section 45.1(a) of FSMA clearly envisages that DIVOPs can be made where a firm is "likely to fail" to satisfy the threshold conditions. Section 45.1(c) removes any link to the threshold conditions, allowing the use of DIVOPs where "it is desirable to exercise that power in order to protect the interests of consumers or potential consumers." Indeed, the FSA has considered the use of DIVOPs in relation to failure to meet its requirements on financial promotions.
- The authorities already have wide powers to ring fence regulated entities in groups, up to removing the authorisation of entities in unsupervisable structures. They also have extensive powers over the directors and senior managers of firms and the appropriateness of controllers of regulated entities.
- It is hard to see how the wording of Section 45.1(c) could be more explicit in allowing the use of DIVOPs to protect consumers.

6.13 The Government will need to consider carefully the framing of any further powers to enable the PRA as micro-prudential supervisor, or the Special Resolution Unit of the Bank, to operate any 'bail in' type arrangement should international policy on this issue develop further.

6.14 There should be full consultation regarding any proposed changes to the Special Resolution Regime (and any equivalent regime regarding resolution of investment banks). Ambiguity in this area could risk market uncertainty and funding issues.

## European and International Issues

6.15 The European Union are developing their own crisis management policy framework and a Directive is expected next Spring. It is essential that the UK regime is planned in a way that will fit with the developing EU framework and also with wider international developments. This is a fast moving area of policy and the UK should be seeking to act as a key influencer in its development.

6.16 It is likely that a harmonisation approach to the availability and use of recovery and resolution tools will be agreed across the EU. If so the UK will need to factor this into its new framework.

**We welcome the proposed crisis management framework but believe that the Treasury's role needs strengthening and that EU and international developments on crisis management need to be fully reflected in the UK's approach.**

## 7. Other Issues

7.1 We would make a number of generic points about the proposed new regulatory framework. We set these out below.

### Administrative Functions

7.2 We note the proposals in respect of the CPMA taking the lead on co-ordinating and administering fund raising for the PRA, itself, the FOS, FSCS and CFEB. We welcome any debate which aims to achieve efficiencies and cost savings under the new regulatory regime. In certain instances it may well be appropriate for one regulator to take the lead if this results in a simpler and more efficient process for all involved.

7.3 Further, we would suggest that as part of the production of the CPMA and PRA's MoU that consideration is given to other administrative areas where efficiencies could be achieved. Depending on the outcome of this review it may be appropriate for the PRA and CPMA to share some essential back office functions, in particular where the output is of interest to both regulators e.g. regulatory reporting via the GABRIEL system and shared usage of the Online Notifications and Applications system.

7.4 There may be an opportunity for the PRA and CPMA to share existing administrative processes as a 'gateway' to share information where a firm that is jointly supervised applies for a regulatory permission, or a variation of permission or a cancellation. The PRA and CPMA should take advantage of existing FSA systems to maintain operational efficiency going forward.

### Funding and Audit

7.5 It is proposed that the PRA and CPMA be funded by a statutory industry levy in the same way as currently applies for the FSA. We are content with this provided there are strong checks and balances to ensure that funds provided by the industry are used efficiently and effectively.

7.6 It is not clear how the new and growing activities of the FPC within the Bank will be funded. The Bank's activities in relation to financial stability to date have been modest and have been funded by the statutory Cash Ratio Deposit scheme. We do not believe it is appropriate to maintain this as a basis for FPC funding and believe that the activities of the FPC should be funded by the entire UK- based financial services industry on a pro rata basis in view of the value that all financial services derive from financial stability.

7.7 Because the FPC, PRA and CPMA will in effect have tax raising powers over the industry they need to be accountable and demonstrate value for money in the way they discharge their responsibilities. For these reason they should have to consult annually on their proposed forward plan and budget and each be subject to full value for money audit by the NAO in addition to whatever statutory audit arrangement are in place. We also consider that the FOS should be subject to statutory value for money audit by the NAO.

### Data Sharing and Confidentiality

7.8 Principles and obligations regarding confidential treatment of information exist in FSMA and the EU directives. These must be transposed into the new regime and should be extended to non-supervisory bodies where relevant (e.g. to HMT with regard to confidential information it receives in relation to the Special Resolution Regime or Recovery and Resolution Plans). We recognise that co-operation between the various components of the UK regulatory regime as

well as between members of colleges and crisis management groups is key. However, firms will need to have confidence that information provided to the authorities will be treated confidentially and safeguarded against unwarranted freedom of information requests. Information gateways must be robust, with a common form of practice around information exchange to be developed between regulators in consultation with the industry.

## Transition Management

7.9 The Consultative Document recognises the importance of minimising disruption to existing arrangements as changes to the current regime are implemented. We remain concerned however about the period of uncertainty for key staff at a time when it is essential that talent and experience is retained and not lost from the regulatory system.

7.10 We are particularly concerned about the recent loss of experienced middle and senior management at the FSA, and the leadership vacuum regarding that part of the FSA that will move into the new CPMA. We urge Government to take action as soon as possible to support the FSA during what will inevitably be a difficult transition period, particularly in view of the need to continue to develop the regime and influence policy making in the EU and internationally.

## Human Resources

7.11 The new structures need to have the resources and ability to attract and maintain good quality, well compensated, and motivated staff with relevant industry experience especially given the disruption period that inevitably comes with change. Effective regulation depends on the people who execute it.

7.12 We note that the FSA undertook a comprehensive retraining programme for supervision staff, the Supervisory Enhancement Programme (SEP), throughout 2008 and 2009. We would like to see the good practice and industry led training that were associated with SEP maintained and indeed improved. Both the PRA and CMA should have strict entry criteria, especially for supervisory staff and there should be a strong training programme in place to ensure they are aware of the complexities of prudential and conduct of business issues. As part of this, it would be good to see industry have an input into this training.

7.13 We would be happy to support mutual secondment arrangements with the new authorities if this could be arranged in a way that avoids the obvious conflicts of interest.

## Annex A: Response to specific consultation questions

### The Bank of England and Financial Policy Committee (FPC)

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

*The FPC should be responsible for discharging the Government's financial stability objective, as set out in an annual remit from the Chancellor (following the model used for the MPC). As set out in paragraph 2.6 and 2.7 of this response document, if the FPC had objectives to maintain appropriate financial stability and, subject to that, to support the economic policy of the government, including its objectives for growth and employment, there would be no need for secondary objectives.*

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

*See response to question 1 and paragraph 2.6 and 2.7 of this document.*

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

*A suggested framework is drafted in paragraph 2.6.*

### Prudential regulation authority (PRA)

4. The Government welcomes respondents' views on:

- whether the PRA should have regard to the primary objectives of the CPMA and FPC; *Yes. See paragraph 3.8*
- whether some or all of the principles for good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice, should be retained for the PRA; *Yes. The 'have regards to' in FSMA should largely be retained. See paragraph 3.8.*
- whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; *Yes. See paragraph 3.8. Also, the PRA's statutory remit should reflect the need to promote an appropriate degree of financial stability and have regard to a full range of FSMA type factors in discharging its responsibilities.*
- whether there are any additional broader public interest considerations to which the PRA should have regard. *Yes, as set out in paragraph 3.7, we believe the remit for the PRA should be framed as follows: "To promote appropriate financial stability through the effective regulation and supervision of financial institutions and activities, having regard to the impact of regulation on competition and support for economic growth, and minimising the impact on the public and on financial markets of any firms which do fail." Also see paragraph 3.8.*

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



*We agree with the model proposed in 3.16 of the Consultative Document, with the caveat that there should be consultation with the FPC before the PRA and CPMA take decisions that could affect stability.*

6. Is the approach outlined in paragraph 3.17 to 3.24 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focused approach to supervision? *See 3.17-3.18 of this response.*
7. Are safeguards on the PRA's rule-making function required?  
*There should be consultation and rights of appeal built into to PRA powers as set out in 3.11*
8. If safeguards are required, how should the current FSMA safeguards be streamlined? *See 3.8*
9. The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable. *We have set out proposals in paragraphs 3.10 to 3.16.*

### **Consumer protection and markets authority (CPMA)**

10. The Government welcomes respondents' views on:
  - whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC; *See response in paragraphs 4.7-4.9.*
  - whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which; *Yes, they could all be retained, taking points made in 4.7-4.9 into account.*
  - whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; *Yes, see 4.3, 4.4, 4.7 and 4.8.*
  - whether there are any additional broader public interest considerations to which the CPMA should have regard. *See 4.3, 4.7 and 4.8*
11. Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator? *No. See 4.10-4.15.*
12. The Government welcomes views on the role and membership of the three proposed statutory panels for the CPMA. *See 4.13-4.15*
13. The Government welcomes views on the proposed funding arrangements, in particular, the proposal that the CPMA will be the fee- and levy-collecting body for all regulatory authorities and associated bodies. *See 7.5-7.7*
14. The Government welcomes views on the proposed alternative options for operating models for the FSCS. *See 4.23*

## Markets and infrastructure

15. The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation. *See 5.1- 5.3.*
16. The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses. *See 5.8 – 5.10.*
17. The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS. *See 5.11.*
18. The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator. *See 5.11.*

## Crisis management

19. Do you have any overall comments on the arrangements for crisis management? *Yes, see chapter 6 of this response paper.*
20. What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17? *See 6.11-6.12.*
21. What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24? *See 6.13-6.14*



Submitted by e-mail to: [financial.reform@hmtreasury.gsi.gov.uk](mailto:financial.reform@hmtreasury.gsi.gov.uk)

18<sup>th</sup> October 2010

### Consultation: A New Approach to Financial Regulation (July 2010)

Thank you for the opportunity to comment on HM Treasury's consultation on *A New Approach to Financial Regulation* ("the Consultation"). By way of background, BATS Trading Limited<sup>1</sup> ("BATS Europe") is based in the UK and is authorised and regulated by the UK Financial Services Authority ("FSA") as the operator of a Multilateral Trading Facility ("MTF").<sup>2</sup> We have set out below our views on the proposed new approach to financial regulation, and have focussed in the Annex to this letter on the questions in the Consultation with specific relevance to BATS Europe as a market infrastructure provider.

### The establishment of an FPC

We agree it is imperative that within the UK's system of financial regulation there are clear lines of responsibility, effective information sharing arrangements and coordination, and appropriate regulatory tools to take pre-emptive action and, where necessary, address issues that have arisen in the financial system and individual firms. We support the establishment of a Financial Policy Committee ("FPC"), in particular to prevent the risk of future regulatory "underlap".

### Ensuring the PRA and CPMA have equal standing

It is important that the proposed Prudential Regulatory Authority ("PRA") and Consumer Protection and Markets Authority ("CPMA") have **equal standing**. Whilst measures have been proposed in this regard, there is a concern that the CPMA may be regarded as a secondary regulator. The CPMA will be the UK's representative in Europe on the – to be formed – European Securities and Markets Authority ("ESMA") and **it is imperative that the CPMA is able to authoritatively represent the UK in European as well as in international forums.**

Whilst we agree that the PRA and the CPMA should have regards to each other's primary objective and consult with each other, we do not agree that the PRA should be the final arbiter with respect to certain decisions made by the CPMA. This clearly upsets the balance that the Government is seeking to achieve between the PRA and the CPMA. A better approach could be to place the role of arbiter with the FPC given such decisions will typically involve consideration of financial stability issues.

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<sup>1</sup> BATS Trading Limited is a fully owned subsidiary of BATS Global Markets Inc. Owners of BATS Global Markets Inc include affiliates of Citigroup, Credit Suisse, Deutsche Bank, GETCO, JPMorgan, Lime Brokerage, Morgan Stanley, Merrill Lynch and Wedbush.

<sup>2</sup> BATS Europe launched its market for the trading of pan-European equity securities on 31st October 2008 and regularly matches more than 10% of the notional value traded in FTSE 100 securities and 5-8% of other major European indices.



## Balancing consumer protection and markets issues in the CPMA

Within the CPMA, **equal weight must be given to consumer protection and markets issues**. This must be reflected in the CPMA's statutory objective and in its senior management arrangements. For example, the CEO of the CPMA must be able to equally and authoritatively represent consumer protection and markets issues.

## The Principles of Good Regulation

Whilst each regulatory authority should have a clear statutory objective, which should have primacy, this should be supplemented by factors to which each regulatory authority should "have regards". In particular, **we support the inclusion of checks and balances similar to those currently in place in place for the FSA in the Principles of Good Regulation**. With respect to those factors currently relating to competition, whilst we agree that the regulatory authorities should not have as their statutory objective the promotion of competition or the competitiveness of the UK, we believe **it is important for the regulatory authorities to have regards to competition factors**. We will also be interested to understand how the Office of Fair Trading's current obligations under the Financial Services and Markets Act 2000 ("FSMA") will be allocated and conducted in the proposed new regulatory structure.

## Rationalisation of the regulatory regimes for infrastructure providers

At present, market infrastructure providers in the UK can choose to operate under an "exempt" regime for Recognised Investment Exchange ("RIEs") and Recognised Clearing Houses ("RCHs"), collectively Recognised Bodies ("RBs"), or they can operate as authorised firms under FSMA. The historical rationale for the RB regime is that these entities are effectively quasi-self regulatory organisations to the extent that they have certain regulatory functions with respect to their users and members that differ from those obligations applicable to authorised firms. However, **the market infrastructure provider landscape has evolved** as a result of, amongst others, demutualisation, the introduction of competition, and changes to the regulatory landscape as a result of European directives. **Therefore, the original rationale for a distinct RB regime no longer exists.**

With respect to RIEs, the Markets in Financial Instruments Directive ("MiFID") has sought to create a level playing field between Regulated Markets ("RMs") – as operated by RIEs under the current UK regulatory structure – and MTFs. The regulatory requirements for both are largely similar and, where differences currently exist, the Committee for European Securities Regulators ("CESR") has recommended to the European Commission that these be aligned. We would also note the FSA has stated that it aims to apply its proportionate approach to regulation to RMs and MTFs, regardless of the fact that they sit under different legal regulatory regimes.<sup>3</sup> **Rationalisation of the two regimes would further the aim of creating a level playing field between RMs and MTFs.**

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<sup>3</sup> Page 13 of *The FSA's Markets Regulatory Agenda* (May 2010): <http://www.fsa.gov.uk/pubs/other/markets.pdf>



Most importantly, the Government’s Consultation recognises the importance of ensuring that regulators have appropriate tools at their disposal to carry out their functions. **The FSA’s current tools with respect to RBs are far narrower – and arguably far less effective – than those available with respect to authorised firms.** In particular:

- The FSA has no rule making powers with respect to RBs. High level “Recognition Requirements” are set out in legislation; however, the FSA sourcebook is only able to supplement these through guidance.
- There is no approved persons regime for RBs and no formal mechanism by which the FSA is able to approve persons conducting what would otherwise be “controlled functions” if the RB was an authorised firm.
- The FSA has limited enforcement powers with respect to RBs, which only include cumbersome powers to direct an RB to take certain action or revocation of the entity’s RB status.

All market infrastructure providers – whether RB or authorised firm – should and currently do have obligations with respect to their regulatory functions. However, given the evolved structure of market infrastructure providers in the UK and the importance of a robust market infrastructure in ensuring market confidence and stability, **it is imperative that the Government addresses the current deficiencies in the RB regime with respect to the regulatory tools available.** Rationalisation of the two regimes would be preferable and more effective than a levelling up, as it would both correct the imbalance with respect to the regulatory tools available, and would ensure consistency; between the entities that currently operate market infrastructure as RBs and as authorised firms, and between market infrastructure providers and all other regulated firms.

#### Proposed tripartite model for markets regulation

It has been widely noted that the proposals in the Consultation would effectively create a tripartite model for markets regulation: primary markets under the Department for Business, Innovation and Skills (“BIS”); secondary markets under the CPMA; and post-trade under the Bank of England (“the Bank”). We have concerns regarding the extent to which the regulation of markets will be split both with respect to whether there will be effective arrangements to provide an appropriate level of coordinated regulation, including to prevent regulatory “underlap”, and the extent to which the UK’s markets interests are effectively and authoritatively represented in European and international forums.

#### *Regulation of central counterparties*

The Government has proposed that central counterparties and settlement systems will be regulated by the Bank with respect to financial stability matters and by the CPMA with respect to conduct matters, whereas exchanges and MTFs will be solely regulated by the CPMA. The Consultation sets out coordination arrangements between the FPC, the PRA and the CPMA, and provides that the Bank and the CPMA will follow the same general principles of cooperation, coordination and consultation with respect to market infrastructure providers, although little detail is provided.



The Consultation also asks whether the PRA and the CPMA should be subject to the same accountability and transparency arrangements with respect to their rule making functions. A specific similar question is not asked in relation to the Bank's proposed functions. Accountability, oversight and transparency are key facets of UK financial regulation and help to ensure confidence in the regulatory system. We believe that all of the regulatory authorities – the FPC, the PRA, the CPMA and the Bank – should be held to comparable and equally high core principles with respect to rule making, decision making and policy development.

The European Commission has recently proposed its European Market Infrastructure Regulation ("EMIR") with respect to a pan-European regime for central counterparties and the clearing of standardised OTC derivatives contracts. The UK has significant interest in this regulation and the accompanying technical standards, which will be developed by ESMA. The CPMA will be the UK's representative on ESMA and must be able to authoritatively represent the UK in European and international forums on post-trade matters. **It is imperative that there are effective arrangements in place between the Bank and the CPMA, and that the regulation of, and policy development in relation to, central counterparties and settlement systems does not become an area of regulatory "underlap".**

#### *Primary market regulation*

The Government has proposed that the UK Listing Authority ("UKLA") could be merged with other regulatory functions relating to companies and corporate information, and could sit within BIS. **We support the UKLA remaining with the other functions currently conducted by the FSA's Markets Division in the proposed new CPMA.**

The UKLA – as part of the FSA's Markets Division – plays a considerable role in ensuring market confidence and investor protection by administering the UK's listing regime and by ensuring compliance with these requirements. There is, therefore, overlap between the objectives of the UKLA and the proposed objective of the CPMA. The CPMA will be the UK's representative in Europe and, given the level of primary market regulation set by Europe, it is important that the UK has a strong voice in European forums on primary markets issues.

The Consultation recognises that there is a significant amount of detail still to be set out and that further consultation will be necessary. We look forward to participating in these consultations.

Yours sincerely

Anna Westbury  
Head of Compliance and Regulatory Affairs, BATS Europe



## Annex

### The Bank of England and Financial Policy Committee (FPC)

- *Question 1: Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?*
- *Question 2: If you support the idea of secondary factors, what types of factors should be applied to the FPC?*
- *Question 3: How should these factors be formulated in legislation – for example, as a list of ‘have regards’ as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?*

We agree that the FPC should have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role. Similarly, the PRA and CPMA should each have a single, clear statutory objective.

Whilst each regulatory authority should have a clear statutory objective, which should have primacy, this should be supplemented by factors to which each regulatory authority should “have regards”. **We support the inclusion of checks and balances similar to those currently in place in place for the FSA in the Principles of Good Regulation.**

With respect to those factors currently relating to competition, whilst we agree that the regulatory authorities should not have as their statutory objective the promotion of competition or the competitiveness of the UK, we believe **it is important for the regulatory authorities to have regards to competition factors**. We will also be interested to understand how the Office of Fair Trading’s current obligations under FSMA will be allocated and conducted in the proposed new regulatory structure.

We support the proposal that the PRA and CPMA should have regards to the primary objective of the other, and that both should have regards to the primary objective of the FPC.

Accountability, oversight and transparency are key facets of UK financial regulation and help to ensure confidence in the regulatory system. Such arrangements include reporting, public consultation, and market failure and cost benefit analysis. It is imperative that the regulatory authorities have the correct tools and an appropriate and proportionate level of flexibility to conduct their functions, including with respect to crisis management. Nevertheless, we believe that all of the regulatory authorities – the FPC, the PRA, the CPMA and the Bank – should be held to comparable and equally high core principles with respect to rule making, decision making and policy development.



### Prudential regulation authority (PRA)

- *Question 4: The Government welcomes respondents' views on:*
  - *whether the PRA should have regard to the primary objectives of the CPMA and FPC;*
  - *whether some or all of the principles for good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice, should be retained for the PRA;*
  - *whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and*
  - *whether there are any additional broader public interest considerations to which the PRA should have regard.*

See response to Questions 1-3 above.

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

The division proposed in paragraph 3.16 would reinforce the model under which the PRA and the CPMA are operationally distinct and clearly responsible for the areas within their respective remits. However, clearly there will be a level of overlap and duplication. We await the Government's further consultation on this area.

- *Question 6: Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focussed approach to supervision?*
- *Question 7: Are safeguards on the PRA's rule-making function required?*
- *Question 8: If safeguards are required, how should the current FSMA safeguards be streamlined?*
- *Question 9: The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.*

See response to Questions 1-3 above.

We would also support further consideration being given to whether statutory panels should be established to whose representations the PRA should have regards (cf. the statutory panels proposed in relation to the CPMA).





## Consumer protection and markets authority (CPMA)

- *Question 10. The Government welcomes respondents' views on:*
  - *whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC;*
  - *whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which;*
  - *whether, specifically, the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and*
  - *whether there are any additional broader public interest considerations to which the CPMA should have regard.*
- *Question 11. Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator.*

See response to Questions 1-3 above.

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

We support the proposal to retain consultative panels and agree they provide important external challenge and accountability. Given the proposed remit of the CPMA, the Panels must be able to equally and authoritatively represent both consumer protection and markets issues.

We would note that sections 9(5)(c)-(d) FSMA provide that the Practitioners Panel should include persons representing RIEs and RCHs. **The proposed statutory Practitioners Panel for the CPMA should include persons representing market infrastructure providers, which may be RIEs, RCHs or authorised firms.** (See also below response to Question 16 on the rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.)

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

No comment.

- *Question 14: The Government welcomes views on the proposed alternative options for operating models for the FSCS.*

No comment.



## Markets and infrastructure

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

It has been widely noted that the proposals in the Consultation would effectively create a tripartite model for markets regulation: primary markets under BIS; secondary markets under the CPMA; and post-trade under the Bank. We have concerns regarding the extent to which the regulation of markets will be split both with respect to whether there will be effective arrangements to provide an appropriate level of coordinated regulation, including to prevent regulatory “underlap”, and the extent to which the UK’s markets interests are effectively and authoritatively represented in European and international forums.

### *Regulation of central counterparties*

The Government has proposed that central counterparties and settlement systems will be regulated by the Bank with respect to financial stability matters and by the CPMA with respect to conduct matters, whereas exchanges and MTFs will be solely regulated by the CPMA. The Consultation sets out coordination arrangements between the FPC, the PRA and the CPMA, and provides that the Bank and the CPMA will follow the same general principles of cooperation, coordination and consultation with respect to market infrastructure providers, although little detail is provided.

The Consultation also asks whether the PRA and the CPMA should be subject to the same accountability and transparency arrangements with respect to their rule making functions. A specific similar question is not asked in relation to the Bank’s proposed functions. Accountability, oversight and transparency are key facets of UK financial regulation and help to ensure confidence in the regulatory system. We believe that all of the regulatory authorities – the FPC, the PRA, the CPMA and the Bank – should be held to comparable and equally high core principles with respect to rule making, decision making and policy development.

The European Commission has recently proposed its European Market Infrastructure Regulation (“EMIR”) with respect to a pan-European regime for central counterparties and the clearing of standardised OTC derivatives contracts. The UK has significant interest in this regulation and the accompanying technical standards, which will be developed by ESMA. The CPMA will be the UK’s representative on ESMA and must be able to authoritatively represent the UK in European and international forums on post-trade matters. **It is imperative that there are effective arrangements in place between the Bank and the CPMA, and that the regulation of, and policy development in relation to, central counterparties and settlement systems does not become an area of regulatory “underlap”.**



### *Primary markets regulation*

The Government has proposed that the UKLA could be merged with other regulatory functions relating to companies and corporate information, and could sit within BIS. **We support the UKLA remaining with the other functions currently conducted by the FSA's Markets Division in the proposed new CPMA.**

The UKLA – as part of the FSA's Markets Division – plays a considerable role in ensuring market confidence and investor protection by administering the UK's listing regime and by ensuring compliance with these requirements. There is, therefore, overlap between the objectives of the UKLA and the proposed objective of the CPMA. The CPMA will be the UK's representative in Europe and, given the level of primary market regulation set by Europe, it is important that the UK has a strong voice in European and international forums on primary markets issues.

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

At present, market infrastructure providers in the UK can choose to operate under an “exempt” regime for RIEs and RCHs, collectively RBs, or they can operate as authorised firms under FSMA.

In its 2000 Discussion Paper on the regulation of the market infrastructure,<sup>4</sup> the FSA noted that:

“Factors that may influence an entity to opt for RIE (or RCH) status include greater flexibility in the regulatory regime, tax advantages and a general regulatory environment that incentivises (and sometimes even requires) market participants to use their facilities.”

The historical rationale for the RB regime is that these entities are effectively quasi-self regulatory organisations to the extent that they have certain regulatory functions with respect to their users and members that differ from those obligations applicable to authorised firms. However, **the market infrastructure provider landscape has evolved** as a result of, amongst others, demutualisation, the introduction of competition, and changes to the regulatory landscape as a result of European directives. **Therefore, the original rationale for a distinct RB regime no longer exists.**

With respect to RIEs, MiFID has sought to create a level playing field between RMs – as operated by RIEs under the current UK regulatory structure – and MTFs. The regulatory requirements for both are largely similar and, where differences currently exist, CESR has recommended to the European Commission that these be aligned. We would also note the FSA has stated that it aims to apply its proportionate approach to regulation to RMs and MTFs, regardless of the fact that they sit under different legal regulatory regimes.<sup>5</sup>

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<sup>4</sup> <http://www.fsa.gov.uk/pubs/discussion/D02.pdf>

<sup>5</sup> Page 13 of *The FSA's Markets Regulatory Agenda* (May 2010): <http://www.fsa.gov.uk/pubs/other/markets.pdf>



There do, however, remain differences between the two regimes in the UK. For example, RIEs can – and currently do – operate both RMs and MTFs. By contrast, regardless of whether an investment firm which operates an MTF meets the same regulatory standards, it is prevented by the current regulatory structure from operating an RM. Similarly, the UK’s Listing Rules restrict listing to markets operated by an RIE, even though the markets operated by these entities may be RMs or MTFs.<sup>6</sup> **Rationalisation of the two regimes would further the aim of creating a level playing field between RMs and MTFs.**

Most importantly, the Government’s Consultation recognises the importance of ensuring that regulators have appropriate tools at their disposal to carry out their functions. **The FSA’s current tools with respect to RBs are far narrower – and arguably far less effective – than those available with respect to authorised firms.** In particular:

- The FSA has no rule making powers with respect to RBs. High level “Recognition Requirements” are set out in legislation; however, the FSA sourcebook is only able to supplement these through guidance.
- There is no approved persons regime for RBs and no formal mechanism by which the FSA is able to approve persons conducting what would otherwise be “controlled functions” if the RB was an authorised firm.
- The FSA has limited enforcement powers with respect to RBs, which only include cumbersome powers to direct an RB to take certain action or revocation of the entity’s RB status.

All market infrastructure providers – whether RB or authorised firm – should and currently do have obligations with respect to their regulatory functions. However, given the evolved structure of market infrastructure providers in the UK and the importance of a robust market infrastructure in ensuring market confidence and stability, **it is imperative that the Government addresses the current deficiencies in the RB regime with respect to the regulatory tools available.** Rationalisation of the two regimes would be preferable and more effective than a levelling up, as it would both correct the imbalance with respect to the regulatory tools available, and would ensure consistency; between the entities that currently operate market infrastructure as RBs and as authorised firms, and between market infrastructure providers and all other regulated firms.

As a final point, under the current regime, there is provision to recognise overseas exchanges and clearing houses on the basis on equivalence and reliance on the home supervisory authority. With respect to exchanges, this has generally been used in a limited fashion to establish a physical presence in the UK and conduct marketing activities. By contrast, there are overseas clearing houses that currently provide clearing services to UK RMs and MTFs, for example, Netherlands-based European Multilateral Clearing Facility NV (“EMCF”) and Swiss-based SIX x-clear AG (“x-clear”); both of which are Recognised Overseas Clearing Houses (“ROCHs”).<sup>7</sup>

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<sup>6</sup> LR 2.2.3 R: <http://fsahandbook.info/FSA/html/handbook/LR/2/2>

<sup>7</sup> It is interesting to note that, prior to applying for and receiving ROCH status, EMCF provided clearing services to UK-based MTFs under the overseas person exclusion in article 72 of the Regulated Activities Order.



Within the EEA, the arrangements for non-UK RBs have effectively been superseded by the pan-European requirements for RMs and MTFs under MiFID, and will be by the pan-European regime for central counterparties under EMIR; thus removing the need for a recognition regime for non-UK EEA RMs, MTFs and central counterparties. That said, it is important to continue to retain the ability to allow a central counterparty from a comparable third country to be able to provide clearing services for UK-based RMs and MTFs.

- *Question 17. The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS.*
- *Question 18. The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator.*

See response to Question 15 above.

#### Crisis management

- *Question 19: Do you have any overall comments on the arrangements for crisis management?*
- *Question 20: What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?*
- *Question 21: What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24?*

See response to Questions 1-3 above.

#### Impact assessment

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

No comment.

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### By post and by email

Dear Sirs

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

This letter is submitted by Berwin Leighton Paisner LLP in response to the above consultation. We welcome the opportunity to comment on the Government's proposals.

We would like to make the initial point that we support the establishment of the Prudential Regulation Authority (**PRA**), as a subsidiary of the Bank of England. It is important to have a body that is responsible for macro-prudential supervision in the United Kingdom, an element lacking in the current regime where this responsibility was not clearly allocated. However, subject to this point, we believe that the Financial Services Authority (**FSA**) is currently "fit for purpose". In our view it would therefore be highly desirable for the Consumer Protection and Markets Authority (**CPMA**) to replicate the FSA as closely as possible, not least to ensure a smooth transition to the new regime for the industry.

More generally, we would also like to make the following comments:

- 1 More clarity is required to determine who is to be regulated by the PRA for prudential purposes. The consultation states that banks, broker dealers and insurers will be regulated by the PRA and notes that the Government will specify in secondary legislation which regulated activities will be regulated by which authority. We query whether the categories above are non-exhaustive and whether there is to be a size threshold on entities for them to be regulated by the PRA. In our view, this would make sense, although we recognise the difficulties involved in setting boundaries on the basis of size.
- 2 The consultation does not itself clarify what is meant by 'prudential' regulation. While it is generally recognised that prudential regulation covers whether a firm is soundly and prudently managed (including with adequate financial resources), it is wholly unclear how widely this will be interpreted under the new regime. The ostensible purpose of creating the PRA appears to be to give a single body the freedom to focus on potentially systemic issues relating to the largest financial institutions, without being distracted by wider supervisory issues. As a result we would strongly recommend that, to the extent that functions could be carried out by either the PRA or the CPMA, such functions are allocated to the CPMA rather than the PRA. This will facilitate the effective operation of the PRA.

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- 3 The importance of co-ordination and co-operation between the two new bodies cannot be overemphasised. For example, both authorities may be responsible for authorisations and the approval of approved persons within firms, as well as other issues such as remuneration, client money and conflicts of interest. This has the potential to lead to confusion and inconsistency of approach. We would be in favour of imposing a statutory duty on the PRA and the CPMA to act together in the supervision of firms in an integrated and cooperative manner wherever practicable. A model clause on which this duty could be based is at Section 354 FSMA. We would like routine supervisory visits (eg ARROW visits) to be conducted by the PRA and CPMA in parallel rather than separately. The authorities will also need to co-ordinate in the area of enforcement to avoid uncertainty in terms of sanctions and possible "double jeopardy". We believe that it is vital for the PRA and CPMA to share IT systems to ensure that they both receive identical information from firms which will enable both authorities to provide seamless regulation to those firms they both regulate, especially as the two bodies are likely to be physically separate from each other.
- 4 There are also some questions as regards remuneration. We believe that responsibility for remuneration will probably sit within the PRA for those entities which come within its remit. However, we assume that the CPMA will also have some responsibility for remuneration, for example, in the case of large investment managers. This, again, will result in a duplication of roles for the two authorities and reiterates the importance of a co-ordinated approach to such matters.
- 5 We are concerned that the proposals set out in the consultation will have the effect of significantly increasing costs for firms. Primarily, the duplication of certain activities by giving both the PRA and CPMA the responsibility for granting or amending permissions falling within their remit, as discussed in the consultation at paragraph 3.16, result in an increase of personnel costs to enable each authority to perform its statutory role. These increased costs will result in a higher levy on the financial services industry. In addition, firms will have higher internal costs as they deal with two regulators. Both these costs will ultimately end up being passed on to customers.
- 6 A further point of concern, with specific regard to the insurance industry, is that care must be taken to ensure that the PRA and the CPMA have the correct sector experience to regulate insurance. It would not be appropriate, for example, for a banking expert within the PRA to supervise an insurer, as the insurance sector has particular needs. In the early days of the FSA, the insurance industry felt strongly that their particular industry was not being supervised by those familiar with it. Secondly, shoehorning insurers into a banking model serves no-one well. The "one size fits all" approach, initiated through PRU was previously found to be unworkable and we are not aware that anything has occurred to change this.
- 7 A key question raised by the consultation is whether the PRA's rule making process can be streamlined. We would be extremely concerned if the public consultation process were to be removed altogether. The industry views consultations as important not only as a way of being able to comment on and influence policy, but also to provide checks and balances on the PRA's rule making powers. In the 2008 economic crisis, the FSA 'banned' short-selling without consultation which ultimately had little effect on the economic situation and was arguably counter-productive. Although this was an emergency measure, a consultation however short may have persuaded the FSA of the lack of merit in this course of action. In terms of the implementation of the Insurance Mediation Directive, industry worked with the

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- FSA and HM Treasury and persuaded them of the merits of reviewing the proposed "gold plating" of the IMD which could have necessitated the authorisation of company risk managers. Without consultations, costly and unforeseen consequences could arise.
- 8 The consultation (in question 4 and question 10) discusses whether some or all of the principles for good regulation currently set out in section 2 of FSMA, should be retained for the PRA and CPMA. On the whole, in our view these principles should be retained, though it seems to us that the "desirability of facilitating innovation in connection with regulated activities" principle should be abandoned. We do not believe that "facilitating innovation" should necessarily be part of the regulator's role as innovation has to be balanced against financial stability which obviously has greater importance. We would like to highlight the need to retain the requirement that the regulator has regard to "the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom". This is to ensure both proportionality and the need for the UK's markets to retain their attractiveness to international business.
- 9 We wish to stress the importance of the UKLA being part of the CPMA markets division. There is much overlap between the work of the CPMA and UKLA and there is a need for information to be freely available. In addition, it is important not to have the UKLA as a standalone regulator as this undermines the move away from the tripartite system. Further, we believe the CPMA must have the authority to represent the interests of both the wholesale and consumer communities.
- 10 We also believe that the CPMA's retail and wholesale responsibilities ought to be split within separate divisions of the regulator, to ensure that the appropriate level of focus is given to each area. Without this there is a risk that the CPMA will focus its resources on becoming an "aggressive consumer champion" at the expense of proper regulation of wholesale markets.
- 11 The consultation addresses the question of enhancing the regulator's "OIVoP" powers by making intervention mandatory at a specified threshold. We are concerned that this could have an unduly burdensome effect on firms as automatic intervention could prevent a firm from fulfilling its contractual obligations, leading to the so-called "death-spiral".
- 12 We also have some concerns about a firm's ability to challenge the regulator on prudential issues. It seems to us that the only way to challenge a prudential decision made by the regulator is by way of judicial review. This seems to us unduly burdensome and costly for the firm affected by the decision, and equally undesirable for the regulator whose decisions will be scrutinised in public by a judge who may be unfamiliar with financial regulation.

Yours faithfully

*Berwin Leighton Paisner LLP*

**Berwin Leighton Paisner LLP**

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Sir.

I write in response to the new proposals for financial regulation.

I run a small partnership specialising in advising limited companies on self-administered pensions. Our turnover is approximately £350,000 per annum and this firm has traded since 1990.

Since 1990 we have been on the receiving end of 5 regulatory visits, firstly by the Personal Investment Authority and subsequently by the Financial Services Authority, most recently we have undergone a "treating customers fairly" review for which we await the result.

In formulating the new regulatory framework I ask you to keep in mind the following principles:

- 1) That the people overseeing the regulation of this industry are experienced in it themselves. For too long I have become accustomed to time-serving civil service tick-boxers.
- 2) That regulation, particularly of the small firms, is done in a helpful way and shows understanding and flexibility, even offering advice. Up to now we have been subjected always to threats of fines if we do not do this or that. Coupled with the tick-boxing this aggressive attitude has produced a very poor impression of the FSA.
- 3) That regulatory visits and general supervision should concentrate on those firms which have received a high number of formal complaints, and not simply used as an attempt to tame and control the industry as a whole.
- 4) That regulation should be simplified to avoid the millions of pounds pouring into the coffers of so-called compliance consultants, whose only job has been to keep small firms one step ahead of the FSA.

Generally speaking the FSA has always tried to tame and control small firms of financial advisers by treating them all exactly the same, even when they patently are not. We have to have exactly the same filing system, send exactly worded letters to our clients and produce a paper trail in a way precisely dictated by the FSA. In speaking to other IFA's I know for a fact that many of them feel that the current regulatory system is totally unrealistic, cumbersome, expensive and detached from the actual day to day business of an IFA. Hence the need for all of us to hire costly compliance consultants.

It is the client who needs protecting from a few unscrupulous IFA's and these advisers are rich enough to hire consultants to cover their tracks. I feel that we all suffer and the guilty ones prosper.

Yours faithfully,

J H C BEVAN LL.B  
The Joseph Bevan Partnership.

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Dear Sirs

We would like to pass on our comments to you regarding the proposed Financial Services reform and in particular the fee structure.

We are a small family business that relies on customer service and has therefore not had to declare any written complaint on our FSA declaration.

For the past few years, we have paid approximately £1200-£1300 in fees to the FSA and FSCS but this year have received a demand for £2900 and increase of approx 125%.

It seems that this is due to the contribution to the FSCS for compensation claims which are mainly made up of mis selling of Payment Protection Insurance.

We do NOT sell this type of cover and feel it very unfair to have to pay towards this just because we are all banded in the same Insurance Intermediary category.

It also seems anti small business to make such huge increases and put already strained business under even more pressure and possibly put them out of business and staff out of jobs.

The other point is, there is no cap so on the increases, we are just told to pay it and as we have to be regulated it seems we have no choice. What if fees went up 1000%, we pay or go out of business.

Therefore, we would suggest two things:

1 - Fees are risk structured. Therefore, if you do not sell higher risk products, you are in a lower band and pay accordingly.

2 - There must be a cap on the increases each year as how can firms pay 100% + increases year on year (some firms have seen over 900% increases).

I hope that these comments do not fall on the same deaf ears as they seem to at the FSCS.

Greg Bishop

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## **White Paper on Financial Reform**

### **Response to Consultation questions**

**Professor Julia Black, London School of Economics and Political Science**

**18<sup>th</sup> October 2010**

**These responses are given in a personal capacity. They are not confidential.**

#### **Preface**

The White Paper does not ask for responses on the initial question of whether the FSA should be broken up. It is my opinion that it should not. The policy decision to split up the FSA was made prior to the election in a very different climate. At a time when quangos are being abolished or merged it seems perverse to spend the time and money splitting up a regulator when most of the problems could and are being addressed by less dramatic legislative changes, improved internal management within both the FSA and the Bank of England, and better communication between them and the Treasury.

The costs of creating the new regulatory structure will be considerable, both direct financial costs and costs in terms of the time and attention of officials in both institutions. There is a real risk that our influence in EU policy making in this area will wane further during the restructuring. It should also be noted that the UK structure of financial regulation will not align well with the new European structure. The proposed CPMA will not have the same remit as ESMA, for example, leaving the CPMA ill equipped to contribute to discussions on matters outside of its remit. Finally, there is little evidence that the new structure will perform the task of banking supervision any better than the FSA. Whilst some may harken back to the 'good old days' of the power of the Governor's eyebrows, it should be remembered that the Bank of England did not always demonstrate high levels of competence when it was the prudential supervisor, as evidenced in the failure of BCCI and Barings banks.

With the proviso of being opposed to the entire restructuring, the questions are answered below on the basis of that restructuring going ahead. However, I fear that they will continue to go ahead simply to 'save face' and not because of any over-powering reasons of efficiency or effectiveness.

#### **The Bank of England and Financial Policy Committee (FPC)**

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

Great care should be taken in setting out any secondary factors for either regulator, beyond the factors of 'good governance' which are common with respect to other regulators. In particular, neither regulator should be required to take into consideration London's international competitiveness. Other prudential supervisors that I have spoken to, notably in Australia and Canada, are astonished that a financial regulator could have this as something they have to take account of. Further, neither regulator should be required to take account of the 'responsibilities of senior management', also in FSMA. This had a deleterious effect on the FSA's approach, as suggested in the Turner report and by senior officials in the FSA, as it made them adopt a less intrusive approach to supervision than they might otherwise have done.

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

The factors should be simply stated to be the 'principles of good governance', eg as set out in the Compliance Code.

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

They should be formulated as a list of 'have regards' – a second set of objectives will confuse their legal relationship with the primary objectives and will detract from the clarity of those primary objectives.

#### **Prudential regulation authority (PRA)**

*4 The Government welcomes respondents' views on:*

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

The PRA and CPMA should be required to have regard to each others' primary objectives. The principles of good regulatory practice should be retained but consideration given to drawing on other principles developed subsequently, eg in the Compliance Code, to clarify the relationship between them.

The requirement to have regards to potential adverse impacts on innovation or competitiveness should NOT be retained as these have had a deleterious effect on supervisory practices.

There should be no broader public interest considerations mentioned (eg lending to small businesses) – if they are not sufficiently important to be an objective (eg financial stability) or to be picked up by other regulators (eg competition) then they should not be mentioned as they distract from the principal objectives.

In particular, the suggested principle that the burden should be proportionate to the impacts should be more clearly formulated as a requirement to undertake regulatory impact analysis with respect to all proposed rules, as applies to the FSA at present. This is a much clearer formulation. At present the proposal risks capturing enforcement decisions as well, which would not be helpful and provide unnecessary grounds for appeal. The proportionality of sanctioning decisions is already well provided for in judicial review and human rights jurisprudence.

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

Each authority should be responsible for all decisions within their remit, otherwise the lines of accountability and responsibility will be detrimentally blurred. It has to be said that the complex forms of cooperation required as set out in the White Paper do call into question the decision to split up the FSA in the first place. However, joint working has to be the norm in the proposed structure.

Further, it should not be the case that one authority is responsible for giving authorisation and permissions, as that authority will not have the same statutory objective as the other authority which is also going to have to supervise the same institution, and so their criteria for authorisation or permissions will be different. Instead, where an institution is asking for authorisation which will have to be supervised by both, the decision to grant authorisation or permission should be jointly made by CMPA and PRA. The same goes for requests for variation in permissions or unilateral variations in permission.

Consideration also needs to be given to how the approved persons regime will work and current practices for interviewing those in significant influence functions. These will have to be done jointly otherwise firms will have to go through the processes twice, at double the cost, and may face inconsistent decisions from the two regulators.

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

Clearly new legislation will need to be drawn up, and the process is likely to be more complicated than going through FSMA and handing out section \* to CPMA and section \* to PRA, as implied in the White Paper.

None of the proposals in the White Paper will enable the regulators to take a 'risk based, judgement focussed' to the extent that they were not before. There was nothing in FSMA stopping this approach. It should also be remembered that the FSA was operating a 'risk based approach' and indeed seen by other financial regulators as being at the forefront of developing such an approach. Canadian and Australian prudential regulators were also operating risk based approaches. Clearly just having a 'risk based' approach is not necessarily enough. Furthermore, there is no magic in putting these requirements in legislation – whether they happen is all down to actual practice. Good practice cannot be legislated for.

Finally, the White Paper here, as elsewhere, seems to be ignoring the fact that it is the European Supervisory Authorities who will be leading EU financial regulation in future. There is an expressed wish to move to a single EU rulebook, and to harmonise supervisory practices. The UK authorities are going to find themselves far less able to decide what their 'risk based' approach should be, or how they exercise their judgement, than they have ever been before, regardless of what their statutes say.

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

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

The current FSMA safeguards have worked well, with the exception that the requirements for consultation and cost benefit analysis should not apply to guidance.

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

These are all sensible measures which should be adopted.

However, the PRA should have the same set of accountability structures as the CPMA. In particular all enforcement decisions should be subject to appeal to the Upper Tribunal, there should be provision for reviews and inquiries, for a complaints body, annual public meetings and consultative panels.

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

**Consumer protection and markets authority (CPMA)**

*10 The Government welcomes respondents' views on:*

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

The objectives and additional 'have regard' considerations of the CPMA and PRA should be aligned as far as possible. Please see responses above to Q4.

In particular the CPMA should NOT be required to have regard to the matters specified, viz. the potential impact of policies or regulatory decisions on consumer and business lending; or the need to maintain diversity in the financial services sector (for example, by removing barriers to entry where possible, and ensuring that its rules do not disadvantage mutually owned financial institutions ); or promoting financial inclusion. These detract from the main objectives and create too many trade offs and conflicting purposes for the regulator to have a clear idea of what it is to do or for what it is meant to be accountable.

Promoting public understanding of the financial system should be an objective not something to simply 'have regard to'.

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

Please see response to Q 9 above.

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

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

Each body should be responsible for collecting its own fees, although it can contract this out to any of the others or to a third party. The responsibility has to be in line with the person setting the fees in order to clarify lines of accountability, otherwise the CPMA will be targetted as the messenger for firms complaining about PRA's fees. Also if CPMA is collecting PRA's fees, it is not clear who can impose sanctions for non payment.

#### *14 FSCS*

The PRA and the CPMA should make rules relating to compensation and levies for the different classes of firm which they regulate but the FSCS should continue to administer all compensation schemes. Clarity for deposit holders and investors is essential.

Moreover, the PRA should put in place a deposit protection scheme which does not, as at present, give a guarantee only per authorised institution, but gives one guarantee per trading name (so that an investor with HSBC and First Direct, or RBS and Nat West, for example, has in effect two guarantees not just one as at present).

#### **Markets and infrastructure**

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

One body should be primarily responsible for all markets and infrastructure regulation, preferably CPMA. However they should be required to coordinate on all rule making decisions with the PRA.

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

As stated above, when existing quangos are being abolished or merged it seems perverse to create a new one, this time for companies. The role of the UKLA should remain with the CPMA. They are overseeing the markets, running the market abuse surveillance regime, overseeing the trading platforms; it makes perfect sense for them to have the listing function as well.

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

I can see no overriding need, in an age of unprecedented budget cuts, to finance the cost of a new, unnecessary regulator.

#### **Crisis management**

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

The OCC does have a mandatory intervention trigger, however note that the Office of the Superintendent of Financial Supervision (Canada's prudential regulator) and the Australian Prudential Regulation Authority (APRA) have both deliberately decided not to have a trigger embedded in legislation on the basis it is potentially too restrictive or too lax (implying no intervention prior to that point). Instead, as part of its supervisory practice, APRA links required levels of supervisory action and intervention with the risk scores of the firms under its Supervisory

Oversight and Response System (SOARS). This is published on its website. This is a preferable way to proceed as it balances the need for clarity, predictability and transparency with the ability of the supervisor to exercise discretion over how to use such a critical power.

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

Ensuring internal clarity and separation of functions within the Bank will be essential. Incidentally, the difficulties raised in the consultation paper illustrate that the restructuring proposed will not remove the difficulties in handling the resolution of banks but simply replace them.

Although not raised in the White Paper, there should also be better and clearer protocols in place for communicating with the chair of the Treasury Select Committee, in secret if necessary, to ensure that Parliament remains fully informed of all expenditure of public money. The mistakes made in with respect to the handling of Northern Rock and the 2008 support arrangements should not be repeated.





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

Date: 18 October 2010  
Ref: RMcMullen 18/2010

Dear Sir

**A new approach to financial regulation: judgement, focus and stability;  
our response to the Treasury paper**

Please find enclosed our response to the various questions posed in your paper. As requested, I confirm that this response is submitted on behalf of Bluefin Insurance Services Limited.

If I may be of any further assistance then confirm and I shall be please to respond.

Yours sincerely,

Russell McMullen  
Corporate Governance Manager

## Consultation questions

### The Bank of England and Financial Policy Committee (FPC)

Q1 Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?

**A1: Yes, we believe FPC's objective should be supplemented with secondary factors to support successful achievement of a coordinated, "joined-up" regulatory environment in the UK.**

Q2 If you support the idea of secondary factors, what types of factors should be applied to the FPC?

**A2: In view of the different bodies playing their respective parts in an overall, UK regulatory system, coordination and transparency will be a necessary prerequisite. A fact recognised in part by the proposal for both the CEOs of PRA and CPMA to sit on the FPC Board. The primary objectives of PRA and CPMA should be secondary objectives for the FPC. Additionally the Principles of good regulation should be incorporated into the secondary objectives to give authority to issues such as operational efficiency and economy, proportionality in decision making, protecting the innovative and competitive nature of UK markets.**

Q3 How should these factors be formulated in legislation – for example, as a list of 'have regards' as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?

**A3: To ensure there is an overall, coordinated, regulatory system FPC should have a secondary set of statutory objectives rather than a list of "have regards" issues.**

### Prudential regulation authority (PRA)

Q4 The Government welcomes respondents' views on:

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

**A: Yes to ensure there is an overall, coordinated, regulatory system PRA should have a secondary set of statutory objectives which repeat the statutory objectives of FPC and CPMA.**

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

**A: Yes, PRA should also operate under the principles for good regulation. With these as secondary objectives to give authority to issues such as operational efficiency and economy, proportionality in decision making, protection of the innovative and competitive nature of UK markets.**

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

**A: Yes, the potential adverse impact on the innovative and competitive nature of the UK financial services sector owing to consequences of regulatory action require these aspects to be in place and in view of their importance, as secondary objectives not just as "have regards" issues.**

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

**A:** To differentiate between the types of firms it regulates so as not to damage the effectiveness of insurers in delivering their products to insurance intermediaries and the public. Particularly in applying more stringent standards that will quite correctly, be required of the banks. The Government should also have regard to the risk of creating a regulatory environment that would encourage registration in another EEA state and use of the passporting regulations to trade within the UK. That would not only undermine the overall objective of creating the FPC/PRA/CPMA but also reduce income for the Treasury.

Q5 Is the model proposed in paragraph 3.16 – with each authority responsible for all decisions within their remit subject to financial stability considerations – appropriate, or would an integrated model (for example, giving one authority responsibility for authorisation and removal of permissions) be preferable?

**A5:** Yes, the model in 3.16 is the one we would wish in place. In our particular circumstance as an insurance intermediary any need to deal with other than the CPMA would create additional and unnecessary administration cost. Cost which we would be unable to pass on to customers and having a direct effect on our margins, profitability and possibly, employment levels .

Q6 Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take a more risk-based, judgement-focussed approach to supervision?

**A6:** Yes, subject to previous comments and safeguards noted below.

Q7 Are safeguards on the PRA's rule-making function required?

**A7:** Yes ones requiring standards of operational efficiency and economy, proportionality in decision making, protection of the innovative and competitive nature of UK markets, to be met. Plus completion of a compelling Cost Benefit Analysis prior to action and external, independent, public scrutiny over the effect of decisions taken.

Q8 If safeguards are required, how should the current FSMA safeguards be streamlined?

**A8:** The current practices in relation to rule-making of consultation with practitioners, the wider public and use of cost-benefit analysis, do not require streamlining and should be retained.

Q9 The Government welcomes views on the measures proposed in paragraphs 3.28 to 3.41, which are designed to ensure that the operation of the PRA is transparent, operationally independent and accountable.

**A9:** Yes subject to our previous comments, we agree with the proposals but with the provisos of a published, annual report and annual, public meeting to publish that report.

## Consumer protection and markets authority (CPMA)

Q10 The Government welcomes respondents' views on:

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

**A:** Yes for coordinated financial regulation, CPMA's secondary objectives should include reference to PRA's (stable and prudent operation of the financial system) and FPC's (improving resilience of the financial system and enhancing macro-economic stability) primary objectives.

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

**A: Yes, the Principles of good regulation should be incorporated into the secondary objectives of CPMA to give authority to issues such as operational efficiency and economy, proportionality in decision making, protecting the innovative and competitive nature of UK markets.**

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

**A: Yes, the Principles of good regulation should be incorporated into the secondary objectives of CPMA including the need to protect the innovative and competitive nature of UK markets.**

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

**A: Yes, to appropriately differentiate between the types of firms it regulates so as not to reduce the availability of service to the public by those whose primary business is that of general insurance intermediary. And by not applying standards to insurance intermediaries which quite correctly will be required of higher risk firms such as those that handle investments and long-term products. We are also concerned by references in the paper to CPMA being a "consumer champion". We believe there is an obvious and irreconcilable tension in CPMA being "on the side" of the consumer whilst simultaneously policing good behaviour within markets. Championing the cause of the consumer is more correctly in the remit of the Consumer Panel, FOS in its deliberations when supporting principles such as Treating Customers Fairly and of course, the Which organisation.**

Q11 Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?

**A11: Yes, we agree that the accountability mechanisms proposed in paragraphs 4.36 to 4.38 for the CPMA are appropriate and sufficient for its role as an independent conduct regulator.**

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

**A12: With the narrower Prudential focus of CPMA greater emphasis will be placed on conduct of business matters. The output from the work of the Practitioner Panel and the Small Business Practitioner Panel will be crucial in assisting in a balanced regime between the needs of consumers (as represented by the Consumer Panel) and regulated firms' legitimate, commercial interests. Membership of the Practitioner Panel and Small Business Practitioner Panel should as previously, be drawn from a representative cross-section of the firms relevant to those panels.**

Q13 The Government welcomes views on the proposed funding arrangements, in particular, the proposal that the CPMA will be the fee- and levy-collecting body for all regulatory authorities and associated bodies.

**A13: Yes, we agree that CPMA should be the single collection point for its own fees and as agent for FOS, FSCS and CFEB fees as this will be the most efficient and economic collection method. However, and as has been noted recently at great length in the trade press, significant effort should be made to ensure that all fees levied reflect the level of service which any individual firm receives from these bodies.**

Q14 The Government welcomes views on the proposed alternative options for operating models for the FSCS.

**A14: We wish to see an end to all cross-subsidies in any future compensation scheme. Further we believe that insurance intermediaries, for whom such activity is their primary business, should only be responsible for compensation costs arising out of failure of another primary, insurance intermediary. We do not believe that defining eligibility criteria to segregate primary insurance intermediaries should be insurmountable. We would expect cognisance be taken not simply of the proportion of a firm's overall earnings from insurance sales but of the percentage of staff, management and directors competent to deal with and supervise, the sale of insurance policies. Also, the width of the range of insurance products sold (at least more than one and each showing a significant proportion of overall insurance sales) as well as account taken of the business profile a firm presents to its customers and the market.**

## Markets and infrastructure

Q15 The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation.

**A15: We note that "the PRA will represent the UK on the new European supervisory authorities for banking and insurance, ensuring that there is a strong and credible voice to promote the UK's interests in these new institutions" (1.18) And "The CPMA markets division will also represent the UK at the new European Securities and Markets Authority." (1.23). However, we are concerned that PRA will be Prudential facing, the involvement of EIOPA in non-Prudential and particularly Conduct issues and the imminent re-working of the Insurance Mediation Directive, making it imperative that CPMA is involved in representing the UK's conduct of business interests within EIOPA.**

Q16 The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.

**A16: We have no comment to make in this respect.**

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

**A17: We have no comment to make in this respect.**

Q18 The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies' regulator.

**A18: We have no comment to make in this respect.**

## Crisis management

Q19 Do you have any overall comments on the arrangements for crisis management?

**A19: We have no comment to make in this respect.**

Q20 What further powers of heightened supervision should be made available to the PRA and the CPMA, and in particular would there be advantages to mandatory intervention, as described in paragraph 6.17?

**A20: We have no comment to make in this respect.**

Q21 What are your views about changes that may be required to enhance accountability within the SRR, as described in paragraphs 6.21 to 6.24?

Impact assessment

**A21: We have no comment to make in this respect.**

Q22 Annex B contains a preliminary impact assessment for the Government's proposals. As set out in that document, the Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm. In particular, comments are sought from all types and size of deposit-taking, insurance and investment banking firms (including credit unions and friendly societies), and from groups containing such firms.

**A22: We note on the sixth page and quote "Costs – regulated firms. Most of the approximately 20,000 firms currently regulated by the FSA will be regulated solely by the CPMA after the reforms have been implemented. These firms are unlikely to suffer any significant transitional costs or significant increases in ongoing costs as a result of the reforms." The use of the word "significant", twice, concerns us. We would remind the Treasury that insurance intermediaries were not responsible for the financial crisis so in equity, should not incur additional cost in the implementation of any remedial, regulatory solution necessary to check the excesses of others. We would respectfully suggest that the principle of "polluter pays" is applicable in this situation and the inevitable cost involved in creating a different regulatory regime should fall upon those to whom blame is due.**

End

18 10 2010

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

18 October 2010

Dear Sir/Madam

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

We write in response to the consultation paper issued in July.

Bovill Ltd is a specialist financial services regulatory consultancy founded in 1999 and with offices in London and Manchester. Our clients come from virtually all parts of the financial services industry and many are small to mid-sized firms. Given the breadth of our experience across the industry and the fact that we work on behalf of a number of smaller firms who are not able to respond to the consultation themselves, we hope that the points we have outlined will be of interest. We would be happy to discuss them with you if this would be helpful.

Our response focuses on those issues that are of greatest concern to us and to our clients (although we note that the opinions expressed in this response are those of Bovill). A number of points do not fit within the consultation questions but we believe they are important and need to be raised at this time.

### **The Bank of England and Financial Policy Committee**

We are concerned that the proposals place a significant amount of power in the hands of the Bank of England and that there must be appropriate constraints on the exercise of these powers so that the macro prudential objectives are not pursued without regard to the implications for consumers and for the wider economy. The FPC should not therefore operate to a single unconstrained objective but should be required to have regard to secondary factors, particularly ensuring that the potential impact on the wider economy is taken into full account.

### **Firms regulated by both the PRA and the CPMA**

A major concern for small to mid-sized firms is the cost of regulation and compliance, both now and going forward. We think it highly likely that the proposals will lead to significant increases in the cost to regulated firms of regulation and compliance, particularly where firms are regulated by both the PRA and the CPMA and so may face multiple and potentially inconsistent requirements. Increased costs arise where firms need to manage requests for information, meetings etc from multiple regulators. We therefore believe first that the population of dual regulated firms should be kept as small as possible, and second that where dual regulation is essential, the two regulators should take an integrated approach to regulation of the firms in question..

We agree that authorisation and permissions is a key area where an integrated approach should be considered, where firms are subject to both regulatory regimes.

Financial services regulatory consultants

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We suggest that some form of lead supervision model will be necessary to ensure efficient coordination of regulatory requests where firms are regulated by both PRA and CPMA. In particular, and in order to avoid duplication and unnecessary cost for both firms and regulators, there should be a single coordinating point for information requests, filing of regulatory returns, coordination of site visits and meeting requests, etc.

It seems likely that PRA and CPMA regulation will have to be covered by separate rule books, which will also add to the complexities of achieving compliance. Some areas of regulation will be of interest to both PRA and CPMA, for example firms' governance and risk management arrangements will typically encompass both prudential and conduct considerations and in such areas it will be essential for both regulators to be aligned and to adopt a common, consistent position in relation to individual firms.

Whilst we appreciate that formal gateways for information sharing will need to be in place between the regulators and for the purposes of ensuring that the FPC has all the information it needs on macro issues, we were concerned to see a reference at para 3.2.6 to the possibility of colleges of supervisors. These have existed both in the UK pre-FSA, and between regulators from multiple jurisdictions and we believe that they have seldom been effective in achieving anything more than limited information exchanges so we do not see this as a good precedent for coordination and cooperation between the PRA and CPMA. Other, more effective, ways of ensuring good communication will need to be found. The sheer length of the list of "formal processes" in box 3B on page 26 of the consultation paper is illustrative of the likely problems: these provisions for consultation and coordination between bodies with different responsibilities are likely to be time consuming and expensive. It is essential that the two regulators are able to act effectively as one when dealing with firms on major issues.

#### **PRA Rule making powers**

We are extremely concerned at the suggestion that the PRA might not be subject to safeguards analogous to the current FSMA safeguards around rulemaking. The case for any new regulation and the associated costs it will impose should always be demonstrably supported by rigorous analysis, including cost benefit analysis, and subject to a process of challenge, and the existing safeguards, even if they are not perfect, are an important element of this. We believe there are many instances where industry input, particularly of a technical nature, has been extremely important in shaping regulations to ensure that they achieve their intended aims and that unintended distortions are minimised.

We would add that when we canvassed the opinion of some of our clients on this point, a number of them felt that there was little or no point in responding to FSA consultations because they considered that the FSA took no or very limited account of comments received. This suggests that, if anything, the regulators need to work further on explaining their position and responding to comments.

#### **PRA and CPMA - Quality of Supervision**

If the proposals achieve the intended significant strengthening of prudential regulation, this will be beneficial and should reduce the risk of certain types of failure going forward.

We observe though that many historical failures were at least in large part due to significant weaknesses in corporate governance. The FSA has, under its "intensive and intrusive" supervision approach, quite rightly increased its focus on the actions and behaviours of Boards and Senior Management and on the 'tone from the top' which they set in terms of compliance and risk management culture. We believe that this needs to remain a key focus of regulators and that a judgement-based approach is needed when assessing these areas. This is because firms must have in place governance arrangements that are 'fit for purpose' in the context of their business and operating model. However, the exercise of judgement by regulators must be based on experience



and a detailed understanding of the business of the firms they supervise. In this respect the FSA has operated with mixed success.

We suggest that it will be critical for both the CPMA and the PRA to recruit and retain first class people to act as supervisors. Experienced and effective supervisors can make up for imperfections in regulation but the reverse is generally not the case. We therefore urge the Government to work towards better regulation implemented by highly experienced supervisors rather than simply more regulation.

## **Markets and Infrastructure**

Given the particular concerns about derivatives markets that underpin the need to strengthen markets and infrastructure regulation, we find it difficult to see the logic for proposed split of responsibilities between the Bank and the CPMA in relation to markets and market infrastructure as it seems impossible to separate out infrastructure concerns from the orderly operation of markets.

## **CPMA as Consumer Champion**

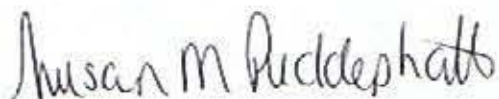
It will clearly be an important part of the CPMA's role to ensure that firms treat consumers fairly in the widest sense, and this will rightly extend to taking strong action where consumers have been treated unfairly, whether by individual firms or by a part of the industry more generally. But we do not believe that it is appropriate for a regulatory body to be characterised as a "consumer champion" as this implies an advocacy role that does not sit well alongside the regulation of individual firms.

Further, an appropriate balance needs to be struck between consumer protection and stimulating enterprise. Small business and start-ups are increasingly looking to individual investors to provide equity finance and indeed a number of government tax initiatives are designed to encourage this (for example, the EIS). It is important that the regulatory regime leaves room for the provision of risk capital from individuals and provides an appropriate and proportionate regulatory regime for regulated intermediaries operating in this area.

## **Consumer Credit Regulation**

We note the suggestion in the CPMA might, in time, assume the responsibilities of the OFT for consumer credit regulation. We believe that there are considerable merits in this proposal, for the reasons set out in the consultation paper. It will be important to ensure, however, that the resourcing and organisational structure of the CPMA is appropriate to the effective discharge of what will be, potentially, a very wide range of responsibilities across a wide range of disciplines and a very large number of regulated firms

Yours sincerely



Susan Puddephatt  
Principal



BREWIN DOLPHIN

A new approach to financial regulation:  
judgement, focus and stability –  
Brewin Dolphin response

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# 1. The Bank of England and the Financial Policy Committee

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

Whilst we agree with the need to legislate for a single body with responsibility and powers to scrutinise macro-prudential risk to ensure financial stability, we believe that the objective is too narrow to encapsulate fully the wide-ranging scope of the FPC. We therefore support the view that the primary objective of the FPC should be supplemented with secondary factors.

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

We think that the proposal to implement macro-prudential policy through regulatory action by the PRA and the CPMA is naturally followed by the requirement to consider:

- the individual statutory objectives of the PRA and CPMA

We understand that where there is conflict between the three entities (FPC/PRA/CPMA), the financial stability objective will take precedence. However, we feel that the likelihood of conflict arising between the three bodies has not been considered fully as the subject lacked clarity entirely.

It has been suggested that each of the three regulators have a primary objective of their own with the HMT seeking views on whether the primary objectives of their counterparts should be secondary considerations. Although it appears to be a foregone conclusion that this would be the approach adopted when the three bodies are carrying out their day to day responsibilities, we fail to see how this differs from the current tripartite model. The issue of ambiguity over the overall cohesion between the three regulators goes much deeper than conflicting objectives but it is perhaps the tip of the iceberg.

The mention of the *'transmission mechanism'* by which regulatory decisions of the FPC will be implemented by regulatory action of the PRA/CPMA and the ability to monitor, assess and direct the activities of the PRA/CPMA does seem to place the FPC in a place of seniority. Please can you clarify this matter?

It needs to be absolutely clear which authority will have the overriding power of decision where regulatory action clashes, due to each body having differing objectives, as well as the necessary authority to intervene in the event of regulatory failure at any level.

We agree that the decision taken by the FPC *'could have far-reaching consequences for the financial sector and the economy more widely'*. For this reason we believe that in pursuing its primary objective the FPC should consider issues such as:

- the wider societal impacts of its decisions and appropriate use of macro-prudential tools as
- the wider fiscal and economic impacts of its decisions and appropriate use of macro-prudential tools



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In addition,

- burden and overall cost of regulation on the industry
- the extent to which its activities will require direct regulatory action by the PRA/CPMA

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

Currently the FSA has five statutory objectives supported by a set of principles of good regulation that they must have regard to when discharging their functions. We believe the principles are often forgotten or disregarded by the FSA in their fervent pursuit of their statutory objectives.

It is unfortunate and evident that applying an approach that follows the letter of the law produces a mentality which breeds a rigid and mechanistic approach to regulation which in turn encourages ‘tick-box’ compliance.

We are concerned that applying a single objective increases the risk of a slavish adherence to one cause at the expense of other important objectives. A more balanced approach is to have clearly defined secondary objectives and whose importance is given credence.

Once enacted a statute is rarely subject to change and consequently hastily drafted rules can become inflexible or obsolete. It is imperative, therefore, that we ensure sufficient consideration is given to getting the balance right. We are concerned that this may be compromised given the short implementation period.

## 2. Prudential Regulation Authority (PRA)

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**4. The Government welcomes respondents’ views on:**

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

As outlined above, considering the close nature of the working relationship between the three regulators it naturally follows that they must consider each other’s primary objectives and that this obligation should not be disregarded.

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

We would challenge the view that ‘not all of the principles of good regulation which currently apply to the FSA under section 2 of FSMA 2000 should necessarily apply to the PRA’. As mentioned above, any previous failures which rendered the principles of good regulation irrelevant to the PRA are due to the loose wording in the statute and which allowed the regulator to apply or disapply them at will. We strongly feel it is important to retain ‘the principle that a burden which is imposed on a person should be proportionate to the benefits which are expected to result’ and are very concerned about the number of occasions when the FSA has failed to publish a Cost Benefit Analysis until after the Consultation process has begun. Honest and transparent dialogue between the regulator and the industry is vital to the health of our industry and an effective consultation process



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facilitates this dialogue. The FSA must take heed of its own findings otherwise the consultation process is meaningless.

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

We would also challenge the view that *'concern for competitiveness leading to a generalized acceptance of a 'light-touch' orthodoxy...was facilitated by the view that financial innovation should be supported at all costs'*. It was, we believe, *'the lack of sufficient consideration or understanding of the impact of complex and new financial transactions and products'* that was the main issue at hand.

The regulator should accept that when it comes to innovation it will always be behind curve and it should not be afraid of that. It must equally accept that in order for the UK financial system to remain *'one of the most open, globalised and successful in the world'*, the regulator must not put in place structures which would hinder competition or innovation and therefore must consider the impact of its regulatory decisions on these factors, which are necessary for economic growth. As such, it should not have less or no regard to these but it must work to understand new and innovative ways of doing business and must equip itself to be able to differentiate dangerous practices from innovative ones. To do this, the regulator should seek highly skilled resource and pursue effective communication and open relations with the industry in pursuing its objectives and to take the necessary time to prepare and draft sensible and long lasting regulatory requirements.

In addition, we believe that the existence of personal accountability facilitated by a robust sanctions regime would help to rein in the adventurous spirit of those walking the fine line between personal profit and benefit to the consumer.

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

Without fully understanding the exact responsibilities of the PRA due to such a high level nature of the proposals, we would initially suggest that the potential wider economic impact of regulatory policies and decisions would be the remit of the FPC due to its ability to scrutinize, direct and make recommendations on the regulatory action of both the PRA and the CPMA.

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

Separating out the regulation and day-to-day supervision *'of all firms subject to significant prudential regulation'* such as banks and other deposit-takers, broker-dealers (or investment banks) and insurers, seems sensible. As mentioned in our covering letter, different business models require different regulatory approaches taking into account the specific risks their business models pose.

However the proposal to then give the CPMA the responsibility of regulating the conduct of all firms *'including all firms authorized and subject to prudential supervision by the PRA'* in their dealings with retail clients creates an enormous possibility of operational overlaps and inconsistencies, which would create delays and uncertainty in matters of mutual concern.

The powers and functions of both the PRA and the CPMA are too ambiguous and we believe that it is not enough to say that *'in some cases there may need to be overlapping powers and functions'* and where such overlap exists *'arrangements will be put in place to ensure the authorities co-ordinate action appropriately to minimise the burden for firms'*. Please can you clarify these arrangements?



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Although we are told that draft legislation on the necessary powers and functions of the PRA and CPMA will be consulted on, the consultation will take place in early 2011, which is a few months after the *'shadow internal structure'* which will *'allocate FSA staff and responsibilities in anticipation of the formal creation of the CPMA and PRA'*. This seems to undermine the consultation process rendering it null and void and one must question whether industry feedback will really be taken into account. Pre-determined outcomes have for a long time now been the bone of contention between the industry and the regulator, hampering instead of encouraging open dialogue between the two.

It is also not favourable for firms to be subject to two different authorisation and permission regimes depending on which regulated activity it wishes to perform as it will increase the amount of red tape, cost expressed in time, resource as well as money.

It does seem to us that administrative functions such as granting permissions as well as collecting fees and levies are in nature tick-box exercises. For this reason we think they should be kept separate to the focused teams of the PRA and the CPMA who are going to be expected to exercise judgement based on their specialist knowledge. We would therefore support the APCIMS view that there should be a joint service company to operate between the PRA and the CPMA covering all activities relating to authorisation of firms, granting of permissions and approval of individuals.

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

We are told that the Government is working to reform FSMA 2000, modifying where necessary to facilitate judgment-led prudential regulation. Whilst there is nothing wrong with this ambition the proposals are far too high level for effective commentary and feedback. Until the proposals based on the results of this review have been published, firms are not in any way able to predict how drafting of high-level legislation will be adopted in practice by supervisory staff. Again the key functions of the PRA seem to overlap with those of the CPMA and these overlaps must first be addressed or the first principle of good regulation which stipulates that there is a need to use resources in the most efficient and economic way, will be breached.

Also, reducing and simplifying the rules and guidance contained in what is currently within the FSA Handbook does not automatically lead to *'risk-based, judgement-focussed'* approach to supervision. We have already heard this rhetoric and seen its effect with the FSA's transition from *'rule based'* to *'principles based'* to *'outcomes-focused'* regulation, with failures occurring whether there were many rules or none. What is necessary is an understanding of firms' business models and risks, employing competent staff with skill set specific to the relevant sector and open and frank dialogue with the firms being regulated.

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

Yes

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

BD believes that the PRA should be subject to the full range of statutory provisions contained within FSMA 2000 in order to avoid the regulator becoming the judge, jury and executioner. Whilst changes may be necessary to address weaknesses or gaps in the regulatory structure, this does not mean the whole process must be completely overhauled. By allowing the regulator to evade the consultation process takes away from the dialogue with the industry and the wider public in general, that is an inherent part of the process. It would be a mistake to underestimate the knowledge, experience and expertise of those providing or benefiting



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from financial services. This detailed understanding and knowledge is invaluable input when it comes to legislating and supervising and such open and frank discussions should be encouraged by the Government.

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

We agree with the accountability and Governance proposals outlined in paragraphs 3.28 to 3.41. However despite the Board being made up of majority of non-executives members we would like to further underline the point that ‘a constructive and independent challenge to rule-making’ will be reinforced by a robust consultation process.

### 3. Consumer Protection and Markets Authority (CPMA)

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**10. The Government welcomes respondents’ views on:**

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

As in Q4 BD believes that due to the Governments expectation that the 3 entities are to work in close arrangements it will naturally follow that the pursuit of their primary objectives should be balanced against the primary objectives of the other 2 regulators. For example, if the PRA took the decision to increase a firm’s capital requirement to such an extent that it threatened the firm’s ability to service its customers then it would be critical for the CPMA to intervene to ensure the best outcome for the clients, the firm and shareholders.

We believe that the HMT must consider the issue of conflicting objectives in much greater detail.

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

The principles of good regulation set out in s2(3) of FSMA state that in discharging its general functions the FSA must have regard to the following;

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

(b) the responsibilities of those who manage the affairs of authorised persons;

(c) the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;

(d) the desirability of facilitating innovation in connection with regulated activities;

(e) the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom;

(f) the need to minimise the adverse effects on competition that may arise from anything done in the discharge of those functions;





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(g)the desirability of facilitating competition between those who are subject to any form of regulation by the Authority.

We believe that these should be redefined, bearing in mind the need to use judgment in order to ensure proportionality in terms of regulatory costs and accurately determined benefits applied in real terms, which will result in fairness to both firms and consumers.

We also feel that the last two principles on ensuring competition in the markets could be condensed into one.

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

It has never been our understanding that the Regulator is ‘responsible for the innovation and global competitiveness of the industries’. The responsibility to innovate and maintain competitiveness is down to each entrepreneur and firm. Ensuring that regulation is not prohibitive but proportionate is absolutely necessary and the regulator must take into account the effect regulatory decisions will have on firms’ ability to continue to provide relevant services and products. Competition not only encourages economic growth but encourages Treating Customers Fairly (TCF). A lack of competitiveness is harmful to individuals and the economy at large.

UK domestic regulation must have regard to the European Single Market for Goods and Services and not place UK firms at a competitive disadvantage.

We would like to comment that the ‘light-touch orthodoxy’ which the HMT is suggesting resulted from the FSA’s emphasis on maintaining competitiveness in the UK is not necessarily the correct view.

By way of example we would like to draw your attention to the increasing cost of regulation borne by our firm and undoubtedly many others like us, which has had a detrimental effect on our ability to compete.

Our FSA fees and other levies totals have gone up considerably over the last three years.

2008	2009	2010
£230,768	£795,051	£1,487,342

Although the FSA fees have grown steadily in line with our business, it is the FSCS levy top-up which has pushed these totals to double year on year. As mentioned in our introductory letter although the investment sector has suffered from notable failures such as Keydata, these can be quite fairly attributed to the FSA’s failure to act on time, despite being aware of fundamental problems within the business. We do not accept that this failure to act came from fear of adverse impact on competitiveness. The rising costs to firms who have had to subsidise these failures has increased the cost to clients of providing a service.

Similarly over the last three years, due to various other regulatory pressures, Compliance Employment Cost, expressed below as a percentage of our total Group Employment Cost, has also gone up in order for us to be able to meet our regulatory requirements.

2008	2009	2010
2.6%	2.9%	3.4%



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These are just examples of the cost to our business.

The cost of the RDR initiative to the FSA has escalated to almost £3million<sup>1</sup> and we as the firms who fund the operation of the FSA will have to meet those costs. The costs break down as follows;

Costs	Amount
Staff	£2.6m
Project management	£249,000
Consultants and agencies	£643,000

The latest Cost Benefit Analysis, done by the FSA shows the ten-year cost rising to around £0.5billion.

Although it comes as no surprise to the rest of us, Adviser Alliance warns that *'RDR will prove costly for consumers as millions will be left without an advisor due to the mass cull resulting from draconian changes'*. We also know that the *'cost to consumers will rise as the regulatory cost burden must be passed on to consumers'*.

Furthermore, our total cost of implementing the TCF initiative was £315,146. We do not begrudge this cost because we deem the TCF initiative to be without merit; we begrudge it because facilitating a competitive environment is fundamentally TCF. Firms such as ours have endured because of the strength of our relationship with our clients. This relationship is carefully maintained and cultivated over a number of years and the bespoke nature of the service we provide ensures that the client receives a service they understand and is suitable for their needs. We talk to them using language they understand, give them advice and then construct a portfolio designed just for them. It is not a mass market product.

We would like to refer you to a study done by the Practitioner Panel on the cost of regulation 2005<sup>2</sup>. We believe that the position for retail firms has worsened over the last 5 years.

For the reasons outlined above we believe that the regulator must retain the duty to consider innovation and competition when making regulatory decisions.

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

BD would query how far the CPMA has to consider the following matters of public interest for the reasons outlined below;

- **Promoting public understanding-** This responsibility seems to have been passed to the Consumer Financial Education Body (CFEB) and it would be an inefficient use of resources to duplicate this work at the CPMA.
- **Promoting financial inclusion by encouraging access to suitable products and services** – We accept the merits and agree with the sentiments underlying this point. We will be interested to assist in

<sup>1</sup> Adviser Alliance figures, as of 20 August 2010

<sup>2</sup> The cost of regulation study, Commissioned by the FSA and the Financial Services Panel 2005.  
<http://www.fs-pp.org.uk/documents/Deloitte%20Costs%20final%20report%2028%20June%2006.pdf>



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developing ideas whereby qualified industry practitioners are able to provide some form of initial financial advice at specifically convened surgeries, throughout the country, on a no fee no claims basis. We would however, point out that our services are designed for investors with an average of £350,000 to invest, and that these investors are required to agree to a 225 clause Agreement before we may advise them – and so that this service may be inappropriate to offer on a free basis.

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

BD offers full support for the APCIMS response to the above question and would like to highlight what we feel are some of the most important points;

- Although the proposals on accountability measures outlined in Para 4.20 are a replica of the current statutory disciplines outlined in FSMA, we are not sure about their effectiveness in influencing FSA activity
- In particular the above view is applied against the consultation process, which the FSA has often applied in an untimely and extravagant manner
- The main examples of this is poorly performed Cost Benefit Analyses, at times published after the consultation paper, which do not accurately represent the true costs and benefits identified by firms. One example of this is the RDR costs outlined above. At the beginning of the consultation process for the RDR, the CBA was published after the consultation paper and the subsequent re-calculations prove that the CBA was not performed with care. In this instance considerable costs were justified by opaque and groundless benefits such as *'many consumers are expected to be significantly better off under our proposals because these would improve the quality of advice, reduce the incidence of mis-selling and lead to increased persistency'* As you have seen above with the comments from Alliance Advisor, this benefit is easily refutable and has been debated by firms such as APCIMS as well as the Practitioner's Panel, to no avail.
- The requirement to implement all aspects of the TCF initiative without consultation or a cost-benefit analysis and without adding rules to the FSA Handbook undermines the statutory disciplines and gives the impression that the FSA is free to use an approach which falls outside the scope of FSMA with no repercussions.
- We do agree with the proposals however and would like to see mechanisms such as the annual reports, public meetings, consultative panels, Tribunal appeals, statutory reviews and enquiries by the NAO retained but also enforced by the new regime.

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

We agree with the Governance proposals of the CPMA and welcome the presence of non-executive Board members. As mentioned in Q9, consultation with the industry is vital to the rule-making process and for this reason we also welcome the proposal to retain the two panels (Consumer and Practitioner) and the introduction of the Small Businesses panel.

We would refer to APCIMS response on the membership of such panels and would like to make the point that the APCIMS proposal to have two Practitioners Panels would be useful in dealing with retail consumers and market conduct separately.

We would also refer to the APCIMS point on how the Panels' contribution is taken into account and would ask the HMT to bolster the legal mechanism by which challenge by any of



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the panels is taken into account and the statutory responsibility to provide a written explanation when this input is disregarded to be observed.

By way of example we would like to refer to Iain Cornish's (Chairman of the Practitioner Panel) comments<sup>3</sup> earlier this year that '*the FSA has not taken sufficient account of industry feedback*'. In most cases, the industry and the regulator have the same goal but differ on the approach and necessary measures required to implement.

In his speech Iain Cornish commented that in view of the change to regulatory structure the main aim of the Panel is to work towards '*clarity, effectiveness and proportionality in regulation*' and we would encourage the HMT to work towards these too.

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

We understand the rationale behind the proposal to give the CPMA the responsibility of collecting fees and levies from firms. Although this may reduce the administrative burden on the other regulator, as well as the other entities on behalf of which the CPMA would act as agent, the proposed model of splitting the regulated activities between prudential and non-prudential activities we believe would increase complexity rather than '*ensure simplicity for firms*'. This is particularly in light of the HMT proposals to give the PRA and CPMA the responsibilities for approving and authorising permissions for their respective regulated activities.

We believe that not only will this method result in an administrative nightmare of calculating the fees and levies for whichever body ends up having the responsibility to do so but also could potentially result in unnecessary duplication of costs for firms which straddle both remits. We would ask the HMT to consider carefully the robustness of the mechanisms put in place to calculate and allocate these fees correctly; bearing in mind the burden such mechanisms may impose on firms.

On the subject of whether the CPMA should be the regulator in charge of collecting fees, we would like to say that we understand the rationale behind this proposal. In making this decision we would ask the HMT to have regard to the wide scope of responsibility already attributed to the CPMA and would ask that this is balanced against the amount of resource that would need to be dedicated to this one task, which at this high level view is fraught with complexity.

As mentioned above and in our introductory letter, we believe that the administration and any necessary tick-box activities such as permissions and fee collection should be performed by a separate delegated organization for both the PRA and CPMA. We believe this will ensure that these organizations remain free to *focus* on exercising *judgment* in regulating clearly defined categories of firms consequently delivering *stability*.

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

We believe that there should be an element of pre-funding so that all firms while a going concern contribute.

As to the proposals on whether there should be two compensation schemes, one for PRA regulated firms and one for firms regulated by the CPMA, we would like to see a separate and more detailed consultation take place – the merits of the two options are not clear.

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<sup>3</sup> FSA Annual Public meeting, July 2010



## 4. Markets and Infrastructure

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

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

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

The suggested merger of the UKLA with the FRC does concern us. We are advisers to over 90 quoted companies and 130,000 private investors with holdings in equities quoted on the London markets. We believe that the specialist knowledge and understanding of primary markets is valuable; the international expertise for foreign companies seeking a listing in the UK is important and the speed, with which the UKLA can act, would all be hard to replicate with the UKLA outside of the main UK securities regulator, the proposed CPMA. The notion that this important function of the London market may be removed to the Financial Reporting Council and separated for secondary markets regulation could severely weaken the competitive position of The City, particularly as it will only be the CPMA who will be a voting member of ESMA.

We would also have concerns if we thought there might be any dilution of the regulatory scrutiny of the market or of listed securities. Listed companies may be small in number in relation to companies in general, but they are huge in capital terms and considerable importance to the economy as a whole, and potential mistakes due to lack of understanding by another regulator could undermine London and threaten our international competitiveness.

However, when considering any reforms of listing rules – on behalf of our 130,000 private investors we would welcome more access to primary market issues. Private investors have been all but excluded due to costs and over arching prospectus regulations.

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

## 5. Crisis management

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

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

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

## 6. Impact assessment

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**22. Annex B contains a preliminary impact assessment for the Government's proposals. As set out in that document, the Government welcomes comments**



## BREWIN DOLPHIN

**from respondents on the assumptions made about transitional and ongoing costs for all types of firm. In particular, comments are sought from all types and size of deposit-taking, insurance and investment banking firms (including credit unions and friendly societies), and from groups containing such firms.**

We refer you to the covering letter from our Chairman addressed to the Financial Secretary and which accompanies this detailed response. In it we outline our main concerns regarding the regulation of our sector and our ideas and hopes for change in the future.

We are anxious to do all we can to assist you in the difficult months ahead while you decide how best to fulfil these goals and will be very happy to lend any members of the team here, to provide help if you would find that useful.

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

### **- Comments by the British Bankers' Association -**

The British Bankers' Association welcomes the opportunity to respond to HM Treasury's consultation paper 'A new approach to financial regulation: judgement, focus and stability'. We represent 220 banks from 60 countries and have 40 associate firms within membership.

### **Executive summary**

#### *Introduction*

- We are supportive of the broad structure of the new UK regulatory framework, including the adoption of a 'twin peaks' approach and the dedicated focus on macro-prudential analysis and action. But within this context we view the proposals set out in the Treasury consultation paper as insufficient in ensuring that appropriate checks and balances are built into the new arrangements.
- We see the following as key considerations for the Government to consider in developing its proposals for the reform of the UK financial services regulatory framework:
  - ◆ The question of how the financial stability objective fits with not only monetary policy, but also fiscal policy and the Government's overall macroeconomic management of the economy and what this means for engagement on the part of the Treasury and Parliament.
  - ◆ The adoption of a more judgement-based approach to prudential supervision, in which firms' strategies and business models are questioned, and the greater emphasis this places on the need for deliberate due process on the part of the PRA and the accountability and transparency mechanisms under which it operates.
  - ◆ The question of whether the broader consumer interest is necessarily represented by the regulator adopting an advocacy role as implied by the use of the term 'consumer champion' and the need for the CPMA to give equal weight to its responsibilities for retail and wholesale markets.
  - ◆ The benefits of a strong, cohesive markets division within the CPMA capable of representing the UK interest in European and international discussions.
  - ◆ Taking a longer term view which is in the national interest by mandating that the regulatory authorities are tasked with ensuring that the UK financial services marketplace remains internationally competitive.

#### *The Bank of England and the FPC*

- The arrangements for the democratic accountability of the Bank need review given its expanded role, in respect of which we believe that the importance of the involvement of the Treasury may have been underplayed as a result of the falling away of the Tripartite arrangements.

- In view of the wide ranging remit now given to the Bank, spanning monetary policy, financial stability, prudential supervision, crisis management and payment systems, we recommend that an evaluation of Court be undertaken to ensure that it is equipped to manage the significant expansion in its oversight role under this and other initiatives.
- The proposed objectives of the FPC (and MPC) have the potential of creating in-built conservatism resulting in insufficient weight being given to the need to foster economic growth. It would therefore seem appropriate for the FPC and each of the authorities to be given a more balanced objective in which economic growth and global competitiveness are also taken into account.
- There may be a case for considering whether the concentration of power and responsibility in the hands of the Bank of England necessitates reserve powers on the part of the Treasury.

#### *The Prudential Regulation Authority*

- There is a potential for significant damage to the UK's reputation for the maintenance of a stable, competitive regime if appropriate commitments on due process and consultation are not made in respect of the PRA and other bodies. Consultation improves the quality of regulation; cost/benefit analysis is an essential discipline.

#### *The Consumer Protection and Markets Authority*

- Consideration needs to be given to the potential downside attached to the characterisation of the CPMA as a consumer 'champion' and the implication that it will be acting as an advocate as opposed to an independent regulator; also the potential damage to the consumer interest of adopting an unduly narrow view.
- Extending the scope of the Consumer Panel, the Practitioner Panel and the Small Business Practitioner Panel to cover not only the CPMA but the PRA may assist with the task of ensuring a strategic cohesiveness between the authorities.
- The opportunity of the forthcoming FSA consultation should be taken to review the governance and accountability arrangements of the Financial Services Compensation Scheme given the expanded use of the scheme under the SRR arrangements.
- In addition to assessing the case for the transfer of responsibility for consumer credit from the Office of Fair Trading to the CPMA the opportunity should be taken to review the scope of the decision-making powers of the Financial Ombudsman Service. If the CPMA is to be a consumer advocate, then this must put into question its right to oversee the FOS given its role as an independent arbiter of disputes.

#### *Listing within the markets infrastructure*

- Emphasis needs to be placed on maintaining a coherent markets division within the CPMA capable of representing the UK interest in European and international discussions and of exercising sufficient oversight of market activity. This necessitates markets division retaining responsibility for the UK Listing Authority.
- We do not agree with the assessment that modern infrastructure providers, including exchanges, are indistinguishable from most large firms in the financial services industry and suggest this be reconsidered. While some might hold significant exposures (eg



CCPs) many others do not. Appropriate regulation differentiated by risk should be the key determinant.

#### *Shared services & funding*

- There is a case for shared services in order to streamline the demands placed on institutions in terms of authorisation, permissions, approved persons and date requirements; also in terms of the authorities benefiting from shared HR, IT and finance.
- There is potential benefit in the CPMA not only acting as collecting agent for the other authorities, but in a single, integrated budget process overseen by the NAO.

#### *Economic crime*

- We support the initiative to draw together different aspects of responsibility for economic crime across all sectors of the economy in to a single agency, but would argue that responsibility for prosecuting criminal offences involving market abuse and insider dealing sits more appropriately with the CPMA, as the body with responsibility for markets supervision.

#### *Crisis management*

- We support strong crisis management arrangements and attach considerable importance to the development of an international framework for crisis management and the introduction of appropriate and consistent European measures.
- We see a need for the criteria for heightened engagement on the part of the Chancellor in a crisis to be broadened since we believe it inconceivable that a systemically important firm could be taken into special resolution without the Chancellor's approval irrespective of whether this required the use of public funds. We would see the creation of a more formal institutional structure – bringing together the Treasury, Bank of England, PRA and other stakeholders – for overseeing crisis management preparations and dealing with the crisis should it occur as an important strengthening of the proposals in this area.

#### *European engagement*

- We would see benefit in the UK's engagement with Europe being strengthened by secondments to the new European Supervisory Bodies being built into career plans for Bank of England, PRA and CPMA personnel.

#### *Implementation*

- We see a need for a concerted effort to recruit and retain high quality staff and to ensure a continuity of expertise given the extended period over which the new arrangements are to be introduced.
- We support the proposed use of 'shadow' arrangements as part of the transitional arrangements. This provides the opportunity to dry run the changes and to make adjustments to their operation in light of experience prior to their finalisation.

Our response below follows the sequential order of the consultation paper and addresses the specific questions set out in the consultation paper as they arise.

## Introduction

We are supportive of the broad structure of the new UK regulatory framework, including the adoption of a 'twin peaks' approach and the dedicated focus on macro-prudential analysis and action, but view the proposals set out in the Treasury consultation paper as insufficient in ensuring that appropriate checks and balances are built into the new arrangements.

As the paper explains there is an emerging consensus on the fundamental cause of the crisis and we would not disagree with the key factors identified: global economic imbalances; mispriced and misunderstood risk; unsustainable funding and business models for banks; excessive build up of debt across the financial system; and the growth of an unregulated 'shadow banking' system. We would add monetary and fiscal policies to the list since the financial sector cannot be said to be the main driver of economic cycles and we would be missing a vital part of the picture if we were to overlook this.

Some of these factors have been the subject of the programme of banking reform begun by the then Financial Stability Forum (now Board) and subsequently adopted by the G20. The reform of the regulatory and supervisory architecture undertaken to date can be said to have focused on two overarching objectives: reducing the probability of an institution failing and its systemic impact:

- Measures to increase the resilience of the banking industry include banks holding more loss-absorbing types of capital, increased capital requirements against the trading book and putting in place better liquidity buffers. It also includes improvements in corporate governance, risk management, supervision, accounting, and product simplification, measures to reduce the interconnectivity of institutions and the 'recovery' part of living wills; and
- Measures to reduce the potential impact of a bank failure include the special resolution measures in The Banking Act 2009, equivalent arrangements for investment banks and the 'resolution' part of living wills which will help ensure that in the event of failure the authorities can act swiftly and effectively.

Considerable progress has been made in the delivery of the reforms needed to strengthen the financial system. Banks are already holding more, better quality capital and liquidity, international agreement has been reached on a new capital and liquidity framework, and concrete steps are being taken towards achieving a regime in which no institution need be viewed as 'too big to fail' meaning that orderly wind down can be achieved without resorting to the type of taxpayer support necessitated by the recent crisis. We are active participants in the international dialogue aimed at achieving a more robust approach to systemic risk and better crisis management arrangements for financial services.

As the paper also explains, there were significant failings in the UK regulatory framework and this related to both recognising and responding to the problems that were emerging in the financial system. We are therefore supportive of the broad institutional changes envisaged by the Government in that they:

- Create greater focus on the different regulatory disciplines of prudential supervision and conduct of business;
- Place within a single body – the Bank of England – responsibility for macro-prudential supervision; and
- Provide for better coordination between macro and micro-prudential regulation through the establishment of the FPC and the Bank of England's oversight of the PRA.

But the new institutional structures bring a new set of challenges to be addressed and it is not clear that the various issues raised by the proposed arrangements have been sufficiently considered.

## **The Bank of England and the Financial Policy Committee**

### ***The role of central banks in financial stability***

It needs to be appreciated that in proposing the transfer of responsibility for prudential supervision to the Bank of England, the Government is not simply advocating a return to pre-1998 arrangements. At that time, the Bank was given independence over monetary policy – a powerful economic tool – and it has since been given responsibility for financial stability. The Treasury paper builds on this by setting out potential macro-prudential tools. This is in addition to the Bank becoming the lead authority for crisis management, since under the new arrangements it will be the resolution authority and responsible for the triggering of any special resolution regime, and its oversight of payment systems.

When you consider the breadth of the Bank's new remit it is easy to see why many consider the proposed accountability to Ministers and Parliament to be undemanding. Accountability to Government Ministers for the activity of the FPC appears to be limited to the Governor briefing the Chancellor once every six months. Likewise, accountability to Parliament will rest with the FPC producing a six-monthly report for submission to the Treasury which will, in turn, lay copies before Parliament. Only in the case of crisis management and a possible call on public funds will the Governor be under an obligation to notify the Chancellor in sufficient time to ensure that all options can be considered and the Chancellor placed in a position to make the final decision on the use of public funds.

Few would argue with the need for a strong, independent central bank. In view of the broad responsibilities now being assigned to the Bank and the increase in the significance of the role it will play in the economy, however, there is a greater need for a more interactive engagement between the Bank and the Government and Parliament. Whilst it may not be possible to develop the type of quantitative proxy for financial stability that can be set for monetary policy and the MPC, the involvement of Treasury Ministers in the work of the FPC should extend beyond the arrangements for the Chancellor to have the opportunity to comment on the risks in the system and the action being taken to address them.

Thought should be given to putting in place an arrangement analogous to that for the Monetary Policy Committee whereby the Government would provide some direction for the decision-making process for the FPC in which financial stability is counterbalanced with broader macroeconomic objectives for jobs and growth. The criteria for heightened engagement on the part of the Chancellor in a crisis should be broadened as it is inconceivable that a systemically important firm could be taken into special resolution without the Chancellor's approval irrespective of whether this required the use of public funds.

It is further arguable that prior Government approval should be required for the exercise of macro-prudential tools that may have significant socio-economic effect. It may therefore be that in drawing up the detailed arrangements we should foresee a need for a public debate about the significance that macro-prudential tools may have for households and businesses.

### ***The Financial Policy Committee***

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

The consultation paper proposes that the objective of the FPC be to protect financial stability by:

- Improving the resilience of the financial system by identifying and addressing aggregate risks and vulnerabilities across the system; and
- Enhancing macroeconomic stability by addressing imbalances through the financial system e.g. by dampening the credit cycle.

It is recognised, in paragraph 2.26, that the use of certain macro-prudential tools ‘is likely to affect the levels of lending to businesses and families and the competitiveness and profitability of UK banks in relation to foreign competitors’. The paper goes so far as to say that it will be important for the FPC to take factors such as these into consideration when pursuing its primary objective. This however is very different from setting a balanced set of objectives underpinned by appropriate checks and balances and democratic accountability.

We therefore believe that the FPC, PRA and CPMA should each be given counterbalancing objectives giving reference to economic growth. If we take the FPC first, its objective should perhaps be drafted in terms more compatible with Article 3.1 of the ESRB Regulation setting out its Mission, Objectives and Tasks:

*“The ESRB shall be responsible for the macro-prudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability in the EU that arise from developments within the financial system and taking into account macro-economic developments, so as to avoid periods of widespread financial distress, and contribute to a smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth.”*

Turning to the PRA and CPMA, recital 9aa of the Regulations applicable to each of the three new European Supervisory Authorities provides in each case that the authority should: take due account of the impact of its activities on competition and innovation, global competitiveness, financial inclusion and the strategy for jobs and growth.

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

We would prefer to see the primary objective struck on a basis which gave recognition to the need to balance the objective for financial stability with broader macro-economic considerations.

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

Our current perspective is that we do not believe an appropriate balance can be achieved other than through the elucidation of the primary considerations to be taken into accounts within a set of objectives of equivalent standing.

### ***Macro-prudential tools***

As discussed in the BBA's paper 'A Possible Macro-prudential Approach'<sup>1</sup>, the nature of financial stability is different to that of monetary policy and so we would not envisage the success or otherwise of the FPC being judged by reference to quantitative financial stability targets. The objectives for the FPC will need to be couched in much more general terms and its overall aim will be to ensure that the banking industry is better prepared to weather economic downturn. In the first instance, this will probably mean seeking to reduce the amplitude of economic cycles rather than attempting to prevent asset bubbles emerging, which may develop more over time.

The remit of the FPC should be qualitative in nature and modest at inception based on an objective to moderate exuberance in economic boom years and enhance the resilience of the banking sector to economic downturn. We would agree that there is a need for this to be encapsulated in an appropriately defined statutory remit and would argue that this should be premised upon a need to balance financial stability with economic growth. The success of the FPC should primarily be measured against criteria born out of financial stability, such as dampening credit cycles and, at some future stage, the avoidance of asset bubbles, we believe recognition should also be given to the generation of conditions suitable for sustainable economic growth.

Whilst we appreciate that international discussions on the nature of macro-prudential regulation are still at a relatively early stage, we believe that it would be helpful for the FPC's objective(s) to be set into the context of the European Systemic Risk Board and the way in which domestic measures would fit within the European and international framework.

The FPC should take its lead from any directives made by the European Systemic Risk Board and others such as the Financial Stability Board or the Basel Committee. Should these advocate the adoption of clear, prescriptive macro-prudential tools, such as the introduction of a counter-cyclical capital buffer, then the FPC should act upon these without gold-plating. In other instances it may be that the FPC should recommend for Government consideration action based on the particular circumstances of the UK market. This for instance could at some point include measures aimed at addressing asset bubbles in particular sectors of the property market, whether buy-to-let or commercial. In these circumstances, however, it is unclear whether it would be for the FPC to act or whether it would be more appropriate for the committee to make observations which Treasury Ministers may wish to pursue in devising public policy initiatives or in making adjustments to government spending or fiscal policy.

### ***Membership & interaction with monetary policy***

An over-arching concern is whether specific reference should be made to the countervailing need to maintain economic growth. The pursuit of financial stability, by definition, involves constraining credit supply (and influencing demand) and there is a risk that, if poorly calibrated, measures pursued could have a disproportionate effect on economic growth. When combined with the focused nature of the objectives of the Monetary Policy Committee you can see that without some recognition of the benefits of economic growth as the means by which businesses and families can prosper then there is a real risk that the natural conservatism of the central bank may result in a significant imbalance in the macroeconomic management of the UK economy.

This therefore begs the question of whether there will be the means by which consistency and inter-connectivity between monetary, fiscal and financial policy can be achieved. Previously,

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<sup>1</sup> [A Possible Macro-prudential Approach](#) British Bankers' Association, March 2010

the Tripartite Standing Committee provided that forum even if it appears that it was under-utilised in this regard. Under the new framework, fiscal policy is put to one side and the link between the MPC and FPC is embodied principally in the person of the Governor of the Bank of England, with the Treasury afforded no formal role beyond 'observer' status. It is difficult to see where aspirations for economic growth fit within the arrangements proposed.

### ***Transparency and accountability***

We are not content that Ministers can have fully thought through the nature and potential impact of the powers now being delegated to the Bank of England. We believe there to be a gap in the governance arrangements resulting from the abolition of the Tripartite Standing Committee and that this needs to be filled.

We are supportive of the intention that the FPC be a Committee of the Bank's Court of Directors and agree that this will draw a clear line of accountability to the Bank's governing body. The Bank of course now has a very wide ranging remit spanning monetary policy, financial stability, prudential supervision, payment systems and resolution. In view of this, we would also recommend that an evaluation of Court be undertaken to ensure that it is equipped to meet with the significant expansion in its oversight role under this and other initiatives.

There is also a case for considering whether the concentration of power and responsibility in the hands of the Bank of England merits the establishment of a more thorough mechanism for reviewing the scope of these powers in the event that this becomes necessary. What we have in mind here is a reserve power akin to the powers set out in section 19 of the 1998 Bank of England Act for directing monetary policy in the event that this is required in the public interest.

### ***Data requirements***

The ability of the FPC to fulfil its function will depend in no small part on the quality of the data on which it bases its judgements. We note that the Government will legislate (2.51) to provide the necessary gateways for information to flow between the three bodies. We would, however, observe that the data requirements that will prove necessary to make macro-prudential regulation work are very poorly understood. There are numerous initiatives underway to put in place systemic risk regulation, but we perceive a very real risk that the requirements will be poorly aligned, requiring firms which operate in more than one jurisdiction to comply with multiple requirements and hindering supervisor-to-supervisor discussions in forums such as colleges of supervisors. We therefore urge that the UK regulatory authorities give priority to working with institutions to develop a regulatory data collection regime which serves the combined need of the FPC, PRA and CPMA. This could include consideration, for example, of a standard regulatory data taxonomy for the UK, and ideally the new European bodies.

### **Prudential Regulation Authority**

#### **4. The Government welcomes respondents' views on:**

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

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

It would seem to us self-evident that the PRA should be cognisant of the primary objectives of the CPMA and FPC. Also, that the PRA should recognise the principles for good regulation as provided by FSMA, be required to consider potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action and respect broader public interest considerations. This is necessary in the first instance to ensure that there is a coherence in the overall strategy pursued by the PRA, CPMA and FPC and essential in the others to ensure that the PRA acts proportionately, is responsible for its actions and acts in accordance with its broader understanding of the economic and socio-political landscape. We can understand the current bias towards focusing solely on stability may appear to be supported by the general public's views on the financial crisis. The public, however, will not welcome a regime which stifles growth and it is therefore necessary to take a longer term view.

The setting of the primary objective for the PRA would therefore appear misguided. Paragraph 3.5 of the consultation paper proposes that the PRA has a primary objective to promote the stable and prudent operation of the financial system through the effective regulation of financial firms in a way which minimises disruption caused by any firms which do fail. Factors to which the PRA would 'have regard' include the principles of good regulation and 'important matters which relate to the public interest'.

In fact, paragraph 3.10 goes as far as to say that the Government is seeking views on whether the PRA need be troubled by secondary considerations such as the importance of it using its resources in the most efficient and economic way or the principle that a burden imposed should be proportionate to the benefits which are expected to result. We find it a matter of some considerable concern that the question needs even be asked.

We similarly believe that the PRA should be under an obligation to consider the potential wider economic impact of its policies or regulatory decisions and the effects on consumer and business lending. It may be that this should be expressed as a public interest test.

We further disagree with the conclusion that the failure of 'light touch' regulation necessarily means that the prudential regulator should not be placed under an obligation to maintain international competitiveness. Competitiveness is the lifeblood of the UK financial services marketplace and respecting the need to maintain a competitive edge and an internationally attractive environment provides a natural check and balance. Good regulation, as measured by international competitiveness, provides a counterbalance to ever increasing regulatory demands and encourages the presence of the best global institutions in the UK marketplace.

As explained above, we further believe that each of the authorities should be given counterbalancing objectives mirroring recital 9aa of the regulations applicable to the three new European supervisory authorities, namely that they should take due account of the impact of their activities on competition and innovation, global competitiveness, financial inclusion and the strategy for jobs and growth.

### ***Scope & coordination between the authorities***

We would expect that in giving further thought will need to be given to whether the scope as outlined in paragraph 3.12 achieves the division that the authorities would wish to see in practice. What we have in mind here is how to ensure an appropriate split is achieved in respect of broker-dealing.

Further thought also needs to be given to the co-ordination arrangements at both a conceptual and practical level. The former includes ensuring that each authority has appropriate regard for the objectives of the other and that there is sufficient integration to ensure a suitably cohesive approach. In this specific regard we consider that there may be benefit in broadening the scope of the three statutory panels planned for the CPMA so that they also cover the PRA.

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

We would see considerable merit in the authorities being supported by a common services organisation which would act as a central point for firms in respect of authorisation, permissions, approved persons, supervisory visits and data gathering; and provide the authorities with a common resource for HR, IT and finance.

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

We can see no reason why draft legislation cannot be drawn up to make appropriate provision for the transfer of powers to the PRA and the adoption of a more risk-based, judgement focussed-approach to supervision. Progress is already being made in this regard under the implementation by the FSA of the enhanced supervisory regime and this provides expertise on which the authorities will be able to draw as we move forward.

But we would add that judgement-based supervision brings with it a need for a more consultative approach on strategy, openness and an ability to appeal major supervisory decisions. We do not therefore support proposals for the PRA to have a reduced obligation to consult and would need a better understanding of what is proposed in respect of the proposed expansion of its own initiative variation of permission (OIVOP) powers in order to be able to comment definitively. (We also comment on this in response to question 20.)

We are cautious of what appears to be an intention to merely work through FSMA as a means of preparing the legislation needed for the new authorities. Given the increasing importance of the EU, including the planned single rulebook, we see merit in the Treasury considering EU texts when preparing the UK legislation. The opportunity should certainly be taken to align terminology, for instance, between the UK's Regulated Activities Order and MiFID.

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

We can see no good reason why the Government should be proposing that the PRA's rule-making function should not be subject to statutory processes and believe that this should continue to require an obligation to consult through a practitioner panel (possibly on the basis of a single panel spanning the PRA and the CPMA - see response to question 12) and on a wider public basis and a duty to carry out detailed cost-benefit analyses prior to the introduction of any new rules. We see this as fundamental to the maintenance of a stable financial regime in which participants have confidence in the regime. We are concerned that the question is even being asked.

A great deal of time and care was taken with FSMA to establish the right balance between providing the regulatory authority the scope to take necessary action to act upon regulatory



shortcomings and the need for appropriate due process and consultation usually associated with changes to the rule of law. These processes are essential to the maintenance of market confidence in the regime in which financial institutions operate and are the bedrock of the type of certainty that institutions look for in determining where to locate business. This is as true an expectation for a UK financial institution as it is for the many overseas institutions that decide to locate financial services operations in the UK.

It is also the case that there are many instances in which consultation has proven an essential mechanism for identifying major unforeseen consequences in planned regulatory changes – a recent high profile example being the inadequate nature of the creditor protections within the Special Resolution Regime first proposed within the Banking Bill. It took a substantial effort on the part of the banking industry and the legal profession to persuade the tripartite authorities, including the Bank of England, that there were significant shortcomings in the proposed arrangements. Due consultative process provided the time and opportunity to make the case for strengthening the inadequate safeguards which were maintained through many Parliamentary stages<sup>2</sup>.

In contrast, the Treasury paper makes clear that the authorities need no longer be bound by a commitment to due consultative process. Paragraph 3.22 in the chapter on the PRA explains that the Government 'is considering whether the rule-making function should continue to be subject to statutory processes, including consultation with a practitioner panel, wider public consultation and the duty to carry out detailed cost-benefit analysis prior to the introduction of any new rules'; paragraph 4.23 in the chapter on the CPMA observes that similar considerations apply to the CPMA and, in addition, that the Government may enhance the own initiative variation of permission powers for the PRA and CPMA.

We caution the Treasury to seriously reconsider this proposal; the SRR inadequacies discussed above are only one among a range of examples of where consultation has substantially improved regulatory outcome or prevented regulatory breakdown. In addition, removal of the requirement to consult would have the effect of removing the accountability of the regulators to the regulated community. It will certainly have significant impact on the UK's attractiveness as a place to do business if members of the financial community and the general public perceive that there is no open and transparent way in which they may contribute to the shaping of regulation.

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

The question that needs to be asked is whether there are the circumstances in which the current safeguards stand in the way of urgently needed rule changes. If there are, and this belief can be supported by concrete examples, then we need consider the ways in which rule changes can be fast tracked and the additional post-event review procedures that would need to be built into the system to ensure that such arrangements were not abused or gave rise to unforeseen consequences. We believe the tools can be found in FSMA as it currently stands.

If, on the other hand, the suggestion results from the fact that we are moving towards a common European rulebook, then the question is whether rules applied without discretion and following a full consultation process at a European level need be duplicated.

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

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<sup>2</sup> [BBA Parliamentary brief](#) – Banking Bill, second reading, October 2008

We are also concerned with the proposed governance arrangements for the PRA. We are unsure, for example, that the only approach is for the PRA to be a subsidiary of the Bank and for the Governor to chair the authority. It would be interesting to understand the extent to which consideration was given to alternative arrangements, for instance, relying more on the provision of powers to the FPC to direct the PRA in the execution of macro-prudential tools. This would have avoided what may be an undue concentration of power within the hands of the Bank and permitted the specific responsibilities of the PRA for the micro-prudential supervision to have a clear identity without losing any of the benefits of setting micro-prudential supervision within a broader macro-prudential framework.

We would also question the proposition that the non-executive directors of the PRA be stood down collectively for decisions on significant regulatory or supervisory decisions concerning individual firms. This to our mind creates a two-tier board and results in a loss of perspective and experience that would result from the involvement of the non-executives in such decisions. Whilst, by definition, their involvement would involve addressing potential conflicts of interest, it should be possible to achieve this through a combination of the selection process and the ability for non-executives to excuse themselves as necessary from discussions.

### ***European engagement***

Whether in terms of the Bank, PRA or CPMA, we believe that priority needs to be given to ensuring that the UK's interests are fully represented around the European policy-making table. This relates not only to the negotiation of directives and other legal instruments, but the staffing of the three new European Supervisory Authorities. We would therefore see merit in European engagement being built into career plans for HM Treasury, PRA and CPMA personnel and would suggest that this should include the setting of ambitious targets for a secondment programme to the new bodies.

### **Consumer Protection and Markets Authority**

#### **10. The Government welcomes respondents' views on:**

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

We believe that the CPMA should be under a statutory duty to pursue policies consistent with the objectives of the PRA and FPC. We further see the principles for good regulation as set out in section 2 of FSMA as fundamental to proper due process and the maintenance of confidence in the UK regulatory regime and believe that they should be maintained for both the CPMA and the PRA. This includes the requirement to have regard to potential adverse impacts on innovation and the international competitiveness of the UK financial services sector. We see this as being in the broader national interest, including the Exchequer.

It is proposed that the primary objective of the CPMA will be to ensure confidence in financial services and markets, with a particular focus on protecting consumers and ensuring market

integrity. This leaves the following expressed as secondary considerations, explicitly referred to as 'have regards' in chapter 4 of the consultation paper:

- the principles of good regulation;
- the potential impact of policies or regulatory decisions on consumer and business lending;
- the need to maintain diversity in the financial services sector.

We are concerned about the CPMA being described as a consumer 'champion'. In our view a more balanced and authoritative characterisation of the CPMA's role would be one based more on the development of a marketplace in which consumers are provided with clear and understandable product information from which they can make informed choices. This involves placing consumers in a position where they can take responsibility for their financial decisions. The implication that the new authority will somehow become their advocate does not help this. It also potentially opens a new avenue for consumer litigation against the CPMA.

We are not in any way suggesting that the new regulatory structure should not place emphasis on ensuring that consumers are afforded a high standard of consumer protection. It is however about suggesting that care needs to be taken in determining how this should be defined. It would not for instance be in the consumer interest if the adoption of a narrow objective resulted in less innovation aimed at providing a rich selection of financial services from which consumers were able to select those which best suited their needs.

The objectives for both the PRA and CPMA as expressed heighten our concern about the lack of check and balance being built into the system. As far as we can see, the intention is that the bodies be exempted from the usual standards of consultative due process applicable to other arms of government and excused from any responsibility of the consequences of their actions on the wider economy and society.

As explained above, we further believe that each of the authorities should be given counterbalancing objectives mirroring recital 9aa of the regulations applicable to the three new European supervisory authorities, ie that they should take due account of the impact of their activities on competition and innovation, global competitiveness, financial inclusion and the strategy for jobs and growth.

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

We are unsure of the need for the proposal in paragraph 4.23 that the CPMA should be able to draw upon enhanced own initiative variation of permission (OIVOP) powers and would appreciate a better understanding of the shortcomings of the current arrangements before coming to a view.

We are supportive of the accountability mechanisms proposed and are pleased to see the CPMA referred to as an independent conduct regulator. This is quite distinct from its description elsewhere in the document as a consumer champion which in our view unhelpfully implies consumer cause advocacy on the part of the CPMA.

The consultation paper has not asked for views on the Government's intention that CPMA progress FSA's current initiatives such as the Retail Distribution Review (RDR) and Mortgage Market Review (MMR) (4.24). However, we have concerns about the FSA's current initiatives and view it as appropriate to highlight these:

- The FSA already had a substantial programme of activities prior to the announcement that the Government would restructure the UK regulatory regime. Planned initiatives must therefore compete with an ambitious change programme.
- Several members of the FSA leadership team have left or indicated an intention to leave the organisation; junior members of staff are also leaving.
- Some initiatives, such as the RDR, are at a crucial stage in development when firms need to engage with FSA to get clarity on the regulator's intentions. As individuals leave or are focused on the restructure, obtaining access to FSA is proving increasingly difficult.
- Both the RDR and the MMR look set to overlap with forthcoming EU initiatives
- The CPMA will be a new organisation; the FSA's initiatives may not accord with what it determines to be its priorities and approach.

For these reasons, we see merit in the FSA reviewing the order of priority under its current agenda, particularly during the shadow operation period, with the aim of maximising the prospect of effective, proportionate and lasting regulation being the outcome.

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

We are supportive of the maintenance of the Consumer Panel and the Practitioner Panel and the placing on a statutory footing of the Small Business Practitioner Panel. We would also see merit in consideration being given to expanding the scope of the panels to include the PRA. When combined with the adoption of appropriate objectives, this could greatly assist with ensuring that a cohesive approach is adopted across the regulatory landscape, including alignment with EU developments. This could play a significant part in bolstering the arrangements for ensuring coordination between the authorities.

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

### ***Funding***

We support the proposal that there be a single body responsible for the collection of all fees and levies and can see the logic in the CPMA being the candidate for this given it will have contact with all firms. We would add – and it is unclear that this is the intention – that we believe this exercise should be broadened so that the CPMA not only becomes the collecting agent of the PRA, FOS, the FSCS and the CFEB, but that the exercise should also entail a single budgetary process and that consultation on the setting of fees and levies should be brought together as a single exercise under the watchful eye of the NAO.

### ***Shared services***

We can see also case for shared services in order to streamline the demands placed on institutions in terms of authorisation, permissions, approved persons and date requirements; also in terms of the authorities benefiting from shared HR, IT and finance. This would contribute substantially to the stated objective of achieving an appropriate level of coordination in order to avoid duplication and inconsistency.

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

We note the FSA's forthcoming consultation on the FSCS Funding Model Review which is expected to be wide-ranging. This review is being taken forward in the context of wider reform

at European level given the Commission's proposals for recast Deposit Guarantee Schemes and Investor Compensation Schemes Directives and a new Insurance Guarantee Schemes Directive. These initiatives could lead to substantive changes in the FSCS's consumer protection arrangements and the basis and level of contribution for industry going forward. Given the expanded use of the scheme under the SRR arrangements we also believe the opportunity should be taken to review and improve the ex-post accountability arrangements to creditors.

## **Other issues**

### ***Associated bodies: the Financial Ombudsman Service***

The reform of the legislative framework also offers an opportunity to address long-running industry concerns about the regulatory impact of the Financial Ombudsman Service. While the role of the FOS is clear in terms of its core function – the provision of an independent, informal and accessible service for resolving for individual customer complaints – difficulties arise where FOS decisions have much wider implication for the industry, often because of the volume of cases involved. In such instances there is a need for a more deliberate due process involving appropriate consultation and analysis from a cost/benefit perspective. A question therefore is whether it would be preferable for such cases to be referred to the CPMA for consideration. This would in our view fit better with other changes being made to the redress mechanisms, including the introduction of new processes aimed at identifying difficulties at an earlier stage and other changes to the arrangements for industry-wide consumer redress schemes. Failing this, we would like to see a review of FOS procedure, including criteria for its decision-making and the need for an appeals process.

In light of the characterisation of the CPMA as a 'consumer champion', we are concerned about the relationship between FOS and the CPMA. We can welcome the consultation paper's assertion that the FOS cannot favour or appear to favour consumers. Unless it becomes clear that the CPMA will not have an advocacy role, then it is arguable that the link between CPMA and FOS should be limited to the collection of levies by CPMA on behalf of FOS. In this event appointment of the Board of the Ombudsman should perhaps move to within the purview of the Treasury and be subject to the Code of Practice on Public Appointments. To ensure accountability, the FOS should be subject to largely the same requirements as the CPMA and PRA, e.g., Annual Reports, NAO scrutiny, etc. We believe it worth considering whether FOS should also have a representative role on the Financial Services Consumer and Practitioner Panels.

The relationship also needs to be looked at in the context of whether FOS's remit remains appropriate in light of CPMA's rule-making function. Currently, FOS is not 'bound' by regulation. In recent years, this has led to a situation whereby FOS has assumed a quasi-regulatory role with its rulings undermining regulatory policy. Clearly this is unfair to firms which, even though abiding by regulatory standards, can still be ruled by FOS to have acted unfairly and be required to redress consumers. It also undermines the role of the CPMA as a conduct regulator.

### ***Consumer protection and securing the right consumer outcomes: consumer credit***

We see merit in the opportunity being taken to place responsibility for consumer credit in one place by transferring responsibility for regulated consumer credit from the OFT to the CPMA. We also consider that the opportunity should be taken to clarify a number of idiosyncrasies in existing consumer credit legislation (such as provisions around 'multiple agreements') and we have been in prolonged discussions with the Department for Business Innovation and Skills on these clarifications.

We also see value in considering additional changes that would have a direct impact on improving the information available to better inform underwriting decisions, such as the provision of Council Tax arrears to Credit Reference Agencies to ensure that lenders have as complete a picture of an individual's financial circumstances as possible.

## **Markets and infrastructure**

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

We are broadly supportive of the scope of wholesale market conduct regulation as set out in the opening section of chapter five of the consultation paper and the proposed assignment of responsibility to the CPMA. More specifically, we can see logic in the markets division of the CPMA having responsibility for regulating exchanges and other trading platform providers and the Bank being responsible for overseeing CCPs and settlement systems. This will bring with it a need for close coordination between the Bank and the CPMA when it comes to the development of the European regime for OTC derivatives, CCPs and trade repositories.

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

We are surprised at the suggestion in paragraph 5.14 that modern infrastructure providers, which would include exchanges, are indistinguishable from most large firms in the financial services industry. This seems to miss the point that infrastructure providers have a different perspective with exchanges, for instance, providing fair and non-discriminatory access on an inclusive basis for a wide range of securities. While CCPs may take on a significant amount of exposure as part of their activities, exchanges on the other hand represent a very different risk profile.

The UK is renowned for its high standard of market regulation in this area and this contributes significantly to its international competitiveness. We therefore see the maintenance of an appropriate regime that makes due allowance for the different risk profiles of different activities as important to the UK's reputation as an international centre for capital raising and can see no benefit in adopting an approach out of step with other EU developments.

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

It is arguable that the objectives for the key bodies, and potentially aspects of the reorganisation, do not place sufficient emphasis on the inter-relationship between the bodies and the European and global financial infrastructure. In the case of the PRA and the markets division of the CPMA, large parts of their activity are governed by European directives and plans are in place for national rules to be superseded by mandatory European rules. It is therefore essential that the authorities give priority to representing the national interest in the relevant European authorities and for their activities to be organised in a way that creates natural 'hubs' for the implementation of the new European rulebooks. It is disappointing therefore to see so little reference given to the European process in the Treasury paper.

We believe, in particular, that there would be merit in aligning the responsibilities of the CPMA's market division with those of the European Securities and Markets Authority (ESMA) to an optimal extent. For this reason, we would not view the potential transfer of responsibility for the UK Listing Authority from the markets division to the Financial Reporting Council as

being consistent with the need to ensure that the authorities be placed in a good position to represent the UK interest in European and international fora.

We view the primary function of the UK Listing Authority in a market regulation light given its responsibility for overseeing consistency in disclosures and processes for listed securities. As a result, we believe that the UKLA should remain within the markets division of the CPMA as we see its function as integral to the regulation of the markets on which securities are admitted to trading. This would keep primary markets regulation and secondary markets regulation in the same place, enabling effective and efficient oversight of the transaction chain, and enable a smoother transition to the new arrangements.

We believe that the guiding principle should be whether the proposed transfer of responsibility for UKLA from the markets division of the CPMA would place the UK in a better or worse position in representing the UK national interest in European and international discussions, most notably in terms of ESME. In our view, it would weaken our representational ability for responsibility to be divided in this way and for this and other reasons the proposal does not have industry support.

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

We do not support the transfer of the UKLA to the Financial Reporting Council and are unaware of any other aspects of financial market regulation which should be moved.

***Other matters: Economic crime***

We are supportive of the initiative to draw together different aspects of responsibility for economic crime that are currently dispersed across a number of Government departments and agencies into a single Economic Crime Agency. Government, the criminal justice system, business and the public each have a role to play in rooting out economic crime – and a stake in each other's success. To be effective the Economic Crime Agency must have a clearly defined remit to act against serious economic crime across all sectors of the economy, public, private and charitable.

While agreeing with the need for a strong and effective Economic Agency, we believe it would be a mistake to give this new body criminal powers linked to market abuse and insider dealing. Currently market abuse investigations commence using criminal and civil powers derived from respective legislation (i.e. Criminal Justice Act 1993 and s.118 of the Financial Services and Markets Act 2000 (FSMA)). We believe such powers should stay in one place, preferably with the CPMA.

Should markets supervision powers go to the CPMA, while insider dealing investigators are relocated to the Economic Crime Agency, the potential exists for duplication within the two new bodies. On the other hand, should insider dealing investigations be moved to the Economic Crime Agency with market abuse residing in the CPMA as a civil offence then, arguably, the CPMA's investigators will be denied crucial investigatory powers

## Crisis management

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

The UK banking industry is highly supportive of there being in place a strong crisis management framework and is supportive of the division of responsibility between the Bank and the Treasury as set out in the consultation paper.

We therefore broadly agree with the discussion on crisis management set out in chapter six. We wish to underline, however, the importance we attach to the development of an international framework for crisis management. We look forward to the forthcoming publication of a proposal for a European crisis management framework and can appreciate that the level of integration delivered by the single European market requires national supervisors to enhance their cooperation and to act in a more coordinated way. Arrangements for crisis management should first and foremost be based on the foundation of good supervision to prevent crises from occurring. For these reasons we are supportive of the proposed enhancements to the European supervisory architecture, on the basis proposed by the Council, believing that the combination of a single rulebook and day-to-day national supervision will deliver more consistent, higher quality supervision which respects national sovereignty. It is important that a crisis management framework underpins this approach.

We understand and indeed share the desire to see greater harmonisation of the tools and arrangements for dealing with ailing institutions. At a high level, we believe that any international or European crisis management framework should:

- Focus on any cross-border financial institution that can jeopardise financial stability and not just deposit taking banks;
- Promote the development of early intervention tools, heightened (and more consistent) supervisory powers and a comprehensive resolution framework;
- Place a strong onus on authorities to remove impediments to effective resolution;
- Be neutral as regards the structure and business model of financial institutions;
- Require the development and production of recovery and resolution plans, prepared at group level;
- Recognise the importance of preserving the rights of creditors and protecting netting and set off arrangements;
- Recognise the international nature of these issues in particular when cross-border institutions are concerned; and
- Address the role of central banks as providers of liquidity in a crisis.

Beyond these core principles, our view is that the framework should start from the point of each Member State introducing resolution powers and tools together with a process to fund the bridging costs which may arise from a resolution. On the former, the UK has made a start with the SRR; collectively the EU needs to consider what an aligned EU regime might look like. On the latter, we believe it is vital that the Commission should not constrain national competent authorities in the choice of the mechanism for meeting these bridging costs but should ensure agreements are in place to avoid overlap.

We also believe that effective recovery planning can and should reduce the need for early-intervention resolution planning. Resolution planning should be based on a pre-crisis alignment of relevant laws, regulations and supervisory actions. Recovery and Resolution Plans should be co-ordinated by the lead regulator, and avoiding the risk of duplication and inconsistency of strategic approaches triggered by multiple requirements from local regulators. Recovery and Resolution Plans should safeguard commercial and legal confidentiality



requirements – regulators may be subjected to political pressure to share sensitive information, local regulators and clients may be irritated by disposal planning, and the resolution plan may serve as a blueprint for a predator.

We are also supportive of the continuation of the dialogue on the exploration of the role that contingent capital or other ‘bail in’ arrangements may play in the event of an institution facing financial difficulty. Making progress on this however involves working through intricate issues of the nature identified in the paper which we published this summer as a contribution to the policy dialogue.<sup>3</sup>

In terms of the proposed UK arrangements, however, we consider that the criteria for heightened engagement on the part of the Chancellor in a crisis should be broadened since we believe it inconceivable that a systemically important firm could be taken into special resolution without the Chancellor’s approval irrespective of whether this required the use of public funds. We also consider that one of the leaning lessons of the most recent crisis was that the tripartite authorities failed to deal adequately with the early part of the crisis and so believe that the proposed arrangements should be further thought through in this regard and a reassessment made of whether the collective monitoring and notification arrangements are as deliberative as they need to be.

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

We are unsure of the need for enhanced rule-making powers under the ‘own initiative variation of permission’ arrangements and would be interested in gaining a better understanding of the precise shortcomings in the current arrangements that the authorities believe need to be overcome. We also believe that there needs to be a fuller discussion about whether the potential changes identified in paragraph 6.17 would contribute to market confidence as presumably envisaged. Whilst we can see that enhancing clarity about the OIVOP power and the circumstances in which it might be used could be helpful, we would view a move to specific thresholds in a different light.

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

We are supportive of the SRR arrangements and fully accept that it is important that in appropriate circumstances the Bank as resolution authority has the opportunity to exercise its powers in an effective and orderly manner. In view of the sums of money involved, however, we do believe that use of the FSCS as a funding mechanism should be accompanied by strengthened accountability arrangements in the form of a properly constituted creditors committee. Also, further clarification would be helpful as to the interplay between the SRR and the proposed special administration regime for investment firms in the case of ‘mixed banks’.

**Preliminary impact assessment**

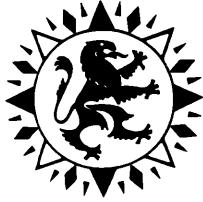
**22. Annex B contains a preliminary impact assessment for the Government’s proposals. As set out in that document, the Government welcomes comments from respondents on the assumptions made about transitional and ongoing costs for all types of firm. In particular, comments are sought from all types and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

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<sup>3</sup> [Resolution and unsecured creditors](#) British Bankers’ Association, August 2010.

We do not accept that the loss of output in comparison to pre-crisis can be said to lie purely at the door of the financial crisis. History we would suggest will show that you cannot buck economic cycles and therefore within figures for loss of output will be amounts relating to the normal rebalancing of activity as part of a progression through the economic cycle. We do not however question that there will be benefit in building into the regulatory toolbox a macro-prudential element governed by a financial stability objective. We need however to ask ourselves whether this in turn will come at too high a price if we do not give appropriate recognition to the benefits of families and businesses prospering through the fostering of the right conditions for the generation of economic growth.

**British Bankers' Association**  
**18th October 2010**



## BRITISH EXPORTERS ASSOCIATION

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

[http://www.hm-treasury.gov.uk/d/consult\\_financial\\_regulation\\_condoc.pdf](http://www.hm-treasury.gov.uk/d/consult_financial_regulation_condoc.pdf)

*Responses by 18 October 2010 to [financial.reform@hmtreasury.gsi.gov.uk](mailto:financial.reform@hmtreasury.gsi.gov.uk)*

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

1. British Exporters Association (BExA) members are drawn from exporters and also their service providers including trade finance bankers, export credit insurers and brokers which are currently regulated by the FSA.

2. This Treasury consultation aims to address the underlying causes for the impact of the global financial crisis on the UK. The crisis was felt by many BExA members whose domestic and export credit insurance was withdrawn and whose banking lines were reduced and at the same time interest margins increased. The combined impact meant that exporters were under pressure to pay their suppliers more promptly, and were not able to offer customers credit terms or finance their export receivables, and together this created a working capital shortage. That these withdrawals and increased charges happened very quickly made it difficult for the companies to manage.

4. It is now clear that before the recession, a small number of banks and insurers did not adequately manage their aggregations of exposure to certain financial risks. When the crisis hit, these entities took massive corrective action on their whole book of customers, including also well-managed, prudent, long-standing customers alongside the high risk elements of their portfolios. It is vital that regulators instil into financial institutions a duty of care to manage and monitor their risks so that their responsible customers can continue to be supported through economic downturns.

5. BExA supports regulation that reinforces good business practice and requires high standards in regulated entities. However, regulation involves considerable investment in training and systems by the entities that are regulated. The government should think carefully before deciding to change the **subject matter** or **methodology** of financial regulation, in addition to changing the **entities** that are acting as regulators, because any additional compliance costs incurred by financial service providers will inevitably be passed to their customers, the exporters. BExA's interest is in maintaining high standards in the UK's innovative financial services but not adding to the costs of exporting since our exporters are selling into a very competitive international marketplace.

**BExA Council**  
October 2010

**BExA**

Page 1 of 1  
Broadway House, Tothill Street, London SW1H 9NQ  
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15<sup>th</sup> October 2010

HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Dear Sirs

**BIBA's response to the HM Treasury Consultation on a new approach to financial regulation**

The British Insurance Brokers' Association (BIBA) is the UK's leading general insurance organisation representing the interests of insurance brokers, intermediaries and their customers.

BIBA membership includes 1,700 regulated firms. Insurance brokers and intermediaries distribute nearly two-thirds of all UK general insurance. In 2007, insurance brokers and intermediaries generated £1.5 billion of invisible earnings and they introduce £22 billion of premium income into London's insurance market each year.

BIBA is the voice of the industry, advising members, the regulators, the Government, consumer bodies and other stakeholders on key insurance issues. BIBA provides unique schemes and facilities, technical advice, guidance on regulation and business support and is helping to raise, and maintain, industry standards. BIBA works closely with the Chartered Insurance Institute to provide training to those working in the industry and actively participates in helping the industry and its customers deal with some of the major issues of the day.

BIBA members provide professional advice to businesses and consumers, playing a key role in identification, measurement, management, control and transfer of risk. They negotiate appropriate insurance protection tailored to individual needs and operate to a very high standard of customer service with the aim of ensuring peace of mind, security, financial protection and the professional advice required.

**Executive Summary**

BIBA believes that insurance intermediaries do not present a systemic risk to UK PLC and therefore the Consumer Protection & Markets Authority is the appropriate body for regulation of our sector. We are therefore pleased that the consultation supports this position.

Insurance brokers pose a low risk to the objectives of the Consumer Protection & Markets Authority and care should be taken to ensure that the new regime leads to appropriate and proportionate regulation of our sector.

We have consulted with a broad cross-section of our members and have composed a two-part response to the consultation paper – the first deals specifically with the questions raised in the consultation paper, while the second provides commentary on the current regime from the perspective of insurance brokers.

In responding to us, our members' concerns can be categorised under four main headings:

1. **Cost** - the regulatory cost burden in the UK is significantly higher than anywhere else in Europe. A competitive and healthy insurance intermediary market is in the national interest and so the issue of cost must be taken seriously. The level of regulatory fees paid by insurance intermediaries in the UK dwarfs those paid anywhere else on mainland Europe. Additionally, the nature of the current funding model of the Financial Services Compensation Scheme (FSCS) is creating an unfair burden on insurance intermediaries.
2. **Appropriateness** – our members have regularly spoken to us about the Financial Services Authority (FSA) taking approaches from other sectors (most noticeably the banking sector) and applying them to insurance intermediaries. This has led to a number of occasions where what we consider to be an inappropriate stance has been taken.
3. **Complexity** – the HM Treasury decision to use the FSA as the „Competent Authority' for the registration of insurance intermediaries (under the terms of the Insurance Mediation Directive) led to insurance brokers being shoe-horned into a regime designed for much riskier sectors of the financial services market. This has led to our members being subject to a rulebook designed for others and a supervisory approach often not in proportion to the risks being posed.
4. **Burdens** – our members have cited a variety of areas where the FSA rules, approach and style create a burdensome regulatory environment. These include the complexity of the Client Money rules (chapter 5 of FSA's Client Assets sourcebook), excessive details required in the FSA's Retail Mediation Activity Report (RMAR), the multitude of management information, the weight of paper necessary to comply with the rules (set against a continuing lack of interest by a majority of consumers) and the cost of compliance consultants to help achieve and maintain compliance obligations.

## **BIBA Response - Part one**

Please find below our response to the questions raised in the consultation paper:

### **The Bank of England and Financial Policy Committee (FPC)**

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

*BIBA believes that the FPC's objective should be supplemented with secondary factors to support successful achievement of a coordinated, "joined-up" regulatory environment in the UK. Furthermore, we believe that these must include consideration of the competitive position of the UK financial services sector.*

- 2 **If you support the idea of secondary factors, what types of factors should be**

## **applied to the FPC?**

*In view of the different bodies playing their respective parts in an overall UK regulatory system, BIBA believes that coordination and transparency will be a necessary prerequisite. This is recognised in the paper by the proposal for both the CEOs of PRA and CPMA to sit on the FPC Board. The primary objectives of PRA and CPMA should be secondary objectives for the FPC. We additionally believe that the Principles of Good Regulation should be incorporated into the secondary objectives to give authority to issues such as operational efficiency and economy, proportionality in decision making, protecting the innovative and competitive nature of UK markets.*

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

*BIBA believes that to ensure there is a fully coordinated regulatory system, FPC should have a secondary set of statutory objectives rather than a list of "have regards" issues.*

## **Prudential regulation authority (PRA)**

### **4. The Government welcomes respondents’ views on:**

- **Whether the PRA should have regard to the primary objectives of the CPMA and FC**

*BIBA believes that the primary objectives must be aligned to ensure the three bodies act in concert. Additional, we prefer a requirement that the PRA „takes into account’ the primary objectives of the FPC and CPMA, rather than simply „having regard to’.*

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

*BIBA believes that the PRA should also operate under the Principles of Good Regulation as secondary objectives. This we believe would give authority to issues such as operational efficiency and economy, proportionality in decision making, protection of the innovative and competitive nature of UK markets.*

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

*It is BIBA’s view that the potential adverse impact on the innovative and competitive nature of the UK financial services sector, owing to consequences of regulatory action, require these aspects to be in place and in view of their importance, as secondary objectives not just as "have regards" issues.*

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

*BIBA is of the view that the PRA needs to differentiate between the types of firms it regulates so as not to damage the effectiveness of insurers in delivering their products to both consumers and insurance intermediaries. Furthermore, we believe that the Government should have regard to the risk of creating a regulatory environment that would encourage registration in another EEA state and use of the passporting regulations to trade within the UK. That would not only undermine the overall objective of creating the FPC/PRA/CPMA but also reduce income for the Treasury.*

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

*BIBA has a preference for an integrated approach for authorisation and removal of permissions as we feel that the alternative would be both cumbersome and potentially overly costly.*

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

*Yes, subject to previous comments and safeguards noted below.*

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

*BIBA's view is that safeguards are required. These should include requiring standards of operational efficiency and economy, proportionality in decision making, protection of the innovative and the competitive nature of the UK financial markets. We also believe that there should be a requirement for a robust cost-benefit analysis prior to action and external, independent, public scrutiny about the effect of decisions taken.*

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

*It is BIBA's opinion that the current FSMA safeguards are appropriate and should be retained.*

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

*BIBA supports the measures proposed in paragraphs 3.28 to 3.41 but would strongly recommend supplementing these with the publication of an annual report.*

**Consumer protection and markets authority (CPMA)**

**10 The Government welcomes respondents' views on:**

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

*BIBA believes that the primary objectives of the three bodies should be aligned. Furthermore, we believe that the CPMA's secondary objectives should include reference to the PRA's (stable and prudent operation of the financial system) and the FPC's (improving resilience of the financial system and enhancing macro-economic stability) primary objectives.*

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

*It is BIBA's view that the Principles of Good Regulation should be incorporated into the secondary objectives of CPMA. This we believe would give authority to issues such as operational efficiency and economy, proportionality in decision making, protection of the innovative and competitive nature of UK markets.*

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

*BIBA is strongly of the view that this should be retained. Regulatory action must be available to protect against adverse impacts on innovation and competitiveness.*

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

*BIBA believes that there are additional broader public interest considerations for the CPMA. We believe that it should seek to appropriately differentiate between the types of firms it regulates so as not to reduce the availability of service to the public by those whose primary business is that of general insurance intermediation. Our members have raised numerous concerns with us concerning references in the consultation paper to the CPMA being a "consumer champion". We believe there is an obvious and irreconcilable tension in CPMA being "on the side" of the consumer while simultaneously policing good behaviour within markets.*

*BIBA also believes that the CMPA should be established with clear and precise rules and not be principle based as applies presently with the FSA.*

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

*BIBA believes that the accountability mechanisms proposed for the CPMA are both sufficient and appropriate.*

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



*BIBA welcomes the proposal to maintain the three current panels. We also applaud the proposal to put the Smaller Business Practitioner Panel onto a statutory footing. As 92% of the entire regulated community consists of smaller firms the SBPP needs to be able to work closely with the new regulator and the regulated community to ensure that the needs of smaller firms are taken into account within the new framework. With the narrower prudential focus of CPMA greater emphasis will be placed on conduct of business matters. The output from the work of the Practitioner Panel and the Small Business Practitioner Panel will be crucial in assisting in a balanced regime between the needs of consumers (as represented by the Consumer Panel) and regulated firms' legitimate, commercial interests. Membership of the Practitioner Panel and Small Business Practitioner Panel should as previously, be drawn from a representative cross-section of the firms relevant to those panels.*

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

*BIBA believes that the proposed funding arrangements are sensible. It is important that excess administration and cost be avoided where possible, both for the regulators and the regulated community. In this regard the proposal that the CPMA act as the fee and collecting agency is one we support, provided of course that the costs are allocated proportionately across all firms.*

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

*BIBA has long held the view that the current FSCS funding mechanism, which incorporates a degree of cross-subsidy unique to the UK, to be unfair. The extension of the current scheme and the use of cross subsidy never anticipated claims to the extent that have occurred as result of failures within the Deposit Taking Sector and there would be more support, in principle, with a move towards compensation and levies for different classes of firms. Furthermore, we are strongly of the view that insurance intermediaries for whom such activity is their primary business, should only be responsible for compensation costs arising out of failure of another primary, insurance intermediary.*

*We therefore would support any move to end the current cross subsidy of other parts of the financial services sector by insurance brokers.*

## **Markets and infrastructure**

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

*BIBA notes that "the PRA will represent the UK on the new European supervisory authorities for banking and insurance, ensuring that there is a strong and credible voice to promote the UK's interests in these new institutions" (1.18) and "The CPMA markets division will also represent the UK at the new European Securities and Markets Authority." (1.23). BIBA is concerned that the current review of the Insurance Mediation Directive, with the involvement of EIOPA in non-prudential and*

*conduct, makes it imperative that CPMA is involved in representing the UK's conduct of business interests within EIOPA.*

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

*We have no view.*

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

*We have no view.*

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

*We have no view.*

#### **Crisis management**

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

*We have no view.*

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

*We have no view.*

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

*We have no view.*

#### **Impact assessment**

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

*BIBA notes on the sixth page and quote "Costs – regulated firms. Most of the approximately 20,000 firms currently regulated by the FSA will be regulated solely by the CPMA after the reforms have been implemented. These firms are unlikely to suffer any significant transitional costs or significant increases in ongoing costs as a*

*result of the reforms." The use of the word "significant", twice, concerns us. BIBA would respectfully remind HM Treasury that insurance intermediaries were not responsible for the financial crisis so in equity, should not incur additional cost in the implementation of any remedial, regulatory solution necessary to check the excesses of others. BIBA would respectfully suggest that the principle of "polluter pays" is applicable in this situation and the inevitable cost involved in creating a different regulatory regime should fall upon those to whom blame is due.*

## **Part Two**

### **A new approach to financial regulation: judgment, focus and stability**

#### **Background – the regulation of insurance brokers and intermediaries**

The announcement of the creation of a new single, statutory regulator in the form of the Financial Services Authority (FSA) in May 1997 provided the catalyst for change in the fragmented regulatory system that non-life (general) insurance brokers and intermediaries had hitherto operated in.

At the time, there was no appetite for the activities of general insurance intermediaries to be drawn into the FSA which already had its hands full with the regulatory and registration functions of the nine other bodies it had inherited. The government therefore took the decision not to extend the scope of the FSA's regulatory responsibilities to include the activities of general insurance brokers and intermediaries. This decision was kept under review, however.

General insurance brokers and intermediaries were distanced further from statutory regulation in July 1998. Helen Lidell, the then Economic Secretary to the Treasury, announced that consultation with organisations representing the industry and customers about potential regulatory requirements for the sector had "reaffirmed my view that a case for continuing statutory regulation through the registration of insurance brokers has not been made."

According to Mrs Lidell the majority of respondents to the consultation had felt that: "the best way forward was offered by self-regulation by a body having support across the insurance industry, independent of insurers and intermediaries but taking their interests and those of their customers into account."

The Insurance Brokers Registration Act 1977 was revoked as a result of the consultation and the Treasury would instead look to voluntary self-discipline rather than statute to maintain and improve professional standards of behaviour in the insurance intermediary sector going forward.

This decision, gave rise to the General Insurance Standards Council (GISC) which began taking on members from among the insurer and intermediary communities in July 2000. Membership of the regulator was voluntary. Those that signed up to GISC agreed among many things to be bound by a single rulebook which included private customer and commercial codes, maintain adequate internal controls and procedures

and were subject to external monitoring of their compliance. The voluntary regulator had a range of investigation, disciplinary action and sanctions at its disposal.

The GISC gained good ground in the insurance industry during its lifetime. Support for the voluntary regulator was strong with numbers peaking at around 6,500 organisations or approximately one third of the market by October 2002.

However, this was all set to change with the advent of the European Union's Insurance Mediation Directive 2002/92/EC. This Directive sought to introduce minimum professional requirements for all insurance intermediaries across Europe and required them to be registered with a competent authority in the home member state.

In December 2001, the Treasury decided not to designate GISC as the competent authority for the purposes of registration under the IMD in the UK. Instead, the FSA's powers were extended to include the regulation of non-life insurance sales and administration. This decision marked the end of the voluntary regulator GISC. The IMD was implemented in the UK on 14 January 2005 and led to a major change in the regulation of general insurance intermediation. The insurance intermediary community became subject to a comprehensive, expensive and far more stringent statutory regulatory regime the like of which it had not experienced before.

### **The current regulatory regime**

In December 2002 Sarah Wilson, Head of the FSA's High Street Firms Division, set out during a consultation some of the goals for the new general insurance brokers and intermediaries regulatory regime. These goals included the fair treatment of customers, the provision of relevant information on both firms and products, and if advice was given that the product recommended should be adequate to meet the customer's needs. If the customer made a claim, then that too should be handled promptly and efficiently.

Mrs Wilson said at the time that the FSA aimed: "to introduce a regime that achieves these goals in a proportionate, cost-effective manner which has regard to issues of competition, both within the UK marketplace and internationally."

The above are all excellent goals which the industry supports. BIBA argues that the regulatory regime to which general insurance intermediaries became subject to in January 2005 never achieved the above aims. Instead, insurance intermediaries were exposed to burdensome, disproportionately complex regulation and a style of supervision that never reflected the true risk that the insurance intermediary sector posed to the FSA's statutory objectives. The Treasury's choice of the FSA as competent authority meant that the UK's general insurance intermediaries were put at a significant competitive disadvantage to their European competitors leaving them facing heavier costs of doing business than in other member states as a result of regulation.

### **BIBA's questionnaire findings**

BIBA surveyed a cross section of its members during August and September 2010 in order to be able to support its response to the HM Treasury's paper *'A new approach to financial regulation: judgement focus and stability'*. Many respondents confirmed BIBA's concerns about the failings of the regulatory regime that insurance intermediaries are currently exposed to and some of these are set out below:

BIBA asked how members judged the FSA's performance against each of its four statutory objectives on a scale of one to ten (where one means very poor and ten means outstanding).

Two thirds of respondents rated the FSA's performance as being poor or very poor with regards to its statutory objective of maintaining confidence in the UK financial system.

Moving on to the FSA's objective of promoting the public's understanding of the financial system 67% of our members agreed that the regulator's performance had again been poor/very poor.

Most damning were views on the FSA's performance against its statutory objective of securing the right degree of protection for consumers where 90% of respondents thought that this had been poor/very poor.

Figures improved with the FSA's efforts to help reduce financial crime where only 50% of respondents thought the regulator's performance had been poor.

The above responses should not be interpreted as an indication that BIBA members are anti-regulation. BIBA has long argued that robust and efficient regulation helps customers and businesses alike, particularly with regards to confidence. Our members went on to confirm this view with two thirds of respondents agreeing/strongly agreeing with the statement in the questionnaire that strong regulation should be for the benefit of the insurance industry as a whole.

Despite the support for strong regulation, two thirds of respondents agreed with a statement in the questionnaire that the 'current regulatory system places an unnecessary burden on insurance intermediaries'. Two thirds of respondents also felt that the FSA focused on consumer protection to the detriment of its current objectives.

### **Style and cost of supervision**

A major criticism of the FSA is the style and cost of its supervision. BIBA has often received complaints from its members that the FSA's approach is inappropriate, unnecessary and disproportionate. BIBA members were asked to submit evidence of this as part of the questionnaire, examples of which have been organised into subject categories as shown below:

#### **Cost of regulation**

The cost of regulation to the general insurance intermediary community has increased significantly during the past decade as a result of the change from voluntary to statutory regulation. These increasing costs were the result of firms not only having to pay annual fees and levies to fund the regulatory framework, but also the cost of internal resources within individual firms to ensure compliance with the regime's requirements which ranged from £10,000 to more than £1 million per annum for respondents.

All respondents to the questionnaire were critical of the increasing cost of statutory regulation, particularly against the current backdrop of difficult economic conditions where the other costs associated with running a business were also rising and firm

income was stagnating or declining as customers looked to make their own cost savings. There were also concerns about the high cost of compliance and whether the FSA was providing good value for money.

For example, the annual FSA fee and levy demands for 2010-11 have caused great concern to BIBA members of all sizes. Increases have been caused by two main factors – firstly the FSA has introduced a minimum annual fee of £1,000 and a „straight line recovery’. This has had the effect of increasing FSA fees for the smallest plus largest intermediary firms (though the 80% or so in the middle have actually seen a reduction in their year-on-year FSA fee).

Our larger intermediary members have complained that these fees are significantly out of kilter with what intermediaries are paying in other EU member states for registration, for example in France intermediaries are subject to a registration fee of €50 which is payable annually, which must be renewed each year, while in Germany €200 to €250 (cost varies according to regional chambers of commerce) plus €10 to 20 for every other European country in which the intermediary intends to render his services plus a registration fee of €25. This lack of parity can mean that large general insurance intermediaries which are active across Europe will pay more here in the UK in annual regulatory fees and levies than in the other 26 states combined.

More problematic is the significant increase in the Financial Services Compensation Scheme (FSCS) levy that general insurance intermediaries will see in 2010-11. The annual levy for the general insurance B2 subclass has increased from £8 million last year to an astounding £61 million for 2010-11, largely as a result of the failure of credit intermediaries having mis-sold payment protection insurance.

One of our members cited the impact on their levy demand. They are a motor insurance specialist and have an annual income of approximately £20m. Two years ago their FSCS levy was £3,000, last year it increased to £18,000 and this year they have paid £95,000 (at a time where their income has remained static).

Our members feel most strongly that this is fundamentally unfair and that the FSA, as part of its fundamental review of the FSCS, must find a way to separate the full time professional insurance intermediary from the „secondary’ players, i.e. firms for whom insurance mediation is not their main or principal activity.

Funding to the FSCS by the general insurance intermediary sector is way out of line with compensation provisions offered to the customers of failed financial organisations in the rest of Europe. The current FSCS mechanism exposes insurance intermediaries to failures of banks and insurers. Nowhere else in Europe are intermediaries exposed to any degree of cross subsidy of other financial institutions.

One respondent to the questionnaire noted: *“By increasing the FSCS fees on such a massive scale, you are driving brokers out of business. These brokers provide expert advice and impartial assistance to the consumer and work to ensure fair claims settlements, competitive premiums and more and more, health and safety advice. They also provide assistance with issues like corporate governance, business continuity planning and business interruption reviews. The increased fees are actually reducing the options for consumers and ultimately acting against their best interests.”*

The level of fees and levies charged to insurance intermediaries in the UK are a matter of huge concern. Our members pay significantly more in regulatory costs than their peers in any other European state, a fact that BIBA is bringing to the attention of politicians and civil servants, both at home and in Europe.

## **Complexity**

The advent of statutory regulation for insurance brokers and intermediaries resulted in a significantly more stringent regime being applied to the sector. Not only was a specific sourcebook created to govern the conduct of business activities of insurance intermediaries, but also other rules contained in the FSA Handbook applicable to all other financial services institutions had to be adopted by the sector too. Gold plating of the IMD's minimum requirement also took its toll resulting in a far greater regulatory burden on the UK's insurance intermediaries than in other countries. In recent years, however, the FSA has worked hard to reduce this gold-plating.

One respondent noted: *"The level of regulation and the cost should be consistent with the degree of risk posed by the different sectors of the financial services industry. General insurance brokers have now been regulated since January 2005 and history shows that they have not posed any significant risk to the FSA's objectives. Also the resources required to regulate them in being proportionate to the risk, should result in considerably less cost imposed upon general insurance brokers relative to other sectors which have proved to be a significant risk to the FSA's objective."*

BIBA has always been critical of the FSA's approach to regulation, arguing that general insurance intermediaries had been shoe-horned in to a regime that had been designed for firms with higher risk businesses which posed systemic risks to the UK's financial system, e.g. banks. We have argued that the FSA has failed to take into account in its regime the low risk profile of the sector and that 'professional insurance brokers/intermediaries' are compliant by nature and by performance.

While we support the statutory objectives of the FSA, some of our members have found that its regulatory approach has been inconsistent, not only towards firms with similar businesses on the same issue, but also with regards to what different supervisors have told the individual firm to do. One respondent complained that the FSA: *"Sometimes erred towards crossing the boundary between their remit and what's outside their remit. In particular we have found over the last 18 months the FSA constantly moving the goal posts in respect of what controls they would like to have in place (stemming from RMAR actions) and an inconsistency in respect of the messages they have delivered."*

Clear communication by the FSA is vital particularly on its bigger initiatives. Respondents also noted that the FSA's move away from specific rules to principle-based regulation meant that firms often had to second-guess the regulator's expectations of them. The Treating Customers Fairly initiative was one such example prompting one respondent to comment: *"The FSA often produced long supporting documents which actually failed to provide any real guidance as to what their thinking was on a particular subject". "It is for firms to decide" was a common theme. This alienated firms with limited resource, confused as to what action was necessary and resulted in their "switching off" when faced with what to them, often appeared nebulous concepts."*

BIBA has seen this problem being repeated again more recently with our wholesale intermediary firms and the FSA's work on Threshold Condition 4 (adequate resources). A number have complained that the stress testing needed to support TC4 is over burdensome and costly. Questions have been asked about who the FSA was trying to protect with these requirements – the consumer or itself – particularly given the lack of systemic risk that brokers pose to the financial system. Concerns were expressed about the high cost of bringing in specialist accountancy staff to verify stress testing work (two large BIBA members had spent £100,000 between them doing this work).

Earlier in 2010 the FSA's approach to TC4 prompted BIBA to challenge the regulator as to why it took such an intense interest in the area of adequate resources and why any regulation is needed. We argued that brokers present no systemic risk and that the potential failure of an intermediary does not present a need for high level regulation of this area with risk transfer, client money protection, professional indemnity insurance, intense competition and the FSCS already in place.

We also urged the FSA to give more clarity to smaller firms regarding 'what good looks like' so that brokers, particularly smaller firms, have a clearer understanding of what a suitable assessment might comprise of.

### **Understanding of the industry**

Another common complaint to emerge from the questionnaire was the FSA's apparent lack of understanding about the general insurance industry and the lack of good, experienced supervisory staff at the regulator.

*One respondent noted: "Turnover of staff and increased management time taken to once again provide detail of our business model so that the new supervisory team understand what we are trying to do. There is a lack of understanding of us as a composite broker. We have felt they have put risks to this model that are not going to occur – giving the impression that they are not fully commercial and would like to reduce the risk to zero. I do not believe the government wants to drive out all entrepreneurial zeal. If not then they need to improve the quality of personnel. We did have a very good relationship manager who was moved from our account. Since then it has been a series of people who lack understanding and commerciality."*

Most of our members are not relationship managed and their day-to-day contact with FSA is via their Firm Contact Centre (FCC). While none of the respondents commented specifically on the FCC on this occasion, we have had many members during the last five years provide us with criticism of how their queries and issues have been handled. The common consensus is that the previous regulatory bodies (GISC and IBRC) provided a better service, though members do understand the constraints that are placed on a statutory body.

Respondents also felt that since the banking crisis there has been a step up in the rigour on regulation for the insurance industry which they felt was disproportionate. They argued that the insurance industry was being tarred with the same brush as those in the banking sector, when the risks posed by the insurance industry to the financial system were very different. There was also a fear among respondents that issues with the quality of personnel and the lack of recognition about the real risks posed by the insurance industry may be carried over to the Consumer Protection and Markets Authority (CPMA).



One respondent commented: *“It appears that the people filling senior roles for the CPMA will come from the FSA. Understandably roles lower down the chain will also be filled by former FSA personnel. We need the new body to appreciate the risk profile of the insurance industry when measured against the banks and other higher risk financial organisations.”*

Recycling the same personnel would in the eyes of another respondent result in *“... more of the same which will not build trust in the regulation nor trust in the ability of the individuals to understand the insurance sector and respond appropriately and not universally when measured against the banking risk.”*

### **‘Consumer-champion’ role**

While the FSA sought to be an even-handed regulator, there has been a growing concern among BIBA members that the balance in the regulatory regime has been tipping towards consumer protection and away from the interests of firms. The growing power of the Financial Ombudsman Service and spiralling FSCS costs have all helped to feed this impression. Naturally, any proposals for the new CPMA to be a ‘strong consumer champion’ as well as regulator have resulted in consternation at member firms.

One respondent noted: *„Fairness by its very definition means that the right thing should be done for all parties involved in any relationship, business or otherwise. By the CPMA becoming regulation and consumer champion combined, this creates a natural proclivity towards the consumer and therefore a conflict of interest arises. By becoming referee and also one team’s star defender, you are always going to act in one team’s favour.”*

Others commented:

*“Having an authority that is both regulator and a ‘strong consumer champion’ could result in a conflict of interest. It would make more sense if there was a dedicated consumer champion and a separate regulator.”*

*“My concern is that there could obviously be a conflict of interest and in the light of the new organisation’s name [CPMA], it is likely that the bias will be with the consumer as opposed to the firm.”*

*“We see that the ‘consumer champion’ role as being in direct conflict to providing suitable and proportionate regulation for the financial services industry. The CPMA should be there to protect the interests of consumer, firm and the financial services as a whole not just in respect of consumers. By flagging itself as a ‘consumer champion’ throws up questions as to how they can have everyone’s interests covered.”*

*“If firms get it wrong for a particular customer then that is why Financial Ombudsman exists to ensure those customers who have complained get a fair hearing. If the CPMA is to be partial in its rule making, ignoring the market and ‘loading the dice’ in favour of the customer then that will undermine the market’s confidence in the regulatory process.”*

The general consensus was that there were already enough organisations e.g. the FOS and the Consumers' Association which are looking out for the welfare of the customer. First and foremost the CPMA should be a regulator.

*“If the CPMA carries out its duties properly the regulation should be enough to protect the consumer. It should not be a consumer champion – there are enough of those who regularly appear on Money Box who do this and do a very good job within the normal confines of the term. The consumer champion title will only confuse the CPMA’s role in regulation.”*

Above all the consensus was that the general insurance broker’s business presents a relatively low risk to any regulator and the sector has a good track record of customer care over a considerable period of time. A new regime of heavy handed consumer championing is unnecessary and is highly likely to complicate and confuse the provider/consumer relationship and will be counter-productive. Better that the regulator uses its valuable resources in other financial sectors where it is needed most i.e. not in the general insurance sector.

Thank you for taking the time to consider our response.

Yours sincerely

**Eric Galbraith**  
Chief Executive

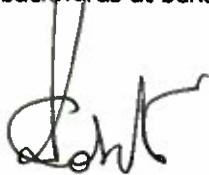
**The British Land Company PLC's response to  
HM Treasury Paper: A new approach to financial regulation: judgement, focus and stability**

I am writing on behalf of The British Land Company plc.

In broad terms we support the thrust of the measures proposed in the consultative paper and have two observations:

Firstly, we support Lord Turner's assessment of flawed micro-prudential regulation and believe further thought should be given to the flow of information between regulator (PRA), auditors and audit committees and the Bank of England. Bringing the PRA within the remit of the Bank of England is a positive step in the direction of better communication for macro-prudential purposes about risk profiles within banks. However, the PRA should also engage more openly with auditors and vice-versa within a framework similar to that operating in the early 90's involving bi or tri-partite meetings between regulator (then The Bank of England), auditors and financial institutions.

Secondly, it is not intuitive that a 'real time regulator' such as the UKLA should naturally merge with the FRC which engages in a very different way, primarily at a policy level and looking backwards at behaviours. A more logical fit would be for it to remain within the remit of CPMA.



Graham Roberts  
**Finance Director**

22nd October 2010

15 October 2010



**BRC consultation submission to HM Treasury**  
**A new approach to financial regulation: judgement, focus and stability**

The British Retail Consortium (BRC) represents the whole range of retailers including large multiples, department stores and independent shops, selling a wide selection of products through centre of town, out of town, rural and virtual stores.

BRC members will be subject to regulation by the proposed Consumer Protection and Markets Authority (CPMA) only, so have confined comments to issues relevant to the CPMA.

BRC members would be pleased to discuss in more detail any comments or issues of interest to the HM Treasury.

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**For what is the CPMA designed?**

1. The overall framework of the FPC, PRA and CPMA is driven by market stability and consumer protection objectives. Primary consideration appears to be regulation of the 'too big to fail' banks. As currently conceived it does not appear that there has been sufficient consideration of the impact on, and implications for, non bank lenders and insurance intermediaries.
2. BRC members are concerned that the CPMA is being designed and created before it is clear who and what it will regulate. If the CPMA is designed and structured to regulate conduct of business of the 29,000 firms currently regulated by the FSA, plus prudential regulation of any of those 29,000 firms which are not banks, insurers or deposit takers, it will struggle to be fit for the purpose of regulating an additional 80,000 consumer credit licence holders.
3. The 80,000 consumer credit licence holders not regulated by the FSA are not currently subject to any prudential regulation – solely the 'fitness' tests of the OFT. If the CPMA does take on prudential regulation of these 80,000 licence holders, the framework needs to be established from the outset.
4. As there is at least a strong possibility that the CPMA will regulate consumer credit licence holders, its structure, governance and powers must take this into account. Again, it will struggle to be fit for purpose otherwise, if and when credit does move to it.

This is particularly important given that the credit regime as regulated by the OFT and the wider financial services regime as regulated by the FSA are currently at opposite ends of the spectrum of approaches to regulation. Credit is based on a prescriptive and highly detailed set of primary and secondary legislation, with the OFT's role limited to



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regulation and enforcement of that legislation. It does so by adopting a risk based but essentially reactive and non intrusive approach. By contrast the FSA has very extensive rule making powers, and is both interventionist and intrusive. If credit is to move to the CPMA, and if the CPMA will apply an FSA style approach to regulation and enforcement, a great deal of work must be done to determine how best, and proportionately, to structure its powers and governance, and to adapt consumer credit legislation to those powers. The debate over its role and powers cannot therefore be divorced from the questions of whether and how it will regulate consumer credit.

## **Proportionality**

5. Key to the above points is the issue of proportionality. A regulatory framework designed for the regulation of major banks and insurers is unlikely to be suitable for the consumer credit market, which includes 80,000 licence holders which are not regulated by the FSA and have no experience of FSA style regulation. As a matter of principle, the cost and burden of regulation must be proportionate to the markets and firms being regulated.
6. BRC members typically engage in low value lending (balances tend to be less than £500. Products supplied in these markets are typically used by people on low incomes who struggle to access mainstream credit and who borrow small sums for short periods). Increases in costs will inevitably also have a disproportionate impact on consumers currently using these facilities. BRC members lend to a relatively high proportion of lower income customers (C2, D and E demographics), who are least able to absorb any increases in cost. The regulatory framework for non bank lenders must be tailored to that market, and be proportionate to it.

## **Clarity of Objective**

7. BRC members are extremely concerned at the lack of clarity to date in the role and objectives of the CPMA, particularly given the emphasis in the paper on the need for absolute clarity as its primary objective.
8. In particular, we would question the extent to which it is possible for the CPMA to be both an independent conduct regulator (as it is described in Box 4B), and a strong consumer champion (as it is frequently described). This is a concern shared widely across industry, not just the retail sector. Indeed, paragraph 4.44 envisages that because the CPMA will not be independent, or be seen as independent, it is imperative that FOS is clearly separated from it, so as not to be influenced by the CPMA's proposed position towards consumer protection.

In our view it will be extremely difficult for the CPMA to fulfil both the role of strong consumer champion and that of independent regulator.

9. Aspects of the CPMA's role which may not accord with the role of consumer champion:
  - a. Market stability and confidence – consumer champions, by nature, tend to be adversarial to institutions. This could have an adverse impact on public confidence and trust in financial institutions and markets.

- b. Whilst the OFT has a consumer protection role, it has very limited rule making powers. It can issue guidance, but is essentially a regulator and enforcer of primary and secondary legislation passed by Parliament. Assuming the CPMA has rule making powers similar to the FSA, it will be able to effectively legislate. This is a serious concern for retailers – a single regulatory body that will have wide ranging legislative, judicial and enforcement powers must be balanced with a comprehensive and coherent system of checks and balances on its exercise of those powers, proportionate to the market it regulates. There is insufficient detail of such a system in the proposals, and given the question of regulation of consumer credit, it is difficult to see how an effective and proportionate system of checks and balances can be finalised until the extent to which the CPMA will regulate credit, and the basis on which it will do so, is known.
  - c. The need for a regulator to promote more than just consumer protection. BRC members believe that competition, innovation, financial inclusion and proportionality are all principles that underpin effective regulation. In addition, it is vital that regulators fully understand the whole of the markets that they regulate – and the consequences of their actions on the whole market place. This is particularly the case with a market as diverse as consumer credit. A remit limited to primarily consumer protection will not encourage the development of the principles of good regulation.
10. Given the extent to which regulatory developments in financial services are now driven by a European agenda, there is a surprising lack of comment in the paper as to how the UK regulators will represent UK interests and views at EU level, and how they will interact with central EU regulatory bodies. This is particularly important in the arena of consumer credit, where a maximum harmonization directive means firstly, that all initiatives and approaches to regulation and enforcement should be consistent across the EU, and, secondly, that there is much more limited scope for unilateral UK approaches.



## **HM Treasury**

A response to the Treasury Consultation, A New Approach to Financial Regulation:  
Judgement, Focus and Stability

Response by the UK's National Standards Body, BSI.

Following communication with HM Treasury (Ref:# 78472/2010 dated 4<sup>th</sup> October 2010, Ruth Hopkinson Financial Regulation Strategy) and a recommendation to elaborate on BSI's activities in the financial sector via the above consultation, in particular our work in developing a standard framework for compliance functions, the following response details some of BSI's relevant standards (and ongoing work) developed with the support of industry, consumer bodies and through engagement with the UK regulator (FSA) and government.

Standards are developed in consensus and typically codify agreed industry good practice, processes and professional competencies. The planned restructure of the regulatory system and formation of the Prudential Regulation Authority and Consumer and Markets Protection Authority mirrors BSI's own approach to the sector in terms of our activity in developing both governance standards with internal and institutional focus, and those with a focus on service delivery and meeting the needs of consumers in the retail markets.

During the course of 2010, and in response to industry interest, BSI has been engaged with the financial services industry, trade associations, government and the UK regulator Financial Services Authority in the development of a new standard designed to help regulated firms (of all sizes and business types) to implement good practice and procedures designed to aid compliance monitoring functions and to identify and lower compliance risk.

This standard, BS 8453 Compliance Framework for Financial Services Firms, went to public consultation in summer 2010 where several hundred interest parties representing a cross-section of firms viewed the standard, many providing comment. The framework standard, due to be published within the coming months, could support firms in demonstrating conformity with good governance processes and practice to both internal and external stakeholders.

BSI's work in the areas of good governance, working with the financial sector and wider industries has already seen proven success through the development of our Business Continuity Management standard (BS 25999) which was developed with a committee including the Bank of England, the FSA, the ABI and members working for financial services providers. A similar approach with Risk Management standards (BS ISO 31000 and BS 31100) has achieved good uptake within the financial services sector. Future standards on Corporate Governance and Anti Bribery Systems will add to good governance best practice for the financial services sector.

In light of the planned creation of the Financial Policy Committee within the Bank of England to fulfil the need for macro-prudential regulation, BSI's risk, governance and business management portfolio appears to offer a logical, robust and rigorous complementary tool to facilitate both internal and external due-diligence and external auditing activities as necessary.

The creation of the Consumer Protection and Markets Authority could be supported by BSI's well-established work on Complaints Handling processes (BS ISO 10002), Data Protection (BS 10012) and more recently our engagement with the Office of Fair Trading, Citizen's Advice Bureau and Consumer Focus to develop a standard for providing Inclusive Services to consumers, especially the vulnerable or disadvantaged. This work has also been welcomed by the UK Financial Ombudsmen Service who will support wider implementation of the standard which seeks to ensure that consumers are treated fairly and not misled or discriminated against in line with relevant consumer protection regulation.

## **BSI Background**

BSI is the UK's National Standards Body, incorporated by Royal Charter and responsible independently for preparing British Standards and related publications. BSI has 107 years of experience in serving the interest of a wide range of stakeholders including government, business and society.

BSI presents the UK view on standards in Europe (to CEN and CENELEC) and internationally (to ISO and IEC). BSI has a globally recognized reputation for independence, integrity and innovation ensuring standards are useful, relevant and authoritative.

A BSI (as well as CEN/CENELEC, ISO/IEC) standard is a document defining best practice, established by consensus. Each standard is kept current through a process of maintenance and reviewed whereby it is updated, revised or withdrawn as necessary.

Standards are designed to set out clear and unambiguous provisions and objectives. Although standards are voluntary and separate from legal and regulatory systems, they can be used to support or complement legislation.

Standards are developed when there is a defined market need through consultation with stakeholders and a rigorous development process. National committee members represent their communities in order to develop standards and related documents by consensus. They include representatives from a range of bodies, including government, business, consumers, academic institutions, social interests, regulators and trade unions.

**British Standards Institution**  
**15 October 2010**



I am responding on behalf of Broadhurst and Company with regard to the new proposed Rules.

We would continue to support the Regulatory Objectives of the FSA. We are an Independent Insurance Brokerage entering our 75th year of trading and have always supported Regulation, indeed we have previously volunteered for self and higher levels of Regulation than was needed, i.e. Insurance Brokers Registration Council and General Insurance Standard Council.

### **Consumer Protection and Markets Authority (CPMA)**

We would continue to support the Regulatory Objectives for the FSA, i.e.

- Market Confidence
- Consumer Protection
- Public Awareness
- Reduction of financial crime

We also would continue to support the **high level** Principles for Business e.g. that a firm must arrange adequate protection for clients' assets when it is responsible for them. We would also continue to support the Treating Customer Fairly initiative, market led solutions such as the Contract Certainty Code of Practice, and the Financial Ombudsman Service.

### **However we would like the CPMA to**

- Adopt a more principles based approach to the regulation of the sale and administration of 'low risk' general insurance products by clearly differentiating between the requirements for private consumers and commercial businesses and between low and high risk products.
- Adopt a more rules based approach to claims management (submission, investigation and settlement) for consumers and commercial customers - consistent with the FSA's TCF principles.
- Remove any anomalies, contradictions and duplications between this regulatory regime, Accountancy Regulations, Companies House Regulations, other UK Laws (e.g. relating to Financial Crime) and recent Court Decisions (e.g. regarding unfair contract terms, duty of disclosures etc.)
- Work with the British Insurance Brokers Association and other trade bodies to understand the general insurance trading environment to ensure the new regulatory regime can be easily understood and fully supported by small as well as large businesses.

### **The reasons for our observations are:**

Although the stated aim of the FSA was to adopt a risk based approach to regulation, this has not been evident in the detailed rules of guidance.

The emphasis appears to have been to heavily regulate sales processes but adopt a lighter touch to claims processes. This seems inconsistent with customers' actual interests.

There appears to have been a lack of real understanding about the role of the general insurance intermediary and the complexity or lack of complexity of different business models.

From our perspective this 'One Size Fits All' approach has led to increased costs with no obvious customer benefit, e.g.

- FCS fees for general insurance intermediaries increasing because of the need to fund Payment Protection Insurance mis-selling,
- Capital Resource Requirement for holding of client's money not appearing to fairly reflect the risk of a general insurance intermediary failure to customers.
- Increased documentation and record keeping.
- A rule book/FSA Handbook that is difficult for a small business, like ourselves, to interpret without the help of Compliance Consultants and attendant cost and without reference to other regulations.
- Additionally we often get comments from customers who are overwhelmed by the amount of "papeprwork" that we have to issue to them these days.

Rob Graham  
Partner  
Broadhurst and Company Insurance Brokers

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## HM Treasury

### ***A New Approach to Financial Regulation: Judgment, Focus and Stability***

#### **Response by the Building Societies Association**

#### **Introduction**

1. The Building Societies Association (BSA) represents mutual lenders and deposit takers in the UK including all 49 UK building societies. Mutual lenders and deposit takers have total assets of over £365 billion and, together with their subsidiaries, hold residential mortgages of almost £235 billion, 19% of the total outstanding in the UK. They hold more than £245 billion of retail deposits, accounting for 21% of all such deposits in the UK. Mutual deposit takers account for about 36% of cash ISA balances. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

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#### **Summary of Main Points**

2. This response provides comments from the BSA on HM Treasury's consultation *A New Approach to Financial Regulation: Judgment, Focus and Stability* (the Paper). We believe that they have the *potential* to deliver improvement and to work in a crisis. Much will depend upon the quality of the leaders and senior management of the new regulatory bodies and how they interact, with each other and with regulated businesses.

3. However, there are major risks; these include the concentration of power in the Bank of England, increased costs and complexity, and overlapping responsibilities. And the contrasting objectives of the Prudential Regulation Authority and Consumer Protection and Markets Authority will externalise conflicts that under the FSA have

been managed within a single body. This will give rise to further challenges that will need careful management.

4. The BSA regards the following four points, which are elaborated later in the response, to be the most important –

- the need to build diversity into the financial system
- the potential cost and complexity of the new arrangements
- the CPMA's role as "consumer champion"
- Bank of England and FPC accountability

## **1. The need to build in diversity**

5. In the BSA's view, the Government was absolutely right (in the Coalition's programme for Government published in May) to recognise the importance to financial stability of diversity in financial services. Financial stability must be the Financial Policy Committee's overriding objective and diversity is integral to it. Financial stability, with diversity as a component part, is also key to the PRA's purpose.

6. Diversity also forms an important aspect of a competitive financial services industry (which the Coalition programme pledges to enhance still further). Accordingly, the BSA welcomes the suggestion in paragraph 4.12 that the need to maintain diversity is suitable as, at the very least, a "have regard" for the Consumer Protection and Markets Authority (CPMA).

7. It is also worth noting that, because of one member-one vote, Board members of building societies, including executive directors are directly elected by consumers - in contrast to many other business forms.

8. Therefore, the BSA believes that the FPC, the PRA and the CPMA should each have a specific statutory remit consistent with, and in discharge of, the Government's policy of encouraging financial diversity. There should be a senior member of staff, in both the PRA and CPMA, with a specific remit of ensuring that diversity, including the particular position of mutuals, is fully taken into account when these new bodies consider regulatory action.

9. We also strongly urge the Government to include in the new legislation a commitment to developing measures of the extent of diversity, and to require the regulatory authorities to examine the impact on diversity of each significant regulatory proposal.

## **2. The potential complexity and cost of the new arrangements**

10. While the BSA recognises the underlying reasons why the Government has proposed the new regulatory framework, there are (as recognised in the Paper) risks of duplication, overlap, confusion and lack of co-ordination in what is planned. Therefore, it is very important that the practical arrangements are focused in such a way as to avert these potential problems.

11. It is also possible that, with several regulators in place of one, regulatory costs will spiral at what is a difficult time for business and the economy. Any increased regulatory burden is likely to be particularly difficult for smaller firms, unless dealt with in a sensible, proportionate manner. Indeed, the impact assessment indicates that between 1,500 and 2,000 firms will be subject to regulation by both the PRA and the CPMA.

12. The BSA believes that certain fundamental principles should be established at the outset; namely –

- an overall limit on the **overheads and budgets** of the new regulators, benchmarked against the existing overheads and budget of the FSA (from which the new regulators will inherit their functions)
- the sharing by the new regulators of **'back office' facilities and services**
- the use by the new regulators of a **common gateway** for firms and others to the new regulators eg for regulatory returns, permissions and approvals etc
- careful planning be undertaken to ensure that the new regulatory burdens do not disproportionately affect **smaller firms**
- **no overlaps between the PRA and CPMA** eg on material in discussions and consultations, thematic work, enforcement etc and there should be a senior Treasury official charged with ensuring that, while the regulators must of course actively co-ordinate, they do not allow any drift into a position where their functions overlap
- no substantial changes to the **FSA Handbook of Rules and Guidance** (for the time being, only necessary modifications to accommodate the new regulatory regime, and any sensible simplifications that can be achieved with minimal further disruption), and
- an early resolution of the **CPMA's regulatory approach** – If the new structure is to be more judgemental and intrusive, on what principles will the judgements be based? Hector Sants' speech on 4 October 2010 *Can culture be regulated?* is a welcome contribution to the discussion, but focused mainly on prudential regulation rather than conduct of business. Irrespective of the nature of CPMA's regulatory culture, its regulation must always be focused and proportionate.

13. Beneath their own primary objectives, the FPC, PRA and CPMA should be subject to the same (or as near as possible, the same) range of statutory factors to which they must have regard, including each other's primary objectives, the importance of diversity in the financial system etc. Such a uniform position would be very much in the interests of consistency. The new structure gives rise to potential conflict between the PRA and CPMA. Ultimately, financial stability is the main prize and that points to the PRA prevailing in any difference between the two regulators.

14. Also for reasons of simplicity and consistency, the BSA would strongly welcome a proposal, in the forthcoming restructuring, that the CPMA take over from the OFT the responsibility for all regulatory matters relating to financial services (including consumer credit) except competition, which should remain the responsibility of the OFT. The BSA believes that – especially in the light of the planned emergence of

several new regulators – *existing* overlaps should be eradicated from the regulatory arrangements as soon as possible. It seems as though this might be possible with the planned reform of the framework for regulating competition in the UK.

### 3. The CPMA's role as a "consumer champion"

15. As a matter of important principle and for a range of practical reasons explained later in this response, the BSA believes that it is inappropriate for a conduct of business regulator to be a "consumer champion" - yet this is what the Government proposes. Accordingly, while we fully recognise that the CPMA must, of course, have a fundamental consumer protection objective, we believe that the proposed primary objective for the CPMA should be extended by the addition of the italicised words, as follows –

"ensuring confidence in financial services and markets, with particular focus on protecting consumers and market integrity *while acting in a fair, impartial and objective manner towards all interested parties and sectors.*"

16. The BSA believes that oversight of deposit protection and the FSCS must be the responsibility of the FPC/PRA and *not* the CPMA as suggested in the HM Treasury Paper (see pages 11 and 21 below for our detailed reasoning).

17. The BSA also believes that the relevant provisions should be clarified to make it explicit that speeches by any member of the new regulatory authorities have no formal regulatory status, are not binding on firms and are not material to the enforcement process. Again, this is explained later in this response.

### 4. Bank of England and FPC accountability

18. Taking a broad view of the proposed arrangements, there is a risk of the emergence of an excessively powerful Bank of England unless very robust accountability and transparency provisions are put in place. The new arrangements, as proposed, will mean that the Governor of the Bank of England will be Chairman of the MPC, the FPC and the PRA, as well as having oversight of the CPMA, and the bank resolution regime. We welcome the Government's recognition of the need for strong accountability, but believe that the proposed arrangements could go further, without diminishing (but, indeed, reinforcing) the overriding importance of financial stability. In UK financial services, and banking in particular, systemic risk is concentrated in relatively few institutions – a fact acknowledged by the Independent Commission on Banking. The combination of this concentration of systemic risk and the concentration of power in the Bank of England is potentially explosive and means that it would take only a very few people to make wrong decisions at critical times for a future financial crisis to be dealt with in a sub-optimal manner. Checks and balances on the Bank are required to mitigate this risk and this response contains certain specific suggestions later. There may be scope to enhance the formal functions of the Treasury Select Committee.

19. In addition, we are strongly of the view that concentration within the banking sector also needs to be addressed and we will be making recommendations to the Independent Commission on Banking accordingly.

20. The remainder of this response provides replies individually to the questions set out in the Paper.

## Consultation Questions

### **The Bank of England and Financial Policy Committee (FPC)**

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

21. In the light of the events of the last three years, the inescapable conclusion is that financial stability must be the fundamental objective of the FPC. However, the Paper accepts in principle that the FPC should take into account other factors when pursuing its primary objective, such as the impact of certain macro-prudential tools on levels of lending and UK competitiveness, and the objectives of other regulatory authorities (paragraph 2.26). The BSA concurs with this view.

22. It should not be forgotten, however, that FPC activity could impinge on a wide range of non-financial objectives as well. To give a very simple objective the FPC might seek to introduce controls on loan to value ratios across the whole mortgage market, with insufficient understanding of the impact this might have on broader objectives in society to see particular trends develop in respect of the number of owner-occupiers, or tenanted properties, or in, say, land use and the growth, or otherwise, in the provision of social housing.

23. However, provided the new regulator has a clear central objective relating to financial stability (which is crucial), it is reasonable for it to have a list of other factors that it should take into account, as long as they are not allowed to constrain the regulator unduly ie in a way that might undermine its primary objective.

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

24. The BSA is comfortable with the factors identified in paragraph 2.28 of the Paper; namely, the economic and fiscal impact of the FPC's macroeconomic decisions and regard to the statutory objectives of other authorities. In addition, the BSA strongly believes that there is a further factor that the FPC should take into account; namely, diversity in the financial services industry – ie different types of institutions competing with each other in a particular market.

25. There is a risk that the new arrangements will favour the plc business model and have insufficient regard to alternative business models, such as financial mutuals, despite the fact that that financial mutuals tend to be subject to a more restrictive powers regime than plcs, (see below). The Government also needs to be alert to the risk that the overall package of the new regulatory structure and tighter prudential requirements leads to displacement or disintermediation - pushing business outside the regulated financial sector on any scale does not necessarily contribute to financial stability.

26. A recent analysis of diversity is by Andrew Haldane, Executive Director, Financial Stability, at the Bank of England. In his speech *Rethinking the Financial Network*<sup>3</sup> in April 2009, he compared the financial services market to various ecological systems.



He pointed out that diversity within the finance system diminished sharply in the run up to 2007. The reliance on the principles of Basel II, the predominance of the ratings agencies, the growth of Value at Risk models and associated stress testing, and the strong trend towards demutualisation all added to the homogeneity of the system.

27. Following an analysis of these factors and comparing them to the collapse of various fish-based ecosystems in the previous 20 years, Mr Haldane went on to say

—  
"In explaining the collapse in fish and finance, lack of diversity seems to be a common denominator. Within the financial sector, diversity appears to have been reduced for two separate, but related, reasons: the pursuit of return; and the management of risk. The pursuit of yield resulted in a return on equity race among all types of financial firm. As they collectively migrated to high yield activities, business strategies came to be replicated across the financial sector. Imitation became the sincerest form of flattery.

So savings co-operatives transformed themselves into private commercial banks. Commercial banks ventured into investment banking.....

Finance became a monoculture. In consequence, the financial system became, like plants, animals and oceans before it, less disease-resistant. When environmental factors changed for the worse, the homogeneity of the financial ecosystem increased materially its probability of collapse."

28. A substantial market share for mutual institutions adds to the diversity of a financial system, whereas a plc mono-culture increases the danger of herd instincts developing. Mutuals bring organisational and regional diversity and add to the richness of the financial services landscape, while reducing – but not removing - the likelihood of all financial institutions behaving in the same (in recent years, wrong) way in a given set of financial conditions.

29. More recently (September 2010) a research report by the Oxford Centre for Mutual and Employee-Owned Business, Kellogg College, Oxford set out a detailed and extensive case for promoting corporate diversity in the financial services sector and the BSA fully supports the report's findings  
[www.kellogg.ox.ac.uk/researchcentres/documents/Mutuals%20oxford%20brochure.pdf](http://www.kellogg.ox.ac.uk/researchcentres/documents/Mutuals%20oxford%20brochure.pdf).

30. A mixed, diverse financial services sector is more likely to be financially stable than one that is dominated by a single type of business organisation. Therefore, diversity is a key factor in encouraging financial stability. A key component in ensuring diversity is the need for a new form of capital instrument for financial mutuals, which has arisen due to the impact of changes in EU capital requirements. The BSA is pursuing this with the FSA, HM Treasury and at the European level and it is crucial to future financial stability that an outcome that is fair to financial mutuals emerges from these discussions.

31. For the reasons set out above, the BSA strongly welcomed the Government commitment (in *the Coalition: Our Programme for Government*) to "bring forward detailed proposals to foster diversity in financial services, promote mutuals and create a more competitive banking industry".

32. It is also relevant that financial mutuals tend to be subject to a more restrictive powers regime than plcs, thus making them inherently safer (but not, of course, entirely safe). For example, the Building Societies Act 1986 restricts societies from –

- acting as a market maker in securities, commodities or currencies
- trading in commodities or currencies
- entering into transactions involving derivatives, except for certain limited purposes (eg hedging).

33. Societies are also limited by statute in the percentage of the funds that they may raise from non-retail sources – 50% of a society's liabilities must be shares in the society held by individuals. In other words, an absolute maximum of 50% of a society's funding may come from non-retail sources.

34. To put this in a practical context, at the end of 1997, shortly after its demutualisation from building society to plc status, Northern Rock was mainly funded by its retail deposits (nearly 63% ie its funding from 'wholesale' sources comprised little more than 37%). But, by the end of 2006, its retail funds represented only just over 22% of its liabilities. The rest of its funding came from non-retail sources, mainly from the wholesale markets and (about 50%) from securitisation.

35. To be more than 75% funded from non-retail sources was very unusual. As *the Run on the Rock* points out, other ex-building societies, such as Alliance & Leicester (43%) and Bradford & Bingley (49%) obtained a much lower percentage of their funding from non-retail sources.

36. But for building societies, the reliance on non-retail funding was even lower – the sector, as a whole, was 29% wholesale funded at the end of 2006. The current level remains very low – 27% on the latest (2009) figures. Other financial mutuals operating in similar business areas also tend to have a relatively low exposure to the wholesale markets.

37. Building societies and their subsidiaries are also restricted from holding substantial shares in businesses that undertake such activities. Societies are also subject to restrictions on creating floating charges over their undertaking or property and limited in the extent to which they may enter into "non-core" business.

38. We believe that the PRA and FPC should take these restrictions fully into account in the exercise of their regulatory functions. In order to help them to do so, there should be a senior member of staff, in both the PRA and CPMA, with a specific remit of ensuring that diversity, including the particular position of mutuals, is fully taken into account.

39. As part of this, the new Act that will facilitate the new regulatory structure should include a commitment to developing measures of the extent of diversity, and the position of mutuals, in the provision of financial services. The regulatory authorities should be required to examine the impact on diversity of each significant regulatory proposal.

In conclusion, we believe that – in financial stability terms – the need for diversity in financial services, which the Government has rightly recognised, is part of the solution. Therefore, while acknowledging that financial stability must always be the FPC’s overriding objective, we believe that it is entirely consistent with – and, indeed, supportive of - the FPC’s fundamental financial stability objective that it should have a specific statutory remit, in line with the Government’s policy, of encouraging financial diversity. In order to help take this forward, there should also be a senior member of staff, in the PRA (and the CPMA), with a specific remit of ensuring that diversity, including the particular position of mutuals.

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

40. It is worth briefly examining the background to the ‘have regards’. Some of the factors set out in section 2(2) are almost semi-independent objectives – in 1999, the Joint Committee on Financial Services and Markets concluded that the factors concerning competition should not be regulatory objectives, but noted that it would have been reasonable for them to have been <sup>4</sup>.

41. On a slightly different tack, debates reported in *Hansard* during the progress of the Financial Services and Markets Bill indicate that innovation and competitiveness were never intended to be central to the FSA’s objectives (being, essentially, matters for firms themselves and for the competition authorities) but still had an important place in the overall framework; for example on 20 January 2000 -

“It is nothing to do with the concept of the FSA’s being a regulator of competition. It has to do with the simple proposition that the objective of the rules and conduct of the FSA, and the way in which it handles them, should be to avoid doing things which damage either domestic competition or the UK’s international competitiveness.” (Howard Flight MP)

“However, I am not saying that the FSA has absolutely no interest in competitiveness. We realise that, as with competition, the way in which the FSA regulates can have an impact on competitiveness, and subsection 3(d) requires the FSA to have regard to that fact.” (Melanie Johnson MP, Economic Secretary)

“If the FSA has regard to the desirability of facilitating innovation, it should not do things that unnecessarily impede it.” (Melanie Johnson MP, Economic Secretary).

42. Therefore, the basis for the ‘have regards’ is strong. It is conceivable that the requirement to “have regard” to certain factors is too weak. Equally, as discussed above, it is imperative that the FPC is not unduly constrained in its fundamental financial stability objective. A sensible compromise might be for the FPC to be required to take the factors “fully into account”.

43. The BSA appreciates the examination given of the accountability of the FPC, beyond the statutory ‘have regard to’ provisions, set out in paragraphs 2.52 – 2.67. Of the accountability measures proposed, the BSA supports –

- the six-monthly Financial Stability Report

- regular FPC meetings, with publicly available minutes (with safeguards against the publication of destabilising or market-sensitive material)
- oversight by the Bank's Court of Directors
- accountability to Parliament and HM Treasury, and scrutiny by the Treasury Committee.
- more generally, consideration of the nature of the role to be played by the Treasury Committee, and whether under the new centralised regulatory arrangements this should be formalised in some way.

44. As explained below, the BSA believes that the PRA and the CPMA should be subject, essentially, to the same statutory accountability provisions as the FSA (see Appendix 1 to this response). We recognise that the position of the FPC, as a body with high-level responsibility for financial stability, is substantially different from the PRA and to some extent the CPMA, whose primary responsibilities are the regulation of individual businesses (The CPMA will have a mixture of individual firm and system-wide responsibilities.). We also note that in the exercise of its macro-prudential functions it may not be possible for the FPC to consult in the way that the FSA has in the past. For example, if it becomes clear that the FPC is contemplating the imposition of maximum loan to value limits in the mortgage market, this fact will alone have market implications, as potential borrowers rush to avoid the impact of new limits. It is not clear how an obligation to consult can be discharged in an environment when the very act of consulting could have a huge impact on a market.

45. Nevertheless, in view of the fact that the FPC will be taking over an aspect of the work that was previously within the FSA's remit, it would be sensible to consider each of the FSA's accountability provisions and examine whether or not there is a case for applying them to the FPC. Such an examination would be in line with the IMF's statement to the effect that a central bank, if given a stronger role in financial stability, should be subject to "robust mechanisms that ensure transparency and a high degree of accountability" (see paragraph 2.66 of the Paper).

**Taking a broad view of the proposed arrangements, there is a risk of the emergence of an excessively powerful Bank of England. For example, the majority of the FPC will be Bank of England executives, the PRA will be part of (and accountable to) the Bank, and the Bank will control interest rates, macro-prudential policy, and individual firm supervision . (We have already pointed out the crucially powerful role of the Governor of the Bank.) This is why there should be a debate on the role of the Treasury Committee in the new arrangements.**

46. We recognise that some of the FSA's accountability provisions may be inappropriate for a broad financial stability regulator that might need to act quickly in the public interest. The BSA would not want to see any inappropriate restraints placed on the FPC.

47. The new arrangements are likely to focus attention on corporate governance at the Bank. Therefore, it would be appropriate to examine whether the FPC, like the FSA currently, should be required to have regard to good corporate governance in managing its affairs. Arguably, it should also be required to have regard to the views

of the statutory panels. Another possibility is for the Treasury Committee to interview the Board members of the new regulators.

48. We welcome the Government's recognition (in paragraph 1.12 and elsewhere in the Paper) of the European-wide, and - indeed - international, nature of the financial stability work, and the fact that the FPC, PRA and CPMA will work closely and in co-ordination with their European and international partners.

49. It would be counter-productive to pre-empt changes that might be required by the EU. We have seen the disruptive consequences of such action in the UK eg in relation to certain product areas, such as consumer credit. Similarly, the provisions of the Equality Act 2010, which are in the process of implementation, are likely to require review once the EU directive on the same subject becomes law.

50. We believe it preferable for the UK authorities to work closely with their EU (and international) partners, influencing the shape of new arrangements where possible, rather than 'going it alone' only for the resulting framework having to be amended in order to comply with subsequent EU law or standards.

#### **Prudential regulation authority (PRA)**

#### **4. The Government welcomes respondents' views on:**

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

51. This and the other sub-questions in 4 require similar consideration to those arising from some of the earlier questions. In common with the FPC, the PRA's primary objective has to focus on financial stability (albeit at a firm, 'micro' level) and the formulation set out in paragraph 3.5 of the paper seems to be fit for purpose. We agree with the statement in paragraph 3.6 that in the event of a conflict of objectives, the PRA should defer to its primary (financial stability) objective.

52. The BSA believes that the PRA should have regard to the primary objectives of the CPMA and FPC. Financial stability is overriding, but it is imperative that the three organisations liaise closely and that one does not cut across what the others are doing. It is difficult to reach any conclusion other than one whereby the PRA at least *has regard* to the primary objectives of the CPMA and FPC.

53. The separation of roles is a positive move, but will not remove the potential tensions between financial stability and conduct of business. To take an entirely simplistic example, but one that illustrates the point, the imposition of a 1% mortgage rate and a 5% savings rate would be good (in the short term) for consumers, but not (in the long term) for financial stability. Externalising of tensions previously managed within a single regulator does not, by itself, abolish them. Therefore, the PRA should be the lead authority over the CPMA.

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

54. We have doubts about the analysis in paragraph 3.9. A reading of *A Run on the Rock* and the FSA's internal audit report on the process of supervision of that

institution do not suggest that an excessive concern for competitiveness was the reason for the regulatory failures in respect of that bank. Indeed, in the 181 pages of *A Run on the Rock* the word 'competitiveness' appears only once and in a different context.

55. Paragraph 3.10 suggests that the factors listed relate "purely to regulatory good practice". However, taking each individually, we do not see why they should be placed outside the PRA's remit. Why should the PRA *not* be expected to use its resources in the most efficient and economic way? Why should it *not* have regard to the responsibilities of those who manage the affairs of authorised firms? Why should the PRA be entitled to disregard the principle that a burden that is imposed on a person should be proportionate to the benefits that are expected to result?

56. To put it another way, would it be right for the PRA to use its resources in a *less than* efficient and economic way? Should the PRA be entitled to disregard the responsibilities of those who manage the affairs of authorised firms? And so on.

57. Therefore, the BSA believes that the principles set out in section 2 should be retained, but naturally on the basis that they must not be allowed unreasonably to impede the PRA's fundamental objective.

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

58. As indicated above, we believe that it is appropriate to retain these items, but on the basis that they must not be allowed to contravene or unduly restrict the PRA's primary objective.

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

59. Yes, diversity in financial services should certainly be included (see our response to question 2 above).

60. Care will need to be given with how the FPC's macro-prudential tools interact with any firm-specific requirements set by the PRA using the same tools. For example, if the PRA requires a specific firm to hold +2% capital, and then the FPC requires all firms to hold +1% capital, will this automatically translate into a +3% requirement on the firm in question?

61. (Regarding the range of tools set out in Box 2.C, we believe that the FPC's use of these tools should (i) be subject to appropriate consultation (although as we point out earlier this will not always be easy when the act of consulting has the ability to shift market behaviours very significantly, possibly in a destabilising manner); and (ii) accompanied by an FSA-type compatibility statement - explaining with reasoning why the proposed use of the tool is the most appropriate way of meeting its stability objectives.)

62. To the list of macro-prudential tools must be added the separate point of the proposed funding mechanism for deposit protection envisaged in the European Commission's proposals for an amended deposit guarantee schemes directive (DGSD). Building up a deposit protection pre-fund at the speed and scale envisaged

by the Commission would have a major impact on profitability in building societies (and banks) over the next decade. This would compromise the UK authorities' ability to deploy other macro-prudential tools. Accordingly, oversight of deposit protection and the FSCS must be the responsibility of the FPC/PRA and not the CPMA as suggested in the HM Treasury Paper.

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

63. At a high-level, the proposed arrangements appear to be suitable, but certain practical matters will need further thought. One such item is flagged up in paragraph 3.16. The Paper proposes that the PRA and CPMA will each be responsible for granting and amending permissions to undertake regulated activities falling within their remit. The final decision on this will depend on the details of the new process.

64. It would make sense for the PRA to have responsibility with regard to significant influence functions, unless they are clearly conduct of business-related. However, in the interests of simplicity, it is very important that there should be one 'gateway' for applications to be made.

65. There are a number of other matters arising from the creation of the PRA and the CPMA that will require detailed consideration in due course. For example, the relevant components of the FSA Handbook will have to be parcelled out. Paragraph 3.24 of the Paper is the only reference to the Handbook. It states that PRA will seek to reduce and simplify the rules and guidance, as far as is consistent with matters such as EU law.

66. While some sensible simplification may be welcome, it is important not to engage in a wholesale re-writing of the Handbook. It is a very extensive document, which the FSA has sought over the years to improve in terms of simplicity, access and navigation. Generally speaking, firms are used to it and it remains, generally speaking, an effective instrument. There will need to be an element of grandfathering of existing rules and guidance, together with transitional provisions during the development of the new regulatory bodies.

67. In broad terms, the high-level standards and the prudential standards in the FSA Handbook would sit best with the PRA, whilst the business standards are relevant to the CPMA. However, there are certain modules that might sit less comfortably in one or the other, but appear to overlap the PRA's and CPMA's functions. Clear destination tables and, if at all possible, a common gateway for regulated firms would need to be established. It would be counter-productive if both the PRA and the CPMA ended up with their own, overlapping versions of Handbook modules, with duplicated reviews, consultations, enforcement etc.

68. Another practical matter is that of regulatory returns. Again, a single gateway would be welcomed by firms. A further question, relevant to our members and to other financial mutuals, is where the mutual registration function, currently with the FSA, will sit. The BSA is content that this should reside with the CPMA, but we understand that some other mutual sectors have specific concerns about the way the FSA has discharged its responsibilities in this area. Certain other outstanding matters will need to be considered in due course, including detailed arrangements regarding financial crime prevention under the proposed new Economic Crime

Agency, and we welcome the consultation on economic crime, flagged in paragraph 5.26. The BSA has responded to the recent Home Office consultation on policing in the 21<sup>st</sup> century.

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

69. We note, and support, the suggestion in paragraph 3.18 that the powers and functions set out in the FSMA should be divided into separate prudential and conduct of business frameworks. This will not be an easy exercise, but it is important to have clear, discrete frameworks for the regulators and business organisations to work within. This is important for all firms, but especially for the smaller ones that are likely to come under greater regulatory pressure in terms of supervisory visits, regulatory returns etc. We hope that the proportionate approach of the FSA, with regard to smaller businesses, will continue within the new regulatory arrangements.

70. Paragraph 3.18 recognises that there might need to be overlapping powers and functions. If this proves to be the case, it will be important to develop a single gateway for firms, wherever practicable.

71. While it is imperative that the PRA and the CPMA co-ordinate their work, it is equally important that their responsibilities do not overlap, so that firms have clear regulatory regimes, with absolute demarcations. It would be very unhelpful if, for example, the PRA and the CPMA began discussions, consultations, themed work etc in substantially the same areas. This is already a problem regarding the numerous overlaps between the respective activities of the FSA and the OFT (see reply to question 14 below).

72. We note the Government's desire for supervision by PRA to be judgement-based. If this is to be the case, much will depend on the quality of the PRA staff charged with making the judgements – and must be subject to safeguards. It should also be subject to the development of appropriate principles. Indeed, the greater the reliance on judgement-based, intrusive, regulation, the more important are the principles on which the judgements are to be based, and consultation on, and explanation of, those principles.

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

73. Emphatically, yes, and we are very concerned that the Government appears to be contemplating a dilution of such safeguards. The BSA believes it essential that the existing safeguards (outlined in paragraphs 3.21 – 3.23 of the Paper) remain in place, as far as is consistent with the PRA's overriding objective of financial stability. As the Paper notes, consultations and cost-benefit analyses are a key part of the FSMA framework and reflect the quasi-legislative aspect of regulatory rule-making.

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

74. It is not clear that streamlining is necessary although we would support any sensible simplification or streamlining of the PRA's rule-making process, as indicated in paragraph 3.23. Whilst we recognise the primacy of financial stability, we would



not support any reduction in the substantive safeguards unless it was shown to be essential.

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

75. The BSA broadly welcomes the governance framework proposed for the PRA comprising, in summary –

- the PRA's status as a subsidiary of the Bank of England
- independence for the PRA in relation to operational matters, but the PRA to be ultimately accountable to the Bank's Court of Directors for budget, remuneration policy and certain other matters
- the PRA Board to have a majority of non-executive directors, but decisions on significant regulatory or supervisory action to be taken by a committee with an executive majority

76. The BSA welcomes the proposal to make the PRA subject to audit by the National Audit Office. We agree that this would deepen accountability and transparency in a proper manner, as described in paragraph 3.39.

77. Paragraph 3.37 proposes that the PRA will, like the FSA, be required to produce an annual report. The Paper notes that the Government will consider which of the FSA's other existing accountability mechanisms, if any, will apply to the PRA (see paragraphs 3.38 and 4.36 of the Paper).

78. We note the government expectation that the PRA should appear before the Treasury Select Committee as requested (para 3.40). We would encourage the government to initiate a debate on the nature of any formal role that the Committee might be given in the new arrangements, although we currently have no firm proposals.

79. The FSA's current accountability mechanisms are set out in Appendix 1 to this response. The BSA can see no particular reason why any of these safeguards should be generally dis-applied. Indeed, in our view it would be consistent if the same accountability provisions applied to both the PRA and the CPMA. In the light of events since 2007, we acknowledge that there might be exceptional circumstances when, in the interests of primary objectives, some of the provisions would need to be dis-applied from application, especially to the PRA.

**Consumer protection and markets authority (CPMA)**

**10. The Government welcomes respondents' views on:**

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

80. The BSA believes that, in the interest of consistency, the CPMA should have regard to these matters. A current example is the mortgage market review, being conducted by the FSA. Some of the proposed changes might benefit certain consumers but they could also lead to severe financial difficulties for lenders – a matter very much within the planned remits of the PRA and FPC. Indeed, it is strongly arguable that “have regard” is too weak in this particular context and “fully take into account” would be a more appropriate formula.

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

81. The BSA understands from the analysis in the Paper that there was an “in-built tension” at the FSA between prudential regulation and conduct of business regulation, but draws a slightly different conclusion (see below). The Paper states that the two types of regulation require different approaches and cultures. We recognise that there is some substance to this argument and, therefore, we understand why the Government seeks to separate these functions.

82. However, where inherent conflicts *do* actually exist, externalising them will not necessarily reduce the problem.

83. Just as there are potential benefits in separating the functions, there are also a number of risks. These include –

- partiality and disproportionate emphasis on ‘championing’ consumer rights, at the expense of good - and fair - regulation
- inadequate communication between the PRA and the CPMA, especially on matters relevant to financial stability of individual firms
- excessive costs in running a number of separate organisations instead of a single regulator.

84. Some of these risks are alluded to in the Paper, so we return to them in context as we answer the relevant questions. The mechanisms envisaged in Box 3.B seem (in aggregate) complex.

85. Within the new framework, however, the BSA broadly agrees with the proposed formulation of the CPMA’s primary objective; namely, that of ensuring confidence in financial services and markets, with particular focus on protecting consumers and ensuring market integrity. We have one major qualification, to do with the proposed “consumer champion” status of the CPMA, which is explained below.

86. In response to the first limb of question 10, we agree that the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC. This would help ensure consistency among the regulators.

87. However, paragraph 4.8 states “In cases of direct conflict between primary and secondary objectives, the Government would generally expect the primary objective to override any secondary considerations.” It is perhaps worth pausing to note that this means, in theory at least, that the CPMA’s primary objective could trump financial stability. However, it is clear that the Government recognises that the PRA will over-rule the CPMA where there is a conflict, irrespective of the CPMA’s primary objective.

88. Nevertheless, it is worth considering an example. Suppose that (in its “consumer champion” role) the CPMA decided that it would be in the interest of consumers if all mortgage interest rates tracked Bank base rate in some way, and ruled accordingly. The lack of ability to administer rates is one of the key problems, in financial stability terms, for some mortgage lenders. Accordingly, this would be an example of where consumer championing could lead to financial instability. Such a decision by the CPMA would attract widespread attention and, one would hope, the PRA and FPC would become involved, but a greater practical risk is of decisions being made at an individual firm level, where an over-enthusiastic CPMA – charged with a consumer champion role – might disregard the financial stability imperative, or the imperative to impose, and assess compliance with, its own rules in a disinterested manner.

89. Paragraph 4.8 also means that “ensuring confidence in financial services and markets, with particular focus on protecting consumers and market integrity” would, again in case of conflict, trump the principles of good regulation (as enshrined in section 2 FSMA). Once more, we have no fundamental objection to this because we accept that extreme circumstances could arise where the PRA’s and, conceivably, even the CPMA’s primary objective would require it to pay less attention to those principles than would normally be desirable.

90. **But** this should be a matter of necessity and not one of culture or of routine. While it would be right for the primary objective to prevail in the event of a conflict, it would be completely wrong if the principles of good regulation were set aside in anything other than cases where the need to do so was absolutely clear.

91. It should be borne in mind that the principles comprise a number of very important concepts, as set out in paragraph 4.10 of the Paper, including the relevant authority’s need to use its resources efficiently, the responsibilities of those who manage the affairs of authorised persons, proportionality of burdens and benefits, the UK’s competitive position, competition aspects etc. These should not be brushed lightly aside.

92. While we can appreciate the importance of the CPMA enforcing regulations designed to protect consumers, it would need to do so (i) in an impartial manner and (ii) with full and proper regard to the principles of good regulation. The division of powers between the PRA and the CPMA and the (entirely appropriate) planned transparency of their operations heightens the risk of the CPMA being swayed by public relations or political considerations.

93. For example, a future case of widespread ‘mis-selling’ of certain financial products, might lead to considerable media coverage and questions in Parliament. The reality might be that there has been some – possibly even a considerable amount of - mis-selling but also a bandwagon effect, driven by the media and claims managers, whereby a large number of customers who were not mis-sold also claimed compensation.

94. In such an eventuality, a disinterested and independent regulator would be required in order to bring about a solution that was genuinely fair and proportionate to everybody concerned. If, as signalled at several points in the paper, the CPMA ultimately is characterised as a 'consumer champion' it is more likely, especially where there is heightened publicity and pressure, to seek a solution that lives up to its billing, even if this turns out to be unfair to some of the businesses involved. Indeed, a consumer champion – by its very nature - is expected to promote consumers' rights only, and it has no duty to consider either consumers' responsibilities or the rights of firms.

95. This is not to say that we do not see a role for consumer champions. Many independent bodies fulfill this role, and it is an important role for the media. It is perfectly right and proper that consumer organisations, such as *Which?* and the FSA Consumer Panel, should have consumer champion roles. These bodies are legitimately counterbalanced by trade associations and the FSA Practitioner Panels.

96. Directors of mutual firms are elected by consumers, and there is often a clear joint interest between building societies and consumers in meeting the same objectives. Indeed the BSA's research clearly shows a much better record in meeting consumer needs on the part of mutuals than plcs in the UK.

97. We do not consider it appropriate for a consumer champion role to reside in a body that also has regulatory responsibilities.

98. Paragraph 4.44 of the Paper notes that the Financial Ombudsman Service's "claim to impartiality, and hence its legitimacy in making rulings that are binding on firms, is only credible if it does not favour, or appear to favour, consumers." In one particularly important sense, the same reasoning applies to the CPMA. While the CPMA *should* favour consumers in that its conduct of business regulation rules should help advance fair treatment of consumers (just as the protection of consumers is a current regulatory objective of the FSA), it should *not* favour them in the sense that it is biased and acts in a partial manner in respect of the application or enforcement of its rules.

99. It is difficult to see how a rule-making and rule-enforcing body can have the impartiality essential for the task, while at the same time being a "champion" of one half of the interested parties. It is rather like a judge being told to apply the law in a case objectively, while at the same time being a "champion" for one of two litigants. It simply does not stack up and is a recipe for massive regulatory confusion, as well as being fundamentally unfair to business. Indeed, paragraph 3.22 of the Paper notes that regulatory rule-making is "quasi-legislative". It would be intolerable for the law-maker and the judge to be mandated to champion the interests of one party only.

100. There are potential pitfalls in the proposed arrangements in respect of both financial stability and fairness to business. The example given above about mortgages tracking Bank base rate is a case in point. While it is only a hypothetical example, it illustrates why the CPMA needs to be impartial in the exercise of its functions.

101. Paragraph 4.25 states -

"The establishment of a new, focused body presents a key opportunity for a frank and open debate about achieving the appropriate balance between the regulation and supervision of firms, consumer responsibilities, consumer

financial capability and the role of the state. These issues will be addressed when the CPMA is established.”

102. This comment appears to be a *non sequitur*. How can it follow from the establishment of a body mandated to be biased in favour of consumers that this would give rise to the opportunity for a frank and open debate about achieving the appropriate balance between regulation on the one hand and, for example, consumer responsibilities on the other?

103. Turning from principles to practicalities, it would be extremely difficult to build trust between firms and the CPMA if the latter were to be made a “consumer champion” because – as noted above - such a body must, by definition, be biased in favour of consumers. If this policy became a reality, it would be difficult for firms to be open with the CPMA and many communications between the regulator and the regulated would become the subject of detailed attention by lawyers. It is likely that appeals to the Upper Tribunal, and judicial reviews would probably become the norm rather than the exception.

104. All of the numerous ramifications of the CPMA as a consumer champion need to be thought through carefully. For example, how could the FSA Consumer Panel continue to have any future formal role in advising the regulator if the regulator itself were a consumer champion? In addition, an impartial regulator is essential in order to conduct its role in relation to the consumer redress mechanism under the FSMA [www.fsa.gov.uk/pubs/guidance/guidance10.pdf](http://www.fsa.gov.uk/pubs/guidance/guidance10.pdf) - would the CPMA being a consumer champion fundamentally undermine this role?

105. To say the least, the BSA sees a real risk of “in-built tensions” for an organisation that is expected to be not only an independent conduct regulator, but also automatically mandated to take one side. We believe that these could put into the shade the in-built tensions that the Paper observes within the current FSA framework.

**The suggestion that the CPMA should be a consumer champion needs to be re-thought and dropped. The BSA believes that the proposed primary objective for the CPMA should be extended by the addition of the italicized words, as follows –**

**“ensuring confidence in financial services and markets, with particular focus on protecting consumers and market integrity *while acting in a fair, impartial and objective manner towards all interested parties and sectors*”**

106. Returning briefly to the question of consumers’ responsibilities, the BSA believes that the subject, while not entirely straightforward, is simpler than the current lack of consensus suggests<sup>5</sup>. Over three years ago, the BSA produced a policy statement regarding consumers’ responsibilities and shared it with the FSA and the OFT. We would be happy also to share the paper with HM Treasury and look forward to engaging in the forthcoming discussions flagged by paragraph 4.25.

107. Inadequate communication between the PRA and the CPMA, especially on matters relevant to financial stability of individual firms, is a risk inherent in the creation of two separate regulators. However, there are a number of ways to guard against the risk of poor co-ordination among the regulators, such as –

- Ensuring that, beneath their own primary objectives, the FPC, PRA and CPMA are subject to the same range of statutory factors to which they must have regard, including each other's primary objectives, the importance of diversity in the financial system etc. The statutory factors are considered in more detail in response to earlier questions.
- Building in both formal and informal co-ordination mechanisms, such as cross-membership of boards and regular communications on matters of common interest.
- Extending the remit of the statutory panels, so as to encompass all three of the new regulatory bodies.

108. The risk is recognised by the Paper and the proposed arrangements, set out in box 3.B on page 26 of the Paper and other places (eg paragraph s 4.27-4.28), appear appropriate, although possibly, in aggregate, complex, at a high-level. Nevertheless, there are a number of outstanding practical matters that still need to be addressed (see response to question 5 above).

109. We deal with the topic of regulatory costs in our response to question 22 (below) on the impact assessment.

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

110. Paragraph 4.11 of the Paper notes that the Government recognises that not all of the principles of good regulation, currently enshrined on a “must have regard to” basis in section 2(3) of the 2000 Act, may be appropriate to the new CPMA. It refers to discussion in the previous chapter (paragraph 3.9) in which it was suggested that

—  
 “There is a strong argument that one of the reasons for regulatory failure leading up to the crisis was excessive concern for competitiveness leading to a generalised acceptance of a “light touch” orthodoxy and that a lack of sufficient consideration or understanding of the impact of complex new transactions and products was facilitated by the view that financial innovation should be supported at all costs.”

111. As noted above, the BSA does not entirely agree with this analysis. The BSA believes that, in exercising its functions, the CPMA must take full account of the impact on competition, competitiveness, innovation and diversity because they are integral to the businesses being regulated. The main protection for consumers is the choice that they are offered from a diverse range of businesses of different sizes and corporate forms.

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

112. We have already (see the responses to question 2 and 4 above), explained why we believe it important that diversity in the financial services industry should be a factor that the FPC and the PRA take into account. The BSA also firmly believes that it should be a factor for the CPMA to take fully into account and welcomes the suggestion in paragraph 4.12 that the need to maintain diversity is suitable as a “have regard” for the CPMA.

113. As noted above, the Government has a policy objective of “encouraging choice and competition” in financial markets. One way of doing this, according to HM Treasury’s White Paper Reforming Financial Markets <sup>6</sup>, of July 2009 “is to encourage and support alternative business models” such as mutuals. Building societies and other financial mutuals have a natural advantage over plcs in that they do not pay dividends to shareholders and can use the funds thus released to pay higher savings rates, offer lower mortgage rates or enhance service standards.

114. Building societies regularly top the best buy tables, notably those tables that look at consistency of returns to savers over longer periods. Recent statistics from *Moneyfacts* (January 2010), for example, showed that for consistent paying savings accounts (over 18 and 36 months, rather than for accounts that are best buys for a week or two and then suffer sharp interest rate cuts) building societies take 72% of the top places. This sort of performance puts pressure on the banks to respond.

115. Similarly, pressure from building societies to maintain free access to ATMs early in the last decade made it more difficult for the banks to implement a policy of imposing ATM withdrawal charges. Furthermore, recently published complaints data demonstrates a very strong track record by building societies in treating customers fairly, both in absolute terms and compared to the plc banking sector <sup>7</sup>.

116. Mutuals offer the choice, diversity, customer service, efficiency, and democracy that we understand the Coalition Government is looking for in a new banking world. Accordingly, the CPMA, if charged with the responsibility “ensuring confidence in financial services and markets, with particular focus on protecting consumers and market integrity” should, in the conduct of its functions, take into account diversity in financial services. For example, rules that would have the effect of placing a requirement that would adversely affect a particular business sector in a disproportionate way when compared to other sectors (and, thereby, adversely affect their customers), should be discouraged.

117. The BSA recognises that the Paper mainly addresses matters that will need to be enshrined in legislation and are, therefore, a priority. However, there is a further important matter that the Paper does not address, but that will need to be considered in due course – namely, the regulatory approach of the CPMA. In other words, should the CPMA continue the regulatory *modus operandi* developed in recent years by the FSA, and to a lesser extent by other regulators and the EU, of ‘principles-based’ regulation (PBR)?

118. We understand that, in the light of events over the last three years, the FSA’s new intrusive and judgement-based approach to prudential regulation will inevitably continue. This means, as we earlier point out in respect of the PRA, that the principles on which the judgements are based become very important, otherwise firms have little way of understanding how the regulator will approach its tasks.

119. We acknowledge the new consumer protection strategy, unveiled by Hector Sants in March 2010, is focusing on deterring problems before they arise through greater supervision of firms (and this approach is supported in paragraph 4.24 of the Paper). But we do not believe that PBR and the new regulatory approach to conduct of business are necessarily mutually exclusive – indeed they are mutually reinforcing.. We would welcome discussion and clarification of this matter as soon as practicable.

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

120. The Paper (paragraph 4.36) indicates that the CPMA will be subject to the same accountability mechanisms as the FSA. The BSA welcomes the proposals on accountability. We believe that the PRA and the CPMA should be subject to, at least, all of the statutory accountability requirements to which the FSA is currently subject – these are set out in Appendix 1 to this response. For the reasons given in paragraph 4.37, the BSA welcomes the additional proposal to make the CPMA subject to audit by the National Audit Office.

121. There is a further change that needs to be made to help ensure a properly accountable CPMA. Currently, speeches by senior FSA staff, although explicitly not binding, may nevertheless be taken into account in enforcement actions. While regulated firms should of course read relevant speeches by the regulator as far as practicable (but bearing in mind that many firms are small and the speeches are numerous – about 60 in the year from October 2009 to September 2010), speeches are not an appropriate medium for delivery of binding regulatory material or even formal guidance.

122. The BSA believes that the relevant provisions should be clarified to make it explicit that speeches have no formal regulatory status, are not binding on firms and are not material to the enforcement process. As, for example, the FSA's *Annual Enforcement Performance Account 2009/10*<sup>8</sup> and the increasing size of fines levied by the FSA demonstrate, the FSA has (and the CPMA will have) plenty of powerful formal regulatory tools. We believe that 'regulation by speech' to the extent that it occurs is inappropriate because not only is it unnecessary, but it also potentially circumvents the normal - and proper - controls on regulatory activity. Having said this, comment by FSA (and in the future PRA and CPMA) officials is welcome (such officials having spoken frequently at BSA events) often provides welcome illumination to the regulator's precise objectives in pursuing a particular course of action, and in answering firms' questions about regulatory activity. A paper prepared by the BSA on topic in 2008 gives further background information and explanation (see Appendix 2 to this response).

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

123. The BSA agrees that the panels are an important consultative mechanism providing external challenge and accountability. We support the proposal to retain the existing consultative panels and to place the Small Business Practitioner Panel on a statutory footing. In the BSA's view, the current arrangements regarding the role and membership of the Panels is broadly satisfactory, subject to the point made in the final sentence of the next paragraph.

124. In order to ease discussions between the new regulators and the panels, it is possible that some reorganisation within the panels themselves is indicated. And we consider that the panels can play an important role in improving the accountability of the FPC, the PRA and CPMA, by having roles that shadow the work of all three regulatory bodies. Having said that, consideration needs to be given to the precise role of the Consumer Panel in the event that the CPMA becomes, as proposed, a "consumer champion", which is one of the roles adopted by that Panel



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

125. The BSA supports the proposals for funding arrangements. The proposed use of the CPMA as a single gateway is sensible. In our view the use, wherever practicable, of 'single gateway' arrangements of this kind should be employed for all relevant purposes because they make administration simpler and should reduce costs.

126. In 2010, the FSA proposed changes - principally the new minimum fee - that will simplify matters and benefit many smaller and medium-sized building societies. While we welcomed these, our concerns about risk and complexity remain unresolved. The relative riskiness of the firms within a fee block is still not recognised. Building societies which, as a sector, operate lower risk business models, are included with complex, much less risk-averse and internationally-active institutions. An example of this is the application of a "premium" recovery rate in the A.1 deposit acceptors fee block, essentially to the largest banking groups and very large building societies.

127. We believe any change to funding arrangements should recognise this fundamental difference. As a minimum, the "premium" should be removed from our sector. We therefore suggest that building societies should be decoupled from banks altogether. This would be far more transparent than the current model and would end cross subsidy.

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

128. We consider it essential that deposit protection is considered in the context of macro-prudential regulation. Developments, such as the European Commission's proposed amendments to the deposit guarantee schemes directive, including a substantial pre-funding mechanism, will have very profound implications for the profitability of building societies and other mutual deposit takers and their ability to build up capital over the next decade or so. Accordingly, responsibility for deposit protection must go hand in hand with prudential regulation, thereby falling within the remit of the PRA and FPC.

129. One of the most significant recent changes to the operating framework of the FSCS is that it is now able to borrow from the Government to meet shortfalls in its ability to fund its compensation liabilities. Therefore, the need for cross subsidy between the various classes within the FSCS has been diminished – and arguably has been removed entirely. The BSA can see logic - and attraction - in removing cross subsidy between different classes of levy payers such as deposit-takers and insurers. The logic for responsibility for compensation schemes being aligned with prudential regulatory responsibility would also suggest that the CPMA would have responsibility for compensation relating to the firms for which it is to have prudential responsibility. If, however, it is felt this would make the CPMA compensation schemes unviable (eg because IFAs would be unable to stand alone as a compensation class, without insurer support) the default option should be for the PRA to regulate all the FSCS schemes. The question of which body should administer the schemes is a secondary consideration, but it would make sense - and be most efficient - if a single body, the FSCS, continued to administer all schemes.

130. Regarding the regulation of consumer credit (which is discussed in paragraphs 4.54-4.56), the BSA agrees that division across two regulatory bodies can lead to confusion, and potentially results in outcomes that are sub-optimal for both consumers and firms. The FSA was designed to be the single regulator for financial services industry, but this objective was not realised because, as noted in the Paper, responsibility for retail banking regulation is split between the FSA and the OFT.

131. The OFT and the FSA have arrangements for co-ordination of their respective regulatory activities [www.fsa.gov.uk/pubs/other/OFT\\_FSA\\_Actionplan.pdf](http://www.fsa.gov.uk/pubs/other/OFT_FSA_Actionplan.pdf). The joint FSA/OFT publication *Delivering better regulatory outcomes – May 2008 update*, reported joint regulatory work on all of the following topics –

- personal bank account pricing
- credit card interest calculation
- credit advertising
- the retail distribution review
- payment protection insurance
- with-profits funds
- communications with consumers
- the Consumer Credit Act 2006
- mortgage arrears
- sale and rent back
- the Unfair Commercial Practices Directive
- anti-money laundering responsibilities
- the Payment Services Directive.

[www.ofg.gov.uk/shared\\_ofg/about\\_ofg/ofg998.pdf](http://www.ofg.gov.uk/shared_ofg/about_ofg/ofg998.pdf).

Indeed, the FSA and OFT recently (March 2010) proposed the setting up of a joint committee on consumer protection [www.fsa.gov.uk/pubs/discussion/dp10\\_01.pdf](http://www.fsa.gov.uk/pubs/discussion/dp10_01.pdf). While this degree of co-ordination is - in one sense - laudable, the need for such a high level of co-ordinated activity gives rise to questions about why two regulators should each have such detailed common interests in so many topics. The logic of such a situation is highly questionable at any time, but especially so in a period of severe financial constraint. It is this kind of - long unaddressed - overlapping regulatory picture that gives rise to serious concerns, expressed earlier in this response, about the potential for overlaps among the *new* regulators.

132. The current proposals, which would mean that there could be *five* relevant bodies – FPC, PRA, CPMA, OFT and – potentially - the Economic Crime Agency – could lead to considerable confusion and the risk of overlap. As acknowledged in the Paper, it is important that steps be taken to minimise these risks and we welcome this assurance.

133. The BSA would also strongly welcome a proposal, in the forthcoming consultation, that the CPMA take over from the OFT the responsibility for all regulatory matters relating to financial services (consumer credit, unfair terms etc) except competition scrutiny, which should remain in the OFT's hands. The BSA believes that the proposal to merge the OFT and the Competition Commission provides a significant opportunity to implement such changes.

134. A related matter, which is also long overdue for action, is consumer law simplification and, therefore, we welcome the Government's commitment to cutting red tape (see

[www.bsa.org.uk/docs/policy/prudentialandfinreg/consumerlawreview\\_response.pdf](http://www.bsa.org.uk/docs/policy/prudentialandfinreg/consumerlawreview_response.pdf)) and hope that it will be more successful than previous exercises, over decades, by successive governments.

### **Markets and infrastructure**

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

135. The BSA is relatively inexperienced in market matters and has few informed views on the proposals in Chapter 5 of the report. A few brief comments follow.

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

136. We can see the logic in the argument that the CPMA should regulate the exchanges and other trading platform activities, but that the Bank should be responsible for overseeing central counterparty clearing houses and settlement systems. Such arrangements would, as noted in the Paper, broadly reflect the existing responsibilities of the CPMA (for conduct of business regulation) and the Bank (for systemic financial stability).

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

137. At this stage, the proposal is very high level and predicated upon "the benefit of bringing the UKLA's regulation of primary market activity alongside FRC functions relating to company reporting, audit and corporate governance". We note the recognition in the Paper (paragraph 5.24) of the synergies that would remain between UKLA and functions within the markets division of the CPMA. Therefore, the arguments seem to be somewhat balanced.

138. While this discussion is not closely related to the building society sector's direct interests, we would as a matter of principle prefer not to see a proliferation of regulators unless absolutely necessary. However, it could be argued that the merging of UKLA and FRC would in fact be a streamlining of current arrangements.

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

139. See reply to question 17.

### **Crisis management**

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

140. The FSA's handling of prudential regulation was by no means the only factor in the credit crisis, in which the rest of the tripartite, the Government, significant elements of the financial services industry, credit rating agencies, and others were all involved to varying degrees. Indeed we broadly agree with the analysis of the causes of the crisis provided at the beginning of the introduction to the Paper. Therefore, we welcome this broader examination of crisis management. It is to be hoped that the emphasis on co-ordination, together with the range of tools that have been developed in recent years, such as the special resolution regime, will provide a regime that is fit for purpose if and when a financial crisis develops again in the future.

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

141. While some clarification and strengthening of the powers might be sensible, a great deal of work on relevant mechanisms (the special resolution regime, the FSA's supervisory enhancement exercise, recent changes under the Financial Services Act 2010 etc) has already been carried out, as well as – yet further – strengthening of the UK Corporate Governance Code. It is now clear that sophisticated safeguards such as prudential regulation, risk management, corporate governance and credit rating need to be combined with the human element. The culture of firms and markets, and regulators, is as important as the detailed rules of regulation in preventing things from going wrong, and correcting them if they do so.. Therefore, we must hope in particular that those in positions of responsibility in the future carry out their duties effectively.

142. However many safeguarding procedures are put in place, it is important to note that a wide range of powers that are exercised ineffectively is inferior to having a leaner, smarter set of powers that a regulator exercises competently and in good time. This brings us back to one of our earlier points – the highly centralised nature of the proposed new system, which may enhance, rather than diminish, the degree of risk involved in the handling of any new crisis if inappropriate judgements are made. Of course, no-one knows the nature of the next crisis, so it is difficult to be certain whether the new framework will be adequate in responding to the nature of that crisis.

143. In principle, especially in times of impending crisis, it is better to rely on judgments than on systems. Having said that, regulated businesses are entitled to a reasonable degree of certainty and the judgements must be objective, impartial and based on facts. The ability of the PRA to deliver this will depend on the quality of staff it is able to recruit.

144. And the PRA's demands for information (eg to run stress tests) should be balanced against the costs to firms of providing this information, accepting that not every possibility can be continually evaluated. If mandatory intervention below certain capital thresholds, as mentioned in paragraph 6.17 of HM Treasury's Paper, are introduced, this would limit the discretion available to the PRA, so any such regime would need to be carefully designed and articulated.

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

145. We agree, for the reasons set out in the Paper, with the proposal to ensure that contingency planning and resolutions are managed separately from the Bank's functions in relation to the PRA.

**Impact Assessment**

**22. The Government welcomes comments.**

146. Any increased costs of the new regulatory framework would ultimately be passed on to consumers in pricing, but the impact assessment in the HM Treasury Paper is optimistic. Costs are not only direct financial costs, but also, possibly more importantly, the increased costs - in terms of management and Board time - of dealing with two or more regulators in terms of their demands for information, the potential introduction of new regulation, lack of understanding of particular business models that require explanation, and a whole host of other firm/regulator interactions.

147. If the new regulatory structure significantly inhibits diversity, innovation and competition, consumers could potentially pay a heavy price. As with many of the issues discussed within this overall agenda there are trade-offs to be made, and the precise costs and benefits of those trade-offs will become apparent only over time.

**At this early stage, the impact assessment acknowledges that “It is impossible quantify the benefits of the proceed option in a realistic way”. Nonetheless, the BSA believes that certain fundamental principles should be established at the outset; namely –**

- (i) an overall limit on the overheads and budgets of the three new regulators, benchmarked against the existing overheads and budget of the FSA,**
- (ii) as far as is practicable and cost effective, the sharing by the three new regulators of ‘back office’ facilities and services,**
- (iii) again as far as is practicable and cost effective, the sharing by the three new regulators of a common gateway for firms and others to the new regulators eg for regulatory returns, approvals and authorisations etc.**
- (iv) careful planning be undertaken to ensure that the regulatory burdens under the new arrangements do not disproportionately affect smaller firms,**
- (v) no overlaps between the PRA and CPMA eg on material in discussions and consultations, thematic work, enforcement etc and there should be a senior Treasury official charged with ensuring that, while the regulators must of course actively co-ordinate, they do not allow any drift into a position where their functions overlap**
- (vi) no substantial changes to the FSA Handbook of Rules and Guidance (for the time being, only necessary modifications to accommodate the new regulatory regime, and any sensible simplifications), and**
- (vii) an early resolution of the CPMA’s regulatory approach**

148. Whilst we welcome the FSA chairman's recent confirmation, in his Mansion House speech on 21 September 2010, that there is a strong focus on ensuring that the ongoing costs of the PRA and the CPMA are no higher than they would have been for the integrated FSA, we believe that a tighter control on costs is required.

149. In the light of the events since 2007, the FSA carried out a 'Supervisory Enhancement Programme', which involved a structural re-organisation and has led to a very significant increase in FSA staff numbers, especially on the supervisory side. In view of this, and taking into account current economic conditions and strictures on both public sector and private sector budgets, the BSA believes that the combined overheads and budgets of the new regulators should be subject to a ceiling for the time being of, say, ninety per cent of the current equivalent FSA measures.

150. This, or some equally robust form of financial control, is necessary to ensure that the new regulators do not grow in a disproportionate and unnecessary way, which is inevitably a risk whenever a single regulator is replaced by a number of regulatory bodies. Placing the regulators under the auspices of the National Audit Office is welcome in operational terms, but would be very unlikely to control the growth in size of the organisations.

151. In principle, the new regulators should share the same back office facilities and services, such as human resources, administrative support, computer systems, a central data unit etc. However, we note that paragraph 3.27 of the Paper states that "support services will in general be based on an integrated model across the Bank of England and the PRA". While we support such an integrated model for the Bank and the PRA, we would ideally like to see it extended, as far as practicable, across all the new regulators, but we recognise that – for the CPMA – the most cost efficient approach might be to utilise existing FSA systems. This all requires careful thinking through.

152. We welcome the statement, later in paragraph 3.27, that "In the case of information technology systems, there will be a review of the applications required by the new regulatory system in its entirety." As noted, provided it is not too disruptive, we favour common back office systems for all the new regulators and urge the Government to ensure, whatever the ultimate arrangements are, that there is as little duplication as possible.

153. As mentioned elsewhere in this response, the BSA believes that – as far as practicable – there should be a common gateway for firms and others to the new regulators eg for regulatory returns, approvals and authorisations etc. Otherwise, it is difficult to see how, for example, SYSC Rules or significant influence functions could be dealt with.

154. We would welcome more information on why the impact assessment considers the risk that certain potential underestimates could outweigh the benefits to be small – namely, potential underestimates of the costs in respect of setting up the new regulatory arrangements and the "additional ongoing costs". This is not borne out by experience to-date.

155. For example, the FSA budget for mainstream regulatory activity in 2000/01 was £162.5 million [www.fsa.gov.uk/pubs/plan/PB2000\\_01.pdf](http://www.fsa.gov.uk/pubs/plan/PB2000_01.pdf). Ten years later, the broadly corresponding figure had more than trebled to £490.9 million [www.fsa.gov.uk/pubs/plan/pb2010\\_11.pdf](http://www.fsa.gov.uk/pubs/plan/pb2010_11.pdf). RPI increased by just over 31% in the same period [www.statistics.gov.uk/downloads/theme\\_economy/focus-on-cpi-july-](http://www.statistics.gov.uk/downloads/theme_economy/focus-on-cpi-july-)

[2010.pdf](#). It could not realistically be maintained that the increase in budget was matched by the organisation's effectiveness. Of course, the FSA took on significant new responsibilities and underwent a supervisory enhancement programme during this period, but the data illustrate the danger of assuming that regulatory costs will be controlled.

## FOOTNOTES

- 1 - Fifth Report of Session 2007-08, Volume 1, page 3  
[www.publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/56/56i.pdf](http://www.publications.parliament.uk/pa/cm200708/cmselect/cmtreasy/56/56i.pdf)
- 2 - [www.fsa.gov.uk/pubs/other/nr\\_report.pdf](http://www.fsa.gov.uk/pubs/other/nr_report.pdf).
- 3 - [www.bankofengland.co.uk/publications/speeches/2009/speech386.pdf](http://www.bankofengland.co.uk/publications/speeches/2009/speech386.pdf)
- 4 – The Joint Committee on Financial Services and Markets First Report 1999, paras 42-45  
[www.publications.parliament.uk/pa/jt199899/jtselect/jtfinser/328/32802.htm](http://www.publications.parliament.uk/pa/jt199899/jtselect/jtfinser/328/32802.htm)
- 5 – FSA FS 09/2: Consumer responsibility: Feedback on DP08/5  
[www.fsa.gov.uk/pages/Library/Policy/DP/2009/fs09\\_02.shtml](http://www.fsa.gov.uk/pages/Library/Policy/DP/2009/fs09_02.shtml)
- 6 - [www.hm-treasury.gov.uk/reforming\\_financial\\_markets.htm](http://www.hm-treasury.gov.uk/reforming_financial_markets.htm)
- 7 - [www.financialombudsman.org.uk/publications/ar09/ar09.pdf](http://www.financialombudsman.org.uk/publications/ar09/ar09.pdf)  
[www.ombudsman-complaints-data.org.uk/](http://www.ombudsman-complaints-data.org.uk/)
- 8 - [www.fsa.gov.uk/pubs/annual/ar09\\_10/enforcement\\_report.pdf](http://www.fsa.gov.uk/pubs/annual/ar09_10/enforcement_report.pdf)

**APPENDIX 1 : FSA Accountability Provisions**

Type of Measure	Description	FSMA Provision
<b>General</b>		
<b>Discharge of functions</b>	The FSA must have regard to firms' own responsibilities, burdens on firms, effects on competition etc	section 2(3)
<b>Investigation of complaints</b>	<b>Arrangements must be made for speedy investigation of complaints against the FSA (arising out of its functions)</b>	Schedule 1
<b>Annual report</b>	Must be made	Schedule 1
<b>Annual public meeting</b>	<ul style="list-style-type: none"> <li>- Must be held no later than 3 months after publication of the Annual Report</li> <li>- Report of the meeting to be published no later than one month after meeting held</li> </ul>	Schedule 1
<b>Consultation</b>		
<b>Panel arrangements</b>	The FSA must have effective arrangements for consulting with practitioners and consumers to whether its practices and policies comply with its duties. It must have Practitioner and Consumer panels and consider their representations	sections 8-11
<b>Rules</b>	Before making rules etc, the provisions must be published in draft, accompanied by certain information. The FSA must have regard to any representations made and publish an account, in general terms, of the representations and its response. A CBA is usually required. Some of these provisions also apply to certain guidance. Copies of rules and general guidance must be sent to HM Treasury (HMT)	sections 155-158
<b>Corporate Governance</b>		
<b>Overall</b>	The FSA must have regard to good corporate governance in managing its affairs	section 7
<i>Governing body</i>	<ul style="list-style-type: none"> <li>- In discharging its legislative functions, the FSA must act through its governing body</li> <li>- Chairman and other members Board appointed/removable by HMT</li> <li>- Non-executive committee must be established and appointed by HMT</li> <li>- Committee must prepare report on discharge of its functions to be included in the FSA annual report</li> </ul>	Schedule 1



<b>Higher Control</b>		
<b>Independent reviews</b>	HMT may appoint independent reviewer of FSA's economy, efficiency and effectiveness but not general policies); report must be public etc	sections 12-13
<b>Directions</b>	The Director-General of fair trading and HMT has power to direct FSA to take certain steps to remedy an adverse effect on competition	sections 159-164 and 302-310
<b>Inquiries</b>	HMT may order inquiries into certain major aspects of the FSA's functions (collective investment schemes, regulation of listed securities etc) – the inquiry would have High Court powers; HMT has discretion over publication of an inquiry's report	sections 14-18
<b>Accounts, audit and record keeping</b>	- HMT has control over FSA compliance accounting and auditing requirements - The FSA must maintain proper records	Schedule 1
<b>Parliament</b>	Parliament has no direct control, but certain FSMA related statutory instruments must be approved by Parliament	section 429
<b>Upper Tribunal (formerly Financial Services and Markets Tribunal*)</b>	The Tribunal can adjudicate on alleged excessive use of powers by the FSA  * The FSM Tribunal was abolished and its functions passed to the Upper Tribunal on 6 April 2010 under the Transfer of Tribunal Functions Order 2010 (SI No 22).	sections 132-137
<b>Judicial review</b>	The FSA can be subject to judicial review, but has a broad exemption from legal liability	Schedule 1
<b>Freedom of Information Act</b>	Applies to FSA	–

## APPENDIX 2

### 'REGULATION BY SPEECH'

#### Introduction

1. Concerns have been raised about so-called 'regulation by speech'. This paper examines whether there is any basis for the suggestion that regulation by speech exists in the first place and, if it does, whether there is a reason for concern.

#### FSA Speeches

##### (a) Non-binding Nature

2. The matter is covered specifically in the FSA Enforcement Guide <http://fsahandbook.info/FSA/extra/4755.pdf>. Paragraph 2.23 states -

"Guidance is not binding on those to whom the FSA's rules apply. Nor are the variety of materials (such as case studies showing good or bad practice, **FSA speeches**, and generic letters written by the FSA to Chief executives in particular sectors) published to support the rules and guidance in the Handbook." (*Our italics*)

3. In addition, paragraph 2.24 states -

"... if a firm has complied with the Principles and other rules, then it does not matter whether it has also complied with other material the FSA has issued."

4. These provide useful confirmation that the contents of FSA speeches are not binding on FSA-regulated firms, although the word "complied" in 2.24 should probably have been in inverted commas or an alternative form of wording used.

5. The FSA Handbook definition of "guidance" initially appears to be very wide- ranging - "guidance given by the FSA under the Act" (*our italics*). But it is clear from FSMA section 157 and section 155 (as applied to guidance by section 157(3)) that, in order to issue guidance, the FSA must go through the normal consultation procedures that it would have to use in relation to making rules. On the face of things therefore nothing in an FSA speech, DCE letter, case study etc could be classified as "guidance".

##### (b) Enforcement

6. However, paragraph 2.23 goes on to state -

"Rather, such materials are intended to illustrate ways (but not the only ways) in which a person can comply with the relevant rules."

And paragraph 2.25 states that -

"Guidance and supporting materials are, however, potentially relevant to an enforcement case and a decision maker may take them into account in considering the matter." The rest of 2.25, and 2.26, elaborate on this. For instance, 2.25(1) gives the example of helping "assess whether it could reasonably have been understood or predicted at the time that the conduct in question fell below the standards required by the principles".

##### (c) Analysis

7. On one interpretation, the FSA is 'having its cake and eating it' because, on the one hand, FSA speeches are not binding but, on the other hand, they could be taken into account by enforcers. On another interpretation, FSA speeches (being non-binding) would be irrelevant as long as a firm had complied with the *binding* provisions, so there should be no problem. But the matter becomes circular because enforcers may be informed by speeches as specified in 2.23(1).

8. Speeches have moved into the FSA's lexicon and into the FSA Enforcement Guide. The Guide is, itself, guidance only but, as noted above, the concept of "supporting materials" (described in paragraph 2.23) is explicitly stated in paragraph 2.25 as "potentially relevant to an enforcement case".

9. On the face of it, there seems to be an inconsistency between paragraph 2.24 ("*... if a firm has complied with the Principles and other rules, then it does not matter whether it has also complied with other material the FSA has issued.*")

and paragraph 2.25 ("*Guidance and supporting materials are, however, potentially relevant to an enforcement case and a decision maker may take them into account in considering the matter.*").

Clearly, it could matter – in enforcement terms - if a regulated firm had not “complied” with what was said in an FSA speech.

10. There might be a reasonable distinction drawn here between an FSA speech and a DCE letter. A DCE letter would be addressed directly to chief executives and it would not seem unreasonable for the FSA to take account of any inaction by a firm in relation to relevant material in a DCE letter.

11. However, 'regulation by speech' would seem a different matter because of the number of speeches, the wide ground they cover, the absence of consultation on the content of those speeches, and the existence of a very extensive FSA Handbook of Rules and Guidance, which regulated firms – entirely reasonably – regard as the document to which they must comply.

12. The BSA members' website does have summaries of, and links to, all relevant FSA speeches (but the adding of a new speech is not usually done by an alert to members)

[http://www.bsa.org.uk/members/policy/prudentialandfinance/fsma\\_section/speeches.htm](http://www.bsa.org.uk/members/policy/prudentialandfinance/fsma_section/speeches.htm)

Chris Lawrenson  
BSA  
30 January 2008

My name is Simon Burton

I run a small high street insurance brokerage, since 1981.

We are currently regulated by the FSA.

We are concerned that the PRA will follow the FSA rulebook without realising that the FSA, when it was given the mandate to regulate General Insurance Brokers, tried to impose the same rules as existed for Independent Financial Advisors.

This reaction produced a rulebook that was "unconsciously incompetent" from day one.

General Insurance products, lasting for no more than one year, need very little intrusive regulation. - this can be demonstrated by internet sales to the general public.

"Keep it simple" is the only way to go forward.

"Treating Customers Fairly" should mean what it says, not adhering to an incomprehensible rule book.

Please see below, my ideas set out 4 years ago. I have not substantially changed my mind since..

Replacement FSA Rule Book For "High Street" Insurance Intermediaries of less than 7 employees. – (Mini-Brokerages)

The preamble: -

The FSA understands that Mini-Brokerages pose only a negligible threat to the General Public and their finances.

The FSA understands that fraud occurs in every walk of life, and no amount of regulation can ever eradicate it. Brokerages of many years standing have shown that they run businesses that customers trust, and return to, year after year.

Only Authorised Brokers are allowed to trade.

The FSA or EU equivalents authorise insurers. Only FSA/EU authorised products may be sold by Mini – Brokerages. The solvency of insurers is not the responsibility of Insurance Brokers

The FSA only needs to hold basic details of the firm. All other details can be seen, by during random inspections.

The FSA should never tell an Insurance Brokerages as to how it should run its day to day business.

The FSA should place the age old concept of "Buyer Beware" as the basis of regulation.

The FSA department dealing with High Street Insurance Intermediaries has the power to enforce the following rules. The FSA sole duty is to ensure brokers to confirm to the rules. It is not in the FSA remit to create rules of trade or instruct on office procedures.

Mini-Brokerages are agents of insurers. It is the insurers who set the conditions for their agents to abide by.

The Rules: -

1. All insurance premiums to be held in designated client's accounts, and the account at all times to cover the premiums owed to the underwriters and clients.
2. All intermediaries to hold PI cover at all times. The minimum level of cover £1,500,000.
3. All intermediaries should issue clients with their terms of business. Details therein should show fee structure, interest charges, the complaints procedure, the firm's legal status and contact details. The firm is to comply to its own Terms Of Business at all times.
4. Staff dealing with clients should be competent in the area of insurance they operate. It is the duty of the owners/directors of any intermediary to ensure that their staff only operate in areas of insurance where they are experienced, treat their clients honestly, fairly and explain the cover, excesses and limitations of any insurance products being sold to clients.
5. All Intermediaries must assist the FSA in any on-site inspection, which may occur without prior arrangement. They must provide any financial, PI or complaints details as requested. Recommendations made following any FSA inspection are to be

adhered to by the Intermediary, any non-compliance corrected. Serious breaches, i.e. financial/fraudulent to be reported by the FSA to the insurers involved.

6. All intermediaries to have a Chartered Accountant sign off their annual accounts within six months of their financial year or lose authorisation.

7. Theft is a criminal offence. Misuse of client's money is theft. The FSA should report to the police any suspected theft immediately.

8. The FSA should have no immunity for slander or libel to ensure no malicious proceedings.

With these few rules, clients are protected, the costs are low, and everybody can understand. - IBRC standards were just about right. What replaced it is fundamentally flawed.

S K Burton Bsc(Hons)  
K Burton & Son Ltd