The Actuarial Profession
making financial sense of the future

Consultation Response

HM Treasury

A new approach to financial regulation: the blueprint for reform

08 September 11

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

The Actuarial Profession
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Financial Regulation Strategy
HM Treasury
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08 September 2011

A NEW APPROACH TO FINANCIAL REGULATION: THE BLUEPRINT FOR REFORM

I am writing on behalf of the Actuarial Profession in response to HM Treasury's consultation entitled "A new approach to financial regulation: the blueprint for reform". The Actuarial Profession represents the members of the Institute and Faculty of Actuaries, the UK based chartered professional body for actuaries. Actuaries work in insurance, pensions, healthcare, investment and banking as well as in the management of risk, and so are directly involved in many of the areas covered by the proposed regulatory structure and, of course, as a profession actuaries are themselves overseen by the Financial Reporting Council.

We note that the subject matter contained in the Actuaries and Auditors section of your previous consultation "A new approach to financial regulation: building a stronger system" (paragraphs 5.92 – 5.97) has not been raised in the current consultation. We are unclear as to your intention in relation to these proposals, but would refer to the views contained in our response to the previous consultation. In particular, we would echo our original concerns regarding the intention to widen the application of section 345 of the Financial Services and Markets Act 2000 (FSMA) to enable the new regulatory authorities to disqualify any individual professional they deem to have failed to comply with the duties under FSMA, irrespective of whether they were appointed as an individual or were representing their firm.

The Actuarial Profession would like to highlight the operation of its own disciplinary scheme as well as its inclusion within the remit of the Accounting and Actuarial Discipline Board (AADB). As previously advised, we are of the view that any widening of the application of section 345 of FSMA should be proportionate and should be designed preferably to reinforce the Actuarial Profession's current arrangements. It may be that, in many circumstances, referral to our disciplinary scheme or the AADB's scheme may be a more proportionate and appropriate response.

The Actuarial Profession also wishes to highlight that, in the proposed Solvency II regulatory regime for insurers, the performing of regulated actuarial activity is not restricted to members of a recognised actuarial profession. As previously advised, we believe that there are merits in ensuring that any regulation or power pertaining to disqualifying actuaries from acting on behalf of an authorised person should also apply to others, who are not members of an actuarial body, acting in the same fashion.

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Overall, however, the Actuarial Profession welcomes the proposals contained in the consultation “A new approach to financial regulation the blueprint for reform” and has no further comments in this regard. We look forward to working with the new regulatory authorities in the development and promotion of the effective and proportionate regulation of actuaries.

We would be very happy to discuss these points with you and the regulating authorities if you wish.

Yours faithfully

Jane Curtis

Jane Curtis
President
Institute and Faculty of Actuaries

Advertising Association response to the Treasury consultation on a new approach to financial regulation

September 2011

1) The Advertising Association
The Advertising Association is the only organisation that represents all sides of the advertising and promotion industry in the UK - advertisers, agencies and the media. In the UK, the advertising industry employs nearly 250,000 people. In 2009, advertising expenditure was £14.5bn.

We promote and protect advertising. We communicate its commercial and consumer benefits and we seek the optimal regulatory environment for our industry. Our goal is that advertising should enjoy responsibility from its practitioners, moderation from its regulators, and trust from its consumers.

The Advertising Association supports any moves towards less and better regulation. As such, the Government's drive towards strong consumer protection delivered by a clearer and more proportional financial regulatory system is something we would support.

We believe it is integral that the Advertising Association (AA), and the Advertising Standards Authority (ASA), are closely engaged with the process of developing the Financial Conduct Authority (FCA) and are called upon by Government to assist with the practical development and implementation of the FCA's proposed financial promotions powers. More generally, we look forward to working with the Treasury, the FSA, the OFT - and the FCA when it is created - to ensure that self-regulation of financial advertising is able to both effectively create competitive markets while also protecting consumers.

2) Overview
As is noted in the Treasury's consultation paper, the move to a new approach to financial regulation is a result of the identified failings of the previous model of financial regulation. It is pertinent to note that financial advertisements are clearly not a key contributor (or even close to being so) to the failings in the system of financial regulation in the UK, or indeed the global economy.

In this paper, we firstly explain the system of regulation for financial advertisements in the UK, and secondly set out our aspirations for how the FCA can work to continue to provide the high level of protection to consumers that the current system allows.

3) The current regulatory regime for financial advertisements
As a starting point, the Advertising Association supports the recognition by Government of the need for a body that aims to protect and enhance confidence in financial services and markets - protecting consumers and promoting competition. So, given the impending dismantling of the FSA, the creation of the FCA is warmly welcomed. A regulatory model designed to protect consumers and promote competition is one that is highly compatible with the ASA, which has the same core goals at the heart of its self-regulatory work. We set out below how the financial advertisements are currently regulated for different products and for different media, and explain how this complex system involving the FSA, OFT, Trading Standards, and the ASA works to provide consumers with a high level of protection.

a) Banking, investments and insurance sectors

All advertising relating to regulated activities in the banking, investments and insurance sectors, are tightly controlled in order to safeguard the consumer in what is a complex area. The relevant provisions are mainly contained within the Financial Services and Markets Act (FSMA) 2000 which empowers the FSA with powers and discretion to regulate this sector, to publish guidance for consumers and industry, and to undertake reviews as deemed necessary.

Non-broadcast advertising: If a complaint about a non-broadcast advertisement falls within the remit of the FSA, then the ASA forwards the complaint to the FSA immediately. The ASA's remit only covers financial advertisements that are not "technical", for example, complaints about advertisements that are deemed to create offence, be socially irresponsible, or make untruthful claims.

Broadcast advertising: If the ASA receives a complaint about a broadcast advertisement that also falls within the FSA's remit, the ASA has a statutory duty to investigate. This is borne out of the co-regulatory relationship that the ASA has via BCAP with Ofcom. The ASA will ensure that the FSA is involved, however, as this will ensure consistency between the two bodies, but ultimately the adjudication will be based upon the ASA's codes for broadcast advertising.

b) Consumer credit sector

For consumer credit advertising, any advertising by a lender must comply with the Consumer Credit (Advertisements) Regulations 2004 (CCAR). This is supported by OFT Guidance, as well as the broader requirements of the broadcast and non-broadcast advertising codes, upon which the Advertising Standards Authority (ASA) adjudicates. These advertising codes approximate the provisions of the Consumer Protection from Unfair Trading Regulations 2008. Article 4 ("Standard information to be included in advertising") of the Consumer Credit Directive contains provisions aimed at further enhancing protection in respect of the advertising to consumers of credit products.

Non-broadcast advertising:
If the ASA receives a complaint which is assessed to fall within the Consumer Credit Act remit, then the ASA will tell the complainant to contact their local Trading Standards. The OFT is only consulted if the complaint needs to be escalated. The ASA will investigate non-technical complaints.

Broadcast advertising: As with advertisements for banking, investments and insurance sectors, the co-regulatory system of broadcast advertising regulation means that the ASA has a statutory duty to deal with these cases. The ASA will consult with the OFT during an investigation.

c) Overview of the system

As detailed above, the ASA works closely with both the FSA and the OFT (depending on the product) when dealing with complaints about financial advertisements. Complimentary to the OFT and FSA systems, specific rules for financial advertisements are contained within the regulatory codes of the Committee of Advertising Practice, the Broadcast Committee of Advertising Practice and, given the co-regulatory system for broadcast advertising, within the Ofcom Broadcasting codes. These rules largely mirror the rules set out in FSMA 2000 and the Consumer Credit (Advertising) Regulations 2004. While the technical elements of financial advertisements are generally covered by either the OFT or the FSA, all financial advertising is subject to the non-technical elements of such communications.

Additionally, it is worth noting, that for broadcast advertising the system benefits from having advance central clearance for credit advertising, provided by Clearcast and the RACC, pre-vet advertisements prior to them being broadcast.

4) Financial advertising: the consumer perspective

The current system, as outlined above, is – broadly speaking - effective and we urge the Government to acknowledge the benefits of this regulatory structure for advertising when reforming the broad financial regulatory regime. While it is clear that the structure of the system is complex, from the consumer perspective these complexities are not evident due to the effective processes between the various regulatory bodies. However, we recognise that these processes could be improved, and as a such see the creation of the FCA as an opportunity to further streamline the processes between regulators.

While the regulatory structure is to all intents and purposes hidden from the consumer, the level of consumer information or "legals" in financial advertising is very evident. We believe that much of this small print is counterproductive. Evidence from Credos, the independently governed advertising think-tank, shows that the more 'proof' offered in advertisements, the less consumers trust the message. Indeed, there is clear evidence that information requirements are perceived to be included in advertising to protect the advertiser, rather than the consumer.

There is also evidence that information requirements in financial advertisements – such as wealth warnings - actually confuse consumers and detract from the products' branding. [1] Such evidence is also backed up in the 2007 report by the Better Regulation Executive and National Consumer Council, "Too Much Information Can Harm"[2] that assess that there is "growing evidence that information is not a panacea, and can cause harm". Rather than increasing information requirements, we believe that there is a case for reducing the amount of information that must be incorporated into financial advertisements. This would address the "information overload" experience faced by consumers, and we believe that mandatory information requirements in advertising are rarely of value to consumers. While we recognise that this issue is not the focus of the Treasury paper, we are keen to ensure that this point is acknowledged as the new structure for the FCA is developed.

The AA firmly believes that financial advertising, as with advertising in any other sector, should not mislead or put prospective customers under undue pressure, and that it should also be fair. We also recognise that financial advertising requires specific attention given that this is a highly regulated environment and the products involved are typically more significant purchases than the average product. The AA considers that the regulatory provisions outlined above are more than adequate to ensure that advertising is carried out in a responsible manner. Furthermore, the AA believes that necessary remit and sanctions are currently in place to punish malpractice.

5) Our vision for the FCA

[1] The Navigator for the UK Radio Advertising Bureau "Radio commercials and wealth warnings" research, February 2004

[2] http://www.bis.gov.uk/files/file44367.pdf

Taking into account the overview set out above, the current regulatory regime for financial advertisements, and the content of the Treasury consultation paper which focuses on the financial promotions powers, our vision for the FCA is as follows:

a) Overview

- The FCA must not only be a strong regulator with a committed focus on protecting consumers but it also must have transparency and cooperation (with other regulatory bodies) at its heart.
- The FCA's strengthened ability to tackle misleading financial advertisements must be compatible with the powers currently administered by the ASA. Clear processes and remits need to be set out between the ASA and FCA to ensure that consumer complaints are dealt with quickly, effectively, and in a consistent manner.
- The FCA must cement its recognition that transparency is a key regulatory tool by setting out clearly how this transparency will be achieved in context with its work in the field of financial advertisements. The ASA model is one that should be considered in this context, the ASA being open and transparent in its operations; publishing all of its adjudications; and responding to enquiries from the public and various organisations.
- For the FCA to be truly effective, it must engage the entire industry in its work and ensure that there is a structured meeting programme leading to an ongoing, positive relationship between regulator and industry. By way of an example, the ASA's system of sanctions goes beyond just "name and shame", including measures such as the refusal by media owners to feature advertisements from companies in breach of the rules. This is only achievable due to the level of engagement in the system between the entire industry – advertisers, agencies and media owners – and the ASA.

b) Sanctions

- The "name and shame" sanction administered by the ASA is well renowned as being an effective driver of compliance by advertisers, and the FCA's proposals in this area should complement the effective sanctions already being administered by the ASA. The processes that the ASA have in place to administer this sanction are generally perceived to be fair, and thus we urge the FCA's model to be as similar to the ASA's as much as possible. The publication of adjudications generates a great amount of media attention in the UK, and frequently internationally, which can significantly damage an advertiser's reputation.
- A rigid sanctions mechanism may undermine the regime it is trying to protect. The FCA should be able to take a flexible approach to enforcement and thus be given the ability, rather than a duty, to publish where a firm falls foul of the rules. An overly exuberant sanctions regime may unnecessarily undermine the market place, while also weakening the negative impact the "name and shame" function could have against serial offenders and other more serious cases.

c) Powers

- The FCA's powers should be clearly set out from the start. We have concerns over the lack of detail on the proposed FCA's powers outlined in the Treasury paper. For example, much greater detail is required to understand how the following powers would be administered in practice: "to direct the firm to refrain from making a promotion, to withdraw a promotion, to publish details of it, or to do anything else the FCA directs it to do in relation to the promotion." Currently, this lack of clarity and detail is a significant concern.
- The FCA should not have the power to contact consumers who have acted upon a promotion which is, for example, misleading. This would be a significant development and may set a dangerous precedent in the way in which advertising is regulated more generally. There is

- sufficient legal protection already in place for consumers in this area and we strongly oppose this proposal.
- Without knowing more about how the product intervention power would work in practice, we cannot hold a clear position on this issue. The Government will have to consult and publish a statement of policy on when it will make temporary product intervention rules. We do, however, welcome the suggestion that any temporary product intervention rules will only last for 12 months and that if the FCA wants to make them permanent it will have to follow their own rule making powers.
- As stated in the Government paper, it is essential that if the FCA is able to ban or demand changes to advertising and marketing communications, the firm must be alerted about the FCA's proposed course of action and allow representations by the firm before publishing any details.

d) Relationship with OFT and TSI

- Given that the OFT and Trading Standards have an important role in the regulation of financial advertising, the impending dismantling of the OFT and increased role of Trading Standards with regards to taking on the OFT's consumer protection powers must be recognised. We welcome the Government's plans to transfer responsibility for consumer credit regulation from the Office of Fair Trading to the FCA. The AA is keen to ensure that the new structure for enforcing consumer credit law retains within it a strong, national body that is able to serve effectively as a backstop to the ASA.

6) Conclusion

The creation of the FCA is one that presents a number of opportunities for the advertising industry but, as ever with any regulatory shake-up, there are number of risks involved with this change. We are keen to meet with Treasury and FSA officials to ensure that when discussion focuses on the FCA's advertising powers, industry is closely involved with this process.

Furthermore, we look forward to discussing the FSA's forthcoming paper on FCA strategy, the further details of the FCA's operational approach, and the Government's plans to transfer responsibility for consumer credit regulation from the Office of Fair Trading to the FCA.

In reforming the regulatory regime for financial services, it is essential that the role of the ASA in this space is fully understood, and that unnecessary new layers of statutory legislation are not introduced.

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ADVERTISING STANDARDS AUTHORITY RESPONSE TO HM TREASURY PROPOSALS ON A NEW APPROACH TO FINANCIAL REGULATION

1 Introduction

1.1 The Advertising Standards Authority (ASA) is the UK self-regulatory body for ensuring that all advertisements, wherever they appear, are legal, decent, honest and truthful.

1.2 The ASA is grateful for the opportunity to submit in writing its views on the Treasury plans for a new approach to financial regulation. Our submission relates specifically to proposals to strengthen the Financial Conduct Authority's ability to tackle misleading financial advertisements.

1.3 Whilst we understand and support the need for robust regulation of financial promotions, we are concerned that these proposals should not undermine the existing role played by the ASA.

1.4 This response provides:

- A summary of the UK advertising self-regulatory system. More detailed information can be found on our website www.asa.org.uk.
- An outline of the ASA's current role in regulating financial advertisements.
- A view on the proposals to strengthen the FCA's ability to tackle misleading financial advertisements.

2 Advertising self-regulation in the UK

2.1 The ASA administers the UK Advertising Codes, which are written and maintained by the Committee of Advertising Practice (CAP) and the Broadcast Committee of Advertising Practice (BCAP). CAP is responsible for the non-broadcast Code and BCAP is responsible for the TV and radio Codes. [1]

2.2 The ASA is widely recognised as being responsible for controlling marketing communications across all media in the UK and we work closely with statutory regulatory partners, including the Financial Services Authority (FSA), the Office of Fair Trading (OFT) and the Office of Communications (Ofcom).

2.3 More information about the ASA and the benefits it brings to consumers and industry is detailed at **Annex A**.

3 The ASA's current role in regulating financial advertisements

3.1 Non-broadcast advertising

3.1.1 Under the CAP Code (non-broadcast), the ASA regulates all financial ads that are not regulated under the Financial Services and Markets Act (FSMA) or the Credit Act 1974 (as amended) and the Consumer Credit (Advertisements) Regulations 2004 (CCA).

3.1.2 Though the Advertising Codes highlight the need for advertisers to comply with the requirements of the CCA and FSMA, the ASA does not enforce the technical aspects of financial ads (e.g. rates of return for investment products, APRs etc.). This is because both the CCA and FSMA place statutory duties on the OFT and FSA to directly deal with technical aspects of financial ads.

3.1.3 For complaints about technical elements of non-broadcast financial ads covered under the CCA, the ASA will direct complainants to contact their local Trading Standards department.

3.1.4 For complaints about technical elements of financial ads covered by the FSA, the ASA will refer the complaint to contact the FSA (or BCSB if a banking product).

[1] The Advertising Codes can be found at: http://www.cap.org.uk/cap/codes/

3.1.5 All non-broadcast financial advertising (press, poster, cinema, online etc) are, however, subject to Code rules that cover non-technical elements of the marketing communication, for example matters of serious or widespread offense, social responsibility and other aspects that do not relate to specific characteristics of financial products.

3.1.6 This means that as well as complying with the requirements of the Consumer Credit Act 1974 (CCA) and the Financial Services and Markets Act 2000 (FSMA) - both of which relate primarily to the technical aspects of the product - advertisers must also comply, in full, with the requirements of the UK Advertising Codes. These Codes ensure that all marketing communications are legal, decent, honest and truthful.

3.2 **Broadcast advertising (TV and radio)**

3.2.1 The ASA has a statutory responsible for regulating all aspects of secured and unsecured credit and financial advertising, including those technical aspects covered by the CCA and FSMA. This is because for broadcast advertising, the ASA works in a co-regulatory partnership with Ofcom, under which we are obliged to consider all complaints about broadcast advertisements, with Ofcom acting as a statutory backstop. These obligations are rooted in the Communications Act 2003.

3.2.2 In liaison with the FSA, the ASA will consider complaints about technical aspects of financial services ads in broadcast media. If it receives a complaint about a technical aspect of a financial services campaign across both non-broadcast and broadcast media, instead of referring the complaint about the non-broadcast advertisement to the FSA, the ASA will liaise with the FSA and consider complaints about the ads in both media.

3.2.3 Similarly, when the ASA considers claims in broadcast advertising about financial products regulated under or the CCA, it makes the OFT aware of the case. However, ultimately the ASA is judging under the BCAP Code.

3.3 Although complaints received about technical aspects of financial ads in non-broadcast media are usually referred to the FSA, it is worth noting that the way the ASA deals with complaints about cross-media campaigns can have an impact on non-broadcast remit: the ASA might investigate complaints about technical aspects of non-broadcast financial ads that form part of a cross-media campaign.

3.4 The ASA liaises with the OFT and the FSA on a daily basis to ensure consistency of approach and to avoid double jeopardy. This all means that regardless of the different regulatory regimes for the technical aspects of secured and unsecured financial advertising, the ASA's remit covering the softer aspects of all financial ads, already ensures a parity of approach across the sector.

4 A view on the proposals to strengthen the FCA's ability to tackle misleading financial advertisements.

4.1 The ASA understands that the Government intends to give the FCA the power to take swift regulatory action against misleading financial promotions, and to publish the fact that it has done so.

4.2 Whilst we understand and support the need for robust regulation of financial promotions, we are concerned over the possible implications that this course of action could have for advertising regulation in this area.

4.3 The ASA currently plays a key role in regulating misleading financial advertisements, working closely with the FSA and the OFT. Publication of our adjudication decisions is a key sanction for us. We are concerned that the proposals to strengthen the FCA's ability to tackle misleading financial ads should not undermine the existing role played by the ASA.

4.4 In light of this, we would be pleased to meet with the Treasury at the earliest opportunity to discuss the future of financial promotion regulation in more detail. The ASA will be in touch shortly to explore the possibility of an early meeting. In the meantime, if there any questions about the ASA's work or this response, please do get in touch.

5 Contact Details

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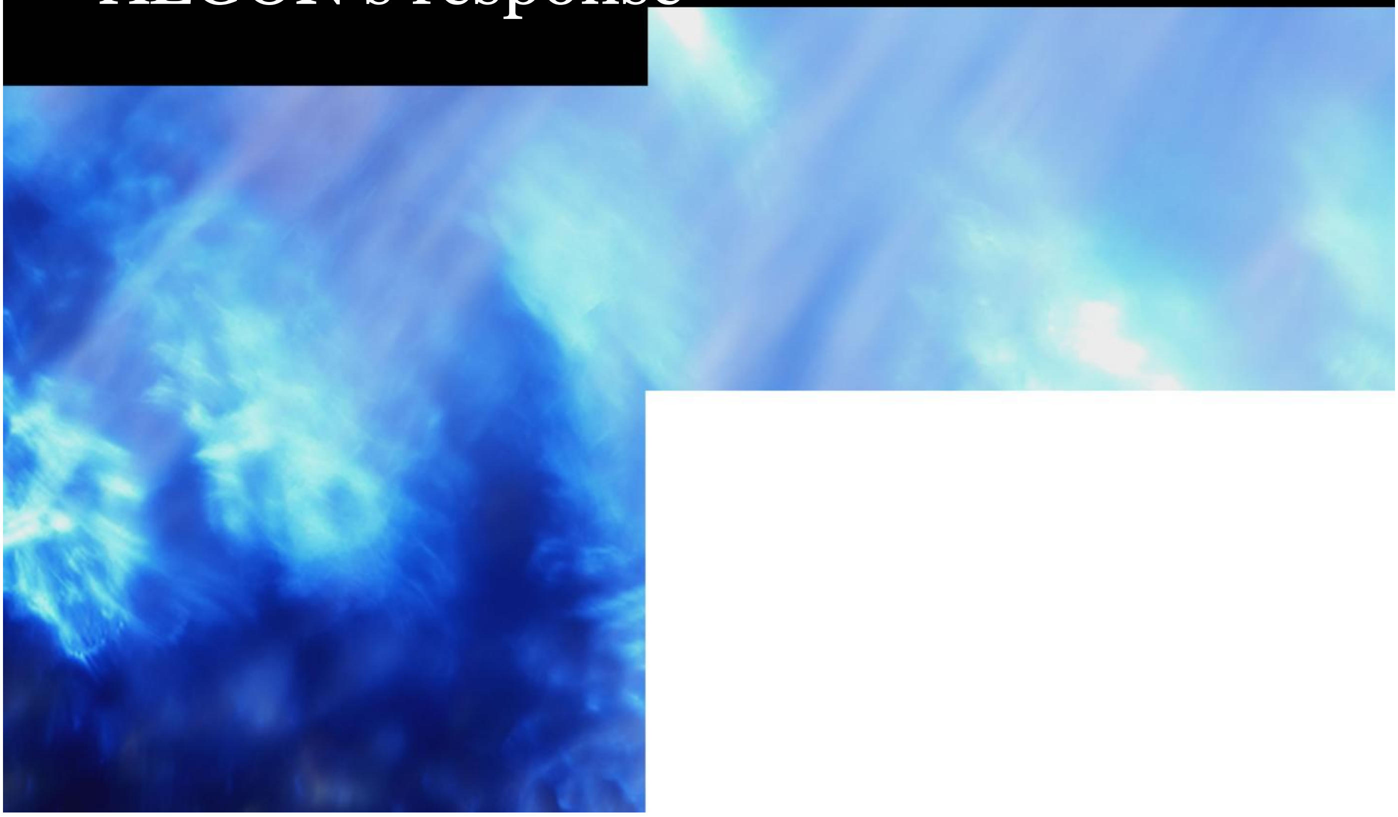
A new approach to financial regulation: the blueprint for reform

AEGON's response



September 2011

About AEGON

AEGON is one of the UK's leading providers of pensions, life insurance, investments and annuities. We also own two large national distribution businesses, Origen and Positive Solutions.

With headquarters in Edinburgh, AEGON employs approximately 3,500 people in the UK and helps around two million customers to secure their long-term financial futures.

We're part of the AEGON Group, one of the world's largest financial services organisations, with a presence in more than 20 countries.

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

No.

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

No.

Q.3 Do you have any comments on:

- **the proposed crisis management arrangements; and**
- **the proposals for minor and technical changes to the Special Resolution Regime;**

as described in paragraphs 2.41 to 2.44 and in Chapters 3 and 4?

No.

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

We welcome the recognition that the insurance sector presents different prudential risks from banks and therefore requires a different approach.

The PRA's proposed 'insurance objective' combined with the regulatory principles which will apply to both the PRA and the FCA, should in principle afford regulators sufficient flexibility to exercise their own judgement, while avoiding disproportionate measures.

The real test, however, will be how this is implemented in practice – and how the PRA interprets the requirement to afford an 'appropriate' degree of consumer protection.

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

The joint paper published by the Bank of England and the FSA, on the future approach of the PRA to the insurance sector, offers a degree of clarification as to how the PRA will apply its objectives and principles in practice. In particular, the paper presents a more detailed outline of how the PRA will interpret the move to 'judgement-led regulation'. We expect to have ongoing conversations with 'shadow' PRA officials as this approach is developed further.

We support the Government's view that regulators should continue to "conduct their own assessment of the costs and benefits of proposed rules", even where those have originated in EU legislation. We also support its stated agreement with the view that judgement-led decision-making must be rigorously evidence-based. We are concerned, therefore, that the proposed change from requiring an 'estimate' of costs and benefits to requiring an 'analysis' may be misinterpreted as a watering down of this requirement.

The fact that, as the White Paper suggests, it has often proved difficult for regulators (and others) to provide robust quantitative estimates in the past, does not mean they should not be required to try in future. The burden of proof, to demonstrate that regulatory action will not incur costs disproportionate to the purported benefit, remains with the regulator.

We would add that there is also a need for objectivity from the regulator not just in assessing the level but also in determining which costs and benefits should and should not be included.

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

We agree with the Government's view that the duty to promote competition does not necessarily need to take primacy over other objectives. Nonetheless, we are not wholly convinced that the combination of a strategic objective, several operational objectives, and a wide range of regulatory principles and 'have regards', lends itself to clarity in the minds of regulators, firms or consumers as to how these ought to be prioritised and applied in practice, especially on those occasions where they are – or appear to be – in conflict with one another. Broader circumstances may change the relative priority of these considerations over time and it will be important there is transparency around this.

The FSA's paper, outlining the FCA's future approach, seeks to provide further clarification. Again, we look forward to discussing this further with 'shadow' FCA officials as they continue to develop their approach.

We are pleased that the FCA's consumer objective, as drafted, includes the requirement that the FCA have regard to "the needs that consumers may have for advice and accurate information; (and) the general principle that consumers should take responsibility for their decisions."

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

We support the Government's desire to see a "clear focus on consumer outcomes".

We would welcome some recognition from the Government and regulators that consumer outcomes are not always best served by an approach which seeks to remove all risk of detriment. There is a need to take into account longer-term consumer outcomes as well as immediate short-term outcomes.

- **Product intervention**

We have responded separately to the FSA's consultation on how it will use its product intervention powers. In that response, we expressed our belief that the FCA could achieve many of the intentions behind this by extending the concept of the Retail Conduct Risk Outlook (RCRO) and suggested that it might move from an annual report to a more dynamic communications medium, with a specific element of consultation with industry.

We also highlighted the wide range of current and future regulatory initiatives affecting products and distribution, emanating from HM Treasury, the FSA and the European Commission. We believe it is important to consider these issues, and their potential impacts on firms and consumers, in the round, to ensure the risk of unnecessary overlap and confusion is mitigated.

- **Financial promotions and early publication of disciplinary action**

We support the principle of transparency around the FCA's powers relating to prevention of misleading financial promotions and welcome the safeguards outlined in the White Paper around the publication of enforcement action.

Equally, we welcome the safeguards around the publication of warning notices. It is important that firms and individuals are held to account but equally it does not serve the objectives set out for the FCA if consumer confidence is unduly undermined.

Despite these safeguards, we remain concerned at the possibility that publication will become in effect the default option. We believe that the decision whether or not to publish should be taken on a case-by-case basis against a set of agreed criteria, which should include the potential impact on consumer confidence in the wider market.

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

It is not in the interests of the industry to allow issues which may be causing significant detriment to consumers to continue unchecked, until they reach a point where intervention becomes inevitable, redress all the more costly, and reputational damage all but irreparable.

This needs to be balanced however, against the potential for unwarranted reputational damage to products and firms where those concerns turn out to be overplayed.

As we understand the proposals, the onus would remain on the FCA to decide whether a referral had *prima facie* merit and whether to publicise that an issue had been referred to it. This is an important safeguard and we would want to see more detail on how this would operate.

As indicated above, we believe the FCA should examine how it could make greater use of the Retail Conduct Risk Outlook; this could help to nip mass detriment in the bud in some instances, and obviate the use of methods which risk unduly damaging consumer confidence and trust.

We agree that the Financial Ombudsman Service (FOS) could potentially act as a bellwether to highlight particular issues which were causing consumer detriment 'spikes'. We believe the relationship between the FCA, as conduct regulator, and the FOS as complaints handler, could be put on a much more effective footing than at present and this is one way in which it could be improved.

There is potentially a role for the FCA's Consumer and Practitioner Panels in this, too, but we would question whether it is appropriate to give non-statutory consumer groups a formal role in the process.

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

We would not favour a situation where issues would be publicised and the FCA required to make a public statement, even where it had determined that there was no substantive case to answer. This seems to us to risk unduly undermining consumer confidence and trust in the industry.

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

We believe the Government's new proposals strike a good balance of powers and duties between the FCA and the competition authorities.

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

No.

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

It is always difficult to strike an appropriate balance between the independence of regulators and the desire for them to be properly accountable. The Government's proposals seem to be a good attempt to improve accountability, without making excessive incursions into the regulator's operational independence.

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

We welcome the requirement for the PRA and FCA to issue a Memorandum of Understanding (MoU) setting out how they will co-ordinate their operations and look forward to the publication of a draft version of this ahead of the Bill's consideration by Parliament.

We welcome also the requirement that the MoU be updated annually. We would prefer to see a formal mechanism to ensure that industry and consumer representatives are consulted on the MoU. This need not take the form of a full consultation process: the Bill could, for example, specifically require the FCA to refer to the Practitioner and Consumer Panels in conducting its annual review. We continue to believe regulators need to find better ways of engaging with practitioners and consumers across the range of their work.

In our responses to previous consultations in this series, we have highlighted the need for the FCA and PRA to co-ordinate their activities in terms of representing the UK in the EU and wider international arena. We are glad that, in its paper on the future approach of the FCA, the FSA has recognised this issue. We would like to see regulators maintaining an effective dialogue with practitioners on EU regulation so that issues which may present particular problems (or opportunities) to the UK industry can be picked up early in the process.

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

We agree with the Government's decision to adopt its 'alternative approach' to authorisations. Nonetheless, this will still require the PRA and the FCA to work very closely together and the process tightly managed to ensure there is minimal inefficiency and delay. It remains unclear how the process will work for firms which would normally fall under FCA prudential regulation, but which form part of a group which is subject to PRA supervision. AEGON's distribution businesses are examples of this.

We also have concerns over how the proposal for the FCA to designate Significant Influence Functions independently of the PRA will work in practice.

We would like to see a formal mechanism to require the PRA and the FCA to consult with practitioners and consumers as appropriate when they draw up and subsequently review their Memorandum of Understanding. This could be done through the relevant Panels.

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

No.

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

14 September 2011

Dear Sirs,

<u>Age UK response to HM Treasury Consultation, 'A new approach to financial regulation: a blueprint for reform'</u>

Thank you for agreeing to accept a late response to this consultation. Please find attached a copy of Age UK's evidence to the Joint Committee on the draft Financial Services Bill by way of response.

We would also like to stress two major points on the new system as currently proposed.

Firstly, we believe that in the light of the Treasury Select Committee's recommendations in its report 'The Future of Cheques' and the decision by one major bank to restrict ATM access to its basic bank account, the FCA must have a role in ensuring access to essential financial services. Some financial services are utilities and access to them should be regulated, as it is with other utilities, even in highly competitive markets such as telecoms.

Secondly, whilst we strongly agree that the culture of the new regulators will be vital, this must be backed up with a legislative framework which makes it easy for the regulator to act appropriately. Regulatory culture should be seen as an overlay to the legislative framework, not a substitute for legislation in certain areas.

Yours faithfully,

Jane Vass
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Age UK is the new force combining AGE Concern and HELP THE AGED WE WILL

Joint Committee on the draft Financial Services Bill

Age UK's written evidence – Joint Committee on the draft Financial Services Bill call for evidence

September 2011

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Introduction

1. The draft Financial Services Bill is an important step forward. It has the potential to play a key role in improving consumer protection in UK financial services. It must also ensure that consumers can rightly have confidence in the system.

2. Age UK represents a wide range of consumer interests. People aged over 50 are a core market for the financial services industry and UK demographics predict that their importance will grow. The percentage of the total population who are over 60 is predicted to rise from 22% at present to nearly 29% in 2033 and 31% in 2058.[i] Analysis of the Financial Services Authority's (FSA) 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 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[ii]

3. At the same time, many older people are poorly served by the financial services market. Thirty-nine per cent of people who do not have access to a transactional bank account are over 65, whereas this age group only makes up a quarter of the population.[iii] Age UK's recent research has also uncovered a potentially larger group of the 'under-banked', for example almost one fifth of people aged over 75 use someone else to access their day to day spending money.[iv] This failure to meet older people's needs is seen both in physical infrastructure, such as ATM design but also in process, such as assumptions that people over a certain age lack the mental capacity to take financial decisions and so cannot be served.

4. Current regulation has failed older people in two main ways: (i) it has not provided adequate consumer protection resulting in a series of waves of major customer detriment, with approximately £15bn compensation paid to consumers since 1990[v]; and (ii) it has not ensured access to essential financial services. We are therefore concerned to ensure that the draft Financial Services Bill works for all consumers, from those with high financial capability and motivation to those who are more vulnerable and are currently excluded from the system. It must also meet the needs of those who may exist somewhere in between, who appear to be part of the system but are under-banked because they cannot access services they wish to use. Our comments focus on changes needed to achieve effective consumer protection and access to essential financial services.

The objectives of the Financial Conduct Authority (FCA) and the role of competition

5. There is a tension between the FCA's strategic objective of protecting and enhancing confidence in the UK financial system, and its operational objectives of consumer protection, integrity and choice and efficiency. In order to meet its operational objective of consumer protection the FCA may need to take steps which reduce confidence in the industry in the short term, for example by publicising enforcement action. Part 1A should be amended to make clear that the strategic objective is balanced by the operational objectives, so that the strategic objective is pursued only to the extent that is consistent with the operational objectives, especially the consumer protection objective.

6. The 'choice and efficiency' objective is not sufficient to ensure a competitive marketplace for all consumers. Choice does not necessarily benefit all consumers,

particularly those who cannot take advantage of the choice available because they are poor or do not have access to good market information. We support calls for a stronger competition objective, provided that this is balanced by:

- a clear statement of what the financial services market should look like in terms of consumer outcomes
- stronger competition powers for FCA, in particular an amendment to s348 to ensure that the FCA can ensure a transparent marketplace
- a power for FCA to conduct market studies
- a right for consumer groups to formally bring consumer issues to the attention of the FCA
- a requirement for FCA to have regard to financial inclusion
- strong product intervention powers for when competition fails.

7. Competition can be an important tool in ensuring an effective and efficient market, however it is a tool not an outcome. The FCA must have a clear vision of what a competitive financial services market should look like. This should be based on consumer outcomes, rather than firm focused, so that the test as to whether the market is competitive is measured by factors such as how easy it is for consumers to switch products and whether the market innovates to meet consumer need. FCA will also need to consider value for money provided by financial services and products in assessing how well competition is operating.

8. The FSA's Product Intervention Discussion Paper highlights situations in which consumers are obstructed from making good decisions by the way in which products are sold. [vi] This could be addressed by rule-making, however FCA must be prepared to make more far reaching rules for example on timing of fees, product bundling and some cross-subsidies. The FCA will need a stronger competition mandate to justify these steps.

9. The Product Intervention Discussion Paper makes clear that there are serious competition failings which cannot be addressed by consumer empowerment alone. Many products are bought only once and consumers will often not know that there is a problem with their product long after their decision to purchase. Rule making and firm specific powers are not designed to address these types of issue and more structural intervention may be needed. The FCA should therefore be given a power to conduct market studies. As the FCA is closer to the market it is appropriate that it can conduct the study and refer on to the Office of Fair Trading or the new Competition and Markets Authority if necessary.

10. Competition cannot be expected to work for customers that financial firms do not find profitable to serve. The FCA therefore needs a clear mandate to improve access to essential financial services.

11. Some financial services are essential services to which consumers must have access in order to participate fully and independently in UK society. For example, it is Government policy to encourage everyone to open a bank account, yet there is nothing to ensure that accounts will be available to everyone who needs them. In fact, we are currently seeing facilities reduced on basic bank accounts, for example RBS has just announced that basic bank account customers will only be able to use RBS cash machines and Post Office network and will not have access to the rest of the ATM network.

12. Access to essential financial services should be understood as more than just having a basic bank account. This should include issues previously covered by the Financial Inclusion Task Force but must go further. The recent cheques saga is a prime example. Consumer payment systems are vital infrastructure and should be

regarded as utility services rather than retail products. The lack of access regulation has meant that the banks, through the Payments Council, have been able to unilaterally announce a target closure date for cheque clearing and take actions that could effectively undermine the cheque. The Payments Council's recent decision to abandon its cheque replacement programme has been achieved largely as a result of external pressure. It is unacceptable that vital infrastructure can be mis-managed in this way. The Government must accept the Treasury Select Committee's recommendation that cheques are brought within the formal regulatory system. These principles do not only apply to cheques, but also other consumer payment services. Government should specify other classes of essential financial services and products with respect to which the FCA should have an access mandate.

13. In addition to specific access regulation in respect of key products and services the Government could consider requiring the FCA to have regard to a financial inclusion code which could be set by the Treasury. Because this is a more flexible approach it could cover an area broader than essential services but help further social policy, for example increasing access to home contents insurance. Alternatively, the FCA could be given a socio-economic equality duty similar to that placed on local authorities and other Government bodies by the Equality Act 2010. Currently, FCA is not a listed body under clause 1(3) of the Act.

14. Financial inclusion and access mandates have been rejected in previous consultations on the grounds that the regulator would be taking over a social policy role from the Government. This is a groundless concern. The Government should set policy, however the FCA will play an important role in its implementation. It is therefore key that the FCA has both mandate and powers to do so.

Consumer responsibility, consumer protection and the rights of firms

15. The draft Bill does not go far enough to instil the appropriate balance between the responsibilities of firms and consumers. This draft Bill is presented following what the FSA's Chairman described in 2010 as 'a series of waves of major customer detriment'.[vii] The FCA Approach to Regulation document gives a figure of approximately £15 billion compensation paid to consumers since 1990 (excluding payment protection insurance (PPI) compensation), with millions of consumers suffering detriment on a large scale.[viii] PPI is an excellent example of how difficult it can be for a regulator to take action to protect consumers even in cases of gross detriment, and it is not a one-off. We can also consider other scandals, mortgage endowments (around £3bn compensation), pensions mis-selling (£11.8bn compensation), split capital investment trusts (£196m compensation).[ix] The FSA accepts that it and its predecessor regulators were too slow to act. The FSA cites PPI as an example in which it started to use a more proactive approach. It was met by a judicial review from the British Bankers' Association.

16. The above examples demonstrate clearly that the balance needs to move towards much greater consumer protection.

17. This does not require that the FCA should be a 'consumer champion', but it does mean that the FCA should have necessary powers, designed to be used as swiftly and effectively as possible. Where safeguards are put in place for firms these must be balanced by transparency and mechanisms which allow consumers and consumer groups to challenge inaction. The consumer protection objective is not sufficient on its own to ensure this, as it is too easy for it to be trumped by specific, more detailed provisions safeguarding firms. For example s348 FSMA, Restrictions on disclosure of confidential information by the Authority could prevent the FCA achieving its

transparency principle. Section 348 should be amended so that it is clear the FCA will be free to use transparency as envisaged in the regulatory principles.

18. We also welcome the new product intervention powers set out in s137C. They follow extensive consultation and discussion, including a review of recent mis-selling and other scandals. The new powers are clear and minimise uncertainty. Innovation should not be impeded as firms will be free to discuss proposals for new products with the FCA well in advance of seeking to market them if the product is potentially 'close to the line'.

19. These powers should, however, go further. They should apply to services, not simply products. Consumers do not distinguish between the two and services are often integral to the suitability of products.

20. We dispute arguments that the proactive approach and product intervention powers will reduce choice and innovation with negative effects for consumers. As stated in paragraph 6, choice and innovation do not always deliver positive outcomes for consumers, if they lead to confusion marketing of poor quality products.

21. The principle of consumer responsibility has provoked some discussion from industry during the consultation period. Some respondents have argued that the Government needs to focus less on disciplining the industry and more on ensuring consumers take responsibility for their actions. We disagree. Consumers inevitably take responsibility for their purchases. They are left with the product, even it is unsuitable and must invest considerable time and effort in any attempt to seek redress.

22. The increase in transparency, especially regarding publication of decisions on financial promotions and enforcement action is welcome. This should incentivise firms to take compliance seriously. Consumers have a right to know which firms do not. The use of the word 'consult' in Schedule 8 to the draft Bill, paragraph 24 is inappropriate. It is appropriate that the FCA give firms notice of an intention to publish an early warning notice and listen to representations from them, however, the notice period should not be a negotiation. An additional provision should be added in respect of both the new power to publish action taken in respect of misleading financial promotions (new section 137P) and to Schedule 8, requiring the FCA to include information in its annual report on how many times it has decided not to publish in respect of each new power. This is important to allow consumers and the Government to monitor the balance of disclosure and the extent to which transparency is achieved.

23. The Government is still consulting on provisions to permit consumer groups to formally bring consumer issues to the attention of the FCA.[x] This is a core provision and without it the balance between consumers and firms will barely have moved and will in fact have reversed. Consumer and other relevant groups should have a formal right to bring mass detriment to the attention of the FCA, with a legislative requirement for the FCA to respond publicly, in detail and within a reasonable time period. This will enable consumers and Parliament to challenge the FCA on its response to perceived detriment and should greatly enhance confidence in the FCA. Currently consumer groups can submit concerns to the FSA and receive no response at all. This undermines trust in the process and discourages consumer engagement. It also represents a key imbalance in the current system. Firms are able to challenge action, but consumers are powerless to challenge inaction.

24. In order to address this profound imbalance the provision should go further and require the FCA to investigate and act if there is reasonable evidence of mass

detriment. We comment on the need for greater clarity on evidence requirements in paragraph 28 below.

25. It is vital that s404 FSMA remains. It has only just been passed into law and is an important consumer protection tool. If the FCA is unable to address consumer detriment effectively it will never gain the respect of consumers or industry and will be unable to act as a credible deterrent to consumer detriment.

26. The FCA's new responsibilities to take into account reports made to them by Money Advice Service (MAS) and the Financial Ombudsman Service (FOS) should also assist the FCA in striking an appropriate balance. MAS and FOS should have a thorough and up to date understanding of the relationship between consumers and firms. This knowledge of how consumers and firms are interacting in practice will enable the FCA to evaluate the effectiveness of its consumer protection work and also to set an appropriate agenda to address future conduct risks.

27. We welcome the approach taken in clause 20, *Proceedings before Tribunal*, to require the Financial Services Tribunal to remit matters back to the decision maker rather than substituting its own opinion.

Judgment based approach

28. The main risk in the new regulatory approach is that the FCA does not act swiftly or effectively. There is insufficient detail on the judgment based approach to show whether it will help or hinder. Our key concern is that it will discourage action if the regulator requires an excessively high evidence threshold before acting. We agree that decisions should be rigorously evidence-based, however more detail should be provided on what constitutes sufficient evidence. This would help consumers provide information to the FCA in the most useful form and would also aid understanding of when the FCA is not able to take something forward for lack of evidence. The evidence required should be reasonable and not impossible to obtain, otherwise consumer bodies, which have no right to demand information from firms, will never be able to make a viable case for the FCA to take action.

Culture of the regulators

29. Currently there is too much reliance on changing the culture of the FCA in order to ensure that the new approach is effective. Culture is vital and the current FSA and shadow FCA do appear committed to the more proactive approach, however this needs to be strongly under-pinned in legislation to ensure durability over time and a robust response to likely challenge from industry.

30. Challenge from external bodies will also be critical in ensuring a new regulatory approach. "Group think" has previously been identified as a real risk in regulation, especially in relation to spotting emerging issues.

31. The provisions regarding panel representation for the FCA are therefore strongly welcomed. However, the Treasury should legislate for similar Panel representation for the Prudential Regulatory Authority (PRA). The Panel system has worked well for the FSA and no reasons have been given as to why it would not work well for the PRA. At a time of such upheaval there is real advantage in using a system which is already familiar and tested. Consultation is an important part of governance and accountability. Given that real consultation will necessarily involve challenge it should not be left to the discretion of the PRA to determine how it occurs.

32. The PRA should also have a requirement to consult consumers, this will allow otherwise unforeseen impacts to be picked up early. It will also ensure that engagement is not simply reactive, but also helps the regulators to set appropriate

agendas. The PRA will take decisions which will have significant impact on consumers (e.g. loan to value ratios) and consulting with the FCA is not equivalent to direct engagement with consumers. It is therefore important that as a minimum the Consumer Panel is able to advise the PRA.

Should the FPC be limited in the actions it can take which might affect the growth of the financial sector?

33. No. Whilst it is right that the FPC should be aware of the importance of the financial sector to the UK economy this should not outweigh the financial stability objective. The general principle that regulation should be proportionate to the risks involved should be sufficient to ensure appropriate balance. The UK needs a sustainable financial sector and if the FPC finds this requires limitation of unsustainable growth then it should be free to act tin the interests of long term sustainable growth for the economy as a whole.

Are the PRA's objectives clear and appropriate?

34. We are concerned that an excessive focus on stability will encourage regulators to subordinate consumer protection to maintaining firms in business, therefore we support the clarification added by the Treasury that the PRA is not tasked with ensuring zero failure. It is important that the PRA does not seek to ensure continuity of service simply by keeping all firms afloat. However the possibility of allowing firms to fail requires that the Financial Services Compensation Scheme (FSCS) remains in operation and effective. If this scheme is not robust and adequate it would be necessary for the PRA to take a different approach to relevant firms. The future of the scheme is therefore critical to the PRA as currently envisaged.

Will the new regulatory arrangements reduce the risk and cost of dealing with miss-selling of financial products?

35. The new arrangements have the potential to reduce costs if they are used proactively. They do not guarantee reduced costs in themselves.

Does the draft Bill contain any proposals or omissions, not covered by the questions above, which cause concern?

36. The Government is still consulting on key provisions regarding the Financial Ombudsman Service (FOS). FOS is a critical part of the consumer protection landscape and must not be weakened. We are aware of a range of criticisms of FOS on the grounds that it has become too influential and acts as a quasi regulator. If FOS has increased in influence it is because of the number of complaints it receives. FOS does not generate complaints and it cannot be penalised for doing its job. In particular FOS must remain free to consumers at point of access.

37. We strongly support proposals to require FOS to publish its decisions. These are an important complement to the FCA's enhanced transparency powers and will help both consumers and firms to make better decisions regarding complaints. FOS should be required to publish the name of the firm involved, unless FOS considers it would be inappropriate. The name of the consumer should not be published as this will deter consumers from taking complaints to FOS.

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[i] National Population Projections, 2008 based, Office for National Statistics, 2009

[ii] An Inclusive Approach to Financial Products, Beyond Financial Inclusion: involving older people by Age Concern, Annex 1

[iii] Fourth Annual Report, Financial Inclusion Task Force 2009

[iv] The Way We Pay; Payment systems and financial inclusion, Age UK 2011
[v] Financial Conduct Authority Approach to Regulation, June 2011, para 2.4
[vi] FSA DP11/01 Product Intervention
[vii] Speech by Adair Turner, FSA Chairman, British Bankers' Association Conference, 13 July 2010
[viii] Financial Conduct Authority Approach to Regulation, June 2011, para 2.4
[ix] Described in greater detail in the FCA Approach Document, Ch 5.
[x] Box2.H A new approach to financial regulation: the blueprint for reform, June 2011

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31 August 2011

Dear Sir/Madam,

UK regulatory reform

The Alternative Investment Management Association ('AIMA')[1] welcomes the opportunity of providing comments to HM Treasury on the Consultation on a new approach to financial regulation (the 'Treasury Consultation') and to the Financial Service Authority (the 'FSA') Consultation regarding the Financial Conduct Authority (the 'FCA Consultation'). The FSA currently regulates an estimated 400 hedge fund managers, including many AIMA members who are registered as investment firms.

AIMA supports a strong, well resourced financial markets supervisor or supervisors and will support any measures proposed that will increase stability in the financial markets and prevent future crises via a coordinated and intelligently designed regulatory framework. To the extent that HM Treasury's and the FSA's proposals achieve these aims we support them. However, we note several areas of the proposals that may require additional consideration before implementation.

Reading the two consultations together gives a fuller view of the potential future regulatory landscape. AIMA has therefore decided to respond to the two consultations together.

Regulatory approach and the objectives of the FCA

Overall we support the Financial Conduct Authority's (the 'FCA') objectives and in particular the single strategic objective of protecting and enhancing confidence in the UK financial system. However, we have concerns regarding the relationship between the FCA's objective of securing an appropriate degree of protection for consumers and the broad definition of consumers provided in the Draft Bill. In particular, the relationship between the new product intervention powers that the FCA is to gain as well as the robust focus on end-consumer protection provides the potential for confusion between the FCA's approach to regulation in retail markets compared to its approach in relation to wholesale markets.

The broad definition of "consumers" in the Draft Bill has the potential to encompass various types of wholesale counterparties, as set out in the FCA Consultation. We believe it could be inappropriate for the FCA to use its intervention powers and, for example, restrict the sale of products, in situations involving wholesale or professional clients or eligible counterparties. This strong focus on consumer

[1] AIMA is a trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,250 corporate bodies in 45 countries.

protection seems inappropriate in relation to the hedge fund industry where market participants are mostly sophisticated institutional investors. The justified focus on the FCA's powers to intervene in retail markets should not lead to similar policy orientations in well developed and functioning professional markets.

The Explanatory Notes to the Draft Bill clarify the fact that the FCA has no statutory duty to take action in relation to the protection of all persons that fall within the definition of "consumer" but that there is a mandate for the FCA to act where it identifies actual or potential consumer detriment. One of the key roles of any regulatory system in achieving its objectives in areas such as consumer protection, is to ensure that there is sufficient clarity to enable market participants to understand fully the risks of regulatory intervention in different scenarios. We do not support regulatory intervention affecting transactions agreed and entered into between non-retail entities which are not only capable of but also responsible and liable to their stakeholders to fully understand and appreciate the associated risks and benefits of those transactions. In this sense we would encourage the FCA to further clarify its objectives in this regard. We support the proposition in the Policy Overview, "that the new product intervention power is unlikely to be appropriate in relation to the protection of professional or wholesale customers" and we believe that it is important for this distinction to be given a more robust recognition in the FCA's policies and rules. The comments in the FCA Consultation on the differences between the wholesale and retail markets are welcome but deserve a more detailed elaboration in order to gain a better and clearer balance in the regulatory objectives.

Further consideration must also be given to the possible impact of the use of product intervention powers in relation to the retail market, where the products in question are part of a wider supply chain involving non-retail entities. Whilst we appreciate the role of product intervention in relation to the protection of retail customers, we consider that it is important that the FCA's policies and rules recognise the need for it to consider the wider market impact on the supply chain of any product or product type before using its product intervention powers. We also support the amendment made through the insertion of new sub-section 137C(1) to the Draft Bill, to make clear that the FCA may not use its new product intervention powers to advance the market integrity objective.

Unregulated holding companies

It is envisaged that the Prudential Regulation Authority (the 'PRA') and the FCA should be granted powers to impose requirements on the unregulated UK holding companies of certain UK authorised firms which are financial institutions. This is seen as a power of "last resort", to be deployed only where the acts of the holding company are having or possess the potential to have a material adverse effect on the regulation of the authorised firm, which available powers in respect of the authorised firm cannot remedy.

It is clear that capital and liquidity issues are two of the potential scenarios which this power is designed to address. Whilst there will be a right to challenge this power by recourse to the Upper Tribunal, AIMA is concerned that this provision could potentially require the directors of the holding company to act in a manner which might breach their fiduciary duties, or conceivably force them to deploy the assets of the holding company to the detriment of its own creditors. In such circumstances, AIMA would expect that the directors should have the protection of an immunity similar to that to be made available to bank administrators under the proposed new section 145A(7). Since non-UK holding companies will not be subject to this power (for legal/jurisdictional reasons), the creation of such a power seems likely to create incentives to restructure financial groups in a way which may ultimately prove counterproductive for the interests of consumers and for the competitiveness of the UK financial markets.

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Prudential expertise

The PRA, as regulator responsible for the supervision of deposit takers, insurers and a small number of significant investment firms, will be empowered to designate firms that could pose significant risks to financial stability (or to PRA regulated entities within their group). The FCA is to be responsible for the prudential regulation of those firms that are not prudentially regulated by the PRA – currently estimated to be in the order of 24,500 firms, and likely to include the majority of AIMA's members. The PRA envisages that it will become a "prudential thought-leader", and its focus will be on ensuring the safety and soundness of the firms it regulates, pursuant to its statutory objective. The FCA, on the other hand, will undertake its prudential regulation on the basis of ensuring that firms can fail in an orderly manner, with appropriate levels of consumer protection, through the Financial Services Compensation Scheme, and the protection or segregation of client assets, and in line with its separate statutory and operational objectives.

At this early stage, the approach document contains sparse detail of the FCA's proposed approach to prudential regulation. AIMA and its members would like to have a better understanding of what its member firms can expect in terms of prudential regulation. In particular, AIMA would welcome greater clarity on how the proposed risk model, currently in development, and its unified methodology covering different types of risk (retail conduct, wholesale conduct and prudential, and between firm risk and thematic risk) will operate in practice in the context of the proposed minimum level of baseline supervision, and of the FCA's issues and sector-based approach and thematic work. It would also be helpful to understand how the FCA will decide which firms are "major firms" which will be subject to a "more active supervisory programme on a 'going concern' basis", what the proposals for the intensive, institution-specific supervision of major firms will involve in practice, and the extent to which this will differ from the prudential regulation such firms are currently experiencing. Clearly it is critical that there should be clarity for firms around the regulator's expectations, and firms will need to understand on what basis, how and when the FCA would propose to intervene.

Whilst the designation of significant investment firms that could pose significant risks to financial stability will be a matter for the PRA, clearly a number of FCA regulated firms will fall within the category of firms that could be PRA-designated. At present, it is not clear precisely what procedural safeguards will surround the designation criteria. It will be critically important for such firms that the approach of those two regulators to the prudential regulation of firms in this "PRA designated" category does not, over time, diverge significantly, so that it becomes a significant barrier to entry in respect of the provision of particular services. AIMA members are particularly concerned that a level playing-field should be maintained in respect of the regulatory approach to the treatment of own funds, and that there should be clarity about how such firms pass across the boundary (in either direction), and some flexibility to ensure that such firms are not required to change regulators often.

Given the move to increase harmonisation of prudential standards in Europe and the new European Supervisory Authorities' power to set binding technical standards, it is, as further outlined below, critically important that both regulators are appropriately represented on prudential issues, and, for AIMA members in particular, at ESMA. The FCA will need to maintain a strong and authoritative voice in the dialogue with ESMA on prudential issues – for AIMA members, this will be particularly critical on issues relating to capital, collateral requirements and security realisations waterfalls. It is important that the PRA's 'prudential thought-leader' branding should not detract from the FCA's authority on prudential matters. Since prudential directions addressed by the Financial Policy Committee (the 'FPC') to the FCA in respect of capital and collateral requirements may impact on the rights of consumers, it is also important that the FPC have some understanding of those potential impacts through consultation with the FCA before the making of such directions.

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Specific regulatory processes involving the FCA

We welcome the addition of new sections 59, 59A, 63 and 64 of FSMA 2000 included in the Draft Bill, which help to clarify the overlap between the FCA and the PRA in relation to the regulation of Significant Influence Functions, and we look forward to further clarification as to how the approvals process will work in practice. As the majority of AIMA's members are likely to be FCA regulated only we understand that they will therefore be required to monitor and comply with the FCA's rules and processes governing Significant Influence Functions, and not those of the PRA. This is a positive development. However, we remain concerned that a number of AIMA members may also be PRA regulated, if they are deemed to present significant risks to the stability of the UK financial system or to one or more PRA supervised entities within their group. In this case it would be highly beneficial to these firms to have further clarity on how the roles of the PRA and FCA are to be coordinated in this area. Because both authorities will be able to make and enforce their own codes and rules on approved persons, there is some risk of overlap and possible inconsistency which makes the need for close cooperation particularly important. Both the Treasury Consultation and the FCA Consultation acknowledge that coordination between the regulators in respect of the development of prudential standards, and in the interpretation of European technical standards, will be critical.

In particular, the PRA and FCA should create a single interface through which applications for approval of Significant Influence Functions can be made. To support this PRA and FCA should also create a single consolidated set of principles and code of practice, which would go some way to ensuring that the process does not cause confusion and increase the regulatory burden on firms.

AIMA welcomes the acknowledgment that the fundamentals of the FSA's authorisation function will carry forward into the FCA in respect of firms solely regulated by the FCA. As a practical matter, AIMA's members would very much hope that their existing authorisations and permissions, and approvals of persons performing controlled functions, will be grandfathered to the FCA. Clearly, it will be necessary for the FCA to maintain its own prudential expertise, and to develop appropriate prudential mechanisms for a broad range of firms. AIMA very much welcomes the assurance that the FCA will tailor its approach and the use of its regulatory tools, to the particular risks in the sectors, firms and products which it regulates, and in particular the need for the oversight of wholesale small and medium sized enterprises, covering activities such as hedge fund asset management and other institutional wealth and long-only management boutiques, to be tailored to their own particular set of issues.

European engagement

The FSA has over the years developed an excellent international reputation for thought leadership and policy development. It has been influential both at the global level in fora such as the Financial Stability Board, IOSCO and the Basel Committee, and at EU level in fora such as ESMA's predecessor, CESR. It will be vital that the FCA maintains a comparable reputation in the fora in which it represents the interests of the UK - particularly in Europe, in ESMA and supporting HM Treasury in negotiation of new EU financial services legislation. Its role in IOSCO will also be important.

We cannot stress enough the need for senior FCA officials to take an active and leading role in European affairs. International markets will inevitably measure the extent of the regulators' engagement by the extent to which it's Chief Executive, and, indeed, its Chairman and top management have a presence in international policy discussions. Senior engagement of this sort will be vital to establish the tone and status of the FCA. It will also be very important to ensure that there is adequate resourcing devoted to markets policy issues within the FCA so that the staffing of ESMA Committees and Working Groups, and support for Council Working Groups continues to be of the highest quality. As the Association representing the interests of alternative investment fund managers we are particularly concerned to ensure that there is a strong knowledge base with regard to fund managers and fund products, particularly alternative investment funds.

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CESR engaged in the debate on alternative asset management at a comparatively late stage versus the debate on 'traditional' asset management - and it is only as a result of the development of the AIFMD that it, and now ESMA, has had to become more knowledgeable about alternative investments. In consequence it is particularly important that the FCA, as the regulator in Europe which has responsibility for the largest number of hedge fund managers works closely with the industry and ensures that it has good quality regulatory expertise feeding into the European policy work.

Conclusion

We hope that HM Treasury and the FSA will continue to consult the industry on the details of the proposed regulatory reforms. AIMA, like HM Treasury and the FSA, is keen to see a strong regulatory and supervisory framework for all financial firms and we support the proposals in this regard. We wish to ensure that the FCA's responsibilities and focus should not be centred solely on the retail market. We also support strong resourcing and engagement at the European and international levels in order to continue the unparalleled leadership of the FSA in matters related to alternative asset management.

We are, of course, happy to discuss further with you any point or detail that arises from this submission.

Yours sincerely,

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Director of Government and Regulatory Affairs

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Association for Financial Markets in Europe

Consultation Response

A new approach to financial regulation: the blueprint for reform

September 2011

The Association for Financial Markets in Europe (AFME)[i] welcomes the opportunity to comment on HM Treasury's (the Treasury's) White Paper: *A new approach to financial regulation: the blueprint for reform* (the White Paper), which includes the draft Financial Services Bill (the Bill).

AFME represents a broad array of European and global participants in the wholesale financial markets, and its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. (AFME was formed on 1st November 2009 by the merger of the London Investment Banking Association and the European operations of the Securities Industry and Financial Markets Association.)

We summarise below our high-level response to the consultation, which is followed by answers to the individual questions raised by the Treasury.

Executive Summary

Structure of the legislative proposals

AFME strongly supports the Government's decision to give effect to the new regulatory framework by amending the Financial Services and Markets Act 2000 (FSMA) rather than repealing FSMA, redrafting it and re-enacting it in full. Whilst a new Act might be the purist choice in the best of all possible worlds, in practice opening FSMA to debate, particularly at this time, would have significantly extended the length of the legislative process and, hence, the period of uncertainty for firms, markets and UK plc. There would also have been a risk that amendments might have been tabled in relation to sections of FSMA that do not need to be altered – possibly re-opening old debates – thus taking focus and, crucially, Parliamentary time away from the new provisions, a number of which warrant careful scrutiny (not least, to ensure there is due process in relation to the new regulatory powers).

In moving forward, it is important to learn the lessons of the past and the passage of the Financial Services and Markets Bill is a salutatory reminder of what one could reasonably have expected had the Government chosen to redraft and re-enact FSMA in its entirety.[1]

Timetable

The benefit of hindsight, however, also suggests to us that the Government's end-2012 timetable for the coming into effect of the new regulatory framework is ambitious and, although we support the desire to reduce the period of uncertainty, possibly even overly ambitious. Much will depend, of course, on the pre-legislative scrutiny (PLS) to be carried out by the Joint Committee on the draft Financial Services Bill (the Committee). Whilst PLS will, hopefully, identify and resolve issues before the Bill is introduced into the House of Commons in, as we understand it, early 2012, it is important not to underestimate the complexity of the task facing the Treasury should the Committee's report, due by 1st December, raise a significant number of complex and/or fundamental issues.

Whilst our response focuses on the draft primary legislation, we are also mindful of the secondary legislation that has still to be drafted or amended and the

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[1] As Lord Saatchi summed it up:

"I have seen grown men weep at the sight of the Bill. It is the single biggest piece of legislation that the Government have introduced. It is 215 pages and 408 clauses long. In its epic 18-month passage through another place it attracted 1,450 amendments. A Standing Committee sat for 70 hours in 35 sessions. A fine Joint Committee of both Houses, chaired by the noble Lord, Lord Burns, prepared a set of 37 recommendations. The Bill outlasted three complete sets of ministerial teams." Extract from Hansard: House of Lords debate, February 21st 2000.

consequential amendments to non-financial services legislation that will be necessitated. FSMA received Royal Assent on 14th June 2000 and the period up to the Act coming into force at 'N2' (midnight on 30th November 2001), was focused on, inter alia, the drafting of secondary legislation, consequential amendments, rule-making and the grandfathering of firms and registered individuals. If the Bill receives Royal Assent in summer 2012, then there would only be a six month period to complete this work; including the time needed to lay the new or amended secondary legislation (40 days for the negative resolution procedure or circa 28 days for the positive resolution procedure).

The possible need to revisit the timetable envisaged at this stage, should be acknowledged: in particular, it is more important to ensure that the new legislative measures – and the new regulatory Handbooks – are drafted to a satisfactory standard rather than to have them in place by a particular date.

Remaining key challenges

Turning to the draft Bill, inevitably, such a complex piece of amending legislation, which brings together the work of separate policy teams, will not be without omissions and drafting issues. However, looking at the bigger picture and reflecting on the direction of travel since the first consultation document (condoc) was published by the Treasury in July 2010, the Financial Regulation Strategy team should be commended for developing a high-level framework into granular proposals – resolving a number of complex operational issues in so doing – and for being willing to take account of the views of stakeholders.

There is still significant work to be done though and AFME stands ready to provide input into both the legislative process *and* the implementation of the new regulators' approaches to regulation. We also recognise that there are areas, such as competition, "*where the policy is still open or developing, [and] draft legislative provisions have not been included [in the draft Bill]"* and note that the Government will *"engage in full, formal consultation on such outstanding issues as appropriate*." We also await the Treasury Committee's report on their inquiry into the Accountability of the Bank of England, the implementation of final report from the

Independent Commission on Banking and, in due course, the report from the Joint Committee on the draft Bill. In respect of a number of the new regulatory powers – in particular, the powers to make product intervention rules and publish warning notices – it is important to provide, given the potential consequences surrounding their use, draft guidance, initially from the Bank/Financial Services Authority (FSA), on how the powers will be used, to inform our review of the relevant legislative provisions.

More specifically, we believe further thought needs to be given, collectively, to the remaining key challenges, which include, but are not limited to:

- coordinating the UK regulatory framework with the European Systemic Risk Board (ESRB), the European Supervisory Authorities (ESAs): we elaborate on this aspect below;
- ensuring there is a clear recognition of where and how domestic regulation – particularly judgment-led regulation and the new supervisory powers – interacts with, and is constrained by, extant and developing EU regulation;
- ensuring the UK regulatory framework, in particular, macro-prudential regulation, is sufficiently international in its focus and the domestic regulators are actively engaged with international standard setters and counterparts;
- identifying effective macro-prudential tools that: (a) can be operated within the constraints to be set by the Capital Requirements Directive 4 (CRD4) proposals; and, (b) are effective and have quantifiable effects, both on the risks to financial stability and the real economy, and ensuring that use of the FPC's macro-prudential toolkit is subject to proper accountability;
- establishing the optimal membership/governance and accountability structure for the Financial Policy Committee (FPC);
- providing a mechanism to seek to ensure/facilitate effective *operational* coordination between the Prudential Regulation Authority (PRA), Financial Conduct Authority (FCA) and the Bank of England (the Bank), including ensuring that overlap, underlap and unnecessary costs are avoided;

- ensuring that the cost of regulation for dual-regulated firms remains proportionate and that administrative and information requirements – and costs – are effectively managed by internal coordination between the PRA and the FCA;
- enshrining the Government's expectations in relation to the use of the new regulatory powers – in particular the FCA's product intervention rules and the publication of Warning Notices – in the Bill, to provide a point of reference for how the powers are to be used in future, thus contributing to ensuring due process; and
- providing an effective approach to the supervision of incoming EEA firms, client assets and international groups.

Over-arching comments

We set out, in sections 1 to 4 below, our detailed comments under a number of heads: our responses to the Treasury's consultation questions are included in section 5 below. Firstly, however, we wish to stress the importance of ensuring that the new UK regulatory framework dovetails with both the EU regulatory and supervisory framework and the reforms underway internationally.

As a European trade association, AFME considers that, notwithstanding the statutory objectives that focus on the protection of the UK financial system and consumers (regardless of where resident) – for which the regulators will be, quite rightly, directly accountable to Parliament – the UK regulatory framework should be more outward facing.

We believe that the Bill and the regulators should recognise explicitly, where the extent and use of their powers is modified or limited by EU regulation and how the domestic and EU regimes will interrelate. For example, how will an ESRB warning or recommendation for remedial action, made under article 3(2)(c) and (d) of ESRB Regulation 1092/2010[2] to the EU or the UK, be addressed by the Bank's Financial

[2] Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board

Policy Committee (FPC)? Also, how would EU product intervention – by the Commission or by ESAs – interact with use of the FCA's proposed product intervention rule-making power?

In summary, the legislation and, to a greater extent, the regulators themselves need to set the UK regulatory framework within the context of the over-arching European and international framework – notably the ESAs and the ESRB – and explain the points of interaction and coordination e.g. by giving greater granularity on how the regulators will seek to work with Home State competent authorities to regulate EU branches and international groups. Whilst it is understandable that the Treasury sought, first, to design a regulatory framework for the UK and then perfect the detail, including dovetailing with the EU supervisory framework, it is now time to pull the threads together and – to the extent it is possible given the significant regulatory changes in the EU – map the regulatory landscape as it currently stands.

The UK regulatory framework, particularly in relation to macro-prudential regulation, also needs to be international in its outlook; working with international standard setters; seeking to promote and ensure a level global playing field; and, maintaining regulatory cooperation and dialogue with third country supervisors, global standard setting and macro-prudential risk monitoring bodies such as the Financial Stability Board (FSB) and the International Monetary Fund (IMF). As the Treasury will be aware, there is, in particular, work ongoing at an international level in relation to Global Systemically Important Firms (G-SIFs), including the FSB's July 2011 consultation on Effective Resolution of Systemically Important Financial Institutions, which will be critically important for reducing the risk of significant disruption to the financial system and economic activity in the event of a failure of a G-SIFI.

The Government and the new regulators will need to ensure that the UK regulatory framework – and each individual regulatory initiative and new power - is aligned to or sufficiently flexible to factor in, in the future, international developments. There has been much debate, including in our response to the February condoc, as to whether the new regulators should have a duty to take into account international competitiveness. We acknowledge the Treasury's position on this issue but believe that the point we have been trying to distinguish may have become obfuscated by the negative connotations now associated with the more general use of the word 'competitiveness'. Hence, we believe that 'international alignment' or 'international consistency' might better describe the outcome we are seeking. In short, to seek to ensure level–playing fields for internationally active firms, we remain of the strong opinion that the new UK regulators should be under a duty, only in so far is compatible with their strategic and operational objectives and when not constrained by EU regulation, to consider whether new regulation is internationally consistent and, when choosing between a number of equally viable regulatory approaches, select the approach which is the most internationally aligned/consistent.

1. Framework: the new regulators

1.1. The Financial Policy Committee

Objectives

We agree that the Bank's financial stability objective should be amended by new section 2A of the Bank of England Act 1998 (inserted by clause 2 of the draft Bill) and that instead of being responsible for "*contributing to protecting and enhancing*" the stability of the financial system – as is currently the case – the Bank's objective, in this regard, should be to "*protect and enhance*" the stability of the financial system. We also concur that the objective of the FPC, as set out in new section 9C of the Bank of England Act 1998 (inserted by clause 3 of the draft Bill), should be "*contributing to the achievement by the Bank of the Financial Stability Objective*."

In our view, giving the Bank sole responsibility for financial stability, while requiring it to work with the FCA and the PRA, will provide a clarity of focus, avoid the risks associated with the current tripartite system (e.g. if the Bank identifies a risk to financial stability in the new framework it will have sole responsibility for taking action) and also put financial stability objective on an equal footing to monetary policy objective.

We agree that the FPC's statutory objectives should be set out comprehensively in primary legislation i.e. new section 9C of the Bank of England Act (inserted by clause 3 of the draft Bill). We were disappointed, however, that the FPC was not given a *positive* objective in respect of giving weight to economic growth – particularly since enhancing financial stability could run counter to economic growth - and although the stronger expression of its obligation in respect of economic growth is welcome, we are concerned that it is too subjective. As currently drafted, the FPC is able to form its own "*opinion*" as to whether a course of action might "*be likely to have a significant adverse effect on the capacity of the financial sector to* *contribute to the growth of the UK economy in the medium or long term*." In the interests of accountability, we believe that Parliament – in particular the Treasury Committee - should be able to form its own view on whether or not the FPC exercised its functions in a way that was reasonably "*likely to have a significant adverse effect…"* on economic growth i.e. a reasonableness test should be substituted for the more subjective "the opinion" of the FPC, thereby allowing Parliament to judge properly the FPC's actions and hold it accountable for, inter alia, the socio-economic effect of any macro-prudential tools it deploys. We also believe that a definition of financial stability is needed, against which the FPC and the Bank can be judged, thus helping to ensure accountability.

We concur that the Treasury's remit should take the form of recommendations, as set out in new section 9D of the Bank of England Act 1998 (inserted by clause 3 of the draft Bill), which will be reviewed at least annually and believe that this MPC-style input will inform the FPC's whilst retaining the FPC's independence from Government. We strongly support the laying of both the Treasury remit and the FPC's response before Parliament and would hope that these documents – together with six-monthly Financial Stability reports – would inform the Treasury Committee and form the basis of a regular or possibly annual, review of the FPC.

Other general duties

Notwithstanding the need to have an objective that is measurable and upon which the FPC is accountable to Parliament, we believe that the FPC should have an explicit general duty to coordinate with the ESRB and work with other international macro-prudential bodies such as the FSB and its US counterpart the Financial Stability Oversight Council (FSOC). This is in addition to the higher level general duty in new section 9E of Bank of England Act 1998 (inserted by clause 3 of the draft Bill), to "*have regard to…(c) the international obligations of the United Kingdom, particularly where* *relevant to the exercise of the powers of the Committee in relation to the FCA and the PRA*."

We believe it is important to recognise that, given the global inter-connectedness of the financial markets and the cross-border nature of financial services, macro-prudential regulation cannot be 100% effective if operating purely at a domestic level. Whilst this should not, of course, prevent the development of domestic macro-prudential regulation, in time there needs to be a global–early warning system, created by linking the new domestic macro-prudential regulators, which monitors and reports on pre-determined indicators.

We welcome the duties in new section 9E(2) of Bank of England Act 1998 (inserted by clause 3 of the draft Bill); namely that – albeit subject to the FPC's objective – the FPC should "*seek to avoid exercising the Committee's functions in a way that would prejudice – (a) the advancing by the FCA of any of its operational objectives, or (b) the advancing by the PRA of its objectives.*"

Governance and accountability

The membership of the FPC is set out in new section 9B(1) of the Bank of England Act 1998 (inserted by clause 3 of the draft Bill). In our response to Treasury's February 2011 condoc, we set out our reservations regarding the FPC's membership: with respect to the balance of external versus internal members, the perceived independence of external members – and on this point we continue to believe that the CEO of the FCA should not be regarded as an external member – and the breadth of financial sector expertise available to the FPC.

We welcome, therefore, the Government's commitment to:

- "*gather views*" on the number of external members over the period of PLS; and
- ensure "*an appropriate balance and breadth of expertise for both the interim FPC and the permanent body…*"

New section 9B of the Bank of England Act 1998 (inserted by clause 3 of the draft Bill) provides that the FPC be constituted as a sub-committee of the Court of Directors, which we are aware has raised issues regarding the exercise of supervision by the Court. Given the Bank's enhanced financial stability objective and the FPC's powers and wide ranging remit, we do question whether the FPC should be a Committee of the Bank, on an equal footing to the Monetary Policy Committee (MPC)?

In summary, given the <u>significant</u> impact that the FPC is likely to have – on financial services, on the economy and on consumers – we remain concerned with respect to the governance arrangements for the FPC and welcome, therefore, the Treasury Committee inquiry into the accountability of the Bank of England and have followed the oral evidence gathering hearings with interest. This is clearly a complex but – given the significant new powers to be given to the Bank and the significant new responsibilities to be placed on its key staff – critical issue and we are reassured both by the thoroughness of the Treasury Committee inquiry and by the Government's statement, in the White Paper, that it intends to "*consider the TSC's findings in detail, as well as the conclusions reached during pre-legislative scrutiny and further consultation, before setting out further specific proposals on Bank governance".*

Macro-prudential measures

Another significant challenge concerns the selection of the FPC's toolkit of macro-prudential measures – which will be specified by the Treasury by order, under new section 9K of the Bank of England Act 1998 (inserted by clause 3 of the draft Bill) – and the use, in practice, of these individual measures.

As the White Paper recognises, the development of UK macro-prudential regulation is inextricably linked to the development of the CRD4 proposals – which may limit the discretion available to Member States in respect of the use of macro-prudential tools – and the international work on potential tools.

The joint, FSB, Bank for International Settlements and IMF, February 2011 update to the G20 finance ministers and central bank governors on "*Macroprudential policy tools and frameworks*" found that although major steps had already been taken:

"…further work is needed to address the remaining challenges in successfully implementing macroprudential policies and institutional frameworks, including:

- *Design and collection of better information and data to support systemic risk identification and modelling;*
- *Design of techniques to identify and measure systemic risk that utilise this information and help inform the design of policies;*
- *Design of an effective macroprudential toolkit of powers and instruments, including the criteria for the choice and calibration of the instruments and methods to assess their effectiveness, as well as the respective merits of rules versus discretion; and*
- *Design of appropriate governance arrangements for the exercise of the macroprudential policy powers."*

It is essential that the UK remains actively involved in this work and seeks to create international, rather than UK-centric or bilateral, solutions, even if that means a slight delay to the UK timetable to allow a consensus to be reached.

We await the publication of the draft secondary legislation with interest and stand ready to provide input, drawing on the expertise of our global network. Again, we believe that decisions concerning the selection of the FPC's tools, how the tools are used in practice and the checks and balances that exist, will have significant ramifications for financial services, the economy and consumers.

We also note that under new section 9L(2) of FSMA (inserted by clause 3 of the draft Bill), that Treasury will have the power where necessary, by "*reason of urgency*", to bring into force new tools without consulting Parliament. We consider that this power should be more tightly circumscribed to reflect that Parliamentary scrutiny should occur in <u>all</u> except the most exceptional circumstances and that the Treasury should provide a report on the circumstance to Parliament, it the event it lays an order after it has been made.

Finally, particularly given the untested nature of many of the tools, we believe that the secondary legislation made under new section 9K(4) of the Bank of England Act 1998 (inserted by clause 3 of the draft Bill), should *always* require the FPC to maintain a policy statement in relation to the use of each tool and that the policy statement should articulate the potential socio-economic impacts of individual tools.

Directions and recommendations

Whilst new section 9E(3) of the Bank of England Act 1998 (inserted by clause 3 of the draft Bill), requires the FPC to have regard to, inter alia, "*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…", we* believe that the FPC should be required to include an impact analysis with its directions. Furthermore, given that, except *in extremis*, we would expect directions to be agreed at FPC meetings – and hence referred to in the minutes and laid before Parliament by Treasury under new section 9J(4) of the Bank of England Act 1998 (inserted by clause 3 of the draft Bill) – we do not agree that the Treasury should be given a discretion, in new section 9J(3) of the Bank of England Act 1998 (inserted by clause 3 of the draft Bill) as to the laying of other directions before Parliament. Arguably, directions not discussed and minuted, at FPC meetings should be given greater scrutiny.

In addition, we believe that the Financial Stability report should also include, under new section 9S(4) of the Bank of England Act 1998 (inserted by clause 3 of the draft Bill):

- details of all directions and recommendations issued by the FPC in the period, together with, for each direction/recommendation, an impact analysis and an ex post assessment of the effect/consequences (including any socio-economic impact);
- details of how the FPC has worked with the ESRB and, where applicable, how its UK directions and recommendations dovetail with ESRB's use of its EU regulatory tools; and
- an assessment of how, in exercising its functions, the FPC has, in addition to achieving its objectives, also had regard to the factors in new section 9E(3) (inserted by clause 3 of the draft Bill).

We also propose that, to avoid duplicative requests for information being made to firms, the FPC should be under an obligation (as does the ESRB), to take into account information held by the FCA and PRA, prior to making the request. Such a requirement could be framed in a form consistent with Article 15, Collection and exchange of information, of the ESRB's founding Regulation (No 1092/2010) which sets out safeguards with regard to collecting information to avoid such duplication.

1.2. The Prudential Regulation Authority and the Financial Conduct Authority: over-arching concepts

General duties

We believe that both the PRA and the FCA should have a general duty to coordinate with the ESAs and to work with international standard setting bodies such as FSB.

As an example, the French Autorité de Contrôle Prudentiel (ACP), an independent administrative authority operating under the Banque de

France, is required (under Ordonnance no 2010-76) to contribute to the achievement of national and European financial stability and business practice convergence objectives. The ACP is required to take account of best practice and of recommendations issued by European community supervisory bodies and cooperate with the competent authorities in other Member States. In particular, it is required to provide support to the various institutions operating within the European Union:

"Dans l'accomplissement de ses missions, l'Autorité de contrôle prudentiel prend en compte les objectifs de stabilité financière dans l'ensemble de l'Espace économique européen et de mise en oeuvre convergente des dispositions nationales et communautaires en tenant compte des bonnes pratiques et recommandations issues des dispositifs de supervision communautaires. Elle coopère avec les autorités compétentes des autres Etats. En particulier, au sein de l'Espace économique européen, elle apporte son concours aux structures de supervision des groupes transfrontaliers."[3]

Finally, as discussed previously, we are disappointed that the PRA and the FCA do not have a duty in respect of competitiveness and would urge the Government to provide that the Treasury become responsible for the ensuring the UK financial services markets are internationally competitive and equipped to contribute to the economic growth of the UK and the EU.

Regulatory principles

We note that under new section 3B of FSMA (inserted by clause 5 of the draft Bill), the regulatory principles include: "*responsibilities, in relation to compliance with requirements <u>imposed by or under this</u> <u>Act</u> [our emphasis], of the senior management of persons subject to those requirements*." Currently, however, section 3(3) of FSMA refers to the wider: "*responsibilities of those*

[3] Art. L. 612-1. – III, Section 1 (Missions et champs d'application), Chapitre II ('L'Autorité de contrôle prudentiel), Ordonnance no 2010-76 du 21 janvier 2010 portant fusion des autorités d'agrément et de contrôle de la banque et de l'assurance.

who manage the affairs of authorised persons". We wonder whether the narrower, drafting in section 3B of FSMA would capture senior management's responsibilities in respect of, for example, compliance with the Money Laundering Regulations 2007 and Proceeds of Crime Act 2002 and, if not, whether this limitation in senior management responsibilities is intended?

As discussed in our response to the February 2011 condoc, whilst we support transparency as a regulatory principle, we do <u>not</u> agree that regulators should start from a position presuming disclosure of information relating to firms. Unless the disclosure is warranted by urgent consumer protection issues, given the sensitivity of firm-specific information – particularly in relation to listed firms – the presumption should be for non-disclosure. More specifically, we also believe that the legal constraints that apply to regulators with respect to the disclosure of sensitive information – including constraints arising from the single market directives that we referred to in our previous response – should be acknowledged in the Bill.

FPC directions and recommendations: comply or explain

In addition to requiring the PRA and the FCA to submit reports to the FPC under new sections 9H(3) and 9O(3) of the Bank of England Act 1998 (inserted by clause 3 of the draft Bill), we believe that either:

- the PRA and the FCA should publish details of how they have complied with FPC directions and/or acted following FPC recommendation or explanations of why they have not acted in accordance with FPC recommendations; or
- the FPC should publish the PRA and FCA reports with the minutes of their meetings.

Coordination

We agree that it is important to draw a distinction between strategic coordination, which should be enshrined in legislation and operational coordination which, quite rightly, should be for the regulators to determine (in consultation with stakeholders where appropriate). The challenge is getting the balance right. We agree, therefore, with the reserve power in new section 3G to FSMA (inserted by clause 5 of the draft Bill), which will allow the Treasury to amend, by secondary legislation, the boundary between the PRA and the FCA. More widely, there is a question about the extent to which the positive resolution procedure should be adopted for the new secondary legislation made under the Bill.

We continue to believe, however, that legislation should establish a *mechanism* through which day-to-day operational coordination can be facilitated.

For example: Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24th November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority) establishes a Joint Committee of European Supervisory Authorities to "*serve as a forum in which the Authority shall cooperate regularly and closely and ensure cross-sectoral consistency…*"[4]

We are of the opinion that a similar joint committee – tasked with, for example, facilitating coordination of rule-making and regulatory processes and the mutual recognition of differing methods of achieving similar objectives – should be established in the primary legislation. This joint committee, or a separate sub-committee or secretariat, should also facilitate international engagement.

In addition to inclusion in the FCA and PRA annual reports, under, respectively, paragraph 11 of new Schedule 1AZ to FSMA and paragraph 19

[4] Article 54

of new Schedule 1ZB to FSMA, paragraph 19 (inserted by Schedule 3 of the draft Bill), we wonder whether the effectiveness of coordination should also be a specific ground for a Treasury instigated review under new sections 1N and 2L of FSMA (inserted by clause 5 of the draft Bill)?

1.3. The Prudential Regulation Authority

Objectives

We support the PRA's revised financial stability objective, in new section 2B(2) of FSMA (inserted by clause 5 of the draft Bill), which focuses on the firms it regulates rather than the financial stability of the wider financial system (which would overlap with the responsibilities of the FPC). We also support new section 2H of FSMA (inserted by clause 5 of the draft Bill), under which the PRA must issue guidance setting out how it will interpret its objective in relation to different kinds of firms or regulated activity.

That said, we note that the PRA's general objective is: "*promoting the safety and soundness of PRA-authorised persons*" while new section 2B(5) of FSMA (inserted by clause 5 of the draft Bill), provides that: "*In this Act "PRA-authorised person" means an authorised person who has permission –*

(a) given under Part 4A, or

(b) resulting from any other provisions of this Act,

to carry on regulated activities that consist of or include one or more PRA-regulated activities."

The definition of PRA-authorised person will, therefore, include incoming EEA firms establishing branches in, or providing cross-border services into, the UK, which are automatically authorised under Schedule 3 to FSMA to carry on PRA-regulated activities.

Given that the single market directives afford limited powers to Host State competent authorities and, in particular, prudential regulation is reserved to the Home State supervisor, it is important that the drafting of the PRA's financial stability objective does not create an expectation that is undeliverable in practice. Host and Home State competent authorities will need to work together closely, in supervisory colleges, to supervise EEA groups and EEA firms that have exercised their rights to passport. Unless there is a change to the single market directives' passporting mechanisms and the Home/Host state division of responsibilities, we do not believe it would be appropriate for a Host State competent authority to question or challenge areas of regulation reserved to Home State competent authorities, however well intentioned its aim. We also believe that the credibility of the PRA might be damaged if it promised (to the general public and to Parliament) a level of regulatory scrutiny of incoming EEA firms that it, ultimately, did not have the power to deliver.

In summary, we consider that the definition of 'PRA-authorised person' is potentially misleading and should be refined. We suggest that the current approach to distinguishing 'FSA authorised and regulated' and 'FSA regulated firms' be continued i.e. using 'PRA-regulated person' when referring to the PRA's regulatory oversight (although, as discussed, this is limited in respect of incoming EEA firms) and 'PRA-authorised person' when referring to firms actually authorised by the PRA under Part 4A FSMA.

Scope

We agree that it would not be appropriate to define the scope of PRA supervision in primary legislation and concur that, as provided for by new section 22A of FSMA (inserted by clause 6 of the draft Bill), the Treasury should specify the regulated activities that are "*PRA-regulated activities*" in secondary legislation (and again, we would note the need to determine the extent to which the positive resolution procedure is to be adopted). We assume that, as set out in the February 2011 condoc document, the MiFID activity of dealing for own account (as opposed to the wider, regulated activity of "*dealing in investments as principal*") will be the PRA-regulated activity that will qualify investment firms for designation.

We believe, however, that if the legislation is to give the PRA power to develop more detailed designation criteria – particularly for investment firms – the criteria should be issued as statutory guidance since, given its importance, it should not have a lesser standing than the statutory guidance on the interpretation of the PRA's objective that will be issued under new section 2H of FSMA (inserted by clause 5 of the draft Bill). The draft criteria should also be subject to consultation.

We welcome the statement in the White Paper that: "*The Government recognises the importance of ensuring that the boundary between PRA and FCA supervision is clear and well understood by regulated firms, and expects the PRA and the FCA to develop arrangements to ensure that firms on either side of this boundary are subject to consistent and effective prudential supervision by both authorities.*" Given the importance of avoiding inconsistencies and regulatory arbitrage at the PRA/FCA boundary, however, we consider that the Government's expectation should be enshrined in the coordination MOU that is required by new section 3E of FSMA (inserted by clause 5 of the draft Bill).

We await the draft secondary legislation and more detailed PRA designation criteria, with interest and stand ready to provide input in relation to the designation criteria for investment firms.

Governance

Whilst supportive of the requirement for a non-executive director majority on the Board of the PRA, we would question the extent to which the PRA will, in practice, have true operational independence. Hence, in addition to the non-executive director majority, the PRA's governance arrangements will need to ensure that the PRA's operations, to the extent appropriate, are distinct from the Bank and include, in some areas, firewalls.

In particular, as discussed in our response to the February 2011 condoc, the PRA will be responsible for triggering a failing firm's entry into the Bank's Special Resolution Regime and for investigating and reporting to the Treasury where there has been a possible regulatory failure. However, given that the Bank's Governor will chair the PRA, as well as having responsibility for the Bank's Special Resolution Unit (SRU), it is important that robust conflict management procedures exist to ensure that the PRA operates independently in reaching judgments on the firms it regulates (as opposed to day-to-day communication on matters relating to, for example, policy and technical issues).

We also believe that the PRA should be required to hold an annual public meeting with stakeholders, mirroring the provisions for the FCA in paragraph 12 of Schedule 1ZA to FSMA (introduced by Schedule 3 to the draft Bill)?

Statutory guidance and consultation

Although we understand that the PRA is likely to have closer and more interactive relationships with the firms it regulates, we continue to believe that the PRA should be given the power to issue statutory guidance. As currently drafted, however, the draft Bill limits the PRA's power to issue statutory guidance, to the guidance on its objectives that is required under new section 2H (inserted by clause 5 of the draft Bill). We do not believe that this approach is sufficiently future proof and, as discussed above, in relation to scope, believe that the PRA will need to issue statutory guidance in other areas.

In particular, we are also concerned that:

- internal staff procedures – which will be necessary to help create a consistent approach between supervision teams/divisions – will, unless included in the PRA Handbook (c.f. the FSA Supervision Manual) – become a de facto unpublished rulebook, which firms and their advisers will not have access to as a matter of course (but which they may seek through the Freedom of Information Act);

- if the PRA publishes informal guidance ('other material'), it will not be required, under section 157(3) of FSMA, to consult; it will be important to ensure any 'other material' does not set out the meaning of rules or expectations regarding compliance with particular rules – i.e. it does not fall within the definitions of guidance 158(5) of FSMA – and it is not taken account of in enforcement proceedings (c.f. FSA Enforcement Guide EG2);
- with informal guidance, firms will not benefit from the 'safe harbour' that statutory guidance provides: "*If a person acts in accordance with general guidance in the circumstances contemplated by that guidance, then the FSA will proceed as if the person has complied with the aspects of the rule or other requirement to which the guidance relates.*"[5]
- important parts of the extant FSA Prudential Sourcebook – e.g. the statutory guidance on the ICAAP – may be removed or, as discussed above, could no longer be relied upon by firms to demonstrate compliance.

Even if the power to issue statutory guidance is not used frequently by the PRA, we believe that both the PRA and the FCA should have identical powers in relation to guidance.

Finally, we welcome the new section 2J of FSMA (inserted by clause 5 of the draft Bill) which requires the PRA to put in place arrangements for engaging with practitioners. We understand that the Government wishes to give the PRA the flexibility to determine the nature of these arrangements and are reassured by the Bank's approach to dialogue with the industry. However, we continue to believe that the statutory remit of the FCA's Practitioner Panel, should be extended to provide that it over-arches both the FCA and the PRA: thus, enabling it to monitor and provide feedback on the operational arrangements for coordination between the PRA and the FCA; and, ensuring that practitioners continue to provide input

[5] FSA Handbook 'Readers Guide'

on the prudential-regulation of dual-regulated firms (rather than just the prudential regulation of FCA-authorised firms).

Independent Complaints Commissioner

We remain of the view that there should be one complaints commissioner – appointed by the Treasury – to determine complaints against the PRA and the FCA and, crucially for dual-regulated firms, complaints relating specifically to coordination between the PRA and the FCA. Separate complaints commissioners will create uncertainties of scope in relation to complaints on PRA/FCA coordination. In addition, since it is particularly important for the PRA complaints commissioner to be seen to be independent, we feel it would be better if they were to be appointed by the Treasury rather than the Bank, notwithstanding the Bank's oversight role.

1.4. Financial Conduct Authority

We wonder whether the requirement, in paragraph 20 of new Schedule IZB to FSMA (inserted by Schedule 3 to the draft Bill), that the PRA to consult on its annual report, should be replicated in relation to the FCA?

1.5. The Bank of England

As expressed in our responses to previous Treasury condocs, we support the bringing together of the regulation of recognised payment systems with the regulation of recognised clearing houses and settlement systems. However, given the interdependencies between the regulation of investment exchanges and the regulation of clearing and settlement – which will require very close coordination with the FCA – and particularly in view of the powers given to the Bank *per se* under new section 285A of FSMA (inserted by clause 25 of the draft Bill), and Schedule 6 of the draft Bill, to enable it to carry out this regulatory role, we believe that a separate unit – with a separately identifiable governance structure – should be formed to regulate systemically important infrastructure (including CREST).

We believe that a distinct unit would assist in providing clear accountability and transparency by distinguishing the Bank's regulation of systemically important infrastructure and the lines of direct responsibility from the Bank's wider remit. A separate unit should also facilitate coordination with the FCA.

At an operational level, we assume vertically integrated exchanges will be regulated by joint FCA/Bank supervisory colleges but we are unsure how an application for recognition under the Financial Services and Markets Act 2000 (Recognition Requirement for Investment Exchanges and Clearing Houses) Regulations 2001, from a vertically-integrated exchange wishing to establish in the UK or an exchange wishing to provide clearing services, will be handled.

We comment on changes to Part 18 of FSMA (as it applies to Recognised Investment Exchanges and Recognised Clearing Houses) in section 3.4 below.

2. New supervisory approaches: ensuring due process

We recognise that the approaches taken by regulators in relation to exercise of their objectives is not a matter for legislation, however, we believe that legislation should contain sufficient points of reference so as to enshrine key principles.

2.1. Judgement-led regulation

Judgement-led regulation is predicated on, amongst other things, the quality of staff and data. Supervisors will need to have sufficient knowledge and understanding to make, often complex, judgements on the firms they regulate and will need to have access to well-targeted, reliable, data. For example, to challenge a firm's business model a supervisor will require a depth of industry experience, the skills to be able to explain and debate with the firm's senior management and an understanding of models used by similar firms. Hence, the quality of supervisors and supervisory data will be of critical importance to the effectiveness of judgement-led supervision. Whilst we are concerned to ensure that costs for dual-regulated firms remain proportionate and effectively managed (and there is no cross-subsidy between sectors), we believe that the new regulators should promote the attractiveness of regulation as a career by hiring more high quality, experienced, industry professionals, and by investing in a rigorous, in depth, training program. Training, particularly if run with input from the industry and a better career structure – including a formal secondment programme to the ESAs (as well as to firms) – would enhance the perception of regulation as a career; leading to better supervision and improved continuity between firms and regulators.

It will also be important to scrutinise the data obtained currently from firms, identify gaps and ensure that the data is mined effectively and reported in an appropriately targeted manner.

Whilst judgement-led regulation is a mature form of supervision, which we welcome, we do have additional concerns regarding its delivery in practice; in particular, concerns relating to the transparency and fairness of decision making and the mechanisms available to firms to escalate disagreements and concerns. It will, therefore, be vital for the PRA to have sufficiently robust internal procedures in relation to the review of judgements and consistency of approach and, where the judgements do not trigger supervisory notices (for example, in relation to capital held by firms under Pillar II), due processes that give firms an opportunity to escalate differences of opinion and concerns within the PRA.

In particular, given the PRA's (and FCA's) increased power for early and robust challenge of firms' actions, there is a need for firms to be given comfort around a number of points including:

- which parts of the process are 'formal' and which are 'informal';
- the consistency and fairness of the process that recommends any particular regulatory action intra or inter firm;
- how much input firms will be expected to have, or be given, in the decision making stages;
- the speed with which the process, and any appeal can be carried out;
- the controls over leakage of information (many regulatory decisions will be commercially sensitive during the decision making stage and any leakage will be potentially materially damaging);
- after a decision, the amount of information to be placed in the public domain and when it is released; and
- the ability of firms to raise disagreements – ideal through a mediation mechanism – without contagion of the relationship with supervisory teams or other regulators.

Whilst we recognise that the internal decision-making procedures for routine 'supervisory' judgements not triggering statutory notices, will be for the PRA (and the FCA) to design and implement, we believe that the Bill should enshrine the key principles and provide safeguards in relation to regulators' discretionary powers. For example, the Bill could enshrine principles such as internal reviews to ensure consistency and the separation of the ultimate decision-makers from the supervision teams and require regulators to develop an escalation procedure for firms wishing to raise issues with independent teams. We also believe that the PRA and the FCA should be required by the Bill to publish statements of their policy in relation to the supervision of firms.

2.2. Regulation of markets and wholesale market conduct

We share the concern, expressed by the IMF in their paper, United Kingdom: The Future of Regulation and Supervision Technical Note,[6] that: "*The new Financial Conduct Authority (FCA), with its broad remit, is subject to some of the lack of clarity present in the current mandate of the FSA. Ways should be found (such as greater clarity in how the remit of the various parts of the FCA are expressed or the internal senior management structure within the FCA) to ensure that* market regulation *[our emphasis] and supervision, and prudential supervision of FCA firms, do not become diluted."* Given the FCA's understandable focus on consumer protection, it is vital that its role as a primary and secondary market regulator is not overshadowed or diminished.

With respect to the regulation of wholesale market conduct, whilst we recognise that, in certain circumstances, there are direct links between specific wholesale market activities and the retail market, it is important that the FCA does not apply a 'one-size fits all' approach to the regulation of wholesale firms but rather understands and regulates specifically any direct linkages or risks to retail consumer.

Where there are no direct linkages between the retail and wholesale markets – for example, where a wholesale firm sells a product to another wholesale market participant and has not been on notice that the product will be linked to a retail product – it is important that a wholesale firm's regulatory responsibilities reflect the actual role it performs in any transaction or chain of transactions and the facts of which it was aware (or ought reasonably to have been aware). As paragraph 1.5 of the 2007) FSA's Guide to The Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD)[7], explains:

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[6] Produced in connection with the IMF's Financial Sector Assessment Program Update on the United Kingdom (IMF Country Report No 11/230)
[7] Came into effect on 12th July 2007

"… we recognise that responsibilities flow from the actual roles or functions undertaken in a transaction, and firms should take this into account in considering their responsibilities under the Principles. In considering which responsibilities apply to it, a firm should consider the functions and roles that it undertakes in the product lifecycle. Whether a particular role or function is fulfilled by the distributor or provider (or both) may vary based on the product or service, or particular arrangements in place…

It is also possible that a product manufacturer creates components that are later (and possibly without the component manufacturer's knowledge) subsumed into retail products designed and marketed to customers by 'retail manufacturers'. In such instances, the pure manufacturer may not have a contractual or other relationship with the underlying customer. The pure manufacturer may not be aware (nor is it necessarily the case that it ought to be aware) of whether the retail manufacturer is using the product for itself or for an underlying customer. However, the pure manufacturer should act with due skill, care and diligence in designing its products (Principle 2). The skill, care and diligence that are 'due' under Principle 2 will be determined taking all the circumstances into account. These may include the manufacturer's knowledge of whether the product or service is provided to a firm, rather than an underlying customer, and the information needs of the firm. In addition, the pure manufacturer will normally be obliged to communicate information to the retail manufacturer in a way that is not misleading (Principle 7) (Note (8))."

We recognise that the definition of "*consumer*" in the draft Bill is changing only in relation to listed activities and that, under FSMA, eligible counterparties and professional clients are already defined as consumers. The FSA, however, as illustrated above, applies a differentiated approach to wholesale market regulation and whilst we recognise the need to review and enhance the current approach – including in respect of any direct linkages to the retail markets – we are concerned that the current emphasis on the wider definition of consumer might lead to FCA conduct of business rules for the wholesale market activity that are disproportionate.

The definition of consumer in new section 1C of FSMA (inserted by clause 5 of the draft Bill) includes all natural and legal persons "…*whether acting in course of trade, business or profession…"* whereas other UK statutes and EU Directives define consumers as, broadly speaking, natural and legal persons <u>not</u> acting in the course of trade, business or profession. For example, in the European Commission Expert Group's feasibility study on the new European contract law for businesses and consumers, the potential European contract law instrument definitions include:

"'consumer' means any natural person who is acting for purposes which are outside his or her trade, business, craft or profession"[8]
"'business' means any natural or legal person who is acting for purposes relating to that person's trade, business, craft or profession."

We are aware that a number of customer categorisation issues, which may limit the professional and market counterparty categorisations, were included in the MiFID review. However, as a fundamental principle, we believe that when an authorised firm enters into a transaction with another authorised firm in the course of carrying on a regulated activity for which the firms have been authorised, both parties should – if the authorisation regime is suitably robust – be presumed to have sufficient knowledge, skills to negate the need for 'consumer protection.'

We are of the strong opinion that the concerns raised above should be ameliorated by recognition, in the FCA's consumer protection objective in section 1C(2)(b) of FSMA (inserted by section 5 of the draft Bill), of the need for appropriately differentiated regulation of wholesale market

[8] Part I Introductory provisions, Chapter 1 General Section 1 Application of the instrument, Article 2: Definitions "A European contract law for consumers and businesses: Publication of the results of the feasibility study carried out by the Expert Group on European contract law for stakeholders' and legal practitioners' feedback" May 2011

participants that are acting in the course of business e.g.: in addition to having regard to, inter alia, "…*the differing degrees of experience and expertise that different consumers may have*" we believe that the FCA should also consider whether consumers are acting in the course of trade, business or profession .

2.3. Recovery and resolution planning

We note that recovery and resolution will be at the heart of the PRA's approach to supervision and will be factored into the assessment of PRA-regulated firms. However, as discussed in more detail in section 4.3 below, we believe there should be improved clarity on the primacy of Home State competent authorities for recovery and resolution planning, notwithstanding the PRA's desire to ensure that recovery and resolution plans for incoming EEA firms will protect UK financial stability. AFME is responding to, and engaging with the FSA in relation to, the FSA's consultation on Recovery and Resolution Plans (CP11/16); we may, therefore, comment further on issues relevant to the new regulatory framework as the detailed approach envisaged is analysed.

2.4. Competition duty and power

In respect of the additional competition powers given to the FCA, we believe that the balance appears to be appropriate: i.e. the FCA will have more tools available without becoming a competition regulator. The relationship between the FCA and the Competition Regulator will, however, require close attention once the future of the UK's competition regime has been decided.

Integrating the new competition duty into the work of the FCA is likely to give rise to a number of philosophical and practical issues. Indeed, some would argue that a regulator with a duty to promote competition is the polar opposite of an interventionalist regulator:

"*Whilst [a high level of regulation] may produce a process which gives investors an admirable degree of protection, the danger is that the outcome is to exclude products which investors would wish to buy or to impose costs which discourage the purchase."*[9]

However, we have a significant concern regarding the interaction between this new duty and the FCA's operational objectives. Notwithstanding the Government's intention that the FCA will not be an economic regulator, we are concerned by statements - both in speeches and the FCA Approach to Regulation document – which indicate that the FCA may become involved in commercial pricing decisions. The FCA's Approach to Regulation document notes, for example, that:

"Where competition is impaired, price intervention by the FCA may be one of a number of tools necessary to protect consumers. This would involve the FCA making judgements about the value for money of products….The FCA will thus consider exercising its powers to take action where costs or charges are excessive…"[10]

We believe that these statements more properly describe the role of an economic regulator. Given that proper competition reduces the need for economic regulation, we do not believe the FCA should be involved in price intervention beyond rules that require prices/charges to be fair and not excessive (specifying factors that firms should take into account, including disclosure, comparable market charges and duty of trust) and set out in plain and intelligible language. It is noteworthy that article 4(2) of the Unfair Contract Terms Directive specifically excludes "*the adequacy of price*" provided the terms are "*plain and intelligible*":

9 C. Ford & J. Kay, "Why Regulate Financial Services?", in The Future for the Global Securities Market, F. Oditah (ed.), 1996

10 Chapter 3, Box 2 (Competition), The Financial Conduct Authority: approach to regulation, June 2011

"*Assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other, in so far as these terms are in plain intelligible language*."

Intervening, ex post facto, in private contracts between professionals and market practices, where prices are not manifestly unfair and are disclosed in plain intelligible language, goes beyond the remit of a financial regulator, Hence, we believe that a backstop should be included in new section 1B(4) of FMSA (as inserted by clause 5 of the draft Bill) to limit the FCA's duty in relation to economic regulation.

3. Supervisory powers and enforcement: ensuring due process

The draft Bill introduces a number of new supervisory powers designed to enable the FCA to intervene earlier, rather than take enforcement action after the event.

FSMA currently provides the FSA with a wide range of supervisory and enforcement powers, some of which, arguably, may not have been utilised to their full extent, for example the wide-ranging general rule-making power in section 138 of FSMA and the Own-Initiative Variation of Permission (OIVOP) power in section 45 of FSMA.

Perhaps not surprisingly, many of the 'new' supervisory and enforcement powers are not entirely new but are strengthened or modified FSMA powers. For example, whilst the Bill makes provision, under the FCA's general rule-making powers, for explicit product intervention rules, arguably the FSA can already make such rules under section 138 of FSMA; the differences, however, are in relation to, inter alia, the outcomes (e.g. unenforceable contracts) and scope (e.g. to agreements unrelated to regulated activity).

We recognise the consumer protection value that some of the new supervisory and enforcement powers can potentially provide. However, the question that concerns members is how the FCA will exercise these enhanced supervisory powers in practice; the answer to which will, of course, be partly dependent on the outcome of the wider philosophical debate about the type of regulator society and Parliament want the FCA to become. It is, therefore, critical that the FCA is required to follow due process and that firms – given the English law presumption of innocence until proven guilty – have appropriate rights of challenge and access to a fair hearing. Indeed, the stronger the regulatory powers, the stronger the protections should be.

As the FCA will be a bold and proactive regulator, with a powerful toolkit of supervisory and enforcement powers at its disposal, it is crucial that the legislation builds in strong procedural safeguards to alleviate concerns and to seek to avoid costly and time-consuming legal challenges (such as judicial review and injunctions). It will also be important to build backstops into the Bill so that the wide ranging powers, given to both the FCA and the PRA, are used, in practice, in the considered and proportionate manner in which the Government intended. This is particularly important given that both the FCA and the PRA will continue to have immunity from liability in damages except in relation to acts or omissions that are in 'bad faith' or breach the Human Rights Act 1998, but not where they acted recklessly. In the Public Bill Committee debate on the Financial Service and Markets Bill, it was argued that *"It is notoriously difficult to prove in court that someone has acted in bad faith; essentially a subjective judgment is made"* and an amendment was moved (but not passed) to "*explicitly remove statutory immunity when there is reckless behaviour."* It may well be appropriate, in view of the commercial impact that the use of many of the new supervisory and enforcement powers could have on firms and listed companies, for the Treasury to reopen the debate regarding the limitation of statutory immunity.

Finally, given the powers now granted to the ESAs, it is important that any new domestic powers (e.g. the product intervention rulemaking powers) are complementary or properly reconciled.

3.1. Product intervention rules

We agree that the FCA should have the power and flexibility to intervene quickly and decisively where it considers that a financial product or, more likely, a product feature is likely to give rise to "*significant consumer detriment*". However, we believe that the proposed power to make product intervention rules, requires modification and refinement to avoid creating legal risk for all firms developing products. We also believe that there should be greater clarity on how the FCA would interact with the ESA (in particular ESMA), when it identifies the need for product intervention, to seek a consistent EU approach.

The proposed rule-making power in new section 137C of FSMA (inserted by clause 21 of the draft Bill), will enable the FCA to make rules prohibiting an authorised person from doing anything set out in subsection (2), including "*entering into specified [by the FCA] agreements with any specified person" and "entering into specified [by the FCA] agreements with any specified person unless requirements specified in the rules have been satisfied*". An agreement could concern an unregulated activity and a direct relationship with a consumer is not required: hence the rules could apply to agreements between wholesale firms which do not, themselves, have direct relationships with retail consumers. We note, in particular, that, unlike the current rule-making power, new section 137C(7) provides that the product intervention rules may provide for breaches to render relevant contracts unenforceable (currently the case with respect to unauthorised investment business).

We welcome the inclusion of safeguards, in new section 138P of FSMA (inserted by clause 21 of the draft Bill), in particular, the requirement that the FCA consult on, and publish a statement of, its policy governing the circumstances in which it may make temporary product intervention rules and the fact that the power cannot be used, except by an order made by the Treasury, in connection with the FCA's market integrity objective. We note that the Government "*recognises that this power could have a significant impact on firms, consumers and the market more generally and must be* *appropriately safeguarded*". However, we believe that additional safeguards should be enshrined in the legislation. In particular:

- *Higher threshold for use of power:* we believe that the Bill should set a higher threshold for use of the FCA's power to make product intervention rules, than for the use of its general rule making power, in order to ensure that the product intervention rule-making power is not used routinely – for reasons of expediency – but only in exceptional circumstances which are likely to result in *significant consumer detriment*. Hence, we believe that the "*necessary or expedient*" test in new section 137C(1) of FSMA is too wide and should be reconsidered.

  On this point we would make two, related, observations in connection with the European Commission's December 2010 public consultation: *Review of the Markets in Financial Instruments Directive (MIFID).*

  Firstly, in discussing a proposed Commission power "*to ban the provision of investment services and the carrying out of investment activities in certain financial instruments*", the Commission stated that:

  "The criteria for such a ban, to be enshrined in the framework directive, could be broad ranging but precise in nature. This could apply if:

  a) Investment services are provided in a way which gives rise to significant and sustained investor protection concerns; or

  b) There is a product or activity threatening the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system."

  Leaving aside the second head, we believe that the Bill should also require the FCA to have <u>significant</u> investor protection concerns before making product intervention rules. Product intervention rules should also be properly focused on these investor protection concerns (e.g. if a product feature gives rise to significant concerns in respect of retail customers but not professional customers, the product should not be banned per se).

Secondly, the Commission also proposes giving national regulators "*the power to temporarily ban or restrict the trading or the distribution of a product by one or more investment firms or the provision of an activity in case of exceptional [our emphasis] adverse developments which constitute a serious threat to financial stability or to market confidence in a Member State or the European Union. …The Commission services consider that the exercise of this power could be pre-notified to and coordinated through ESMA.*" This proposal was supported in The House of Lords European Union Committee's July 2011 report, The EU Financial Supervisory Framework: an update.

Again we believe that the Bill should reflect the exceptional nature of these powerful rules and should require that the FCA coordinates with the ESAs.

- *Temporary rules in emergency situations*: new section 138N (inserted by clause 21 of the draft Bill) provides that the FCA is able to make temporary (less than 12 months) product intervention rules without consultation, following the same "*necessary or expedient*" test as in new section 137C of FSMA.

Again, the MiFID review consultation makes the case that: "*In view of the potentially significant consequences for market participants and businesses, the Commission services consider that any such ban would, except in extraordinary circumstances, require consultation, be based on appropriate evidence of risks and require cost/benefit analysis.*"

We also believe that expediency should be reserved for emergency situations and that, except *in extremis*, the FCA should follow due process (e.g. consultation and CBA); we consider that new section 138N of FMSA must be reworded accordingly.

- *No ex post facto rules:* to ensure legal certainty, it is crucial that the FCA does not, as a general approach, make ex post facto rules (or rules that have ex post facto effect), in particular, those which retrospectively alter private contract rights by rendering contacts unenforceable that were entered into legally prior to the rules coming into effect.

The Compatibility with the European Convention on Human Rights statement in the Explanatory Notes to the draft Bill[11] recognises that: *"A ban on the provision of a financial services "product", or the imposition of a restriction in exercise of the powers conferred by the new section 137C of FSMA has the potential to interfere with a person's peaceful enjoyment of their "possessions" and is likely therefore to engage A1P1 [Article 1, Protocol 1 of the ECHR]. The Government considers that interference in a person's A1P1 rights is justifiable by reference to the need to ensure that the FCA can take appropriate steps to protect consumers."*

However, we believe it is important to distinguish between intervention resulting from FCA rules, made under the new section 137C of FSMA, that:

- bans or limits the provision of a particular product from the date on which FCA rules come into effect; and
- bans or limits the provision of a particular product from the date on which FCA rules come into effect and <u>also</u> have ex post facto effect, rendering contacts relating to the particular product, entered into prior to the date the rules came into effect, unenforceable.

[11] Para 458

The Joint Committee on Human Rights considered the ex post facto effect of section 139A (General rules about remuneration) powers in the previous Financial Services Bill. In their report of 21st December 2009, the Committee noted that it: "*appears that the general worded power in the Bill, which, on its face, appears to give the FSA the power to interfere with existing contractual terms, is not intended to do so. We recommend that the Government make this limitation explicit on the face of the Bill, which should meet the concerns about the provision's compatibility with Article 1 Protocol 1*." This limitation now appears as section 139A(11) to the Financial Services Act 2010.

Whilst we understand that the power is to be used prospectively, we are of the view that, to provide legal certainty for parties contracting in good faith, a similar limitation is required in new section 137C of FSMA.

If, however, the FCA product intervention rules were indeed intended to have ex post facto effect, then, to give some degree of legal certainty, the Bill should explicitly state that the remedies in section 137C(7)) of FSMA, in so far as they result in interference to existing private contact rights, are only available where, for example, the significant detriment or risk to a consumer was reasonably foreseeable e.g. following the test used in the law of Tort, both the retail consumer and the harm caused by the product, must be reasonably foreseeable. Otherwise, legal uncertainty as to whether a new product may become subject to a product intervention rule in the future, is likely to dampen product development. Given that corporate end users rely on the capital markets to manage their risk and invest their capital, introducing measures that could have the effect of limiting access to deep, liquid and typically bespoke products could damage businesses and the UK economy. The FCA must also give firms clear guidance on how to comply with a product intervention rule and, whilst not approving products nor replacing the need for individual legal advice, be prepared to discuss expectations with individual firms at an early stage of product development.

We are also concerned that the FCA, acting unilaterally, will not be able to make rules that place requirements on, or prevent the sale of, products by incoming EEA firms provide financial services in the UK on a cross-border basis. Whilst product intervention rules will be effective against firms authorised under Part 4A of FSMA, the business conduct of EEA firms carrying on cross-border services into the UK is reserved to Home State competent authorities. We also question whether the product intervention rules would be capable of rendering a contract made with a UK branch of an EEA firm under, say, German law, unenforceable?

On this point, the House of Lords European Union Committee report recommended that, amongst other things: "*Given the cross-border nature of financial services across Europe, we strongly believe that such actions should take place in a uniform and coordinated way across the EU to avoid market disruption or temporary regulatory arbitrage. We welcome the ESAs' coordinating role in these cases.*"[12]

Again, we are of the strong opinion that the Bill should seek to place the FCA's powers in an EU context by requiring them, except in extremis, to co-ordinate with the ESAs prior to making a product intervention rule, to seek, in the first instance, a consistent EU approach. In particular, we are unsure how the FCA's proposed powers to make product intervention rules would dovetail with the powers now available to the European Supervisory Authorities, discussed above, and believe that this needs to be clarified in the Bill. The FCA should also consult with key international regulators/regulatory bodies, when its concern relates to globally competitive products.

[12] Paragraph 24

3.2. Financial promotion powers

As we discussed in our response to the Treasury's February 2011 condoc, currently firms amend or withdraw financial promotions on the request of the FSA's Financial Promotions Team, hence, we were unsure of the extent to which this new power to give directions in relation to financial promotions – now contained in new section 137P of FSMA (as inserted by clause 21 of the draft Bill) - is required. We now understand, however, that its main aim is to allow the FCA to publicise the withdrawal of financial promotions.

We welcome, therefore, the Government's recognition that the publication of a direction may cause reputational damage to firms but we believe that such publication is also likely to expose a firm to a significant risk of legal action (e.g. a class action on behalf of individuals who invested in a product, as a result of a direct market advertisement that was subsequently withdrawn). We believe, therefore, that, publication should be reserved for egregious breaches and that in addition to publishing only "*such information about the direction as it considers appropriate",* the FCA should be required to include a fair summary of representations made (c.f. the Advertising Standards Authority).

3.3. Strengthening the listing regime including powers over sponsors and listed companies

As we set out in our response to the February 2011 condoc, we strongly support the Government's decision to retain the UK Listing Authority (UKLA) within the FCA and believe that this will ensure that the FCA's Markets Division continues to be an effective and efficient regulator of both the primary and secondary markets. We also support the proposed new power that will allow the FCA to discontinue or suspend a listing following a statutory notice period.

However, as we also discussed in our previous response, the UKLA, as the competent authority for listing will have different priorities to the FCA and, therefore, whilst we understand the rationale for bringing the legislative framework for listing and other primary market regulation "*more fully under the general FSMA-legislative framework*", we remain concerned that all the implications of the proposal may not have been considered fully.

We feel that the very limited statement in support of the proposal is conclusory; nor is an explanation given of the basis for concluding, implicitly, that the FCA would not otherwise be "*an effective conduct regulator dealing with all aspects of market integrity and investor protection*". On the contrary, in our view, the decision to bring the UKLA and Part VI within the general legislative framework of the FCA, rather than retaining a discrete Part VI regime, is unlikely to lead to any positive benefit in terms of primary market regulation. Furthermore, we believe that:

- the UKLA, like other listing authorities – such as the Australian Stock Exchange – should continue to have a competitiveness focus;
- the FCA's operational objectives are not sufficiently tailored for a listing authority / nor appropriate for a primary market regulator; and
- the 'have regards to' duties set out in section 73 of FSMA remain appropriate for the specialised regulatory function which the UKLA carries out, which is neither prudential nor conduct based.

In short we believe that the FCA, when acting in its capacity as the UKLA, should continue to have a separate operational objective and separate set of 'have regard to' factors, which are more closely aligned to those set out in section 73 of FSMA.

We note that the Government believes that "*the package of technical improvements to Part 6 will strengthen the listing regime and maintain London's reputation as a leading centre for capital raising and primary markets without compromising the ability of UK businesses to obtain the financing they need*." However, we have serious concerns regarding the use of the proposed FCA powers:

- in section 88A of FSMA (as inserted by clause 15(4) of the draft Bill), to impose sanctions on sponsors in relation to certain contraventions; and
- in section 88E of FMSA (as inserted by clause 15(4) of the draft Bill), to suspend or limit a sponsor's approval.

We recognise that these powers will be subject to due process in FSMA and that sponsors would have the right, under sections 88B and 88F(3) of FSMA (as inserted by clause 15(4) of the draft Bill), to appeal to the Upper Tribunal (Tax and Chancery Chamber) (the Tribunal), however, as these are broad powers to deal with sponsors' behaviour or performance – the case for which we do not believe has been made – it is crucial that the legislation sets appropriate thresholds for their use, particularly given that due process in the draft Bill will involve the publication of Warning Notices (see our comments in section 3.6 below). We are concerned, in particular, by section 88E of FSMA, which would enable the FCA to "*take action against a sponsor…if it considers it desirable to do so in order to advance one or more of its operational objectives*." Given that the exercise of this power may result in sponsors incurring substantial costs and liabilities – which would effect their charges – we believe that the FCA should be required to have reasonable grounds before imposing sanctions and should not have the power to sanction sponsors for reasons relating solely to the advancement of its operational objectives when extant rules have not been breached. If the FCA needs to take action to advance its operational objectives, we believe that additional rules and guidance should be issued. In addition, whilst the FCA will be required, under section 88C and 88D of FSMA (as inserted by clause 15 of the draft Bill) to prepare, consult on and issue a statement of policy with respect to the use of its section 88A powers, we note that there is also no requirement for the FCA to formulate and consult upon a policy statement in relation to its section 88E powers.

We also have concerns in respect of the proposed power in section 97A of FSMA (as inserted by clause 18 of the draft Bill) for the FCA to require a person (e.g. issuers and sponsors) to provide a report on "*any matter*" by a skilled person. In particular, we are concerned that this power will inevitably be viewed as increasing the regulatory burden and cost of being listed in the UK, specifically for debt and specialist securities issuers.

As discussed in section 3.5 of this response (see below), given the significant financial and human resources cost involved with a skilled person's report, it is vital that the power is used proportionately and, particularly in relation to issuers, the test for the FCA's use of the power is set at a far higher threshold. Currently, the report need only be "*reasonably required in connection with the exercise by the FCA of functions conferred on it*…" but we would recommend that the FCA be required to have very strong grounds, which are disclosed to the person concerned, before requiring a report. Otherwise, we believe that frequent use of this power at a low level of materially is likely to discourage issuers from outside the UK from listing within the UK. It is also essential that when the FCA exercises their power under section 97A of FSMA, the person who is required to provide a skilled persons report should have a right of appeal..

In summary, we believe that, the Government should reconsider whether the use of a skilled persons report is an appropriate power in connection with the listing process, with respect to either sponsors or issuers. Notwithstanding, we believe that additional checks and balances are necessary, particularly given the risk that the new, unconstrained, powers, when viewed cumulatively, may discourage new entrants to the sponsorship role and undercut materially the viability of the UK Premium Listing Regime.

3.4. Enhanced powers over RIE's (amendments to Part 18 regime)

The changes to the Part 18 FSMA regime, outlined in paragraphs 2.32 to 2.36 of the White Paper, appear to be technical provisions that allow for the smooth transfer and ongoing good-functioning of the regulatory regime for recognised clearing houses. We note, in particular, that changes will be made at a future date in order to comply with the EU Regulation on central counterparties and trade repositories (EMIR) when passed: we support this approach.

In respect to the changes to section 785 of the Companies Act 2006, as set out in clause 66 of the draft Bill, it would be helpful to understand: (a) the impact of the 'immunity from liability in damages' provision; and (b) the Treasury's approach to the forthcoming European CSD Regulation, which may impact both the definition of settlement system currently within the Uncertificated Securities Regulations 2001 and introduce other requirements not currently considered.

It is important, that the FCA continues to distinguish investment exchanges from regulated firms in relation to enforcement powers but currently, there appears to be no recognition of the regulatory functions investment exchanges may have and their immunity in relation to the exercise of these functions. It is important that this distinction is explicit in the Bill.

We note that "*work is underway to identify the appropriate future framework*" for the regulation of CREST's clearing-related functionality, as regulation as an RCH, under Part 18 FSMA, will apparently no longer be possible under EMIR. AFME would be interested in learning more about this work and possibly contributing to the debate.

3.5. Extension to section 166 powers

New section 166A (inserted by schedule 11 to the draft Bill), will enable the PRA and the FPC to require a firm to appoint a skilled person to collect or update information described in specific rules. Whilst we assume that the greatest use of this power will be in relation to recovery and resolution plans, the power could also be used in relation to transaction reporting and Client Asset rules, amongst others.

Over the past five years there has been a significant increase in both the FSA's use, and the costs, of section s.166 reports: *"S.166 SPRs are already being used more frequently than in the past. The FSA estimates that 140 will be initiated in 2010/11 compared with 88 in 2009/10 and only 18 in 2006/07."*[13] A Freedom of Information disclosure by the FSA gives the average cost to firms of a section 166 report as £128,000 in 2009/10 (£80,000 in 2007/08) with the most expensive in that year being £4.4 million (£1.1 million in 2007/08).

Given the significance of the costs involved, it is important to ensure that the s.166 power is used proportionately and that guidance is given as to when such reports might be required. We believe that a firm should have access to mediation if they are unhappy with the scope of the report to be commissioned – particularly if the FCA's power extends to circumstances in which a firm has breached an obligation to collect/maintain data and, as discussed in section 3.2 above, also applies directly to issuers, sponsors and primary information provider (and directors of these) under new section 97A of FSMA – and a right of appeal to the Tribunal (as an alternative to judicial review).

3.6. Power to publish Warning Notice

We welcome the changes the Government has made to the proposal to give the FCA the power – but not the duty or presumption – to publish warning notices; these changes go *some* way to reflecting *some* of concerns raised in our response to the February 2011 condoc (e.g. limiting the power to enforcement not supervisory decisions). We also welcome the Government's statement that it expects the FCA to address the issues raised in consultation responses in setting its policy re the exercise of the power. However, our significant concerns relating to the principle of publically disclosing ongoing enforcement action before the subject of that action has had an opportunity

[13] FSA/FRC FS11/1 Enhancing the auditor's contribution to prudential regulation Feedback on DP10/3 (March 2011)

to make formal representations, as set out in our response to the previous condoc, remain extant.

Notwithstanding, we agree that transparency with respect to the commencement of enforcement proceedings may, in *egregious* cases with probable consumer detriment, enhance consumer protection. However, we believe that it is *vital* to draw a distinction, in the legislation, between cases where urgent (early) publication is necessary in the interests of consumer protection (e.g. cases involving unauthorised investment business or systemic miss-selling) and other enforcement cases where the cost (to firms) of public disclosure may outweigh any benefit.

On this point, we would refer the Treasury to the case of Re (S) v X [2011] EWHC 1645 (Admin), a judicial review permission hearing in which the Court gave permission to judicially review X's decision to publish a decision notice pursuant to section 391 of FSMA (as amended by the Financial Services Act 2010. The claimants had challenged the FSA's decision to publish, seeking an injunction preventing publication until their claim is determined, which was also granted.

Key points in the judgment include:

- *"X makes its decision and communicates it by decision notice. In the proceedings before the Upper Tribunal, it will seek to defend that decision. No doubt X considers that its decision is right. No doubt also it is for that reason amongst others that X considers that the decision should be published. But where a reference has been made to the Upper Tribunal it will be for the Upper Tribunal to decide whether the decision notice is right. The maker of the decision has no general basis for publishing a decision notice that may be wrong*."
- *"Further, if delay is considered to be a problem, the fact is that the reference will have been made within 28 days and there seems to me to be no good reason why, if an application is made to the Upper Tribunal for*

any order relating to confidentiality, X should not seek an early direction hearing to have that matter resolved. If it does so, then any danger of further unjustified delay in the publication of a decision notice will be resolved by a judicial body competent to deal with it. In those circumstances, it seems to me arguable that X has entirely failed to make out its case for publication by it in circumstances in which, ex hypothesi, the case is not one in which it thought that urgent publication, regardless of the decision to refer, was necessary in the interests of the public."

We believe that this judgment highlights the need to separately distinguish, in the Bill, cases in respect of which there is a compelling need to publish and other cas**es.**

In the US, when the SEC files criminal charges their complaint is made public. However, a Warning Notice should be compared with a 'Wells Notice' and not a complaint. A Wells Notice may be issued by the SEC under its enforcement procedures (but not mandated by statute), to advise persons under investigation: that it is considering recommending or intends to recommend civil enforcement action; of the potential violations upon which the recommendation is based; and, that arguments or evidence may be submitted to the SEC. A Wells Notice is *not* published by the SEC but listed firms may have to disclose under market disciplines.

The SEC, however, separately distinguishes cases where there is a need for urgent action in the public interest. When determining whether to issue a Wells Notice, the SEC enforcement manual states that staffers should consider, inter alia: "*Whether immediate enforcement action is necessary for the protection of investors. If prompt enforcement action is necessary to protect investors, providing a Wells notice and waiting for a submission may not be practical (for example, a recommendation to file an emergency action requesting a temporary restraining order and asset freeze to stop an ongoing fraud). In addition, providing a Wells notice may alert potential defendants to* *the possible asset freeze and put at risk the investor funds that the recommendation is intended to protect."*

Where enforcement action does not involve urgent consumer protection issues, we believe that, instead of the publication of a Warning Notice, it is appropriate to rely on market disciplines for the publication of relevant information to the market (and, hence, to clients and investors).

An argument is also made that the publication of a Warning Notice is consistent with a criminal charge. It is, however, <u>not</u> apt to compare criminal law with the exercise by a regulator of an administrative jurisdiction. Notwithstanding, as discussed in our response to the February 2011 condoc, the evidential test set out currently in FSA's DEPP requires a far lower standard of proof than the Code for Crown Prosecutors i.e. there is higher standard of proof in relation to criminal charges and the Code sets evidential and public interest tests. It is also noteworthy that a charge is subject to review/approval by the Crown Prosecution Service (CPS), whereas a Warning Notice, despite being reviewed by the Regulatory Decisions Committee – which is, of course, an FSA committee – is more akin, in procedural terms, to a caution, as it is issued at the sole discretion of the FSA without an independent review.

We continue to believe that if the FCA is empowered to publish Warning Notices, the FCA should be required, by the Bill, to meet a *higher standard of proof* (as per the Code of Crown Prosecutors) in cases where the power is to be exercised. There should also be a statutory requirement for the FCA to publish a Code of Practice, covering the drafting of the statement – for example, the summary of the warning notice should be succinct, must refer to allegations and being subject to due process and must state facts and not use emotive language – and related press statements and media briefings. It will also be important to ensure there is *fully* independent (CPS-type) legal review and input up to the point of publication. An equally prominent statement should be issued by the FCA if the case is closed or not proven.

The case of Re (S) v X [2011] EWHC 1645 (Admin), discussed above, also raises interesting questions regarding the ability of a regulator such as the FCA to nullify, by publishing a Warning Notice, the Tribunal's powers to make orders prohibiting the disclosure or publication of documents or information under Rule 14 of, and Rule 3 of Schedule 3 to, The Tribunal Procedure (Upper Tribunal) Rules 2008 (the Tribunal's Procedural Rules): "[the respondent's] *submission is that in cases where no proper argument for confidentiality has been made, X is in as good a position to decide on publication as the Tribunal is. I find that position difficult to accept. It is arguably wrong."*

Whilst the judge was not persuaded, in this case, of arguments relating to the European Convention on Human Rights (ECHR), we feel that the fact that Warning Notices preceed the formal hearings – notwithstanding any opportunity to comment on a draft of the investigation report – is likely to add considerable weight to ECHR arguments.

As discussed above, we welcome the safeguards that the Government has now included in the draft Bill: i.e. the power to publish is expressed in section 391(1) of FSMA (as amended by paragraph 24(2) of Schedule 8 to the draft Bill), as a discretion and not a duty with no presumption of publication and the FCA may not publish where section 391 (6A)(a), (b) or (c) apply (as inserted by paragraph 24(6) of Schedule 8 to the draft Bill). However, in addition, we believe that:

- Given that reputational damage will inevitably flow from publication, the parties served with notice of publication would inevitably claim publication was unfair. We are, therefore, unsure what additional unfairness must be proved and what other factors the FCA would take into account under 391(6)(a) of FSMA (as amended by paragraph 24(2) of Schedule 8 to the draft Bill). Hence, we believe that there should be greater specificity in the legislation as to when the FCA would be prevented from publishing a Warning Notice on the grounds that it was, inter alia, "unfair to the person with respect to whom the action was taken…"; an objective measure of unfairness is also needed;

- Whilst section 391(1)(c) of FSMA (as amended by paragraph 24(2) of Schedule 8 to the draft Bill), provides that the FCA must consult the persons to whom the notice is given or copied prior to possible publication, we believe that the Bill should provide specifically for a formal Maxwellisation process;
- There should be an effective and efficient right of appeal to the Tribunal in relation to the FCA's <u>decision</u> to publish a Warning Notice and that an FCA decision to publish should be subject to scrutiny by the Tribunal as part of any appeal relating to the case itself;
- Any legal or natural person named in the Warning Notice should have the right to make their own statements to the media, i.e. it must be clear that the person/firm is free to comment publically (including claiming that the FCA action is wrong or misconceived and referencing pertinent facts not included in the Warning Notice) if a Warning Notice is published.

In summary, we agree that the FCA should have the power, in the interests of consumer protection, to warn of pending enforcement action. However, we believe that the Bill should set out the circumstances in which the power may be used (which should be clearly linked to consumer protection); require a *higher standard of proof* (as per the Code of Crown Prosecutors) in the cases where the FCA is exercising its power to publish Warning Notices; require the FCA to publish a Code of Practice; and provide greater specificity in respect of the safeguards. The discretion to publish a Warning Notice should only be exercised if the statutory tests can be satisfied, showing publication was necessary to protect consumers.

Without further refinement and clarity in the Bill, we believe that the FCA may face costly and time-consuming litigation when they seek to use the power (a concern also expressed by Margaret Cole in a 27th June Reuters interview), as firms and individuals are likely to turn to the judicial system to protect their reputations.

3.7. Reduction in period for representation

We are concerned by the reduction in the period for representations from 28 days to 14 days, in sections 387 and 393 of FSMA (as amended by Schedule 8, paragraphs 20(30) and 25(3) of the draft Bill), particularly since we understand that lawyers acting on behalf of firms frequently need to request extensions beyond the current 28 days. Whilst we understand the need to speed up the enforcement process, given the time taken in respect of other parts of the process, it appears unfair to limit a firm's or individual's opportunity to build and put forward its case.

3.8. Changes to statutory notice decision-making requirements

We note that in section 395 of FSMA (as amended by Schedule 8, paragraph 27(4) of the draft Bill), decisions related to the issue of a statutory notice could also be made "*by two or more persons who include a person not directly involved in establishing that evidence" rather than only "by a person not directly involved in establishing the evidence upon which the decision is taken*."

We also note that the exceptions are now wider (e.g. advancing any of the FCA's operational objectives) and that the person taking the decision need no longer be "*of a level of seniority laid down by procedure*." We are concerned by this change to the statutory notice decision-making process and believe the new powers – particularly publication of warning notices – in fact require <u>stricter</u> separation between decisions takers and those involved with investigations. We are strongly of the opinion that, whilst not currently mandated by statute, the FSA's Regulatory Decisions Committee, with its external practitioner input and the ability to consider decisions independently – albeit in accordance with the FSA policy – should continue and perhaps be enshrined in the Bill.

3.9. Appeals to the Tribunal

We welcome the Government's decision not to limit access to the Tribunal but have reservations regarding the proposal to limit the Tribunal, in the case of supervisory decisions, to remitting the case back to the regulator rather than determining the action to be taken. As a minimum, we believe that cases should be referred back with recommendations. As discussed previously, we also believe that there should be an appeal mechanism for PRA supervisory judgements that do not trigger the issue of a statutory notice, which may have significant ramifications for firms' capital and business plans.

3.10. Publication of FOS determinations

We support the Financial Ombudsman Service, which provides an easy route for consumers to obtain redress. We note, however, that, as provided in new section 230A (inserted by clause 34 of the draft Bill), the FOS will be under a duty to publish determination unless the FOS deems it inappropriate to do so. However, determinations are made by the FOS on a "fair and reasonable basis" and not on legal reasoning and firms have no right to appeal. We believe, therefore, that further thought needs to be given with respect to safeguards for firms e.g. the FOS should follow due legal process and, if published, give the firm a right to make their case, particularly since publication will create reputation and, in particular, legal risk to firms. We support, therefore, the more detailed response from the City of London Law Society on this important issue.

4. Coordination and regulatory processes

Coordination – both domestically and internationally – was, in our opinion, the weakest link in the new regulatory framework. It is undoubtedly one of the most complex aspect of the proposals and its effectiveness, in practice, is still a major concern. We welcome, therefore, the focus that the Treasury has given to regulatory coordination and regulatory processes and their engagement with the industry. We believe that the provisions in the draft Bill are significantly enhanced – however, given the inherent complexities, there is still a need for further work.

We recognise that there is a distinction between the statutory duty to coordinate and the operational arrangements that the regulators need to put in place to discharge that duty and a fine balance to be struck between legal prescription and operational flexibility. We understand why the Government does not "*believe it would be appropriate to set out operational matters for the PRA and FCA in primary legislation*" – however, as a number of our remaining concerns relate to how the arrangements will work in practice, we question whether the duty to coordination is sufficiently robust and whether there is a need for provisions in legislation to provide points of reference. For example, a duty for the PRA to consult the FCA on recovery and resolution plans for firms that hold client assets.

We continue to believe that a joint committee should be mandated in the Bill: for example, to coordinate rule-making, particularly in relation to the over-arching regulatory standards and systems and controls; to facilitate mutual recognition as the regulatory approaches diverge; and to assist in managing the UK's relationships with the ESAs.

On this point we would note that:

- The IMF Technical Note, referred to in section 2.2 above, also found that: *"While the proposals have built in a variety of cooperation and coordination mechanisms, the experience in certain other countries suggests the need for a forum for formal and/or informal relationship building, cooperation, and coordination. These relationships will be necessary for effective operation of the framework, especially in a crisis. A clear locus for all regulatory agencies to interact might also assist the United Kingdom in interacting effectively with the new European Financial Stability Board (EFSB) and with the European Supervisory Authorities (ESAs)."*

- In France, the establishment of a 'Pôle commun' (joint committee) between the ACP and the AMF is mandated by legislation with the detail set out in an MOU. Whilst there is a greater overlap of responsibilities for consumer protection between the ACP and the AMF, the joint committee plays an import and effective role as a mechanism for coordination. We believe that this French model serves as a helpful example for the UK.

  "*A propos du Pôle commun*[14]

  L'ordonnance du 21 janvier 2010 créant l'Autorité de Contrôle Prudentiel (ACP) introduit également un mécanisme de coopération entre l'ACP et l'AMF pour renforcer le contrôle du respect par les entreprises et leurs intermédiaires de leurs obligations à l'égard de leurs clientèles.

  A cet effet a été institué un pôle commun aux deux autorités, qui est à la fois un mécanisme de coordination, notamment de la veille des pratiques de commercialisation, et un point d'entrée commun pour les demandes des clientèles.

  Le Pôle commun ne modifie pas la répartition des pouvoirs de chaque autorité, chacune conservant sa compétence propre. Toute décision demeure prise uniquement par l'ACP ou par l'AMF, selon les cas, notamment s'agissant des suites des contrôles diligentés et des éventuelles sanctions qui en découleraient."

  We would, in particular, highlight the Annual report 2010 (an English version is available from http://www.abe-infoservice.fr/IMG/rapportGB.pdf), which demonstrates the value of such a coordinated approach.

[14] Communiqué de presse du Pôle commun a L'ACP et l'AMF: Publication du premier rapport d'activité du pôle Assurance Banque Épargne - Paris, le 3 mai 2011

- The Joint Committee of the ESA's serves "*as a forum in which the three European Supervisory Authorities shall cooperate regularly and closely and ensure cross-sectoral consistency among them. The Joint Committee shall ensure cross-sectoral consistency of work and reaching joint positions where appropriate, in particular regarding the area of supervision of financial conglomerates, accounting and auditing; micro-prudential analyses of cross-sectoral developments, risks and vulnerabilities for financial stability; retail investment products; measures combating money laundering; and information exchange with the European Systemic Risk Board (ESRB) and developing the relationship between the ESRB and the ESAs*."[15]

We wonder also whether the FCA would be under a duty, by virtue of new section 354A (inserted by schedule 11 to the draft Bill) to coordinate with the FPC and the new National Crime Agency i.e. we are not sure whether they could be described as having functions "*similar to those of the FCA*"?

4.1. European and international

The Government has emphasised the "*need for the UK to have a single, coherent and consistent strategy*" for both EU and international engagement, notwithstanding the differences in scope between domestic and EU supervisory authorities, and has stated its desire "*to see the UK continue to play a key role in the development and implementation of international financial regulation*". We believe, therefore, that the FSA's international division should continue as part of the overarching joint committee discussed above, or as a separate secretariat, serving not only the interests of the PRA and the FCA but the Bank of England *per se*, and other UK stakeholders such as The Pensions Regulator and the Financial Reporting Council.

[15] Decision of the Joint Committee of the European Banking Authority, European Insurance and Occupational Pensions Authority, and European Securities and Markets Authority adopting the Rules of Procedure of the Joint Committee of the European Supervisory Authorities

It is also crucial that the new framework is outward looking: recognising explicitly, EU obligations and constraints, reflecting the desirability of level international and international good practice and facilitating mutual cooperation. There is also a need to be clear about the extent of the powers available to a UK regulator in relation to international firms and the degree of reliance on overseas regulators and to set realistic expectations of what UK regulation can and cannot deliver. For example, client assets will be regulated and supervised by the FCA but the client asset protection offered by incoming EEA firms will be dependent on their Home State regulatory regime, as client assets regulation is reserved to Home State competent authorities.

As discussed above, we believe that the FCA should have a statutory duty to coordinate with the ESAs, in particular ESMA, in respect of matters within its scope and work with international standard setters.

4.2. Passporting

We support the proposed approach to passporting, which chimes with the approach to authorisation, but question:

- whether, if the FCA is designated as the competent authority for MiFID, the PRA will be in a position to issue consent notices for PRA-authorised investment firms, under paragraph 19(7B) to Schedule 3 to FSMA (as inserted by paragraph 7 of Schedule 4 to the draft Bill)?
- the degree to which the PRA, as a prudential Host State regulator, can supervise incoming EEA firms and the extent to which the PRA's rules will constitute "applicable provisions" for incoming banks and insurers new paragraph 13(1F) of Schedule 3 to FSMA (as inserted by paragraph 2(3), of Schedule 4 to the draft Bill); and
- particularly given the proposals for CRD, how the supervision of incoming EEA firms with UK branches will be divided between the FCA and the PRA?

We also believe that the "*arrangements between FCA and PRA*" should also reflect the need for ongoing coordination in relation to outwardly passporting UK firms, given that the FCA will be responsible for supervising: (a) the business conduct of UK firms providing cross-border services into other EEA Member States; and, (b) compliance with the Client Assets Sourcebook by UK firms providing services from branches in other EEA Member States.

4.3. Coordination of crisis management

As the Treasury will be aware, it will be vital to coordinate the domestic crisis management arrangements with the wider EU and international framework. We await the EU Commission's legislative proposals on crisis management (relating to common resolution tools and home-host cross-border cooperation) and the outcome of the FSB's work on resolution and may comment further on the UK proposals when the EU and FSB proposals are published.

Domestically, however, whilst we believe that, in general, the proposed crisis management arrangements appear sensible, we have the following comments at this stage.

We continue to believe that the crisis management MOU in clause 43 of the draft Bill should include the FCA given its responsibilities for regulation of Client Assets and investment exchanges. We also note that although the White Paper discusses the special resolution regime (SRR) for banks established by the Banking Act 2009, in respect of which we assume the PRA will take on the role of the FSA, no mention is made of The Investment Bank Special Administration Regulations 2011, made under the Banking Act 2009, the objectives of which include ensuring the return of client assets as soon as is reasonably practicable. We believe that the FCA, as the client assets regulator, should have a defined – but not necessarily exclusive – role in relation to the Special Administration Regime which should, inter alia, be reflected in the MOU.

Indeed, as recent events have demonstrated, it is critical that regulators can move at speed and with no confusion with respect to the extent or scope of their powers to protect client assets. We believe that coordination in respect of client assets protection should, more generally, be explicitly provided for in the coordination MOU.

In respect of the Bank's obligation to notify the Treasury, under clause 42 of the draft Bill, we do not believe that this notification requirement should be limited to situations where there might be a call on public funds but, given the potential risks to client assets, a notification should be triggered for all instances where the Special Resolution Regime or Special Administration Regime has been triggered by the PRA (or, in the latter case, arguably the FCA).

We also believe that the legislation should provide the framework for a crisis management committee, with membership drawn from the PRA, FCA and the Bank and chaired by the Governor or Chancellor, to review and periodically test the operation of the crisis management MOU; to meet with key industry representatives; and to assist in coordination in a crisis.

Finally, in relation to the Special Resolution Regime, we believe that the proposed minor and technical changes appear sensible, although we wonder why the Bank is required to report to the Chancellor on the private sector purchase tool but no other resolution tools.

4.4. Coordination of recovery and resolution planning

Our initial – and still developing – thinking on recovery and resolution planning is as follows:

- We believe that clarity is needed on the primacy of Home State competent authorities for recovery and resolution planning. Although the policies from individual regulators are still emerging it would appear that there are some differences between regulators, especially at the detailed level, in expectations for structure and process around recovery and resolution plans (RRPs). For global banks with significant operations in more than one jurisdiction it remains critical to be able to develop a coherent RRP at group level, particularly on recovery options. For recovery plans, firms may wish to outline a series of options across the group and consider the efficacy of these for all entities. On resolution plans, although information to be provided and analysed will be on a local entity level, it is likely that there will be support functions relevant to a jurisdiction that are provided by entities outside it. Ultimately, it may mean that a group will need to share some or all of a group plan with all its regulators. Therefore, a strong degree of harmonisation between regulators and an early indication of how they will work together to engage with firms through the process would be beneficial to all stakeholders

- In relation to the domestic rule-making powers, we would question whether, under new section 137I (inserted by clause 21 of the draft Bill), the PRA should have the power to make rules on recovery and resolution plans for investment firms without a statutory duty to consult the FCA's Client Assets Unit (and, arguably, the Treasury and the Bank of England)? Furthermore, we also believe that, in relation to the power in sections 137K and 137L (inserted by clause 21 of the draft Bill), the FCA, as the client assets regulator, should also have an opportunity to comment on the adequacy of recovery and resolution plans or to appoint a skilled person.

As noted earlier, AFME is responding to, and engaging with the FSA in relation to, the FSA's consultation on Recovery and Resolution Plans (CP11/16) and, hence, our view may change or develop. We may, therefore, comment further on issues relevant to the coordination of recovery and resolution planning in the new regulatory framework, as the detailed approach is analysed.

4.5. The Threshold Conditions and authorisation

We believe that the "*suitable having regard to the regulated activities…*" test in new paragraph 5A, Schedule 6 to FSMA (as inserted by clause 7 of the draft Bill) is too vague. We believe that this test should be consistent with the other threshold conditions and refer to "*nature, scale and complexity*"? We also believe that the reference, in this paragraph, to regulator should read *appropriate regulator*.

Given that a "*PRA-authorised person*" will include an incoming EEA firm with automatic permission under Schedule 3 to FSMA, the reference to the use of the OIVOP power in new section 55C of FSMA could be read, erroneously, as extending the power to incoming EEA firms that fail or are likely to fail to satisfy the threshold conditions. We believe that this should be clarified.

4.6. Approval of Significant Influence functions

We believe that the Government's policy for the approval regime is far clearer and we concur that both the PRA and the FCA should have the power to designate significant influence controlled functions (SIFs) and issue Statements of Principle and Codes of Practice in respect of, and determine applications for, these controlled functions. However, the precise mechanics around the approvals process – particularly given that both the PRA and the FCA have roles in relation to SIFs – requires further clarification to avoid overlap and uncertainties. In particular, paragraph 2.160 of the White Paper states that: "t*he Government remains of the view that one authority should have a deciding say in the application process*" yet there is concern that the draft Bill could be read as if a dual-regulated firm would need to submit an application for approval to both the PRA and the FCA separately.

Coordination, particularly with respect to applications for approval and the scope of the respective statements of principle will be crucial (see our comments below under rule-making). In addition, we note that:

- A provision does not appear to have been included – for example in section 60 (Application for approval) – to ensure that the PRA and FCA will consult each other in relation to applications for SIFs (e.g. an application for CF1). Such a provision is, however, included in section 63 of FSMA as amended by subsection 1C (introduced by clause 11 of the draft Bill); we believe that the provision should be replicated in relation to initial applications for approval.
- We are not sure there is sufficient clarity in the draft Bill as to whom an application should be submitted. Although we assume that the reference to "*body to whom an application is made under section 60*" in section 61 is designed to help clarify responsibilities of the regulators, given the definition of "*appropriate regulator*" in section 59(4), we wonder whether this construction is necessary or whether it creates more confusion. We suggest an additional subsection be included in section 60 to the effect that one applies to the appropriate regulator for approval.
- SIFS that are approved by both the PRA and FCA will have to comply with the separate Statements of Principle and Codes of Practice issued by the regulators: it is important that there is coordination between the PRA and the FCA regarding the drafting of these Principles and Codes so that the duties of SIFs – in relation to their different functions – remain compatible.

4.7. Rule-making

As discussed at the start of this section of our response, we continue to believe that a joint committee should be mandated by statute to facilitate coordination of rule-making, particularly in respect of the over-arching high-level regulatory standards (including systems, controls and senior management responsibility provisions and, as discussed in section 4.6 above, the Statements of Principle and Codes of Practice for approved persons).

4.8. Supervision of Groups

We understand that members of the same group will not necessarily be prudentially regulated by the same regulator. However, notwithstanding consolidated supervision, we strongly support an approach whereby there is one prudential regulator for a group i.e. where a group has an PRA-authorised firm, the PRA should be the prudential regulator for all other firms in the group. We believe a single prudential regulator for all group firms will ensure consistent prudential oversight and minimise the regulatory burden. We believe this is particularly desirable given that the Treasury has confirmed that the PRA and FCA will have separate prudential rulebooks.

5. Consultation questions

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

See section 1.1 above.

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

See sections 1.5 and 3.4 above.

Q3. Do you have any comments on:

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

See section 4.3 above.

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

See section 1.3 above.

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

See sections 1.3 and 2.5 above.

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

See section 2.4 above.

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

See sections 2 and 3 above; in particular 3.1, 3.2, 3.5 and 3.6.

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

As AFME is as a European capital markets trade association, we will not be responding to this question.

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

AFME, as a European capital markets trade association, is not responding to this question.

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

See section 2.4.

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

See sections 2.2, 3.3 and 3.4.

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

See section 1.4 above.

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

See section 4 above.

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

See section 4 above.

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

See section 3.10 above.

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[i] **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, investors 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).

AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

For more information please visit the AFME website, www.AFME.eu.

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

Response from the Association of British Credit Unions Limited (ABCUL)

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Financial regulation reform –
Response from ABCUL

Association of British Credit Unions Limited

1. Executive Summary

1.1 Credit unions are a sector of small, deposit-taking financial co-operatives. To give a sense of scale, in a recent analysis of the size of ABCUL member credit unions in the year October 2007 – September 2008 (the most recent year for which complete figures are available to us) the following features were found:

- 56% had less than 1,000 member customers
- 53% had assets of less than £500,000
- 32% had no staff at all and relied entirely on volunteers to operate
- 82% generated less than £200,000 turnover
- 56% generated a pre-tax profit of less than £10,000
- 46% were unable to pay their depositors a dividend return on their savings

1.2 Under the proposed regulatory structure credit unions, as deposit-takers, are set to be dual-regulated by both the PRA and the FCA. We support entirely the classification of firms by function as opposed to size and wish to remain under the same regulatory framework as the larger deposit-taking institutions.

1.3 Whilst we support our position within the new framework it is imperative that credit unions are regulated proportionately within that. Even when taken as a whole, the sector poses very little systemic risk and could not cause a financial crisis as seen in 2008. It would be ironic if an unintended consequence of the new framework, designed to cope with those that caused the crisis, was to stifle the development of the firms that did not. This would be at odds with the Government's policy of supporting credit union development through both legislative reform and potential investment in the modernisation of the sector.

1.3 Despite this, we feel that the proposals as framed will have the unintended consequence of increasing the regulatory burden upon the credit union sector out of proportion with the benefits of doing so. In our previous responses we have raised these concerns repeatedly.

1.4 Nevertheless, the White Paper states in its impact assessment point 39:

The PRA will also be responsible for prudentially supervising much smaller firms which take deposits or effect and carry out contracts of insurance. Almost all credit unions and some friendly societies and building societies would fall [sic] *to be considered as small firms; many credit unions would be very small by any standard. Some investment firms regulated by the PRA may also be small firms although it is likely that they will be parts of groups that include a bank or insurance company. The transitional costs for these firms seem likely to be relatively less depending on the circumstances of the individual firm.*

And further at point 45:

Consultation respondents were concerned that dual-regulated firms would face significantly higher costs and that these would disproportionately on [sic] *smaller dual-regulated firms. In practice, this* *probably means that the smallest dual regulated firms would (e.g. credit unions) would* [sic] *not be much affected while the largest banks and insurance companies would not face significantly higher compliance costs in comparison with their current compliance costs. The effect could be greatest in smaller banks or proprietary trading firms.*

1.5 It is unclear on what grounds the Government feels that the proposals will not have a material impact upon credit union compliance costs. In terms of compliance resource requirements we take the view that the smaller a firm is, the greater these costs are relative to the firm's limited resource. Very small credit unions may struggle to meet their regulatory obligations because of their over stretched resource and their lack of economies of scale which allow larger firms to deal more easily with such functions. We disagree with the assertion that the smallest firms will not see a substantial increase in compliance costs.

1.6 Similarly, we are concerned with the escalating estimations of transitional costs for implementing the new regulatory framework. In the second consultation, *Building a Stronger System*, these costs were estimated at £400 million, whilst the White Paper puts them at £770 million. It appears to us that the new framework, by splitting the institutional capacity of the FSA between two bodies, is also likely to duplicate the overheads and back room costs on an ongoing basis. The combined effect of the transitional and ongoing costs of implementing the new framework will be to increase the pressure to raise industry fees further than under the FSA. Credit unions currently enjoy a reduced minimum fee framework because of their size and the social value that they create and we would like to see this retained. With such pressure on the cost base of the regulatory system, however, we are concerned that this may not survive.

1.7 We support measures proposed to enshrine proportionality at the heart of the new principles of regulation as well as measures to ensure that any new regulatory development is assessed for its effect on mutuals as distinct from other corporate ownership structures. These will go some way to ensuring that credit unions are fairly, appropriately and proportionately regulated and supervised. We do, however, recommend a series of further measures which would embed proportionate treatment for small, dual-regulated firms under the new framework:

1.7.1 It is important that CREDS the specialist regulatory sourcebook which is to be implemented alongside the Legislative Reform (Industrial and Provident Societies and Credit Unions) Order which is currently before Parliament is retained. This has been developed specifically for credit unions and is constructed in a rules-based format which is more suitable than principle-based regulations which are more suited to larger, more complex organisations.

1.7.2 We propose that mechanisms are not only retained but strengthened for smaller firms – such as credit unions – to hold the new regulatory bodies to account and have an input into decision making. The Practitioner Panels should be retained for both bodies, the Smaller Businesses Panel should be put on a statutory footing for both and smaller firms should be given a voice in the governance structures of the new regulators.

1.7.3 A greater emphasis should be placed upon Cost Benefit Analysis (CBA) and this should be provided for in statute. Not only should individual regulatory developments be subject to CBA but regular, sector-wide assessments should be conducted to assess the overall impact of regulatory developments rather than ad hoc piecemeal assessments which only take account of one specific issue. This would put the statutory obligation to proportionality on a directly measurable footing.

1.7.4 A single point of contact is needed for dual-regulated firms to deal with both bodies. At present there are very complex proposals in place for different regulatory approvals and processes – approved persons authorisations, for example – which will be very difficult for small firms especially to negotiate without the creation of a single port of call through which all such issues are communicated and behind which the regulatory split is co-ordinated by the two bodies themselves. This would alleviate the resource-strain of dealing with two regulatory bodies.

1.7.5 Fees must not be allowed to rise significantly from the level that they are at present outside of reasonable incremental increases. It should not be the case that fees increase more rapidly than they would have under the FSA. Regulatory fees are one of the key expenditures credit unions are required to meet and major increases brought on through the division of the FSA and behind-the-scenes duplications of function would add no value but put significant strain on the financial position of many small credit unions.

1.7.6 The costs of funding the Financial Services Compensation Scheme must be kept under control and set up such that they are proportionate to the risk that various sectors pose to the stability of the financial system as a whole. We have benefitted greatly from the FSCS's protection but current proposals under discussion – such as the EU proposal to pre-fund guarantee schemes – could leave our sector facing very serious difficulties.

1.8 Whilst we appreciate that Government considers some of these proposals to be operational matters for the regulators to assess and implement as they see fit, we feel that it is important to embed such measures by legislation in order to ensure true proportional treatment of smaller firms – especially small, dual-regulated firms of which our sector is almost the only example.

1.9 Credit unions have an extremely valuable role to play in providing financial services to those otherwise excluded from fair and equitable access to the mainstream and, as they grow, in providing vital diversity and competition in financial services which will serve to enhance the stability of the industry in the UK. We urge the Government to look again at our proposed measures which we feel would greatly reduce the burden of the new framework upon our sector; a sector which did not have a hand in the financial crisis and therefore should not be unduly burdened by the regulatory response to the it.

2. Introduction

2.1 We welcome the opportunity to respond to this consultation. ABCUL is the main trade association for credit unions in England, Scotland and Wales, and our members serve around 80% of Britain's credit union membership. Credit unions are not-for-profit, financial co-operatives owned and controlled by their members providing safe savings and affordable loan facilities. Increasingly a small number of credit unions offer more sophisticated products such as current accounts, ISAs, Child Trust Funds and mortgages.

2.2 At the end of March 2011, credit unions in Great Britain were providing financial services to 808,686 adult members and held more than £682 million in deposits with more than £586 million out on loan to members. An additional 114,709 young people were saving with credit unions.[1]

2.3 At 30 September 2010, the 325 credit unions belonging to ABCUL were managing around £512 million of members' savings on behalf of over 611,037 adult members.

2.4 The Credit Unions Act 1979 sets down in statute the objects of a credit union; these are four-fold:

- 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.

2.5 Credit unions in Britain are small, co-operative financial institutions often extending financial services to those unfairly excluded from the financial services the majority take for granted. They are owned and controlled by a restricted membership and are operated for the sole benefit of this membership. The Credit Union Act 1979 sets down these operating principles in law.

2.6 In the past decade, British credit unions have trebled their membership and assets have expanded four-fold. As this growth has taken place, the role that credit unions can play – both in providing equitable financial services to the whole of their communities and providing diversity in the financial services sector – has been increasingly recognised by government and policy-makers.

2.7 The Coalition's Programme for Government committed to promoting mutuals as part of a diverse financial services system and the Department for Work & Pensions is currently conducting a feasibility study the outcome of which will determine whether and how the earmarked £73 million credit union modernisation and expansion fund will be invested in the credit union sector. Both of these initiatives demonstrate the strength of the Government's commitment to the promotion of credit union growth in Britain and a cornerstone of any growth strategy is the implementation of effective, appropriate and proportionate regulation.

[1] Figures from unaudited quarterly returns provided to the Financial Services Authority

3. Consultation Questions

3.1 We have only answered a selection of questions which relate directly to our sector and the concerns of our membership.

Q.3 Do you have any comments on:

- *the proposed crisis management arrangements; and*
- *the proposals for minor and technical changes to the Special Resolution Regime*

3.2 We have no concerns regarding the proposed arrangements for crisis management or the minor and technical changes to the Special Resolution Regime.

3.3 We would, however, like to raise the particular circumstances faced by failing credit unions under the present arrangements. Currently, where a credit union is failing and there is no credit union both in a position to acquire the troubled entity and operating in an immediately adjacent area, the only remaining option is for a credit union to resort to the Financial Services Compensation Scheme to protect its depositors. Legislative reforms currently before Parliament will remove the requirement for an acquiring credit union to be operating in an immediately adjacent area and the situation will be further improved by the FSA acting more quickly in the case of a credit union starting to fail but there will remain limits to the capacity of credit unions to step in and retain a credit union's services for an area.

3.4 In other parts of the world where credit union systems are considerably more advanced than here in the UK – the United States, Ireland and Australia, for example – arrangements are generally put in place to stabilise credit unions that are struggling to remain solvent. This generally involves a central fund whose sole objective is to prevent its own drawdown through imposing stringent requirements on failing credit unions to right their financial position independently but with technical assistance and direction.

3.5 In 2010, Liverpool John Moores University produced a research report, commissioned by ABCUL, into the feasibility of such a system in Britain and the functioning of such similar systems around the world. We would like to explore the potential for such a system to be created for British credit unions as a means of reducing their reliance upon the Financial Services Compensation Scheme and believe that the current review of financial regulation presents the ideal opportunity to look at the potential for a credit union stabilisation fund in Britain.

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

3.6 Our key concerns in relation to the proposals as set out relate to the potential for the regulatory burden on small, dual-regulated firms to increase disproportionately to the risk that our sector poses to the systemic stability of financial services – i.e. out of step with the stated aims of the regulatory reform programme.

3.7 To this end we welcome the inclusion in the PRA's objectives and scope both of the principle of proportionality which is fundamental to any regulatory system for credit unions and the proposal to ensure – in line with the government's commitment in its programme for government – that it will assess any new regulations for their specific effect on mutuals with a view to ensuring a level playing field between different corporate structures.

3.8 What we would like to see, however, is a greater commitment in the proposed legislation to ensuring that true proportionate treatment is embedded within the framework. Measures to achieve this include:

- statutory provision for a single point of contact for both regulators for dual-regulated firms behind which the apportionment of regulatory responsibility would be conducted. This would minimise the resource strain applied to small firms by having to report to two bodies instead of one.

- provision to ensure that the regulatory fees and levies do not increase above a set level over the coming years – given the likely increase in overheads and running costs arising from the splitting of the FSA, there will be significant pressure upon the new system to raise further revenue from the industry. Credit unions presently enjoy a lower minimum fee than other firms in consideration of the social value they engender and we would like to see this retained. It seems unlikely that, other than through statutory provision, there will be anything other than a steady increase in regulatory fees under the new system especially since transitional cost estimates have almost doubled between last year's second consultation paper and the White Paper under discussion here.

- provision for the retention of the specialist Credit Union Sourcebook which sets out a specially-designed regulatory framework for credit unions which is proportionate and appropriate to the sector's needs.

- a new statutory requirement obliging the new regulatory bodies to regularly – perhaps annually – conduct cost-benefit analyses of the overall regulatory burden upon a specific sector as it evolves and changes over time. Currently, the FSA is only under an obligation to undertake such analysis per regulatory proposal but the creeping cumulative burden of regulation should be kept under regular assessment also, transparently and with public accountability.

- the Financial Services Practitioner Panel and the Smaller Businesses Practitioner Panel should be put on a statutory footing within the PRA structure in addition to the FCA and there should be credit union and / or smaller business representation within the high-level governance structures of all regulatory bodies to ensure the views of smaller regulated firms are heard at the highest levels of policy development.

Q.5 Do you have any comments on the detailed arrangements for the PRA described above?

3.9 It is vitally important that the judgement-led regulation as proposed is properly accountable and can be challenged and appealed against. It must also be applied proportionately as with all other proposals put forward. This involves ensuring that the finer details of credit union operations are not scrutinised in such close detail that they are stifled or blocked since the credit union sector poses comparatively little risk to financial stability as compared with the other dual-regulated firms.

3.10 As set out in our response to the previous question, we would like to see greater accountability to and governance input from smaller firms and the credit union sector in particular.

3.11 Whilst we appreciate that HM Treasury considers such arrangements to be operational matters for the PRA, we feel it is vital to the proper, proportionate functioning of the regulatory bodies that they are held directly to account and scrutinised by smaller firms as well as larger firms.

3.12 To ensure sufficient representation and influence for smaller firms the Financial Services Practitioner Panel and the Smaller Businesses Practitioner Panel should both be put on a statutory footing within the PRA and smaller firms, such as credit unions, should have direct representation within the governance structure of both regulatory bodies.

3.13 These measures will ensure that the needs of smaller, dual-regulated firms – such as credit unions – are taken into account and applied proportionately and will prevent inadvertent damage being done to a sector with specific needs but with, at present, a small voice.

3.14 We absolutely support the commitment to full public consultation around proposed rule changes in the manner conducted by the FSA at present.

3.15 We would also like to see a statutory obligation placed upon both regulators to require them to conduct a regular – perhaps annual – overall cost benefit analysis of the regulatory burden to a particular sector of firms as it evolves over time. Whilst the current FSA arrangement to assess each proposal as it is developed is welcome, in our members' view it is the cumulative effect of a combination of regulatory developments over time which present the real compliance and resource burden and without regularly assessing this there is no way of measuring the increase in this burden.

Q.6 Do you have any views on the FCA's objectives – including its competition remit – as set out above?

3.16 Again we welcome the commitment to proportionality in the FCA's principles of regulation and to the obligation to assess regulatory changes for their effect on mutuals both of which are positive proposals which are in step with the Government's commitment to promoting mutuals.

3.17 We would, however, like to see further statutory provision which would ensure that these high-level principles are adhered to in practice and will ensure that the effective statutory intention of the government survives operational interpretation.

3.18 The measures we would like HM Treasury to consider in order to ensure the proportionate treatment of credit unions are as set out above in our answer to question 4. To summarise:

- a statutory single point of contact for dual-regulated firms.

- a statutory requirement to keep regulatory fees and levies under a certain ratio.
- provision for the retention of the specialist Credit Union Sourcebook of regulations.
- a new regulatory obligation to conduct annual, sectoral cost benefit analyses.
- a governance position for small firms and / or credit unions within the governance structures of the FCA.

3.19 We wait with anticipation for the publication of further policy development around the proposal to move consumer credit regulation into a FSMA-style regime under the FCA. We have concerns regarding various aspects of this proposal and will be keen to raise these once more as the process progresses.

Q.7 Do you have any views on the proactive regulatory approach of the FCA?

3.20 We appreciate the motivations of HM Treasury behind the proposals on taking a much tougher line with firms who do not meet conduct expectations. This more proactive approach, if applied properly, should have the effect of better protecting consumers from the excesses of some firms.

3.21 Again, however, we stress that any use of such a power must be proportionate to the benefit it will provide to the general public and to the stability of the financial services system.

3.22 Credit unions, as a sector of small firms serving a fraction of the total consumers in financial services, should only be affected by such interventions where there are sufficient reasons to feel that not to do so would be to the significant detriment of consumers. This is unlikely to happen very frequently and these powers should be used accordingly.

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

3.23 We have no objection in principle to the proposal to allow nominated parties to refer issues of mass consumer detriment to the FCA for consideration. This appears similar to the OFT super-complaint procedure which allows certain pre-approved groups to raise issues of serious concern for the OFT's consideration.

3.24 Any such system under the FCA should be based on a tight – possibly statutory – definition of which bodies are suitable to hold the privileged referral right and there should be a publicly transparent and accountable approval process.

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

3.25 We have no objection in principle to the proposal for the FCA to have to set out is view on whether a product or issue is causing mass detriment. Given some recent cases of mass misselling and resulting serious consumer detriment this could be a useful tool in protecting vulnerable consumers.

3.26 Any such obligation, however, must be underpinned by a clear definition of what amounts to 'mass detriment' and this definition must be subject to full public scrutiny. Ideally, this criteria would be set independently of the FCA, perhaps in legislation, so that there is a division of powers between setting the terms of the new power and its interpretation.

3.27 It is critical to the proper functioning of this power that it is applied both proportionately and appropriately to ensure that no inadvertent damage is done to financial firms through inappropriate usage of the power.

Q.10 Do you have any comments on the competition proposals for the FCA set out above?

3.28 We support a strong competition role for the FCA. It is vital that a more competitive financial services industry is created which will ensure the best service for customers and stability for the system overall.

3.29 As the Government set out in the Coalition Agreement, a strong mutual sector is vital for a competitive financial services industry which delivers for the consumer and is not reliant on implicit state guarantees. We would therefore urge that our recommendations for minimising the impact of regulatory change upon credit unions are considered carefully as over-burdensome regulations will stifle credit union growth, reduce the multiplicity of firms operating in financial services and therefore work counter to any efforts to promote and / or enforce effective competition.

Q.12 Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA?

3.30 The FCA should be required by statute to consult on its business plan, annual report and any regulatory developments which is proposes. These are key accountability mechanisms for the FSA presently and should absolutely be retained by the FCA. It is disheartening that some of this has been deemed operational by the Government.

3.31 We welcome the retention of the 'Panels' for the FCA and urge the same to be done for the PRA. Bringing the Smaller Businesses Practitioner Panel onto a statutory footing, in particular, is vital to ensuring that smaller firms, such as credit unions, are able to hold the FCA to account.

3.32 We would also urge the Government to consider again the case for stipulating some small firm representation within the formal governance structure of the FCA. This will ensure that the needs of small firms, such as credit unions, are voiced at the highest levels of policy development and will help ensure that the principle of proportionality is effectively implemented.

Q.13 Do you have any comments on the general coordination agreements for the PRA and FCA described above?

3.33 We are disappointed in the Government's response to calls for a single point of contact for dual-regulated firms. Whilst there is some weight in the notion that it is an operational matter to determine such issues, we feel that for small, dual-regulated firms there is a real risk of disproportionate regulatory compliance burden in having to deal with two regulators rather than one.

3.34 The detailed division of responsibilities between the PRA and the FCA is an extremely complex arrangement which, for small dual-regulated firms, is likely to be very difficult to apply on a day-to-day basis. This will increase greatly the resource that must be dedicated to effective compliance.

3.35 A single point of contact, therefore, would ensure a truly proportional experience for dual-regulated firms where the co-ordination of functions between the two regulators can be managed by the regulators themselves leaving firms only to handle their overall regulatory obligations as opposed to two, intrinsically-linked sets of obligations.

3.36 A single point of contact therefore is a key provision for ensuring proportionate treatment of smaller firms and we therefore ask the Government to consider our arguments once more.

3.37 We agree with proposals for co-ordination between the two bodies to be scrutinised by Parliament and to be covered in each body's annual report so that it can be scrutinised by regulated firms and the general public also. It is vital to the efficient running of the new regulatory framework that co-ordination is monitored for effectiveness on an ongoing basis.

3.38 We would also like to see statutory ceilings applied to the increase in overall regulatory costs moving forwards. This would be effective in ensuring efficient co-ordination and prevention of duplicated functions as the regulators' continued supervisory success would be contingent upon streamlined, well-functioning co-ordination and co-operation.

3.39 The possibility for the two regulators to share overheads and central back office functions should be explored and potentially legislated for in order to ensure that the fixed costs of regulation do not multiply as a result of these reforms.

Q.14 Do you have any views on the detail of specific regulatory processes involving the PRA and FCA?

3.40 We have some concerns regarding specific regulatory processes for authorisations, permissions, and approved persons. These are some of the very processes that we would like to be administered via a single point of contact to reduce the resource burden of applying an extremely complex arrangement of two regulators for firms with very limited resource availability.

3.41 Should the Government continue to reject calls for a single point of contact, it must be made absolutely clear to dual-regulated firms which body is responsible for which area of business and which approvals and regulatory processes are conducted by which authority. Joint communications with firms appear to be the simplest way of achieving effective communication of these issues as the interplay between various internal functions and their corresponding regulatory authority will be very difficult for, especially smaller, firms to determine independently.

3.42 We support fully the proposal to assess any regulatory developments for their specific impact on mutuals by way of ensuring a level playing field for different corporate forms. This is entirely in keeping with the Government's commitment to promote diversity and competition in financial services.

3.43 We feel that the proposal for a joint rulebook is an interesting one which should be explored. It would have the effect of minimising – or eliminating entirely – duplication and tension between the two authorities and therefore generally reducing the scope for increased burden on firms. In any case we would like to see provision made for the retention of the Credit Union Sourcebook which has been developed as a proportionate and appropriate response to the specific regulatory needs of the credit union sector and therefore should be retained in order to ensure the continued growth of credit unions in line with the Government's commitment on mutuals.

Q.15 Do you have any comments on the proposals for the FSCS and FOS set out above?

3.44 We have no objections to the proposed treatment of the FSCS and FOS.

3.45 We would like to reiterate, however, our concerns regarding the levy structure of the FSCS and the continued discussions around reform to deposit guarantee schemes at EU-level. It is imperative to the success of the FSCS that, firstly, it reflects in its levy structure the risk posed to it – i.e. that levies are raised proportionate to systemic risk posed – and that levies are affordable to firms. With proposals for pre-funding circulating in the EU and the legacy of the financial crisis continuing to burden FSCS levy payers, there is a real risk that, especially smaller, firms will struggle to meet the ever-increasing costs of deposit guarantees.

3.46 Because credit unions are subject to an interest rate ceiling and are restricted in the kinds of ancillary services they can provide, they are not able to pass through extra regulatory costs to their customers. So whilst increasing FSCS costs may leave consumers in general worse off through higher bank charges, they may have the effect of forcing some credit unions to close. This would be a terrible state of affairs and all possibilities for the future funding of the FSCS must be considered in light of the very substantial problems that the scheme presently faces.

ABCUL – September 2011

A New Approach to Financial Regulation

The ABI's Response to HM Treasury's consultation paper 'the blueprint for reform'

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 HM Treasury's consultation paper *'A New Approach to Financial Regulation: The Blueprint for Reform'*.

Overall Comments

3. The ABI welcomes many of the Government's proposals in the draft Financial Services Bill but we do have some substantial concerns about how the system will operate.

- Close **co-ordination** between the PRA and FCA will be necessary to ensure that the new regulatory structure operates in an efficient and effective manner. It is vital that the PRA and FCA do not duplicate each others' activities. It is particularly important for dual regulated firms that there is effective co-ordination in order to ensure a consistent and proportionate approach to regulation.
- Overall **accountability** arrangements need to be better defined to make clear who is ultimately responsible for decision-making within the system and to ensure clarity and transparency of responsibility between and within the different institutions within the system.

- The proposed **timetable** is very ambitious. The financial sector is facing other substantial regulatory developments, for example RDR and Solvency II. Both firms and the regulatory authorities are stretched responding to these developments and have limited capacity to absorb further changes. The current timetable does not appear to make provision for any transitional arrangements – firms will require time to make changes to documentation and review and implement changes arising from the new rulebooks.

- We think there is a clear risk that fees will increase under dual-regulation. It is therefore important that there is greater transparency to help ensure additional overheads or any rises in regulatory fees looked at across both regulatory bodies (together with FOS, FSCS and MAS) are proportionate and represent value for money for customers who, ultimately, finance regulatory costs. We believe that there also needs to be a stronger commitment by the regulatory authorities over future cost control as there has been a marked increase in regulatory fees for insurance firms over recent years.

- The proposed UK architecture does not fit well with the EU structures. The **European Supervisory Authorities** (ESAs) are based on a sectoral approach (banking, insurance, securities) rather than the functional (prudential and conduct) approach being pursued by the UK Government. This will mean that there will be an onus on the UK authorities to ensure proper co-ordination to ensure that UK interests are fully represented on the ESAs by the appropriate authority. The ESAs are becoming the main source of detailed regulatory requirements for UK financial services firms for both prudential and conduct issues. In order to retain their influence the UK authorities will have to do more to guide the process of setting EU rules. This is likely to require new skills on the part of UK representatives on the ESAs – negotiating and influencing skills and a higher level of political awareness will be needed in addition to a high degree of technical skill. This needs to be taken into account in selecting UK representatives on the ESAs and more generally in the recruitment of staff to the UK regulatory bodies and the setting of work priorities and allocation of resources. The UK authorities should also work closely with industry to ensure wherever possible that a unified UK approach is taken.

- We are concerned that some of the powers proposed for the new bodies may go beyond what is permissible under **EU law**. For example, it is by no means clear that all of the intrusive product regulation powers proposed for the FCA are permitted under the terms of MiFID or the Life and Non-life Framework Directives. Equally, it is not clear that the proposed PRA powers over branches of foreign domiciled providers of financial services are compatible with the usual split of responsibilities between home and host regulators in EU legislation. We get the impression that compatibility with EU law was a rather late consideration when the Government was formulating its proposal, and that it has been grafted on after the main ideas were fixed. Clearly it is essential for legal certainty that the Government goes back and checks that all the proposed powers are indeed compatible with EU legislation.

Bank of England and the Financial Policy Committee

4. We agree with the decision of the Government to set up a Financial Policy Committee (FPC) to oversee the Bank of England's financial stability remit and are content with most of the proposals in the Bill concerning the FPC. However, we continue to have concerns in a number of areas:

- The current proposals give the **Bank of England** wide powers over aspects of economic as well as regulatory and monetary policy. The Government must ensure that it retains overall control of economic management and has powers to ensure that the Bank of England complies with its priorities.

- The FPC needs to ensure that it draws on a wide variety of **experience** (including from the insurance sector) and we are concerned that as presently constituted the FPC is overly weighted towards Bank of England insiders.

Prudential Regulatory Authority

5. We welcome the setting up of the PRA and in particular the recognition by the Government that insurers need to be considered separately and be subject to sector specific regulation.

- The proposed **general objective** clearly sets a micro-prudential remit for the PRA (which we believe is the correct focus) whereas the PRA seems to be required to meet this objective by focusing on financial stability issues (a macro-prudential objective). We believe that the focus of the PRA should be on its micro-prudential remit of ensuring the prudential soundness of individual institutions while macro-prudential policy is a matter for the FPC.

- We agree with the focus of the **insurance objective** being on policyholder protection. However, we are unclear about the implications of extending the objective to cover those who 'may become policyholders'. While both the firm and the regulators have a clear responsibility for ensuring adequate protection of policyholders it is not clear that any such duty extends to the as yet undefined category of those who may become policyholders or what the regulatory implications of ensuring adequate protection for this class of person would entail.

- We remain unclear about how the proposed **judgement-led** approach will operate alongside UK regulatory requirements which will have to comply with relevant EU directives (such as CRD and Solvency II) which contain many detailed, technical rules. The UK regulatory regime sits within the EU level regulatory regime, and EU level rules and decisions take precedence over rules and decisions generated domestically. The UK regime needs to be transparently situated in its EU context if regulated companies are to avoid double jeopardy. To avoid regulatory uncertainty and supervisory confusion for regulated companies, it is essential that judgement-led decisions are communicated transparently in their EU context, and cleared prior to promulgation with the necessary EU authorities where this is necessary.

- The requirements for the PRA to **consult** are much improved since the initial consultations but remain less secure than those for the FCA. Many of the requirements to consult are to be developed by PRA rather than being set out in legislation.

Financial Conduct Authority (consumer)

6. The ABI welcomes the opportunity for a fresh start in conduct regulation. We need a regulatory framework that commands consumer and industry confidence and allows a competitive market to deliver positive outcomes for consumers.

   - We are broadly content with the FCA's proposed **objectives** and the statutory duty to promote competition. However, there should be a specific requirement on the FCA to increase access to financial products. This will ensure that FCA places due weight on the value of consumers accessing products that meet their needs, and does not act as a barrier to more saving and a resilient society.

   - More clarity is needed from Government and the FSA about the FCA's enhanced role in influencing the **products** that are available in the market. Regulators should not be involved in designing or approving financial products. Instead, the focus should be on effective, proactive and consistent supervision and enforcement of the existing requirements on firms to treat customers fairly, including when developing products.

   - We are very concerned by the proposal that FCA could publish a warning notice indicating that it has commenced an **enforcement** action. This could cause lasting reputational damage to the firm (and indeed the regulator) before the facts have been fully determined, and before the case has been proven.

   - We support the **Financial Ombudsman Service** (FOS) in its important role as an independent and free service for resolving individual disputes. However, the respective responsibilities of the FCA, FOS and the courts should be set out in statute. For example, novel points of law should be referred to the courts and broader regulatory matters determined by the FCA. In addition, new measures are needed to ensure that the FOS is properly transparent and accountable.

   - We have reservations about the proposed new requirement on the FOS to **publish reports of their determinations** (unless the ombudsman concerned considers it 'inappropriate' to do so). This is a significant change in policy, particularly combined with recently enhanced FSA rules/guidance requiring firms to take account of ombudsman decisions. There is a danger that the stock of ombudsmen determinations will unintentionally be interpreted by firms and consumers as a second rulebook. It may also deter firms from appealing an adjudicator's decision to an ombudsman, even if they regard the adjudicator's decision to be a poor one. We believe open debate and consultation is needed about the implications of this new power, led by the FCA when it is established. In the meantime, we suggest the FOS should have the statutory option (rather than statutory obligation) to publish determinations, and this should be balanced by safeguards for a firm to challenge publication which it considers would be inappropriate.

- We should be wary of a ‘compensation culture’ being fuelled by the rapid expansion of **Claims Management Companies** (CMCs). CMCs are involved in nearly half of all cases that go to FOS, even though the FOS has pointed out that they do not deliver better outcomes for consumers, and they take a considerable proportion of redress payments. The current regulatory framework for CMCs (low key and under-resourced Ministry of Justice regulation) is inadequate so the Government should consider inclusion of CMCs within the regulatory scope of the FCA.

Financial Conduct Authority (markets)

7. We agree that responsibility for markets regulation should be within the FCA but have some concerns with the Government’s proposals:

- The approach of the FCA with its strong consumer focus creates a considerable risk that **wholesale market conduct** will be viewed through a retail lens. The output from the FCA Approach to Regulation document concedes that there may be differences between the retail and wholesale markets, but envisages greater emphasis in future on wholesale conduct, both for its knock-on effect on retail markets and for its systemic impact. More thinking is needed on this including the way in which UK approaches will interface at European level with a MiFID regime which is currently subject to review.

- As investors we are concerned that responsibility for **regulation of clearing and settlement** will rest wholly with the Bank of England. It is well-understood that the Bank should be closely interested in the effective and safe operation of systemically important infrastructure. However this is ancillary architecture that supports the operation of markets and needs a close working relationship to be established with the FCA as markets regulator. We believe an appropriate specification of shared responsibility, which has precedents in other jurisdictions applying similar twin peaks regulatory model, is needed for the UK.

8. The attached annex sets out our comments in more detail including comments on specific provisions in the draft Bill.

ANNEX

Questions for Consultation

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

We agree with the decision of the Government to set up a Financial Policy Committee (FPC) to oversee the Bank of England's financial stability remit and are content with most of the proposals in the Bill concerning the FPC. However, we continue to have concerns in a number of areas:

- The current proposals give the Bank of England, through the FPC, wide powers over macro-prudential policy – decisions taken by the FPC could have significant impacts on the real economy. The Government must ensure that it retains overall control of economic management and has powers to ensure that the Bank of England complies with its priorities. We are not convinced that the requirement (in draft section 9C(4)) for the FPC to ensure that its actions do not have a significant adverse impact on the financial sector provides adequate checks and balances.

- The FPC needs to ensure that it draws on a wide variety of experience (including from the insurance sector) and we are concerned that as presently constituted (draft section 9B(1)) the FPC is overly weighted towards Bank of England executives.

- It would considerably aid debate about how the FPC will operate if information about the proposed range of potential macro-prudential tools was available for the pre-legislative scrutiny phase rather, than as currently proposed, only for the introduction of the Bill.

- We are concerned that the power in draft section 9H(2) will enable new rules to be imposed on firms without proper consultation. We believe that the regulatory authorities should only make rules to implement a FPC direction without consultation where this would meet the requirements of draft section 138M of FSMA. This would still enable directions to be implemented speedily where necessary but would preserve the normal procedures that apply to rulemaking by the regulatory authorities – as it stands the power in section 9H(2) will enable the normal procedures to be by-passed at the whim of the FPC.

- We are unclear about the purpose of draft section 9P. This allows the FPC to make recommendations to any person (other than the Treasury, Bank, PRA and FCA which are specifically covered by other sections of the Bill). It is unclear under what circumstances the FPC may give such recommendations, whom they may be made to, what action the recipient of such recommendations is expected to take or what the consequences of rejecting such a recommendation might be.

It is clear that most of the thinking in relation to the work of the FPC and the macro-prudential tools that it might adopt has been focused on the banking sector. We agree that this is the correct focus given the much greater risks to financial stability posed by banks compared to insurers. However, we understand that the FPC will, quite rightly, include insurance within its remit. Therefore, there will be a need for the FPC to consider the need for macro-prudential tools to tackle problems that might arise in the insurance sector. As the Treasury and FSA have acknowledged, insurers operate different business models from banks and so it will not be appropriate for macro-prudential tools designed for banks to be applied to insurers. The FPC needs to give separate consideration to insurers and should ensure that it has access to relevant expertise within its membership in order to undertake this work.

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

We still have serious reservations about the arrangements for regulation of systemically-important infrastructure. As referred to in the Summary of Responses to the February 2011 consultation on '*A new approach to financial regulation*' there was considerable emphasis on the need to ensure effective co-operation between the Bank of England and the FCA in an area of key concern to the markets regulator. We suggested in our response that the need for such co-operation needed to be clearly referenced in the legislation through a duty on the bank to consult the FCA and share relevant information. However, no means of promoting this co-operation has been provided under the legislative proposals.

We agree that the Bank, in its role as guardian of financial stability, needs to be closely interested in the effective and safe operation of systemically important infrastructure. The resilience of the payments system is of particular importance to the effective operation of the banking sector. However, the scope of the Bank's regulatory and supervisory remit is now to run well beyond this and into territory that is of primary concern to the markets regulator. Just as the boundaries of banking activity have expanded and become blurred so has the definition of ancillary services and infrastructure such as central clearing houses that support banking as opposed to market activity. This is an argument for shared responsibility for supervision between banking and market regulators which we now believe needs to be enshrined in the Bill. This would also greatly enhance the ability of the UK through the FCA to engage credibly at the European level where ESMA rightly has responsibility for the relevant activities.

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

We welcome the proposals in the draft Bill in relation to crisis management. However, whether the arrangements work in a crisis will be dependent on the working relationships between the parties rather than on the legal requirements. We do not, therefore, think that we can comment further until the draft MoU on crisis management is available for comment.

There is considerable work being undertaken internationally on crisis management (for example, we understand that EU proposals on crisis management are expected in the autumn) and it is essential that any UK measures are compatible with international developments.

In relation to the wording of draft clause 43 we are concerned that 43(5)(c) could, at least in theory, allow EU authorities (notably the ESAs) to be parties to the proposed MoU on crisis management. While it is clearly important that the UK authorities maintain close relationships with the EU authorities during a crisis it is not clear that it would be appropriate for them to be party to the proposed MoU.

More generally we are concerned that almost all the thinking about crisis management, whether in the UK or at EU and international level, has been focused on banks. The very different nature of insurers means that solutions which may be appropriate in a banking context will not be relevant to insurers. In particular we would note that where an insurer fails its liabilities will fall due over an extended period which allows time for regulatory intervention and enables insolvent insurers to be resolved under ordinary insolvency laws. For these reasons we do not believe that insurers need to be subject to the equivalent of the SRR process that applies to banks.

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

We agree with the proposed scope of the PRA.

We are grateful for the recognition in the draft Bill of the need for the PRA to have a specific objective for insurers. We also welcome the proposal in draft section 2H that the PRA must give guidance on how it intends to advance its objectives and will provide specific guidance on each sector. However, we believe that further thought needs to be given to the proposed objectives of the PRA:

- We agree with the general objective as set out in draft section 2B(2). However, it is not clear to us that this is consistent with subsection (3). The general objective clearly sets a micro-prudential remit for the PRA (which we believe is the correct focus) whereas subsection (3) seems to require the PRA to meet this objective by focusing on financial stability issues (a macro-prudential objective). We believe that the focus of the PRA should be on its micro-prudential remit of ensuring the prudential soundness of individual institutions while macro-prudential policy is a matter for the FPC.

- We agree with the focus of the insurance objective (in draft section 2C(2)) being on policyholder protection. However, we are unclear about the implications of extending the objective to cover those who ‘may become policyholders’. While both the firm and the regulators have a clear responsibility for ensuring adequate protection of policyholders it is not clear that any such duty extends to the as yet undefined category of those who may become policyholders or what the regulatory implications of ensuring adequate protection for this class of person would entail.

- We agree that provision along the lines of draft section 3F (with-profits policies) is needed and that it is correct for the PRA to be responsible for matters related to policyholders' reasonable expectations. We will, however, consider further the drafting of the section to be sure that it is appropriate and adequate, particularly in relation to the definition of 'surplus'.

The ABI considers that the regulatory principles should include a requirement on the PRA (and the FCA) to take account of the competitiveness of the UK financial services industry in setting its rules. The FSA is subject to a similar requirement. The UK financial services industry is a world leader and this provides substantial benefits to the wider UK economy through creating many skilled jobs, its impact on the balance of payments and on tax receipts. An effective 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 burdensome costs for UK wholesale and retail consumers.

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

We remain unclear about how the proposed judgement-led approach will operate alongside UK regulatory requirements which will have to comply with relevant EU directives (such as CRD and Solvency II) which contain many detailed, technical rules. The UK regulatory regime sits within the EU level regulatory regime, and EU level rules and decisions take precedence over rules and decisions generated domestically. The UK regime needs to be transparently situated in its EU context if regulated companies are to avoid double jeopardy. To avoid regulatory uncertainty and supervisory confusion for regulated companies, it is essential that judgement-led decisions are communicated transparently in their EU context, and cleared prior to promulgation with the necessary EU authorities where this is necessary.

The requirements for the PRA to consult are much improved since the initial consultations but remain less secure than those for the FCA as many of the requirements to consult are to be developed by PRA rather than being set out in legislation. In particular, we believe that requirements for practitioner panels (similar to those currently existing for the FSA and proposed for FCA) should be included on the face of the Bill.

Paragraph 2.68 of the paper notes that the insurance industry was keen that there should be insurance expertise on the PRA Board but there is no requirement in the legislation for any of the members of the Board to have insurance (or any other relevant) expertise. We believe that the legislation should make clear that Board members will be chosen on the basis of having relevant expertise – this could take the form of a requirement similar to that proposed for FPC members in section 9B(3)(a) of the Bank of England Act 1998.

Other than this we are largely content with the detailed arrangements proposed for the PRA.

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

As stated in our response to the previous consultation on regulatory reform, the ABI considers that the proposed strategic and operational objectives are a sensible balance. However, the FCA should be explicitly required to facilitate consumer 'access' to financial services. The FSA often points out that it is not statutorily required to put weight on the potential benefits from more consumers having access to financial products that meet their basic financial needs. If the Government wants to ensure that the FCA does not act as a barrier to additional saving and a resilient society, we suggest a reference to access should be added to the efficiency/choice objective.

We support the proposed FCA free standing duty to have regard to the need to minimise the extent to which firms may be used for purposes connected with financial crime. But the FSA's consultation on the FCA's approach to regulation did not specify any new measures or strategy with regard to financial crime. We suggest that this is an area that requires further thought during the transition to the new regulatory framework and we urge the FSA to prioritise the development of a clear strategy for combating fraud. The FCA will need to exercise judgement on the extent to which firms should have controls in place to prevent financial crime (e.g. on anti-money laundering) given that this might adversely impact on access to insurance.

The ABI welcomes a greater regulatory focus on effective competition given its importance in delivering good outcomes for consumers. However, we agree that pursuit of competition should not be the exclusive objective of the FCA, given the other important considerations such as consumer protection and market integrity.

As stated in our response to question 4 above, we believe the FCA should be subject to a regulatory principle requiring it to take account of the competitiveness of the UK industry.

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

The ABI stresses we need a regulatory framework that commands consumer and industry confidence and allows a competitive market to deliver positive outcomes for consumers. So we support a more proactive approach to regulation but this should be risk-based, focusing on retail markets where there is evidence of consumer detriment and market failure. We can see little need to add to the FSA's extensive rulebook and instead suggest the FCA should focus on effective, proactive and consistent supervision and enforcement of the existing requirements on firms to treat customers fairly, including when developing products. To that end, we do not support the FSA's suggestion that the FCA will significantly reduce its investment in individual supervision of firms, as we have made clear in our response to the consultation on FCA's regulatory approach.

We are concerned about the proposed additional product intervention powers proposed in the draft Bill and, in particular, the right to make temporary product intervention rules without consultation and cost-benefit analysis (CBA). Although we are somewhat reassured that the FCA will be required to publish a statement of policy on the use of this power, we are not persuaded that the suspension of basic regulatory safeguards is justified. Legislative safeguards are needed to ensure that any such power is used as a last resort rather than on a regular basis.

We also remain strongly opposed to the early publication of disciplinary action against firms and we are disappointed that the Government has maintained its commitment to a power which appears contrary to natural justice. There is a risk it will cause lasting reputational damage to firms before the facts have been fully determined, and before the case has been proven. At the very least, we propose there should be stronger statutory safeguards on the use of the power, such as requirements on FCA to consider the impact of the disclosure upon the firm, and to publicise discontinuation of the enforcement action.

The FCA should be encouraged to work with the Money Advice Service to build consumer confidence about financial products so that consumers become more confident in taking responsibility for their financial decisions.

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

We are not clear why a new statutory process is needed in order for the FCA to deal with any future issues that are causing mass detriment. Given the FCA's proposed objectives, powers (including the FSA's recently enhanced consumer redress powers) and considerable resources it might reasonably be expected that the FCA would be in a position to take responsibility for addressing such issues, without requiring external parties to alert them. Furthermore, granting such a power to FOS may compromise their role as an independent alternative dispute resolution service, and create a public perception that they are a consumer body. However, if a process of this sort is established, consumer bodies should be required to meet clear criteria to become a nominated party, and they should be expected to submit clear evidence of detriment if they are to put an issue on the FCA's agenda.

More generally, we do believe there is a need for more clarity about the respective roles of the FOS and the FCA. We agree with the Government that the FOS should be able to focus on processing individual complaints on a case-by-case basis rather than having to deal with mass issues. We hope that there will be few, if any, cases of mass detriment in the future, given the FCA's commitment to early intervention and the work of the insurance industry and others to address risks of consumer detriment. But if there are future cases on the scale of PPI we agree it would be better for the regulator to take the lead in resolving the matter rather than FOS.

More broadly, we suggest that it is not the role of individual ombudsmen to privately make final decisions on precedent-setting cases, which could have wider implications for potentially thousands of similar cases. The small minority of cases that fit into this category ought to be referred to the FCA or the courts.

We believe the legislation and FCA rules should set out a clear process for decision-making on cases requiring regulatory or legal clarification, perhaps building on the recently established FOS, FSA and OFT Co-ordination Committee. This might include giving trade associations and other stakeholders the right to refer such cases to the appropriate body. The legislation should also require FOS to take account of the relevant regulation at the relevant time when making determinations.

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

In the event that the Government does provide statutory powers for FOS and other nominated parties to refer potential causes of mass detriment to the FCA, we agree the FCA should set out its response in a timely manner. It will, however, need time to consult with the industry and other parties, and to properly assess the costs and benefits of alternative approaches.

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

We are content with the specific proposals regarding the FCA's competition powers. However, we believe further thought needs to be given to the implications of the FCA's enhanced role in ensuring competition in financial services. Given the OFT will retain general competition law powers and the right to conduct market studies in relation to financial services markets, there is a risk of duplication and/or lack of coordination between the two bodies. We suggest the FCA and the OFT ought to be subject to a statutory duty to cooperate and to produce a Memorandum of Understanding (the FSA and OFT have voluntarily published a MoU in recent years). This should make it clear that the FCA would normally take the lead on competition matters in financial services markets, and the OFT would only undertake market studies in exceptional circumstances.

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

The approach of the FCA with its strong consumer focus creates a considerable risk that wholesale market conduct will be viewed through a retail lens. The output from the FCA Approach to Regulation document concedes that there may be differences between the retail and wholesale markets, but envisages greater emphasis in future on wholesale conduct, both for its knock-on effect on retail markets and for its systemic impact. More thinking is needed on this including the way in which UK approaches will interface at European level with a MiFID regime which is currently subject to review.

We are largely supportive of the legislative proposals as regards wholesale and markets regulation and in respect of the FCA's role as the UK Listing Authority. As regards the latter we firmly support the Government's decision to retain the Listing Authority role within the markets regulator.

We share the concerns, acknowledged in the consultation document, over the powers of the FCA as Listing Authority to require issuers and others to commission skilled person reports. The scope of such reports would therefore be extended to those companies who list their shares but who are in a quite different position from companies who properly come within the scope of regulatory jurisdiction as financial services companies. We are not convinced that this is a proportionate provision, or that it could with any confidence be expected to help strengthen the listing regime and maintain London's reputation as a leading centre for capital raising and primary markets without compromising the ability of UK businesses to obtain the financing they need.

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

The ABI is generally content with the proposed arrangements for the governance and accountability of the FCA and we particularly welcome the provision for the National Audit Office (NAO) to launch value for money investigations into the FCA.

We do, however, have serious concerns about the erosion of 'due process', in various parts of the Bill. In a more interventionist and judgement-based regulatory environment, the ability to challenge the regulator's decisions should be strengthened not weakened. For example, we are surprised by the proposal that the Upper Tribunal should no longer be able express an opinion about the appropriate cause of regulatory action in the event that it does not uphold the FCA's original regulatory decision.

As outlined in more detail in our response to Q7, we are also concerned by the planned suspension of requirements to consult and conduct a CBA when the FCA makes use of its product intervention powers, and the proposals around early warning notices.

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

Close co-ordination between the PRA and FCA will be necessary to ensure that the new regulatory structure operates in an efficient and effective manner. It is vital that the PRA and FCA do not duplicate each others' activities. It is particularly important for dual regulated firms that there is effective co-ordination in order to ensure a consistent and proportionate approach to regulation. We, therefore, welcome the proposed statutory duty of co-operation.

The proposed MoU between the PRA and FCA will clearly be a vital tool for ensuring that co-operation works in practice – we believe that the Government should ensure that a draft of the MoU is available for public discussion during the pre-legislative scrutiny phase, rather than being delayed until the time the Bill is introduced, in order to inform debate at this important stage of the process.

We are generally content with draft section 3D setting out the duty to co-operate. However, we are concerned that the exemptions in section 3D(2) could, if interpreted widely, significantly limit the requirement to co-operate. We would propose that additional guidance should be given making clear the extent to which these exemptions might be used to disapply the duty to co-operate in particular circumstances.

The list of issues to be covered in the MoU in draft section 3E(2) seems comprehensive but more detailed comments are not possible until the draft MoU becomes available. However, whether the arrangements work in practice will be dependent on the working relationships between the parties rather than on the legal requirements. It will, therefore, be important for the FSA and Bank of England to ensure that close working relationships between the units that will become the PRA and FCA are built up and maintained during the period of ‘internal twin peaks’ which is currently being introduced and will last until the revised legislation comes into force. These close working relationships will need to be formed at all levels of the respective organisations. We will look to the FSA and the Bank of England to keep the industry informed of its progress in developing the ‘shadow’ PRA and FCA and to consult where appropriate.

In relation to the proposed legislation on the MoU we have the following comments:

- Draft section 3E(4) to 3E(7) requires that the MoU is regularly reviewed and published. We welcome these requirements. However, there is no requirement for the PRA and FCA to consult on changes – we believe that the authorities should be required to consult. How the authorities work together will impact directly on regulated firms and it is important that they are able to comment on proposed changes which may impact on them.
- Draft section 3E(8)(b) allows technical or operational issues relating to co-operation between the authorities to be left out of the MoU. We are concerned that this will allow issues which have a direct and material impact on firms to be omitted and we believe that any agreements covering such issues should be made public.

From the point of view of dual-regulated firms a single point of contact and a single rulebook would provide greater clarity in their dealings with the regulators and would help to ensure that overlaps and inconsistencies were avoided. However, requiring such an arrangement on a legal basis would not be in keeping with the underlying intention of the proposed reforms. However, it would make sense for the PRA and FCA to undertake joint working wherever possible to minimise the burden on firms. It is also essential that where both the PRA and FCA have an interest in a particular section of the rule book that any rules and subsequent changes are made jointly in order to ensure that differences do not arise between the requirements of the two regulators.

We think there is a clear risk that fees will increase under dual-regulation. It is therefore important that there is greater transparency to help ensure additional overheads or any rises in regulatory fees looked at across both regulatory bodies (together with FOS, FSCS and MAS) are proportionate and represent value for money for customers who, ultimately, finance regulatory costs. We believe that there also needs to be a stronger commitment by the regulatory authorities over future cost control as there has been a marked increase in regulatory fees for insurance firms over recent years.

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

We note the Government is proposing (in draft section 55A) that authorisations should be carried out by the PRA (in consultation with the FCA) for PRA authorised firms and otherwise by the FCA. We welcome the Government’s move towards a more unified approach in comparison with its proposals in its earlier consultations.

However, the proposed approach will still require both the PRA and the FCA to have teams to undertake authorisations which could give rise to additional costs for firms. We continue to believe that the most appropriate approach would be for all authorisations to be carried out by the FCA (subject where appropriate to agreement by the PRA).

We are concerned that the proposed process for approving holders of controlled functions (clause 11) appears unnecessarily complex and is not yet fully thought through. It is unclear from the drafting which regulator will be responsible for designating and approving some functions. We would continue to suggest that it would be more appropriate for there to be a joint responsibility on the part of PRA and FCA to approve holders of significant influence functions for dual-regulated firms. Whatever system is put in place it is important that it is run as efficiently as possible to ensure that the approval process is undertaken quickly and with the minimum of overlap. Candidates should only have to put forward one application and attend a joint interview. In order to ensure this it would be appropriate, as with authorisations, for either PRA or FCA to take the lead in processing applications consulting the other as necessary.

Our members are already concerned by the length of time which it can take for the FSA to agree authorisations and approve candidates for significant influence functions and by how onerous these processes can be – we are particularly concerned that many potential candidates for roles within financial services firms (particularly non-executive directors) will be unwilling to undergo these processes thereby reducing the number of available candidates. These delays are inefficient and potentially costly. We are concerned that the current proposals will exacerbate this situation.

We are also concerned by the planned halving (from 28 to 14 days) of the minimum period that firms have to make representations before warning notices are issued, which exacerbates our concerns about early publication.

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

The ABI supports what we understand to be the Government's main objectives in relation to FOS:

- Retaining an independent alternative dispute resolution body
- Making the respective roles of the regulator and the ombudsman service clear and distinct
- Strengthening the accountability of FOS

We therefore welcome some of the specific legislative changes included in the draft Bill, such as requiring FOS to publish an annual plan and making it subject to NAO audit.

However, we suggest additional statutory measures are needed in order to achieve the Government's stated objectives. As set out in response to Q8 above, we believe clarity is needed about the respective roles of the regulator and the ombudsman service in the rare occasions where individual complaints raise matters which require regulatory accountability.

To strengthen the accountability of FOS, we suggest FCA should conduct regular reviews of its overall operations, policies and procedures. This would not, and should not, compromise the operational independence of ombudsmen when adjudicating on individual cases.

We also suggest that the ombudsman service should be required to exercise its functions in a manner which is consistent with the FCA's strategic and operational objectives and the regulatory principles. The Legal Services Ombudsman is subject to a similar high-level requirement to operate within the regulatory framework for legal services, and we consider this to be a reasonable discipline on FOS. The FOS should also be required to consult with stakeholders before it issues guidance (or 'technical notes') about its procedures and its approach to handling common categories of cases.

We have reservations about the proposed new requirement on the FOS to publish reports of their determinations (unless the ombudsman concerned considers it 'inappropriate' to do so). This is a significant change in policy, particularly combined with recently enhanced FSA rules/guidance requiring firms to take account of ombudsman decisions. There is a danger that the stock of ombudsmen determinations will unintentionally be interpreted by firms and consumers as a second rulebook. It may also deter firms from appealing an adjudicator's decision to an ombudsman, even if they regard the adjudicator's decision to be a poor one. We believe open debate and consultation is needed about the implications of this new power, led by the FCA when it is established. In the meantime, we suggest the FOS should have the statutory option (rather than statutory obligation) to publish determinations, and this should be balanced by safeguards for a firm to challenge publication which it considers would be inappropriate.

The ABI continues to believe that responsibility for regulation of Claims Management Companies (CMCs) should be transferred from the Ministry of Justice to the FCA, given the large number of CMCs that get involved in financial services complaints. Stronger regulation is needed to address consumer detriment associated with some CMCs, including high fees for poor service, misleading communications, unsolicited advertising and fraudulent activity.

We are content with the accountability and governance proposals in relation to the FSCS. However, there will be a need for the future funding structure of the FSCS to be determined under the new regime - FSCS funding policy is currently set by the FSA and it is unclear what will be the respective responsibilities of the PRA and the FCA. The ABI remains strongly opposed to cross-subsidy between sectors and believe that the existing arrangements should be dismantled as part of any revised policy.

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

1 September 2011

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

AFM Response to consultation on the blueprint for reform

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 in the blueprint paper.

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 55 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 have actively engaged in the process of regulatory reform, and it is pleasing to see the way in which the new regime has been articulated. The government has sought to align the roles of FPC, PRA and FCA with clear statutory objectives, and taken careful consideration of comments in developing the more detailed picture.

5. We are in particular pleased that the government has sought to explore ways in which the new regulatory regime encourages support for corporate diversity. The proposals made, and the positive way in which FSA has sought to take some of these on board already, are very encouraging.

6. Detailed responses to individual questions raised in the consultation are attached.

7. We would be pleased to discuss further any of the issues raised by our response.

Yours sincerely,

Martin Shaw

Chief Executive
Association of Financial Mutuals

Responses to specific questions

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

We agree with the proposal for Treasury to set a remit annually for the FPC, and for the FPC to respond- with explanation of the degree to which it agrees with the remit and what actions it plans. This will ensure there is proper two way dialogue and accountability- in particular it is important that FPC is given clear evidence that its work is not swayed by political as opposed to economic influence by the Treasury.

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

We have no comments.

3 Do you have any comments on:

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

The approach to crisis management in many respects amounts to the single most important aspect of the new regulatory regime. The failure to work effectively and in a co-ordinated manner of the three separate agencies involved in overseeing the banking crisis in 2008, resulted in the crisis worsening and a calamitous fall in consumer trust in financial services.

Knowing when and how to intervene is crucial, and requires constant monitoring, as well as a more effective analysis of the underlying drivers to the success, and failure, of the financial system.

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

We support the introduction of a specific **insurance objective** for the PRA. This should avoid the concern that as previously set out, the PRA's approach was too strongly directed towards deposit-takers. The wording of the proposed objective refers to "contributing to the securing of an appropriate degree of protection for those who are or may become policyholders". In a proprietary insurer, the phrase "may become policyholders" is likely to be interpreted as relating to the product development and sales process. In a mutual insurer, there is a wider responsibility explicit in the operating model, that the mutual has a responsibility to manage its finances in the best interests both of today's, but also future, members. This appears to be consistent with the proposed objective, and would require PRA to look beyond the protection of today's policyholders only, and as a result we believe the draft objective is appropriate.

We agree with the inclusion of **revised competition scrutiny** for both the PRA and FCA. The possibility of challenge if a regulator is considered to have prevented, restricted or distorted competition is clearly not as strong as if an objective to encourage competition was inherent in the role of PRA, but should adequately ensure the regulators pays constant regard to the impact of their work on competition.

We are grateful to the government for acting on our recommendation that the authorities "consider and consult on the impact of proposed rules on **mutual societies**". We believe this will:

- Encourage regulators to enable mutuals to compete on more equal terms with non-mutuals;
- help avoid clumsy and lazy rule-making, which in the past has created unintended consequences of rules designed for shareholder-owned companies which translate poorly to mutuals;
- open the eyes of regulators to the value of different forms of business model, and encourage the evolution of outcome-based rules that properly allow firms to achieve agreed outcomes by different approaches; and
- broaden dialogue with and understanding of the mutual sector.

We are pleased to note that in anticipation of this requirement, FSA has appointed a senior person to lead work within the Prudential Business Unit on mutual insurance (mirroring the position for building societies).

The draft amendment to FSMA, section 138L, requires a regulator to set out a statement, where the impact will "be significantly different" (for a mutual as opposed to another corporate form). This appears to leave discretion to the regulators on:

a) what is significant; and
b) when the impact is different.

We anticipate this could cause problems in the future, either because it leaves open the possibility that the rule developer has not considered the mutual impact, or where the specific impact the rule is focusing on has consequential implications elsewhere. We consider that it would be preferable to ask the regulators to include a statement in relation to mutuals within each consultation, unless it can satisfy itself that there is either no differential impact on mutuals, or no impact at all. This would require a regulator to always consider whether there is a different impact on mutuals which would lead to more effective rule-making.

We also agree with the proposal that PRA will have "sole responsibility for securing an appropriate degree of protection for the reasonable expectations of policyholders as to their returns under **with-profits** policies". We recognise at the same time that this raises important consumer protection issues, and that the PRA will seek to consult with FCA on the interests of policyholders. We would anticipate that the coordination MOU should be sufficient to ensure such consultation between PRA and FCA is effective.

With regard to the draft wording, we note that the definition of with-profits policy at section 3F (2) is different to, and potentially wider than, the glossary definition provided in the FSA Handbook (which defines with profits as: "a contract falling within a *class* of *long-term insurance business* which is eligible to participate in any part of any *established surplus*". We think the misalignment of these definitions could present problems in the future, if new forms of with profits policy emerge.

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

We are comfortable with the detailed arrangements for PRA.

We agree that both PRA and FCA should be bound by the same consultation principles as FSA. This is a vital aspect of the regulatory process, and it is important that regulators respect the importance in engaging in effective discussion on regulatory developments. We have seen in the recent past an unhealthy disregard for proper consultation in parts of the FSA, with a reluctance to change plans, even where they produce unintended consequences or unreasonable outcomes. By way of example:

- There has been a long-running debate between FSA and the mutual insurance industry regarding the management of with-profits fund. FSA aligned itself with one piece of legal advice and in so doing dismissed nine other advice to the contrary;
- Child Trust Funds have important concessions from Treasury, designed to ensure they can be operated at low cost, particularly for disengaged customers. A recent consultation/ policy statement from FSA undermines that by requiring providers to issue fund reports and accounts even though these contradict the Treasury position and offer no value to the majority of customers.

We agree with the proposed retention of the FSA's current grounds of appeal for PRA and FCA. We do not consider that this is inconsistent with a judgement-led approach, but helps ensure that regulators are fair, rigorous and evidence-based in the way they exercise judgement.

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

We support the FCA's objectives. In particular we agree that FSA needs to play a role in promoting competition. Issues such as consumer protection, market integrity and competition are not always likely to have a strong overlap, so it is important that in its approach FCA is balanced, fair and realistic.

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

The blueprint document provides helpful amplification of the intended use by FCA of powers for product intervention, financial promotions and early publication of disciplinary action, and of how the government is constructed safeguards with a view to reducing the risk of reputational damage. We support the need for the FCA to take positive and significant action sometimes to protect consumers, but it must also recognise that these powers must be handled sensitively and carefully and with proper accountability.

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

We support the proposal to allow nominated parties the opportunity to refer issues to FCA that may cause mass detriment. FSA has always operated a process for dealing with cases with wider implications, but this was poorly developed and underused. The process envisaged that as well as the FOS and consumer agencies, a wide range of parties might refer an issue with wider implications, including a firm itself or a group of consumers.

There have in reality been few cases where the existing process works properly. This is in spite of the significant data that parties like FOS or the OFT hold, and the clear warning that issues had a wider impact. In particular, strong evidence of the shortcomings of the current approach are exposed by FSA's failure to tackle in a timely fashion (and without a super-complaint sponsored by Which?), the consumer detriment resulting from the mis-sale of payment protection insurance by banks.

The proposal to limit the new process to nominated parties should enable FCA to seek common agreement on the grounds for triggering its process for dealing with mass detriment, and to act more seriously on issues that are referred to it.

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

Box 2.H indicates there will be a requirement for FCA to state publicly whether an issue is causing mass detriment, and what it plans to do. There is a risk however that in some situations, where the regulator confirms an issue has been referred to it, and even where it concludes there is no mass detriment, this could trigger further speculation from the media and a negative response from consumers that in itself could result in that detriment (cashing in a long-term policy, or causing a run on the bank may be examples of this).

To avoid this, FCA should either avoid publicising referrals where it concludes there is no mass detriment, or have an explicit MOU with nominated parties to highlight the basis by which an issue can be referred and the weight of evidence that is needed to support a referral.

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

We support the government view that competition in financial services is an important part of the required reform of financial services. It is vital that markets work efficiently and in the best interests of consumers, and that anti-competitive practices, which distort the market and undermine confidence are acted on properly.

We are pleased, as highlighted above, that the government will require PRA and FCA to consider the different impact that new rules might have on mutual organisations.

More broadly the consultation proposes that FCA should refer competition issues to OFT. We agree that this is the best approach.

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

We have no comments.

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

We support the approach to governance, accountability and transparency.

With regards to the FCA Board we consider that regulators should wherever possible seek to embrace best practice, such as the components of the Financial Reporting Council's UK Corporate Governance Code. For example in relation to composition, as was initially found to be wanting within the interim FPC, it is important that independent non-executives are just that.

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

We have no comments.

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

We have no comments on the areas covered.

We note that this paper does not consider the proportionality of regulation with regard to its impact on smaller firms: proportionality is considered only with regard to the work of regulators. However as regulatory costs continue to increase at an alarming rate, it is regrettable that the government has not adequately considered this feature of the market. More intrusive regulation has its placed, but this also means regulation must be measured, and the cost of making excessive demands of smaller firms (often because it is easier to do this than to segregate them out) must be weighed up against whether this provides any real value to the regulator.

Similarly it is not clear how the government seeks to ensure the regulators do not impose any unwarranted barriers to entry. For example, no new friendly society has been established since 1995, and much of the reason is due to the amount of capital and nature of regulation for new market entrants.

Small firms and new entrants provide active choice for consumers and improve competition, but the UK financial services sector continues to migrate towards large institutions- the blueprint does not seek to address this.

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

This paper has not offered any substantive exploration of the role or operations of the FSCS or FOS.

With regard to FSCS, whilst developments in Europe may restrict immediate action, it is disappointing that the ground for reform has not been set out in this paper.

With regard to issues with the FOS, again opportunities for reform via the draft Bill seem to have been missed. A number of trade bodies, including AFM, wrote to the Financial Secretary in April. We have not had a response to that letter, and the important structural issues it explored have not been acted on.

Confidence in the regulatory system requires confidence in all its aspects and there is a risk that failure to address shortcomings in the funding model of FSCS or the operational performance of FOS will frustrate attempts to achieve real and effective change elsewhere.

Impact assessment

We responded to the February consultation, expressing disappointment that the government had not set an initial ambition of transition to the new regulators at zero incremental cost. We believe this would have produced some thoughtful recognition of how the regulatory objectives might have been achieved more cost effectively. In our April response we suggested some option for improving cost-effectiveness, which have not been taken forward.

The revised impact assessment recognises that quantifying benefits of the new regime will be difficult, particularly where the primary motive relates to reducing the frequency and impact of sever financial crises.

The costs by comparison are high, and for firms, as well as the higher costs to be paid to regulators, there are very significant new costs in complying with new requirements, as well as the opportunity costs of diverting resource to regulatory action. In some cases that can be justified by greater consumer protection, but the advantage this creates will vary due to the nature of firms: regulators accept insurers are not banks, and they should not have to be regulated in the same way or pay the price of more intrusive regulation of banks. And for insurers in particular, the proposal to migrate to the new regulators at the end of 2012 is poorly timed, taken account of the immense weight of significant change in place over the next 18 months.

AIFA's response to HMT's

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

September 2011

About AIFA

The Association of Independent Financial Advisers (AIFA) is currently 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.

Introduction

AIFA clearly recognises the important role that regulation plays in making the retail financial services market a safer place for consumers, and a place in which they can have trust and confidence. We are therefore fully in favour of cost effective, proportionate regulation which builds on that which already works.

The process of redesigning the regulatory structure in the UK is long and complex. AIFA believes that there are three key levels to the structure: the legal powers granted through FSMA, and the associated policy intentions of HMT, the approach taken by FCA and PRA in their interpretation of their powers and policy formation, and finally the supervisory methodology adopted by the regulators and how it works in practice.

As noted in the Consultation Paper, this document focuses primarily on the key policy issues, and AIFA looks forward to engaging in further consultation and through Parliamentary pre-legislative scrutiny with the technical and legal detail of the draft legislation; we also note the need for subsequent formal consultation by HMT where draft legislative provisions have not been included in this white paper. This response should also be read in conjunction to our response to HMT's February consultation and our submissions to, and meetings with, FSA on the FCA Approach.

Overview

Whilst we welcome HMT's acknowledgement of the specificities of several sectors within the wider regulatory approach, we believe that the intermediary community is now under represented. The inclusion of a statutory objective of PRA with regard to insurers, and the acknowledgment of the need for diversity through mutual societies, on top of the banking focus, leaves the intermediary sector potentially under represented. Whilst the Smaller Business Practitioner Panel statutory footing is to be welcomed, we believe more should be done to acknowledge the diversity and competitive dynamic encouraged by the intermediary sector.

We also believe that HMT must ensure that the regulatory structures develop in a transparent and accountable manner. We expand on this further in response to the questions.

The impact on small firms does not solely lie in the actions of the FCA. As detailed below, there are examples of impact by the actions of FPC and PRA on the smallest of firms and AIFA believes that better representation is therefore necessary to achieve the best outcomes.

One key area not covered by the white paper is that of both cost and funding. In a closed sector, the costs of regulation are fundamentally borne by the end consumer, and AIFA is concerned that the cost of three regulatory bodies could substantially increase above the cost of one regulator today.

AIFA would also welcome further debate as to the method of cost recovery employed. As has been demonstrated, IFAs do not pose systemic risks to the system and in a changing regulatory approach, where the regulator is looking at different elements of the product chain AIFA believes this is the opportunity to reconsider how best to recover the costs of regulation.

Specific Questions:

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

As HMT acknowledge in its paper, the macro-prudential tools are 'novel and untested'. It is quite clear that the policy intentions of HMT are that financial services will be operating under an entirely different regime. AIFA accepts that there have been failings and sub-optimal outcomes in areas of financial services regulation historically, and supports HMT in seeking to create an improved regime. However, we remain concerned that much of the approach appears to be 'untested'. In agreeing that the outcomes appear to be fundamentally 'different', we cannot agree that they are necessarily 'better'.

AIFA believes that FPC has a potential market impact for a wider range of firms than has been perhaps acknowledged. By example, in the event of an asset bubble in the housing market, it is acknowledged that FCA could alter the prudential or conduct of business requirements of an individual mortgage adviser; they could also address the conduct of business requirements of a lender. The PRA, in turn, could address the prudential requirements of a lender. However, it is clear that the FPC has the potential macro-prudential tools – and ability to instruct the action of FCA – to also have a notable impact on even the smallest mortgage adviser. We feel this may need to be better acknowledged in the structure, perhaps through the membership of the external members of the FPC.

Whilst HMT reviewing the remit of FPC annually will allow flexibility of approach, there is always the concern that such reviews could produce changeable – and unpredictable – regulatory approaches. Consistency is important for firms' planning. AIFA does however support the remit being laid before Parliament to enhance transparency and accountability.

As previously highlighted AIFA shares some industry concern around the concentration of responsibilities now held within the Bank.

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

We have no comments on this.

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

We have no comments on this.

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

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We also believe that coordination between the prudential aspects of FCA and PRA are important; the transition from 'top-end' FCA to 'entry-level' PRA should be as harmonious as possible, to avoid either arbitrage or regulatory shock to those firms moving across the divide.

We welcome the additional guidance that PRA will publish with regards to the way it will interpret its objectives for different firms; we see this as an opportunity to both demonstrate proportionality and to recognise the unique elements of large distributors.

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It is clear that the PRA should not be accountable to industry but it should be consultative with it. Within the wider regulatory structures we believe that there should be greater formalised engagement with the industry on behalf of the PRA. While we support HMT's clear commitment demonstrated by FSMA new section 2J, and think that there is scope for either the Panels – or the Chairs of the Panels – to also be enshrined themselves in the PRA structure, the acknowledgement of the Smaller Business Practitioner Panel via its own statutory footing within FCA seems to be tacit acknowledgement of their work and value. We believe this should be enshrined in the primary legislation.

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AIFA has responded directly to the FSA's 'FCA Approach' consultation and to the HMT Consultation in April with regard to the objectives.

Specifically considering the issue of competition, AIFA supports HMT in not creating a new economic regulator in the FCA. However, we feel that FCA should provide further clarity of their intentions in this area. Whilst the White Paper acknowledges that FCA is not a price regulator, FSA's own FCA Approach document illustrates the need to make assumptions on the 'value' of transactions. Whilst reviewing explicit fees – MEAFs for example, or intra-fund expenses that in a binary manner could negate returns, an assessment of 'value' is quite different.

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AIFA considers there may be occasions when it is possible that the competition objective will pose significant difficulties and conflicts for the regulator. For example, some areas of financial services have witnessed unnecessary product switching which the regulator has been able to address from a suitability perspective; AIFA is aware of economic regulators, also formed under statute, who have simultaneously considered the same data as an economic failure due to lack of switching in the same market. This could cause internal conflicts if not carefully considered.

Given the importance and underlying application of the Competition duty to all FCA interventions, AIFA believes that it may be beneficial to consider a requirement to publish a 'Competition/benefit analysis'. Functioning in a similar manner to the Cost/Benefit Analysis, this could allow FCA to publically consider the relative competition merits of solutions. It would also ingrain this new area into their policy formation.

On the subject of Consumer Credit, AIFA believes that HMT must take due care to the potential wider audience in this arena. Whilst firms are currently regulated by the OFT, it would be easy for firms to only engage on the operation aspects of a transfer of CCA regulation to FCA at some stage in the future, rather than engaging now in the structural development of the regulator.

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

AIFA has previously welcomed elements of the product intervention strategy, particularly the 'follow the money' focus of considering the whole product chain rather than solely focusing on point of sale. We continue to believe there is merit in this proactive regulatory approach.

With regard to the supervisory approach, the key area of concern for AIFA is the potential risk appetite of the regulator. FSA has identified that FCA is likely to have a lower risk appetite than FSA. Whilst this may be appropriate, we do not believe that either the impact of this, nor articulation of the consequences have been fully considered. We have previously called for FCA to publically articulate their initial risk appetite, the likely impact on certain historic examples both in terms of detriment that would have been avoided, but also the choice that would have been lost, and continue to rearticulate this over time. Previous descriptions such as 'banning products that disadvantage the majority for the sake of the minority' have serious implications if taken at face value, when considered in the context of impaired life annuities or even term assurance. Further reassurance and detail would benefit the market.

The European dynamic is one which AIFA believes requires further consideration. We believe that there is substantial duplication of powers between, for example, FCA and ESMA in their ability to ban products. We would like to see further evidence of how this will work in practice.

More worryingly we believe that inwardly passporting firms will be able to circumvent significant elements of the product intervention agenda. As an example, whilst AIFA believes that an insurance company setting up a UK branch would find the majority of their host state's (UK's) conduct of business rules applicable, we question what power FCA would have over the product set of an inward passporting tied intermediary who is the sole route to market in the UK for a European insurer; in this case the insurer themselves would not be passporting, only their wholly owned tied subsidiary. In this case we fear FCA will be unable to address product related issues at the parent entity.

To extrapolate these concerns further AIFA believes that FCA would wish to be comfortable with its legal position with regard to MiFID products. A MiFID product provider distributing in the UK solely through its wholly-owned, passported, tied-intermediary could find itself with a product set 'banned' by the FCA, but not 'banned' by ESMA. In this example, the legal challenge that the UK could face is clear.

AIFA continues to support transparency in financial services. However, we do believe that there are operational elements of FCA's proposed approach to transparency that could be better developed.

The early publication of enforcement activity is one approach that may assist consumers – and intermediaries operating as their agents – to make sound judgements. However, whilst in an environment where enforcement action ends in a final notice, early notification may be of benefit; AIFA understands that in two-thirds of cases potential enforcement action isn't publically 'concluded'. This could result in firms appearing to have been 'warned' publicly, but without the conclusive end point of a final notice. This could result in firms bearing an inaccurate unlimited on-going risk of 'pending action' without any way of publically confirming their innocence. We believe this needs to be better considered.

AIFA also believes that there needs to be a more formal, transparent approach to deciding what is and isn't published. Whilst for some large firms the theory of a Judicial Review of a regulatory decision is possible, AIFA believes that a more robust solution should be in place for smaller firms to challenge the publication of information. AIFA believes that there may be a role for the RDC to act in this situation.

Finally, AIFA believes that it is important that the issue of transparency is legislated as an 'ability', rather than a 'requirement' or 'duty'. FCA must be allowed flexibility to operate as they see fit, even under a presumption towards disclosure.

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

AIFA supports the separation of mass and individual complaints. Indeed, AIFA continues to support the work of FOS in adjudicating individual complaints.

Mass complaints should rightly be tackled at an industry level, in particular utilising the revised s.404 powers of FSMA. This will restore balance between FOS and the wider issues. We agree that FOS is well placed to identify trends – as they are today under the 'issues of wider implications' route.

Given that the s.404 Consumer Redress powers are based on legal precedence and therefore a statute of limitations, and additionally bind FOS into the scheme, AIFA calls again for FOS's wider remit to benefit from a statute of limitations in line with the s.404 scope.

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

Whilst there is merit in imposing a set period of time, AIFA would not like to see the regulator unnecessarily bound by rules. We would expect FCA to engage with industry participants and to conduct research and a longer period may on occasions be beneficial.

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

AIFA broadly supports the alternative policy stance proposed by HMT which interacts with the OFT regime. The reality is that competition regulation requires specialist skills which we believe are better housed with the OFTand accessed via enhanced referral, rather than duplicated in the FCA structure. We also believe that elements of the competition agenda may conflict with other aspects of conduct of business regulation and are better segregated.

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

We have no comments on this area.

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

AIFA believes that one key element of the success of FCA will be achieved by its culture. AIFA welcomes an approach that seeks to command the respect of both consumers and firms. A culture of transparency and openness is vital to the success of FCA, and to engender a spirit of accountability.

AIFA continues to support transparency in financial services. However, we do believe that there are operational elements of FCA's proposed approach to transparency that could be better developed.

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Whilst FCA will be an 'independent' regulator founded by statute, as a public body it must seek to tackle an impression held by some that it lacks accountability.

Clearly, FCA has direct accountability to HMT, and AIFA also supports the Treasury Select Committee in taking a proactive role with FCA in addition to this. We also support the new statutory footing of the Smaller Business Practitioner Panel, the maintenance of the Practitioner and Consumer Panels, and the creation of the Markets Panel.

The role of an independent assessor of value is important, as is retaining the NAO in an auditing capacity of the FCA.

However AIFA believes that further improvements can be achieved: as part of the cultural shift we expect to see in the FCA, we believe that responsiveness is important for consumer trust but also industry respect. The structures will provide the formal accountability, but the culture must be seen as being responsive.

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

In the approach of FCA, the issue of co-ordination remains of concern to AIFA. The ability of multiple regulatory approaches to create both under and overlap is worrisome.

The reliance on MOUs between parties – PRA and FCA, or other parts of the FSMA family such as between FSCS or MAS and FCA will be extremely significant tools in the robust, or otherwise, operation of the regulatory approach. AIFA looks forward to engaging with stakeholders when the MOUs are published.

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

We have no comments

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

We have no additional comments beyond our HMT submission in April and FSA submission in September, both of which are attached.

AIFA

September 2011

Enc.:

- AIFA's Response to HM Treasury's Paper - 'A New Approach to Financial Regulation: Building a Stronger System' – April 2011
- AIFA's response to 'The Financial Conduct Authority – Approach to Regulation' - September 2011

SUBMISSION BY THE ASSOCIATION OF LLOYD'S MEMBERS (ALM)

ON CM8012 "A new approach to financial regulation: building a stronger system"

The ALM have discussed the points set out below with the FSA, and with the Lloyd's Members' Agents, who support these proposals while, of course, intending to make a further submission of their own. The points which follow below primarily reflect the issues raised in the Consultative Document (CD); but also touch on various topics which have been the subject of FSA/PRA/FCA presentations, conferences and papers during the summer. Most of the interests of the individual capital providers ("Names" for short) are touched on only rather tangentially in the CD, and accordingly the comments which below are set out in the most logical, free-standing way, rather than forced into the procrustean framework of the standard questions adopted in the CD.

The future role of Lloyd's and the regulation of Names and Members' Agents

1. For some years now the FSA has in practice worked in substantial measure through the Corporation of Lloyd's and its staff while having responsibility for the supervision of Lloyd's. We understand that this relationship is likely to continue with relatively modest changes, with the PRA and FCA standing in the shoes of the FSA. We believe it is a sensible collaborative arrangement, and would strongly urge that it be continued largely intact. To that end, the intended publication of a **draft Memorandum Of Understanding (MOU)** setting out the new relationships between Lloyd's and the FSA's two successor bodies is clearly critical. **We trust there will be opportunities for full consultation on this draft MOU when it is agreed shortly between the Treasury and the FSA.**

Supervisors and Supervision

2. It is clearly important to concentrate in one unit or team, the limited FCA resources available for supervising Lloyd's and its players.

3. In deciding the manner in which individual businesses are supervised, much will presumably depend on some kind of impact analysis which will be undertaken by the new FCA when it works out the different kinds of supervisory approach to be applied to those businesses in its direct line of responsibility. Given the rather idiosyncratic nature of Lloyd's and, to an even greater degree, of Members' Agents and Names, **we trust that we would be able to take part in a discussion of the approach to any such impact analysis and classification, before any major decisions are set in stone.**

4. We understand that the Lloyd's Members' Agents and Lloyd's itself will be making a separate submission on the importance of reflecting the special nature of their business and of their clients (Names) when setting up the new regulatory apparatus. As will be appreciated, the relationship between a Members' Agent and a Name is not that of a conventional retail fund management business with its client, but based largely on a sophisticated principal/agent agreement. For this reason neither Members' Agents nor Names would seek the intrusive regulatory involvement and protection which might be appropriate to conventional retail financial service businesses of comparable size.

5. That said, there are clearly important imbalances of power and information as between Members' Agents and Names jointly on the one hand, and Managing Agents/ professional underwriters/corporate investors in the Lloyd's market place on the other. This is a **special feature which will also need discussion with the FCA as the new regulatory supervisory apparatus is developed.**

Reliance by supervisors on skilled persons and auditors

6. There has been a notable emphasis in various public statements on the intention that the new regulatory bodies will rely to a greater extent than hitherto on the use of skilled persons reports; and consult the auditors of regulated businesses more closely and more actively. It is a self-evident risk that the use of skilled persons will at times tend to become the remedy or substitute for manpower shortages or weaknesses in the regulators, and **an assurance that this will not be allowed to happen would be of great value.** In addition, it is easy to forget that in the case of Members' Agents, the business is intrinsically a simple one, and the role of the auditors is, therefore, relatively limited. If a regulator wishes to obtain a good idea of the quality of the management of a Members' Agent, the obvious way in which to do this in any except very special circumstances would be to rely on having good direct contacts with the non-executive directors of the Members' Agency, and with those of Lloyd's staff who are dealing with Members' Agents.

Important consultations are looming

7. We presume that there will continue to be a timely publication of proposals for further developments of the regulatory legislation, rule book, codes of conducts etc; and appropriate opportunities to discuss and consult on these proposals before they are finally determined. In that context there are certain areas of particular concern which we should note:

a) **Complaints and Compensation**.

Lloyd's already has a well developed if not perfect system. We see little need or scope for any major changes; and considerable danger that there could be unintended damage to existing arrangements if care is not taken. Once again, it is critical that there should be **clear proposals published in good time to permit the consultation with Lloyd's market** to identify and head off any such risks.

b) **Procedures and institutions for developing regulations of rules, codes of practice, etc.**

We presume that the new legislation will provide that the key features of present practice will be retained and strengthened. Once again it is important, given the rather specialised nature of the Lloyd's market place, to see such proposals published in draft in good time in order to permit a sensible process for Lloyd's related business. We well appreciate that much of the time there will be little if any need for (potentially onerous) involvement of representatives of the Lloyd's market place for individual capital. That said, we would trust that there will be **reasonable access when appropriate to any umbrella bodies for the insurance market, not least to any relevant successor body to the Practitioner Panels.**

c) **Greater stress on competition**

This is an important innovation, and a matter of real interest for a sector which has been only recently the subject of a substantial and onerous enquiry by the competition authorities. It is important that the **Treasury and the new regulators should at the next stage detail the goals and objectives of this greater emphasis on competition policy**, how they will be pursued and by whom within the new regulatory apparatus.

d) **FCA fees for Members' Agents**

We understand that at this point it has not yet been possible for the yet-to be created FCA to determine the criteria on which it will set up a fee blocks within the universe of firms under its aegis. This is important, not least because of the idiosyncrasies of Members' Agents already mentioned, and because of the fact that Members' Agents already pay substantial fees to Lloyd's itself and will continue to do so. [By that token we also have an interest in the FCA fees for Lloyd's ….!]. **It is clearly important to learn of the principles which the FCA in due course proposes; and to see illustrations of how they might be implemented as part of the consultative processes.**

THREE MAJOR ISSUES

In concluding, we should like to stress three other topics on which serious debate has yet to develop.

FAIR CHARGES AND AVOIDING CROSS SUBSIDIES: A STATEMENT OF PRINCIPLE IS NEEDED

One of the recurrent controversies in the financing of the Financial Services Authority (FSA) has been the definition of fee blocks; and the degree to which the FSA has committed itself to, and adhered to, the principle of not charging businesses fees for regulatory work and services or any other activities which were not pertinent in any way to their particular area of business. Adherence to that fundamental principle is as important for the new regulatory institutions as it was for the FSA. At present the draft legislation is silent on the subject. It is a matter of the greater concern, therefore, that the next draft of the Bill should include a **prominent commitment** to **fair charging and the avoidance of cross-subsidy**. This applies both to contributing to the costs of different aspects of the regulatory and administrative process; and also to the provision of funding for compensation and other analogous schemes. A particular anxiety for Members' Agents is that they might be held liable for compensation for major scandals in unrelated areas of retail finance such as occurred in the recent years in relation to the mis-selling of pensions, PPI etc.

APPEALING ENFORCEMENT DECISIONS

Under the present Financial Services & Markets Act (FSMA), a right of appeal was instituted; initially to the FINSMAT; and subsequently to the TRIBUNAL. Entrenchment of this right of appeal to an appropriate regulatory body against arbitrary regulatory action is of fundamental importance. We trust that there will be **clear**

provisions made for such an appeal procedure which will be applicable to the Lloyd's market place.

REPORTING TO THE TREASURY ON A REGULATORY FAILURE

It is proposed that the FCA should make a report to HMC in the event of a regulatory failure. This is a highly sensitive issue for Lloyd's since, as the history of the last 30 years in the Lloyd's market place shows all too clearly, the issue of whether there was regulatory failure at Lloyd's and, if so, who should investigate it and what should be done, was a matter of constant and heated concern; and also of some very lengthy, expensive and controversial litigation. The current proposal is appropriate as far as it goes, inasmuch as it requires the FCA to make a report. But it leaves a glaring gap in the determination of **what** is to be a "regulatory failure", **who** is to decide that it has happened.

In addition it provides that the regulator investigates itself – in circumstances in which involvement of independent outsiders would seem to be essential, as has long been accepted in the handling of complaints against the Police.

Given the history and experience of Lloyd's, we will urge that in the next stage of the legislation process, **proposals be developed to provide a robust and realistic definition of regulatory failure; to provide for responsible parties other than the regulators to have a say in initiating investigation of a failure**; and to provide for a **measure of independent outside involvement in any such investigation.**

ANR
7 September 2011

AMI's response to HMT's

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

September 2011

About AMI

The Association of Mortgage Intermediaries (AMI) is the trade association representing over 75% of UK mortgage intermediaries. Intermediaries active in this market act on behalf of the consumer in selecting an appropriate lender and product to meet the individual consumer's mortgage requirements. Our members also provide access to associated protection products. Our members are authorised by the Financial Services Authority (FSA) to carry out mortgage and insurance mediation activities. Firms range from sole traders through to national firms and networks with thousands of advisers

Introduction

AMI clearly recognises the important role that regulation plays in making the retail financial services market a safer place for consumers, and a place in which they can have trust and confidence. We are therefore fully in favour of cost effective, proportionate regulation which builds on that which already works.

The process of redesigning the regulatory structure in the UK is long and complex. AMI believes that there are three key levels to the structure: the legal powers granted through FSMA, and the associated policy intentions of HMT, the approach taken by FCA and PRA in their interpretation of their powers and policy formation, and finally the supervisory methodology adopted by the regulators and how it works in practice.

As noted in the Consultation Paper, this document focuses primarily on the key policy issues, and AMI looks forward to engaging in further consultation and through Parliamentary pre-legislative scrutiny with the technical and legal detail of the draft legislation; we also note the need for subsequent formal consultation by HMT where draft legislative provisions have not been included in this white paper. This response should also be read in conjunction to our response to HMT's February consultation and our submissions to, and meetings with, FSA on the FCA Approach.

Overview

Whilst we welcome HMT's acknowledgement of the specificities of several sectors within the wider regulatory approach, we believe that the intermediary community is now under represented. The inclusion of a statutory objective of PRA with regard to insurers, and the acknowledgment of the need for diversity through mutual societies, on top of the banking focus, leaves the intermediary sector potentially under represented. Whilst the Smaller Business Practitioner Panel statutory footing is to be welcomed, we believe more should be done to acknowledge the diversity and competitive dynamic encouraged by the intermediary sector.

We also believe that HMT must ensure that the regulatory structures develop in a transparent and accountable manner. We expand on this further in response to the questions.

The impact on small firms does not solely lie in the actions of the FCA. As detailed below, there are examples of impact by the actions of FPC and PRA on the smallest of firms and AMI believes that better representation is therefore necessary to achieve the best outcomes.

One key area not covered by the white paper is that of both cost and funding. In a closed sector, the costs of regulation are fundamentally borne by the end consumer, and AMI is concerned that the cost of three regulatory bodies could substantially increase above the cost of one regulator today.

AMI would also welcome further debate as to the method of cost recovery employed. As has been demonstrated, IFAs do not pose systemic risks to the system and in a changing regulatory approach, where the regulator is looking at different elements of the product chain AMI believes this is the opportunity to reconsider how best to recover the costs of regulation.

Specific Questions:

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

As HMT acknowledge in its paper, the macro-prudential tools are 'novel and untested'. It is quite clear that the policy intentions of HMT are that financial services will be operating under an entirely different regime. AMI accepts that there have been failings and sub-optimal outcomes in areas of financial services regulation historically, and supports HMT in seeking to create an improved regime. However, we remain concerned that much of the approach appears to be 'untested'. In agreeing that the outcomes appear to be fundamentally 'different', we cannot agree that they are necessarily 'better'.

AMI believes that FPC has a potential market impact for a wider range of firms than has been perhaps acknowledged. By example, in the event of an asset bubble in the housing market, it is acknowledged that FCA could alter the prudential or conduct of business requirements of an individual mortgage adviser; they could also address the conduct of business requirements of a lender. The PRA, in turn, could address the prudential requirements of a lender. However, it is clear that the FPC has the potential macro-prudential tools – and ability to instruct the action of FCA – to also have a notable impact on even the smallest mortgage adviser. We feel this may need to be better acknowledged in the structure, perhaps through the membership of the external members of the FPC.

Whilst HMT reviewing the remit of FPC annually will allow flexibility of approach, there is always the concern that such reviews could produce changeable – and unpredictable – regulatory approaches. Consistency is important for firms' planning. AMI does however support the remit being laid before Parliament to enhance transparency and accountability.

As previously highlighted AMI shares some industry concern around the concentration of responsibilities now held within the Bank.

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

We have no comments on this.

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

We have no comments on this.

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

AMI supports the creation of a strong PRA. However, it is imperative that PRA's actions are proportionate. Whilst AMI supports the additional objective relating to insurers and the diversity acknowledgment of the role of mutuals, we believe that the small but significant number of large investment businesses – some of them in the IFA sector – which fall under PRA now risk being under acknowledged. While we understand the Government's reticence to define the scope of PRA supervision in primary legislation, we believe this does add additional concern to those firms at the boundary.

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Value by definition is a subjective view of both the service/product offered, and the cost. If FCA attempts to operate in this space, we fear that they will either immediately undermine their work in the area of consumer responsibility by second-guessing perceived value, or have to intervene in cost, which is merely price regulation. We believe further work is necessary on this point.

AMI considers there may be occasions when it is possible that the competition objective will pose significant difficulties and conflicts for the regulator. For example, some areas of financial services have witnessed unnecessary product switching which the regulator has been able to address from a suitability perspective; AMI is aware of economic regulators, also formed under statute, who have simultaneously considered the same data as an economic failure due to lack of switching in the same market. This could cause internal conflicts if not carefully considered.

Given the importance and underlying application of the Competition duty to all FCA interventions, AMI believes that it may be beneficial to consider a requirement to publish a 'Competition/benefit analysis'. Functioning in a similar manner to the Cost/Benefit Analysis, this could allow FCA to publically consider the relative competition merits of solutions. It would also ingrain this new area into their policy formation.

On the subject of Consumer Credit, AMI believes that HMT must take due care to the potential wider audience in this arena. Whilst firms are currently regulated by the OFT, it would be easy for firms to only engage on the operation aspects of a transfer of CCA regulation to FCA at some stage in the future, rather than engaging now in the structural development of the regulator.

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

AMI has previously welcomed elements of the product intervention strategy, particularly the 'follow the money' focus of considering the whole product chain rather than solely focusing on point of sale. We continue to believe there is merit in this proactive regulatory approach.

With regard to the supervisory approach, the key area of concern for AMI is the potential risk appetite of the regulator. FSA has identified that FCA is likely to have a lower risk appetite than FSA. Whilst this may be appropriate, we do not believe that either the impact of this, nor articulation of the consequences have been fully considered. We have previously called for FCA to publically articulate their initial risk appetite, the likely impact on certain historic examples both in terms of detriment that would have been avoided, but also the choice that would have been lost, and continue to rearticulate this over time. Previous descriptions such as 'banning products that disadvantage the majority for the sake of the minority' have serious implications if taken at face value, when considered in the context of impaired life annuities or even term assurance. Further reassurance and detail would benefit the market.

The European dynamic is one which AMI believes requires further consideration. We believe that there is substantial duplication of powers between, for example, FCA and ESMA in their ability to ban products. We would like to see further evidence of how this will work in practice.

More worryingly we believe that inwardly passporting firms will be able to circumvent significant elements of the product intervention agenda. As an example, whilst AMI believes that an insurance company setting up a UK branch would find the majority of their host state's (UK's) conduct of business rules applicable, we question what power FCA would have over the product set of an inward passporting tied intermediary who is the sole route to market in the UK for a European insurer; in this case the insurer themselves would not be passporting, only their wholly owned tied subsidiary. In this case we fear FCA will be unable to address product related issues at the parent entity.

To extrapolate these concerns further AMI believes that FCA would wish to be comfortable with its legal position with regard to MiFID products. A MiFID product provider distributing in the UK solely through its wholly-owned, passported, tied-intermediary could find itself with a product set 'banned' by the FCA, but not 'banned' by ESMA. In this example, the legal challenge that the UK could face is clear.

AMI continues to support transparency in financial services. However, we do believe that there are operational elements of FCA's proposed approach to transparency that could be better developed.

The early publication of enforcement activity is one approach that may assist consumers – and intermediaries operating as their agents – to make sound judgements. However, whilst in an environment where enforcement action ends in a final notice, early notification may be of benefit; AMI understands that in two-thirds of cases potential enforcement action isn't publically 'concluded'. This could result in firms appearing to have been 'warned' publicly, but without the conclusive end point of a final notice. This could result in firms bearing an inaccurate unlimited on-going risk of 'pending action' without any way of publically confirming their innocence. We believe this needs to be better considered.

AMI also believes that there needs to be a more formal, transparent approach to deciding what is and isn't published. Whilst for some large firms the theory of a Judicial Review of a regulatory decision is possible, AMI believes that a more robust solution should be in place for smaller firms to challenge the publication of information. AMI believes that there may be a role for the RDC to act in this situation.

Finally, AMI believes that it is important that the issue of transparency is legislated as an 'ability', rather than a 'requirement' or 'duty'. FCA must be allowed flexibility to operate as they see fit, even under a presumption towards disclosure.

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

AMI supports the separation of mass and individual complaints. Indeed, AMI continues to support the work of FOS in adjudicating individual complaints.

Mass complaints should rightly be tackled at an industry level, in particular utilising the revised s.404 powers of FSMA. This will restore balance between FOS and the wider issues. We agree that FOS is well placed to identify trends – as they are today under the 'issues of wider implications' route.

Given that the s.404 Consumer Redress powers are based on legal precedence and therefore a statute of limitations, and additionally bind FOS into the scheme, AMI calls again for FOS's wider remit to benefit from a statute of limitations in line with the s.404 scope.

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

Whilst there is merit in imposing a set period of time, AMI would not like to see the regulator unnecessarily bound by rules. We would expect FCA to engage with industry participants and to conduct research and a longer period may on occasions be beneficial.

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

AMI broadly supports the alternative policy stance proposed by HMT which interacts with the OFT regime. The reality is that competition regulation requires specialist skills which we believe are better housed with the OFT and accessed via enhanced referral, rather than duplicated in the FCA structure. We also believe that elements of the competition agenda may conflict with other aspects of conduct of business regulation and are better segregated.

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

We have no comments on this area.

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

AMI believes that one key element of the success of FCA will be achieved by its culture. AMI welcomes an approach that seeks to command the respect of both consumers and firms. A culture of transparency and openness is vital to the success of FCA, and to engender a spirit of accountability.

AMI continues to support transparency in financial services. However, we do believe that there are operational elements of FCA's proposed approach to transparency that could be better developed.

The early publication of enforcement activity is one approach that may assist consumers – and intermediaries operating as their agents – to make sound judgements. However, whilst in an environment where enforcement action ends in a final notice, early notification may be of benefit; AMI understands that in two-thirds of cases enforcement action isn't publically 'concluded'. This could result in firms appearing to have been 'warned' publicly, but without the conclusive end point of a final notice. This could result in firms bearing an inaccurate unlimited on-going risk of 'pending action' without any way of publically confirming their innocence. We believe this needs to be better considered.

AMI also believes that there needs to be a more formal, transparent approach to deciding what is, and isn't published. Whilst for some large firms the theory of a Judicial Review of a regulatory decision is possible, AMI believes that a more robust solution should be in place for smaller firms to challenge the publication of information. AMI believes that there may be a role for the RDC to act in this situation.

Whilst FCA will be an 'independent' regulator founded by statute, as a public body it must seek to tackle an impression held by some that it lacks accountability.

Clearly, FCA has direct accountability to HMT, and AMI also supports the Treasury Select Committee in taking a proactive role with FCA in addition to this. We also support the new statutory footing of the Smaller Business Practitioner Panel, the maintenance of the Practitioner and Consumer Panels, and the creation of the Markets Panel.

The role of an independent assessor of value is important, as is retaining the NAO in an auditing capacity of the FCA.

However AMI believes that further improvements can be achieved: as part of the cultural shift we expect to see in the FCA, we believe that responsiveness is important for consumer trust but also industry respect. The structures will provide the formal accountability, but the culture must be seen as being responsive.

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

In the approach of FCA, the issue of co-ordination remains of concern to AMI. The ability of multiple regulatory approaches to create both under and overlap is worrisome.

The reliance on MOUs between parties – PRA and FCA, or other parts of the FSMA family such as between FSCS or MAS and FCA will be extremely significant tools in the robust, or otherwise, operation of the regulatory approach. AMI looks forward to engaging with stakeholders when the MOUs are published.

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

We have no comments

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

We have no additional comments beyond our HMT submission in April and FSA submission in September, both of which are attached.

AMI

September 2011

Enc.:

- AMI's Response to HM Treasury's Paper - 'A New Approach to Financial Regulation: Building a Stronger System' – April 2011
- AMI's response to 'The Financial Conduct Authority – Approach to Regulation' - September 2011

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6th September 2011

Financial Regulation Strategy
HM Treasury
1 Horse Guards Road
LondonSW1A 2HQ

Dear Sirs,

APCIMS[1] Response to HM Treasury – A new approach to financial regulation: the blueprint for reform

We set out on the attached appendix our response to the consultation questions in the above document.

We would strongly recommend that there is a framework established within the bill to place an obligation upon the relevant regulator to ensure they have effective processes and appropriate level of regulatory support to enable firms to meet their regulatory obligations. There is no analysis within the paper entitled "The Financial Conduct Authority: Approach to Regulation" identifying what actions the FCA could take to improve the assistance to firms, to enable them to meet their regulatory obligations and thereby mitigate the need for preventive action. We are disappointed the FCA has not recognised this issue as a major weakness of the FSA.

By way of illustration, factors to be considered could include:-

- Better management of the nature, extent, and timing of regulatory communications –the current volume of material is simply too great for firms to review and absorb;
- Clearer identification as to what communication is relevant for what types of firms;

[1] The Association of Private Client Investment Managers and Stockbrokers represent 186 member firms acting on behalf of private client investors. Of this number 119 members are private client investment managers and stockbrokers and 67 are associate members who provide related services to our firms. 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 (no advice) 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 c.30 000 employees. Over £400 billion of the country's wealth is under the management of our members. Our aim is to ensure that the regulatory, tax and other changes across Europe are appropriate and proportionate for the investment community.

- Review of support material produced for each sector together with a control to ensure such material is subject to periodic updating and if applicable removed;
- Review of the communication strategy and particularly the website which is seen by the industry and individual FSA staff as no longer fit for purpose;
- Greater transparency regarding the process adopted for undertaking specific theme visits identifying the FCA's expectations and approach at sector level;
- Earlier feedback of issues emerging from theme visits;
- An independent review of the current operational effectiveness of the firms contact centre with recommendations on how the service to firms could be improved. Any review should include extensive consultation with firms; and
- FAQ section on current 'hot topics' based upon issues being raised with the firms contact centre and questions being raised with other departments within the FCA.

We have found it difficult in a number of areas within the bill to ascertain how the proposed provisions would apply in a European context, for example, the application of the product intervention rules. The paper appears surprisingly UK centric given the fact that most activities of regulated firms are driven by European legislation. We are uncertain how certain of the proposals in the bill will apply in a wider European context.

Authorised firms and other stakeholders have expressed concern about the costs of the new regulatory structure. The relevant regulators must ensure that they have an effective mechanism for consulting on costs. The FSA's consultation process on fees and levies is inadequate. No historic costs data is provided and there is no supporting cost trend analysis. In the past, fees have increased to fund investment in IT designed to reduce the costs of the FSA but there has been no subsequent feedback as to whether the projects were delivered on time and on budget or whether the anticipated cost savings have been achieved. Whilst we recognise the desire of HM Treasury not to prescribe detailed administrative arrangements it is important that all stakeholders can monitor the cost of regulation effectively.

The bill provides an opportunity to improve the accountability of the funding of the Money Advice Service. The current process outlined on the Money Advice Service's website is that the organisation consults on their budget each year with HM Treasury, the Office of Fair Trading, and the Department for Business, Innovation and Skills. After this consultation, the Money Advice Service must have their budget approved formally by the Financial Services Authority. The Money Advice Service does not discuss their budget with trade bodies representing authorised firms who provide the funding for the service. The lack of engagement and accountability to the authorised firms who provide the funding of the organisation is a major failing. The industry in general is unaware of the objectives and obligations of the Money Advice Service and is not in a position to challenge the costs of the organisation or assess the effectiveness of the organisation. The industry is very concerned that in effect they are providing an 'open cheque' for the funding of the service. We note that HM Treasury withdrew their share of the funding of the service last year and the FSA just replaced the shortfall with additional funding from the industry. In order to effectively monitor the costs of the relevant regulators the funding of the Money Advice Service should be shown as a separate levy.

We would point out that the Financial Services Compensation Scheme and the Financial Ombudsman Service do actively engage with the industry and hold meetings with trade bodies to explain their budgets and the impact on the levy being raised from the industry.

Please do not hesitate to contact us if you wish to clarify further the content of our response.

Yours faithfully,

Ian Cornwall
Director of Regulation

List of consultation questions

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

No comment.

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

No comment.

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

No comment.

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

Paragraph 2.48 states that the PRA must issue guidance setting out how it will interpret its objective in relation to different types of firms or regulated activity whilst reference is also made to the fact that the legislation will make it explicitly clear that the new regime will not be operated on a 'zero-failure' basis. We support the fact that the PRA will not operate on a 'zero-failure' basis but the guidelines should provide a mechanism to enable an assessment to be made as to whether or not the PRA have met their supervisory obligations. Amongst other things, the default of a systemic firm within our sector may result in investment firms, both large and small, being levied considerable sums to meet FSCS claims.

We are concerned about the provisions in the draft bill which effectively state that if, in the opinion of the relevant regulator, the costs or benefits cannot reasonably be estimated, or it is not reasonably practicable to produce an estimate, the cost benefit analysis need not estimate them, but must include a statement of the PRA's or the FCA's opinion and an explanation of it.

Our experience of the FSA is that they have not taken their obligations to produce a cost benefit analysis in support of policy proposals seriously. We, and other trade bodies, continuously find failings in the cost benefit analysis often due to a lack of real understanding as to how different firms operate. For example, the cost benefit analysis supporting the RDR, a major policy development, was flawed as we set out in our submission to CP09/18 and in a separate letter to the FSA. The cost-benefit analysis supporting the proposals in CP09/18 were, to a large part, based on a survey of compliance costs and changes to business models by Deloitte which were based on early policy assumptions of the RDR proposals as published in Feedback Statement 08/06. FSMA s.155(10) defines a cost benefit analysis as "an estimate of the costs together with an analysis of the benefits that will arise if the proposed rules are made" – however, because the CP09/18 CBA was based on research undertaken in pursuit of earlier policy assumptions, it cannot be truly said to address the rules proposed in CP09/18. Given the potential impact of this initiative on the entire financial services industry; we do not think it is acceptable for the FSA and, in future the FCA, to publish a CBA which does not actually address the proposals subject to consultation.

Similarly there are concerns about the FSA overriding the findings of their cost benefit analysis. The Practitioners Panel Annual Report for 2008-2009 stated that *"In cases where the CBA case is weak or non-existent for an initiative, the decision should be taken not to proceed or any decision to proceed in the face of the CBA should require more extensive justification."*

Given the industry's experience of the FSA's approach to meeting their existing obligations there is considerable scepticism as to the extent to which the clauses in the draft bill will be used by the relevant regulator to avoid preparing a cost benefit analysis in support of policy proposals. The content of the bill provides no opportunity to challenge the basis of the regulatory bodies' opinion and explanation. It is unclear what level of work should be undertaken in support of their opinion and explanation. We can fully appreciate that in certain circumstances, particularly those likely to involve systemic issues and/or overall stability of the UK's financial system(s), there should be a facility for the relevant regulator to formulate policy quickly without perhaps the need for more formalised routine processes to be undertaken, (usually due to time constraints and the need to act quickly). However, from an FCA standpoint, we strongly suspect that many policy proposals will in future be brought forward without a supporting cost benefit analysis which we regard as a retrograde step.

We believe existing Practitioner Panel ('the Panel') arrangements should apply to the PRA rather than the more informal arrangements set out in paragraph 2.77. It is entirely unclear on what basis 'the Government proposes that the PRA should have some flexibility in deciding what kind of arrangements it wants to establish for engaging with industry' and yet the Government, correctly in our view, believes there is a role for the Panel the FCA's administrative structure. We believe it is important that the Panel is engaged in the activities of both the FCA and the PRA; the Panel provides a formal mechanism for communicating the views of the industry to the relevant regulator. The Panel can provide further benefits under the new regime by identifying potential areas of overlap and duplication and assessing the co-ordination between the relevant regulators.

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

The impact of the FCA's competition remit is difficult to assess. We already have concerns that the FSA is developing policy which has an impact on competition in that recent rules are mandating the costs of a service. For example, PS11/9 Platforms introduces an obligation on firms acting as nominees for authorised funds to forward certain documentation to the underlying beneficiary without making any charge for this additional service, which is contrary to the position agreed by HM Treasury in respect of securities.

The position regarding immunity in respect of the FCA's competition activities needs to be reviewed. Our understanding is that other competition authorities do not enjoy immunity in respect of their activities.

It would be helpful if there was further information regarding the manner in which the FCA is expected to meet its competition duty with regard to the European single market.

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

We have a number of concerns regarding the powers allowing the FCA to disclose the fact that a warning notice in relation to proposed disciplinary action has been issued against a firm. Our concerns are detailed below.

- The bill gives the FCA the power but not the duty to disclose the fact that a warning notice has been issued. It is unclear what obligations will be placed upon the FCA to ensure this power is exercised on a consistent basis.

- The FSA's current DEPP rules provide for a role for the RDC in respect of contested warning notices. The publication of warning notices may increase the level of notices that are contested by firms. In order to ensure that the FCA exercises its powers regarding the disclosure of warning notices to the public in a consistent manner we believe that any disclosure should require the approval of the RDC which would ensure there is a suitable level of accountability in exercising the FCA's power to publish warning notices.

- We are assuming that the warning notice will provide some indication of the issues giving rise to concern and presumably will be carefully drafted to ensure consumers in particular understand the content.

- Where a warning notice subsequently gives rise to an enforcement action and a final notice is issued against the firm, the content of the warning notice will normally outline the action taken by the firm to address the shortcomings identified in the warning notice. A notice of discontinuance is issued where, following the publication of the warning notice, no subsequent enforcement action is taken. We have been told by regulatory lawyers that the current content of such notices contains limited information. In future, where a notice of discontinuance has been published, the content of the notice should contain sufficient information so consumers can clearly understand that the matter has been closed. There appears to be no obligation upon the FCA to publish a notice of discontinuance where a warning notice has previously been published. As a result, a firm could be in a position where the FCA has disclosed that a warning notice has been issued but is under no obligation to publicly disclose that a notice of discontinuance has been published, resulting in uncertainty for consumers and continuing damage to a firm's reputation.

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

We are broadly supportive of nominated parties being able to refer to the FCA issues that may be causing mass detriment and we believe trade bodies such as APCIMS, should be within the definition of a nominated party. Trade bodies and their member firms are well placed to identify issues causing mass detriment. In bringing formal submissions to the FCA there needs to be some indication of the approach nominated parties should adopt and the nature and extent of any supporting evidence.

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

The ability of the FCA to respond within a set period of time will depend in part on the quality of the submission of the nominated party. We believe that it may also be necessary for the FCA to conduct further analysis across the different business models within the financial sector to ascertain the extent of mass detriment for different types of service offerings. Mass detriment attributable to a particular issue or product may not apply across the entire financial services sector.

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

We would refer you to our response to question 6.

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

No comment.

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

The FCA must been seen by all stakeholders as being a truly accountable organisation, with a clear duty to respond in an open and transparent manner. The FCA Board must have non-executive Directors who are empowered to challenge the Executive, particularly in areas of cost control and the management of policy development. Internally, there must be clear ownership of major regulatory developments and an effective overview and monitoring of the regulatory burdens, and associated costs, being placed on regulated firms.

The FCA must have mechanisms to effectively monitor and model the regulatory cost burdens being placed upon firms by the existing regulatory regime and assess the impact of regulatory changes. The analysis should be available at firm level. The regulatory cost burdens being imposed on firms should be subject to a periodic review to determine whether or not there could be cost savings. For example, firms spend significant resources producing data for the FSA which in many cases appears, after a period of time, to be no longer needed. Indeed, we have been surprised about the lack of awareness amongst FSA staff as to what data is actually captured and we strongly suspect that certain data is currently of little use to the FSA.

The cost of the new regulatory regime is of considerable concern to firms and the relevant regulators must provide much greater cost analysis on an ongoing basis to ensure amongst other things, firms are able to readily monitor cost trends and the outcome of major investments in areas, such as IT infrastructure. The current FSA model for consulting on fees should be recognised as being severely limited with insufficient information provided to firms to act as an effective consultation process.

There needs to be improvements to the accountability of the funding of the Money Advice Service. Firms are not clear on what basis the Money Advice Service is seen as having met their objectives and how the FSA determines the required resources. There is no engagement by the Money Advice Service with the industry. In contrast, both the Financial Ombudsman Service and the Financial Services Compensation Scheme actively engage with trade bodies and other stakeholders to brief them on proposed budgets and cost implications.

The FCA should consider establishing a mechanism to enable stakeholders to formally raise issues giving rise to concern. For example, a number of recognised stakeholders including member firms and the press raised significant concerns regarding issues associated with firms 'selling penny shares' such as Pacific Continental securities and Wills & Co which were not addressed by the FSA resulting in huge claims on the Financial Services Compensation Scheme.

Membership of the Market Practitioner Panel will be derived from:-
(a) authorised persons,
(b) persons who issue financial instruments,
(c) sponsors
(d) recognised investment exchanges, and
(e) primary information providers.

It is important that there are a sufficient number of authorised persons covering authorised firms that are members of exchanges, (covering firms that are market makers and stockbokers providing services to the wholesale and retail markets) and authorised firms that are users of the services of the market. We believe the definition of authorised persons in the bill should be amended to reflect this position.

We welcome the proposals to place both regulators under a duty to investigate and make a report to the Treasury on possible regulatory failure. One of the main areas where the industry has identified apparent regulatory failures is in respect of the number of significant claims that have arisen on the FSCS. It would be helpful if there was a reference to the fact that significant claims, (determined by reference to the subclass threshold limit), on the FSCS could be indicative of the fact that the FCA is not meeting its operational objectives.

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

We would refer you to our response to question 5; the Practitioner Panel would provide an additional assurance that there is effective coordination between the relevant regulators. We would seek greater clarity as to the extent to which the PRA's veto would apply where the FCA would be undertaking an enforcement role, which could potentially entail criminal proceedings. We are also concerned about the effect of the PRA's veto in the context of action being taken by the industry as a whole. For example, if enforcement action was being taken in respect of a major mis-selling of a product, it could be the case that a large systemic risk firm was not subject to enforcement action but other smaller non-systemic risk firms were subject to enforcement action. In this example small firms may suffer a significant competitive disadvantage as a result and invariably the industry would be seeking an explanation and/or speculating as to why a larger institution conducting the same business had not been subject to enforcement action. It could be that speculation about whether or not the PRA has exercised a veto actually gives rise to financial instability in respect of the large institution.

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

Enforcement - The Government believes that minimum period for making representations should fall from 28 to 14 days because many cases are straightforward or the person has admitted their contravention or does not respond at all, and that the existence of the requirement slows down the enforcement process unnecessarily. Our view is that the potential disclosure of a warning notice is likely to result in more contested cases and greater focus on the precise content of the wording of the notice given the content may be disclosed. The reduction to 14 days (calendar days not business days) is too short; we believe the period should be 15 business days. The considerable difficulties firms and their advisers will have in meeting this deadline outweighs any benefits arising from reducing the period for making representations by two weeks. It is entirely unclear on what basis the relevant regulator would exercise their discretion to extend the period for making representations.

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

No Comment.

Anna Deibel-Jung
Financial Regulatory Strategy
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

2 September 2011

Dear Ms Deibel-Jung

Aviva's response to *'The blueprint for reform'*

Aviva is pleased to respond to this White Paper. We broadly welcome the Government's proposals but still have some areas of concern. In our view the key issues remain:

- **Stability and consistency** – An effective regulator acts consistently and values stability. This consistency enables firms to comply with relevant rules in an efficient manner. Inconsistency and slow decision making can lead to unnecessary costs, which may be passed on to consumers.

- **Accountability and governance** - The governance arrangements in and between the various regulatory bodies are crucial to ensuring that they are effective. It is important that the independent members of the FPC, as well as the Boards of the PRA and FCA, reflect a balance of experience from within the financial services industry, including the insurance sector.

- **Due process** – A shift to judgement-based supervision should be balanced with a strengthening, not an undermining, of challenge mechanisms for firms. The proposals to weaken the remit of the Tribunal should be dropped.

- **Europe** - It is paramount that the UK authorities co-ordinate effectively and influence and negotiate successfully in Europe and internationally. We recommend the establishment of a forum or secretariat to help enable this.

We set out in the attached appendices our broad views on the proposals and detailed response on the consultation questions.

Yours sincerely

Andrew Moss
Group Chief Executive, Aviva

Appendix 1: Key issues

Stability and consistency

We believe that it is the effectiveness of supervision, rather than the structure, that is key to achieving good outcomes. A very important way in which a regulator can be effective is by acting consistently and valuing stability. This consistency enables firms to comply with relevant rules in an efficient manner. We understand that regulators will need to change rules to tackle emerging risks, but these changes must be done in an orderly way, with advanced notice, as uncertainty can lead to unnecessary costs. For example, the FSA's Retail Distribution Review, which we broadly support, has been running since 2006 but final decisions have still not been made on important elements of it. The resulting uncertainty has made it difficult to develop new propositions and means that firms, even now, cannot be sure of the likely cost. This can have significant implications for cash flow management and capital allocation.

So, we would urge the new regulators to learn lessons from the FSA's experiences and seek to deliver stability and certainty. As part of this, any new policy that the regulators take forward must have an appropriate time table for completion and implementation.

Transparency, accountability and governance

Transparency and accountability are key to an effective relationship between regulators, markets and firms. Given the wide and significant powers being proposed, appropriate accountability and governance arrangements are an important part of the model to be implemented.

Overall, accountability arrangements need to be better defined to make clear who is ultimately responsible for decision-making within the system and to ensure clarity and transparency of responsibility between and within the different regulatory institutions.

We remain concerned that the appointment processes for the Court of the Bank of England, FPC and the Boards of the PRA and FCA are not transparent enough. Also, there should be requirements for these bodies to have a balance of experience from within the financial services industry, including the insurance and asset management sectors.

We recommend that provisions are added to the Bill to require the Treasury to explicitly consider the balance of experience required when it appoints independent members to the FPC and the Boards of the PRA and FCA.

The PRA's accountability would be strengthened by engagement with the Practitioner Panel, and we call on the Government to mandate this. Consideration should also be given to enabling the Chairs of the Practitioner, Smaller Business Practitioner, Consumer and Markets Panels to formally engage with the FPC.

Parliamentary scrutiny of the regulators is necessary. We recommend that senior leaders within the regulatory structure (including the Governor, Deputy Governors, Chairs and Chief Executives of the key regulatory actors) attend sessions at the Treasury Select Committee. The discipline of attending regular sessions would sharpen focus amongst the Boards and Executive Management terms of their role and the challenges that exist.

Due process

We are concerned that the White Paper grants the regulators a mandate for more intrusive intervention, while at the same time it weakens due process for firms in a number of areas. For instance, the Tribunal will only be able to remit issues back to the authorities and will no longer be able to issue directions.

Whilst we understand the desire to give supervisors' powers to take swift and decisive action to meet their objectives, in some cases by making subjective judgements, this is precisely the set of circumstances when one would expect there to be a concomitant strengthening of mechanisms which enable firms to challenge the regulators' judgements.

We urge the Government to include appropriate challenge mechanisms within the draft Bill, such as regarding the Tribunal, to help ensure that the implications of the regulators' judgements can be independently reviewed where appropriate.

In addition, industry consultation (that is duly taken into account) is an important part of the process for making rules. The FPC should consult on and publish a cost benefit analysis on its tools, allowing stakeholders to engage and challenge the FPC. This would be consistent with the PRA and FCA. Also, the PRA should have the same rules for publishing cost-benefit analyses and consulting on rules as the FCA.

Naming and shaming

Different regulators take different approaches to using information disclosure as a supervisory tool. In our experience, the supervisory relationship works well when the regulator and the firm can have open, frank and confidential discussions. Relationships typified by high levels of trust can be very constructive and lead to issues being aired and resolved speedily.

We are concerned that a number of proposed changes, such as the publication of warning notices, constitute a strategic move towards 'naming and shaming' firms. This may lead to a more adversarial relationship between the firm and the supervisor, particularly when a firm's reputation is at risk. Critically, this type of relationship many not actually deliver the practical outcomes that the supervisor is looking for.

Remaining active and focused in key European negotiations

The new EU supervisory architecture, and its interactions with the UK regulatory framework, is very important for businesses like Aviva with operations across Europe. Additionally the presence in the United Kingdom of the head offices of many insurance groups means that UK regulators face a challenging role as Group Supervisor leading the supervision of these groups across Europe and in particular ensuring college effectiveness.

The new European Supervisory Authorities (ESAs) are preparing for greater harmonisation across Europe in terms of regulatory rules and methodologies. It is paramount that the UK authorities maintain close and active participation in ESAs as they develop their rule-making powers. For these reasons, it is critical that the new authorities are well equipped to engage with EU and international bodies such as the International Association of Insurance

Supervisors, International Organisation of Securities Commissions and the Financial Stability Board.

The government has stated that it is not appropriate to set out operational matters for the PRA and FCA in primary legislation. However, effective international coordination is a priority for the financial services industry, and we believe that the need for strong international regulatory influence is such that it requires a legislative underpinning. We welcome the proposals to ensure co-ordination in the EU and internationally and would urge the Government to consult with the industry on the proposed MoU on overall international co-ordination.

The IMF's Financial System Stability Assessment of the UK, published on 1 August, recommended that the UK "establish a forum for ensuring good governance and coordination among organizations in the new regulatory structure." We believe that there may be merit in setting up a forum or secretariat in relation to EU and international engagement. A forum or secretariat could help co-ordinate strategy and support activity by the regulatory actors (but should not be a barrier to action).

Consumer issues

We agree with the Government's emphasis on delivering positive consumer outcomes, which should be aided by the references to the pursuit of competition and consumer choice within the FCA's objectives.

We are pleased to note that the regulatory regime will require that consumers should take responsibility for their own decisions. However, we believe that more can be done to ensure consistent, joined up policy making when it comes to financial services.

It is important that the FCA and Money Advice Service (MAS) work well together to educate consumers and demonstrate how financial services can help them meet their aims and needs. We consider that the Money Advice Service's MoU with the FSA should be subject to annual public consultation.

There needs to be some appreciation within the FCA that financial services products that are designed, marketed and sold appropriately can be (and often are) of value to consumers. There is a risk that without formal FCA recognition of the benefits of financial services that it could engage in continual and far reaching consumer protection activities that could lead to unintended consequences - such as reduced consumer engagement with financial services. This could lead to wider public policy issues, such as low rates of long term saving or protection from risks.

We recommend that firms should be able to refer significant cases to the Tribunal or the FCA. Enabling firms to refer significant cases to the Tribunal would encourage the FOS to be cognisant of baseline legal obligations.

Product intervention rules

We welcome the spirit underpinning the policy – i.e. the desire for earlier intervention to tackle badly designed products, or those products which are targeted at inappropriate customer segments or sections of society. We are though concerned that there may be unintended consequences of such a policy.

There is the risk that frequent use of product intervention rules could put at risk product innovation and harm competition. An overly interventionist approach could result in a narrow and homogenised product suite which does not benefit consumers.

Enforcement

The government rightly distinguishes between disciplinary action and decisions that involve supervisory assessments. There needs to be a balance between the two types of action as the excessive use of enforcement action may harm confidence in the financial system. Further, supervisory assessments of whether enforcement is appropriate should take into account whether or not firms have taken action on their own account to identify, resolve and inform supervisors of issues.

Ensuring coordination and effective working relationships

We note the Treasury's intended approach is for operational matters such as inter-agency coordination to be governed though a series of Memorandums of Understanding (MoUs) and not through primary legislation.

We welcome the fact that the PRA and FCA will be under a 'duty to co-ordinate' and be obliged to produce a Memorandum of Understanding (MoU) setting out how they will deliver this duty. This co-ordination is critical to minimising the costs to firms of dealing with multiple regulators. It should also help the two regulators to be aware of and manage overlaps between conduct and prudential regulation.

However, we urge the government to include a specific requirement on the regulators to identify areas of activity that can be undertaken centrally to reduce firm costs and enable more efficient interaction with firms.

Group supervision

As an insurance group that includes an asset management business, we have a concern about how Aviva plc will be supervised. Aviva's life and general insurance businesses will be subject to dual regulation, whilst Aviva Investors will be mainly subject to conduct and prudential supervision from the FCA alone. Were the PRA to lead on group supervision for Aviva plc, it is vital that it works closely with the FCA to understand asset management issues and the conduct insurance issues that the FCA deals with.

It is critical that the regulator that takes the lead on group supervision co-ordinates effectively with the other regulator when making assessments or decisions about the group. This co-ordination is important as the lead UK regulator will impact our non-UK businesses through its actions in regulatory colleges. Relevant expertise must be shared between the regulators and the group should have one point of contact. This would ensure that unnecessary costs are not incurred that would no doubt be ultimately borne by consumers.

Appendix 2: Aviva's response to the consultation questions

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

Court of Directors of the Bank of England

The role of the Court of Directors of the Bank (including setting the Bank's objectives and strategy, and ensuring the effective discharge of the Bank's functions) will become more important in light of the Bank's new regulatory powers. In addition to this increase in importance, the draft Bill proposes changes to the Court's remit, such as new section 9A of the draft Bill, which requires the Court to determine the Bank's strategy in relation to the Bank's financial stability objective.

Given this extra responsibility consideration should be given to amending the Bank of England Act 1998 so that the selection process for appointing members of the Court of Directors is transparent. This process should aim to ensure that the Court's expertise covers a spread of financial sectors, including wholesale markets and insurance. Overall, increased responsibility requires stronger governance arrangements and transparency.

Objectives and regulatory principles

We welcome the proposal for the Treasury to make recommendations to the FPC regarding the Bank's financial stability objective. This should help the FPC pursue its objectives and assist joined up policy making (whilst maintaining the FPC's independence).

We consider the PRA's and FCA's regulatory principles, as described in the February consultation (*Building a stronger system*) to be sensible.

We support the FPC having regard to the principle of proportionality; the merits of disclosure of the FPC's views and the disclosure of information; and the international obligations of the UK.

Membership of the FPC

We agree with the Treasury Select Committee's view that the membership of the FPC may be weighted too heavily towards the Bank. We would support the FPC containing a majority of members from outside the Bank.

We also agree with the Government's and the Bank of England's aim that there be an appropriate balance and breadth of experience in the FPC. For example, without, practical insurance experience on the Committee, there is a risk that issues that arose in the insurance sector could be missed or misinterpreted.

We consider that the selection process for members of the FPC should aim to ensure that the FPC's expertise covers all financial sectors, including insurance and wholesale markets, and is not overly focused on banking. There needs to be a legislative device to secure balance and breadth of experience - one way would be for the Bill to require the appointing body to publish a short statement explaining how the appointment maintains an appropriate balance and breadth of experience in the FPC.

We therefore recommend that PART 1A, 9B of the Bill is amended as follows:

(3) Before appointing a person under subsection (1)(e), the Chancellor of the Exchequer must-
(a) be satisfied that the person has knowledge or experience which is likely to be relevant to the Committee's functions,
(b) *consider whether the appointment is consistent with the objective of ensuring an appropriate breadth of sectoral experience within the Committee,*
(c) consider whether the person has any financial or other interests, that could substantially affect the functions as member that it would be proper for the person to discharge, and
(d) publish the rationale for the appointment with particular reference to how it will affect the sectoral experience of the Committee.

Engagement with Panels

We consider that a single panel made up of the Chairs of the FCA's Practitioner, Smaller Business Practitioner, Consumer and Markets Panels should engage with the FPC. This would help make the FPC accountable to stakeholders and would also enhance its transparancy.

Macro-prudential tools

It is important that the FPC undertakes rigorous analysis of the potential impact and likely effectiveness of macro-prudential tools before it makes use of any of these mechanisms. It should take care to use its macro-prudential tools in a proportionate and risk based way. We propose that the FPC be required to publish a cost-benefit analysis and consult, before giving directions to the PRA and FCA, and before making recommendations to the PRA, FCA and others. It should use the consultation procedures set out for the FCA in section 138J of the draft Bill.

We therefore recommend that PART 1A, 9G of the Bill is amended as follows:

(1) The Financial Policy Committee may give a direction to the FCA or the PRA ("the regulator") requiring the regulator to exercise its functions so as to ensure the implementation, by or in relation to a specified class of regulated persons, of a macro-prudential measure described in the direction*, subject to 1A below*
(1A) Before making a direction under (1) the Financial Policy Committee should consult on the sectoral impact of the proposed action.]

We note that the macro-prudential tools are being developed in a banking context and are most relevant to banks. As insurers and asset managers have very different business models and engage in different activities to banks, the use of tools developed for banks on insurers and asset managers would be inappropriate.

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

We do not have comments on these proposals.

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

We welcome the Treasury's commitment to publish a draft of a crisis management MOU during pre-legislative scrutiny of the draft Bill to help clarify how the Treasury and the Bank will co-ordinate their activities in order to resolve a threat to financial stability.

The Bank's regulation of systemically important infrastructure must be closely co-ordinated with the FCA given its responsibilities as the regulator of wholesale markets.

<u>Special Resolution Regime</u>

We would stress the inappropriateness of applying regulatory tools such as the Special Resolution Regime, which was designed to mitigate the risks posed by bank failures, to insurers. Banks and insurers have fundamentally different business models and their failures will have different impacts. Faced with a very large event, an insurer can fail; but in contrast to what we have witnessed in the banking sector, winding up an insurer is an orderly process that does not generate systemic risk.

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

We hope that the absence of any specific reference to promotion of the UK's financial services sector in the regulatory objectives will not lessen HM Treasury's and the authorities' appreciation of this.

We welcome the fact that the PRA now has a specific statutory objective governing its responsibilities for the insurance sector.

We welcome the confirmation, set out in the PRA and the Bank of England's paper*, 'Our approach to insurance supervision',* that insurance regulation will be an equal priority for the PRA.

Historically the purpose of the prudential regulation of insurance companies has been the protection of consumers. 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. Both the previous Treasury consultation and '*Our approach to insurance supervision'* acknowledge that insurance business models are different to those of banks, especially in terms of liquidity risk and the fact that insurance firm failure is generally less likely to be of systemic importance. In our view traditional insurance activities do not pose any systemic risk to the financial system, and the size of a firm is not a relevant consideration in this assessment, as evidenced by Northern Rock.

It is vital that the prudential supervision of insurance firms is risk based and proportionate. We note that the Prudential Business Unit, the interim function within the FSA which will develop into the PRA, has separate management lines for banks and insurers and we believe this should continue under the PRA. The PRA must recognise the different prudential risks posed by banks and insurers and apply appropriate and prudential supervision to individual insurers and have the focussed insurance expertise to achieve this.

We consider the PRA's and the FCA's regulatory principles to be sensible.

With-Profits policy holder protection

Clause 5 of the draft Bill provides for the PRA to have sole responsibility for securing an appropriate degree of protection for the reasonable expectations of policyholders as to their returns under with-profits policies.

We agree that the PRA should have sole responsibility for securing an appropriate degree of protection for with-profits policy holders. However, we consider the inclusion of 'reasonable expectations' in the wording of this provision is unclear, unnecessary and open to interpretation. The PRA already has the proposed objective of securing an appropriate degree of protection for policyholders, and the treatment of with-profits policy holders should be consistent with this.

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

We note the White Paper's comments on the need for the PRA Board to provide a robust challenge to the Executive. The draft Bill should require the Bank to ensure that the Board has an appropriate balance of experience from within the financial services industry, including the insurance sector.

Consultation

Fair consultation processes are an important way in which the PRA can be made accountable to firms.

We welcome the Government proposal that there should be no significant reductions to the existing FSMA requirements to consult on rules by both the PRA and the FCA. However, the Government proposes that the PRA should have some flexibility in deciding what kind of arrangements it wants to establish for engaging with industry. Therefore, while the Bill places the PRA under a statutory duty to put in place arrangements for engaging with practitioners, it does not specify in detail what those arrangements must be.

We can see no good reason why the PRA and FCA's consultation processes should be inconsistent, and are concerned that this opens up the (unjustifiable) possibility of the PRA having weaker arrangements for consulting with practitioners than the FCA. So, we propose that the FCA's consultation processes be replicated for the PRA.

We believe that the same provisions for consultation should apply to guidance issued by the new authorities. Guidance can have a similar effect to rules under the regulatory system where the authorities are able to use guidance to introduce interpretations that are not evident from the rules alone. Therefore, regulatory guidance should be subject to the same consultation arrangements as regulatory rules.

Consequently, we recommend that section 139A (5) is amended as follows:

"Where this subsection applies, ~~subsections (1), (2)(e) and (4) of~~ section 138J (consultation) apply to the proposed guidance as they apply to proposed rules, unless the FCA considers that the delay in complying with those provisions would be prejudicial to the interests of consumers."

Tribunal

A shift to judgement-based supervision should be balanced with a strengthening, not an undermining, of challenge mechanisms for firms. The White Paper states that the draft Bill will limit the course of action available to the Tribunal in the event it chooses not to uphold the relevant regulator's decision. We strongly disagree with this view and believe that the course of action available to the Tribunal should remain unchanged. Namely, the Tribunal should continue to be able to reach its own view on the regulatory action which should be taken by the regulator and not simply direct the regulator to reconsider its decision.

Firms only tend to refer matters to a Tribunal as a 'last resort' as this process is time consuming and costly. If the Tribunal's powers to make a judgement on whether a decision was fair and reasonable are limited, and the only recourse is for the Tribunal to direct the regulator to reconsider the decision, then all the time, effort and costs associated to the firm will be wasted. So, firms would probably be very unlikely to challenge decisions.

We understand the new authorities will use judgement-led decision-making. As these decisions may have a material impact on firms, it is all the more important that the decisions of the authorities can be challenged and independently reviewed in an appropriate way. The ability to challenge decisions does not undermine judgement-led decision making, but provides an appropriate check and balance so that corrective action can be taken in the event that decisions are not fully thought-through by the regulator. The knowledge that decisions may be challenged and reversed may also lead to higher quality supervisory decisions.

We therefore recommend that the current wording of Section 133 in FSMA, concerning the proceedings of the Tribunal, is retained. Judgment-based decision-making should mean that, if anything, the Tribunal should be strengthened.

Practitioner panel

This is another area where the PRA can be made more transparent and accountable to stakeholders.

We note that the draft Bill places the PRA under a statutory duty to put in place arrangements for engaging with practitioners but does not specify what those arrangements should be. It seems clear that the most simple and effective arrangement is for the FCA's Practitioner Panel to engage the PRA. We can see no good reason why the PRA and FCA's practitioner engagement arrangements should be inconsistent, and are concerned that this opens up the (unjustifiable) possibility of the PRA having weaker arrangements for engaging with practitioners than the FCA. We urge the government to require the PRA to engage with the industry via the Practitioner Panel.

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

We support the inclusion in the PRA's and FCA's regulatory principles of the general principle that consumers should take responsibility for their own decisions.

We welcome the FCA's operational objective to facilitate efficiency and choice in the market for financial services. We believe that facilitating choice should include broadening consumer access to suitable products. We note that the FCA objectives do not refer to innovation, which is one way to promote choice in the market. We therefore recommend that HM Treasury consider maintaining one of the FSA's principles of good regulation: "the desirability of facilitating innovation in connection with regulated activities". This principle could be included in 1C(2), as one of the factors the FCA must have regard to when considering what degree of protection for consumers may be appropriate.

We consider that there needs to be some appreciation within the FCA that financial services products that are designed, marketed and sold appropriately can be (and often are) of value to consumers. We fully appreciate the FCA's lower tolerance of consumer detriment and its willingness to intervene earlier and more intensively to prevent such risks from crystallising. However, we believe that this needs to be balanced with an appreciation that consumers also face risks by not accessing financial services: for instance, by not saving enough for retirement or by families not protecting themselves from the risk of the loss of an income. This would be in line with Government objectives to promote a resilient society, financial inclusion and increased saving for retirement.

We therefore believe that HMT should consider amending clause 1C (2), on the consumer protection objective, to the effect that the FCA should have regard to the potential benefits of consumers accessing financial products that meet their needs. Alternatively, a reference to access should be added to the efficiency/choice objective. Without this balance there is a risk that the FCA may take ever stronger and rigorous consumer protection action which has unintended consequences, such as the dampening of innovation, fewer market entrants, or restricted consumer access.

We welcome the FSA's commitment, referred to in its consultation on the approach to regulation for the FCA, to recognise the differences between wholesale and retail markets in delivering the objectives and of the importance of the links that pose specific risks to confidence in the UK financial system

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

<u>Product intervention</u>

We welcome HMT's acceptance that product intervention is unlikely to be appropriate in relation to the protection of professional or wholesale customers, and that the product intervention power should therefore be focused on retail 'consumer' protection, rather than for market integrity reasons. We believe it is important that the FCA consider whether or not a product is targeted solely at wholesale customers. The fact that a retail customer may be able to gain access to such a product through a wholesale intermediary should be a conduct of business matter in relation to that intermediary and should not necessarily lead to a ban on the product itself.

We are concerned by the risk that product intervention powers are used excessively and disproportionately, thereby hindering product innovation and, potentially, competition. To ensure that product intervention powers are only used when appropriate and when proportionate, we consider that the FCA should publish a cost-benefit analysis when it makes temporary product intervention rules. If no cost-benefit analysis is published, then the temporary product intervention rules should only be valid for six months. Unless this power is used conservatively, there is a risk that its use results in a narrow and homogenised product suite which does not benefit consumers.

137C(2) makes it clear that the product intervention rules only applies to new products. However, it ought to be made clear that the application of rules about prohibiting the creation of agreements/obligations should only be in relation to a breach of the rules going forwards, and that these rules won't apply to agreements/obligations already in place. 137C(7) should be amended to refer to relevant new agreements and obligations only.

We note that the proposals are silent on how (or if) the FCA will apply its product intervention powers where products are marketed cross border, on both an inward and outward basis. In the absence of a level playing field, there is a risk that products marketed into the UK from other jurisdictions will not afford the same levels of consumer protection compared to those marketed within the UK. There is also a risk that UK firms will seek to market more products cross border where there is a less intrusive approach to product regulation.

We note that the Government will legislate to require the FCA to consult on and publish a statement of its policy with respect to the making of temporary product intervention rules. We welcome this initiative and are keen for it to provide the clarity and certainty the industry needs to continue developing products for a wide range of consumer needs.

<u>Financial promotions</u>

We believe that the new power regarding financial promotions in new section 137P may enable interventions which do not lead to a proportionate benefit to consumers. The power enables the FCA to give a direction if it "considers that there has been, or is likely to be, a contravention of financial promotion rules in respect of the communication or approval." We consider that the FCA should only be able to make a direction when it considers that a rule has been breached, and not when a rule might be breached. Otherwise, the FCA will be able to direct firms when they have not actually breached any rules.

We are pleased that the Government recognises the reputational damage that firms could incur through the FCA's publication of directions on financial promotions, and consider the proposed controls to be appropriate.

<u>Publication of warning notices</u>

We continue to disagree with the proposal to enable the FCA to publish warning notices and are concerned that the regular publication of warning notices could damage consumer confidence in the industry.

There is also a risk of significant reputational damage to the individual or firm where the FCA publishes a warning notice but then decides not to take forward enforcement action. Any subsequent statement that enforcement action was not necessary or justified is unlikely to counter the negativity created by the warning in the first instance.

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

See response below.

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

Consumer redress to be an important issue and the FCA should be required to prove that there is mass detriment before taking any action. The process for identifying and proving instances of mass detriment should include a requirement for the FCA to take into account the industry's views and evidence.

This requirement should also extend to any instances where a designated party brings a mass detriment issue to the FCA's attention. For instance, once an issue has been raised this could be a trigger for trade associations and firms to make representations, which the FCA would have to take into account.

It is also necessary to explore the value of the FCA seeking an industry led solution by working with trade associations. Trade associations could have a window of time to effect changes agreed with the FCA, and if they are not able to do so, then the FCA could take alternative action. This approach could lead to swifter action by firms to provide consumer redress.

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

We do not have comments on these proposals

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

We agree with the decision that the UKLA should remain part of the FCA.

We remain concerned with the change to Part VI whereby the UKLA could require an issuer to have a skilled person prepare a report on a matter which the UKLA requires information. We consider this to be a significant increase in power and could add to the regulatory burden and cost of being listed in the UK. This requirement does not fit with the regulatory regime for which UKLA is responsible and our view remains that a skilled persons report is not appropriate for the listed issuer environment.

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

It's important that standard corporate governance principles are applied to the new regulators. The selection process for appointing members to the FCA Board should be transparent. This process should aim to ensure that the FCA Board's expertise covers all financial sectors supervised by the FCA, including insurance and asset management.

We welcome the proposal that the FCA should be scrutinised by a Practitioner, Small Business Practitioner, Consumer, and Markets Panels. We strongly believe that the

Practitioner Panel should engage with the PRA and can see no good reason why this is not the case.
Annual reports to the Treasury

We welcome the proposals that the Authorities must make an annual report to the Treasury with specified content including consideration of the principles in section 3B (which include efficient use of resources and that the burden of regulation should be proportionate to the benefits). In considering the efficient use of resource and the burden of regulation it is important not just to focus on the annual budget of the authorities met through fee levies but also to consider the costs directly imposed on firms. The FSA has increasingly been making use of section 166 skilled persons reviews, a trend that may well continue under the new authorities. These are requested by the FSA with the costs of investigations being met by the firms being investigated. (The Financial Times reported on 27 June 2011 that the average cost of such reviews is £339,000 with the highest over £4 million).

We therefore recommend that the provisions set out in Schedule 1ZA that the annual report should cover should make explicit reference to direct and indirect costs of regulation in the consideration of efficient use of regulatory resources and regulatory burden. We propose that the wording to Schedule 1ZA Part 1, 11 is amended as follows with similar amendment to Schedule 1ZA Part 1, 19 also

(1) At least once a year the FCA must make a report to the Treasury on-
(a) the discharge of its functions,
(b) the extent to which, in its opinion, its operational objectives have been advanced,
(c) the extent to which, in its opinion, it has acted compatibly with its strategic objective,
(d) how far its general functions have been exercised in a way which promotes competition,
(e) its consideration of the matter mentioned in section 1B(5)(b),
(f) its consideration of the principles in section 3B,
(g) In considering cost efficiency and regulatory burden under (f) above both direct costs and indirect costs, (e.g. costs arising to firms through a S166 skilled persons report), imposed on firms, (and ultimately consumers), should be taken into account
~~(g)~~ (h) how it has complied with section 3D,
~~(h)~~ (i) any direction received under section 3F during the period to which the report relates, and
~~(i)~~ (j) such other matters as the Treasury may from time to time direct.

Parliamentary scrutiny

We believe that the FCA should be subject to scrutiny by Parliament; with both the Chair and CEO attending sessions at the Treasury Select Committee who could review performance of the organisation against its strategic and operational objectives. The discipline of attending regular sessions would sharpen focus amongst the Board and Executive Management Team in terms of their roles, delivery and the challenges that exist.

We support the proposal for both new regulators to have a duty to investigate and make a report to the Treasury on possible regulatory failure.

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

We note the Treasury's intended approach is for coordination to be governed though a series of Memorandums of Understanding (MoUs) and not through primary legislation.

We welcome the fact that the PRA and FCA will be under a 'duty to co-ordinate' and produce a MoU setting out how they will deliver this duty. This co-ordination is critical to minimising the costs to firms of dealing with multiple regulators. It should also help the two regulators to be aware of and manage overlaps between conduct and prudential regulation.

We welcome the White Paper's proposal that the PRA and FCA must include in their annual reports an account of how they have co-ordinated during the year.

Shared processes

We agree with the government that the two regulators can be expected to develop their own culture and regulatory approach with firms. It is for this reason that it is very important that the draft Bill require them to identify areas where they can share services or co-ordinate activities in order to minimise duplication and burdens on firms. This sharing or co-ordination would reduce costs for firms (and, ultimately, consumers) without imposing costs on the regulator or impinging on their ability to meet their objectives. The Government's proposed remedy, of references to the need for each regulator to use its resources efficiently and to only impose restrictions or benefits which are proportionate to the benefits, will not necessarily achieve this outcome. This is because both regulators could set the same requirement (e.g. on interviewing people in significant influence functions) which would be proportionate to their benefits and an efficient use of each regulators' resources. However, there could still be duplication which would waste a firm's resources.

We therefore urge the government to include a specific requirement on the regulators to identify areas of activity that can be undertaken centrally to reduce costs and enable more efficient interaction with firms. Firms should have a single process for standard interactions like notifications, changes to permissions or SIF interviews. Maintaining the ONA online system for the submission of applications and notifications for central access by both authorities would assist in this.

We recommend that Part 1A Chapter 3, section 3E (2) in the draft Bill is amended as follows:

(2) The memorandum ~~may~~ *should* in particular contain provisions about how the regulators intend to comply with section 3D in relation to-
(a) applications for Part 4A permission;
(b) the variation of permission;
(c) the imposition of requirements;
(d) the obtaining and disclosure of information;
(e) cases where a PRA-authorised person is a member of a group whose other members include one or more other authorised persons (whether or not PRA-authorised persons);
(f) functions under Schedule 3 (EEA passport rights) and Schedule
4 (Treaty rights);
(g) powers to appoint competent persons under Part 11 (information gathering and investigations) to conduct investigations on their behalf;
(h) functions under Part 12 (control over authorised persons);
(i) functions under Part 13 (incoming firms: intervention by regulator);
(j) functions under Part 19 (Lloyd.s);
(k) functions under section 347 (record of authorised persons etc.);

(l) fees payable to either regulator;
(m)the sharing of common services;
(n) the coordination of supervisory monitoring to avoid duplication
We believe that clarity is required on how the PRA and FCA will co-ordinate in relation to regulatory notifications and liaison with firms. Aviva's life and general insurance business will be subject to dual regulation, whilst Aviva Investors will be mainly subject to conduct and prudential supervision by the FCA. Where notifications are required, consideration should be given to whether firms will be required to notify the lead regulator or to notify both the FCA and PRA. Similar considerations need to be given to how the FCA and PRA will co-ordinate visits to firms to ensure there is no duplication of effort by the regulator or additional burdens placed on firms.

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

We are content with the government's proposal that the authority responsible for the prudential regulation of an applicant for authorisation will manage the application process and grant permission.

It is important that the approved person regime is run as efficiently as possible with the minimum of overlap. Candidates should only have to put forward one application and attend a joint interview. Similarly it should be clear to incumbents which regulator they are accountable to in their particular approved function.

<u>OIVOPs</u>
The draft Bill (55J) provides that authorised persons permissions can be varied on the initiative of the authority (OIVOP) in three scenarios. The first two provide an objective measure being that the authorised person is failing or likely to fail to satisfy the threshold conditions, or has failed during a period of at least 12 months to carry on regulated activity to which the permission relates. The last scenario is subjective in that it is desirable to exercise the power in order to advance the objectives of the authority. The Bill also provides that such a variation can be imposed immediately if the warning notice issued states that this is the case (55Y), and that such warning notices could be made public (schedule 8 part 6, 24).

We do not object to the immediate implementation of an OIVOP where it is based on an objective measure, as in the first two scenarios, however, we are concerned that such a power could be used to vary a firms permissions immediately and make this public leading to possible reputational damage based on a subjective assessment where the firm has not been able to make prior representations. Therefore, we recommend that the Bill is amended so that where 55J (1) (c) is the basis for the OIVOP that it should not take effect or be published until after the 14 day period allowed to make representations.

We therefore recommend that 55Y (2) is amended as follows:

(2) A variation of a permission or the imposition or variation of a requirement takes effect.
(a) immediately, *where 55J (1) (a) or (b) applies* ~~if~~ and the notice given under subsection (4) states that that is the case, *and after the notice period for representations in all other cases,*
(b) on such date as may be specified in the notice, or
(c) if no date is specified in the notice, when the matter to which the
notice relates is no longer open to review.

Schedule 8 part 6, 24 should also be amended as follows:

24 (1) Section 391 (publication) is amended as follows.

(2) For subsection (1) substitute.
.(1) In the case of a warning notice falling within*55J (1) (c) and* subsection (1ZB).

> (a) neither the body giving the notice nor a person to whom it is given or copied may publish the notice;
> (b) a person to whom the notice is given or copied may not publish any details concerning the notice unless the body giving the notice has published those details; and
> (c) after consulting the persons to whom the notice is given or copied, the body giving the notice may publish such information about the matter to which the notice relates as it considers appropriate, *subject to 55Y (2) (a)* .

<u>Single rule book</u>

The consultation notes in 2.170 that the Government does not believe it would be appropriate to require the regulators to put in place a joint rule book. We disagree with the Government. A single UK view is necessary for negotiations in developing European regulation and therefore a single UK rule book should naturally flow from this and would mitigate the risk of differing interpretations of the same EU requirements between the new authorities.

<u>Rule making and rule waivers</u>

We agree that the PRA and FPC should only be able to make rules in pursuance of their objectives, and should consult each other before making rules.

We disagree with the proposal that where a firm is a member of a group which includes a dual regulated firm that each authority must consult the other prior to issuing a waiver or modification. Aviva Investors is a member of the dual regulated Aviva group but will be prudentially supervised by the FCA. In this case, it would be unnecessary for the PRA to approve a waiver or modification that had no prudential implications.

<u>Dual supervision</u>

As an insurance group that includes an asset management business, we have a concern about how Aviva plc will be supervised. Aviva's life and general insurance businesses will be subject to dual regulation whilst Aviva Investors will be mainly subject to conduct and prudential supervision from the FCA alone. Were the PRA to lead on group supervision for Aviva plc, it is vital that it works closely with the FCA to understand asset management issues. It is critical that the regulator that takes the lead on group supervision co-ordinates effectively with the other regulator when making assessments or decisions about the group. This co-ordination is important as the lead UK regulator will impact our non-UK businesses through it actions on regulatory colleges and groups. Relevant expertise must be shared between the regulators and the group should have one point of contact.

<u>Enforcement</u>

The White Paper rightly distinguishes between disciplinary action and decisions that involve supervisory assessments. We would stress that that there needs to be balance between the two types of action and that excessive use of enforcement action may harm confidence in the industry.

Further, supervisory assessments should take into account whether or not firms have taken action on their own account to identify, resolve and inform supervisors of issues in determining whether enforcement is appropriate.

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

The Financial Ombudsman Service (FOS) plays an important role and we believe that the industry needs an independent arbiter of complaints for those cases when there is an impasse between firm and consumer. Having a strong, consistent and quality Ombudsman is an important feature of the regulatory framework. However, we have some concerns about the FOS' accountability, the quality of decision making and of the risk of wider application of FOS decisions. There remains a risk that a poor decision made by the FOS may be applied widely to other similar cases. At the moment there is little room for challenge after an Ombudsman has given his ruling.

Whilst it is positive for consumers that groups representing them are able to act on themes and issues representing large groups of people, we would like to ensure that there are appropriate checks and balances to guard against seriously erroneous decisions.

Where firms have cause to challenge an adjudication they must ask for the case to be referred to an Ombudsman, after which the only recourse is to apply to the High Court for judicial review. The threshold for establishing grounds for judicial review is very high (i.e. a firm has to prove that a decision was perverse or irrational) as otherwise it would simply be viewed as a further appeal process against a decision. Furthermore, it is very costly to firms. If successful, the firm would apply for the decision to be overturned. However the Ombudsman would then have to make the decision again and consequently there is a risk that they could arrive at a similar decision though perhaps for different reasons.

Currently, firms have to operate within the confines of a framework where any arguments submitted may be strong enough to win court cases, but not necessarily persuade the Ombudsman as to their merits. The principal reason for proposing an appeals process is the desire to mitigate the risk of material issues arising from a FOS determination, which may have a significant impact on the strategy (e.g. target market, demographic etc) or capital position of a firm, or result in an expensive large scale rectification project. An adverse determination may have the potential to cost millions of pounds and the lack of a viable means of appeal is fundamentally unfair to firms. This may be viewed as an inequitable arrangement and arguably firms should have the means available to them to refer to a higher authority; and that the tests for doing so, while high, should not be prohibitively so.

Any appeal process designed to provide a further challenge to usual Ombudsman determinations could be considered counter-productive. However in the rare instances where an Ombudsman has made a determination that the firm believes may have a much wider impact on their business or the industry (in spite of their best efforts to persuade the FOS of the likely outcome of their decision) it would be appropriate. One alternative would be for any appeal to be limited to the general application of a determination (and so the actual determination would stand as part of the formal process) since this would avoid impact on the complainant.

In response to this challenge, we recommend that firms, trade associations or the FOS should be able to refer significant cases to the FCA (or the Tribunal). Our preference is for firms to be able to refer significant cases to the Tribunal as this would encourage the FOS to be cognisant of the baseline legal obligations. Alternatively, if a firm referred a case with material impacts to the FCA, the FCA should conduct a full consultation and cost-benefit analysis regarding the impact of decision, and set out binding rules on how FOS should handle all similar cases.

<u>Money Advice Service</u>

It is important that the FCA and Money Advice Service work well together to educate consumers and demonstrate how financial services can help them meet their aims and needs. We consider that the Money Advice Service's MoU with the FSA should be subject to annual public consultation.

HMT: A new approach to financial regulation: the blueprint for reform – AXA UK Group Response

The Financial Policy Committee

Question	Response to question
1. Do you have any specific views on the proposals for the Financial Policy Committee (FPC)?	We are disappointed that the independent members of the FPC have a banking background, rather than more diverse financial services experience. It is noted that an individual with risk management experience has not been appointed to the board as suggested by the TSC. We believe that individuals with other financial services experience ought to be appointed to the FPC, as well as members with practical business experience and not just academics. Any toolkit developed must consider all Financial Services firms and not just be focused on banks. Insurers and other financial services firms have very different business models and engage in different activities from banks, therefore tools developed for banks would be inappropriate for insurers. We believe that the FPC should look at developing tools appropriate to insurers where appropriate. It is important when considering the development of such tools that visibility is maintained of international events and progress with requirements.. We note and welcome the Government's intention to continue to look at the concentration of responsibilities within the Bank. New section 9B of the Banking Act 1998 sets out the appointment of the members of the FPC. To enhance independence from the Bank we propose that all of the external members should be approved by the Chancellor of the Exchequer.

	New Section 9D, (2) introduces the requirement for the Treasury to make recommendations to the FPC. It will be helpful to understand the nature of these recommendations. New section 9K (2) of the Banking Act 1998 introduces macro prudential orders made by the Treasury and outlines the action to be taken in emergency circumstances. We recommend that the Treasury should consult an emergency committee of the FPC consisting of at least one non executive director and not just the Governor of the Bank.

Systemically important infrastructure

Question	Response to question
2. Do you have any specific views on the proposals for the Bank of England's regulation of RCH's, settlement, and payment systems as described?	No comment.

Coordination of crisis management

Question	Response to question
3. Do you have any comments on: • **The proposed crisis management?** • **The proposals for minor and technical changes to the Special Resolution Regime?**	No comment.

The Prudential Regulation Authority

Question	Response to question
4. Do you have any comments on the objectives and scope of the PRA?	We note the proposed rule making powers of the PRA as set out in clause 137E. We note this gives the PRA rule making powers which takes into account wider group companies but excludes EEA firms where matters are reserved for the home state regulator. Any rules applying to non regulated activities should not place any additional requirements on UK firms which go beyond EU directives in respect of Group Supervision. This should be included within the primary legislation. We note the rule making powers in respect of resolution plan. Any extension of these powers to firms regulated by the PRA which are not banks must reflect the nature of their business and be subject to appropriate scrutiny and controls. We are still not in favour of the PRA developing its own designation criteria to determine which firms will fall within its remit as set out in clause 22A of the draft Bill. We still think this should be determined by the primary legislation in order to ensure the appropriate legislative consultation process.

Judgement-led supervision

Question	Response to question
5. Do you have any comments on the detailed arrangements for the PRA?	We question whether a judgement led approach will work since EU directives now follow a more detailed and prescriptive approach. We also think the PRA needs to reflect the requirements set at European and international level. We are concerned that this judgement led approach appears not to include any adequate or robust appeal mechanisms and that there is a risk that an 'unlevel' playing field results in respect of how comparable firms are supervised. We are also concerned about the limited course of action available to the Tribunal in the event it chooses not to uphold the relevant regulator's decision. We note that the paper discusses the need for the PRA to recognise the difference between banks and insurance entities. However we are still concerned that the PRA will have a more banking focus as a subsidiary of the Bank of England. We also question why the ex officio Chairman of the PRA will be the Governor of the Bank of England as we feel the governance would be strengthened if the chairman was independent of the Bank of England.. We note that the board of the PRA will have a non-executive majority. However it is essential that the experience of the non-executive directors reflects the firms regulated by the PRA. We note that appointments to the board of the PRA will be made by the Bank of England with approval by the Treasury. Again we question the independence of the PRA.

	We also question why the proposals suggest that there will be no requirement for the PRA to establish a non-executive committee. We think that FSMA Schedule 1 sub-paragraph 3 (1) (b) and 4 – creation and functions of the non–executive committee should apply to the PRA. This will provide independent challenge outside of the Court of the Bank of England.

Financial Conduct Authority

Question	Response to question
6. Do you have any views on the FCA's objectives – including its competition remit?	We note that the FCA must discharge its 'functions in a way which promotes competition'. However it is essential that the FCA considers the international character of financial services and the impact of any decision on the competitiveness of UK firms. The implementation of any EU rules must not be 'gold plated'. This is to ensure that UK firms can easily compete in Europe without additional onerous requirements. The FCA should not only consider the appropriate degree of protection afforded to consumers but the appropriate type of protection. This will help ensure that the protection being considered is proportionate to the benefit so that the industry can work effectively and provide product choice to the consumer.

A new approach to conduct regulation

Question	Response to question
7. Do you have any views on the proactive regulatory approach of the FCA?	We are concerned about the FCA's enhanced role in influencing the products that are available in the market. We still do not believe the FCA requires these additional product intervention powers.

	The widespread problems that have arisen in recent years have not necessarily been attributable to the product itself but the sales process. Firms are always looking to develop products to provide enhanced benefits which will benefit consumers. This provides a healthy competitive market. Therefore the FCA should not just focus on products but also look at the sales process. We are not in favour of the regulator being involved in product design or stipulating mandatory minimum standards. We think this should be reached through industry level agreement and codes of practice. Regulatory involvement in product design could also stifle innovation and the competitive market place. We are not in favour of the new power to publish a warning notice indicating that enforcement action has commenced. We are particularly concerned that publishing a warning notice could ruin the reputation of both firms and individuals who may later be found not to be at fault. We feel that if warning notices are to be given these must be directed at the relevant individual/firm only after the outcome of the full investigation/hearing. We welcome the proposal that the Government expects the FCA to take into consideration in setting its policy on these powers, the concerns raised regarding reputational damage and undermining consumer confidence in financial services generally. We recommend that the Government reviews the number of warning notices issued by the FSA compared with the number of final notices in order to assess whether this new power for early publication of enforcement action remains appropriate.

Consumer Redress (new proposals, not consulted on in earlier papers)

Question	Response to question
8. What are your views on the proposal to allow nominated parties to refer to the FCA issues that may be causing mass detriment? **9. What are you views on the proposal to require the FCA to set out its decision on whether a particular issue or product may be causing mass detriment and preferred course of action, and in the case of referrals from nominated parties to do so within a set period of time?**	8. We agree with the suggested approach for resolving cases of mass detriment. 9. We agree that the FCA should be ultimately responsible for determining which issues will be deemed to be causing mass detriment and making this public.

Competition powers

Question	Response to question
10 Do you have any comments on the competition proposals for the FCA?	The approach seems sensible.

Wholesale and markets regulation

Question	Response to question
11. Do you have any views on the proposals for markets regulation by the FCA?	No comment.

Governance and accountability

Question	Response to question
12. Do you have any comments on the governance, accountability and transparency arrangements proposed for the FCA?	No comment.

Coordination and regulatory processes

Question	Response to question
13. Do you have any comments on the general coordination arrangements for the PRA and FCA?	We note that the primary legislation will specify the legal duty for the PRA and FCA to coordinate their activities. The detail on how the PRA and FCA will coordinate these activities will be set out in a Memorandum of Understanding. However it is essential, to minimise regulatory overlap that the regulators are open and transparent when creating these mechanisms. It is essential for the regulators to consult stakeholders and this requirement should be set out in the primary legislation. We welcome the proposal that the Bank and the FSA will be required to produce a draft of the MOU in time for the introduction of the Bill to Parliament. The Joint Committee should also be given the opportunity to scrutinise the MOU. We are still concerned that two regulators will lead to considerable inefficiencies, additional costs and overlapping jurisdictions between the PRA and FCA. It is essential that the PRA and FCA do not duplicate each others' activities. 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.

Specific regulatory processes

Question	Response to question
14. Do you have any views on the detail of specific regulatory processes involving the PRA and FCA?	No comment other than the need for the PRA and FCA to coordinate their activities to avoid unnecessary duplication.

Compensation, dispute resolution and financial education

Question	Response to question
15. Do you have any comments on the proposals for the FSCS and ombudsman?	No comment.