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

Baillie Gifford & Co
Calton Square
1 Greenside Row
Edinburgh
EH1 3AN

Telephone 0131 275 2000
Fax 0131 275 3999

www.bailliegifford.com

14 April 2011

Dear Sirs

A new approach to financial regulation: building a stronger system

We welcome the opportunity to respond to the important matters raised in the above Consultation Paper on behalf of Baillie Gifford & Co.

Baillie Gifford & Co is an independent fund management firm based in Edinburgh with around £72bn under management and advice. The firm is a private partnership under the laws of Scotland and includes a group of companies which are regulated by the FSA in the UK.

We have had the opportunity to review the response submitted by our trade body, the Investment Management Association and are broadly supportive of their stance and wish only to reiterate the following points:-

Chapter 3 - Prudential Regulation Authority

The PRA will authorise and supervise all banks, building societies, credit unions and insurers. We note at page 54 of the consultation, *'The PRA will be a focused regulator, dealing only with firms that manage significant risks on their balance sheets.'*

Investment managers, whose only insurance business is the management of pooled pension funds do not 'manage significant risk on their balance sheets.' They do not have the same balance sheet risks generally associated with banks and insurers. We are therefore of the view that such entities should be solely supervised by the FCA , which will be responsible for the prudential supervision of asset managers rather than by the entity charged with supervising systemically important institutions.

A list of partners' names is available at the above address

Authorised and regulated by the Financial Services Authority

INVESTOR IN PEOPLE

Chapter 7 – European and international issues

We note that the PRA, as regulator of banks and insurers, will hold the UK seat on the European Banking Authority (EBA), it will therefore be at the forefront of regulatory change to the Capital Requirements Directive, however it will not regulate any 'limited licence firms.' We are therefore mindful to ensure that the interests of this group is appropriately represented in such negotiations and that a proportionate approach continues in the application of this Directive to such firms, which do not trade on their balance sheet and are quite distinct from banks and insurers. In this respect the MoU and lines of communication between the PRA and FCA will be key to ensure the interests of limited licence firms continue to be represented in European fora.

We trust that the above comments are helpful, and please contact us should you require clarification of any particular point.

Yours faithfully

Katherine Moses
Regulatory Developments Manager

BAKER & MCKENZIE

Baker & McKenzie LLP
100 New Bridge Street
London EC4V 6JA, UK

Tel: +44 (0)20 7919 1000
Fax: +44 (0)20 7919 1999
DX No: 233 Chancery Lane
www.bakermckenzie.com

Asia Pacific
Bangkok
Beijing
Hanoi
Ho Chi Minh City
Hong Kong
Jakarta
Kuala Lumpur
Manila
Melbourne
Shanghai
Singapore
Sydney
Taipei
Tokyo

Europe & Middle East
Abu Dhabi
Almaty
Amsterdam
Antwerp
Bahrain
Baku
Barcelona
Berlin
Brussels
Budapest
Cairo
Dusseldorf
Frankfurt / Main
Geneva
Kyiv
London
Luxembourg
Madrid
Milan
Moscow
Munich
Paris
Prague
Riyadh
Rome
St. Petersburg
Stockholm
Vienna
Warsaw
Zurich

North & South America
Bogota
Brasilia
Buenos Aires
Caracas
Chicago
Dallas
Guadalajara
Houston
Juarez
Mexico City
Miami
Monterrey
New York
Palo Alto
Porto Alegre
Rio de Janeiro
San Diego
San Francisco
Santiago
Sao Paulo
Tijuana
Toronto
Valencia
Washington, DC

Our ref: IJM
Your ref:
Direct line: 0207 919 1000

13 April 2011

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

Dear Sirs,

A NEW APPROACH TO FINANCIAL REGULATION: BUILDING A STRONGER FUTURE - CONSULTATION RESPONSE

Baker & McKenzie welcomes the invitation to respond to HM Treasury Consultation: A new approach to financial regulation: building a stronger system. We would like to comment of the following key issues:

The scope proposed for the PRA, and the allocation mechanism and procedural safeguards for firms conducting the "dealing in investments as principal" regulated activity.

In relation to scope, the current proposals provide that certain investment firms which have permission to deal in investments as principal and which meet the "BIPRU 730" threshold will be capable of being designated as being "systemically important institutions." Broadly, this seems therefore to bring within the potential scope of designation firms that are subject to the Capital Adequacy Directives. Whilst there is a clearly justifiable policy objective in systemically important investment firms being regulated by the PRA, we have concerns as to the procedures which are proposed in the decision as to whether to designate a firm as being sufficiently "important" to warrant regulation by the PRA.

Under the current proposals, the PRA would be required to make a statement of policy as to how it would exercise its discretion, which would be produced in consultation with the FPC. There would then be a requirement to consult with the FCA prior to reaching an individual designation decision. We welcome the fact that firms would be able to make representations and that there would be an appeals procedure of some kind in place. However, we believe that providing such wide discretion to the PRA may create uncertainty in the market. In particular, if the PRA drafts a policy statement and then acts as adjudicator in the case of individual firms, there is a risk that the process would not be subject to sufficient oversight. In our view, it would be preferable for primary or secondary legislation to set out criteria which the PRA would be required to consider in reaching a decision on designation.

Baker & McKenzie LLP is a limited liability partnership registered in England and Wales with registered number OC311297. A list of members' names is open to inspection at its registered office and principal place of business, 100 New Bridge Street, London EC4V 6JA.

Baker & McKenzie LLP is regulated by the Solicitors Regulation Authority of England and Wales. Further information regarding the regulatory position is available at http://www.bakermckenzie.com/london/regulatoryinformation

Baker & McKenzie LLP is a member of Baker & McKenzie International, a Swiss Verein.

This would effectively require the PRA to then justify its individual designation decisions in accordance with the statutory criteria.

In relation to the right of appeal, it is not currently clear to whom any appeal would be made and the way in which the Government envisages ensuring the independence of this process from the operational decision-making process at the PRA. It would be helpful to understand further whether any appeal would be made:

- to the PRA itself;
- if so, whether the appeal would be made to a separate committee / body within the PRA;
- to an independent body.

It would be helpful to understand also whether there would then be an opportunity to appeal further to the Upper Tribunal, for example.

The proposed judgement led approach of the PRA.

The current proposals provide that the PRA will take a judgement-led supervisory approach to the firms it regulates. We understand that the intention is for the PRA to focus on a "purposive" application of the PRA rules and the use of principles. It is proposed that the PRA will be required to include short statements of purpose in relation to the PRA rules in order to assist regulated firms in understanding the rationale and policy reasons behind the rule. Finally it is being proposed that the PRA will not require a power to make statutory guidance.

The proposed judgement-led approach to an extent appears to be quite similar to the FSA's "principles based" regulatory approach. We understand the need for a flexible regulatory regime that allows regulators to extend their enforcement power to situations that do not fall within the letter of the law but clearly offend its spirit. However, we believe that caution should be exercised in putting in place a regulatory framework that requires a high degree of interpretation from market participants.

It is our experience that market participants will often need certainly in relation to high risk and/or high cost commercial arrangements and it appears to us that reliance upon a statement of purpose will not meet the needs of the industry.

Currently, the FSA has developed a helpful supervisory approach whereby (a) large institutions have a dedicated supervisor, (b) smaller firms do not have direct access to a supervisor but can contact the FSA and request informal guidance and (c) provides firms with the ability to request individual guidance in relation to matters that require certainty. Applying for individual guidance is often a costly process for firms but it is a very valuable mean of ensuring that the arrangements proposed by the firm do not in the opinion of the regulator violate any rules.

Therefore, although we welcome the inclusion of purpose statements in the PRA's rules we believe that it is important to clarify at an early stage whether the PRA will provide dedicated supervisors and/or an effective helpline and more broadly to set out in detail the mean of communication that regulated firms and their advisers will have with the PRA. Additionally, we believe that firms should have the right to request individual guidance from the PRA on important matters.

The proposed product intervention powers of the FCA.

It is proposed that the FCA should have a greater role in the supervision of product design and product sales. The consultation document proposes that the FCA should be able to make rules to place requirements on products or product features, mandate minimum product standards, restrict the sale of a product to a certain class of consumers and in certain cases ban a product if it identifies serious problems with that product.

We understand that the rationale for the new product intervention powers is to avoid widespread consumer detriment. However, we are not convinced that the proposed powers are the most appropriate way for achieving that and we are concerned that firms and consumers might interpret an FCA decision not to ban the sale of a product as equivalent to approval.

Furthermore, the FSA has been recently focused on supervising the product design and product sale processes of firms closely by carrying out thematic reviews and by exercising its disciplinary powers against firms that are not compliant with the suitability rules. We believe that the industry is responding to the FSA's supervisory approach. For instance, the £7.7 million fine imposed on Barclays Bank has caused many product providers to revisit their product approval processes.

Furthermore, we believe that products are not inherently "bad" or "good" and that even a risky investment can be suitable for certain investors.

For the above reasons we believe that the focus should remain on compliant suitability processes and the onus of achieving such compliance should remain on the regulated institutions rather than the regulator.

The proposed new power in relation to warning notices.

We consider that the proposed power to enable both the FCA and the PRA to publish the fact that a warning notice has been issued without allowing the individual or firm under investigation to make representations is premature and does not allow for due process.

Currently the FSA is only able to publish details of enforcement action at either the decision notice stage or final notice stage.

At the warning notice stage, the FSA's Regulatory Decisions Committee (RDC) under the current process will have received evidence from the Enforcement team, but will not have received the written or oral representations from the firm or individual. We consider that this is a very important step in the process, and the

FCA/PRA's decision should not be published until after representations have been made.

Publicity at the warning notice would be highly prejudicial both for firms and individuals. However we consider that it would impact most severely on individuals, who could be continuing to work at a firm whilst still under investigation. The investigation would have been confidential up until publication, and their work colleagues being aware of the investigation (and proposed sanction) would have an adverse impact on their employment.

We consider that the notice of discontinuance that is proposed in the Consultation to be issued where regulators choose not to take further action is an inadequate remedy. It is almost impossible to claw back a reputation. There is a risk, particularly for individuals of being "guilty until proven innocent." Accordingly, we do not support this proposal.

Passporting

We understand that it is proposed that the FCA will have responsibility in relation to conduct of business matters for all branches within the UK and will also have responsibility for the passporting process and oversight functions of firms that have passported into the UK. Therefore, it will receive all notifications from overseas regulatory authorities. In general, we consider the fact that all passport notifications will be received and processed by one authority to be a positive proposal on the basis that it should help to ensure consistency of approach in terms of processing techniques and practices adopted by passported firms.

Where a firm passports under the Banking Consolidation Directive, the host state regulator will be responsible for setting liquidity standards within the UK. The ability of the host state regulator to set liquidity standards for incoming passporting firms raises the question of whether and how a dual approach to passporting under the new regime will work in practice (i.e., the FCA will be responsible for all conduct of business issues for incoming branches but the PRA will be responsible for setting liquidity standards and supervising compliance with those standards).

The issue of how and whether this dual approach will work in practice is also raised in respect of UK firms who passport into the EEA. We understand that the PRA will be responsible for the financial soundness of PRA regulated firms while the FCA will be responsible for conduct issues where these are not the responsibility of host state regulators. However, it is not clear from the Government's proposals which regulator will take receipt of passporting notifications from PRA regulated firms. This raises the question of how and the extent to which the FCA and the PRA will liaise with each other in respect of passport notifications received from UK dual regulated firms as the FCA will be the authority who receives passport notifications from FCA regulated firms.

We also note that the PRA would consider the impact on UK financial stability of incoming cross border firms carrying on business in the UK and work with home state

regulators to ensure the financial stability of the UK system. We question what impact this would have in practice as the host state regulator (i.e., the PRA) has no power or authority to impose any prudential requirements on incoming firms who passport into the UK on a cross border basis, and with respect to branches, its remit is limited to liquidity issues.

Insolvency

We consider that any consultation procedure required before insolvency proceedings can be commenced should be transparent and efficient and any consent required should be provided quickly. In most insolvency scenarios time is of the essence and any delay can be critical. Where a formal insolvency process is appropriate we strongly recommend that the appointment of an insolvency office holder takes place as soon as is practical to assist creditors and preserve the value of insolvent firm's assets.

Any delay which allows a potentially insolvent firm to continue to deal with its assets, could have a significant effect on the value of the insolvent firms' assets especially where the insolvent firm is accustomed to transferring some of its assets, e.g. cash, to another group entity in the course of its day to day trading. As the High Court will be involved in the case of most formal appointments there is already a level of independent scrutiny. Administrators and liquidators appointed by the court are officers of the court and so are accountable to the court for their actions. Insolvency practitioners' actions are also already subject to scrutiny by their licensing and regulatory bodies. A further safeguard may be to establish a panel of insolvency practitioners who are approved by the PRA to be appointed as the insolvency officeholders of insolvent firms. A panel system may provide an additional safeguard to prevent the appointment of insolvency officeholders who may, the view of the PRA have insufficient resources to deal with insolvency of an investment firm.

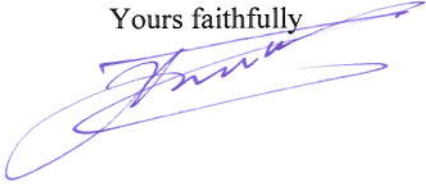
We consider that rather than restricting the ability to appoint and possibly delay the appointment the consultation and consent procedure should be revised so that an insolvency office holder once appointed cannot take substantive steps in the conduct of the insolvency (other than necessary steps to preserve the value of the firm's assets) without first notifying the PRA and obtaining its consent.

The raft of other proposed changes e.g. living wills etc which firms will be subject to will also arguably also reduce wider financial stability issues.

The Second Consultation demonstrates that the Government has yet to decide the appropriate division of responsibility between the PRA and the FCA regarding the appropriate consent required prior to the commencement of the voluntary winding up of a life insurer. We recommend that where any consent is required it be limited to a single consent and the consent procedure is kept as transparent and efficient as possible.

We trust these comments are helpful. Please contact Ian Mason if you would like to discus further.

Yours faithfully



HM Treasury Consultation

A new approach to financial regulation: building a stronger system

Response from Barclays
April 2011

Contents

Page

1. Executive summary 3

2. Bank of England and Financial Policy Committee 5

3. Prudential Regulation Authority 11

4. Financial Conduct Authority 15

5. Regulatory processes and coordination 21

6. Compensation, dispute resolution and financial education 26

7. European and international issues 28

Appendix: Question and answer map 29

1. Executive summary

1.1 The quality and effectiveness of the UK's new financial services regulatory regime will determine both the future resilience of the UK financial system and its ability to support sustainable economic growth. Barclays welcomes the Government's commitment to an open process at every stage in the design of the new regime and is pleased to have the opportunity to provide feedback.

1.2 We appreciate the fact that the Government has taken on board points made in response to last year's consultation and modified its approach in a number of areas. However, we remain concerned that the proposals in the consultation document still do not adequately reflect:

- the need for UK regulatory and supervisory developments to fit within a wider international regime, both under the Basel accord and in-keeping with G20 decisions;
- the relevance to the UK of EU regulatory and supervisory developments including new EU-wide supervisory architecture, and the impact of this new framework on the exercise of judgement and discretion at member state level;
- the importance of encouraging effective competitive markets in terms of both stability and the delivery of good economic outcomes to customers and clients; and the need to reflect this in the statutory remit of all parts of the new regime, not just the FCA;
- the need for proper democratic accountability and controls, and HM Treasury involvement in, macro-prudential policy development and implementation and systemic crisis management;
- the need for openness and transparency of policy frameworks and the ability of stakeholders to make representations on these frameworks, in an environment where more decisions are to be judgement based; and the right of appeal by those affected on substance as well as process; and
- the importance of effective coordination mechanisms between the PRA and FCA including the establishment of shared back office functions, systems and processes.

1.3 We welcome the Government's confirmation that the FCA will be an independent regulator, not a consumer champion. We are disappointed, however, that the opportunity has not been taken to align the work of the Financial Ombudsman Service more closely with that of the retail conduct regulator by making FOS a subsidiary of the FCA within the new statutory

framework, so FOS must discharge its responsibilities within a wider policy framework and share information with the FCA as required.

1.4 In view of the radical and important nature of the proposed regulatory reforms, we suggest that Government should undertake a full post-implementation review of the new regime, perhaps three years after enactment of relevant primary and secondary legislation, in order to fine tune the new system and ensure it is achieving the objectives intended. Further, such a review would offer an opportunity to assess the success and efficiencies delivered by a joint back office function

2 Bank of England and Financial Policy Committee

Introduction

2.1 Barclays understands the thinking behind the construct of the proposed Bank of England group and can see the value of close coordination and policy coherence between macro-prudential policy and micro-prudential supervision.

2.2 We continue to believe that the proposed new construct could pose its own risks and challenges, given the wide span of important policy responsibilities that will reside within the Bank group and vest in the Governor and his immediate team. These responsibilities include:

- Macro-prudential policy, analysis and application of tools
- Monetary policy and application of tools
- Micro-prudential supervision of banks and insurance companies within the Bank group
- Crisis management responsibilities
- Resolution authority responsibilities
- Central bank 'lender of last resort' policy and application and liquidity provision
- Regulation of systemically important infrastructure

2.3 We are not aware of so much responsibility being vested in any other central bank in the developed world, and are concerned about the 'concentration risk' where multiple responsibilities are vested in a small number of senior individuals.

2.4 In addition, it seems to us that macro-prudential policy responsibilities are different in kind from the Bank's monetary policy role, where policy is made by Government and the Bank as independent agent implements in order to seek to achieve a pre-determined target. Macro prudential policy is closer in nature to taxation as it has differential social and economic effects.

2.5 In view of both these factors, proper accountability frameworks for the Bank group and its constituent parts are of very high importance. We do not believe the proposals go far enough to address these legitimate concerns.

The FPC

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

2.6 We welcome the establishment of the FPC to analyse macro-prudential risk, help develop tools, and take action to deal with macro-prudential, or systemic, risk.

We note, however, that policy thinking in this area is at an early stage, not just in the UK but around the world. We therefore urge the Government to proceed cautiously so that learning and experience can be built up step by step as policy thinking and experience evolves. This is of particular importance in view of the extent to which the UK needs to align with international and EU policy, and the interaction between macro-prudential policy, monetary policy and fiscal policy.

2.7 We urge the Government to ensure that there is strong governance and oversight by the Treasury in the important area of macro- economic policy. The application of macro-prudential policy will result in winners and losers and could have deep socio-economic consequences. For this reason it is essential that the definition of macro-prudential tools, the purpose they are designed to achieve, and how and when they may be used, should be set by Government and approved by Parliament, following full public consultation.

Statutory Remit

2.8 The proposed FPC statutory objective is focused on the UK financial system for understandable reasons. However, the recent crisis has demonstrated that financial instability in one market can infect another, and international coordination is needed. We therefore suggest the Bank and FPC's financial stability objective be reframed as follows:

> 1 ***An objective of the Bank shall be to protect and enhance the stability of the financial system of the United Kingdom, having regard to the international nature of financial markets that operate here***.

2.9 We are pleased to note the new reference to economic growth within the FPC's proposed statutory remit. However, we do not believe the FPC should have unfettered discretion about what is, or is not, likely to have a significant adverse effect on the growth of the UK economy. For this reason we urge that the words 'in its opinion' be deleted from clause 4 of the FPC's objective:

> 4 ***This does not require or authorise the Committee to exercise its functions in a way that would be likely to have 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.***

2.10 Both the Bank and the FPC should be required to have regard to the potentially distorting effects that their actions may have on competition and competitiveness. The application of some macro-prudential tools have the potential to significantly distort competition between entities doing business in the UK if a level playing field is not achieved, or if their effects are felt on UK entities operating outside the UK.

2.11 We support the three factors which the FPC will have regards to (proportionality, openness, and international law). However, we believe that the proportionality requirement should be strengthened. Rather than requiring the FPC to consider proportionality, it should be required to '***ensure the proportionality of the likely***

benefits of its actions compared to the costs they would impose'. It is clear that disproportionate action would never be in the interests of the economy and so the wording should be strengthened. This 'have regards to' should also include the clause that '***action must not result in significant market distortions'***.

Accountability and Governance

2.12 Barclays welcomes the importance the consultation document attaches to the issue of accountability for the FPC, but believes that stronger mechanisms need to be built into the framework. The Government must take overall responsibility for financial stability and the FPC must be accountable to the Government. We fail to see a meaningful role for the Court of the Bank of England in this regard and do not believe that the proposed construct would deliver the appropriate level of public accountability for the FPC.

2.13 We are encouraged to learn that the Treasury will formally set the remit for the FPC in writing, by way of a letter from the Chancellor to the Governor. We believe this process should be repeated at least once annually, as with the MPC, rather than on a discretionary and periodic basis. We support the views expressed by Deputy Governor Paul Tucker at the Treasury Select Committee on 2 March:

> *"It is for the Government and Parliament to decide what the objectives of any regime are, yes. We feel completely comfortable with that, otherwise we start to abrogate to ourselves the responsibility for deciding society's end objectives. I mean that is exactly analogous to the monetary policy regime. We don't choose the target. The Government choose the target and report it to Parliament, and we in the MPC have the job of meeting that target."*

2.14 The publication of the bi-annual Financial Stability Report and meeting records, and the publication of minutes of six monthly meetings between the Chancellor and the Governor, have some value but are not enough. Formal engagement between the Bank and the Treasury should go beyond the relationship between the Governor and the Chancellor. Officials from both bodies should meet frequently to share views on current risks and thematic concerns regarding financial stability in the wider context of economic growth.

2.15 The Government must consult publicly on how the FPC should apply its macro-prudential tools including the use of directions and recommendations. The Treasury should also be consulted in advance on any emergency action taken on financial stability grounds.

2.16 The consultation document is clear that macro-prudential tools should only be applied to address system-wide rather than firm-specific characteristics and we agree. We are concerned, therefore, that the document later suggests that the FPC's macro-prudential interventions may be aimed at just one or two firms. It is

crucial that the FPC does not stray into micro-prudential regulation and we would urge Government to establish a clearer boundary between the FPC and the PRA.

2.17 Barclays supports the need for a diverse range of experience and views on the FPC. Under the current proposals the FPC would comprise six Bank executives, the Chief Executive of the FCA, a non-voting Treasury representative and four independent members. Eight of the 12 members would be public representatives or regulators. We do not consider that this provides sufficient independent practitioner and markets expertise. We believe a better balance would be achieved were there to be six external independent members and fewer Bank executives, in order to achieve the consultation document's stated policy objective:

> *"In particular, it will be important to ensure external members are able to offer insights from direct experience as financial market practitioners – not only in banking, but also other sectors such as insurance and investment banking."*

2.18 The presence of a single external member for a quorum to be reached is not sufficient.

Macro-Prudential Tools

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

2.19 Macro-prudential supervision is a new concept and there is little practical experience of the effectiveness and impact of particular tools in modern western economies. There is no clear consensus that regulators will be able to use these tools to mitigate risks on an arising basis as often there is no clear consensus. For example, Alan Greenspan recently noted in *The Financial Times*[1] that "regulators… can never get more than a glimpse at the internal workings of the simplest of modern financial systems". The interactions within the system are highly complex and the risk of unintended consequences is high.

2.20 In addition there is relatively little academic research in this area. A number of potential tools are being actively considered in international fora including the Financial Stability Board, Basel Committee of Banking Supervision and the European Systemic Risk Board ("ESRB").

2.21 Whilst we agree that macro-prudential tools should be consulted on by the Treasury and fully set out in secondary legislation, including the scope of the power and the types of circumstances when they should be applied,the FPC should seek to align its approach and eventual toolkit with the ESRB toolkit and coordinate action internationally wherever possible.

[1] http://www.ft.com/cms/s/0/14662fd8-5a28-11e0-86d3-00144feab49a.html#axzz1IYEtichs

2.22 Apart from these general points, we believe it is premature to comment in detail on potential macro-prudential tools until further work has been done at international level and by the interim FPC. There will need to be full and open consultation on policy development at every stage so that unintended consequences can be identified and the interconnections between micro-prudential, macro-prudential, monetary and fiscal policy, and impact on the real economy properly evaluated.

Information gathering

2.23 Care needs to be taken with information disclosure requirements, as information can become unmanageable data for users if the requirements are not appropriately targeted. More is not necessarily better.

2.24 We support the proposed placing of a statutory bar on information received from the Bank being disclosable by the PRA and FCA under FOIA. However, this raises mirror concerns regarding Barclays-specific information being passed from the PRA / FCA to the FPC, the Bank and to the Treasury. The protections from disclosure arising under FSMA s348 *et seq*., the EU directives, and the exemptions under FOIA must be maintained and should be extended to cover explicitly firm specific information passed by the relevant regulatory bodies to the Treasury.

2.25 The legislation on information gathering and disclosure should include a 'proportionality' clause to protect against unhelpful and/or excessive information requests.

2.26 There should be robust statutory rules governing the gathering, use, storage and sharing of information by the Bank. Rules which apply to the FSA (and, soon, to the PRA and FCA) should equally apply to the Bank if it is necessary that information is shared by the regulators. An annual or biennial review could be held to remove disclosure requirements which are no longer relevant. MOUs between the authorities regarding information sharing and other matters should be in the public domain.

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

2.27 Not at this stage.

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

2.28 Barclays supports the proposed technical improvements to the regulatory regime for payment systems outlined in the consultation document.

2.29 We are pleased that the Government has modified its approach to the regulation of Recognised Clearing Houses following consultation, and are broadly supportive of the approach now being proposed. Some key issues, including access to liquidity for central clearing counterparties, remain to be resolved at

European level. We fully support the Government's stance that the new European Market Infrastructure Regulation (EMIR) regime must maintain a level playing field across all European member states with regard to the clearing of euro denominated and other business.

Crisis management

2.30 Barclays welcomes the recognition that the Bank and the Treasury will be the key players in any crisis situation. However, there is a need for stronger Government involvement and leadership in a crisis situation. Ministers will be accountable to Parliament and the public in a crisis and will therefore need to take more of a central role on crisis management than that currently envisaged. Barclays supports the Treasury Select Committee's view:

> *"... if a systemic crisis occurs which the Bank considers public money is required to resolve, it is hard to see how the Government could assess such a request while remaining at arm's length from the process. As we have seen recently, rescuing the financial system may have significant effects on public finances. Only a democratically elected Government should make such decisions. It will bear the responsibility for any errors; it must have the information and freedom it needs to choose its position. In times of crisis, it has to be the Government that is in charge. Once it appears likely that intervention beyond a single firm is necessary, and where public funds are put at risk the authorities should take decisions together, led by Treasury Ministers, and where appropriate, the Chancellor, chairing any crisis management meetings."*

3 Prudential Regulation Authority

Introduction

3.1 Barclays welcomes the Government's commitment to more effective prudential supervision. This will require a higher level of supervisory skills than has hitherto been the case and a different regulatory culture. How this change will be brought about, as former FSA staff transfer to the PRA, is not clear and we look forward to engaging with the forthcoming FSA consultation document on this issue.

3.2 We welcome the commitment to use more supervisory judgement and move away from a 'box ticking' approach. However, it is essential that transparency and openness of policy-making in the new regime is fully maintained, and that persons impacted by regulatory decisions have proper appeal rights on substance as well as process.

3.3 Barclays will in future be dual regulated by the PRA and the FCA as well as international and European colleges of supervisors. Effective coordination of these supervisory approaches will be important if UK firms are to experience high quality, proportionate and risk-based regulation.

3.4 We note that 18,500 UK firms will be prudentially regulated by the FCA rather than the PRA, and that the FCA will adopt a relatively 'light touch' approach to its prudential responsibilities as described in Box 4.E of the consultation document. We believe more thought needs to be given to the dichotomy in the approach taken by the two authorities and the impact this may have on the future development of financial markets and the potential build-up of systemic risk.

3.5 Whilst we acknowledge that insurance firms are not generally as interconnected as banks, the role of AIG in the recent crisis suggests that the PRA and FPC must remain alert to the ways in which insurance firms can be exposed to, and propagate, systemic risk.

Statutory Remit

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

3.6 The PRA's strategic objective on financial stability should have regard to the international nature of financial markets that operate in the United Kingdom. The PRA should have regard to the effects of its actions on sustainable economic growth in the discharge of its functions and this should be built into its statutory remit. We therefore suggest a strategic objective for the PRA as follows:

> ***2 The PRA's strategic objective is: contributing to the promotion of the stability of the UK financial system, having regard to the international***

nature of UK financial markets and the effect of its actions on sustainable economic growth.

3.7 We are surprised to see so little mention of the EU in the proposals for the PRA bearing in mind that significant EU legislation such as CRD 4 and Solvency 2 will govern prudential regimes in the UK. This needs to be properly reflected in the PRA's remit, and the PRA will need to work closely with the new European supervisory bodies such as the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA).

3.8 On regulatory principles to be applied to the PRA and FCA, we believe the second should be strengthened as follows:

2 ***The principle that a burden or restriction imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits and based on thorough cost/benefit analysis;***

3.9 On the proposed fifth principle, whilst we support transparency we believe the principle around making information available to the public should include the provision of information about markets as well as authorised persons, as some issues may be generic across a number of firms and product markets.

3.10 We are concerned that the Government believes the PRA should have no regard to competitiveness. Whilst it is correct that appropriate levels of stability are an important pre-condition for competitiveness, we do not agree that effective competition detracts from stability. The lack of a level playing field will usually result in regulatory arbitrage, which undermines the effectiveness of regulation and can impact stability.

3.11 Similarly, whilst we agree that facilitating innovation per se is not necessarily appropriate we are disappointed that the Government does not see a need for the PRA to have regard to the need to facilitate an appropriate level of innovation. It is right that supervisors should be risk averse, but this needs to be appropriately bounded if the financial services industry is to meet the evolving needs of the real economy.

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

3.12 Whilst it is clear that the PRA will authorise and supervise all banks, building societies, credit unions and insurers, it is less clear how the regulation of groups will be conducted. We encourage the Government, the FSA and the Bank to consider this matter further.

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

3.13 Whilst a purposive approach to the application and enforcement of rules brings with it the potential advantages of flexibility and the associated capacity to respond to changes in market dynamics, it presents at least three material hazards which need to be seriously considered and addressed. These include:

- the lack of legal certainty, which risks reducing the attractiveness of the City as a place to do business;
- the potential for divergence of regulatory standards, particularly in an international context. If regulators responsible for the oversight of peer institutions apply standards through a prism of purposive interpretation, then the potential for a divergence of regulatory standards is embedded within the regulatory framework and this could be contrary to the objective of achieving an international level playing field;
- lack of accountability, if the proposed narrow basis of appeal on judgement based decisions is retained.

3.14 We do not believe the judgement based approach described in the document fits well with the developing EU regulatory and supervisory regime. We remain concerned about the impact that judgement-led regulation and discretion by UK authorities could have on competitiveness and a level playing field, in Europe and more broadly.

3.15 On the question of challenge of decisions and appeals, the current safeguards set out in FSMA should not be diluted. Affected persons must retain full rights to challenge and appeal against the application of regulatory powers on the merits of the case. Such rights are an important check and balance in a system that grants significant powers to a regulatory body. They contribute heavily to ensuring that the powers of regulators do not infringe the property rights and fair trial rights of business, their directors and shareholders. This is particularly important in view of the PRA's front line responsibility for important aspects of market regulation.

3.16 We note that no consultation has been published on the Proactive Intervention Framework, and look forward to engaging fully in discussions around this when more detailed proposals are published.

Governance and Accountability

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

3.17 We are pleased that the PRA will be an autonomous subsidiary of the Bank with its own board and governance structure, nesting within the wider Bank of England group. However, we remain concerned about the multiple roles of Bank senior executives including the proposal that the Bank Governor be Chair of the PRA. We find it difficult to understand how the Governor's important

responsibilities for monetary policy, macro-prudential supervision, crisis resolution and lender of last resort can be stretched further.

3.18 We do not consider it appropriate that an Executive Board Committee comprising the Governor (as PRA Chairman), Deputy Governor Financial Stability and PRA executives should make 'decisions involving major firms'. This would compromise the PRAs operational independence and could result in conflicts of interest, especially over the potential triggering of the Special Resolution Regime.

3.19 We can see merit in the PRA being accountable to the Court for administrative matters but do not see a legitimate role for the Court in terms of PRA strategy. The PRA should be accountable to Parliament and the wider public for the strategy it adopts, in much the way that the FSA is at present. The PRA's articles of association setting out the relationship between the PRA and the wider Bank group should be approved by Government and Parliament.

3.20 We see no reason why the Court of the Bank should not follow the Code of Practice for Ministerial appointments when appointing new Directors to the PRA Board and we suggest appointments should be subject to confirmation by Treasury Ministers as is currently the case with the FSA.

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

3.21 The budget and fees of both the PRA and the FPC should be consulted on before they are agreed, including levies for other functions such as the Financial Services Compensation Scheme (FSCS), Money Advice Service (previously CFEB) and the Financial Ombudsman Service (FOS), as these are a proxy tax on the UK financial services industry. We believe it proper that the National Audit Office has statutory oversight of the economy, efficiency and effectiveness of the entire new regulatory structure including all the Bank of England group, the FCA and associated bodies that are industry funded.

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

3.22 We are content in principle with the arrangements set out in the consultation document but would like them to be strengthened. There should always be a consultation process on the policy approach to be followed, including when discretionary powers are used (for example when implementing EU rules where discretion is permitted). Whilst we accept it may not always be possible to undertake a rigorous cost-benefit analysis, the PRA should nonetheless be required to analyse the likely impact of its actions, identify potential unintended consequences and set out how it plans to avoid them.

4. Financial Conduct Authority

4.1 Barclays supports the overarching strategic focus and objectives of the FCA. We welcome the clarification that the FCA is not intended to operate as a 'consumer champion' but will operate as an 'impartial' regulator.

4.2 As the consultation document states, the FCA will be responsible for regulating approximately 27, 000 firms. The enormous range of type and size of firms supervised by the FCA means that the shape and variation of supervisory approach will likely be as important as the specific rules and powers given to it. We respond further to the issue of scope later in this submission, including the issue of group supervision.

4.3 The FCA will face a number of competing demands in terms of its priorities. In addition to its conduct of business responsibilities the FCA will also be prudential regulator for the majority of the firms it supervises, as well as having responsibility for financial markets supervision, oversight of client assets, and countering financial crime. The FCA will need to balance these areas of responsibility and ensure that appropriate focus and resource is allocated.

4.4 We welcome confirmation that the FCA will be on an equal footing to the PRA. In relation to this, we welcome recent action taken by the FSA to strengthen its ability to attract and retain staff of the calibre needed to perform its functions. Clearly the FCA needs the status and authority to continue to recruit and retain appropriately experienced staff and engage with European bodies and others in an effective way. We look forward to supporting the FCA as it seeks to ensure that European regulation meets the needs of the City of London as Europe's leading financial centre. This will require significant focus, proper resourcing and high level engagement.

Statutory Remit

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

4.5 Barclays is broadly supportive of the proposed FCA statutory remit, to protect and enhance confidence in the UK financial system. We support the operational objectives around efficiency and choice, appropriate consumer protection and protecting the integrity of the financial system. These are highly relevant to the current product regulation debate.

4.6 We welcome inclusion of a duty to promote competition within the statutory framework. Effective competition rather than competition per se is the usual expression used in other regulatory frameworks. By qualifying competition in this way we are not sure it is necessary to condition the objective further as proposed in the consultation document. We therefore suggest the following wording:

> ***'The FCA must discharge its general functions in a way which promotes effective competition'.***

4.7 Barclays broadly supports the regulatory principles set out for the FCA. We suggest that the wording of the 'proportionality' principle reflects the wording we have suggested for the PRA:

> ***'The principle that a burden or restriction imposed on a person, or on the carrying on of an activity, should be proportionate to the benefit, based on thorough cost/benefit analysis'***

Governance and Accountability

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

4.8 We are broadly content with the governance and accountability framework proposed for the FCA. We would like further clarification about the proposal that a proportionate number of non-executives be appointed by the Treasury and BIS.

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

4.9 The consultation document refers to a more proactive, interventionist approach than that of the FSA, including intervening earlier in a product's life cycle. These significant changes to approach will place substantive demands on FCA staff. We will be responding in more detail to the FSA's recent discussion paper on product intervention.

4.10 Barclays understands and supports the motivation behind early intervention but has a number of concerns about the practicality and implications of such an approach. We strongly agree that the FCA should not take on the role of vetting and pre-approving all products and are concerned that the FCA could inadvertently be drawn into this. If so, there would be considerable resourcing requirements and a potentially chilling effect on innovation that would be hard to reconcile with the FCA's operational objective to facilitate efficiency and choice.

4.11 Product intervention could conceivably occur on two levels. It could occur in relation to how an individual firm, or subset of firms, have designed a product, or it could occur on a cross-market basis. In the first case it is not clear that the FCA needs additional powers. FSMA gives the FSA and its successors ample powers, (e.g., through own-initiative variations of permission and through its ability to make rules) to address how individual firms design, promote and sell their products and ensure proper product governance. It is less clear that the FSA has powers to act on a cross-market basis to ban or impose changes to a generic product. Given highly diverse consumer needs, most product features are unlikely to be so toxic that they could not appropriately be sold to anyone, so sweeping market action may not be justified. Any intervention power therefore needs to be framed carefully and – absent an emergency – be subject to full

consultation. We welcome the proposal to require the FCA to develop a set of principles governing the use of such powers.

4.12 There needs to be clarity about what product intervention powers can and cannot achieve so that they do not give rise to unrealistic expectations. Product intervention can deal with issues of mis-design, but cannot address issues of mis-selling. Any product can be mis-sold and customer detriment can occur if firm and staff behaviours are inappropriate. The traditional FSA approach, focusing on promotion and behaviours at point of sale, will remain important. While we understand the need to draw a distinction between the supervision of the past and that of the future, any new product regime should supplement, not supplant, other approaches.

4.13 We would caution against the FCA being given wide ranging 'interim' powers given the ongoing wider debate on product intervention. This debate needs time in order to arrive at an approach that delivers better consumer outcomes. We would note that similar issues are being considered in the context of the MiFID review. It will be important to ensure the UK's stance is properly integrated into the overall EU regime.

The Government would welcome specific comments on:

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

4.14 In principle we support the proposed new power to direct a firm to withdraw a misleading financial promotion. We believe that an initial step should be notifying the firm that there is, or is likely to be a breach. If this does not lead to appropriate action by the firm, then notification of the decision to amend or withdraw the promotion should follow, after a decision has been taken by people of sufficient independence and seniority. Publication of a decision should only follow a direction where the initial notification was ignored. This additional step would encourage better dialogue between the firms and the regulator and incentivise firms to put matters right themselves. It is essential to avoid the case workers with an interest in the investigation taking the decision, due to the kinds of conflicts of interest that s.395 of FSMA currently removes.

4.15 Publication of the direction to withdraw a financial promotion before a formal enforcement finding poses significant reputational risk damage that can subsequently be found to be unjustified. If the case attracts media attention, there is also the risk of an inherent bias in a subsequent enforcement investigation, particularly if the FCA is less ready to take into account representations from the firm during the enforcement process.

4.16 We have similar concerns about the new power relating to publishing warning notices. Whilst some safeguards are discussed, these appear insufficient to protect against the obvious risk of potentially significant damage that warning notices could cause a firm. It is not uncommon for the scope of the conduct criticised, or the particular breaches set out at an early stage, to be narrowed as the enforcement process progresses. In light of this, it is hard to see how early publication would provide sufficient robust information to aid consumer decision making other than in exceptional cases. Publicity resulting from a warning notice on alleged mis-selling could lead to a raft of consumer complaints on a matter where the firm may not be in breach. The risk that the information misleads customers and changes their behaviour, or leads to a change of behaviour by the regulator, also creates concerns about the property and fair trial rights of the recipient and its shareholders. Clearly transparency concerning the outcome of enforcement actions is valuable, but providing case-specific information at a time when it is subject to change is not generally an appropriate application of the principle of regulatory transparency.

4.17 We recognise that it may occasionally be appropriate to be transparent at an early stage. We see this measure as necessary only in exceptional cases where a firm or individual is being demonstrably uncooperative or where there is an overwhelming public interest in disclosure, for example to prevent disorderly trading resulting from speculation about whether the FSA/FCA is pursing enforcement action. In these cases, where the FCA publishes a warning notice and regulatory action is subsequently not taken, the FCA should be obliged to publish a subsequent notice of exoneration or decision not to proceed so that reputational damage may be mitigated.

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

4.18 We support an FCA objective to promote competition, as set out in the consultation document and in line with the recent recommendations of the Treasury Select Committee. A formal remit to promote competition can help balance and guard against over-regulation or an overly intrusive regulatory stance and culture. We recommend however that the Government considers replacing the term 'competition' with 'effective competition' in the FCA's statutory remit. Effective competition is usually used to describe the desirable characteristics of a market from a competition perspective. Yet more competition and choice is not always beneficial from the perspective of behavioural economics and consumer outcomes: what is needed is competition that works - in other words, effective competition.

4.19 We are pleased to note that the FCA cannot pursue greater competition in a way that is incompatible with its strategic objective of protecting and enhancing market confidence, or its operational objectives which include appropriate consumer protection, and think the proposed formulation of the FCA's statutory

remit strikes the right balance. We assume that the FCA objectives as formulated would place the FCA outside the scope of Article 3 of EC Regulation 1/2003 (the "Modernisation Regulation") which require that if a body is given competition powers, those powers are applied first to any issue which it is investigating, and only after competition law has been excluded can the body move to application of consumer / regulatory powers. We would welcome confirmation that our understanding is correct.

4.20 We would welcome more clarity around how the FCA's remit to promote competition would interface with the powers and responsibilities of the proposed Competition and Markets Authority. We note the need to provide the FCA with appropriate tools if it is to have a more credible role in promoting competition and that existing regulatory tools could often be applied to address both consumer and competition concerns, as set out in the document. We can see some merit in the FCA having powers to keep competition in financial markets under review and make market investigation references to the new CMA where appropriate, as the FCA will have the detailed knowledge and expertise about complex financial services markets and will need to apply all its powers, including undertaking any market studies, under its wider statutory framework. However, we would welcome more clarity about how the FCA and CMA would relate to each other and coordinate on such matters.

4.21 We note that the FSA already has concurrent powers with the OFT on unfair contract terms and we assume these powers would pass to the new FCA. On super-complaints, the policy choice will be either for designated bodies to have the right to refer super complaints on financial services to the CMA, the FCA or both. We can see benefits in the FCA being the body to receive such complaints and considered them in the light of its overall statutory remit. The FCA would be likely to have more knowledge and expertise on the matter concerned than the generic CMA. However, were this to happen, the FCA would need to coordinate closely with the CMA and have the right skills and expertise to carry out the required analysis.

4.22 We agree with the consultation document that the FCA should not have concurrent powers to enforce prohibitions on cartels and abuse of dominance. Such powers for financial services markets should reside with the new CMA.

The Government would welcome specific comments on:

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

4.23 We support the proposed approach to the regulation of recognised investment exchanges, and the need to await the outcome of the MiFID review in Europe. It will be important to ensure a level playing field of regulation for entities and execution venues which perform a functionally similar role. There are currently differences in the way in which Recognised Investment Exchanges (RIEs) and Multilateral Trading Facilities (MTFs) are regulated, but few practitioners

understand the nuanced differences in this esoteric aspect of law. The lack of transparency on the differing regulatory standards applying to entities which perform similar functions will become increasingly undesirable as more trades move to RIEs and MTFs and away from bilateral over the counter (OTC) trading.

5. Regulatory processes and coordination

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

5.1 Barclays welcomes recognition of the need for careful and effective coordination between the PRA and the FCA, and the proposed statutory duty on both to coordinate the exercise of their functions.

5.2 Any system of regulation stands or falls not by its structure (for which there is no single 'right' answer), but by the strength of communication and co-operation between the bodies concerned. We understand that further detail on philosophy and operating models will be subject to consultation with the FSA and the Bank. However, for firms like Barclays who will be regulated by both FCA and PRA, the quality of coordination between these two regulators will be a key factor in determining the overall success of the new regime.

5.3 Statutory duties and memoranda of understanding are important but are no substitute for supervisors developing and maintaining close working relationships where these are required. The first days of the new regime will be an important opportunity to build bridges between the staff of the PRA and FCA as they share common origins in the FSA. If this opportunity is lost, the organisations could start to drift apart. As we made clear in our response to last year's consultation:

> *The division of responsibility for enforcement activity between the PRA and CPMA could run the risk of a fragmentation of approaches and potential conflict between the bodies involved. It is critical that the right mechanisms for cooperation and coordination are established, and that firms are not subject to overlapping regulatory regimes and a disproportionate regulatory burden.*

5.4 We strongly urge that a common 'back office' is established and charged with responsibility for essential common regulatory processes such as authorisations, change of control, cancellations, variations of permission and the like in addition to the administrative functions of fee and levy collection. The effectiveness of the UK regulatory system requires that such processes operate in a timely and expeditious way, supported by effective IT systems and appropriately skilled personnel. A single back office operation, acting on behalf of the PRA and FCA, would ensure common standards between the supervisors and deliver cost savings as well as reducing lead time for firms.

5.5 We welcome the fact that specific responsibility for regulation of dual-regulated firms will be allocated on a statutory basis. Clarity and certainty are crucial. In practice, open lines of dialogue between the regulators and regulated will be vital

but the onus of coordination must be on the regulators, not the regulated entities themselves.

5.6 Streamlining and aligning the supervisory processes undertaken by the FCA and PRA would help ensure that firms receive a consistency of approach and that the new regime is efficient where, for example, similar data is required by the PRA and FCA. It should be feasible to go beyond coordination so there is joint working, for example a joint ARROW review. This would ensure that FCA and PRA would have a common understanding of strategy and risks, despite coming from different perspectives.

5.7 We support a legal duty to coordinate and an associated MoU. However, we note that the current tests in limbs one and two are high-level in nature. In limb one the duty to coordinate only arises where the PRA (or FCA) independently forms the view that its actions may materially impact the other's objective. Limb two requires the PRA and FPC to consult only "where necessary". These hurdles are potentially too easy to rebut and a lower test should be applied, such as one based on expediency.

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

5.8 The PRA and FCA need to be seen as independently effective and stand on a level footing. If FCA decisions are subject to one-sided veto from the PRA, this could damage FCA credibility and effectiveness. The PRA veto power should be reserved for extreme cases such as where FCA action could precipitate a disorderly failure, and this should be clear on the face of the Bill. There should be a process for Parliamentary review of the reasons behind the use of the veto measure after the event, if it is used.

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

5.9 As noted above, we recommend the establishment of a common back office for regulatory processes. Of the options canvassed we see more merit in the alternative approach to authorisation although we would welcome further clarity on how this would work in practice. We believe that the authority responsible for prudential regulation of the firm should be responsible for co-ordinating the authorisation process. The key point for us is that one authority should be charged with processing each application and seeking consent from the other authority on the areas where they have expertise. A coordinated approach with a common back-office would help this process be efficient and effective. A two track process as suggested under the lead proposal would be costly, unduly bureaucratic and deliver a poor result for the UK.

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

5.10 Where a firm is prudentially supervised by the FCA but subject to Group supervision by the PRA, the FCA should consult the PRA on any proposed action so that any potential for contagion is considered.

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

5.11 The current approved persons regime is already a major process for regulated firms, and firms such as Barclays have thousands of approved persons. Unnecessary duplication or overlap would further complicate a complex process. For dual regulated firms, a single process managed by a common back office with a joint decisions panel with PRA with FCA representation as appropriate would be preferable.

5.12 FCA should take the lead in approving persons for sales roles. As a rule we would not envisage that the PRA would have much interest in these applications, although it may wish to be involved in the approval process for some senior sales positions especially on the investment banking side.

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

5.13 The issue of passporting exemplifies both the international nature of financial services operating in the UK and the increasing need for careful coordination and clarity between jurisdictions. It will be crucial that the passporting regime functions in a way that maintains a level playing field with other regulatory jurisdictions.

5.14 The Government's proposals consider the issue of passporting from a UK perspective and, seen in that context, make sense. Passporting should also be considered from the point of view of the jurisdictions receiving these passport notifications. It is important that others are clear about with whom in the UK they need to interact. From the perspective of an authority receiving a notification of a UK passport, it is likely that a single issuer of UK passports would be preferable. If so, given that it is likely that the major UK firms will be the heaviest users of the passport, the lead authority should be the PRA.

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

5.15 We strongly support a system whereby the PRA and FCA share essential back office functions. This is particularly relevant where the output is of interest to both regulators e.g., regulatory reporting via the GABRIEL system and shared usage of the Online Notifications and Applications system. We expect there to be a number of opportunities for the PRA and FCA to share existing administrative processes, such as a 'gateway' to share information where a jointly supervised firm applies for a permission, a variation of permission or a cancellation. We welcome the effort the FSA has made to improve the efficiency of regulatory processes over recent years. The PRA and FCA should take advantage of existing FSA systems and further enhance them.

5.16 We support a more open and transparent decision making process, with those responsible for supervision empowered to make firm specific decisions, particularly in relation to waiver applications for Internal Ratings Based (IRB) models, Effective Expected Positive Exposure (EEPE) and Value at Risk (VaR). Such waivers are highly technical and the process is greatly improved by open communication between the regulator and the firm to resolve issues or clarify areas. The success of this process relies on a limited number of specialist staff, and splitting regulatory processes work would lead to these skills being spread even more thinly.

5.17 There is a risk that the proposed organisational changes could further complicate and obscure the decision making process. For dual regulated firms we would expect the PRA to take the lead in most instances although there may be certain risks to the FCA's objectives which would need to be considered. Nonetheless, we believe the decision making process should be streamlined to ensure more timely regulatory decisions. This is particularly important where decisions relate to fast moving trading activities, market events and/or changing risk profiles. Firms should have access to the decision making process and the ability to appeal decisions/judgements on a day to day basis rather than being constrained to the Tribunal process.

The Government would welcome specific comments on:

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

5.18 We are concerned about the lack of clarity over group supervision arrangements under the new regime. It seems likely that while Barclays Bank PLC and a number of its major regulated subsidiaries will be prudentially supervised by the PRA, and the group as a whole will be subject to consolidated supervision by the PRA, some regulated entities within the Barclays group may be subject to prudential supervision by the FCA.

5.19 For dual regulated firms, it may be preferable for all prudential supervision of regulated entities within the group to be conducted by the PRA – not least because intra-group flows of funds, intra-group exposures and internal dividend policies are important to prudential supervisors.

5.20 If a sub-division proposed in the consultation document is to work, it is important that there is some commonality of view about the strategy and the position of the group as the starting point for the effective supervision of the individual regulated entities. This may be assured by contact between PRA and FCA staff, or by PRA and FCA staff conducting a periodic joint risk assessment of the firm as a successor to the ARROW risk assessment framework. It would clearly be sub-optimal for the PRA and FCA individually to have discussions with management about very similar issues.

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

5.21 We agree with the proposals on this point, although we believe that this could be more simply framed as the responsibility of the prudential authority taking full account of the observations and objections of any other relevant body – and could be more easily achieved by a joint back office. While we appreciate and welcome the Government's intention to make the two new regulators communicate and co-operate, the unintended result is sometimes to create an unduly bureaucratic construct.

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

5.22 It should be clear in relation to Part VII transfers that this is a PRA-led matter. It should be clear that the undoubted interest that the FCA has and which is noted in the document does not give it the power of veto.

5.23 We agree that the FCA should not be able to petition for the winding up of a dual regulated firm without the consent of the PRA. We also consider that the FCA should not be able to petition for the winding up of an FCA prudentially regulated firm in a PRA prudentially regulated Group without the consent of the PRA.

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

5.24 We welcome the intention to collect fees through a single organisation. Fees and levies should be subject to full consultation.

5.25 We are unclear as to how the powers to levy fees for the FSCS will be shared, given that the FSCS allows some cross-subsidy between sub-schemes within the overall FSCS. There is, under the current construction of the FSCS, no hermetic seal between the PRA sub-schemes and the FCA sub-schemes, and PRA regulated firms will be members of FCA sub-schemes. There needs to be an overall guiding institution behind the rules for the FSCS, co-ordinating with the other regulatory body as appropriate.

6. Compensation, dispute resolution and financial education

6.1 We recognise and support the valuable work that the Consumer Financial Education Body (CEFB), now the Money Advice Service, undertake. Improving and developing our customers' understanding of financial services and products is an important outcome and one that Barclays continues to support. We offer a wide range of help to customers to support their financial decision making. In part this has been delivered via our flagship programme, Barclays Money Skills, through which we are investing £15m over three years to help one million people build the skills, knowledge and confidence they need to manage their money more effectively. We have worked closely with predecessor structures over many years to develop our financial capability programme and resources, to fund financial inclusion officers to work within the affordable housing sector and identifying how the new MAS financial health check and advice services can be signposted to customers and branch staff for appropriate referrals. We welcome the launch of the Money Advice Service as a new way to give consumers information about managing their money and choosing the financial products that are right for them.

6.2 We have also developed a good working relationship with the FSCS, most recently during the implementation of the 'single customer view' (SCV) where Barclays has helped develop best practice and provided advice on how to operationalise SCV. More recently, Barclays supported the FSCS's media campaign to raise awareness of deposit protection and other forms of compensation available to consumers and small businesses.

6.3 In terms of operational oversight, we recognise the need for the Money Advice Service, the FOS and the FSCS to have a level of independence. However, we have some concerns about how independence, without proper controls, can result in unintended consequences. One unintended consequence has been that the approach taken by the FOS has changed over the last ten years. We support the need for an independent arbitrator of financial services disputes and that the FOS should fulfil this role. However, the role of the FOS has developed beyond this remit and it now acts as a 'quasi-regulator', setting policy through its decision making on individual disputes. We would advocate that whilst the FOS remains entirely independent in respect of its case management and judgments, that matters of policy should remain with the FSA and other regulatory bodies. We continue to hold the view that FOS should become a subsidiary of the FCA in the new regime in order to improve governance over the FOS and deliver more clarity, certainty and regulatory coherence.

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

6.4 As noted above, it is unclear how the joint responsibility of the PRA and FCA will be exercised given that the financial structure is determined by a holistic view of the capacity of the UK financial system and the sub-sectors within it, to meet compensation demands in any one year. This is supplemented by an element of cross-subsidy both within and between sub-schemes. Currently the financing rules for the FSCS are determined by the FSA, and it would seem to us that a single body needs to remain in overall control to ensure the overall coherence of compensation arrangements in the UK.

6.5 We are not persuaded that arrangements for joint oversight of the FSCS will best serve the national interest. At best it means duplication of effort.

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

6.6 We are disappointed that the opportunity has not been taken to reform the statutory framework for the Ombudsman regime, particularly in view of the widespread dissatisfaction of the way in which the dispute resolution landscape has developed under FSMA. It is critically important, in the new regime, that there is clarity around the regulatory regime applying to products and services sold to retail consumers. For this to be achieved it is not acceptable for the FOS to continue to resolve cases in issues of wider public interest just on the basis of the individual merits of each case.

6.7 Our recommendation is that the FOS be brought within the wider FCA family as a subsidiary of the FCA, and that the objectives of the FOS scheme be revisited so the Ombudsman has to take decisions on cases in accordance with relevant FCA rules and guidance. We would also like statutory recognition that the FOS regime is intended to apply to individual idiosyncratic complaints and that where common features appear in a significant class of complaints across a product market or within a firm then FCA review processes would be triggered. Such a regime would deliver greater certainty and consistency for firms and for consumers and be more cost effective, whilst still safeguarding the rights of consumers to refer complaints to an independent Ombudsman unless the FCA had established a wider redress scheme. Consumers would retain their statutory right to take a case through the courts if they remained dissatisfied.

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

6.8 We support the proposal for statutory audit and value for money review by the NAO.

7. European and international issues

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

7.1 Our views on international and European issues are set out fully in the relevant chapters of this response and we do not seek to repeat them here. Our over-riding concern is that the proposals in the consultation document do not give sufficient weight to the crucial need for the UK authorities to strengthen their level of influence over European regulation, directives and supervisory standards that impact the UK market. As Europe's main financial services centre, the UK has very important interests at stake and needs to devote more and better resource to this crucial area of policy, regulatory and supervisory development.

7.2 To this end each UK regulatory body or function will need to establish a dedicated expert team to further develop relationships with key European stakeholders; monitor developments, provide essential policy input , evidence and analysis where needed; and engage more intensively than hitherto. The UK view will need to be coherently presented and there is a crucial role here for the Treasury. Unless this happens the UK market risks suffering the consequences of inappropriate or damaging regulation regardless of how well the new UK authorities perform their UK functions.

7.3 Significant effort also needs to be invested in international developments at FSB/G20 level and in terms of promoting regulatory coordination between the EU, UK, US and other key markets. This is less about who sits on what committee that a regulatory culture and philosophy that looks outwards and understands the importance of maintaining good external relations, stress testing global coordination, and maintaining an open and learning stance to future developments.

Annex: Question and answer map

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

See paragraphs 2.19-2.26 of this response document.

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

See 2.27.

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

See 2.6-2.6.

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

See 2.27-2.29.

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

See 3.6 – 3.11.

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

See 3.12

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

See 3.13-3.16

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

See 3.17-3.20.

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

See 3.21.

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

See 3.22.

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

See 4.5-4.7.

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

See 4.8.

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

See 4.9-4.13.

14 The Government would welcome specific comments on:

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

See 4.14-4.17.

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

See 4.18-4.22.

16 The Government would welcome specific comments on:

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

See 4.23.

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

See 5.1-5.7.

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

See 5.8.

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

See 5.9.

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

See 5.10.

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

See 5.11-5.12

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

See 5.12-5.14.

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

No response given.

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

5.15-5.17

25 The Government would welcome specific comments on:

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

See 5.18-5.20.

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

See 5.21.

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

See 5.22-5.23.

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

See 5.24-5.25.

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

See 6.2 and 6.4-6.5

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

See 6.3 and 6.6-6.7.

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

See 6.1-6.8.

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

See 7.1-7.3. International coordination points are also made throughout the document.

EXECUTIVE SUMMARY

INVESTING IN CIVIL SOCIETY: A FRAMEWORK FOR A BESPOKE REGULATORY REGIME

1. Introduction

1.1 This position paper sets out in clear terms how a proportionate social finance legal and regulatory regime could be established, to enable the Government to achieve its policy objectives of growing the social investment market and making the Big Society Bank a success, whilst protecting investors from the risk of misselling.

1.2 There is a serious need for law and regulation to recognise the special characteristics of social and community finance investment offerings and activity. At the moment, the cost of compliance with mainstream financial services regulation is often prohibitive and prevents or seriously delays much necessary and important social finance activity from taking place.

2. Proportionality

2.1 There is a need for proportionate and tailored regulation which:

2.1.1 makes retail investment in civil society more feasible;

2.1.2 provides an appropriate level of protection for investors;

2.1.3 reflects the distinctive characteristics of community and social finance; and

2.1.4 covers the full spectrum of community and social finance activity.

3. A Framework

3.1 Our experience and consultation with sector experts suggests the following steps would help to create a suitable framework for a bespoke regulatory regime:

3.1.1 create new legal form exemptions to the Financial Promotion Order[1], to include charities, community interest companies, charity trading subsidiaries and companies limited by guarantee;

3.1.2 add a new social investor exemption (with appropriate conditions) to the Financial Promotion Order to exempt investors who are not motivated exclusively by financial returns but who are also motivated by social returns;

3.1.3 issue a new Community and Social Finance Order, as subordinate legislation to FSMA 2000, to form the statutory basis of a new regulatory regime for community and social finance to cover investment in legal forms and offers to social investors which are exempt from the Financial Promotion Order;

3.1.4 differentiate community and social finance practice standards and enable market leading organisations to lead on standard setting in each area;

[1] The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005.

3.1.5 ensure the Community Shares partners – Co-operatives UK and Locality – lead on standard-setting in the community finance context;

3.1.6 encourage the establishment of an independent sector-led standards board (the "Standards Board"), which is representative of the social finance sector, to articulate and propose practice standards for social finance offers;

3.1.7 establish a new Social Finance Regulator, a public official to sit within the proposed new Financial Conduct Authority (the "FCA") (in a relationship comparable to that between Companies House and the Community Interest Company Regulator), with:

(a) obligations to promote the social investment marketplace, protect investors and act as a registrar of community and social offers; and

(b) power to approve and give legal force to practice standards articulated and proposed by the Community Shares partners and the Standards Board; and

3.1.8 clarify in the objectives of the FCA that it should take steps to ensure an appropriately enabling regulatory environment for investment in civil society

3.2 A regime of this kind would meet the needs of the wider community and social finance sector whilst providing appropriate investor protection. It would also be flexible enough to be adapted as the community and social finance sectors develop, and could, by means of exemptions from the Regulated Activities Order[2], within the confines of the Markets in Financial Instruments Directive, permit the proportionate regulation of specialist "*social finance regulated activity*" and so stimulate the growth and development of social finance intermediaries.

4. The Policy Context

4.1 There is a small window of political opportunity for a bespoke regime.

4.2 The Government needs to deliver on its Big Society agenda and has ambitious goals when it comes to boosting social investment and making the Big Society Bank a success. These goals depend on proportionate regulation.

4.3 A co-regulatory regime with the broad outline described above would provide a framework for a bespoke and proportionate regime which would protect investors.

5. A Public Consultation

5.1 We call upon HM Treasury, as part of its reform of the FSA, to create a proportionate co-regulatory regime for community and social finance and to issue a public consultation on the scope of a Community and Social Finance Order to FSMA 2000.

5.2 We invite representatives from the community and social finance sectors to join with us in asking HM Treasury to consider and to consult upon the scope and content of a bespoke co-regulatory community and social finance regime.

[2] The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

APPENDIX A

RECOMMENDATIONS

1. The Government should, as a matter of urgency, issue a consultation on proposals to establish a bespoke co-regulatory regime for community and social finance

2. Exemptions under the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 should be extended to include offers by charities, community interest companies, wholly-owned trading subsidiaries of charities and companies limited by guarantee and offers to social investors

3. A new Community and Social Finance Order, dedicated to community and social finance, should be issued under the revised Financial Services and Markets Act 2000

4. A new independent Community and Social Finance Standards Board(s) should be established to articulate practice standards for community and social finance offers

5. A new office of the Social Finance Regulator should be established under the revised Financial Services and Markets Act to review and approve standards issued by the Standards Board and to act as the registrar of community and social finance offers

6. The Community and Social Finance Order should:

6.1 set out a co-regulatory regime for community and social investment offers;

6.2 set out a new category of "*social finance regulated activity*";

6.3 treat community and social finance activity in a co-ordinated and unified way;

6.4 be updated and adapted from time to time to ensure proportionate regulation of a developing social investment market, including with respect to peer-to-peer lending, online and social media activity, crowd-funding and the development of social funds.

7. Consideration should be given to the place within a bespoke regime for the following:

7.1 differential treatment of community and social investment offers;

7.2 self-certification for community and social investment offers:

7.3 a social motivation test for social investors;

7.4 risk warnings;

7.5 declarations for investors and for promoters of investment offers; and

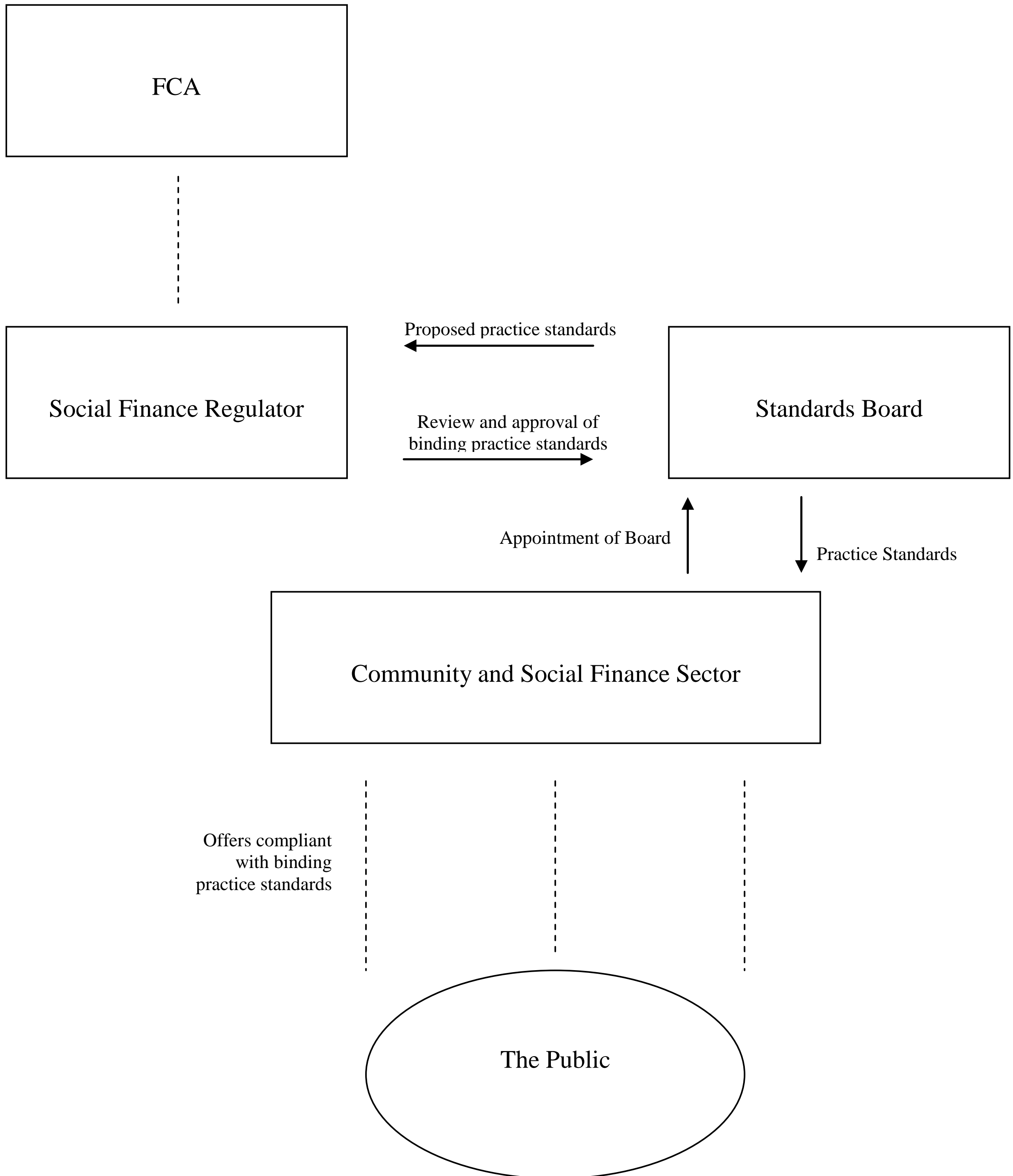
7.6 practice standards for community and social offers issued by the Community and Social Finance Standards Board(s).

8. The FCA's objectives should be elaborated to note the importance of social finance

9. A new section of the FSA Handbook should be dedicated to the work of the Social Finance Regulator and the scope of the Community and Social Finance Order

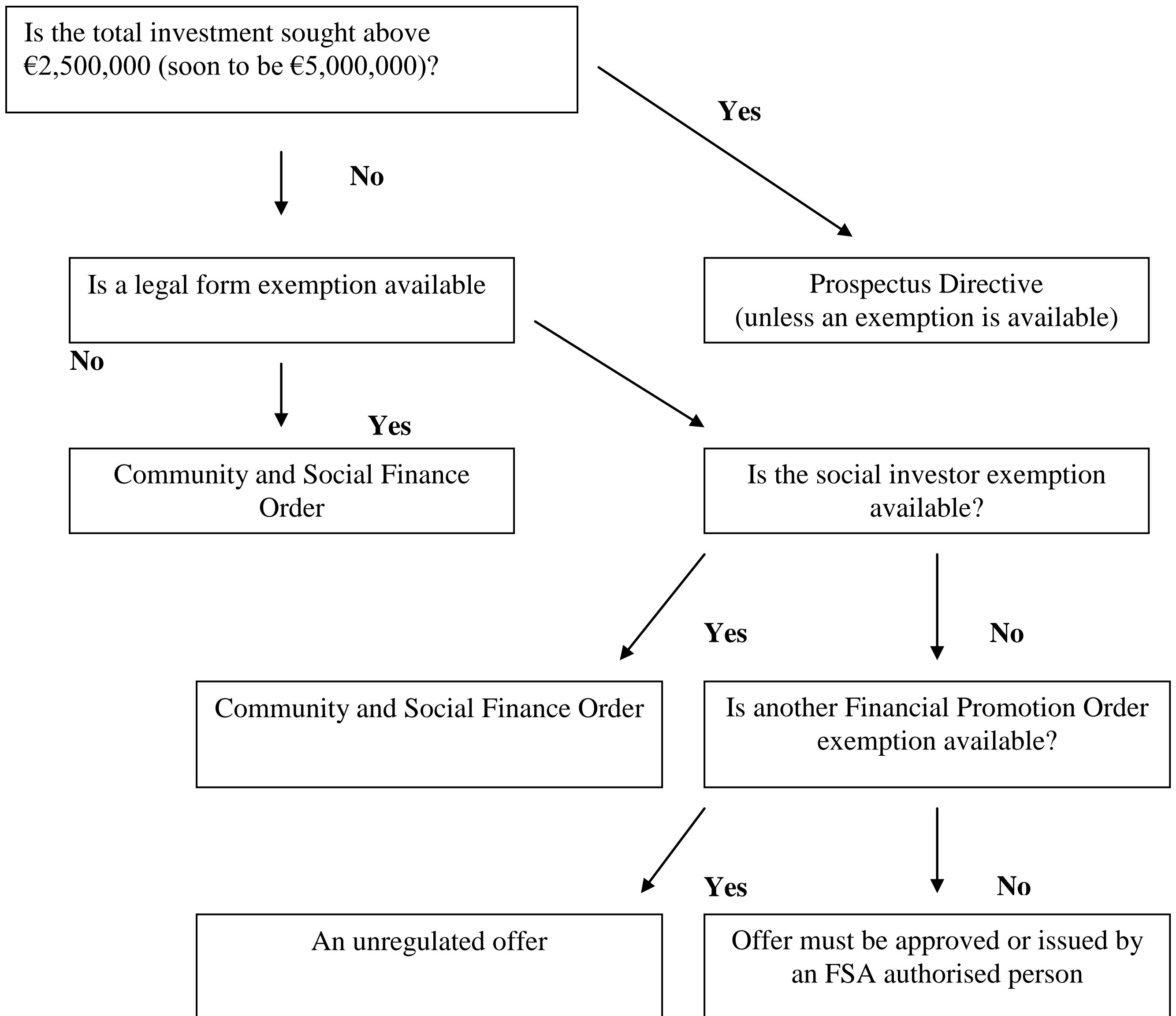
APPENDIX B

CO-REGULATION OF COMMUNITY AND SOCIAL FINANCE



APPENDIX C

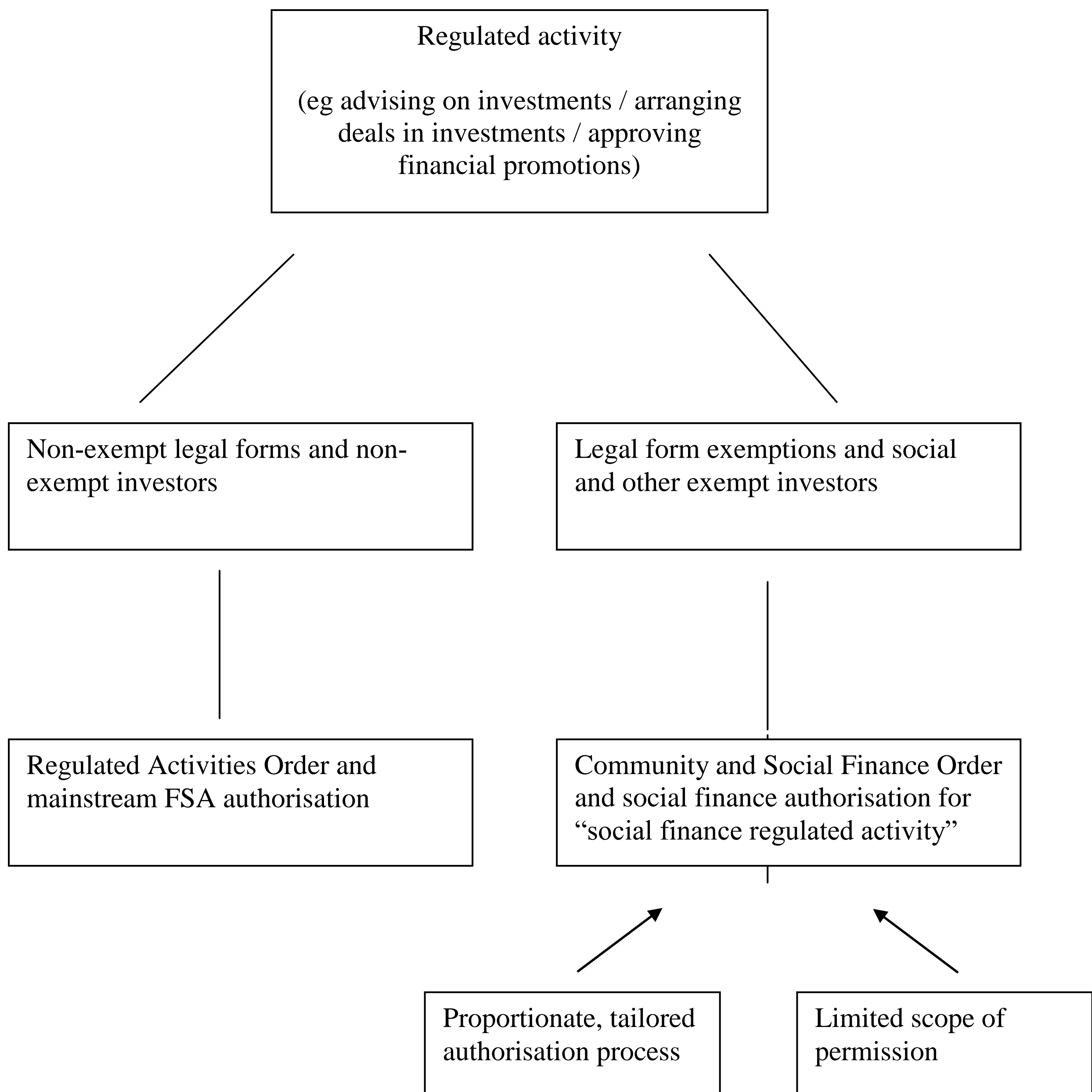
COMMUNITY AND SOCIAL FINANCE ORDER



208253/0003/000883845/Ver.01

APPENDIX D

SOCIAL FINANCE REGULATED ACTIVITY



208253/0003/000883845/Ver.01

BERWIN LEIGHTON PAISNER

Berwin Leighton Paisner LLP
Adelaide House
London Bridge
London EC4R 9HA
Tel: +44 (0)20 3400 1000
Fax: +44 (0)20 3400 1111
DX92 London
www.blplaw.com

Date: 15 April 2011
Our ref: NWLL
Your ref:
DDI: 020 3400 4367
e-mail: Nathan.Willmott@blplaw.com

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

By Email and Post

Dear Sirs

A new approach to financial regulation: building a stronger system (the Consultation Document)

This letter is submitted by Berwin Leighton Paisner LLP in response to the above Consultation Document. We welcome the opportunity to comment on the Government's proposals.

We would like to make the initial point that we support the majority of the proposals set out in the Consultation Document. However, we wish to re-iterate the point made in our response to your previous consultation that the Financial Services Authority is "fit for purpose", and therefore it would be highly desirable for the proposed Financial Conduct Authority (FCA) to mirror the FSA as closely as possible to ensure certainty for firms.

We wish, however, to make the following comments in relation to a number of key issues raised by the Consultation Document:

Appeals from judgement-based supervisory decisions

In Chapter 3 of the Consultation Document, which relates to the Prudential Regulation Authority (PRA), section 3.32 (headed "enforcement") discusses the fact that the Government is considering whether appeals from judgement-based supervisory decisions should be heard by the Tribunal on limited grounds on a "Judicial Review" basis, rather than the "full merits review" currently employed.

As a primary point, we believe that such appeals from judgement-based supervisory decisions will not only stem from the PRA, but will also cover the judgement-based supervisory decisions of the FCA, covering many different supervisory issues, such as authorisations and approved person issues. This is not clearly reflected in the Consultation Document.

We have certain reservations about this proposal. Our major concern is that firms will be discouraged from challenging the decisions of the regulator if they can only do so on limited Judicial Review type grounds. Given the importance to firms of many supervisory decisions, it would be preferable to retain the current system. In any event, both the PRA and FCA need to have a robust internal decision-making process which allows for the internal escalation of proposed supervisory decisions, to avoid the risk of these regulators being perceived to be taking decisions in an arbitrary way.

Berwin Leighton Paisner LLP ("BLP") is a limited liability partnership registered in England and Wales (registered number OC315919) and is regulated by the Solicitors Regulation Authority. A list of members of BLP and of the non-members who are designated as partners is open to inspection at the above registered office. The term partner is used to refer to a member of BLP or an employee or consultant of BLP or an entity in the BLP group who is a lawyer and with equivalent standing and qualifications as the members of BLP. In respect of Goltsblat BLP LLP, partner is used to refer to an employee or consultant who is qualified to practise under applicable Russian law.

Early publication of enforcement action

We have serious concerns about the proposals for the early publication of enforcement action. We have significant fears that if legislation is passed which allows for the publication of the fact that a warning notice has been issued, and of a summary of that notice, this could lead to significant detriment for the firm and any individuals concerned. Those involved in enforcement actions are very concerned that once a matter is in the public domain, even though the FSA's allegations have not yet been proven, this will have significant reputational implications for them. The concern is that press reporting may lead the public to believe that there has been a finding even though the person concerned has not had any opportunity to make submissions as to why the allegations are unfounded. They risk losing significant amounts of business and, indeed, some smaller financial services providers fear being driven out of the industry altogether.

A recent illustration is the significantly prejudicial impact on the business of Gartmore when it became known that one of its senior fund managers was under investigation. Permanent damage had occurred to the business by the time that the FSA's investigation was discontinued. We appreciate that a firm will have the right to make limited representations to the regulator on content before any summary is published, but we believe there needs to be more stringent constraints around this to protect firms and individuals in particular.

Who regulates whom?

We believe that more work needs to be done on which firms will be regulated by the PRA for prudential matters. Although, it is clear that the PRA will regulate all banks, building societies, credit unions and insurers, it is less clear in regard to some investment firms. The Treasury Select Committee agrees that it is important to avoid confusion about "which firms will be regulated, or part-regulated, by which regulator". Although it is currently proposed that BIPRU €730k firms will be capable of being designated by the PRA, we agree strongly that further consultation is required, especially in relation to firms who have permission to "deal in investments as principal" in order to provide clarity in this area.

The co-ordination of the PRA and FCA

We have a number of concerns about the co-ordination of the PRA and the FCA and how this may affect dual regulated firms.

The proposals in the Consultation make it clear that both regulators will handle applications for authorisation and approved person status for dual regulated firms. The Government identified "the importance of effective co-ordination between the new regulatory authorities" as one of its key themes in its summary response published in November 2010. A process where both regulators have to supply consent requires a great deal of effective co-ordination to prevent firms being placed at a disadvantage in the regulatory process and opens up the PRA and FCA to regulatory arbitrage. It depends on the issue at hand as to whether the PRA or FCA is the final adjudicator in any matter. This makes it difficult for firms to understand which regulator they should be engaging with at any one time. Certainly we believe that more work should be carried out in this area to provide clarity for the industry.

A further concern is that duplication of application to both regulators may slow down the timing on such application processes, resulting in further cost to businesses. As a practical solution, we suggest that a key individual for each firm be identified in either the PRA or FCA as appropriate, who can act

as a conduit for information on each application to ensure that the firm only has to interface with one person, who can then pass information to the other relevant authority, rather than doubling time and effort.

We agree that safeguards must be placed around the PRA and FCA's rule making abilities to ensure that any rules made are harmonious and that there is no tension or conflict between the two sets of rules.

PRA Rules

We have some concern around the PRA's approach to rule based regulation. It is proposed that the PRA will, "make greater use of principles in implementing its approach and will enforce a 'purposive' application, and enforcement, of PRA rules requiring compliance with the 'spirit' as well as the letter of the rules". This seems to us to be at odds with the general return to rule based regulation, as it was widely agreed that a principles based approach to regulation was unsatisfactory. We believe that rules-based regulation is extremely appropriate where prudential regulation is concerned. Prudential regulation stems on the whole from European Directives which do not provide great detail, and it is detail which provides clarity especially when dealing with prudential issues.

Yours faithfully

Berwin Leighton Paisner LLP

djac\16414504.1

Bluefin

Submission by Bluefin Insurance Services Limited
HM Treasury consultation document
A new approach to financial regulation: building a stronger system

Box 2.D: Consultation questions

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

Answer: We understand there to be limited experience as to the use or effectiveness of the tools in question and would respectfully suggest a period of deliberation should elapse before their use is considered and caution exercised in their use.

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

Answer: With the extent of the proposed tools, we have no comment to make in this respect.

Box 2.F: Consultation question

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

Answer: We do not believe that individually, insurers pose a risk to the stability of the UK's financial system. We also do not believe that in the area of general insurance any would qualify as a systemically important financial institution due to the capacity of the market to promptly replace their products and services to customers. Therefore any actions considered by the FPC should be proportionate to the risk to the stability of the UK's financial system presented by insurers compared to for instance, the banks.

Box 2.G: Consultation question

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

Answer: Please see our answer to Question 3 above.

Box 3.C: Consultation question

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

Answer: We broadly agree with the proposals. However we would comment in view of the range of firms which PRA will regulate that proportionate, appropriate and cost-effective regulation is required relative to the degree of risk that each firm presents to the stability of the UK financial system. In particular the risks associated with insurers as compared to banks.

Box 3.D: Consultation question

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

Answer: Please see our answer to Question 5 above.

Bluefin Insurance Services Limited is authorised and regulated by the Financial Services Authority.
Registered Office: 5 Old Broad Street, London, EC2N 1AD. Registered in England No: 931954.

Box 3.E: Consultation question

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

Answer: We broadly agree with the proposals. However, we have not seen any evidence of a failure in the existing appeals process. Therefore, we do not believe it should be narrowed as proposed and see value in this remaining on a "full merits review" basis.

Box 3.F: Consultation question

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

Answer: We broadly agree with the proposals. In particular, we would comment that for market confidence in the PRA its Board should include those with practical experience of the range of firms regulated by the PRA.

Box 3.G: Consultation question

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

Answer: We agree with the proposals.

Box 3.H: Consultation question

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

Answer: We broadly agree with the proposals. However, we do not support the narrowing of the consultation process on rule making or implementing EU rules. That could have the detrimental effect of both excluding valuable input by regulated firms and lead firms to conclude the convenient categorising of a change as one falling in the "prejudicial to its objectives" exception, to avoid a necessary consultation.

Box 4.B: Consultation Question

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

Answer: We broadly agree with the proposals. In particular, we would acknowledge the comment that the FCA will "not as general principle take on the role of vetting and pre-approving products". For the efficiency of markets and to ensure responsibility in this respect remains firmly with firms' senior management, we see FCA's role as one of monitoring development of products and intervening only at the point at which it believes there is potential for customer detriment. Becoming involved with individual products prior to their launch would risk FCA's resource being deflected from its primary regulatory and supervisory role. It might also present customers with the misleading picture of quasi FCA approval of a product.

Box 4.D: Consultation question

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

Bluefin Insurance Services Limited is authorised and regulated by the Financial Services Authority.
Registered Office: 5 Old Broad Street, London, EC2N 1AD. Registered in England No: 931954.

Answer: We broadly agree with the proposals. However, we see the challenge the Government, Treasury and Bank face in this respect is ensuring that the FCA, its staff, regulated firms and the general public do not perceive the FCA as the "junior member" in these new arrangements.

Failure in this respect could undermine the effectiveness of the FCA, affect the quality of staff FCA might attract and risk a loss of respect by both firms and the general public. We believe this to be a potential risk and one which needs to be addressed during implementation of these new arrangements.

Box 4.F: Consultation question

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

Answer: We acknowledge the comment that the FCA will "not as general principle take on the role of vetting and pre-approving products". For the efficiency of markets and to ensure responsibility in this respect remains firmly with firms' senior management, we see FCA's role as one of monitoring development of products and intervening only at the point at which it believes there is potential for customer detriment. Becoming involved with individual products prior to their launch would risk FCA's resource being deflected from its primary regulatory and supervisory role. It might also present customers with the misleading picture of quasi FCA approval of a product. We await publication by FCA of a consultation "on a set of principles under which it will use this new product intervention power" to see how these risks may be effectively managed.

Box 4.G: Consultation question

14 The Government would welcome specific comments on:

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

Answer: We have concerns in respect of only one aspect of this proposal and that is the proposed new power in relation to warning notices. This proposal has the potential to cause serious harm to a firm and as described in the consultation document. Discretionary authority granted to the PRA and FCA as to when they might not publish a warning notice is not a sufficient check or balance. There also seems to be an underlying assumption in the consultation document that a warning notice would lead to a successful enforcement action. However, as this cannot be the guaranteed outcome in all cases a process for publishing a "notice of discontinuance" is proposed. Whether this would result in a firm being seen as innocent of an alleged offence or merely guilty but not proven and with consequent reputational damage, cannot be predicted with any certainty. Therefore, we would prefer the existing process of publishing enforcement notices be retained as that is in line with the legal principle of the assumption of innocence.

Box 4.H: Consultation question

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

Answer: It is not clear what specific powers are proposed for FCA in this respect other than a general outline of the possibility of referrals to the Competition Commission and or OFT or their successor bodies. As the Government is to "come forward with more detail as the wider

Bluefin Insurance Services Limited is authorised and regulated by the Financial Services Authority.
Registered Office: 5 Old Broad Street, London, EC2N 1AD. Registered in England No: 931954.

review of the competition regime is progressed" then that would seem the right moment to respond to specific proposals.

Box 4.I: Consultation question

16 The Government would welcome specific comments on:

• the proposals for RIEs and Part XVIII of FSMA; and

• the proposals in relation to listing and primary market regulation.

Answer: We have no comment to make in respect of these proposals. However, as there does not seem another appropriate place and mention is made here of the FCA holding the UK's seat on ESMA there is another issue on which we do wish to comment. This is in respect of our concern that with major work occurring on IMD2 during this year, the UK's seat on EIOPA will be held by the PRA or presumably the part of FSA operating as a "shadow" in that respect. As much of the work on IMD2 will be in respect of conduct issues we would wish the part of FSA creating a "shadow" of FCA to carry out this responsibility and in avoiding any detriment to the UK in implementation of IMD2.

Box 5.A: Consultation question

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

Answer: We agree with the proposals.

Box 5.B: Consultation question

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

Answer: Merely to observe that as per the consultation document, the PRA's responsibilities are in respect of individual firms but that if instability to the financial system in a wider context were an issue then that would be for FPC to decide upon the appropriate action and not the PRA.

Box 5.C: Consultation questions

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

Answer: As proposed, we would be solely regulated by the FCA and would wish that to be the case for all matters including the authorisation process.

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

Answer: As proposed, we would be solely regulated by the FCA and would wish that to be the case for all matters including the variation and removal of permissions process.

Box 5.D: Consultation question

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

Answer: As proposed, we would be solely regulated by the FCA and would wish that to be the case for all matters including the regime covering approved persons.

Bluefin Insurance Services Limited is authorised and regulated by the Financial Services Authority.
Registered Office: 5 Old Broad Street, London, EC2N 1AD. Registered in England No: 931954.

Box 5.E: Consultation question

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

Answer: We agree with the proposals.

Box 5.F: Consultation question

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

Answer: We have no comment to make in this respect.

Box 5.G: Consultation question

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

Answer: As proposed, we would be solely regulated by the FCA and would wish that to be the case for all matters including the making and waiving rules?

Box 5.H: Consultation question

25 The Government would welcome specific comments on

• proposals to support effective group supervision by the new authorities – including the new power of direction; and

• proposals to introduce a new power of direction over unregulated parent entities in certain circumstances?

Answer: As proposed, we would be solely regulated by the FCA and would wish that to be the case.

Box 5.I: Consultation questions

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

Answer: We agree with the proposals.

Box 5.J: Consultation question

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

Answer: We agree with the proposals.

Box 5.K: Consultation question

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

Answer: We agree with the proposals but would comment that any fees or levies should be proportionate, appropriate and cost-effective in relation to the service which individual firms receive from their regulator.

Bluefin Insurance Services Limited is authorised and regulated by the Financial Services Authority.
Registered Office: 5 Old Broad Street, London, EC2N 1AD. Registered in England No: 931954.

Box 6.A: Consultation question

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

Answer: We believe that two issues are essential in this respect. First, any cross-subsidy between different types of regulated firms should cease and in particular insurance brokers should not be at risk of funding compensation in the banking sector. Second that full-time insurance brokers should for the purposes of FSCS be separated from other, secondary sellers of general insurance, currently in the insurance intermediary sub-class. These changes to be effective by the start of 2012, if not sooner

Box 6.B: Consultation questions

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

Answer: We agree with the first two proposals but would wish to see and separately respond to, the FOS consultation in respect of the principles it would apply in determining when to publish determinations. However, we would also comment that FOS levies should cease to be based on the general insurance intermediation class subsidising the banks for necessary work on PPI complaints generated by the actions of the banks and insurers. This change to be effective no later than31/03/2012 and in force for FOS's next financial year.

Box 6.C: Consultation question

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

Answer: We agree with the proposals.

Box 7.C: Consultation question

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

Answer: We agree with the proposals but would repeat our concern that with major work occurring on IMD2 during this year, the UK's seat on EIOPA will be held by the PRA or presumably the part of FSA operating as a "shadow" in that respect. As much of the work on IMD2 will be in respect of conduct issues we would wish the part of FSA creating a "shadow" of FCA to carry out this responsibility and in avoiding any detriment to the UK in implementation of IMD2.

End

13/04/2011

Bluefin Insurance Services Limited is authorised and regulated by the Financial Services Authority.
Registered Office: 5 Old Broad Street, London, EC2N 1AD. Registered in England No: 931954.

The voice of banking
& financial services

financial.reform@hmtreasury.gsi.gov.uk

A new approach to financial regulation: building a stronger system

- Comments by the British Bankers' Association -

The British Bankers" Association welcomes the opportunity to respond to HM Treasury"s consultation paper „A new approach to financial regulation: building a stronger system". We represent 220 banks from 60 countries and have 40 associate firms within membership.

Executive summary

Introduction

- We welcome the identification of themes which lie at the heart of key concerns expressed by industry observers and others, including the need for the regulatory authorities" core statutory objectives to be balanced and supplemented by other factors and the importance of accountability and transparency for the PRA, the FCA and FPC. We are unclear however on whether the proposals set out in the paper can be said to deliver on these needs with sufficient clarity and rigour.

- In instances where the consultation paper appears to have accepted in principle industry concerns raised in response to the July 2010 consultation, this is usually discernable from the commentary and it is not always evident how this will translate into tangible measures. We therefore need the opportunity of reviewing the draft legislation and operating plans before we can provide a definitive industry view.

- We see issues concerning the statutory objectives of the new bodies, their accountability, aspects of their new powers and the arrangements for their working together.

The Bank of England and the FPC

- While we are supportive of the addition of a macro-prudential element to the regulatory toolbox we see it as imperative that this be introduced in an internationally coordinated way. Given the potential socio-economic impact of these tools we see a need for much further thought to be given to: the circumstances in which these tools may be deployed and what they are trying to achieve; consultation required before their application; their tie-in to monetary and fiscal policies; and the recognition of economic growth over the medium to long term as a fundamental policy objective.

- While we see the need for certainty, long term focus and a degree of insulation from political influence, we remain concerned about the checks and balances within the system given the proposed concentration within the Bank of England which becomes responsible for: financial stability, including macro-prudential policy, monetary policy, oversight of micro-prudential policy, prudential regulation of key financial infrastructure, such as payment and settlement systems and central counterparties, the resolution of failed or failing banks under the Special Resolution Regime (SRR) and the provision of liquidity insurance to the financial sector.

- We are unsure that the degree to which the FPC will need to coordinate its activities with the Financial Stability Board and the European Systemic Risk Board is sufficiently appreciated.

- We fail to see the circumstances in which the FPC would have a legitimate need to adopt macro-prudential tools in an emergency given its medium-to-long term focus.

- We are highly supportive of the initiative to strengthen the crisis management framework, not only domestically, but internationally and in Europe. But we are concerned that the circumstances in which the Chancellor will have the final decision on the course of action to take in the event of an emerging financial crisis may not be drawn on a basis compatible with the public interest.

- We believe infrastructures should be subject to a recovery and resolution regime. As the Bank is also the UK"s Special Resolution Authority, this could create conflicts with its role as direct supervisor of infrastructures and appropriate internal divisions should exist.

- We see a need to clarify in legislation the use of the SRR in the case of holding companies of groups which contain both bank and non-bank entities.

Prudential Regulation Authority

- We view it as short-sighted for the Government to reject the proposal that the PRA and FCA should be required to consider the effect on international competitiveness and innovation of their decisions and would like to see this issue given further thought.

- It is still unclear which investment firms will be subject to PRA supervision. We urge, in the interests of efficient, co-ordinated supervision, that all investment firms within a group should be prudentially supervised by the same regulatory authority. It is not evident from the consultation that this will necessarily be the case.

- We are concerned at the prospect of the Government potentially concluding that appeals from judgement-based supervisory decisions should only be heard on the basis of a judicial review as opposed to the full merits review currently provided for in relation to FSA supervisory decisions which engage the statutory notice procedure.

- We await further details around the proposed Proactive Intervention Framework (PIF). At this stage we would note that any approach with „demarcated stages" regarding pre-resolution could reinforce a downward trajectory for a firm as soon as it becomes clear to the market it has entered a particular stage. Equally, we do not believe that a framework around ex-ante determinations of risk would be sufficiently responsive to the individual circumstances of any given firm.

- A change of position since the previous consultation is the suggestion that the PRA be given flexibility to establish appropriate decision-making structures, with the involvement of non-executives as appropriate consistent with the principles of good corporate governance. This is a potentially significant change depending upon how the PRA exercises its discretion.

- The PRA is to be both the prudential regulator and responsible for triggering the use of SRR powers which gives us concerns around the potential for conflict between the PRA and the Bank, given the PRA will be a subsidiary of the Bank. We note this consultation expresses the view that the potential for conflicts to arise is limited because the roles and legal responsibilities are clear and because the PRA will be operationally independent from the rest of the Bank but remain unconvinced.

- We support the Government creating a new requirement for the regulator to make a report to the Treasury - and for this to be laid before Parliament - where there is regulatory failure, addressing the regulator‟s action and decision making and considering what lessons can be learned by firms and regulators; and for the Treasury to have a power to direct the regulator to produce a report when that would be in the public interest.

- We are pleased to see acknowledgement that the PRA should be under an obligation to publicly consult when it makes rules but would like a better understanding of the circumstances in which this would be viewed as being *"prejudicial to its objectives"* and the practical effect of there being *"no significant reductions to the existing requirements to consult".*

- We welcome the acknowledgement that the PRA will need to engage with practitioners, trade bodies and other industry representatives, but are concerned with the uncertainties which remain including the suggestion that the PRA moving towards a more judgement-based approach means that it requires flexibility in deciding what kind of consultation arrangements are appropriate.

- We have no difficulty with a streamlined consultation process for the implementation of EU rules where these have already been subject to consultation; indeed, we would welcome this and would suggest that subsequent consultation should focus principally on incremental differences in the way in which the UK applies EU rules. We see a case for a renewed commitment to the avoidance of gold plating.

- We see a case for the scope of the FCA practitioner panel encompassing common shared services between the PRA and FCA. The presence of a panel relationship of this nature is not incompatible with allowing the PRA flexibility in the way it engages with the industry.

Financial Conduct Authority

- While we are supportive of the establishment of a new regime for conduct regulation and see this as part of the rebuilding of trust and confidence in financial services, we shared the concern of others in the characterisation of the regulator as a „consumer champion‟ and therefore welcome the clarification given as to the principles to which the regulator will adhere.

- The Government should reassess its decision not to include recognition of the importance of international competitiveness and innovation. We also believe that a clear statement should be given in respect of some of the other considerations identified as having some relevance, including financial inclusion and diversity.

- The new intervention powers and enforcement powers envisaged are wide and potentially intrusive and we would urge the development of detailed and appropriate safeguards and clarity over the use of the powers.

- We agree that the FCA will need a complaints procedure, but do not believe that these arrangements should be in a more limited form than currently exists.

- We welcome the recognition of the need for the FCA to contain a strong markets division and for this to be in a position to represent the UK interest in relevant European and international bodies.

- It is important that the combined impact of the Government‟s proposals and the FSA‟s evolving supervisory philosophy, as embodied by the product intervention tools, is properly considered; the FSA's intensive supervision already covers an element of product regulation and therefore it would be prudent to establish whether there is a need for anything over and above this.

- Consideration should be given to placing a more formal obligation on the FCA to act quickly in response to whistle blowing reports from industry which point to future conduct failures. Such a mechanism could be integrated with the FCA‟s enhanced horizontal risk scanning methodology. This would be consistent with the FCA‟s more proactive supervisory approach.

Regulatory processes and coordination

- We welcome the strengthened commitment to the PRA and FCA coordinating their activities within the new framework through the introduction of a statutory duty to coordinate and provisions for shared regulatory processes but would like to see a much more ambitious plan for the development of common shared services offering a single gateway for dual regulated firms.

- We urge the Government to develop a single process for Authorisations, Variation of Permissions and Approved Persons for dual regulated firms. While it is clear that both authorities need to be involved in the above processes, there is also a need for consistency for firms and a need for processes to be followed in an effective and efficient manner.

- We are supportive of the PRA levying its own fee and the FCA being responsible for its fee and that of the CFEB and FOS, but believe that the raising of fees and levies should be brought into a single, coordinated budgetary exercise and that the NAO should assess the cost of regulation in a single, coordinated exercise.

Compensation, dispute resolution and financial education

- We are supportive of a strong, operationally independent mechanism for dealing with consumer compensation and as an industry have implemented the single customer view programme in support of 7 day payout against a demanding timetable and at an expected cost approaching £1 billion. We do not believe, however, that the governance arrangements of the FSCS have been sufficiently upgraded in keeping with its expanded use.

- We agree that the FOS should remain an operationally independent alternative dispute resolution service but believe that it should be the FCA which has the statutory remit to make policy in light of wider implications.

European and international issues

- It remains critical that all aspects of the new regulatory framework are designed to fit within the international regulatory reform programme and that the new regulatory authorities be placed in a position to influence the dialogue within international and European circles. As a matter of practicality we would propose a shared back office secretariat to coordinate briefing for international and European meetings and draw attention to the contribution that the industry can make.

Responses to specific questions

Bank of England and Financial Policy Committee

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

The impact and effectiveness will depend first and foremost on the level of international agreement reached over their use and implementation. A tool unilaterally adopted and applied to UK regulated institutions would be of limited utility unless it was applied equally to non-UK regulated firms operating in the UK and to the non-regulated sector. In many ways, the use of macro-prudential tools in these circumstances could propagate systemic risk by driving exposures below the radar of supervisors.

With this point and the embryonic nature of the international debate in mind, we believe it is too soon to select the most appropriate macro-prudential tool/s. We support the decision to use (affirmative) secondary legislation to establish the toolkit once more evidence on effectiveness has become available but would stress that we believe this must be subject to full and open consultation. Once adopted, the secondary legislation authorising the use of the tools should have a „sunset" clause which requires Parliament to take stock of any further international evidence on the effectiveness and suitability of the tools before authorising them for a further period. This will ensure that the toolkit remains up-to-date and that Parliament remains accountable for the tools.

The FPC will be responsible for decisions over the exercise of a number of new macro-prudential tools, including: countercyclical capital buffers; variable risk weights; leverage limits; liquidity tools; forward-looking loss provisions; collateral requirements, such as loan-to-value or loan-to-income constraints on mortgages; „haircuts" on repurchase agreements; and margin requirements on equities or other instruments. These require detailed examination but it is important to appreciate that they have different objectives (strengthening the resilience of the financial system or managing credit flows), many of which can only be achieved through international coordination[1].

It is further proposed that the FPC should have the power to direct the regulators to require firms to disclose information that it believes would be beneficial for reducing systemic risks. This is an issue upon which we would need much further information before being in a position to comment sensibly. What we can say for now is that there is a clear need to give thought to how best to avoid duplicative applications for information being made by the authorities.

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

We would encourage the FPC to engage fully with the FSB and ESRB to develop a toolkit which can be applied in a way which minimises the possibility of cross-border and cross-sector leakage.

There is much to be learnt from the application of macro-prudential tools in other countries in which our members operate, particularly in Asia where such tools have been effective for some time. Appendix 1 provides a brief account of some of these.

[1] See Macroprudentuial policy tools and frameworks: Update to G20 finance ministers and central bank governors (FSB): 14 February 2011.

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

We remain concerned that the potential socio-economic effect of the application of macro-prudential tools has not been fully appreciated and accordingly believe that the objective, governance and accountability mechanisms should be further reviewed.

We would begin with our stated concern about the potential effect of the application of these measures on economic growth. Box 2.B on page 18 links the FPC"s objective into the Bank"s existing financial stability objective and in the process adds as point 4 that this linkage "does not require or authorise the Committee to exercise its functions in a way that would *in its opinion* 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." This is a subjective test and, since growth is placed on a lesser footing, the FPC will be obliged to err on the side of caution so as to ensure that they hit their stability objective. If it later becomes clear that they made the wrong call, action would appear justifiable on the grounds that *in its opinion* at the time measures taken were appropriate.

The recognition of the importance of the contribution of the financial sector to economic growth is expressed in much more positive terms in Article 3.1 of the ESRB Regulation setting out its Mission, Objectives and Tasks:

"*The ESRB shall be responsible for the macro-prudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability in the EU that arise from developments within the financial system and taking into account macro-economic developments, so as to avoid periods of widespread financial distress, and contribute to a smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth."*

In keeping with this we see a case for objective 4 in Box 2B on page 18 of the consultation paper being amended to read:

"4. In discharging its functions the Committee must, so far as is reasonably possible:

(i) ensure the sustainable contribution in the medium and long term of the financial sector to economic growth in the United Kingdom; and
(ii) maintain the international competitiveness of the United Kingdom as a platform from which providers of financial services and markets may carry on business."

It further needs to be appreciated that the impact and effectiveness of macro-prudential tools will also depend upon the effectiveness and stability of monetary and fiscal policies as well as micro-prudential regulation and supervision. It must be understood that the use of macro-prudential tools will not in isolation be sufficient to compensate for inappropriate use of other policy levers. Government therefore needs to ensure that it has a balanced approach and that the component parts of its macro-economic policy work harmoniously.

We note the belief that cross membership of the FPC and MPC will be sufficient to manage interaction and avoid potential conflicts and that the intention is that the MPC will be the „last mover", placing its decisions into the broader context provided by the broader actions taken by the FPC with its eye to the medium-to-longer term.

We support the proposition that the Treasury should set out the FPC"s toolkit in secondary legislation but are concerned that pre-notification and consultation on the use of tools appears to be optional This would seem in contradiction to the statement in paragraph 2.49

that it "will be vital that the FPC set out clearly how it intends to use tools and the rationale for their use".

We would add that because of the potential socio-economic effect of the application of these tools we believe that their use should be subject to the explicit authorisation of the Chancellor. We also believe that further thought needs to be given to the accountability arrangements for the FPC, including the question of whether responsibility for financial stability policy should be scoped out of the Court"s oversight function so establishing that the committee is accountable, through the Chancellor"s remit letter, to the Government, Parliament and the public.

We would also question the need for the FPC to have the power to adopt a tool in an emergency and direct the PRA or FCA to take action, with Parliamentary authorisation for the use of the tool following within 28 days. Whilst we note that this power is not intended to be used to make a firm-specific intervention or to override the PRA, we remain to be convinced that the power would not be used with this effect, particularly in a market where there are a small number of significant players. At the very least, this power does not sit well with the suggestion that macro-prudential policy should be focused on the medium to long-term.

An assessment of the likely impact and effectiveness of tools cannot be detached from the objective of macro-economic policy. The tools used to strengthen the banking sector in the face of the economic cycle will be different to those orientated towards smoothing the economic cycle.

The recognition of the need for proportionality and openness is welcome; we would, however, argue that the commitment to taking into account constraints imposed by international law should be broadened to a requirement to take into account agreements reached within international and European fora which may stop short of constituting a requirement under international law, but which nevertheless should be central to the actions of the FPC.

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

We can see the logic in the Bank assuming direct responsibility for systemically important infrastructure. It makes sense to bring payment and settlement systems together and also for the Bank to regulate central counterparty recognised clearing houses given the contribution that it is envisaged that they will make to financial stability via the firewalls that they will inject into certain key markets and the risk assumption that this involves.

As the consultation paper recognises, this will result in a division in responsibility for infrastructure since the FCA will be responsible for other parts of the infrastructure, notably Recognised Investment Exchanges (RIEs), and this will bring a specific need for the Bank and the FCA to work together. This applies in respect of the exercise of their prudential duties, conduct of business issues relating to central counterparty recognised clearing houses and in terms of the UK representation in the European Securities and Markets Authority (ESMA) which will be headed by the FCA.

As the paper also relates, there will be a need to amend Part XVIII of FSMA to align the regime applying to securities settlement systems and clearing houses with that which applies to payment systems under the Banking Act 2009, notwithstanding the fact that UK legislation will be superseded by a directly effective EU regulation on derivative transactions, central counterparties and trade repositories in the form of the European Markets Infrastructure Regulation (EMIR). There will therefore be a balance to be achieved in setting out the

necessary legislative framework for the enforcement of EMIR‟s requirements and ensuring that the UK legislation aligns to the European regime which remains under discussion.

We note that the Government is still giving thought to what reserve powers should be given to the Bank to take direct regulatory action in the event of needing to deal with a new risk expeditiously – assuming such action is permissible under European law – and look forward to being consulted on the form that these may take.

Crisis management – coordination, changes to the special resolution regime and EU crisis management

We are broadly supportive of the initiative to strengthen the crisis management arrangements in the UK and have been very much involved in the development of both recovery and resolution elements. The BBA has also provided the European Commission with its views on a proposed EU-wide framework for bank recovery and resolution. The proposals cover the full crisis management spectrum: from the steps needed to strengthen the supervision of an institution through to the resolution tools and powers necessary to ensure no firm can be considered too big to fail. We commented upon this in full in our submission to the European Commission in response to a recent consultation on a European framework for crisis management.[2]

We particularly welcome the two specific mechanisms which will frame and support the close cooperation between the Treasury and the Bank in the event of an emerging financial crisis:

- The regular twice-annual update from the Governor to the Chancellor on developments in prudential regulation and financial stability; and
- A statutory duty on the Bank to notify the Chancellor as soon as it becomes clear that there is a potential risk to public funds.

We remain concerned however that the proposed duty to notify the Chancellor of an emerging financial crisis may be too narrowly scoped and share the view of the Treasury Committee that, in the event of a crisis, it is difficult to see how the Government can remain at arm‟s length. We therefore have sympathy with the view that once it becomes likely that intervention beyond a single firm is necessary, and where public funds may be called upon even as a temporary funding mechanism for the FSCS, then the authorities should take decisions collectively led by Treasury Ministers and with the Chancellor chairing any crisis management meetings.

We believe that infrastructures should be subject to a recovery and resolution framework. As the Bank is also the UK‟s special resolution authority, this could create conflicts with its role as a direct supervisor of infrastructures and so appropriate internal divisions would need to exist. The PRA is to be both the prudential regulator and responsible for triggering the use of SRR powers which gives concern around the potential for conflict between the PRA and the Bank, given the PRA will be a Bank subsidiary. We note this consultation expresses the view that the potential for conflicts to arise is limited because the roles and legal responsibilities are clear and because the PRA will be operationally independent from the rest of the Bank but we remain unconvinced.

We further note that it is not intended that the legislation be used to make substantive changes to the SRR other than to reflect the authorities‟ new roles. There may be a case, however, for making an exception to this to clarify the position of bank holding companies. The concern relates to instances where a bank exists within the group structure of a predominantly non-banking business. Whilst we would look for the authorities to have a range of tools to facilitate the orderly resolution of a failing or failed bank, it is important that

[2] BBA submission on an EU framework for crisis management, March 2011.

the non-banking businesses should not be effectively subordinated to the interests of the banking part of the group. We therefore support the application of resolution powers to a bank holding company for the purpose of resolving the group as a whole or in a way which separates the banking entity to be resolved from the rest of the group, when at least one of the subsidiaries is a credit institution or investment institution within the scope of the SRR arrangements. It is difficult to see a justification beyond this for resolution powers being extended to bank holding companies and used in a way which subordinates the interest of creditors and other stakeholders in non-banking parts of the group to the banking part of the group.

Prudential Regulation Authority

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

We agree with the strategic and operational objectives proposed for the PRA insofar as they go and can see the logic in expressing a set of regulatory principles to be applied to both the PRA and FCA. We are disappointed however that the Government has decided to reject the proposal that the PRA and FCA should also be required to bear in mind international competitiveness and innovation and would ask that this be reconsidered.

We acknowledge that the PRA will contribute to the competitiveness of the UK economy and the financial system through promoting its stability and that the intention is that it should pursue this in a proportionate way. There are however many instances where international competitiveness has not been at the forefront in determining how to proceed and we believe that UK competitiveness is at far more of a knife edge than previously may have been the case. We therefore cannot see why the Government would not wish to send out a strong signal that "Britain is open for business" by committing to a competitive regulatory regime. The attractiveness of the UK as a place from which to conduct financial services cannot be taken for granted and there increasing anecdotal evidence of new operations being opened up overseas in preference to in the UK. We therefore see a case for a renewed commitment to better regulation and the avoidance of gold plating.

We also disagree with the assessment that innovation should not be a relevant factor for the PRA and FCA. While we would fully agree that the events of the past few years have shown that a more nuanced approach to innovation in financial services is required, including the maintenance of a regulatory environment in which innovation can deliver desirable outcomes for the users of financial services, we cannot see why this should prevent this from being expressed or the reasons why it should be viewed as any less desirable. In fact it is arguable that the construction placed on this in paragraph 3.17 is precisely the type of approach that we should want to see in bold print.

We would see this as being entirely consistent with the objectives provided to the three European Supervisory Authorities under recital 9aa of the regulations applicable requiring that each should take account of their activities on competition and innovation, global competitiveness, financial inclusion and the strategy for jobs and growth. The fact that the European authorities accept this makes the UK Government"s reluctance all the more difficult to comprehend.

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

The consultation paper explains that the PRA will focus on soundness of firms and stability of the financial system and explains that in the case of investment firms those classed as BIPRU €730k will be *capable* of PRA regulation. This is clearly a matter upon which greater

clarity is needed. We would make the point that for banking groups in particular it would be preferable for the entire group, including investment firms that may otherwise not be PRA regulated, to fall within the scope of the group‟s regulation by the PRA. This would provide a much tidier solution than having some group entities PRA regulated and others not, and would remove an unnecessary source of complication.

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

We are supportive of the PRA adopting a judgement-led supervisory approach to the firms it regulates and support the objectives and approach being reflected in specific aspects of its legislative framework, including as identified:

- Being required to provide a short statement of purpose in relation to rules it makes in order to provide insight into the rationale behind the rules and the desired outcome.
- The PRA taking a „whole firm‟ approach to considering applications in light of its assessment that the firm will be prudently managed within a viable business model and with effective controls for risk mitigation; and
- The application of a judgement-led approach to determining whether individuals are fit and proper to exercise significant influence over the financial soundness of a dual-regulated firm.

The PRA will establish a Proactive Intervention Framework (PIF) with the aim of increasing the probability of recovery of firms. While more detail will be provided in due course, this represents a significant new process, particularly when combined with a judgement-led approach. We would highlight at this stage that any approach with „demarcated stages‟ regarding pre-resolution could reinforce a downward trajectory for a firm as soon as it becomes clear to the market it has entered a particular stage. Equally, we do not believe that a framework around ex-ante determinations of risk would be sufficiently responsive to the individual circumstances of any given firm. We believe the focus should be on the response to the actual risks as they occur rather than adherence to a prescriptive rulebook.

A further aspect of the proposals giving rise to particular concern is the prospect of the Government potentially concluding that appeals from judgement-based supervisory decisions should only be heard on the basis of a judicial review as opposed to the full merits review currently provided for in relation to FSA supervisory decisions which engage the statutory notice procedure. Judgement-based supervision brings a much greater reliance upon the quality of banking supervision decision-making and increases the challenge of ensuring that decisions are made on a consistent basis. It would seem to us that judgement-led supervision redoubles rather than reduces the need for good access to an appeals mechanism and therefore do not understand why the Government would be contemplating restricting access in this way.

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

Given that a key motivation behind the reform of the regulatory structure is to overcome the situation under the tripartite arrangements where no one authority had overall responsibility for financial stability, it makes evident sense that the PRA should be part of the Bank „group‟ bringing together macro-prudential and micro-prudential regulation under the auspices of a single institution. It is also the case that this results in a significant concentration of power and responsibility and that the new architecture therefore needs to be underpinned by effective governance arrangements including suitable checks and balances.

A key check and balance within the system will be the PRA having full operational independence in relation to prudential regulation. This is established by the PRA being legally responsible for the exercise of its statutory functions and its accountability to Ministers, Parliament and the wider public for the way it does so.

It is also intended that the PRA"s operational independence be underpinned by the PRA having a strong, independent board with a majority of non-executives. It is further proposed that the legislation provides that the board should have a non-executive majority and that non-executive directors should be independent and free from material conflicts of interest, as defined under the principles of good corporate governance within the UK Corporate Governance Code – where viewed as relevant.

A change of position since the previous consultation is the suggestion that the PRA be given flexibility to establish appropriate decision-making structures, with the involvement of non-executives as appropriate in line with the principles of good corporate governance, as opposed to the earlier intention that significant regulatory decisions on specific firms be taken by an executive committee or a committee in which executive members were in a majority. This is a potentially significant change – depending upon how the PRA exercises its discretion – and is to be welcomed.

The need for a full complement of checks and balances leads in turn to:

- Further grounds for putting in place an appropriate appeals mechanism not reliance on judicial review; and
- A need for appropriate consultative and accountability mechanisms, upon which we comment next.

We can see the logic of the PRA not needing to establish a non-executive committee since many of the functions that such a committee would usually have carried out will be fulfilled by the Court of the Bank of England. We also support the proposal that appointments to the board of the PRA be made by the Bank with the approval of the Treasury in accordance with the Code of Practice for Ministerial Appointments to Public Bodies, though do not understand why this need be qualified “as far as possible”. The arrangements for dismissal, on the grounds of incapacity, serious misconduct or material conflict of interests also look appropriate.

While we fully appreciate that the intention is to break with the Tripartite arrangement and that the intention is for the Bank to have prime responsibility for financial stability within the financial system, this brings a concentration of duty which places a heavy a burden on a few individuals which may bring concurrent risks for sound policy-making. It may also give rise to a conflict of interest where responsibilities overlap and this requires further attention. This would include the Governor"s chairmanship of the PRA in instances where the issue in hand concerned the PRA determining how to act upon a recommendation from the FPC within the PRA"s statutory framework, and the PRA making an assessment of whether to trigger the SRR (as opposed to the Bank"s determination of which of the resolution tools to use).

The Government"s response to the Treasury Committee"s report on the financial regulation proposals acknowledges that it is right that the final decision to put a failing firm into the SRR should rest with the PRA executive (rather than the Bank) and asserts that the PRA will be operationally independent in its decision. Triggering the SRR should be a regulatory decision, based on the regulator"s judgement, and the PRA can be held accountable for its decision. Yet by the same token key PRA decisions involving major firms or other high risk issues will be taken by an executive committee of the board, including the Chairman – the Governor – and two Deputy Governors. In these circumstances it is difficult to see how the PRA can maintain its operational independence. Further thought needs to be given to this

and one solution may be for an MoU between the Bank and the PRA on the conduct of resolution discussions.

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

We welcome the retention of the power in section 12 of FSMA for the Treasury to commission independent reviews of the efficiency and effectiveness with which the PRA has used its resources, the confirmation that the PRA will be subject to full audit by the NAO and accountable to the Public Accounts Committee and the retention of a power equivalent to the FSMA section 14 power enabling the Treasury to order inquiries by an independent third party into any regulatory failure by the PRA and FCA.

We also support the Government creating a new requirement for the regulator to make a report to the Treasury, and for this to be laid before Parliament, where there is regulatory failure, addressing the regulator‟s action and decision making and considering what lessons can be learned by firms and regulators. We note that the legislation will define a trigger for when a report must be produced – which we look forward to seeing – and that the Treasury will also have a power to direct the regulator to produce a report when that would be in the public interest. Such reports need to be subject to usual standards of supervisory confidentiality.

We note the intention that the PRA should have an internal complaints procedure for regulated firms and others who believe that they may have been subject to maladministration or incompetence, including the inappropriate treatment of sensitive information and the authorisation process proving unacceptably protracted. As explained above, though, this does not fully meet the need for an appeals process against regulatory decisions.

We also note that the PRA will be fully subject to the FOIA and underline the importance of ensuring that the safeguards are sufficiently robust. These arrangements have worked under FSMA.

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

The BBA was one of the many organisations surprised by the suggestion in the July 2010 consultation paper that the PRA should not necessarily abide by the usual standards expected for consultation, impact assessment and better regulation. We are therefore pleased to see that the Government has had a re-think on this, but remain in a position of needing to understand what precisely is meant by there being "no significant reductions to the existing requirements to consult" and the circumstances in which it would be deemed appropriate for the PRA to determine that publicly consulting on rule changes "would be prejudicial to its interests".

We agree that it is unrealistic to produce quantitative cost-benefit analyses in circumstances where it is not possible to monetize or quantify costs and benefits in a meaningful way. This however is not a reason for saying that they should never be produced or for misleading Parliament and the public by saying that there are no costs involved in particular proposals as opposed to the authorities not being in a position to quantify them with any accuracy. It will therefore be interesting to see how it will be proposed that proportionality be applied in determining the way in which CBAs should be produced.

We have no difficulty with a streamlined consultation process for the implementation of EU rules where these have already been subject to consultation, including due MFA and CBA analyses. Indeed, we would welcome this and would suggest that subsequent consultation

should focus principally on incremental differences in the way in which the UK applies EU rules, although we are of a firm view gold plating should be avoided. There will however still be a need for appropriate due process where EU rules need transposition into UK legislation.

We welcome the acknowledgement that it will be essential for the PRA to engage practitioners if it is to regulate effectively and to engage with trade bodies and industry representatives where they have appropriate expertise. We are concerned however with the vague nature of the way in which this is described in paragraph 3.69 and do not see the link between the PRA moving towards a more judgement-based approach and it requiring flexibility in deciding what kind of consultation arrangements it wants to establish.

We can see the reasons why the Government would conclude that the PRA need not have a consumer panel but see the case for the remit of the FCA practitioner panel being expanded to included common shared services with the PRA. This arguably would provide a means of strengthening the cooperation and coordination between the two authorities.

We support the PRA being given a legal duty to run an annual consultation process on its annual report and the extent to which it has achieved its objectives, but would wish to see this undertaken as part of an integrated process with the FCA.

Financial Conduct Authority

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

We are supportive of the FCA having as its core purpose protecting and enhancing the confidence of all consumers of financial services and can see why the Government would wish to put appropriate consumer outcomes at the centre of the regulatory process. We shared the concern of others over the characterisation of the FCA as a „consumer champion", and welcome the clarification that:

- The Government recognises that, as impartial regulator, the role of the FCA should not be confused with that of consumer advocate organisations;
- The FCA"s regulatory focus on achieving better consumer outcomes should recognise not only the limitations of regulation, but also the potentially negative effects of excessive regulation on market efficiency and consumer choice; and
- The concept of consumer responsibility for their own choices will also be important.

We also welcome the recognition of the need for the FCA to contain a strong markets regulation function and, consistent with this, the transfer of the relevant specialist functions within the FSA to the FCA and the intention that the FCA plays a key role in maintaining the UK"s standing and influence through its seat on ESMA. The FCA needs to ensure that the markets division has an operational separateness and capability commensurate with its regulation of some of the largest and deepest capital markets in the world.

We therefore support the FCA having a strategic objective to protect and enhance confidence in the UK financial system and this being complemented by the operational objectives identified. We are also supportive of the Government elaborating on the FCA"s objectives to ensure that the FCA must, wherever appropriate, exercise its general functions in a manner intended to promote competition.

Also supported is the intention that the PRA and FCA be given a consistent set of regulatory principles to which they both must have regard in exercising their general functions. In terms of the FCA these principles mean:

- Efficiency requiring the regulator to use its resources in the most efficient and economic way, to be reinforced by NAO audit;
- Proportionality requiring the burden or restriction imposed on a person or activity being proportionate to the benefits expected to result.
- Informed and capable consumers being responsible for their decisions, within an environment of adequate consumer protection, an outcomes-based approach to regulation and financial education.
- Senior management of firms being responsible for securing compliance with the regulatory framework;
- The use of „openness and disclosure" about supervisory or regulatory decisions as a means of delivering market discipline and best practice; and
- The regulator conducting its business as transparently as possible so that appropriate information is provided in respect of supervisory decisions and the regulator is more open and accessible to the regulated community and the general public.

We would argue that principle 5 – "*the desirability in appropriate cases of each regulator making information relating to authorised persons or recognised investment exchanges available to the public, or requiring authorised persons to publish information, as a means of contributing to the advancement by each regulator of its strategic and operational objectives"* – should acknowledge explicitly the balance between public policy and private rights given that publication without due consideration of the implications could have a detrimental impact on the firm(s), industry and consumer(s).

As explained above, we believe that the Government should reassess its decision not to include recognition of the importance of international competitiveness and innovation. We also believe that a clear statement should be given in respect of some of the other considerations identified as having some relevance, including financial inclusion and diversity. We reiterate that recital 9aa of the regulations applicable to each of the European Supervisory Authorities provides in each case that the authority should take due account of the impact of its activities on competition and innovation, global competitiveness, financial inclusion and the strategy for jobs and growth. If the UK regulators are not required to consider the impact there is a risk of UK gold plating and regulatory arbitrage compared to other jurisdictions.

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

We support the FCA being governed by a Board with a majority of non-executives and that these should be appointed by the Treasury. We also agree that future appointments to the post of Chief Executive should be made by the Treasury and would further recommend that these appointments be subject to Parliamentary confirmation on the part of the Treasury Committee.

We also support the statutory provision for the FCA to have Practitioner, Smaller Business Practitioner, Market and Consumer Panels, but can see benefit in the scope of the Practitioner Panel being extended to include common shared services between the PRA and FCA. This would provide a mechanism by which the Practitioner Panel could provide input on whether the statutory objective for cooperation was being met.

We also agree that the FCA will need a complaints procedure, but do not believe these arrangements should be in a more limited form than currently exists.

We note that the FCA will be fully subject to the FOIA and underline the importance of ensuring that the safeguards are sufficiently robust.

We agree with the new requirement that the FCA be required to report to the Treasury where there is a regulatory failure and for the legislation to stipulate a trigger for when a report must be produced. We note that the regulator will be responsible for determining when the trigger has been met and, in view of the difficulty in defining objectively a trigger based on a failure of conduct regulation, that the Treasury will have a backstop power to be able to direct the FCA to produce a report where it considers that the regulator should have produced a report or otherwise views the production of a report as being in the public interest. Such reports will be laid before Parliament. We support this subject to their being subject to usual standards of regulatory confidentiality.

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

The intention is that the FCA has a lower risk appetite for issues affecting the whole sector, sub-sector and type of product. It will be less prepared to see detriment occur and will therefore be more inclined to intervene in a more proactive manner with greater scrutiny of firms" product design and product governance complementing the traditional focus on sales and marketing and the disclosure of information. The approach will imply a greater use of judgement but will not mean that the FCA will pursue a zero-failure regime since this would be to the detriment of the market that the FCA is seeking to regulate.

Key elements of the new product intervention powers will be:

- The FCA to have statutory powers to make temporary product intervention rules for a period of up to 12 months with immediate effect where it considers it expedient to meet its operational objectives.
- A statutory requirement for the FCA to publish and consult on a set of principles governing the circumstances under which it will use its new product intervention power.
- The FCA to have a statutory power to make provision on the unenforceability of contracts made in breach of its product intervention rules, temporary or permanent.

It is important that the combined impact of the Government"s proposals and the FSA"s evolving supervisory philosophy, as embodied by the product intervention tools, is properly considered.

The FSA's intensive supervision already covers an element of product regulation and therefore it would be prudent to establish whether there is a need for anything over and above this. Key concerns relate to the effect of product regulation on product innovation and market competition, limiting the range of products available to consumers, and the ability of the FCA to keep up with market developments.

We acknowledge the FSA"s view that more regulatory intervention could prevent future mis-selling practices and reduce the need for retrospective regulatory action and the significant costs that this carries for industry, FSA, FOS, FSCS and ultimately consumers. However, it is important to ensure that an appropriate balance is struck between maintaining competition and promoting consumer protection.

It is important that the conduct risk strategy complements current consumer initiatives across the EU to ensure a coordinated approach to conduct risk. In particular, this issue is under discussion in the MiFID review and we believe there would be a risk of incompatible EU and UK legislation should the outcome of the MiFID review be pre-judged in national legislation. There are a number of initiatives already underway in the retail space, e.g. self-regulatory price transparency from the EU, basic bank account access, etc. which we do not believe have been sufficiently considered in the FSA"s Discussion Paper. We believe there should be transparency and clarity around the FCA"s expectations and use of product intervention powers to provide firms with certainty in the development of new products.

We consider that some market failures could have been mitigated by more prompt action on the part of the FSA. For example, there are concerns across the industry regarding the speed of the FSA‟s response to the Keydata case, given the resulting consumer detriment and the related FSCS action which led to significant levies falling on to industry.

We believe that consideration should be given to placing a more formal obligation on the FCA to act quickly in response to whistle blowing reports from industry which point to future conduct failures. Such a mechanism could be integrated with the FSA‟s enhanced horizontal risk scanning methodology. This would be consistent with the FSA‟s more proactive supervisory approach.

We encourage the authorities to take the opportunity of the current Government led regulatory reforms and the establishment of new FSCS governance arrangements, including dual reporting to the FCA and PRA, to incorporate more proactive whistle blowing arrangements as described above.

Question 14 – The Government would welcome specific comments on:

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

It is intended that greater regulatory transparency and disclosure should be used a regulatory tool and that the FCA should have statutory powers to:

- Direct a firm to withdraw or amend misleading financial promotions with immediate effect and to publish the fact that it has done so; and
- Make public the fact that a warning notice has been issued together with a summary of the notice including the grounds on which the action is being taken – a power to apply to the PRA also.

We are concerned about the potential loss of market confidence that could follow the early publication of a warning notice and the damage that may be caused even if the action is discontinued. We would therefore question the appropriateness of the policy and ask whether a better course would be to speed up enforcement action in order to remove the need to publish warning notices on a pre-emptive basis that may subsequently be withdrawn.

Failing this, we see a case for the early publication of enforcement action to be contemplated in exceptional circumstances only where it is clear that customer detriment would otherwise be the consequence. We would also underline, given the potential threat to the reputation of firms and individuals before they have the opportunity to make their case that any such powers must come with detailed and appropriate safeguards.

Given the potential consequences for financial stability, a process is also needed to ensure that the early publication of a warning notice does not circumvent the PRA‟s right of veto.

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

We are unsure of the need for additional powers on the part of the FCA given the substantial overhaul of the competition framework that is taking place and would limit our observation to suggesting that the Government should perhaps reconsider, in light of European practice, whether a dual tier for competition regulation and enforcement is necessary. Failing this, it

should ensure that any powers deemed necessary at the FCA level fit harmoniously with those of the new Competition and Markets Authority.

Question 16 – The Government would welcome specific comments on:

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

As the consultation paper acknowledges, the decision to retain the Part XVIII regime for RIEs is dependent upon the outcome of the European Commission"s review of MiFID. We support the proposals for listing and primary markets regulation.

Regulatory processes and coordination

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

We are supportive of the proposal that there should be a „positive and precisely specified" legal duty on the PRA and FCA to coordinate their activities and agree that the three identified strands to this – material impact on the achievement of the objective of each, taking advantage of the expertise of each, and the coordination or combination of supervisory activities – provide a suitable basis for expressing their legal duty to coordinate their activity; also for the legislation to set out a non-exhaustive list of matters that must be included in the MoU between the two authorities. We also agree with the proposed CEO cross membership on boards.

We are concerned however that the MoU may prove insufficiently ambitious in terms of the means by which they seek to avoid unnecessary regulatory burden in accordance with regulatory principles. We therefore believe that the Government should set the authorities the task of establishing common shared services on an optimum basis that would ensure that dual authorised firms face a common gateway for firms" authorisations, approvals, variations, waivers, notifications and so on and that this single approach should manifest itself in:

- An integrated regulatory reporting system ensuring full consistency in the data demands of each of the authorities.
- A single regulatory handbook with the PRA and FCA assuming lead responsibility for relevant parts.
- A single authorised persons application process, even if in some cases authorisation was dependent upon the satisfaction of the PRA and FCA for differing aspects of responsibility.
- Common back office functions, spanning finance, IT and personnel.
- A single point of contact for the host regulators of international active firms domiciled in London. This would help to ensure that host regulators are easily able to engage with UK regulators and we believe should most appropriately reside in the PRA.

We would therefore seek clarity on how the Government envisages regulatory returns will be split between the two authorities. Gearing up to meet new regulatory reporting requirements requires considerable effort and time on the part of firms and regulators to meet operational and technical criteria. We would note the recent case where the FSA"s systems were not ready to meet the new Approved Persons reporting requirements it had laid down. This highlights that relatively straightforward system and reporting changes still require significant resource and time outlay and we would urge the Government to consider the greater complexity, time and potential issues which could arise from managing two sets of regulatory returns.

There should also be an optimal level of coordination in respect of Arrow visits and appropriate coordination to ensure a minimal level of consistency in regulatory decisions and full awareness of relevant discussions held with the other regulator, possibly within a formalised „relationship" arrangement in which PRA and FCA officials dealing with a particular firm would have full access to correspondence, data and file records.

There needs to be complete clarity around all the authorities" regulatory powers and processes and we would urge the Government to give the industry an opportunity to comment on the MOUs. Service level standards for the PRA and FCA should be determined and published in order to provide a measurable indicator of efficacy. We would expect, for example, that the timescales to which the FSA is today bound in completing regulatory processes must also be adhered to by both the PRA and FCA whether a firm is dual regulated or FCA-only regulated.

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

Given the overriding public interest in the objectives for financial stability in the banking reform programme being pursued overall we see the necessity for a veto on the part of the PRA in the event of the FCA potentially taking actions that would be likely to lead to the disorderly failure of a firm or wider financial instability. We agree, however, that this should be a limited power and that the veto should be notified to Parliament and reported upon in the PRA"s annual report subject to appropriate considerations of financial stability and confidentiality. We do not see this as being inconsistent with the objectives of the FCA.

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

Authorisation is already a highly complex process and institutions entering the market can find themselves in an extended dialogue with the regulatory authorities in order to pass the various hurdles before they can trade. We therefore see it as imperative that the new arrangements do not complicate this process even further. Of the two alternatives given, we would favour the alternative approach outlined in paragraph 5.39, but only if the Government accepts that all entities within a dual regulated group should be subject to PRA regulation..

Our absolute preference, however, would be for a fully integrated approach provided through a single gateway on a shared services basis.

In addition, although not mentioned in the consultation, we assume that it is the intention that all existing approvals and permissions will be grandfathered. This will be critical to ensure a smooth transition.

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

We have no difficulty with the Own Initiative Variation of Permission (OIVoP) or the Voluntary Variation of Permission (VVoP) procedures being replicated in the new structure and would agree with the PRA having a veto over the FCA"s actions in this area for a dual regulated firm. For dual regulated firms, we believe the PRA and the FCA must have a statutory duty to consult with each other and reach agreement before exercising OIVoP powers. In regard to the VVoP, for dual regulated firms we believe that for efficiency purposes the process should be aligned to application for Part IV permission (see our answer to Q19) i.e. that the firm would make its request to vary its permissions via one authority which would coordinate with the other as set out under the alternative approach. In our response to the July 2010 consultation paper we objected to the undefined proposals

for these powers to be extended and would be grateful for confirmation that this is no longer the intention.

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

We have strong reservations about the proposals set out regarding the approved persons regime and are not convinced that the proposed approach would work in practice given that many of the controlled functions span both prudential and conduct matters.

While a division of lead responsibility for controlled functions between the PRA and FCA in the case of dual regulated forms would seem inevitable, we see the application of the approved persons regime as a prime example of where the two authorities should fully integrate their processes. It is not entirely clear from the consultation paper that this is the intention. A shared back office function could process the applications and reach out to both the PRA and FCA for their approval where the controlled function spanned the remit of both authorities. Notwithstanding this suggestion, we would propose that processing approved persons applications is subject to an alternative approach, as explained in response to question 19, so that there is one entry point for firms for consistency and efficiency.

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

We agree that the FCA, as conduct of business regulator, should receive all notifications from overseas regulatory authorities concerning services passported into the UK through branches; also that the relevant prudential authority should be responsible for issues relating to financial soundness in respect of UK-authorised firms passporting financial services out of the UK through a branch, with the caveat that the FCA is responsible for all conduct issues where relevant. The PRA, however, should lead in respect of firms passporting out of the UK. A shared back office function would meet all needs.

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

We agree that neither regulatory authority should promote or favour one ownership model over another and that the same consumer protection, conduct and prudential standards should be applied to every regulated firm irrespective of its ownership model. We can see that as part of this the PRA and FCA should consider whether their proposals impact upon mutually-owned institutions differently. But we would suggest that the concept be broadened so as to require an analysis of whether proposed measures may disproportionately impact upon smaller firms and others with different ownership models.

We see no reason why the Government should not proceed with the other proposed amendments to legislation affecting building societies.

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

On rule-making:

- We are concerned that the rule-making process outlined has the potential to cause confusion and uncertainty for dual-regulated firms, as it states both the PRA and FCA may make rules applying to the same function e.g. systems and controls. In addition, as both the PRA and FCA will regulate firms from a prudential standpoint, it remains unclear whether a single set of prudential regulations will be developed, which would be our preference. We at least would urge the Government to mandate that all

investment firms within the same group should be subject to one prudential rulebook and one prudential regulator.

- We believe an efficient coordination mechanism around rule-making is required to avoid under and overlap and conflicting rules. We would suggest a single handbook prepared by a common shared services division, with common definitions, joint (PRA and FCA) rules and guidance in relation to the overarching high-level regulatory standards such as SYSC and common regulatory processes (c.f. the FSA‟s Supervision manual). These joint rules and common definitions should overarch both the PRA and the FCA.

On rule-waivers:

- We agree it is appropriate for both the PRA and the FCA to have such powers in relation to their own rules. In relation to dual regulated firms, it should be mandated that the authorities must first consult with each other before approving such rule waivers.

Question 25 – The Government would welcome specific comments on:

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

Further information is needed before we could comment on the appropriateness of the proposed arrangements. In the interests of efficient and co-ordinated supervision, all the investment firms within a group should be prudentially supervised by the same regulatory authority. It is not clear from the consultation that this will necessarily be the case.

As mentioned in connection with crisis management, in determining the scope of the regulatory authorities we also need to ensure that non-banking businesses should not be effectively subordinated to the interests of the banking part of the group.

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

The proposals look appropriate in view of the respective responsibilities of the PRA and FCA.

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

We can see the reasons for either authority being able to bring insolvency proceedings and support the provision that the prior consent of the Bank be required (and for the PRA to be given the opportunity to exercise its veto in the case of proposed action by the FCA).

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

We are supportive of the PRA levying its own fee and the FCA being responsible for its fee and that of the CFEB and FOS and support the proposal that the FCA collect all fees. We are disappointed, however, that the consultation paper has not pursued the earlier suggestion that the raising of fees and levies should be brought into a single, coordinated budgetary exercise and that the PRA and FCA should first coordinate their consultation on

fees and levies and second that the NAO should assess the cost of regulation in a single, coordinated exercise.

Compensation, dispute resolution and financial education

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

We remain concerned that the accountability mechanisms for the FSCS have not kept pace with its current use and expanded role under the SRR. While we support the expanded role, and would wish to see it replicated under the developing European framework, we see a need for the Government to put in place arrangements for an enhanced creditors‟ committee so that contributing institutions have a mechanism for ensuring appropriate representation in relation to the estate of a failed credit institution.

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

We agree that the FOS should remain an operationally alternative dispute resolution service but believe that its role should focus entirely on dispute resolution and not cross over into making policy on conduct of business issues. This should be the sole domain of the FCA and at the very least we would wish to see this set out in the planned MoU.

But we would go so far as to say that we see the limited reappraisal of the position of the FOS as a missed opportunity and would urge the Government to consider whether it should adopt a more radical approach to the operations of the ombudsman service as part of the restructuring of the regulatory authorities. We see grounds for:

- The statutory remit of the FOS focusing entirely upon its role as an alternative dispute resolution service.
- The FCA being given statutory responsibility for consideration of wider implications arising from the FOS‟s case work.
- A review of whether an appeals mechanism is necessary.
- The Ministry of Justice pressing ahead with its review of the role of claims management companies and their access to the ombudsman service.

We are unclear about what is meant by the FOS being “able to publish its determinations in a proactive and coordinated way” and would welcome further discussion on this including whether any such action will be subject to PRA veto.

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

We agree that the FSCS and FOS should be placed under a statutory obligation to publish annual plans and that they should consult on these; also that the FSCS, FOS and the CFEB should be audited by the NAO.

We also support the Government‟s proposal that that the FSCS has dual lines of accountability to both the PRA and FCA given the locus of the compensation scheme.

European and international issues

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

We welcome the renewed emphasis that the Government has placed on international engagement and the confirmation that this will remain an on-going priority, with the new regulatory authority‟s to put the time and effort into ensuring that the UK‟s voice is heard at the European level and that the decisions taken are appropriate. We cannot stress too strongly the imperative that the industry places on the UK engaging actively so as to ensure that these bodies both deliver the right outcomes on their agreed work programmes. This is critical given the binding nature of the technical standards to be developed by the ESAs. It is also the means by which we can ensure that they remain focused on the activities for which they have been given authority.

We therefore support the concept of a statutory MoU between the Treasury, the Bank, the PRA and the FCA on overall international coordination within the UK‟s system for financial regulation and agree that the legislation should set out a non-exhaustive list of the key areas that the MoU should cover. This should map out the arrangements for representing the UK interest across the full range of European and international organisations and networks. As a matter of practical expediency, consideration should also be given to maintaining a single international secretariat across the relevant authorities as a common shared service and the establishment of cross-authority teams to ensure that international representatives are in a position to draw upon all relevant expertise and knowledge.

Industry also has a wealth of practical experience and can contribute to the forging of allegiances across member states. The same is true in respect of the UK‟s representation on international bodies such as the Financial Stability Board, the Basel Committee and the International Organization of Securities Commissions.

For further information on this submission please contact Paul Chisnall, Executive Director, British Bankers‟ Association: paul.chisnall@bba.org.uk

British Bankers' Association
14h April 2011

Appendix 1: Examples of macro-prudential tools utilised in other jurisdictions

Hong Kong

The macro-prudential measures in Hong Kong mainly target the housing market:

1. Hong Kong Monetary Authority issued a circular on 23 October 2009 to banks to provide guidance to cap the loan-to-value ratio at 60 per cent for properties valued at above HKD20mn;
2. On the same day, the Hong Kong Mortgage Corporation announced that the maximum loan size eligible for the Mortgage Insurance Programme would be lowered. In addition, non owner-occupied properties have been suspended from coverage under the programme;
3. On 3 March 2010, HKMA instructed lenders to set their mortgage rates 0.7ppt above the one-month HIBOR rate to prevent interest price competition from eroding banks‟ profit margins and potentially the stability of the financial system; and
4. In the FY2011 budget, Financial Secretary John Tsang acknowledged that the “increased risk of a bubble forming” had “aroused public concern about the difficulty of buying a home”. In response, the government proposed four measures:

    a. Increase housing supply, especially of small- and medium-sized residential flats, by fine-tuning the land auction mechanism and reviving the secondary market for Home Ownership Scheme (HOS) flats;
    b. Increase transaction costs for luxury property speculation by increasing stamp duty;
    c. Improve market transparency; and
    d. Prevent excessive growth in mortgage lending.

China

Local government investment vehicles (LGIVs)

In the past 18 months projects and financing have increased in reflection of the central government‟s response to the economic crisis. Now the central government has begun to address outstanding debt and potential repayment problems. First, the Ministry of Finance has proposed draft rules to restrict the ability of LGIVs to credit, and is considering the possibility of allowing localities to issue their own bonds. On the banking regulation side, in early 2010, the CBRC instructed to banks to:

(1) be very careful about lending to new LGIV projects;
(2) evaluate LGIV projects they have previously lent to in order to ensure they are legal, have adequate capital funding, and that the money will be repaid; and
(3) clarify exactly which collateral has been provided and which guarantees have been offered by local governments.

The intention is to ensure that banks have evidence of local governments‟ commitments to these loans. For LGIVs with more than two bank loans, the CBRC is encouraging banks to co-ordinate on calculating total exposures and clarifying who has the rights to which collateral.

Property Market

The government is attempting to cool the property market, in response to a surge in prices in large cities. Policies introduced since 2009 include:

(1) To encourage the building of welfare and lower-end-market housing, developers granted a lower minimum capital ratio of 20 per cent for such homes versus the 30 per cent for other types of commercial housing;
(2) In June 2009, Ministry of Housing and Urban-Rural Development (MoHURD) published detailed plans for annual targets for welfare housing over the period before 2011;
(3) In November 2009, the Ministry of Land & Resources and NDRC jointly issued policies on land use (an extension of 2006 regulations), including limits on land to be used for commodity residential developments (< 7 hectares for a small city (town), < 14 hectares for medium-sized, and < 20 hectares (300 acres) for large cities);
(4) 50 per cent down-payment of land premium from government land with the subsequent amount being paid within a year and developers with overdue land premiums being prohibited from participating in land auctions before all overdue payments have been settled;
(5) Tax exemption period for business tax on secondary market transactions restored back to five years from two years, starting from 1 January 2010. All property transactions will be charged with 5.5 per cent business tax on the entire sales proceeds, unless the properties are held for more than five years;
(6) Reiteration of 11 policies from the State Council to increase supply, encourage first-time home purchases but rein in speculative purchases. Local governments released their own 11 policies, with regulations specific to local housing markets, e.g. Beijing, Chongqing, Guangzhou and Hangzhou; and
(7) 40 per cent deposit required for the purchase of second homes.

Money Supply

The Peoples Bank of China (PBoC) targeted CNY7.5trn new credits in 2010, which amounts to a credit growth rate of 18 per cent year on year. To manage the amount of liquidity in the market, PBoC increased the reserve requirement ratio (RRR) twice by 50bps each in January and February.

Taiwan

Property Market

The existing regulation limits mortgage lending to less than 30 per cent of a bank"s deposit base. Although some banks are reported to be nearing this cap, overall mortgage loans to total deposit in the banking system as a whole is about 20 per cent. Meanwhile, the government is considering plans to raise property taxes and increase land supply as a means to rein in property market speculation. To this end, some state-owned banks have lowered their LTV ratio to 70 per cent, especially for clients deemed to speculators, and have lowered the approval limit for managers on mortgage loans.

Money Supply

In CBC"s quarterly policy meeting on 25 March 2010, CBC signaled it will accelerate the withdrawal of funds from the financial system and impose "prudent" measures on property lending to prevent the emergence of asset bubbles.

Korea

Financial system

The Financial Services Commission released a white paper in December 2009 that unveiled plans to adopt loan-to-deposit ratio as one of its bank management guidance ratios. The Financial Supervisory Service amended the regulation on 26 March 2010 to employ banks" liquidity or loan-to-deposit ratio to measure bank management soundness. The target for

banks" loan-to-deposit ratio is to be set at 100 per cent with a grace period until the end of 2013 whereupon banks will be required to maintain a ratio of less than 100 per cent from 1 January 2014. To oversee the progressive lowering of the ratio during the grace period, the FSS will review the ratio retrenchment plans of each respective bank on an annual basis.

To strengthen local financial institutions" FX management, the Financial Services Commission and Financial Supervisory Service proposed the following measures on 19 November 2009 to strengthen its supervision:

(1) Fine-tuning the Regulation on FX Liquidity Ratio;
(2) New Standards for FX Liquidity Risk Management;
(3) Mandatory Minimum Holdings of Safe FX Assets;
(4) New Standards for FX Derivatives Risk Management;
(5) Tightened Regulations to Increase Mid- to long-term Financing in Foreign Loan Portfolios;
(6) Promotion of Reasonable FX Hedge Practices by Asset Management Companies;
(7) Clarification of Rules over Mandatory Reporting of Foreign Exchange Transactions; and
(8) Review the Foreign Asset Limit (leverage ratio) by the Basel Committee on Banking Supervision.

In the 2010 Financial Policy Agenda, the Financial Services Commission, the Fair Trade Commission and the Ministry of Strategy and Finance set out the policy objectives for 2010 with the following proposal to enhance the soundness of financial system:

(1) Improve the coverage of deposit insurance through the Korea Deposit Insurance Corporation on newly introduced financial instruments;
(2) Revitalise the RP market by improving on the RP trading infrastructure and easing RP regulations for asset management companies to resolve the issue of excessively active Call trading; and
(3) Reform the CP market by adopting an electronically traded short-term borrowing market under the Short-term Borrowing Act.

Philippines

Monetary policy

Bangko Sentral ng Pilipinas (BSP) began its exit strategy from extraordinary support measures introduced in late 2008. The unwinding included in the 28 January policy meeting, BSP increased the Peso rediscount rate by 50bps to restore it to the same level as the overnight Reverse Repo Rate, as the need for rediscounted loans was reducing as stability returned to the financial system. In the 11 March policy meeting, BSP reduced the Peso rediscounting budget from PHP60bn to PHP40bn (still PHP20bn higher than the pre-crisis level). Meanwhile, BSP restored the loan value of all eligible rediscounting papers from 90 per cent to 80 per cent of the borrowing bank"s credit instruments, and reintroduced the non-performing loan ratio requirement of 2 percentage points (from 10 percentage points) above the latest available industry average NPL for banks wishing to access the rediscounting facility.

India

Macro-prudential regulation by the Reserve Bank of India (RBI) has been facilitated by RBI"s framework of multiple objectives, multiple targets and multiple instruments. Other than looking at standard inflation measures, RBI is mandated to monitor aggregate credit growth, sectoral credit growth and the incremental credit-deposit ratios of banks. These variables provide the backbone for macro-prudential regulatory framework in India.

Although there have been no explicit asset price targets, RBI has always considered asset price inflation and taken appropriate steps to curb it. Lack of proper asset price measures (house prices) have been one of the big challenges but RBI has still used the twin tools of adjusting risk weights and altering provisioning norms on lending to particular sectors to moderate credit flows to sectors which showed signs of overheating. This sector specific approach has ensured that the flow of credit to productive sectors has remained unaffected as excessive credit growth has been limited to a few sectors.

Although there is no formal dynamic provisioning regime, RBI lowered provisioning norms in the wake of the crisis to improve profitability of the banks and restore confidence. Furthermore, the mandatory requirement of lending a certain proportion of assets (40 per cent) to the priority sector (agriculture and agriculture related, SMEs etc) has also ensured that leverage to other sectors has not grown in a disproportionate fashion.

Banks" exposure to equity markets has been capped at 5 per cent and deposit taking non-banking financial companies have also been regulated by RBI with respect to their exposures, capital and liquidity. The RBI is considering whether to extend this to non-deposit taking, non-banking financial companies also. In this context, the RBI has identified a small number of financial conglomerates (based primarily on size) which are perceived to be systemically important. Their intra-group transactions and exposures and exposures to other counterparties are monitored by all regulators but no 'systemic capital surcharge' has been introduced.

To counter liquidity risks, the RBI has put in place prudential limits on banks on their purchased inter-bank liabilities as a proportion of their net worth to encourage greater reliance on stable sources of funding. The mandatory requirement of 25 per cent of liabilities being held in government securities is regarded as a solvency and liquidity buffer. The excess securities, over the 25 per cent limit, have moved in a counter-cyclical fashion to reflect risk appetite and liquidity perception.

Opening up of the capital account has been done in a gradual fashion. While equity inflows have been mostly allowed, debt inflows have been prudentially capped through both quantity and price based measures. Outflows on the capital account are still quite highly regulated. This was one of the reasons why Indian banks exposure to global toxic assets were extremely limit

Singapore

The Monetary Authority of Singapore (MAS) has set limits on banks exposures to single counterparties, the types of exposures to be included in or excluded from those limits, the basis for computation of exposures, the approach for aggregating exposures to counterparties that pose a single risk to the bank, the recognition of credit risk mitigation and aggregating of exposures at the bank group level (25 per cent or such other percentage of the eligible total capital of the bank group as may be approved by the Authority).

Initially, the MAS intended to set the limit on banks' property exposure at 35 per cent of its total loans and debt instruments. The government announced the immediate withdrawal of the Deferred Payment Scheme (DPS) for property purchases in view of the strong economic and property market conditions.

Malaysia

The Bank Negara Malaysia (BNM) has set limits on exposures to a single counterparty group. The BNM also imposes a limit on property lending by banks at 20 per cent of its total loans and debt instruments.

The Malaysian currency MYR has not operated outside the international system since September 1998, because of the 1997 Asian financial crisis in which the central bank imposed capital controls on the currency. As a part of a series of capital controls, the currency was pegged between September 1998 and 21 July 2005 at USD/MYR 3.80. In recent years, the BNM started to relax certain rules to the capital controls, although the currency itself is still not traded internationally/off-shore yet.

Thailand

In addition to the supervision under Basel I, commercial banks in Thailand are also subjected to "Single Lending Limit". Namely, banks are not permitted to have exposes (lending and derivative exposure) to a company (including its subsidiaries) of greater than 25 per cent of the bank's capital.

For mortgages, commercial banks are permitted to provide only prime loans (or standard loans). That said there are no sub-primed loans (or sub-standard loans) in Thailand.

Canada

Canada has tight limits on the overall leverage of banks. The leverage ratio limits total assets/Tier 1 + Tier 2 capital to 20 times. In addition, the Canadian government largely requires mortgages with loan to value ratios above 75 per cent to have a guarantee. These guarantees are provided (for a fee) by the government-owned Canada Mortgage and Housing Corporation (CMHC) or by a number of private insurers, though these themselves are guaranteed by the CMHC. The CMHC therefore effectively underwrites the housing system. Were there to be a crash in house prices it would be the government taking the losses. The CMHC effectively controls lending terms, maximum LTV etc.

4 April 2011

HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Dear Sirs

BIBA's response to HM Treasury consultation *A new approach to regulation – building a stronger system*

The British Insurance Brokers' Association (BIBA) is the UK's leading general insurance organisation representing the interests of insurance brokers, intermediaries and their customers.

BIBA membership includes 1,700 regulated firms. BIBA brokers handle around half the value of all UK home, contents, motor, travel, commercial and industrial insurance policies. Insurance brokers make a direct and indirect contribution of 1% to UK GDP.

The UK insurance industry employs more than 275,000 people, generates more than £1.5 billion of insurance premium tax and £2 billion of corporation tax.

Brokers provide professional advice to businesses and individuals, playing a key role in the identification, measurement, management, control and transfer of risk. They negotiate appropriate insurance protection tailored to individual needs.

BIBA is the voice of the industry advising members, the regulators, consumer bodies and other stakeholders on key insurance issues. BIBA provides unique schemes and facilities, technical advice, guidance on regulation and business support and is helping to raise, and maintain, industry standards.

Executive summary

BIBA is a supporter of proportionate, appropriate and cost-effective regulation. We welcome the open approach taken by Government to the consultation process and we trust this will continue as plans for the new architecture take stronger shape.

BIBA welcomes the decision to regulate insurance brokers in a single authority and support the decision to change the name to the Financial Conduct Authority as we believe this better reflects the strategic aims of the new authority.

We do however have some serious concerns about the proposed supervisory approach, as detailed in the table between paragraphs 4.48 and 4.49 and are disappointed that a question was not posed in the paper asking for comments.

You may recall that in response to the previous consultation paper, we stated that the FSA's approach to the regulation and supervision of insurance brokers was inappropriate, disproportionate and overly costly. In the subsequent meeting we had with the Bill team, we are asked to better articulate what a more appropriate and proportionate approach could look like.

On 21 March 2011 we published research which we have attached to our email submission of this response, in response to the request for better articulation. To summarise the research:

- Insurance brokers play a crucial role in the general insurance market This independent research has established that UK insurance broking sector makes a direct and indirect contribution to GDP of 1%, putting us on a par with the agriculture sector.

- The research considers in detail the intermediary sector and the risks that we pose to the regulator's objectives. The research has found just two areas where there is a significant risk of market failure. The first concerns the potential for low quality advice resulting in mis-selling of products, and The second is the potential for loss of client money.

- The research demonstrates that the FSA approach to the supervision of our sector has not been based around the identification of regulatory risk. Instead the FSA has been too quick to identify issues in other unrelated sectors and then pursue these issues in our sector. Issues like Adequate Resources where the supervisory approach has been lifted from the banking arena and dropped onto our larger firms without due regard to the nature of the risks we represent. The result has been an increasingly intrusive approach to supervision, based on supervisory gut feel rather than on prescribed rules and the necessary consultation that any such change needs to be based upon.

- The research clearly demonstrates the significant impact that indirect costs are having on the regulatory burden. The research highlights the disproportionate impact of indirect costs for both the very smallest and very largest firms. The research also highlights just how out of line with the rest of Europe the costs are. Not only are the direct costs, in other words the fees and levies the highest by a wide margin, but the indirect costs bear no relation to costs elsewhere in the EU. This cannot be right or acceptable!

- We would like an approach from the new FCA that focuses much more on the limited risks that our research has identified. Our members tell me repeatedly that they want certainty and so a more prescribed approach on areas like capital requirements and adequate resources would seem to be more appropriate. We are an important and valuable sector and this should at least entitle us to a more appropriate and proportionate approach from the regulator and would therefore welcome the opportunity to discuss how this can best be delivered with HM Treasury.

BIBA's response to the consultation questions

BIBA welcomes the opportunity to respond to the consultation paper and our comments are restricted to the questions from chapters 4, 5 and 6.

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

BIBA answer: We believe that the strategic and operational objectives are suitable for the FCA.

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

BIBA answer: BIBA supports the proposed arrangements for governance and accountability. We welcome the adoption of the four panels and the maintaining of the formal consultation process for new rule making. We also welcome the fact that the majority of FCA board members will be non-executives. Finally, we welcome Government's plan to include within the legislation the audit of FCA by the National Audit Office. We expect the legislation to specify the frequency of these audits.

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

BIBA answer: BIBA welcomes the proposal for the FCA to consult on a set of principles governing the circumstances under which it will use these new intervention powers. Our views on product intervention will be determined by this consultation.

14 The Government would welcome specific comments on:

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

BIBA answer: Whilst we are apprehensive about the use of transparency as a regulatory tool, we take some comfort in Government's assurance that the new powers will contain the necessary safeguards to ensure an appropriate balance between the interest of

consumers and regulated firms. We welcome the proposed new power to direct firms to withdraw misleading financial promotions and to then publicise that the fact that it has done so as we believe this is an area that could benefit from such intervention. Finally, we do not agree that early publication of enforcement action of itself is necessary, though the threat of such a publication could achieve the desired outcome. We would welcome further clarity on how the powers might be used in practice, bearing in mind the safeguards listed at paragraph 4.89.

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

BIBA answer: We welcome moves to extend the FCA powers in relation to general competition law but have no particular view on the appropriateness of the suggested solutions. It is important that the chosen solution prevents any reoccurrence of the FSA's disastrous handling of PPI – the super-complaint launched in 2005 should have led to a far quicker and more effective response from the FSA to a problem that continues to get worse to this day.

16 The Government would welcomes specific comments on:
- the proposals for RIEs and Part XVIII of FSMA; and
- the proposals in relation to listing and primary market regulation.

BIBA answer: We have no view.

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

BIBA answer: We believe the mechanisms and processes proposed to support effective coordination between the PRA and the FCA to be appropriate.

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

BIBA answer: We approve of the proposal with the caveat that a firm should not be able to gain competitive advantage in a situation where the PRA vetoes action proposed by the FCA.

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

BIBA answer: Our members will all be regulated by the FCA and so we do not have strong views on the proposed authorization models, other than care must be taken regarding the allocation of costs.

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

BIBA answer: We approve of the proposals on variation and removal of permissions.

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

BIBA answer: We approve of the proposals for the approved persons regime.

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

BIBA answer: We approve of the proposals on passporting. Our members do have concerns about the current passporting system, which allows firms not subject to the same supervisory oversight or rules on capital to passport into the UK. Where this involves insurers, our members are concerned for the potential impact on the Financial Services Compensation Scheme so we would expect close scrutiny to be kept when serious concerns are raised with FCA and PRA in future.

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

BIBA answer: We have no view.

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

BIBA answer: We support the proposals regarding the process and powers proposed for making and waiving rules.

25 The Government would welcome specific comments on

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

BIBA answer: We share the belief that the regulator should have a power of direction over an entity which itself is not regulated. This appears to extend the powers of the regulator far in excess of its statutory limits. We do not believe that the proposed safeguards are adequate to address the wide discretion the FCA would have in deciding what action is desirable for the purposes of fulfilling its statutory objective.

If the proposal is implemented, we believe it is important that consultation is undertaken and then clarity given as to the circumstances under which the powers would be exercised and the extent of such powers.

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

BIBA answer: We have no views.

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

BIBA answer: We support the proposals for the new regulatory authorities' powers and roles in insolvency proceedings.

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

BIBA answer: We support the proposals for the new authorities' powers in respect of fees and levies. However, the fees and levies in respect of insurance brokers are totally disproportionate to the limited risks we pose to the FCA and are way out of line to the rest of the EU (see our attached research). This is a matter that must be given serious consideration in the new approach to financial regulation.

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

BIBA answer: We support the proposed operating model, coordination arrangements and governance for the FSCS. However, we have major concerns regarding the current FSCS funding model.

The insurance intermediary sub-class is the largest sub-class by number of firms it contains and the most diverse sub-class by type of firm it contains. There are approximately 14,000 firms in this sub-class, of which only around 3,500 are 'insurance brokers' i.e. firms for whom insurance broking is their 'core' business. The other firms in the sub-class are either firms with multiple FSA permissions e.g. banks, IFAs and mortgage brokers, or firms with a single permission whose core activity is not insurance e.g. motor dealers, caravan parks, doctors, dentists, vets and credit brokers.

The problem with the current model is this pooling together of the 14,000 intermediaries with permissions to sell insurance. There has been widespread mis-selling of payment

protection insurance (PPI), a product sold primarily by lenders and credit brokers, but by very few 'insurance brokers'.

There are an increasing number of credit brokers who are unable to fund the compensation required following their mis-selling of PPI and folding, leaving the resulting compensation to be picked up by the FSCS. This failure of credit brokers has led to a 50-fold increase in the FSCS budget for compensation from the insurance intermediary sub-class over the last three years. The impact on insurance brokers is devastating – a firm with a £20m commission income paid a £3,000 levy in 2008, £16,000 in 2009, £125,000 in 2010 and in 2011 will be paying £150,000. Firms of all sizes have been exposed to this degree of increasing levy.

BIBA is calling for the FSA to urgently progress its consultation on the fundamental review of the FSCS, to ensure that new rules are in place for April 2012. As part of the fundamental review, BIBA demands that the FSA:

1. Separate the 3,500 full time 'insurance brokers' from the other 'secondary sellers' currently in the insurance intermediary sub-class.
2. Remove the current system of 'cross-subsidies' from the funding model. Nowhere else in Europe are insurance brokers exposed to the possibility of funding compensation in the banking sector.

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

BIBA answer: We welcome the move to consult on the principles that would apply to the publication of FOS determinations. Our members have concerns about the remit of FOS and its current ability to base decisions outside either regulatory or contractual boundaries and believe that this 'scope' should be the subject of separate consultation.

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

BIBA answer: We support the proposal to subject these bodies to audit by the National audit Office and suggest the legislation prescribes a suitable time period.

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

BIBA answer: It is vital that the new regulatory architecture allows for the appropriate engagement with the international authorities

Thank you for taking the time to consider our response. If you have any further queries please contact Steve White, Head of Compliance and Training.

Yours sincerely

Eric Galbraith
Chief Executive

BRITISH RETAIL CONSORTIUM
for successful and responsible retailing

British Retail Consortium submission to HM Treasury consultation "A new approach to financial regulation: building a stronger system"
14 April 2011

The British Retail Consortium (BRC) represents the whole range of retailers including large multiples, department stores and independent shops, selling a wide selection of products through centre of town, out of town, and rural stores, and distance retailers operating both online and via mail order.

Summary

In March 2011 the BRC submitted a comprehensive response to HM Treasury & BIS joint consultation "A new approach to financial regulation". This response is designed to build on and complement the issues raised in that submission, as well as introduce new considerations in response to proposals in this latest consultation.

BRC members will only be subject to regulation by the FCA, and do not expect to fall within the ambit of the PRA. As such, this response does not comment on the issues raised in Chapters 2 and 3 (Bank of England, FPC and PRA). Rather, the BRC response is structured as follows:

1. Overview of significance of credit for BRC members
2. FCA: Flawed by design – building a more proportionate approach to regulation of the unsecured retail credit market
3. Significant concerns: Building in greater accountability; Product intervention; FOS and Claims Management Companies

Second Floor, 21 Dartmouth Street, London, SW1H 9BP T: 020 7854 8900 F: 020 7854 8901 email: info@brc.org.uk www.brc.org.uk

Scottish Retail Consortium, PO Box 13737, Gullane, EH31 2WX T: 0870 609 3631 F: 0870 609 3631

A Company Limited by Guarantee No. 405720 A Registered Company in England

1. Significance of credit for BRC members

To put the views in this response into proper context it may be helpful to briefly explain the different ways in which BRC members are impacted by consumer credit in their business models. These include:

- Lenders – retailers who themselves or through separate companies in their group provide credit to their own customers.
- Credit intermediaries – retailers who have arrangements with a bank or finance house which provides their customers with point of sale retail credit, either through fixed sum loans or running account credit.
- Acceptance of credit cards issued by third parties.

There are a number of variants on the second of these models, including storecards, branded credit cards and instalment credit, offered through a variety of affinity and joint venture relationships between banks/finance houses and retailers.

Some BRC members are currently authorised and regulated by the FSA as insurance intermediaries, as well as being licensed by the OFT. Others are not regulated by the FSA.

The availability of accessible and convenient sources of credit is critical to the retail sector. Its importance lies primarily in the retail demand generated via access to credit, and goes far beyond the income or profit generated by the credit products themselves. Any action which restricts access to or convenience of credit will also impact retail demand, and slow consumer spending. There are therefore direct implications for UK economic growth.

Additionally, widespread availability of convenient and secure payment mechanisms is absolutely critical to the continued development of the e-commerce marketplace, particularly for online and mobile transacting. Credit cards and retail credit accounts provide precisely this mechanism, not least for the inherent benefit of connected lender liability that is provided under sections 75 and 75A of the CCA.

By way of illustration of the importance of consumer credit to the retail sector:

- Credit and charge cards were used to make 2 billion purchases in the UK to a value of £139 billion in 2009.
- Amongst retailers with their own lending operations, such as the home shopping companies, it is not untypical for more than 90% of sales to be made using their own credit facilities, with most of the balance using third party credit cards.

2. FCA: Flawed by design – building a more proportionate approach to regulation of the unsecured retail credit market

BRC members have a major concern that the thought processes driving the design of the FCA are centred on the existing FSA, and the products and markets currently regulated by the FSA. However, if the Government's preferred option for future regulation of consumer credit is adopted, the majority of FSA regulated firms will be consumer credit providers, and it will be regulating a huge and diverse sector which has not been considered when its structure and operating principles are formulated.

In particular, it is a working assumption that the FCA will regulate approximately 27,000 firms. This assumes that the vast majority of existing consumer credit licence holders will not be regulated by the FCA. This therefore assumes that either:

- Regulation of consumer credit will not move to the FCA; or
- The number of consumer credit licence holders will be reduced by circa 80/90%, so that very few firms not currently regulated by the FSA will fall under the FCA. This can only be

achieved by taking most consumer credit licence holders outside the scope of regulation, or by introducing an appointed representative style regime for credit. However, industry responses to the consumer credit reform consultation are universal in their views that lenders will be unwilling to accept regulatory responsibility for brokers and other firms carrying out ancillary credit activities in the kind of intrusive, aggressively regulated regime that the consultation paper envisages, particularly given the onus being placed on personal accountability of management. The risks for firms and for approved persons in accepting accountability for the controls and activities of third parties will simply be too great.

Accordingly, there is a huge risk that the FCA will be designed to regulate a market similar to the existing FSA regulated market, but will actually find itself regulating a much bigger and diverse market. It will therefore not be fit for purpose.

The proposals should be redesigned to reflect as a working assumption the Governments stated preferred option that consumer credit will be within the scope of the FCA's remit. Given that the government has made it clear that this is its preference, making this the working assumption appears the most sensible option, and will not be construed as pre judging the outcome of the consumer credit reform consultation.

The FCA must be designed to allow a proportionate approach to regulation, particularly consumer credit. This must reflect the different risk dynamics of the credit market as opposed to the investment and insurance markets, and particularly the economics and cost efficiencies of the retail credit market, where loan or credit limit values are usually in the hundreds of pounds, not the thousands.

3. Significant concerns: Building in greater accountability; Product intervention; FOS and Claims Management Companies

Accountability

Accountability of the FCA to Parliament must be substantially increased. The actions and policies of the regulator have major economic impacts on the market they regulate, and as the UK retail and consumer economy, and accordingly consumer confidence, is inextricably linked to the retail credit market, it is imperative that regulator has clear and direct accountability to Government. Publication of an annual report is a long way short of adequate to provide this accountability.

Product intervention

The need for accountability is even greater given the potentially far reaching economic impacts of the proposals on product intervention, such as:

- Price or interest rate controls, which would inevitably remove access to regulated credit from certain sections of the community.
- Prescriptive or intrusive "responsible lending" criteria, which would also extend financial exclusion.
- Limiting access to point of sale credit, which would have a major impact on retail sales and the consumer economy.
- Increased regulatory burdens and compliance costs, which will prove unsustainable for many firms (especially smaller firms), reducing the number of providers and weakening competition.
- Regulation of products by hindsight, under the "product intervention" proposals, will create unacceptable degrees of risk for lenders. The response will inevitably be a reduction of innovation in the market place, and a market with fewer players, all offering similar products, with little competition or innovation.

Any actions which restrict access to or availability of retail credit will inevitably have a correlating effect on retail sales, on retailers, and on the UK retail and consumer economy.

FOS and Claims Management Companies

The proposals on product intervention to declare products void, or issue warnings, will have a potentially catastrophic impact on individual businesses and sectors. In particular:

- Any public statement from the FCA that it has concerns about a product, or that a product has, in its opinion been mis-sold or is void, will trigger a feeding frenzy by the claims management companies (CMCs). Given that the CMCs have the threat of referring any claim that isn't settled to FOS, with a £500 fee being automatically triggered, retail credit providers (with typically balances below £500) will be in a helpless position, unable to defend themselves cost effectively.
- The threat of unenforceability may also impact the ability of lenders to obtain funding under securitizations or other funding structures based on the value of the receivables portfolios as security. If a wholesale funder believes there is any risk of systemic unenforceability which overnight will render their security worthless and the receivable portfolio wholly uncollectable, their willingness to provide the funding initially will be called into question. Such action by the FCA in the credit markets could render portfolios valued in the billions valueless overnight. This would have a knock on effect into the wholesale markets, as the wholesale funders themselves are hit by the loss of their wholesale loans.
- Unenforceability of whole portfolios in the credit market will inevitably lead to business collapse and job losses. This will not be investment banker jobs. It will be call centre staff, operations staff and, where retailers are dependent on that credit provider for point of sale credit, retail staff.

These risks are exacerbated by the proposals on early publication of warnings and supposed transparency:

- The initial FCA "warning" will attract a blaze of publicity, and immediately cause immense damage to any business (potentially to the extent of a "run" on the firm).
- The claims management companies will immediately start a TV and media campaign to attract "aggrieved customers".
- The affected firm (which has not had chance to legally argue its position) will incur huge costs in dealing with the upsurge in complaints and litigation that will immediately ensue, including £500 a claim for each case referred to FOS.
- FOS will see an immediate increase in complaints on the issue.
- The firm has effectively been tried and found guilty in public, but with no opportunity to defend itself.

The "early warning and transparency" proposals indicate a limited understanding and appreciation of the impact such action would have on a firm or a sector in today's marketplace. Subsequent litigation by impacted firms and shareholders against the FCA would seem inevitable at some point.

Given the "legislator, judge, jury and executioner" role of the FCA, it is essential that appropriate independent checks and balances be provided to enable a firm to challenge FCA decisions and actions quickly and cost effectively. It is in no one's interest that when the FSA is perceived to be acting beyond its powers, or irrationally or unfairly, the only recourse for firms is a judicial review, as with the current BBA application in connection with PPI. An internal appeals process to an independent judicial body is essential, particularly given the even more extensive powers and sanctions being proposed.

The role and funding structure of FOS must be included in the review. As indicated above, retail credit providers regularly find themselves having to choose between defending an unmeritorious claim in the FOS, and incurring a £500 fee, or settling it at a lesser cost simply because it is not

cost effective. The availability of the threat of such a referral and fee is a key weapon for CMCs, who know it is not cost effective for lenders to defend claims below this figure. The impact of the combination of the availability of FOS, the non refundable FOS fee and the growth of the CMC industry has not been sufficiently factored into Government and Regulator thinking in the consultation, although it has been acknowledged by the OFT in the consultation process over the Irresponsible Lending Guidance, and the risk to consumers from the less scrupulous CMCs has been widely acknowledged by the OFT and the MOJ. This has been a major shift in market dynamics over the last 5 years, and the cost to industry and the systemic threat it poses needs to be better understood by Government and Regulators.

Contact: richard.braham@brc.org.uk; 020 7854 8950.

HM Treasury

Response to HM Treasury Consultation on Reforming the Financial System

Response by the UK's National Standards Body, BSI.

BSI is the UK's National Standards Body and facilitates the development of national, European and International (ISO) Standards. BSI has a long history of developing standards to help organizations implement good practice and specifications for products to ensure consumer protection and provide assurance.

BSI already has experience of developing standards with the financial services industry. For example, BSI publishes many standards that underpin payments methods and transactions that take place between financial institutions every day.

In addition, BSI recently pulled together an industry coalition to develop a best practice approach to managing compliance risks within financial institutions. Our work developing competency-based standards for financial planning brought together industry and consumer representatives. This work focussed on the 'treating customers fairly' agenda. Our standard for providing inclusive services to vulnerable and disadvantaged groups has been championed by the Financial Ombudsman Service as a tool to improve consumer protection.

Standards are used by businesses to:

- Reduce business risk
- Support compliance in highly regulated areas
- Support innovation
- Protect consumers and help them make informed choices

BSI would be pleased to put our expertise at the service of HM Treasury to promote the use of existing standards that can reduce risk and improve customer outcomes in the financial services sector and to facilitate the development of new standards where necessary.

The relevant BSI standards referenced in this document include:

BS 8453: Compliance framework for regulated financial services firms
BS 18477: Inclusive service provision – Identifying and responding to consumer vulnerability
BS 25999: Business continuity management
BS 31000: Risk management – Principles and guidelines
BS ISO 10002: Customer satisfaction – Guidelines for complaints handling
BS ISO 22222: Personal financial planning – Requirements for personal financial planners

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

In relation to the principle that Senior Management are responsible for managing their firms in a way that is compliant with the regulatory framework: In highly regulated sectors, standards have a role to play to help senior management proactively manage risks that may

impact their business, their clients and jeopardize the financial system. Standards such as BS 8453 (financial services compliance) and BS 31000 (risk management) have been developed by industry to set out good practice that can help senior management build a culture of risk management and due diligence within organisations.

Adoption by the financial services organizations of standards that are internationally recognized and widely used in many industries would help demonstrate commitment to transparency and accountability. For example, standards such as BS 25999 (business continuity management) are increasingly recognized by the insurance industry as lowering the risk of business interruption and business failure, and could be applied across the financial services sector.

Question 7. What are your views on the mechanisms proposed to make the regulator judgement-led, particularly regarding: rule-making; authorisation; approved persons; and enforcement?

When making judgements, compliance with standards can provide evidence that a firm or individual is following recognised good practice. The FSA has welcomed the BSI's latest standard for the financial services industry BS 8453 - Compliance framework for regulated financial services firms. BS 8453 is designed to help firms establish robust systems and controls for managing compliance risks and to demonstrate a commitment to building a culture of compliance through training and internal advice. There are many contexts where standards are used to support principles-based regulation by offering a practical approach that can help organisations comply with the intention of the regulation(s), and we would welcome a discussion of the role standards could play in supporting the future regulatory framework.

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

Standards could help support a number of the FCA's objectives:

- Facilitating choice in the market for financial services: setting standards for simplified financial products could help underpin greater consumer confidence and choice in the complex environment of financial products.
- Securing protection for consumers: The FCA in its supervisory function could take account of BSI's existing portfolio in the areas of consumer protection, including BS ISO 10002 (complaints handling), BS ISO 22222 (financial planning) and BS 18477 (inclusive service, recently adopted by the Financial Ombudsman Service). New work is also underway in the area of financial advice for advisory firms and banks.
- Protecting the integrity of the financial system: Standards can reduce the complexity for firms and regulators when seeking to demonstrate competence and good governance. Dialogue has already taken place with the FSA's supervisors and policy makers on the role standards could play in regulatory visits/inspections and how frameworks such as BS 8453 can provide assurance that risks are being managed.
- Promoting competition: Standards offer a level playing field that can enhance competition between providers of financial products and services. A range of standardized products would provide easier comparability across providers, allowing providers to compete on the basis of issues such as price and quality of service.

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

If the FCA intends to set minimum product standards, these should be based on a consensus of interested parties. BSI has already submitted a response to the HM Treasury consultation on simplified financial products, setting out how BSI could facilitate this work,

bringing together stakeholders from industry, consumer bodies and government to ensure compatibility with existing regulatory frameworks and codes.

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

Standards have the potential to play an important role in the authorization process in terms of easing the burden of regulation (whilst improving the efficiency of process) for both firms and regulators. Compliance with BS 8453, which helps firms to establish an effective approach to managing a regulatory compliance programme, could help firms to demonstrate adequate systems and controls are in place for example. Additionally, adherence to other customer-facing standards and could help retail firms to demonstrate that quality processes have been embedded to manage complaints (BS ISO 10002), provision of advice (BS ISO 22222) and their approach to financial promotions and responsible marketing (BS 18477).

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

Standards can offer a useful starting point for firms passporting into the UK and for individuals working within institution looking for assistance in meeting good practice. This is especially so where standards have been adopted internationally, as has happened with ISO 22222 and ISO 10002. BSI can facilitate the progression of British Standards into Europe via CEN or globally through ISO.

BSI Background

BSI is the UK's National Standards Body, incorporated by Royal Charter and responsible independently for preparing British Standards and related publications. BSI has 107 years of experience in serving the interest of a wide range of stakeholders including government, business and society.

BSI presents the UK view on standards in Europe (to CEN and CENELEC) and internationally (to ISO and IEC). BSI has a globally recognized reputation for independence, integrity and innovation ensuring standards are useful, relevant and authoritative.

A BSI (as well as CEN/CENELEC, ISO/IEC) standard is a document defining best practice, established by consensus. Each standard is kept current through a process of maintenance and reviewed whereby it is updated, revised or withdrawn as necessary.

Standards are designed to set out clear and unambiguous provisions and objectives. Although standards are voluntary and separate from legal and regulatory systems, they can be used to support or complement legislation.

Standards are developed when there is a defined market need through consultation with stakeholders and a rigorous development process. National committee members represent their communities in order to develop standards and related documents by consensus. They include representatives from a range of bodies, including government, business, consumers, academic institutions, social interests, regulators and trade unions.

British Standards Institution
14 April 2011

Building Societies Association

A New Approach to Financial Regulation: Building a Stronger System

HM Treasury and the Department for Business, Innovation & Skills

Response by the Building Societies Association

Contents

Topic	Page
I. Introduction	1
II. Key Points	2
III. Other Commentary and Responses to Consultation Questions	
• **Bank of England and Financial Policy Committee** *(questions 1-4)*	7
• **Prudential Regulation Authority** *(questions 5-10)*	11
• **Financial Conduct Authority** *(questions 11-16)*	14
• **Regulatory Processes and Co-ordination** *(questions 17-28)*	21
• **Compensation, Dispute Resolution and Financial Education** *(questions 29-31)*	26
• **European and International Issues** *(question 32)*	29

I. Introduction

1. The Building Societies Association represents mutual lenders and deposit takers in the UK including all 48 UK building societies. Mutual lenders and deposit takers have total assets of over £365 billion and, together with their subsidiaries, hold residential mortgages of almost £235 billion, 19% of the total outstanding in the UK. They hold more than £245 billion of retail deposits, accounting for 22% of all such deposits in the UK. Mutual deposit takers account for about 36% of cash ISA balances. They employ approximately 50,000 full and part-time staff and operate through approximately 2,000 branches.

2. The BSA responded to HM Treasury"s 2010 consultation *A New Approach to Financial Regulation: Judgment, Focus and Stability* www.bsa.org.uk/docs/policy/regulatory_reform/bsa_response_18.10.pdf and to the more recent consultation concerning regulatory reform *Reforming the Consumer Credit Regime* www.bsa.org.uk/policy/response/index.htm. We welcome the opportunity to comment on the current consultation *Building a Stronger System* (the CP).

II. Key Points

<u>Effectiveness and cost of future regulatory arrangements</u>

3. On a broad point, it is of the utmost importance that the regulators - the Financial Conduct Authority (FCA) in particular - „hit the ground running". The FSA"s supervisory enhancement programme, its strengthened consumer redress powers, and the wide range of recent and current initiatives relating to conduct of business (most of which will be completed by the end of 2012 - see the table at the end of this executive summary) should put the FCA, by the time of its planned inception, in a position where it can move forward with strong, well-thought-out regulatory approaches and tools that have real shelf life. A hiatus while the new bodies "get up to speed" is in no-one"s interest.

4. Notwithstanding the natural desire of any new organisation to differentiate itself from its predecessor and assert a distinctive identity, after the upheavals of recent years it is imperative that the FCA does not seek to re-invent the wheel soon after its inception. We need strong, focused, impartial and proportionate **conduct of business regulation to become „business as usual"** under the new framework right away – it is crucial to consumers, businesses and the UK economy that a strong degree of certainty returns.

5. In addition to the above point, our key outstanding concerns are about the **effectiveness of practical arrangements and their cost**. We welcome the commitments, set out in the CP, to deliver a new regulatory regime that is efficient (with due regard paid to value-for-money and cost-effectiveness) and proportionate, and that incorporates effective co-ordination between the regulatory bodies. However, the CP also states that "detailed day-to-day arrangements" will be left to the individual regulators to decide (paragraph 5.28). This leave two key questions unanswered –

- ***What does an efficient, proportionate regulatory regime look like?***
- ***What controls are required to ensure that such a regime is delivered in practice?***

6. While the CP recognises the need for cost control, the relevant control mechanisms („efficiency" and „proportionality" principles) are not, in themselves, adequate to ensure effective regulatory arrangements and prevent the overall regulatory costs increasingly significantly again – we believe that greater focus on these aspects of the exercise is required as matters progress and we provide detailed information in this response.

7. In summary, we believe that, in order to deliver an efficient and proportionate regulatory regime, the authorities should commit to a close examination of the following ten matters and, where practicable, they should be included in the legislation –

(i) **a common gateway for firms" authorisations, approvals, variations,** waivers, notifications, reporting etc: dual-regulated firms - ie all BSA members, banks, insurance companies etc - should not have to duplicate communications with the Prudential Regulatory Authority (PRA) and the FCA.

(ii) the „integrated regulatory reporting" system (GABRIEL) be maintained within the common gateway

(iii) retention of a **single regulatory Handbook**, with one of the two regulators being the contact point in areas of potentially shared responsibility

(iv) sharing by the PRA and FCA of **back-office functions,** should be the norm (given that the FSA currently has a single back-office, as shown on its 4 April 2011 organogram, notwithstanding the functional separation of the prudential and conduct business units), and exceptions should be individually justified

(v) co-ordination between the PRA and FCA in respect of **regulatory supervision/visits** to minimise duplication for firms, eg on informational requirements preceding regulatory visits, or concurrent but unrelated visits by PRA/FCA

(vi) co-ordination between the PRA and FCA in respect of **regulatory approaches** (eg to rule-making, enforcement etc)

(vii) **no overlaps between the PRA and FCA** eg on the subject matter of discussions and consultations, thematic work, enforcement etc and there should be a senior Treasury official charged with ensuring that, while the regulators must of course actively co-ordinate, they do not allow any drift into a position where their functions overlap

(viii) careful planning be undertaken to ensure that the regulatory burdens under the new arrangements new arrangements do not disproportionately affect **smaller firms**

(ix) methods of ensuring that the proposed **IT spend** is the most cost-effective way forward, and

(x) apart from transitional costs, an overall cap on the first year **budgets** of the PRA and the FCA should be introduced, which should be no higher than the current FSA budget (and clear controls be put in place on levels of future budgets).

Welcome elements

8. The BSA finds much to welcome in the CP, including the following important matters of principle -

- **New strategic and operational objectives** for the Financial Policy Committee (FPC), PRA and the FCA. We strongly support the operational principles to be introduced for the PRA and the FCA, including regulatory efficiency and proportionality (value-for-money and cost effectiveness), openness and transparency, regulatory accountability, senior management responsibility in firms, and consumer responsibility. The success of these objectives going forward is very important to the financial services sector"s contribution to a strong UK economy.

- The new arrangements will recognise **corporate diversity** – we welcome the Government"s decision that both the PRA and FCA will be required

specifically to take account of mutuals in relation to cost-benefit analyses - but this is not the fundamental point: the main issue is that there should be a level playing field for businesses of different corporate forms (see response to question 23 below).

We had hoped for a more fundamental, specific commitment to diversity of corporate structure, as flagged in the earlier CP. Nonetheless, such an approach appears to be integral to the requirement for proportionality; the CP states (paragraph 4.25) "Proportionality also means that the regulator must tailor its actions to the specific characteristics of the sector being regulated." However, we would welcome confirmation that our interpretation is correct.

- A commitment to strong **co-ordination** between the regulatory bodies (with ultimate primacy for the PRA over the FCA in certain circumstances). Co-ordination between the regulatory bodies is a key to their success.

- The measures to help ensure **proper coordination with the EU** and internationally. It is crucial for the UK economy that our regulators are fully involved at EU level, in particular. In this context, we call for an end to the damaging practice of legislative „front-running", whereby UK laws are introduced in the knowledge that EU legislation (on the same, or substantially the same) matters is already in train.

- Wherever appropriate, the FCA will have to exercise its general functions in a manner intended to promote **competition**.

Remaining matters of concern

9. However, some aspects of the CP continue to give rise to concern, especially the following -

- While the debate over the regulatory architecture is now largely settled , we do have some outstanding concerns about the **accountability of the Bank of England** and believe that it is time to strengthen the resources of the Treasury Select Committee.

- Both the FPC, in its macro-prudential role, and the PRA, in its micro-prudential role could cut across **wider Government policies** and we believe that the new arrangements need to have relevant safeguards.

- The characterisation of the FCA as **"consumer champion"** remains and the explanation in the CP - while helpful - does not, in our opinion, provide satisfactory reassurance. In view of the fact that the Government is continuing with the description, we believe that a *statutory* requirement on the FCA to act in a fair and impartial manner is now necessary.

- There will be a more intrusive, interventionist approach to **conduct of business regulation** by the FCA - while not necessarily objecting to this, the extent of the proposed product intervention powers seem to pre-empt the continuing FSA discussion (DP 11/1), which the BSA will respond to in the next week. Furthermore, the CP appears to revive discussion of limits on loan-to-value or loan-to-income limits, in relation to conduct of

mortgage business, which the FSA had ruled out from a conduct of business perspective as part of the mortgage market review.

- There are worrying signs that **firms" rights** to challenge regulatory decisions and regulatory certainty will be diminished by aspects of the proposals – notably, the proposed withdrawal of a „full merits review" basis of appeal to the Upper Tribunal in respect of PRA enforcement processes (paragraph 3.32), and the plans for the publication of FCA warning notices (paragraph 4.88). We question whether these changes are compatible with the rights guaranteed under Article 6 of the European Convention on Human Rights: if, as we argue, they are not, they must not proceed. We would also like to see a legislative provision making it explicit that, in order to have *regulatory* effect, measures introduced, or statements made by, the FCA must go through the relevant statutory processes.

- The **planned timetable** is to put the regulatory architecture in place by the end of 2012. The BSA view is that, while this high-level timetable may be practicable, it is likely that crucial detailed arrangements (such as systems and other technical matters) will take longer. It is important not to underestimate the logistics of these underlying technical exercises. The need for caution has been highlighted by the recent experience of FSA online notice and applications (ONA) with, first, the deferment of the implementation of the new CF31 approved persons function and, more recently, with the delay in the implementation of the new significant influence functions.

Recent and current exercises potentially affecting conduct of business (approx. last 3 years)	
Beginning	**Exercise** (responsible authorities in brackets)
	General
2008	• Consumer Protection from Unfair Trading Regulations 2008 (OFT)
2008	• Tougher enforcement (FSA) – total fines 2007: £5 million; 2010: £89 million
2009	• Treating customers fairly (FSA) – from the „embedding" deadline: end 2008 – flagship project for principles-based regulation
2009	• Publication of complaints statistics (FOS and FSA)
2010	• „Outcome-based" („intrusive") conduct regulation strategy (FSA)
2010	• Consumer redress powers (FSA)
ongoing	• Simple financial products (HM Treasury)
ongoing	• Product intervention (FSA)
ongoing	• Consumer Rights Directive (European Commission)
	Individual Sectoral
2009	• Banking regulation (FSA)
2009	• Payment Services Regulations (FSA)
2009	• *Lending Code* - subscribers only (Lending Code Standards Board)
2010	• Irresponsible lending guidance (OFT)
2011	• Consumer Credit Directive - implemented in UK by various regulations (OFT)
ongoing	• Consumer credit and personal insolvency review (BIS)
ongoing	• Future regulation of consumer credit consultation (HM Treasury and BIS)
ongoing	• Mortgage market review (FSA)
ongoing	• Consumer protection in the mortgage market (HM Treasury)
ongoing	• Responsible lending and borrowing (European Commission – potential directive)
ongoing	• Personal current accounts market study (OFT)
ongoing	• Retail distribution review (FSA)
ongoing	• Structured deposits proposals (European Commission)
ongoing	• Markets in Financial Instruments Directive review (European Commission)
ongoing	• Insurance Mediation Directive review (European Commission)

The Building Societies Association
April 2011

III. Other Commentary and Responses to Consultation Questions

Bank of England and Financial Policy Committee

10. The BSA observes that the debate about the regulatory architecture is now largely settled. The division of responsibilities between the FPC and PRA on, respectively, macro and micro-prudential lines should enable the bodies to focus on their own key responsibility, under the overall management of a single institutional structure. In principle, this should help avert a repetition of some of the fundamental problems experienced with the Tripartite under the earlier regime.

11. However, the need for co-ordination remains, so it will be essential for the Bank to identify interdependencies between the different elements in the arrangements and manage them effectively. The importance of effective management by the Bank and proper co-ordination between the new regulatory authorities is identified in chapters 1 and 2 of the CP.

12. In addition, the BSA supports and endorses –

- the FPC"s strategic objective concerning the stability of the UK financial system
- the principles, set out in paragraph 1.25, to which the PRA will also be required to have regard
- the FPC"s operational objectives (set out in paragraph 1.26)
- the requirement, where compatible with its objectives, for the FPC to discharge its functions in a way that promotes competition.

We believe that the formula for ensuring that the FPC takes into account the potential for adverse impacts on economic growth (set out in paragraph 1.21) needs strengthening and it would be preferable to express it as a positive duty.

13. There is an argument that the concentration of so many powers within the Bank of England might fragment the Bank"s focus. We provide some suggestions regarding Bank of England accountability later in this response.

14. We agree with the Treasury Committee that, if the FPC is to be given lead responsibility for securing financial stability, there needs to be clarity about what such "stability" means. Whilst this is by no means an easy matter, more detailed examination is necessary, including how success will be measured and what tools will be used to achieve it.

15. We support the approach that would permit the FPC to direct the PRA and FCA in certain circumstances, but leaving them with discretion - in the case of recommendations, rather than directions - not to comply, provided they explain their reasons. This framework, as explained in paragraphs 2.36 - 2.45, should give appropriate flexibility to the overall arrangements, if used appropriately.

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

16. First, we agree strongly with the TSC"s recommendation that the secondary legislation that will establish the FPC"s detailed toolkit will be subject to affirmative procedure, and we welcome the Government"s acceptance of this (paragraph 2.44). Some macro-prudential tools are, of course, already prescribed by international standards, notably the binding European legislation corresponding to Basel III (with implementation beginning about the same time as the new UK financial regulators are established). The European dimension must never be overlooked.

17. We also welcome the discussion in paragraphs 2.89 to 2.97 about the transparency and accountability of the FPC"s use or proposed use of such tools. We strongly support the general statement in paragraphs 2.49 and 2.50 -

> *"It will be vital that the FPC set out clearly how it intends to use the tools and the rationale for their use and provide an ongoing assessment of how it believes they are working…...the Treasury may require the FPC to publish a policy statement in advance, setting out how it plans to employ the tool and the circumstances in which it might be used."*

We accept, of course, that it would not be appropriate or desirable for the FPC to consult prior to each use of one of its macro-prudential tools. But we strongly endorse the general point that FPC should be obliged to consult on how it would envisage using its toolkit. This would help to develop understanding of how macro-prudential tools affect the wider economy, and therefore also have an impact on the achievement of the MPC"s objectives.

18. The assessment called for in paragraph 2.49 should also extend to any spillover effects and unintended consequences of its macro-prudential tools, many of which are relatively untested at present. For example, in relation to collateral requirements (paragraphs 2.63 – 2.64), the CP envisages the possibility of the FPC seeking, as is the power in certain other jurisdictions, to introduce controls on loan-to-value ratios across the whole mortgage market. This would be a problem if the FPC made such a decision with insufficient understanding of the impact it might have on broader policy objectives; for example, to see particular trends develop in respect of the number of owner-occupiers, or tenanted properties, or in, say, land use and the growth, or otherwise, in the provision of social housing. Therefore, caution would need to exercised to ensure that FPC activity did not impinge on a wide range of non-financial objectives as well.

19. Furthermore, there should be thorough forward and back testing, using appropriate models, of the regulatory tools - not just for the FPC"s macro-prudential toolkit, but also for the tools potentially to be used by PRA. This should identify (within the limitations of any models) which tools, if used in known circumstances in the present or recent past, would have produced which outcomes. Such a process could be invaluable in equipping the regulators for the wise use of their regulatory tools in future. In view of the stringent stress testing requirements now placed on firms (eg in respect of capital and liquidity), it would seem very odd if regulatory tools were not similarly subject to stringent testing.

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

20. In our response to the previous CP *Judgment, Focus and Stability,* we stated the following –

> *"To the list of macro-prudential tools must be added the separate point of the proposed funding mechanism for deposit protection envisaged in the European Commission"s proposals for an amended deposit guarantee schemes directive (DGSD). Building up a deposit protection pre-fund at the speed and scale envisaged by the Commission would have a major impact on profitability in building societies (and banks) over the next decade. This would compromise the UK authorities" ability to deploy other macro-prudential tools."*

We stand by this position and believe that it is a message that the UK authorities need to carry forward strongly in the EU. And, to the extent that any modified proposal for pre-funding may finally come into force, it is essential that its potentially severe macro-prudential impact is properly taken into account in considering whether any other tool is needed. Once implemented, the pre-funding tool cannot temporarily be laid aside in favour of another tool – it will be a constant baseline factor for 10 -15 years.

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

21. Taking a broad view of the proposed arrangements, there is still a risk of the emergence of an excessively powerful Bank of England unless robust accountability and transparency provisions are put in place. The new arrangements, as proposed, will mean that the Governor of the Bank of England will be Chairman of the MPC, the FPC and the PRA, as well as having oversight of the FCA, and the bank resolution regime.

22. Therefore, we welcome the Government"s recognition of the need for strong accountability, with mechanisms and controls to be put in place, as set out in the CP, such as publication of FPC meeting records, a twice-yearly financial stability report, certain accountability mechanisms for the FPC"s use of directions and toolkits, audit of the FPC and PRA by the National Audit Office, a Treasury power to order independent inquiries into regulatory power, further governance and accountability arrangements for the PRA among others.

23. We believe that the proposed arrangements could go further, without diminishing - but, indeed, reinforcing - the overriding importance of financial stability. In UK financial services, and banking in particular, systemic risk is concentrated in relatively few institutions – a fact acknowledged by the Independent Commission on Banking. The combination of this concentration of systemic risk and the concentration of power in the Bank of England means that it would take only a very few people to make wrong decisions at critical times for a future financial crisis to be dealt with in a sub-optimal manner. Checks and balances on the Bank are required to mitigate this risk and certain specific suggestions are set out below.

24. Key among the accountability mechanisms to which the enhanced Bank will be subject is accountability to Parliament, principally via the Treasury Committee.

Given the importance of ensuring appropriate levels of political accountability, it would seem now to be the right time to assess whether the Treasury Select Committee is properly resourced.

25. The BSA understands that the Committee has very few support staff, certainly compared to the Bank of England and other regulatory agencies; given the high profile of its work, the range of reports which it publishes, and the possible enhancement of its responsibilities discussed in this note it may be unrealistic for it to continue with current low staffing levels. There would appear to be scope for the formal functions of the Treasury Select Committee to be enhanced; for example by routinely interviewing new appointments to the board of the new regulators.

26. Moreover, arguably, the concentration of power in the Bank of England, and the very wide range of subjects already covered by the Treasury Committee will be such as to warrant a dedicated Select Committee to provide adequate oversight of its activities. Typically, Select Committees cover the areas that are the particularly the responsibility of a Department of State; however, we would support moving away from this model, with the creation of either a Financial Regulation Select Committee, or a Bank of England Select Committee.

27. The financial crisis of the last few years has had, and is having, a huge effect on the structure of the banking industry in the UK, and on the structure of regulation. On the face of it, it would be odd if the arrangements for Parliamentary oversight of regulation of the finance industry were not even discussed.

28. We recognise that the position of the FPC, as a body with high-level responsibility for financial stability, is substantially different from that of the PRA, whose primary responsibility is the prudential regulation of individual businesses. Nevertheless, it would be appropriate to examine whether the FPC, like the FSA currently, should be required to have regard to good corporate governance in managing its affairs. Arguably, it should also be required to have regard to the views of the statutory panels.

29. Macro-prudential decisions are essentially about seeking an optimum combination of financial stability with growth in the wider economy, as is implicitly recognised in the FPC"s objectives. Too much stability may be accompanied by economic stagnation, and too much credit growth may endanger stability. But this shows that financial stability is not a good that can be pursued in isolation, but is inevitably connected with wider economic matters, and indeed with several aspects of social policy which are the preserve of the elected Government – such as access to housing and access to credit. Therefore, it may not be possible for the FPC to be as explicitly independent of Government influence as the MPC.

30. There is also the specific interaction between monetary policy and macro-prudential regulation. Co-ordination is the key, incorporating such matters as cross-membership (of the MPC and FPC, with the Governor as chairman of both) and sensible sequencing of meetings. We agree with the Treasury Committee that, so that policies on financial stability can be coordinated more effectively, provision for joint MPC/FPC meetings may be required.

31. The independent members of the FPC will play a very important role but, whilst the MPC has four external members out of a total of nine, the FPC would have five external members out of twelve. We agree with the Treasury Committee that a better balance between internal and external members of the FPC could be achieved by increasing the number of external members on the FPC, to say six. Further, to aid

the achievement of the FPC"s statutory objective of not having a significant adverse effect on the capacity of the financial sector to contribute to the growth of the UK economy, it would be beneficial to appoint more external members with direct and recent experience of working in the financial sector. In the interim FPC, just one out of the four external members has such direct experience.

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

32. We have no comments on the proposals, which seem sensible. But we have two comments on the measures proposed in respect of **crisis management** (dealt with in paragraphs 2.137-157 of the CP). First, the proposed Memorandum of Understanding between the Treasury and the Bank group seems a sensible idea. However, it appears likely at least to overlap substantially with the statutory Code of Practice on the use of the SRR required under the Banking Act 2009. This overlap should be dealt with and the Memorandum, like the Code, should be subject to full public consultation.

33. Second, the Memorandum will rightly focus *inter alia* on questions about the risk to, and possible use of, public funds. We have previously observed - in the context of the SRR and its Code of Practice – that it is not only public funds (taxpayers" money) that need to be protected. Funds held in the FSCS, or capable of being levied by the FSCS on banks and building societies, are not a "free good". They can be used either to finance a bank resolution or to pay deposit compensation directly. Where used for bank resolution, choices made as to which SRR tools are used, and at what stage early interventions are or are not made, could affect the ultimate cost via the FSCS to banks and building societies.

34. Just as the Chancellor rightly protects the taxpayer interest, we argue that one of the authorities – perhaps the Bank – should also be tasked with minimising the recourse to the FSCS (whether as a resolution fund or as a compensation fund). Money drawn from the FSCS ultimately constitutes a "tax" on building societies, banks and their customers. And on the principle of no taxation without representation, it is also time to upgrade the formal role that deposit-takers have in overseeing the conduct of any SRR interventions that use FSCS money. The FSCS should be made accountable to a creditors" committee in respect of any interventions along the lines of Bradford & Bingley and the Icelandic banks.

35. Finally, on the EU crisis management proposals, we welcome the Government"s support (paragraph 2.156) for prevention and early intervention, and flexibility for national authorities to use tools and powers within the parameters of their own national arrangements. The BSA made similar points in its own submission to the Commission.

Prudential Regulation Authority

36. As noted above, we welcome the principles, set out in paragraph 1.25, to which the PRA will also be required to have regard. We believe that there should be stronger accountability and controls in respect of the PRA budget.

37. There needs to be some mechanism whereby the PRA's micro-prudential policy initiatives should also have regard to the Government's wider economic and social policy imperatives. We are very concerned about the posited withdrawal of the right of firms to appeal on a „full merits review" basis to the Upper Tribunal in respect

of PRA enforcement. Also, it will be important for the PRA to develop relevant approaches to the consultative process.

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

38. Subject to comments elsewhere in this response (eg regarding corporate diversity – see below), we support the objectives and principles.

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

39. The BSA has little experience of this particular topic and, therefore, we make no comments.

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

40. Understandably, there is little current detail on the judgement-led approach and the proactive intervention framework but, by and large, what is set out appears to be sensible and we await the further information referred to in paragraph 3.33.

41. The BSA has one comment, regarding enforcement. We believe that the current rights of firms to appeal, on a „full merits review" basis, to the Upper Tribunal in respect of supervisory decisions should not be reduced.

42. Businesses have human rights (*Wilson v First County Trust* [2001] 3 All ER 229). Article 6(1) of the European Convention on Human Rights (ECHR) begins by stating that –

> *"In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent tribunal."*

The ECHR was incorporated into UK law by the Human Rights Act 1998. Because of its limited scope, judicial review falls considerably short of providing an appeal. It is inappropriate to interpret human rights restrictively (*Delacourt v Belgium* (1970) 1 EH).

43. In view of all these matters, we believe that the Government needs to reconsider its proposals regarding enforcement – which, as they stand, could be in breach of Article 6.

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

44. The governance framework proposed for the PRA appears to be clear and broadly appropriate. However, we have no direct experience of the Court of the Bank of England and are unqualified to comment on the Court"s suitability to the various roles set out in the CP.

45. One point does concern us and that is the matter of accountability in respect of the PRA budget. Under current plans, the Court will have the responsibility of approving the PRA‟s objectives for funding, financial management, budgets and remuneration policies. We would like to see greater controls (for example, a more detailed remit for the National Audit Office).

46. We would also like to see greater co-ordination in respect of the budgets of the PRA and the FCA. Indeed, we believe that there should be some method for controlling the combined budget of the two organisations because –

- In the light of the events since 2007, the FSA carried out a „Supervisory Enhancement Programme‟, which involved a structural re-organisation and led to a very significant increase in FSA staff numbers - the FSA budget for mainstream regulatory activity in 2000/01 was £162.5 million; ten years later, the broadly corresponding figure had increased, by over 300%, to £490.9 million (RPI increased by just over 31% in the same period)

- The PRA‟s responsibilities derive directly from those currently held by the FSA

- At a time of national financial constraint, regulatory bodies – like all other organisations - should exercise financial restraint.

We provide more detail below, in respect of the FCA.

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

47. The BSA broadly supports the PRA‟s independence in operational matters, subject to the points made elsewhere in this response. We believe that the PRA should be subject, essentially, to the same statutory accountability provisions as the FSA. The BSA also believes that the PRA should have regard to the primary objectives of the FPC and FCA. Financial stability is overriding, but it is imperative that the three organisations liaise closely and that one does not cut across what the others are doing. As we stated in our response to last year‟s CP, *Judgment, Focus and Stability*, it is difficult to reach any conclusion other than one whereby the PRA at least *has regard* to the primary objectives of the FPC and FCA. We recognise that the coordination requirements go some way towards meeting this point.

48. We welcome the fact that the new arrangements recognise corporate diversity – we note the Government‟s decision that both the PRA and the FCA will be required specifically to take account of mutuals in relation to cost-benefit analyses. However, as we explained in our response to the previous CP, there are strong reasons for both the PRA and the FCA to be required to have specific regard to corporate diversity and we are disappointed at the decision not to implement such requirements. Nonetheless, such an approach appears to be integral to the requirement for proportionality; the CP states (paragraph 4.25) “Proportionality also means that the regulator must tailor its actions to the specific characteristics of the sector being regulated.” However, we would welcome confirmation that our interpretation is correct.

49. While it would not be appropriate for the PRA's day-to -day supervision of firms to come under Government control (and thereby responsibility), nevertheless there needs to be some mechanism whereby the PRA's micro-prudential policy initiatives should also have regard to the Government's wider economic and social policy

imperatives. Otherwise, there is the risk of measures that may appear justified in a narrow regulatory context but which are clearly sub-optimal, or even undesirable, when viewed against the wider context. Micro-prudential regulation is not an end in itself - it should serve wider societal objectives. We have made similar comments (above) about the FPC"s macro-prudential role.

50. The FSA has a culture of consultation because of the requirements, prescribed by the FSMA, to consult on prospective rules and guidance. The Bank of England has not been subject to such requirements and it will be important for the PRA to develop relevant approaches to the consultative process.

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

51. The arrangements appear to be appropriate and we particularly support the PRA"s duty to consult practitioners (paragraph 3.70). We appreciate that the detailed arrangements will need to be worked out.

Financial Conduct Authority

52. Our key concerns are that the FCA should „hit the ground running" as a conduct of business regulator, and that it should coordinate effectively with the PRA. We make a number of specific, practical suggestions about regulatory coordination.

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

- **General**

53. It is of crucial importance that the regulators are able to „hit the ground running". This is particularly important in respect of the FCA as a conduct of business regulator. It would be most unfortunate if on, or soon after, its inception the FCA decided to revisit conduct of business strategy. The FSA has already done a great deal of good work in this area and we believe that the next eighteen months or so should be used to refine the regulatory approach to conduct of business so that, from the FCA"s inception, there is much greater certainty than hitherto. This is a matter of considerable importance to consumers, businesses and the UK economy.

54. There is considerable evidence that, over the last two years or so, the supervisory enhancement programme has made the FSA a stronger and more effective conduct of business regulator than it was in the past. This, together with its recently enhanced consumer redress powers and the wide range of current initiatives relating to conduct of business (see the table above) should put the FCA, by the time of its planned inception at the end of 2012, in a position where it can move forward with strong, well-thought-out regulatory approaches and tools that have real shelf life. In particular, the rules should be designed in such a way as to be, if not fully „future-proofed", at least capable of addressing changed circumstances and new challenges without the perceived need to revisit the entire regulatory strategy or major aspects of it because, for example, of a new mis-selling episode.

55. Long-term, it would make great sense to simplify laws and regulations relating to conduct of business. The BSA has had a policy on this matter for some years www.bsa.org.uk/policy/response/dberr.htm and, while we welcome some recent changes, we believe there is much still to be done. We firmly believe that

simplification would favour the UK economy, consumers, and well-run firms that have a genuine culture of treating customer fairly. But we recognise that any major work in this area would need to be conducted in the long-term – the priority now is to establish the new regulatory arrangements and to move forward with strong, clear conduct of business regulation.

56. We note and welcome the clarification of the FCA"s "consumer champion" role and, in particular, the confirmation (in paragraph 4.9) that the FCA will be an entirely impartial regulator from whom firms and consumers can expect fair treatment. The BSA set out detailed reasons for our concern about this charcterisation in our response to the previous CP, *Judgment, Focus and Stability.* In the light of the assurances in the CP, we presume there would be no objection to including a requirement in the forthcoming Bill on the FCA to be a fair and impartial regulator.

- **The FCA"s proposed objectives and PRA/FCA principles**

57. Regarding the FCA"s objectives, we stated in our response to the previous CP, *Judgment, Focus and Stability* -

> *"Within the new framework, however, the BSA broadly agrees with the proposed formulation of the [FCA"s] primary objective; namely, that of ensuring confidence in financial services and markets, with particular focus on protecting consumers and ensuring market integrity."*

We commented in much more detail in our earlier response. In the light of the fact that the proposed objectives remain broadly the same, we make no further comment.

58. Turning to the proposed regulatory principles, in our earlier response we strongly supported the provision of a consistent set of regulatory principles for both the PRA and the FCA. Therefore, we welcome the decision (referred to in paragraph 4.23) that the two organisations will share the common principles of –

- efficiency,
- proportionality
- consumer responsibility
- responsibilities for senior management
- openness and disclosure, and
- transparency.

59. Some of these principles are already well-known and established; others will need fleshing out in due course. The first principle, which requires the regulators to use their resources in the most efficient and economic way, could be re-inforced by a number of practical measures. For example, by the introduction of -

- methods of ensuring that the proposed IT spend is the most cost-effective way forward, and

- apart from transitional costs, an overall cap on the first year budgets of the PRA and the FCA, which should be no higher than the current FSA budget (and clear controls be put in place on levels of future budgets).

60. Furthermore, we believe that impact assessments should not, in future, be limited only to the costs and benefits of the particular measure, or set of measures, being considered, but should encompass separate, related measures and recent changes that have taken place in the same, or substantially the same, area. With so many regulatory and legal changes, affecting conduct of business, in recent years (and so many more in the pipeline) *cumulative* costs and benefits should be taken into account.

61. A good example of the importance of this suggestion, in respect of cumulative costs, are those incurred by consumer credit businesses following changes to law and regulation in that area, resulting from the following –

- the major revision of the legislation that resulted in the Consumer Credit Act 2006 and a series of regulations designed to implement it over the following couple of years

- the equally substantial changes resulting from the Consumer Credit Directive 2008 (implementation was completed earlier in 2011)

- *potentially*, the unraveling of all consumer credit legislation, and inclusion of it in a regulatory handbook, as envisaged by the recent consultation, *Reforming the Consumer Credit Regime.*

It is questionable whether the benefits to consumers brought about (or potentially to be brought about) by the above changes justify the cost of the constant upheaval over a long period, which is ultimately borne by consumers themselves.

62. The cost of cumulative changes is only one part of the picture – to that must be added the cost of *overlapping* changes (see, for example, the range of initiatives set out in table earlier in this response, many of which cover much the same ground). In conclusion, we believe that impact assessments, taken in isolation, are - nowadays – too limited, in their present form, to be of much value.

63. Proportionality is potentially a key principle because of the very wide range of firms that the regulators will be responsible for and the need to tailor regulatory approaches accordingly. We hope, and would welcome confirmation that, the principle of proportionality will embrace different business forms (eg mutuals, as well as plcs) in addition to firms of differing size and complexity of operation.

64. Subject to our reservations about the "consumer champion" label for the FCA (see above), we fully support the inclusion within the FCA"s remit a key objective of capturing better outcomes for, and protection of, consumers. We also welcome the recognition of consumer responsibility – we believe that, while the matter is not always straightforward, it is clearer than is sometimes recognised, and the BSA has a long-standing policy on the matter; see for example our response to the FSA discussion paper DP 08/5 - www.bsa.org.uk/policy/response/consumer_responsibility.htm.

65. We agree that, although major financial crime could potentially have a destabilising effect on a firm, it is closer to the kind of conduct issues to be dealt with,

for dual-regulated firms, by the FCA than to the prudential matters that the PRA will be responsible for. Therefore, the BSA supports the decision to give the FCA a free-standing duty regarding financial crime prevention.

66. Regulatory transparency is very important to effective conduct of business regulation and to trust in the regulatory authority. We strongly support its inclusion among the proposed regulatory principles.

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

67. The BSA supports the proposals regarding governance and accountability of the FCA, including retention of the practitioner and consumer panels, maintenance of the arrangements for the investigation of complaints, freedom of information provisions and reporting to HM Treasury. We have a small number of qualifications, one high-level and the others technical (but, nonetheless, important in principle), as follows.

- **FCA as "consumer champion"**

68. As noted above, we believe that the FCA"s characterisation as a "consumer champion" needs to be counterbalanced by a statutory requirement that it conducts itself in a fair and impartial manner, and we explained our position in detail in our response to the earlier consultation *Judgment, Focus and Stability.*

- **Regulation by speech**

69. While comment by regulatory officials often provides welcome illumination to the regulator"s precise objectives in pursuing a particular course of action, and in answering firms" questions about regulatory activity, the problem of „*regulation* by speech" needs to be addressed. By way of explanation, we repeat the relevant passage from our response to the earlier consultation, *Judgment, Focus and Stability* -

> *"There is a further change that needs to be made to help ensure a properly accountable [FCA]. Currently, speeches by senior FSA staff, although explicitly not binding, may nevertheless be taken into account in enforcement actions. While regulated firms should of course read relevant speeches by the regulator as far as practicable (but bearing in mind that many firms are small and the speeches are numerous – about 60 in the year from October 2009 to September 2010), speeches are not an appropriate medium for delivery of binding regulatory material or even formal guidance.*
>
> *The BSA believes that the relevant provisions should be clarified to make it explicit that speeches have no formal regulatory status, are not binding on firms and are not material to the enforcement process. As, for example, the FSA"s* Annual Enforcement Performance Account 2009/10 *and the increasing size of fines levied by the FSA demonstrate, the FSA has (and the [FCA] will have) plenty of powerful formal regulatory tools. We believe that „regulation by speech" to the extent that it occurs is inappropriate because not only is it is unnecessary, but it also potentially circumvents the normal - and proper - controls on regulatory activity."*

As the current CP is silent on this matter and we re-iterate our concerns now and call on the Government to respond appropriately in the forthcoming legislation.

- **Guidance consultations**

70. In October 2010, the FSA introduced a new "guidance consultation" (GC) process. The website says its use might include some Dear CEO letters and good and bad practice guides (speeches, CEO letters and good practice guides etc are not subject to safeguards on rules or guidance on rules as laid down by sections 155-157 of the Financial Services and Markets Act 2000*)*. Staff in regulated firms have been finding, however, that the content of some of these GCs are more akin to what is normally found in rules or guidance on rules.

71. Since their introduction, there have been several such guidance consultations. According to the notice that announces the new GC process, the FSA will "normally consult on that guidance for a minimum of two weeks". www.fsa.gov.uk/pages/Library/Policy/guidance_consultations/new_process/index.shtml. This minimum appears to have become the norm - of the 16 GCs issued to the end of March 2011, 12 had a two-week deadlines and only four had longer deadlines. This does not leave firms, or indeed trade body staff, sufficient time to consider the guidance under consultation.

72. The timing of the consultation is, sometimes, equally impractical. For example, the consultation on the implementation of systems and controls was issued late on 7 December 2010 with a deadline of 23 December.

73. The notice on GCs says that the FSA is "introducing a new process for issuing general guidance that relates to FSA rules but is *initially* published outside of our Handbook". There is a concern that *initially* should not mean that such guidance will merely move at some future date into the Handbook and not be part of the consultation process as laid down by the FSMA.

74. There is a worrying blurring of procedures here - the FSMA (section 157(3)) is quite clear that (subject to very limited exceptions) all FSA guidance on rules, like the rules themselves, must be made in accordance with the procedures in sections of FSMA section 155(1),(2),(4-10)) – regardless of whether or not it is in the Handbook. A related area of concern is the lack of a cost-benefit analysis in GCs. To date, the vast majority did not include an impact assessment. When any change to a process is proposed rarely is there no cost involved but, as we note earlier in this response, we need broader impact assessments.

75. In conclusion, we believe that the legislation should be explicit that –

- the FCA is obliged to conduct its activities in a fair and impartial manner, and

- only rules and guidance that have been through the relevant process laid down by FSMA (or its successor) will have regulatory effect or will be relevant to enforcement proceedings.

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

76. The BSA will respond in full to the FSA"s discussion paper, DP 11/1 *Product Intervention*, the deadline for which is soon after the response date for this CP. We can note, at this stage, that the extent of the proposed product intervention powers (see paragraphs 4.60-4.68 of the CP) seem to pre-empt the continuing FSA discussion.

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

- **Transparency and disclosure**

77. As a sector that regards fair treatment of customers as the top priority, we welcome the enhanced enforcement and redress approach of the FSA outlined in paragraphs 4.69-4.72. The BSA believes that the FSA has, following its supervisory enhancement programme, become a stronger conduct of business regulator. This is evidenced, among other things, by the increase in regulatory fines (from around £5million in 2007 to about £89 million in 2010) and the recent use of its consumer redress powers.

78. In principle, we favour transparency and disclosure. For example, the BSA supported the publication, by the FSA and FOS, of complaints data, which began in late 2009 and through 2010. We recognise the point acknowledged in paragraph 4.76 of the CP that there have to be adequate safeguards in respect of confidential information.

- Financial promotions

79. The new powers envisaged for the FCA appear to be similar to the „stop now" powers available to agencies such as the Office of Fair Trading and the Information Commissioner. The firm will have only a short time to make representations before the FCA finalises and publishes the notice. Because appeal to the Upper Tribunal will be available to the firm after the notice has been published, it is very important that the FCA uses this power only in cases where the advertisement is misleading beyond reasonable doubt. If a firm were to be successful in any appeal to the Upper Tribunal, the damage – in both commercial and PR terms – would already have been done.

- Warning notices

80. We have serious concerns about the proposed power for the regulators (primarily, the FCA – paragraph 4.88) to be able to publish the fact that they are *proposing* to take enforcement action. The CP states that "this will enhance consumer and industry confidence in the new regulatory system, and enable consumers to make more informed decisions". We disagree. In our view, it is a strong, effective, fair and impartial regulator that would have that effect.

81. Since its supervisory enhancement exercise, the FSA has become a stronger and more credible conduct of business regulator. However, it has done so by a more active programme of regulation, leading to final notices on significant regulatory breaches and penalties against firms that have been shown, on proper examination,

to have breached FSA rules and/or principles. Its reputation will no doubt be further enhanced by judicious use of its strengthened consumer redress powers.

82. But advance publication of *proposed* enforcement action risks a new presumption of "guilty until proven innocent" in respect of regulated firms, which is unlikely to improve confidence in the regulatory system. The safeguards set out in paragraph 4.89 are inadequate – the first two rely entirely on the regulator‟s discretion and the third is „after the event‟; the reputational damage having already been done. As we understand it, the FSA often begins investigations that lead to no disciplinary action.

83. Our concern is that, as acknowledged in paragraph 4.89, once information about proposed enforcement action is published, reputational damage will be done to the firm, irrespective of the outcome of the action and without the firm having had recourse to an appeal process. While we acknowledge that such publication is technically not the same thing as a final determination of rights, it can have a very similar effect in terms of a firm's reputation. Further, the firm will not have an opportunity to appeal to the Upper Tribunal or to the courts in the time available.

84. We believe that the Government should give serious consideration to the unintended consequences of the proposed measure, to the principles of natural justice and to the fundamental rights of the firms involved (please see the comments about firms' human rights set out in reply to question 7 above).

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

85. We support, in principle, the proposed operational objective for the FCA in relation to competition – although it is welcome, we note that it falls short of the Treasury Committee‟s recommendation of a primary statutory objective for the FCA of promoting competition. We believe that it is appropriate for the FCA to seek to promote competition, but the policing of anti-competitive practices should remain the role of the designated competition authorities.

86. Therefore, we urge the exercise of caution in introducing powers that potentially involve overlap between the FCA and the competition authorities. It is by no means clear that the FCA will have relevant „in-house‟ expertise to make decisions regarding competition law. The recent consultation *Reforming the Consumer Credit Regime* was predicated on the removal of such regulatory institutional overlaps and a consistent position on such matters would be useful.

87. The BSA is examining the further consultation *A Competition Regime for Growth*, which deals with competition matters in detail and is considering whether to submit a response.

16 The Government would welcomes specific comments on:

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

88. The BSA is relatively inexperienced in wholesale market matters and has few informed views on the proposals at the end of chapter 4 of the CP.

89. We broadly agree with the comments in paragraphs 4.101-107 to the effect that the FCA"s approach to the wholesale markets will differ from its retail supervision because there is often no immediate retail dimension – but, because (for example) products sold to retail customers may be based on instruments traded on the wholesale markets, the FCA will place appropriate and proportionate regulatory focus on the wholesale markets.

90. While the discussion about the UK Listing Authority (UKLA) is not closely related to the direct interests of financial mutuals, we would as a matter of principle prefer not to see a proliferation of regulators unless absolutely necessary – therefore, we support, in principle, the decision (set out in paragraph 4.110) to retain the UKLA as part of the FCA.

91. Most relevant stakeholders are agreed about the key importance of the UK regulators exercising as much influence as possible in the EU sphere in the UK national interest. Therefore, the assurances about strong UK representation (in paragraphs 4.117-4.118) are welcome.

Regulatory Processes and Co-ordination

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

92. The BSA welcomes the high-level principles for co-ordination, outlined in paragraphs 5.6, 5.8 and 5.10-11 of the CP. We particularly support the statement that "from the perspective of firms, coordination must result in regulatory and supervisory engagement that cost-effective and mitigate the risk of duplication". As a principle, this is excellent, but it is important to clarify how it will be put into practice. The CP goes on to state that "the key to delivering effective coordination is to allow the PRA and FCA flexibility about how they engage with each other, rather than specifying onerous and bureaucratic processes in statute". We understand this approach, but it leaves us no further forward in understanding how coordination will be achieved. Cross-membership of boards and memoranda of understanding, whilst important, are not mechanisms guaranteed to deliver co-ordinated processes.

93. Paragraph 5.10 of the CP states –

> *"The Government will set out clearly in primary legislation the legal responsibilities of each regulator. Where appropriate, this will include allocating specific responsibility for particular processes and regulatory decisions relating to dual-regulated firms or groups"*

and paragraph 5.11 provides that –

> *"both regulators will be subject to a requirement to ensure that processes involving both regulators are managed congruently and efficiently. This would include, for example, taking steps to coordinate or combine supervisory activities to reduce unnecessary burdens on dual-regulated firms".*

94. The BSA strongly supports these approaches and, consistent with them, we urge the authorities to commit to a close examination of the certain specific measures (set out below) and, where practicable, their inclusion in the forthcoming legislation.

95. Paragraph 5.8 states that "The Government believes that the key to delivering effective coordination is to allow the PRA and FCA flexibility about how they engage with each other, rather than specifying onerous and bureaucratic processes in statute". We do not view the measures we propose as "onerous or bureaucratic processes" but, rather, sensible and reasonable practical ways of helping achieve key Government objectives for the new regulatory system. The measures are as follows -

(i) a common gateway for firms" authorisations, approvals, variations, waivers, notifications, reporting etc– dual-regulated firms - ie all BSA members, banks, insurance companies etc - should not have to duplicate communications with the PRA and FCA

(ii) in particular, the „integrated regulatory reporting" system (GABRIEL) should be maintained within the common gateway

(iii) sharing by the PRA and FCA of back-office functions, as the norm

(iv) retention of a single regulatory Handbook with one of the two regulators being the contact point in areas of potentially shared responsibility

(v) co-ordination between the PRA and FCA in respect of regulatory supervision/visits to minimise duplication for firms eg on informational requirements prior to regulatory visits

(vi) no overlaps between the PRA and FCA eg on material in discussions and consultations, thematic work, rule-making, provision of guidance, enforcement etc and there should be a senior Treasury official charged with ensuring that, while the regulators must of course actively co-ordinate, they do not allow any drift into a position where their functions overlap.

96. Regarding a common gateway, it would be far more practical and cost effective for the regulators themselves to manage the duplication inherent in the „twin peaks" model than for each one of all the dual-regulated firms to be obliged to do so. We believe that a common gateway is an essential characteristic of properly coordinated regulatory arrangements.

97. Since 2006, the FSA has introduced GABRIEL with the laudable intention of simplifying and reducing duplication in regulatory reporting. This has, however, required considerable input from firms in terms of devising internal systems and reports in order to be able to provide the data items required. A large proportion of this information is financial and presumably will, in future, fall within the remit of the PRA as opposed to the FCA. The CP implies that the PRA and the FCA will have separate IT systems and, if so, presumably GABRIEL would not be used by the PRA as the method of submitting regulatory returns.

98. For firms to have to go through the process again with a view to submitting a different set of data to the PRA using a different system would seem to be contrary to the stated objective to ensure that "due regard is paid to value-for-money and cost-effectiveness considerations". In this regard the BSA strongly recommends that there should be a common gateway for regulatory reporting and that so far as possible, it should be based on the GABRIEL returns, amended as necessary.

99. We strongly urge the Government to establish as the norm that the PRA and the FCA must share „back office" functions. We note that, as illustrated in the FSA"s

transitional organogram[1] effective 4 April 2011, FSA is now – by way of transition into the new regime – organised into a Prudential Business Unit (ie a shadow PRA) and a Conduct Business Unit (a shadow FCA) supported by a shared Operations directorate covering finance, HR, IT and facilities. This transitional structure will probably last for at least eighteen months. We do not see why, when the new successor bodies replace their shadows, the same shared back office arrangements should not in general continue. A failure to give serious consideration to the economies of them doing so where practicable would make a mockery of efficiency and value for money.

100. Regarding the regulatory handbook, we recognise that the PRA and The FCA will, respectively, be responsible for the subject matter covered by different modules, although some overlap is inevitable. However, we do not see why it should be necessary to dismantle and re-arrange the Handbook, with the re-writing that such processes would also no doubt entail, because of the twin peaks approach.

101. So far as regulated firms are concerned, there should continue to be a single regulatory handbook, albeit flagged to indicate which regulator is responsible for which module, rule etc. In case of overlap, one regulator should be designated to take lead responsibility.

102. The twin peaks approach inevitably means that dual-regulated firms will have to develop separate relationships with both the PRA and the FCA. Nevertheless, active co-ordination between the regulators could minimise overlaps in respect of many regulatory activities; for example, regarding information requests to firms, discussion and consultation papers, thematic work, enforcement etc. We believe that such coordination should be overseen by a senior Treasury official, who would be empowered to deal with failure of co-ordination.

103. The BSA believes that each of the coordination suggestions outlined above should -

- be included in the forthcoming legislation, or
- if the Government considers it impracticable to do so in the case of any particular proposal, it should commit to a full examination of how the relevant measure might be introduced in practice, or
- if the Government decides not to examine a particular measure, then a reasoned explanation should be provided as to why it is not considered appropriate to include the matter in the new regulatory architecture.

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

104. The BSA agrees with the proposals relating to the management of the risk of disorderly firm failure. It is appropriate that the PRA should hold a veto over the FCA in the unlikely event of the two regulators being unable to agree, but we support the parameters placed on the veto.

[1] http://www.fsa.gov.uk/pages/About/Who/pdf/orgchart.pdf

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

105. As noted above, the BSA firmly believes that there should be a common gateway for firms" authorisations, approvals, variations, waivers, notifications, reporting etc. In light of the commitment towards regulatory coordination, contained elsewhere in the CP, it is disappointing that the only lead proposal in the CP relevant to specific regulatory processes is one that runs counter to such coordination.

106. We believe that dual-regulated firms should not have to apply to both the PRA and the FCA for permission. If the commitment to regulatory coordination is to be carried through in practice, this is an example of where a common gateway should be put in place ie allowing firms to make one application and for the regulators to take up the dual processing themselves. Accordingly, we strongly prefer the alternative approach set out later in chapter 5 (paragraphs 5.38 – 5.40).

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

107. We are content to support the proposals, provided they can be achieved through a common gateway such as that described above.

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

108. Again, we are broadly content to support the proposals, provided they can be achieved through a common gateway such as that described above.

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

109. The proposals for regulatory responsibility and operation in respect of passported firms seem appropriate.

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

110. The BSA, and the financial mutual organisations it represents, seek no special favours and, therefore, we agree with the fundamental position set out in paragraph 5.54 –

> *"The Government is clear that neither regulatory authority should seek to promote or favour one type of ownership model over another, and that consumers should not be advantaged or disadvantaged because of the ownership model of their provider. The same consumer protection, conduct and prudential standards must be applied to every regulated firm, regardless of their ownership model."*

111. However, mutuals do seek a genuinely level playing field and object to unfair competition. During the financial crisis from 2007, large incumbent plc banks benefited disproportionately from the intervention of the authorities, and some continue to enjoy State backing. In addition, those deposit-takers that had not relied excessively on wholesale funding, in the way (for example) that Northern Rock did, were unfairly prejudiced by the FSCS funding model, so that their prudence counted against them in the bail-outs of the Icelandic banks and Bradford & Bingley.

112. It is one thing to make assurances about equal, or fair, treatment, but it is crucial that discrimination against specific business models does not persist *in practice* under the new regime; for example, the definition of core capital in the regulatory requirements should allow instruments that are consistent with mutual ownership.

113. The proposal about cost-benefit analyses is welcome, but – tested against the substantial examples of unfair discrimination highlighted above – it is insufficient to ensure a level playing field for financial mutuals and less than included in the last CP. As we explained in detail in our response, the BSA believes that the FPC, the PRA and the FCA should each have a specific statutory remit consistent with, and in discharge of, the Government"s policy of encouraging financial diversity. There should be a senior member of staff, in both the PRA and FCA, with a specific remit of ensuring that diversity, including the particular position of mutuals, is fully taken into account when these new bodies consider regulatory action.

114. However, as noted above, we recognise that such an approach may be integral to the requirement for proportionality; the CP states (paragraph 4.25) "Proportionality also means that the regulator must tailor its actions to the specific characteristics of the sector being regulated." We would welcome confirmation that our interpretation is correct.

115. Regarding the location of registry functions, we have no strong views but are inclined to agree with the CP that the function is more of a prudential than conduct nature and is probably better located at the PRA. As to the registration arrangements for non-financial mutuals, while we agree with the CP that it seems inappropriate for their registration to be dealt with by a financial services regulator, we suggest that the Government should re-engage with leading representatives of non-financial mutuals, especially Mutuo and Co-operatives UK, with a view to finding a satisfactory alternative.

116. The BSA welcomes the legislative amendments referred to in paragraph 5.58, on which we have worked with HM Treasury. The flexibility regarding payment and settlement systems is particularly needed as societies will need to engage more and more with such systems, both in respect of securities and derivatives. The reference to „shareholders" is technically correct under the building societies legislation, but we note for information to readers of this response that, in the building society context, the term refers to ordinary savers whose "share accounts" confer membership of the society. Building societies do not, of course, have PLC-type shareholders.

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

117. As noted above, the BSA believes that there should be -

- a common gateway for firms" authorisations, approvals, variations, waivers, notifications, reporting etc in dual-regulated firms, including the „integrated regulatory reporting" system being maintained within the common gateway

- retention of a single regulatory Handbook with one of the two regulators being the contact point in areas of potentially shared responsibility.

Provided the proposed arrangements are accommodated within the above mechanisms, we support the proposals.

25 The Government would welcome specific comments on

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

118. The BSA recognises that these matters are now largely governed by EU directives (paragraph 5.66), which seem very complicated, so we have no comments to make on proposals that broadly reflect that governance. The BSA has little direct interest in the point about unregulated holding companies, but we observe that the CP provides no detail about what matters a power of direction would deal with.

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

119. The proposals seem to be sensible.

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

120. As far as our members are concerned, the arrangements appear to be based largely on legislative requirements, so we have no comments.

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

121. We welcome the assurances about effective coordination and consideration of the impact on firms, especially those that are dual-regulated and, in particular, the small, dual-regulated firms. The proposals for collection of the fees appear to be sensible.

122. The crucial point is that the regulators exercise careful control over costs. As noted above, we believe that - apart from transitional costs - an overall cap on the first year budgets of the PRA and the FCA should be introduced, which should be no higher than the current FSA budget (and clear controls be put in place on levels of future budgets).

123. As noted earlier in this response, the FSA‟s supervisory enhancement process significantly inflated the FSA budget. While we supported the process and believe that it has been executed efficiently, it means that the new regulatory arrangements will start from an already high cost base. Even regulators should not be immune from the need to control costs, especially in a difficult economic climate.

<u>Compensation, Dispute Resolution and Financial Education</u>

124. We believe that FOS is fast approaching a crossroads where its future arrangements will depend on whether or not it continues to be required, in effect, to „quasi-regulate‟ mass claims. We set out more detailed comments below, in response to the CP questions.

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

125. The BSA supports the proposals that the PRA should take on the FSA"s powers and responsibilities in respect of the FSCS and that the FCA should assume the equivalent responsibilities regarding the FOS and MAS (formerly known as CFEB). These proposals are consistent with the, respective, prudential and conduct of business responsibilities of the PRA and the FCA.

126. We agree with the Government"s decision to retain the FSCS as a single organisation to administer compensation – it is right that there should be a separate body with this role; it is not appropriate for one of the regulators to assume such responsibility.

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

127. We agree with the statement in paragraph 6.19 that the Ombudsman"s statutory functions and objectives are, and should remain, distinct from those of the regulator. This is entirely appropriate because FOS is meant to be an adjudicator of individual complaints and should be able to conduct that role in an independent manner, free from interference. We support the other measures (outlined in paragraphs 6.20 and 6.21) concerning co-ordination between FOS and the FCA. The BSA also welcomes the proposal for greater transparency regarding FOS determinations.

128. These comments disregard the quasi-regulatory effect of Ombudsman decisions in the so-called „wider implications" (WI) or „mass claims" cases. As far as such cases are concerned, FOS is increasingly part of the continuum that runs through the regulatory and complaints system – the proposal to require FOS to pass certain information to the FCA (paragraph 6.20) underlines this point.

129. The BSA believes that the WI arrangements for dealing with such matters, despite attempts to enhance them over the years, were not a success and we will not mourn their passing (mentioned in FSA Feedback Statement 11/2, in late March 2011). As the CP states, the new tools available to the FSA – especially the section 404 FSMA powers – could, if used properly, have a significant effect and allow FOS to focus on what it was set up to do – ie deal with *individual* complaints. Indeed, the question might reasonably be asked – should FOS continue to be expected to deal with „mass claims" type cases or should it now be allowed to return to its original function?

130. We believe that FOS is fast approaching a crossroads. If it is to continue to be expected to deal with mass claims and is to be increasingly linked, in respect of policies and practices, with regulatory processes then a radical overhaul of its activities and accountability, and also its lack of an appeal process, may well be unavoidable.

131. We recognise that a joint FSA/OFT/FOS statement on claims management companies (CMCs) is due later this year, but we are disappointed at the lack of reference in the CP to the significance of CMCs in relation to FOS and to complaints generally. Last year, 28% complaints were made to FOS on behalf of consumers by CMCs. In our view, their prominence and impact now justifies CMCs –

- being regulated to the same level of conduct of business standards and enforcement as FSA-regulated firms, and

- like FSA-regulated firms, making a financial contribution to FOS.

132. The most recent consultation by FOS on its plan and budget www.financial-ombudsman.org.uk/publications/pb11/pb11-1.html confirms that "Mass claims are usually driven by internet campaigns, claims-management companies and publicity in the media". Some of our members have provided the BSA with evidence that certain CMCs are taking active steps to prevent their clients from communicating with the firm being complained about and seek to push complaints through to the Ombudsman with no serious commitment to mediation. Such practices would be contrary to the forthcoming guidance in the FSA Handbook on handling PPI complaints (PS 10/12) –

> *DISP 3.3.4G – The firm should make all reasonable efforts (including by contact with the complainant where necessary to clarify ambiguous issues or conflicts of evidence before making any finding against the complainant.*

133. There is a negligible cost for the CMC in such a *modus operandi*, but the firm must usually pay a case fee even if FOS reject the complaint (unless FOS decides that it is frivolous or vexatious – in practice only a very small percentage: see below). These organisations usually charge consumers fees or commissions, sometimes in the order of 35% of the ultimate award (if any). The FOS annual review 2009/10 states –

> *"We are a free service for consumers, while commercial companies charge consumers to bring a complaint on their behalf. And our procedures are designed to be simple for consumers to use. We decide cases by looking at the facts – not at how well the arguments are presented. We prefer to hear from consumers in their own words."*
>
> *We decide cases by looking at the facts – not at how well the arguments are presented. We prefer to hear from consumers in their own words And in our experience there is no difference in the outcome of complaints – whether consumers bring them to us themselves direct, or whether they pay a claims-management company to complain on their behalf."*
>
> www.financial-ombudsman.org.uk/publications/ar10/ar10.pdf

134. For several thousands of members of the public to be paying for a service, which according to FOS – overall – leads to no difference in the outcome of complaints, cannot possibly be in the interest of consumers. The current situation is no longer sustainable and the BSA is working with other trade bodies towards possible representations in favour of rule changes in respect of CMCs. These might include, for example, the implementation of the Hunt Review recommendation that, as businesses, CMCs – but not consumers – should be required to pay a case fee.

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

135. The BSA welcome the plans, outlined in paragraphs 6.27-6.28 regarding the accountability of the FSCS, FOS and MAS. We particularly support the proposal that

the National Audit Office should be responsible for auditing these bodies. At any time, but especially at a time of recession, it is crucial that publicly or industry-funded bodies provide good value-for-money.

136. There is a further dimension to **FSCS"** accountability on which we commented earlier in this response. While supporting a statutory requirement for FSCS to publish and consult on its Annual Plan, we also insist on a stronger voice for banks and building societies as levy-payers into the deposit-taking side of the FSCS in relation to any major use of its funds to finance a bank resolution (cf Bradford & Bingley, Icelandic banks). In those situations, FSCS, as the principal creditor in the wind-down of the rump banks, should be overseen by a creditor"s committee representing the deposit-takers who are footing the bill.

137. While the BSA fully respects the importance of the independence of **FOS** in its role as an adjudicator of individual complaints, it has long-standing concerns about the lack of accountability at FOS in respect of wider implications-type cases – see, for example, our response as long ago as 2004 to the FSMA 2 Year Review www.bsa.org.uk/policy/response/100557.htm. In principle, our concerns remain but, as noted above, the consumer redress powers now available to the FSA are capable of addressing some of the difficulties posed by wider implications cases. Also as noted above, the question of accountability of FOS increasingly turns on whether the organisation is to be simply an adjudicator of individual complaints or whether it is also, in effect, to be expected to quasi-regulate mass claims.

138. We believe that there is one modest development in respect of FOS that could be set in train immediately. Firms usually pay a case fee of £500, unless the Ombudsman rejects the complaint on one of certain grounds specified in the Dispute Rules („dismissal without consideration of the merits"). One of the grounds is that a complaint is „frivolous or vexatious". The FOS annual review 2009/10 addresses the matter as follows –

> *"of the 166,321 complaints we settled during the financial year 2009/10, we concluded that 702 cases (0.4% of the total) could be categorised in that way. 677 of these cases were complaints – mostly brought by claims management companies – relating to payment protection insurance (PPI) policies that had never been taken out. We do not charge a case fee to the business complained about where we decide that a complaint is frivolous and vexatious."*

139. It is clear from this that the vast majority of cases deemed to be „frivolous or vexatious" are cases where the firm complained about had not sold the product in the first place. Only 25 of 166,321 complaints settled last year (0.01%) that were determined to be frivolous and vexatious were categorised as such for other reasons – we understand that some of those were frivolous or vexatious because they were „duplicate" complaints.

140. In view of this tiny number in contrast to the fairly broad range of situations covered by the terms „frivolous" and „vexatious", the BSA believes that it would be appropriate for a review to be put in place of FOS"s processes for determining whether or not a case is frivolous or vexatious.

European and International Issues

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

141. We welcome the measures to help ensure proper coordination with the EU and internationally. It is crucial for the UK economy that our regulators are fully involved. The table earlier in this response is limited to conduct of business measures, and does not extend eg to prudential matters, but it still emphasises the substantial contribution made by the EU to UK regulation.

142. It needs to be recognised that much, perhaps most, micro-prudential policy (eg on capital and liquidity) is now settled at EU level with the UK having less and less room for independent manoeuvre. Increasingly, this is also true of conduct of business regulation. So - in future - at least as important as consultation on actual rules and guidance will be consultation on the agreed outcomes that the UK should seek from current and future EU regulatory initiatives, which will then inform the UK negotiating strategy. (As explained above - see response to question 23 - this should include a level playing field for UK businesses of different corporate forms.)

143. This illustrates moreover a fundamental flaw in the FSMA consultation requirements which could have been foreseen before 2001, but is now even more manifest. Where, for instance, a piece of micro-prudential policy is agreed at European level by way of a maximum-harmonising Directive, and FSA has to implement this by way of making rules, it must still go through a meaningless and pointless charade of consultation even though the European legislation must be implemented without amendment or super-equivalence. But at the point where consultation and cost-benefit analysis might actually have added some value – i.e. before settling on the policy position which the UK would advance in European negotiations – there is no requirement to do so.

144. We suggest that this lacuna be addressed as follows - there should be a standing requirement for the Treasury, PRA or FCA as the case may be, to carry out both consultation and cost-benefit analysis on any proposal for European legislation in order to establish what negotiating position actually represents the UK national interest. Informal soundings are simply not robust enough.

145. It is imperative that the UK regulators coordinate closely with the European authorities in order to –

- represent the UK interest – UK regulators will no doubt understand the need to ensure that their divided roles must not be allowed to reduce the strength of UK representation in the EU regulatory framework, and
- avert further episodes of legislative „front running" ie where UK agencies introduce new laws and rules, which then have to be unravelled because of the implementation of EU legislation that was already in the pipeline when the UK exercise began (consumer credit legislation is a clear example of this practice, which is very unhelpful to the UK economy – see www.bsa.org.uk/policy/response/response_hmt_bis.htm). It would be most welcome if, in addition to its very helpful recent commitment against „gold-plating" of EU law, the Government could also commit to ending the damaging practice of „front-running".

The Building Societies Association
13 April 2011