Maximilian J B Hall, Professor of Banking and Financial Regulation
Department of Economics
Loughborough University Leicestershire LE11 3TU UK
Switchboard: +44 (0)1509 263171 Department: +44 (0)1509 222714

Emil Levendoglu
Head of Financial Regulation Strategy
HM Treasury
Room 3/09
1 Horse Guards Road
London
SW1A 2HQ

Loughborough University

Direct Line: +44 (0)1509 222714
Fax: +44 (0)1509 223910
E-mail: M.J.Hall1@lboro.ac.uk

14 September 2010

Dear Mr Levendoglu

Thank you for your e-mail of 8 September. I'm afraid I do not have the time to answer the consultation questions set out in Appendix A to HM Treasury's July 2010 publication entitled "A new approach to financial regulation: judgement, focus and stability", but, nevertheless, enclose for your interest three recent publications of mine which address most of the issues raised from a personal perspective. My main concern regarding the proposed "structural" changes is that there is no guarantee that returning prudential regulation and supervision to the Bank of England from the FSA will raise the cost-effectiveness of regulatory and supervisory policy. I concede that the FSA performed poorly in the run-up to and during the recent financial crisis but, I would argue, it seems to have already "raised its game" considerably since then under new leadership; and the same charge could be levied against the Bank. Accordingly, I, for one, would be willing to give the FSA the chance. The Bank of England's previous "failings" with respect to Johnson Matthey Bankers, BCCI and Barings, although evident some time ago, do not inspire confidence that the policy *volte face* will necessarily prove productive. I remain unconvinced that the required changes in culture at the Bank to promote sound regulation and supervision will emerge; I look forward to being proved wrong. Moreover, the dramatic increase in responsibilities to be given to the Bank raise concerns about its future credibility (because of the inevitability of future bank failure) and independence (because of Parliament's increased scrutiny).

As for the switch to a "twin peaks" type structure, it is not self-evident that "performance" will improve. I believe the criticism of the FSA's alleged pre-occupation with "conduct of business" rules, to the detriment of its other supervisory duties, is somewhat overdone.

In summary, given the enormous "costs" associated with the proposed changes, I am not convinced that either the cost-effectiveness or the effectiveness of financial regulatory and supervisory policy will improve vis-à-vis the current, post-crisis operating environment should the current reform proposals be implemented. This is not to argue necessarily in favour of the status quo – my own structural reform proposals are set out in my "UK Financial Reform" publication – but some cost-benefit analysis might usefully be undertaken of alternative structures.

With best wishes.

Yours sincerely

M. J. B. Hall

Maximilian J. B. Hall
Professor of Banking and Financial Regulation

Encs

Response to HMT paper [Cm7874] on a new approach to financial regulation

By Peter Hamilton,
Barrister

Introduction

1. I am a barrister in practice at the above address. I have been involved in the regulation of the retail end of the financial services market since Professor Gower published his review in January 1984.[1] At that time I was the company secretary and head of the legal department of Hambro Life Assurance plc.[2] I returned to the Bar in the spring of 1991. Since then, issues arising from the regulation of financial services have formed a substantial part of my practice.[3]

2. In this paper I address two important issues which are raised in the Treasury's paper on a new approach to financial regulation ("the paper") which was published in July 2010, namely:
   (a) The relationship between the CPMA and the government; and
   (b) The relationship between the FOS and the CPMA.

3. I deal with each issue briefly. But if it would be helpful to expand or explain any point further, I would be happy to do so.

4. I have adopted the abbreviations used in the Treasury's paper.

[1] *Review of Investor Protection*, Cmnd 9125.
[2] Later to become Allied Dunbar Assurance plc.
[3] My full CV is available on request from the clerks@4pumpcourt.com.

The relationship between the CPMA and the government

5. In paragraph 4.30 of the paper, it is said that the "new CPMA will be independent of Government." It is not clear from the paper to what extent the CPMA will in practice be independent of the government, given its duty[4] to work closely with the Bank of England and the Prudential Regulation Authority, which is to be a subsidiary of the Bank. But one of the dangers of its nominal independence is that it might be excluded from the jurisdiction of the Parliamentary Ombudsman.

6. One of the defects in the present regulatory framework is that the FSA is not within the jurisdiction of the Parliamentary Ombudsman.

7. The office of the Parliamentary Ombudsman is an important part of the constitutional arrangements of the UK. It is important that there should be an independent person who has the jurisdiction to investigate allegations of maladministration in government departments and other bodies, especially those established to take on duties which would otherwise have to be performed by the government itself. If the FSA had not been created, the job of regulating the financial services industry would have had to be carried out by the government. Indeed, before the Financial Services Act 1986, those aspects of financial services that were regulated at all, were regulated by the DTI.

8. The role of the Parliamentary Ombudsman in the investigation of failures in administration is important for at least two reasons. First, she provides the last resort for citizens whose complaints and grievances have not been properly addressed in other ways, either through normal complaints' procedures or by means of legal action. Secondly, if the citizen in question has sustained loss or damage, although she cannot herself award compensation, her recommendation that compensation should be paid is usually followed by the department concerned. In the case of the FSA, its statutory immunity from legal action means that in practice the victims of maladministration by the FSA are without remedy. This is because the FSA is not subject to the jurisdiction of the Parliamentary Ombudsman, and so she is not able to help.

[4] See paras 2.48 to 2.51 of the paper.

9. Although there is a Complaints Commissioner appointed under the Financial Services and Markets Act 2000, that officer does not have the same status as the Parliamentary Ombudsman, chiefly because he does not report direct to Parliament.

10. The Parliamentary Ombudsman produced the much admired report in which she exposed the maladministration of the FSA (when during the 1990s it was acting as the agent of the Treasury and its predecessors) relating to the prudential regulation of Equitable Life during the 1990s.[5] Thanks to her, it is now likely that Equitable Life policy holders will receive some compensation.[6]

11. By contrast, experience shows that one cannot rely on those working in the relevant areas to self-correct the way in which things are done.

12. Thus, shortly after Equitable Life closed to new business, the FSA's internal audit department carried out an inquiry into the FSA's performance from 1 January 1999 to 8 December 2000 which was the date on which the company actually closed to new business.[7] It concluded that the FSA could have done better in crucial respects. For example, the report concluded that the prudential regulation of the insurance companies was less intrusive and involved compared with the regulation of banks. The report recommended that the FSA should "be prepared to act more proactively… to ensure that the interests of customer are properly protected".[8] In other words, the FSA should take action when necessary to protect customers.

13. In her report referred to above into the prudential regulation of Equitable Life, the Parliamentary Ombudsman made 5 findings of maladministration against the FSA.[9]

14. Northern Rock provides the next example. One of the reasons for its failure was its flawed business plan: it was borrowing short and lending long. That was of course a management failure. Anyone, including the FSA, giving that business plan appropriate thought would have concluded

[5] *Equitable Life: a decade of regulatory failure*, HC 815-I, 16 July 2008.
[6] See the Equitable Life (Payments) Bill 2010-11, which is now before Parliament.
[7] The Baird Report, published by the House of Commons on 16 October 2001.
[8] The Baird Report, para 7.7.
[9] See her report, chapter 11.

that there were undue risks. But the FSA apparently did nothing.

15. Again, the FSA's internal audit department carried out an inquiry and issued a report which concluded that the FSA should have done better.[10] On the same day[11] as the principal conclusions of that report were published, Hector Sants issued a response in which he said:

> "As we have already made clear…, the failure of Northern Rock should first and foremost be attributed to the failure of its board and executive to create a durable funding model which could withstand the exceptional set of market circumstances that occurred in summer 2007. Nevertheless, the FSA acknowledges that its supervision of Northern Rock… was not of sufficient intensity or appropriate rigour to challenge the company's board and executive on their risk management practices and their understanding of the risks posed by their business model."

In other words, there was no proper challenge and a failure to take appropriate action.

16. HBOS provides a further example. As a result of the disclosures made by Paul Moore[12] to the Treasury Select Committee in early 2009, the FSA felt compelled to issue a press release on 11 February 2009. It speaks volumes about the FSA's own performance as well as that of HBOS. The FSA said that it had carried out a full risk assessment of HBOS in late 2002, in which "it identified a need to strengthen the control infrastructure within the group". Another risk assessment followed a skilled person's report[13] in 2004, and the FSA concluded "that the risk profile of the group had improved…but that the group risk functions still needed to enhance their ability to influence the business…".

17. After Paul Moore's dismissal at the end of 2004, the FSA continued to pursue its concerns, and wrote to HBOS on 29 June 2006 (ie about 18 months after Mr Moore's dismissal) with yet a further risk assessment. The FSA's letter said that there were still control issues and that it would closely track progress in this area. In its letter, the FSA added that "the growth strategy of the group posed risks to the whole group and that these risks must be managed and mitigated". Not

[10] Published in March 2008.
[11] 26 March 2008.
[12] Ex-head of regulatory risk at HBOS. He was dismissed by James Crosby in December 2004.
[13] Under s. 166 of the Financial Services and Markets Act 2000.

long afterwards HBOS failed.

18. The FSA's press release of 11 February 2009 begs the question of what steps the FSA itself took to ensure that the risks to the *whole group* were indeed managed and mitigated, and why, if the FSA did act, did HBOS fail? The answer might well be, as with Equitable Life and Northern Rock, there was no proper challenge of the management and a failure to take appropriate action.

19. It would be an important and substantial improvement to the regulatory regime if the CPMA were to be brought within the jurisdiction of the Parliamentary Ombudsman so that any future maladministration could be investigated, and exposed by a report to Parliament. That improvement would benefit the customers of the regulated community, that community itself, and the FSA.

The relationship between the FOS and the CPMA

20. It would also be an important and substantial improvement if the FOS were to be removed from the regulatory regime altogether and, with appropriate modifications, transformed into a tribunal under the Courts' Service and the Ministry of Justice.

21. The government proposes that the CPMA will take on the FSA's existing responsibility for the FOS. The paper says[14] –

> "It will be important for FOS to remain independent of the CPMA, as is currently the case with respect to the FSA. Its claim to impartiality, and hence its legitimacy in making rulings which is binding on firms, is only credible if it does not favour, or appear to favour, consumers. Therefore it should not be part of a consumer champion. Similarly, FOS decisions to reject particular complaints will only be credible if it is independent of bodies with, for example, a financial stability objective."

22. There is a confusion of thought in that paragraph. The government is right to emphasise that the legitimacy of the FOS depends on its impartiality, which in turn depends on its independence. In particular, the government is right to say that FOS should be independent of the CPMA which will be "a strong consumer champion". But the government has reached the wrong conclusion. It makes no sense to propose that the FOS should continue to be subject to the supervision of the very body from which it should be independent. On the contrary, the point made by government should lead to the conclusion that the relationship between the FOS and the CPMA should be completely severed.

23. Most people involved in the financial services industry do not regard the FOS as independent of the FSA, because, for example, the FSA makes the rules relating to time limits within which complaints may be entertained by the FOS[15], and is responsible for the much-criticised and disliked failure to include a long-stop time limit analogous to s.14B of the Limitation Act 1980. The FSA also appoints members of the board of the company that operates the FOS, and has the

[14] At para 4.44

[15] Financial Services and Markets Act 2000 ("FSMA"), s.225(4) and Sched 17 para 13.

power to dismiss them in certain circumstances.[16] The FSA must approve the budget proposed by FOS before the start of each financial year.[17]

24. Further, there is a wide-spread view that the FOS appears to favour consumers. That may not be an accurate perception, but it is widely held. The fact that that perception is held should be a powerful argument for correcting it. The first corrective step should be to sever the relationship between the FOS and the CPMA. The FOS should then become part of the tribunal system. That would ensure its independence and its impartiality. In other words, the FOS should become a specialist tribunal, run by the Courts' Service under the Ministry of Justice. That could be done without making many changes to the broad way in which the FOS currently operates.

25. Such a reform would have several other advantages, including –
(a) the decisions would become appealable, and not subject only to judicial review;
(b) the ombudsmen would apply the law of England or, if appropriate, the law of Scotland or Northern Island, including the law of limitations; and
(c) the larger cases, with a value, say of £50,000 or more, and involving issues of professional conduct and negligence, would be tried in a way that reflected their value and importance to the parties, in public, and in accordance with normal rules applicable in comparable tribunals.

26. It would probably be necessary to retain the case worker approach so that unrepresented complainants could get some help in the proper framing of their cases. The cost of the tribunal could be met by the financial services industry through a case fee.

27. There are undoubtedly many other details and issues to be addressed in order to implement this reform. But none appear to be insuperable.

[16] FSMA Sched 17, para 3.
[17] FSMA Sched 17, para 9.

PETER HAMILTON

18 October 2010

Dir + 44(0) 20 7887 1000
Fax +44 (0) 20 7887 1010
john.nelson@hammerson.com

Hammerson

John Nelson
Chairman

Your ref
Our ref SJH\2026439v1\SZR

12 October 2010

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

By post and email: financial.return@hmtreasury.gsi.gov.uk

Dear Sirs

HM Treasury – A New Approach to financial regulation: judgement, focus and stability.

We write in response to the consultation document and in particular the question of whether the UK Listing Authority ("UKLA") should be part of the new Consumer Protection and Markets Agency wholesale markets division ("CPMA") or the Financial Reporting Council ("FRC").

Having considered the proposal, we support the London Stock Exchange's view that the CPMA wholesale markets division would be the appropriate place for the UKLA for the following reasons:

- **Need for focus on enforcement and implementation** which fits better with the role of the CPMA, rather than the FRC the focus of which is more related to policy development.

- **The overlap with CPMA market supervision functions** will deliver synergies and more effective application of regulation and enforcement.

- **Consistent with current Government aims.** Placing the UKLA in the CPMA wholesale markets division would be consistent with the Government's drive for a true 'twin peaks' model to avoid the problems that arose with information flow in the current tripartite system.

- **The need for a commercially-orientated UKLA.** To ensure we preserve the attractiveness of London as a capital raising centre, it is critical to have a quick and efficient listing and capital raising process in the UK. This requires the UKLA to be commercially-oriented and familiar with the latest market practices, developments and integrated into the wider regulation of wholesale markets.

- **The role of the UKLA is a regulator of securities, and not of companies**

- **The need for a strong voice in Brussels.** The UK will only have one voting member at ESMA, which will be the CPMA markets division. It is vital that the UK representative is able to speak with direct authority on both primary and secondary market issues.

- **Maintaining London's ability to compete internationally** Our ability to strengthen and improve the standards for listing in London, as set by the European Directives for Prospectus, Disclosure, Transparency and Market Abuse, is key to London's ability to compete internationally. It is important that this standard is preserved and that London's ability to preserve its unique listing rules in maintained at ESMA, and not eroded in the name of European harmonisation.

The core aim of the Government's consultation on financial regulation is to enhance the UK's financial stability and to avoid another financial crisis. This is an opportunity to deliver a robust, commercially-orientated regulatory system, which will enable the UK's financial services sector to continue to compete on the global economic stage.

Placing the UKLA in the CPMA wholesale markets division is an important step towards achieving this. Placing the UKLA within the CPMA is also consistent with the Government's vision for a 'twin peaks' regulatory model.

We believe that this outcome is critical to London and the UK's ongoing competitiveness and attractiveness as a listing and trading venue.

Yours faithfully

John Nelson
Chairman

UNIVERSITY OF Southampton
School of Law

Response to Consultation: *HM Treasury A new approach to financial regulation: judgement, focus and stability* (CM 7874, July 2010)

Response to Markets and infrastructure
Questions 17 and 18 only

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

1. A merger of UKLA with the FRC, as a first step towards creating a companies regulator under BIS, is desirable and I would support the proposed change in structures.

2. An oddity of company regulation in the UK is that once incorporated there is little by way of oversight of companies other than through disclosure via the public registry, Companies House. Occasionally, investigations and disqualifications occur, but typically on insolvency only (investigations and disqualifications' staff are located tellingly within the Insolvency Service). Enforcement of the companies legislation (mainly the Companies Act 2006) is primarily a matter for civil remedies by those aggrieved and for many reasons civil remedies are pursued only in a limited number of cases. Criminal prosecutions are rare.

3. Of course, for most companies most of the time, the approach outlined above is appropriate. Of the 2.3m companies on the register of companies, roughly 85% have an issued share capital of £100 or less. They are economically insignificant and not worthy or requiring of regulation to a degree greater than that noted. Companies House

pursues these companies for non-filing of their annual accounts and returns and the Insolvency Service pursues a small number of their directors for disqualification if, on insolvency, they are found to be unfit. Individual shareholder disputes are resolved as a civil matter via a useful statutory procedure governing unfairly prejudicial conduct within the company. If those companies are set to one side, that leaves about 15% of the register, 345,000 companies, as potentially economically significant (further statistical analysis would shrink that figure considerably, no doubt) made up of a mixture of large private companies and public companies. It is on these economically significant enterprises that any regulator will want to concentrate.

4. The question then is the appropriate level and manner of regulation of those private and public companies which are economically significant and whose collapse would have serious repercussions for providers of capital/credit and employees. The aim is to try to prevent their collapse to the extent that that is possible (i.e. by trying to minimise non-economic reasons for collapse such as fraud, incompetence, poor judgment and management).

5. This regulatory aim is promoted by: (a) imposing standards of conduct on those running a company in an attempt to minimise the risks; (b) imposing obligations of disclosure and transparency which allow others to monitor the risks and, if necessary, take corrective and/or evasive action; and (c) imposing sanctions when collapse occurs for reasons other than economic factors. This last element raises issues beyond the scope of this initial question of the merger of the FRC and UKLA and is more an issue as to the powers of any new companies regulator so it is not considered further here. The question is how do the current structures address (a) and (b), above, and how would the proposed change improve matters ?

6. At the moment, standards of conduct are imposed and transparency required through a mixture of hard and soft law techniques. The hard law is derived primarily from the Companies Act 2006, the Financial Services and Markets Act 2000 and related subordinate legislation with responsibilities at this level divided between BIS (overall responsibility) and UKLA (responsibility for the areas addressed by the Listing Rules (LR), the Prospectus Rules (DR) and the Disclosure and Transparency Rules (DTR)). Alongside there is an ever-increasing body of soft law mainly within the remit of the FRC, covering in particular corporate governance, stewardship and accounting and audit issues (though there are elements of hard law on accounting and audit, especially). There are also soft law contributions from the UKLA through its influential guidance and technical notes.

7. There is then an overlap in the manner of regulation but also in content and coverage. For example, the FRC, through the UK Corporate Governance Code takes a leading role on board matters such as appointments, composition, structure, role, risk management, internal controls etc. Many of these matters are also addressed in the LR and, of course, 'comply or explain' as far as the Code is concerned is embedded in LR9.8.6(5) and (6). The Corporate Governance Code provides significant guidance on audit committees which are also the subject of DTR 7.1. Likewise on stewardship, the FRC has just taken responsibility for the Stewardship Code (which essentially addresses institutional shareholder engagement) and shareholder engagement is reflected also in various requirements of the LR and DTR, for example on proxy rights and communication with and dissemination of information to shareholders. On accounting and audit issues, the FRC takes the lead through the work of its constituent bodies, the Accounting Standards Board and the Auditing Practices Board, while the LR and DTR too address accounting and audit issues such as the content and publication of annual accounts and reports.

8. A detailed analysis would reveal many specific examples of overlap, yet the bodies promulgating the rules are different, the wording of the requirements are different (contrast the Corporate Governance Code and the DTR requirements on audit committees), the legal basis for the various requirements is different (depending on whether a soft or hard law option is used and subject to European obligations) and the scope of application is different. The FRC remit extends to all companies though the application of a particular requirement may be more narrowly focused whereas the UKLA is primarily concerned with listed companies though, for example, the Prospectus Rules apply to non-listed companies wishing to make a public offer.

9. It is confusing and expensive for companies to keep track of all of these requirements and rather than having two sources of obligations, these matters should form the remit of a single unified body. Having a single body would also allow the regulatory choice as between soft and hard law tools to be made in the light of the most appropriate method of addressing the matter under consideration and taking into account European requirements. A single body pulling together a broad spectrum of expertise, focused on targeted standard-setting and oversight, should generate a better, more coherent, regulatory process resulting in better drafted and clearer regulation from one source only which is easier for business to understand and implement.

10. While the current remit of the FRC is wide, capital raising is the missing element from the range of corporate activities covered by the FRC. Bringing that aspect of corporate regulation and investor protection within the FRC allows for the FRC to develop a focus on shareholders and stewardship (investor protection and engagement being core aspects of any such focus) to complement the extensive work the FRC currently does (through the UK Corporate Governance Code) on directors and board structures and processes. Given that accounting

and audit issues are already a pillar of the FRC structure, bringing capital raising within the FRC creates a more complete regulatory structure covering the core activities of the corporate enterprise.

11. Even without a merger, in all probability the remit and influence of the FRC is likely to continue to expand as efforts are focused, internationally as well as nationally, on improving the regulation of economically significant companies in recognition of the social, economic and political consequences of their collapse. These developments create a corresponding need for the UK to have a strong companies regulator to take a lead on these issues. A merger of UKLA with the FRC would allow for a single point of focus for domestic representations on corporate regulation (from bodies such as the AIC, ABI, NAPF, IOD, ICAEW etc) and a single point of response to international governance initiatives with which the UK needs to engage, for example, perhaps contributing to the corporate governance work of the OECD or responding to initiatives from organisations such as the International Corporate Governance Network or simply looking at broader governance lessons from specific regulatory responses, such as Basel III on the financial crisis.

12. To sum up, a merger of the FRC with the UKLA would:

- facilitate the development of a more coherent, balanced, framework of soft and hard law rules governing larger companies which would be more easily understood and implemented by business; it would eliminate the overlap and duplication of effort otherwise arising from having two sources of obligations and reduce the costs to business of complying with equivalent but not identical requirements;

- bring greater clarity and coherence to the regulatory framework overall; provide a single point of focus for domestic representations concerning corporate regulation and a single voice to respond to international initiatives; and provide a foundation for further evolution into an effective companies regulator.

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

13. As discussed above, capital raising is the missing pillar from the FRC's remit from the perspective of corporate regulation and I would not consider, at this stage at least, that there are other aspects of financial market regulation which should be moved to a companies regulator. Issues concerning takeovers would potentially be something for a companies regulator but, given the pre-eminence of the Takeover Panel, it would be difficult to make a case for any transfer of this area at the moment, though there will necessarily be some degree of overlap on issues such as directors' duties and shareholder protection between the Panel and any other company regulator.

Professor Brenda Hannigan
Professor of Corporate Law
University of Southampton
Faculty of Business and Law

11 October 2010

A New Approach To Financial Regulation: Judgement, Focus And Stability

RESPONSE TO CONSULTATION PAPER

Braydon Heape, Solicitor, MA, LLB (UNSW)

A New Approach To Financial Regulation: Judgement, Focus And Stability

RESPONSE TO CONSULTATION PAPER

Overview of Chapter One of the Consultation Paper

HM Treasury's recent Consultation Paper *A New Approach to Financial Regulation: Judgement, Focus and Stability* sets out the Government's detailed plans for a new model of financial services regulation and supervision in the UK.

The introductory chapter establishes the context for the reforms, the central element in which is, of course, the occurrence of the worst financial crisis in a century. The factors identified as contributing to this outcome include a set of global economic circumstances comprising unsustainable trade imbalances, mismanagement of banks' funding and general business models, the build-up of excessive debt levels, and the growth of an unregulated shadow banking system. The authors admit, however, that fundamental regulatory failings were also involved. Regulators did not identify and address problems as they emerged, and they failed to address them adequately after the financial crisis erupted.

The paper attributes these errors to the incoherence of the tripartite regulatory model for financial services introduced in 1998, encompassing the Bank of England (the "Bank"), the Financial Services Authority (the "FSA") and the Treasury. In particular, it is said that the regulatory model:

- over-burdened the FSA with prudential and consumer protection duties;
- charged the Bank with financial stability, but failed to equip it with the tools necessary to achieve that objective; and
- gave the Treasury broad responsibility for the entire regulatory framework, but none for emergencies.

In essence, it is said, no single regulator had responsibility for macro-prudential policy[1], which, as a result, fell between the gaps. In addition, the authors are critical of the FSA's approach to micro-prudential policy (the focus on the solvency of particular firms), which

[1] Macro-prudential policy has been defined by Professor Davis of Brunel University as "policy that focuses on the financial system as a whole, and also treats aggregate risk as endogenous with regard to collective behaviour of institutions" – E.P. Davis and D. Karim "Macroprudential regulation – the missing policy pillar" Keynote address at the 6th Euroframe Conference on Economic Policy Issues in the European Union, 12th June 2009, entitled "Causes and consequences of the current financial crisis, what lessons for EU countries?"

they characterise as formalistic, and lacking in substantive evaluation of the business models of firms.

The framework for the Government's reform involves three elements, on which the Government bases three new regulatory institutions.

First, there will be a central role for macro-prudential policy, the institutional headquarters for which will be a new Financial Policy Committee (FPC) in the Bank of England, a forum analogous to the existing Monetary Policy Committee. The FPC will include a new Deputy Governor for prudential regulation.

Secondly, micro-prudential regulation will become the responsibility of a new subsidary of the Bank, to be called the Prudential Regulation Authority (PRA). The FPC will have the power to direct the PRA to implement macro-prudential policy in relation to all firms under its supervision. The new Deputy Governor for prudential regulation will be the chief executive of the PRA.

Thirdly, "conduct of business" regulation[2] will be carried out by a new consumer protection and markets authority, able to dedicate its resources and focus to the protection of consumers and the conduct of participants in wholesale markets.

Observations on Chapter One of the Consultation Paper

While there are no consultation questions seeking feedback on Chapter One of the Consultation Paper, the correct analysis of the deficiencies in the existing regulatory regime is clearly critical to generating appropriate reforms.

With this in mind, it is worth noting that there appear to be three omissions in the analysis:

- no consideration is given to the emerging view that supervisory will, rather than regulatory structure, was a key difference between regulators who dealt successfully with the financial stability challenges posed by recent destabilising global trends and those who did not;
- little justification is given for the counterfactual implication that the Bank would have been successful in prosecuting macro-prudential regulation if it had been provided the machinery to do so;

[2] Essentially, regulation of matters concerned with the marketing and disclosure of financial products, but extending to wider concerns involving the honest and efficient conduct of financial services business.

- no international comparative analysis has been presented justifying the new financial regulatory institutional structure proposed.

In the following sections I make some brief remarks on each of these points.

Supervisory will

On the first point, it is now widely considered that supervisory attitudes were a key distinguishing factor in the relative performance of financial services regulators over recent years. In a paper last year for a World Bank conference on financial regulation and supervision, John Palmer and Caroline Cerruti expressed the view that "supervisory culture and behaviour" were more important in shaping regulatory outcomes than rules and regulations.[3] Furthermore, the IMF recently highlighted good supervision (as opposed to regulation) as a difference between the performance of prudential regulators in the lead-up to the financial crisis.[4] That view has been reiterated by others. For example, John Laker, the Chairman of the Australian Prudential Regulation Authority (APRA) has strongly endorsed the IMF's view. In an appearance before the Australian Senate Committee on Economics recently, Mr Laker stated:

"As many now acknowledge, some advanced countries with similar financial systems, operating more or less under the same set of global regulations, were less affected than others in the crisis. Australia is one such country. While there may be a number of reasons for this, the IMF has recently highlighted one explanation — that supervision in some countries had not proved to be as effective as it should have…. The IMF identifies the key elements of good supervision as being "intensive, sceptical, proactive, comprehensive, adaptive, and conclusive." The IMF goes on to say that: "To achieve these elements, the "ability" to supervise, which requires appropriate resources, authority, organisation and constructive working relationships with other agencies must be complemented by the "will" to act.""[5]

Clearly, APRA performed well as a bank supervisor in recent years, and it appears to be a good example of a regulator that benefited from a superior supervisory culture. However, the history of the regulator has not been untroubled, and the culture and attitude were fostered by difficult experiences. APRA recently acknowledged that the "scrutiny and soul-searching", occasioned by the collapse of the HIH Insurance group in

[3] "Is there a need to rethink the supervisory process?"paper presented at the international conference on "Reforming Financial Regulation and Supervision: Going Back to Basics", Madrid, 15 June 2009, available at www.bde.es.
[4] *The Making of Good Supervision: Learning to Say "No"*, available at www.imf.org.
[5] Opening Statement, Appearance before Senate Standing Committee on Economics, Canberra 3rd June 2010, available at www.apra.gov.au.

in the early part of the decade, and the Royal Commission that followed, strengthened the Australian regulatory regime for the unprecedented stress of the global financial crisis.[6]

The Royal Commission's recommendations on supervisory attitude were therefore clearly important in fortifying APRA's questioning and proactive approach to the supervision of key financial institutions over recent years. It is worth noting the Royal Commissioner's (Justice Neville Owen's) recommendations in this regard, to gain an insight into the development of APRA's approach to supervision. The recommendations were:

> "26 I recommend that the Australian Prudential Regulation Authority develop a more sceptical, questioning and, where necessary, aggressive approach to its prudential supervision of general insurers. Consultation, inquiry and constructive dialogue should be balanced by firmness in its requirements and a preparedness to enforce compliance with applicable standards.…
>
> 27 I recommend that the Australian Prudential Regulation Authority continue to develop and review processes, guidelines and training to assist its staff in considering the appropriate approach to take towards supervised entities in different situations.
>
> 28 I recommend that the Australian Prudential Regulation Authority develop systems to encourage its staff and management continually to question their assumptions, views and conclusions about the financial viability of supervised entities, particularly on the receipt of new information about an entity."[7]

Competence of the Bank

Secondly, the implied view that the Bank would have more effectively supervised the macro-prudential aspects of financial stability is not adequately explained by the authors of the Consultation Paper. What was the role of the Deputy Governor for Financial Stability at the Bank prior to the crisis?[8] If that role was appropriately discharged without regard to macro-prudential policy, in what way are monetary and macro-prudential policy in fact complementary, such that the Bank has a natural role to play in both? Further, if the Bank has had no recent role in macro-prudential advice or policy, and that responsibility was solely reposed in the FSA as suggested by the authors, how does that now qualify the Bank to supervise such policy?

---

[6] "Reform of Global Banking Regulation: Balancing National and International Interests" paper presented by Wayne Byres, Executive General Manager of APRA at the Bond University Symposium on the Global Financial Crisis, 9 April 2010, available at www.apra.gov.au.
[7] HIH Royal Commission Report, available at www hihroyalcom.gov.au
[8] The House of Commons Treasury Committee sought answers on this question in its proceedings on 1 February 2007.

On the other hand, if the Bank is indeed best-placed and best-qualified to supervise deposit-taking institutions, does it also have the expertise necessary to supervise insurance companies, the failures of which are far-reaching - as the HIH example shows - if not, in the same way as banks, systemic?

Comparative analysis

Thirdly, has any comparative analysis of the proposed new structure of regulators been performed? As a close international comparator would appear to be the Australian model, has any scrutiny been done of the Wallis Inquiry recommending that model, or the HIH Royal Commission's Report recommending changes to it? Is there any other precedent for the model proposed?[9]

To conclude these observations on Chapter One, the Government may now have committed itself irrevocably to the regulatory structure outlined in the Consultation Paper, but I believe it nonetheless needs to recognise the importance that supervisory culture must play at the new PRA. It must not rely on an untested Bank to supply it. This needs to be recognised not only in relation to the prudential regulation of banks, but also, more obviously, in relation to insurers, and other supervised financial institutions. I believe the Government should take full advantage of the technique of international comparison in shaping its new regulatory architecture, to benefit from other insights available from regimes that managed the crisis well. Where relevant, these points are developed further later in this submission.

Chapter Two of the Consultation Paper

This chapter describes further the nature and purpose of the FPC. According to the Consultation Paper, the objective of the FPC will be:

"to protect financial stability by:

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

The authors recognise that the actions of the FPC will have ramifications for the supply of credit in the economy. This will of course impact on the activities of businesses and households, and on the level of bank profits. The FPC will also need to take into account the objectives of its co-regulators in pursuing its primary objective. There is a case for

[9] A letter to the editor of the Financial Times dated 21 June 2010, from Mr David Green, suggests that there is no precedent for the proposed UK model.

for making explicit these considerations. In regard to this issue, the authors pose the following consultation questions:

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

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

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

Response to consultation questions in Chapter Two of the Consultation Paper

The FPC should explicitly take into account secondary factors for which its primary obective has important consequences. Financial stability is not of course an objective to be achieved at all costs. The legislation should recognise this fact.

However, this indirectly exposes the Bank to the kind of pressure that is exercised in every business cycle to justify unsustainable levels of leverage and inadequate reserving in financial institutions. The solution, I believe, is legislatively to require the FPC to have regard to the desirability of adopting a sceptical, questioning approach to the financial viability of the institutions it supervises. I suggest the following wording, based partly on the recommendations of the HIH Royal Commission:

(1) The FPC must so far as reasonably possible discharge its functions in accordance with its regulatory objectives.

(2) The regulatory objectives of the FPC are to protect financial stability by—
(a) improving the resilience of the financial system by identifying and addressing aggregate risks and vulnerabilities across the system; and
(b) enhancing macroeconomic stability by addressing imbalances through the financial system.

(3) In discharging its functions in accordance with its objectives the FPC must have regard to—
(a) the desirability for the overall health of the UK's economy of economic participants having appropriate access to credit;

(b) the desirability of maintaining consistency with the objectives of the PRA and CPMA;
(c) the desirability of it continually questioning its assumptions, views and conclusions about the financial viability of supervised entities; and
(d) the desirability of it fostering within the PRA a culture in which staff and management continually question their assumptions, views and conclusions about the financial viability of supervised entities.

The balance of Chapter Two of the Consultation Paper addresses in further detail the macro-prudential function of the FPC, the macro-prudential tools to be made available to it by regulations, the membership of the FPC, its relationships with co-regulators, disclosure and accountability matters, and implications for the Bank. No feedback is sought on these matters.

Nonetheless it is worth noting that, in addition to the new Deputy Governor for prudential regulation, one other member of the FPC will be a Deputy Governor for Financial Stability, whose own committee is to be abolished. It is not absolutely clear why two Deputy Governors with apparently closely related roles are needed on the FPC.

It is also notable that the external members of the FPC are to include persons having expertise in insurance. In my view these appointments will be very important in order to balance the overwhelming focus on banking that will be created by vesting macro-prudential responsibilities in the Bank.

Chapter Three of the Consultation Paper

Chapter Three details the role and functions of the PRA. The primary objective of the authority will be "to promote the stable and prudent operation of the financial system through the effective regulation of financial firms". In a similar way to the FPC, the issue of the PRA's obligation to have regard to consequential matters in exercising its primary objective arises. The following consultation questions are raised on this issue:

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

the PRA should have regard.

In my view, in a similar way to the FPC, the PRA should explicitly take into account secondary factors for which its primary objective has significant consequences. Again, the promotion of financial stability and prudence should not be an unconstrained objective, if this would eliminate consideration of other legitimate objectives such as competitiveness. However the PRA should be encouraged to take a sceptical view of asserted loss of competitiveness, in light of the primacy of long-term financial stability.

I do not believe that references to innovation should be maintained. However this is principally because innovation is an aspect of competitiveness.[10] To mention both is to over-emphasise the point. The three existing references to competition in the current provision (one specifies international competition) are likewise overdone. The other existing principles for good regulation set out in section 2 of the Financial Services and Markets Act 2000 ("FSMA") should, however, be retained. I suggest the following wording:

(1) The PRA must so far as reasonably possible discharge its general functions in accordance with its regulatory objective.

(2) The regulatory objective of the PRA is to promote the stable and prudent operation of the financial system through the effective regulation of financial firms.

(3) In discharging its general functions in accordance with its objective the PRA must have regard to—
(a) the need to use its resources in the most efficient and economic way;
(b) the responsibilities of those who manage the affairs of authorised persons;
(c) the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;
(d) the need to minimise the adverse effects on competition that may arise from anything done in the discharge of those functions;
(e) the desirability of maintaining consistency with the objectives of the FPC and CPMA;
(f) the desirability of developing within the PRA a culture in which, and systems whereby, staff and management continually question their assumptions, views and conclusions about the financial viability of supervised entities.

[10] Peter W. Roberts and Raphael Amit "The Dynamics of Innovative Activity and Competitive Advantage: The Case of Australian Retail Banking, 1981 to 1995" Organization Science, Vol. 14, No. 2 (Mar. - Apr., 2003), pp. 107-122.

The Government also seeks views on the coordination of activities of the PRA and CPMA. It is proposed that each be responsible for granting permissions and authorising persons in relation to regulated activities within their remit (para 3.16). The following consultation question is posed:

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

I believe that the model proposed is the only generally efficient solution possible in the context of a mult-agency regulation regime. While there would certainly be lower transaction costs involved for some complex institutions in dealing with one agency, the inefficiencies involved in separating one agency's control from its responsibility in the multi-agency context will in most cases outweigh the savings. Therefore, where necessary, separate licensing regimes and application processes should be developed for each agency. Such processes should, however, be designed with a view to minimising idiosyncracy, to make the compliance processes easier for those institutions that need to deal with both regulators.

In limited circumstances such harmonisation of processes may include the facility to deal with one regulator only (operating for itself, and as agent for the co-regulator) in relation to specific matters. This occurs, for example, in Australia in relation to certain limited regulatory functions. For example, the trustees of Australian public offer superannuation funds are required to obtain a Registrable Superannuation Entity (prudential) licence from APRA and an Australian Financial Services (marketing) licence from the Australian Securities and Investment Commission (ASIC). The difficulties involved in such institutions complying with two quite different licensing regimes came to a head over breach reporting requirements, which were designed substantially differently for each regulator. The issue was resolved recently by allowing APRA to serve as ASIC's agent in relation to receipt of compliance breach reports, and by making other efforts to harmonise the reporting regimes, such as by standardising the definition of a breach.[11]

Next the Consulation Paper seeks views on the specific powers and functions of the PRA, to underpin a more "informed and judgemental" approach to supervision, and a more streamlined rule-making process. The following questions are raised:

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

[11] See APRA's Discussion Paper on Streamlining Breach Reporting, available at http://www.apra.gov.au/Policy/upload/Discussion-paper-Breach-reporting-4-10-07.pdf

judgement-focussed approach to supervision?

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

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

As to the first question, it is somewhat difficult to see how the approach set out in the stated paragraphs specifically enable the type of supervisory approach that is sought. The sole relevant paragraph appears to be 3.17, which proposes a general examination of FSMA with a view to modifying it to achieve this objective.

Nonetheless, the drafting I have suggested above, in relation to the objectives of the FPC and the PRA, should assist in the development of a supervisory culture more attuned to critical judgement.[12] There are other changes of a mechanical type which will obviously need to be made to FSMA to reflect the differentiated objectives of the new regulators (ie the PRA and the CPMA). Some of the required changes have fortuitously occurred recently. For example, s 45(1)(c) of FSMA until recently referred, in the context of the own-initiative variation power for permissions, to the exercise of this power "in the interests of consumers". However, the Financial Services Act 2010 amended this provision (and certain structurally similar provisions) to refer to the exercise of the power "to meet any of its [the FSA's] regulatory objectives". Presumably, remaining provisions such as these will be changed to reflect financial stability and prudence considerations, in the case of the PRA, or simply to refer to generic regulatory objectives of either the PRA or the CPMA.

However it is also worth asking whether the legal powers available to the FSA are sufficient to allow it to make effective critical judgements where circumstances demand. In this regard, there appears to be no analogue, in relation to the FSA, to the powers of APRA in Australia to give directions to banks. APRA has had powers to give such directions where standards are breached, or in other situations considered necessary, since its inception, though they have also been supplemented since.[13] The FSA has a direction-making power available in relation to critical emerging situations affecting collective investment schemes, under s 257 of FSMA, but it has no counterpart power in relation to banks.

The individual capital guidance procedure outlined at paragraphs 2.2.12 to 2.2.15 of the Prudential Sourcebook for Banks (BIPRU) is illustrative of the existing powers of the FSA in an important situation concerning capital requirements for banks. Essentially, the

[12] See my responses above, pages 7-9, to consultation questions 3 and 4.
[13] See Division 1BA of Part II of the Banking Act 1959, available at www.comlaw.gov.au.

procedure applies where the FSA considers after a supervisory inspection that the capital levels of a bank need to be bolstered. After the review, the FSA gives the bank individual "guidance" on the amount of capital it should hold. If the firm disagrees with the guidance the matter may be discussed with the FSA. However, if the parties cannot agree after discussion, the FSA may resort to its "own-initiative" permission-varying powers under s 45 of the FSMA to force the firm to adjust the quality or amount of its capital.

While the powers to vary permissions are clearly important, they may be cumbersome. Section 53 of FSMA permits an own-initiative variation of permission by the FSA to take effect immediately. However, the notice must state the reasons for the variation <u>and</u> for the date of its effect, and, pursuant to s 55 of FSMA, all such variations are subject to challenge before the Financial Services and Markets Tribunal.[14] By contrast, for APRA, a notice of direction need only cite the statutory ground on which the direction is based. Furthermore, only certain of the directions able to be given by APRA – not those motivated by urgent solvency or financial stability concerns - are susceptible to review on the merits by the Administrative Appeals Tribunal (although they may still be amenable to more limited judicial review).[15]

In relation to the PRA's rule-making function, the procedural provisions in relation to Part X of FSMA are somewhat more onerous in formal terms than might be the case in other jurisdictions, due to the strict statutory requirement for consultation pursuant to s 155. Consultation is of course something that should ordinarily be done anyway, on a best-practice basis. However, s 155 could perhaps be made more flexible. In Australia, APRA's bank prudential standards[16] are subject to the Legislative Instruments Act 2003, which sets out a comprehensive regime for the making, publication and scrutiny of such legislative instruments.[17] Section 17 of this Act requires that the rule-maker carry out such consultation, before making a legislative instrument, as is reasonably practicable and appropriate. However, section 18 sets out examples of instruments in relation to which consultation may be unnecessary or inappropriate, including instruments required as a matter of urgency. Exceptions such as these could be incorporated into the requirements for consultation imposed on the PRA under s 155 of FSMA.

---

[14] See also section 7.2 and 7.3 of the FSA's Supervision manual, included as part of its Handbook.
[15] See recommendation 23 and the related discussion of the HIH Royal Commission Report, above, note 7; and the *Review of Prudential Decisions* Consulation Paper issued May 2007 by the Australian Treasury, available at http://www.treasury.gov.au/documents/1266/PDF/Review_of_Prudential_Decisions.pdf.
[16] S 11AF of the Banking Act 1959.
[17] Available at www.comlaw.gov.au. See also the Legislative Instruments Handbook, at http://www.ag.gov.au/www/agd/agd.nsf/Page/Administrativelaw_BackgroundtotheLegislativeInstrumentsAct2003

The final consultation question in relation to Chapter 3 of the Consultation Paper is posed in respect of the governance, transparency and accountability, and funding of the PRA, as follows:

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

My only comment here is in relation to the proposed board structure of the PRA. In this regard I note the relevance of certain recommendations of the HIH Royal Commission in respect of the governance of APRA. A key recommendation to improve accountability was that the largely part-time, non-executive board of APRA be replaced by a small full-time executive, comprising a chief executive and two or three commissioners.[18] Another was that the involvement on the board of APRA of representatives of the central bank and the consumer protection commission end. It distracted the focus of the board member concerned, put the chief executive in the difficult position of being assessed by the standards of different agencies, and did little to contribute to inter-agency coordination.[19]

The proposals in the Consultation Paper take a different approach. Whether consciously or not, the suggested arrangements for governance of the new Prudential Regulation Authority emulate the pre-Royal Commission structure of APRA, favouring a largely non-executive governing board and cross-memberships of boards of the co-regulators. In my view the proposals would benefit from reconsideration in terms of the recommendations noted above.

Chapter Four of the Consultation Paper

Chapter Four discusses the key features of the proposed new CPMA. The authority will have the primary objective of ensuring confidence in financial services and markets, with particular focus on protecting consumers and ensuring market integrity. In a similar way to the FPC and the PRA, the issue arises of the CPMA's obligation to have regard to consequential matters in exercising its primary objective. The matter is raised in the following consultation questions:

> The Government welcomes respondents' views on:
> • whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC;
> • whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained for the CPMA, and if so, which;

[18] See above, note 7, recommendation 18 of the Report.
[19] Above, note 7, recommendation 20 of the Report.

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

On the whole, the drafting suggested above in relation to the objectives of the PRA is, I believe, serviceable for the CPMA.[20] However, that leaves relatively open the policy route by which the CPMA is to achieve its objectives. For example, it does not prescribe for consideration either the traditional disclosure-based promotion of consumer understanding nor the more paternalistic approach to consumer protection in which recent developments have been made.[21] The best approach may be to leave to the authority the choice of policy method best suited to particular financial products, within the confines provided by the substantive legislation. I therefore propose the following drafting, based on the draft provision I have provided in respect of the PRA:

(1) The CPMA must so far as reasonably possible discharge its general functions in accordance with its regulatory objective.

(2) The regulatory objective of the CPMA is to ensure confidence in financial services and markets, in particular, by protecting consumers and ensuring market integrity.

(3) In discharging its general functions in accordance with its objective the CPMA must have regard to—
(a) the need to use its resources in the most efficient and economic way;
(b) the responsibilities of those who manage the affairs of authorised persons;
(c) the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;
(d) the need to minimise the adverse effects on competition that may arise from anything done in the discharge of those functions;
(e) the desirability of maintaining consistency with the objectives of the FPC and PRA.

The next section of Chapter Four discusses the scope of responsibility, powers and functions of the CPMA, including rule-making, authorisation, supervision, and coordination with the FPC and PRA. This is followed by a section on governance and accountability, including board structure, and transparency and accountability. The last

[20] See pages 8-9 above.
[21] See W. Sy's APRA Working Paper entitled "Toward a national default option for low cost superannuation" August 2008, available at http://www.apra.gov.au/Research/upload/APRAWorkingPaperNationalDefaultOption.pdf

topic includes the membership of certain consultative panels, two of which are constituted under Part I of FSMA. The following consultation questions are posed:

> Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?
>
> The Government welcomes views on the role and membership of the three proposed statutory panels for the CPMA.

The accountability mechanisms nominated, including annual reporting to Parliament, exposure of decisions to appeal in the Upper Tribunal, and audit by the National Audit Office appear to me to be appropriate, having regard to standards in other jurisdictions. With respect to the second question, I note that the provisions of Part I of FSMA with respect to the proposed statutory panels appear to be adequate, and I do not have any additional comment on this question.

The following section of Chapter Four addresses funding. It explains that each of the PRA and CPMA will set the fees relating to activities within its remit. However for reasons of efficiency it is proposed that the CPMA not only collect its own fees but act as agent for the collection of all fees on behalf of the PRA. The following consultation question is posed:

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

The setting of fees by the agency responsible for the particular activity to which the fee relates is clearly sensible. However I am not convinced that the proposed simplification of collection arrangements will work without excellent coordination (including very efficient technical systems) between the PRA and CPMA. To take a simple example, what will be the coordination arrangements in place to ensure that the processing of a permission application is not delayed by confusion over whether the application fee has been paid? Timing of such applications can often be critical and delays of a few days on account of this issue might easily attract unfavourable international comparisons.

The balance of Chapter Four covers associated bodies (the Financial Ombudsman Service, the Financial Services Compensation Scheme and the Consumer Financial Education Body), consumer protection and the government's proposal to examine how it is enshrined in FSMA, and consumer credit and a proposal to tranfer entire responsibility for its regulation to the CPMA.

The remaining consultation question is in relation to the operation of the Financial Services Compensation Scheme. An option proposed is to differentiate compensation schemes as between different classes of firm. Each of the PRA and CPMA would have a role in establishing schemes for the different classes of firm each would regulate. However the new schemes could continue to be administered by the existing Financial Services Compensation Scheme entity. The authors invite views on this issue:

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

I believe this proposal has merit if the collection of levies on a sectoral basis would encourage firms more closely to consider the risks posed by practices of their peers. The proposal might achieve that by more directly linking levy increases to practices within a firm's particular sector. This might assist in bringing closer professional pressure to bear on firms to discourage practices adverse to consumers.

Chapter Five of the Consultation Paper

Chapter Five concerns the regulation of conduct in wholesale markets, and of their infrastructure.

The CPMA will regulate conduct in wholesale markets (investment exchanges, multilateral trading facilities, and over-the-counter financial markets) through an operationally separate division of the authority.

Market infrastructure providers (trading platform providers, central counterparty clearing houses, settlement systems and payment systems) are to be regulated according to a differentiated regime. The CPMA is to regulate trading platform providers. However the Bank will assume responsibility for regulating settlement systems and central counterparty clearing houses, in view of their systemic importance.

The Government is also considering rationalising the permission regime under Part IV of FSMA and the recognition regime under Part XVIII in respect of the operation of exchanges, platform providers and central counterparty clearing houses. At present, recognised investment exchanges and clearing houses have an exemption under section 285(2) of FSMA, permitting them to carry on certain regulated activities which would otherwise require authorisation by the FSA under Part IV of the Act.

The related consultation questions are as follows:

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

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

In relation to the first question it is clearly sensible that the CPMA have responsibility for the regulation of wholesale markets. Regulation through a separate operating division is no doubt an efficient way of proceeding, providing of course that liaison and communication processes between the separate divisions of the authority are effective. It is also consistent with the the CPMA's role that it should regulate trading platform providers.

In relation to other infrastructure providers, while it is clear that the Bank should have a role in regulating settlement systems and central counterparty clearing houses, it is not obvious that the CPMA should have no responsibilities for these providers.

The Australian counterpart to the CPMA, ASIC, set out the purposes of regulating clearing and settlement facilities in a recent regulatory guide.[22] These were to:

(a) maintain financial system stability;

(b) reduce systemic risk;

(c) ensure clearing and settlement services are provided in a fair and effective way; and

(d) protect investors dealing in financial products and users of such facilities.

While the first two objectives are those commonly tasked to central banks, the last two relate to consumer protection.

In Australia such facilities are regulated by both the central bank and by ASIC. The Government may wish to consider adopting a similar regime in respect of settlement systems and central counterparty clearing houses.

In relation to the second consultation question, it would clearly be possible to rationalise Part IV and Part XVIII of FSMA in a limited way, perhaps by establishing a special category of Part IV permission for markets and infrastructure providers.[23] Whether there are net benefits of such a change, taking into account the compliance costs inevitably involved, is perhaps open to doubt.

[22] Regulatory Guide RG 211, available at http://www.asic.gov.au/asic/pdflib nsf/LookupByFileName/rg211.pdf/$file/rg211.pdf

[23] By way of comparision with the Australian regime, see Chapter 7, Parts 7.2, 7.3 and 7.6 of the Corporations Act 2001, available at www.comlaw.gov.au.

Chapter Five also considers stock exchange listing and related activities. The Government proposes transferring the functions of the UK Listing Authority currently performed by the FSA to a new companies regulator that would also assume the responsibilities of the Financial Reporting Council (FRC). It sees merit in regulating listing activities alongside the corporate governance, audit and reporting functions regulated by the FRC. At the same time the Consultation Paper concedes that arguments in favour of change need to be weighed against the benefits of regulating listing activities in conjunction with other market supervision carried out by the CPMA. Also, the fact that bonds and other securities are listed on exchanges in addition to corporate instruments, calls into question the synergy between the functions of the UKLA and the FRC that is relied upon in proposing the new companies regulator.

The following consultation questions are posed:

> The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS.
>
> The Government would also welcome views on whether there are other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator.

In my view there is little merit in the proposal to create a companies regulator apart from the CPMA. The proposal would drive a wedge between markets for listed products and other markets for financial products, and between listed securities issued by companies and other exchange-listed financial products. This seems to go against the trend, commencing with the establishment of the FSA, of regulating financial products and services on the basis of economic function, rather than legal form and sectoral distinctions. The benefits of this change are not obvious and in my view none have been convincingly argued. I also do not consider there are other aspects of financial market regulation that could be made more effective by removal to a new companies regulator.

Chapter Six of the Consultation Paper

The final chapter of the Consultation Paper concerns the capacity of the regulatory regime to respond to emerging crises. It discusses the coordination of responsibilities between the Treasury, Bank, FPC, PRA and Special Resolution Unit, in a crisis. It also addresses the adequacy of tools available to the new regulators in dealing with crises, refinement of the Special Resolution Regime, and the international representation of UK interests concerning crisis resolution. The following consultation questions are raised:

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

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

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

In my opinion the arrangements set out for crisis management in the Consultation Paper appear to be well-defined. I do not have further comment on these.

In relation to the question of further supervisory powers, I have referred above in relation to Chapter 3 of the Consultation Paper to the fact that the FSA lacks powers to give directions to banks.[24] Such powers are able to be exercised by APRA in Australia, and by the FSA in relation to collective investment schemes. APRA may (relevantly) exercise these powers in relation to a banking corporation, where:

(a) the body corporate is, or is about to become, unable to meet its liabilities; or
(b) there is, or there might be, a material risk to the security of the body corporate's assets; or
(c) there has been, or there might be, a material deterioration in the body corporate's financial condition; or
(d) the body corporate is conducting its affairs in an improper or financially unsound way; or
(e) the failure to issue a direction would materially prejudice the interests of depositors; or
(f) the body corporate is conducting its affairs in a way that may cause or promote instability in the Australian financial system.[25]

There are similar triggers specified in relation to the activities of banking corporations' subsidiaries.

Directions may (relevantly) be of the following type:

(a) to comply with the whole or a part of the Banking Act or cognate legislation, or with the whole or a part of a prudential requirement regulation or a prudential standard;
(b) to order an audit of the affairs of the body corporate, at the expense of the body corporate, by an auditor chosen by APRA;
(c) to remove a director or senior manager of the body corporate from office;

---

[24] See page 11-12 above.
[25] See note 13 above, and section 11CA of the Banking Act 1959.

(d) to ensure a director or senior manager of the body corporate does not take part in the management or conduct of the business of the body corporate except as permitted by APRA;
(e) to appoint a person or persons as a director or senior manager of the body corporate for such term as APRA directs;
(f) to remove any auditor of the body corporate from office and appoint another auditor to hold office for such term as APRA directs;
(g) not to give any financial accommodation to any person;
(h) not to accept the deposit of any amount;
(i) not to borrow any amount;
(j) not to accept any payment on account of share capital, except payments in respect of calls that fell due before the direction was given;
(k) not to repay any amount paid on shares;
(l) not to pay a dividend on any shares;
(m) not to repay any money on deposit or advance;
(n) not to pay or transfer any amount to any person, or create an obligation (contingent or otherwise) to do so;
(o) not to undertake any financial obligation (contingent or otherwise) on behalf of any other person;
(p) anything else as to the way in which the affairs of the body corporate are to be conducted or not conducted.[26]

As I have indicated above, the PRA may benefit from the development of a similar regime of powers, which may be deployed more speedily in a crisis.

As regards the final question of the Special Resolution Regime, I note that the regime appears to compare favourably with other regulatory frameworks of this type, according to a recent paper by Mr Peter Brierley.[27] Having regards to the discussion in that paper of triggers for the Special Resolution Regime I am not persuaded of the concerns in relation to conflicts expressed in the Consultation Paper. For those reasons I have no changes to suggest regarding the regime.

Conclusion

The correct analysis of failures in prudential regulation and supervision is of critical importance in drawing the right conclusions about reform.

[26] See section 11CA(2) of the Banking Act 1959.
[27] Peter Brierley "The UK Special Resolution Regime for failing banks in an international context" Bank of England Financial Stability Paper No.5, July 2009, available at http://www.bankofengland.co.uk/publications/fsr/fs_paper05.pdf.

In my opinion the developing view that supervisory will was more important than regulatory structure in ensuring the successes of some national regulators should be recognised as a key insight in reforming the system of financial regulation in the UK. For that reason I have built into the draft provisions for objectives of the new prudential institutions clauses requiring the regulators continually to examine their assumptions regarding the viability of the firms they supervise. The drafting is modelled on recommendations of the HIH Royal Commission in Australia important in strengthening APRA's proactive approach to the supervision of financial institutions over recent years.

The technique of international comparison is more generally a powerful method of gaining insight into the processes and institutions that have worked successfully in other jurisdictions. I have drawn upon developments in Australia throughout my submissions where these assist in informing the consultation questions posed. This is particularly so because Australia several years ago adopted the "twin-peaks" approach to financial regulation, a variant of which is proposed in the Consultation Paper.

Specific issues that can be clarified by Australian example are those relating to:

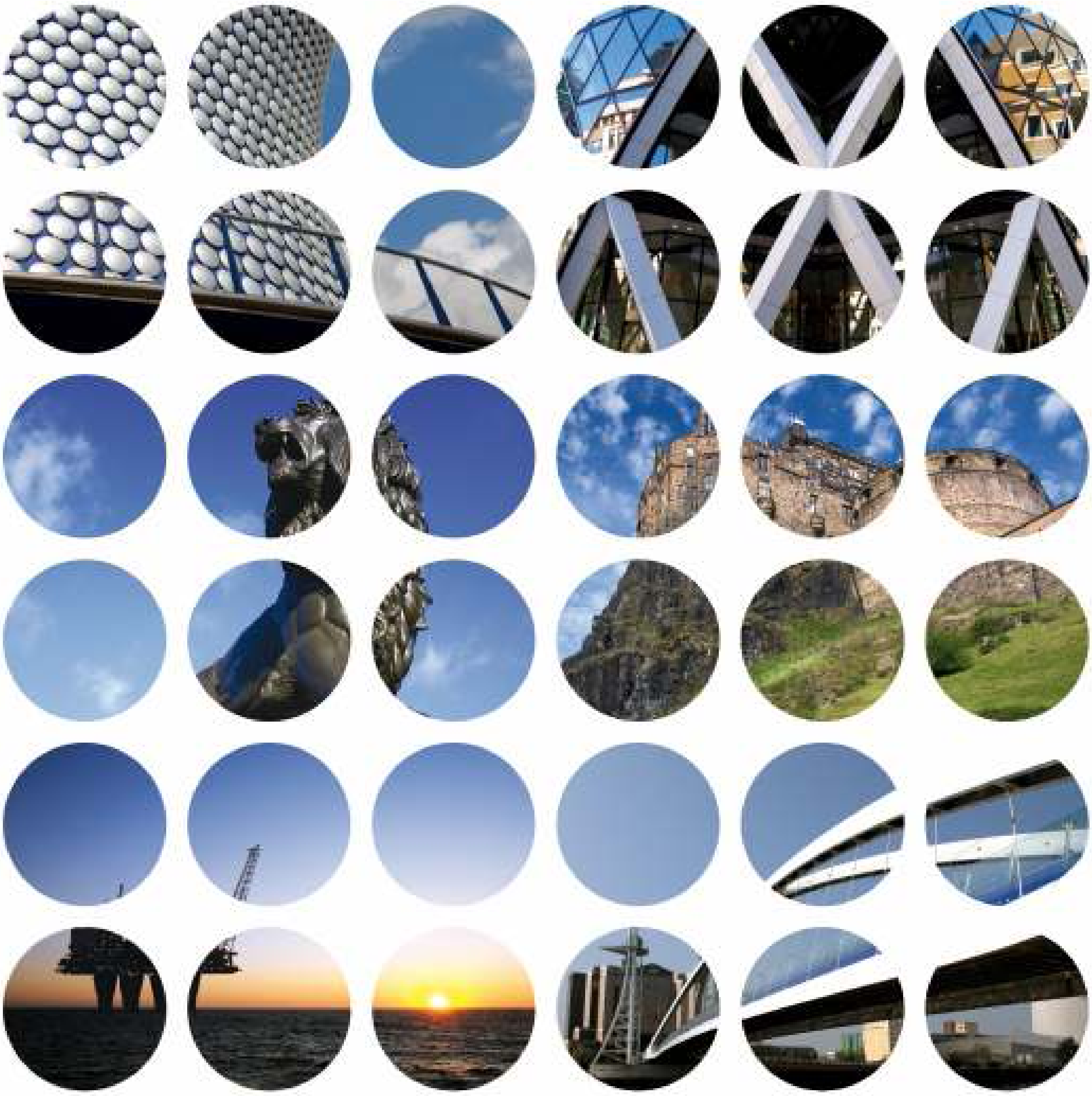
- the allocation of functions between the PRA and CPMA;
- the enhancement of powers of the PRA to deal with emerging crises;
- the PRA's rule-making function;
- the governance of the PRA and CPMA; and
- the regulation of settlement systems and clearing houses.

To conclude, I am grateful for the opportunity to respond to the Consultation Paper and would be happy to answer any questions on this submission.

Heath Lambert Employee Benefits

Response to the HM Treasury Consultation
A New Approach to Financial Regulation

October 2010



Heath Lambert
Employee Benefits

Creatively different

Heath Lambert Employee Benefits (HLEB) welcomes the opportunity to comment on the consultation paper.

Introduction – HLEB (Heath Lambert Employee Benefits)

At HLEB, we specialise in designing, implementing and managing employee benefits for employers, advise pension scheme trustees and provide financial advice to individuals.

HLEB is a trading name of Heath Lambert Consulting Limited, authorised and regulated by the Financial Services Authority and a member of the Society of Pension Consultants.

Please note that we are not responding to all the questions posed by the Consultation paper, as we have focused on the areas most relevant to our business activities. Answers that address two or more related questions have been grouped together and any unanswered questions have been omitted.

Response to the Consultation

1. **Should the FPC have a single, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?**
2. **If you support the idea of secondary factors, what types of factors should be applied to the FPC?**
3. **How should these factors be formulated in legislation – for example, as a list of have regards as is currently the case in the FSMA 2000 or as a set of secondary statutory objectives which the FPC must balance?**

We agree there is a need to create a new regulatory body which focuses on systemic risks that could threaten the stability of the financial sector as a whole and that for such body to be effective, it will need the appropriate tools and powers of intervention. Given the scale of these new powers and their potential to create far-reaching effects, both intended and unintended, upon UK business and families, we believe that the primary objective of preserving financial stability should be supplemented with secondary objectives which the FPC should be legally obliged to consider. These secondary objectives should be aligned with those of the new regulatory authorities responsible for implementing the FPC's high level measures.

In particular, any future legislation establishing the new regulatory framework should take into account the impact of any measures taken upon competition and the profitability of UK companies, especially those smaller in size, and should aim to minimise the fiscal and administrative burdens that may arise from anything done in the discharge of the primary regulatory functions. A market dominated by just a few banks and product providers could contribute to stability, but would also mean less competition, and therefore less choice for consumers.

In the interest of both transparency and public confidence, we believe that any secondary objectives should be formulated as statutory objectives rather than a list of ‘have regards’.

4. The Government welcomes respondents’ views on:

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

We agree that in future supervisors should focus more on understanding firms’ models and strategies, and that any complex new products must be understood and their risks controlled within each individual business. However, we also feel that most of the principles for good regulation currently set out in section 2 of FSMA should be retained for the new regulatory bodies, both the PRA and the CPMA, particularly the principle that a burden or restriction which is imposed on UK businesses, or on the carrying on of their activity, should be proportionate to the benefits which are expected to result from the imposition of that burden or restriction.

Other principles under FSMA which in our view should be maintained going forward, preferably in the form of secondary statutory objectives, are:

- the need to use the new bodies' resources in the most efficient and economic way;
- the desirability of facilitating innovation in connection with regulated activities;
- the desirability of facilitating competition between those who are subject to any form of regulation by the supervisory authorities.

Regarding the requirement to have regard to potential adverse effects on innovation or the competiveness of the UK financial sector, we disagree that including these within the objectives of the PRA and the CPMA would impair their primary focus on financial stability and consumer protection. The soundness of risk-taking firms will always be linked, at least in the long term, to their level of innovation and international competiveness, and we cannot see how taking these factors into account could have adverse effects upon the markets whose overall health and sustainable growth have to be the ultimate objective of any regulator.

The PRA should also have regard to the primary objectives of the FPC and CPMA, as some firms will be regulated by two different regulatory bodies (the PRA and the CPMA), which could give rise to increased compliance costs and even conflicting compliance priorities. The new regulatory bodies should also be sensitive to the implementation complications which might initially arise under the new regime.

6. Is the approach outlined in paragraph 3.17 to 3.23 for transfer of regulatory functions and rule making sufficient to enable the PRA to take more risk-based, judgement-focussed approach to supervision?
7. Are safeguards on the PRA's rule-making function required?
8. If safeguards are required, how should the current FSMA safeguards be streamlined?

We agree there is a strong case for splitting the powers set out in the FSMA into separate stand-alone prudential and conduct regulation frameworks, with the PRA being responsible for making prudential rules for the firms it regulates. The drive towards a more risk-based approach to supervision, however, should always respect the safeguards provided by the statutory processes recognised within the FSMA, including wider public consultation, practitioner panels and the duty to carry out detailed cost-benefit analysis prior to the introduction of any new rules, subject to any emergency measures justifiable under certain 'trigger events'. Doing away with due process for the sake of expediency and speed of intervention could have a negative impact on the levels of confidence and engagement of all participants in the financial markets.

10. The Government welcomes respondents' views on:

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

Our view, as stated under question 4, that the principles for good regulation currently set out in section 2 of FSMA should be retained applies to both the PRA and the CPMA. The principle that a burden imposed on a firm should be proportionate to the benefits expected would be particularly relevant to firms that are solely regulated by the CPMA, as is expected to be the case for most small and medium firms. Implementing new regulatory processes can involve large overhead costs which not all firms can always afford. The same applies to the need to minimise the adverse effects on competition, as certain types of intervention and regulatory burdens could be absorbed by larger firms, but be crippling for the smaller ones.

This consultation paper makes it clear that the Government intends the CPMA to become a 'strong consumer champion' with a 'tougher, more proactive and more focused approach to regulating conduct in financial services and markets.' This should not in itself be a worry for firms which have already embedded the Treating Customers Fairly principle within their corporate culture, as has long been advocated by the FSA.

We would also like to point out, however, that for such a tougher, more proactive approach to work effectively and without detriment to firms with a positive attitude to regulation, the new regulator should make a renewed effort to create constructive relationships with regulated entities. One way of achieving this would be to make CPMA relationship managers available to a larger number of firms. This would allow more firms to exchange ideas, including new service propositions, with their regulator as and when the need arises, rather than having to rely on their own interpretation of the rules and then having to defend them if an adverse outcome has materialised.

Another key consideration to successful regulation is the ability of relationship managers to have relevant experience of the regulated firm. A recent trend in FSA to consolidate relationship management with one person for mixed activity firms (financial services and insurance, for example) has the potential to dilute positive interaction.

We also feel that the new regulator's increased pro-activity should also extend to a fuller engagement with the industry regarding the development of new advice models, such as 'simplified advice', which has the potential to give access to protection, long-term savings and retirement products to a wider share of the population. There is a very real risk that the very people most in need of advice will be disenfranchised if new models do not flourish. The regulator's continued emphasis on achieving the right outcomes cannot be applied to all transactions regardless of the level of advice provided. By providing regulatory guidance on the principles that would govern a simplified advice model the new regulator would give the industry the confidence needed to develop new advice propositions that are both cheap and accessible to all.

Regarding the future relationship between the CPMA and the Financial Ombudsman Service, we agree that they should be independent from each other, since the CPMA's proposed role of consumer champion would conflict with the impartiality of the FOS. We also believe however that the Government should take the opportunity of this regulatory overhaul to review some of the rules governing the FOS, so as to make them equally fair to both consumers and the industry. In particular, we would welcome changes along the following lines:

- Firms should not have to pay fees for complaints which fall outside the jurisdiction of the FOS, even if the FOS has to carry out some work to determine their lack of jurisdiction. If the cost of this preliminary work needs to be covered, this should not be at the full rate.
- The FOS should not charge anything to the defending firm for complaints that are spurious and clearly unfounded.
- The fees payable for reasonable complaints that are refuted should be significantly lower than those payable for complaints that are upheld.
- The FOS must urgently review the punitive and unfair interest rate (8% p.a.) that it currently applies to redress payments.
- Oral hearings should be made automatically available for complaints involving potential awards over a certain size.

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

We strongly favour the proposal that there should be one single authority (CPMA or other) to collect all fees and levy data in respect of all regulatory authorities and associated bodies, including PRA, CPMA, FOS, FSCS and CFEB, so as to minimise the administration costs for regulated firms. In any case, if the aim is to avoid any significant increases in ongoing costs as a result of the changes to the regulatory framework, as is stated in the consultation paper's Impact Assessment, we would urge the CPMA to ensure that the combined cost of all regulatory bodies should not exceed the current level of FSA fees.

HISCOX

Hiscox plc

11 October 2010

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

Dear Sirs

Treasury Paper: A new approach to financial regulation (July 2010)

Introduction

Hiscox is an international specialist insurer, underwriting a diverse portfolio of property and casualty lines of business for both the personal and commercial markets. A FTSE 250 company domiciled in Bermuda since 2006, we have over 100 years of underwriting heritage and now have more than 1,100 staff, with offices in 11 countries, and in 2009 controlled a gross premium income of £1.7 billion. There are three main underwriting parts of the Group - Hiscox London Market, Hiscox UK and Europe and Hiscox International. Hiscox London Market underwrites internationally traded business in the London Market - generally large or complex business which needs to be shared with other insurers or needs the international licences of Lloyd's. Hiscox UK and Hiscox Europe offer a range of specialist insurance for professionals and business customers, as well as high net worth individuals. Hiscox International includes operations in Bermuda, Guernsey and USA.

Hiscox considers itself to be a responsible participant in the non-life insurance industry and the Group is fully supportive of the need for effective, efficient and proportionate regulation in line with the internationally-recognised 'principles of good regulation'. In this letter I set out our comments on the proposals outlined in the Treasury paper "A new approach to financial regulation" and our suggestions.

Lack of focus on the insurance sector

The proposed architecture is heavily bank-centric. We acknowledge that this addresses the public need for change and allocates resources to the area of most systemic risk to the economy. However, the insurance industry seems to have been included as something of an afterthought. We run the risk of the regulatory system becoming unsuitable for the specific needs of the insurance sector in terms of culture, expertise and focus.

We recommend that sufficient representation for the insurance industry be included within the new governance structure by the creation of a Deputy Governor of the Bank of England for Insurance and a Managing Director for Insurance to sit on each of the boards of the Prudential Regulation Authority ("PRA") and the Consumer Protection and Markets Authority ("CPMA"). We also propose that the Financial Policy Committee ("FPC") should include sufficient members with expertise and understanding of insurance to balance those with a banking focus. The FSA already has insurance-focused staff with great knowledge and continuity of service. These experienced individuals should be positioned appropriately in the new regulatory system to ensure efficiency and continued high standards.

Hiscox
1 Great St Helen's
London EC3A 6HX

T +44 (0)20 7448 6000
F +44 (0)20 7448 6900
E enquiry@hiscox.com
www.hiscox.com

HISCOX

Complexity, cost and duplication

The practicalities of implementing the proposed dual regulatory system in the insurance industry will result in increased regulatory complexity, compliance spend and duplication, without a commensurate increase in benefits. The overlapping roles of the PRA and the CPMA in regulating the insurance sector will require considerable, detailed and ongoing co-ordination by the regulators and the regulated to minimise unnecessary overlap, gaps, duplication and inefficiencies.

We recommend, for operational efficiency and effectiveness, that a central body should administer for the PRA and CPMA such joint functions as enforcement, supervision and authorisations. We also propose that insurance brokers should be regulated by the CPMA and not either solely or jointly by the PRA, since the CPMA will focus on regulating intermediation activities.

Timing

The timing of these proposed regulatory changes will coincide with the implementation of three major Europe-wide regulatory initiatives directly impacting the insurance sector: Solvency II, the Intermediaries Directive Review, and the introduction of the new EU insurance super-regulator EIOPA. The fundamental reconstruction of UK regulation at this time will disturb the negotiation and development of these initiatives, and dilute the focus and resources available within the industry. In particular, a diversion of resources away from Solvency II over the critical next few years could significantly impact the competitiveness of the UK insurance industry.

We recommend that the proposed timing be put back by at least 12 months in order to allow the FSA and the insurance industry to successfully implement Solvency II.

Summary

Whilst we acknowledge that the proposed changes will be implemented for the insurance sector, we ask that our comments be considered. We believe that our suggestions will help reduce the negative effects of the transition and contribute to a sound regulatory environment for the UK insurance industry.

Yours faithfully,

p.p. J. Jones

Bronek Masojada
Chief Executive

Hi,

I am an IFA of 28 years experience and can tell you that the new approach will not be welcomed by most of my colleagues because of Hector Sants. He has been associated with the pathetic performance of The FSA, especially when it comes to the banking collapse. He has no credibility at all, most especially when he wrote to all his colleagues at The FSA and told them to vote for Labour at the election. This is totally and utterly immoral. A person in his role should be totally impartial..

I would not support any thing that Mr Sants is involved in. I have no confidence in his professionalism, performance and most of all in his integrity. He should go as soon as posssible.

Regards,

Simon Hoadley

Dear Sirs,

As individual I have been involved with bank charges refund claims over the last few years.
Along with discussions of the matter my local MP Alan Reid pointed me to this consultation which I have read with interest.

I would like to take the chance to provide a number comments to the consultation paper from a customer rather than a financial services expert view.
Being my area of interest these all relate to the area of consumer protection and hence the proposed CPMA.
Other aspects of the consultation are outside my remit and I can’t really comment on them.

1. The establishment of the CPMA with a clear remit as regulator and customer champion and the mentioned future consultation
on potentially moving responsibilities from the OFT to the CPMA have be much welcome given the OFT’s past failure to effectively champion and protect customer interests especially in the so-called “test case” on banking charges.
2. The proposed setup of the CPMA will hopefully at long last establish a body ready and willing to challenge unfair and
unacceptable terms of banks etc., something the FSA in the past has failed to do, even telling me that they were no regulator.
3. As the consultation admits itself customer protection has been insufficient in the past and indeed in my experience has
even further worsened since the dramatic failure of the OFT “test case”.
Banks since widely have returned to simply refuse claims even in areas like credit card charges and business banking that clearly weren’t in the scope of the “test case” and in some areas the FOS is not even making negotiation attempts anymore but simply refuses handling of escalated complaints leaving customers in the absence of any support vulnerable to the banks.
The only route left to customers for now is court which for ordinary people like me due to the costs is clearly no feasible option.
4. 4.44 of the consultation mentions to ensure that the FOS “does not favour, or appear to favour, consumers”.
With reference to the aforesaid it for now surely appears to customers that the FOS currently rather favours the banks.
Neither is acceptable and a future revamp of the FOS certainly has to ensure proper independence of both banks and customers.
At the same time the governing bodies within the proposed setup need to enabled to enforce and regulate the FOS as required to
ensure independence.
5. Given the past failures of the various organisations like FSA, FOS and OFT the CPMA’s remit clearly should include the
ability to rectify past short comings. It has been widely acknowledged throughout the political spectrum during this year’s General Election campaign that eg the matter of banking charges may require regulatory intervention including hindsight corrections and

customer compensation enforced on the financial sector. Respective regards don't appear to be included in the consultation.

6. Companies outside the traditional financial sector yet applying similar charges for financial services, eg airlines
charging credit card payment fees depending on the means of payment chosen, in the past have escaped complaints and refund claims arguing that current FSA etc. regulations don't apply and the FOS has upheld that leaving customers unprotected at the hands of
these companies. I hence should be considered to widen the definition of financial services to ensure this loop hole is closed.

7. Given the vast majority of financial services customer including myself are legal lays the CPMA's champion role should have
an explicit regard to proactively act as a kind of "legal counsel" in the interest of customer as part of its "broader public interest considerations" (consultation question 10).

I hope these comments are helpful as a response out of the general public and I look forward to the next steps in the consultation process.

Regards
Martin Holzke

Dear Sir/ Madam

A new approach to financial regulation: consultation questions

Homeserve Membership Limited (HML) is a large insurance intermediary which falls within the general insurance intermediation category for regulation purposes. HML is likely to be solely regulated by the Consumer Protection and Markets Authority as it does not fall into a category of firm which requires significant prudential regulation.

Further to your request for feedback on your proposals for the future of regulation I offer the following comments on behalf of HML.

Section 4 Consumer Protection and Markets Authority

Box 4.A
10 The Government welcomes respondents' views on:

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

Given the far reaching consequences of regulation we believe that there should be a duty upon regulators to consider the impact of regulation upon innovation and competitiveness and for them to make judgement decisions accordingly.

Box 4.B
11 Are the accountability mechanisms proposed for the CPMA appropriate and sufficient for its role as an independent conduct regulator?

We welcome the Government's intentions for the CPMA's performance, efficiency and effectiveness, to be subject to independent audit.

We would ask for clarity regarding the negative consequences of an unsatisfactory audit and the obligations and mechanisms in place to ensure that concerns are addressed in a timely manner. We are also unclear as to the potential role and powers of the Public Accounts Committee (PAC) in relation to the CPMA as we understand that funding would be raised from the financial services industry rather than by utilising public monies.

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

Although we agree with the principal of a consultative mechanism that provides challenge and accountability, without tangible evidence of beneficial changes which can be attributed to previous representations made by these panels we are unable to offer any endorsement of their activities.

In recent years the intermediary sector and their relevant trade associations have raised legitimate concerns with regards to the fairness of current funding structures, particularly for larger intermediary firms who have seen a significant rise in fees. However, this has not been addressed satisfactorily either by way of a change in the funding model or an explanation from regulators why the model remains appropriate. The effectiveness of statutory panels in representing these concerns is therefore questionable.

Box 4. C
13 The Government welcomes views on the proposed funding arrangements, in particular, the proposal that the CPMA will be the fee- and levy-collecting body for all regulatory authorities and associated bodies.

We are broadly in agreement for the CPMA to act as the fee and levy collecting body as this appears to be the most cost efficient mechanism. We would of course expect the processes to also be within scope of any independent audit to ensure that they remain effective, efficient and fair.

With regards to fee and levy setting powers we urge the Government to address the weaknesses of the current funding model. Our views on a fair and proportionate funding structure are as follows:

- A funding model should recognise the principle that it is unfair for firms to contribute to the cost of regulating business for which they are not involved. The current method of implementing fee blocks for each type of business activity only partly addresses this requirement.

- A further distinction should be made, at a level below that of a fee block, between firms that carried out high impact risk activities or low impact risk activities. These comments apply equally to the funding models for the CPMA, the FOS and the FSCS.

  For general insurance intermediation in particular, such a distinction was significant enough to merit substantial changes to the FSA's Insurance Conduct of Business rules with insurance differentiated between high risk/ impact 'protection products' and lower risk/ impact 'other' products. The split reflects the greater regulatory and supervisory burden associated with protection products although this is not reflected within the current funding model. This is inconsistent with the principle that it is unfair for firms to contribute to the cost of regulating business for which they were not involved.

  Payment Protection Insurance (PPI) and its unprecedented impact in terms of increased regulatory scrutiny, FOS complaints and FSCS claims is well documented, with the latter bodies singling out PPI as a significant driver of their costs in handling general insurance complaints and claims. The FSA, in the light of their PPI complaint handling and redress rules, expect such costs to continue. The FSA has estimated this cost to be at least £3.2bn, a proportion of which will inevitably fall on the FSCS, and thus to levy-paying firms.

  Without a tiered fee structure that takes into account the activity of firms within the PPI market, those that were unexposed to this high risk market ('low impact' firms), and thus did not benefit from what the Competition Commission have deemed persistent and excessive profits, are unfairly cross-subsidising the fees of those firms that were ('high impact' firms). Such has been the adverse impact of PPI that a 'one size fits all' model has seen fees for all firms within the insurance intermediation fee block substantially inflated as the costs for dealing with the problem have been equally apportioned across all firms regardless of whether they contributed to the problem or not.

  This cross subsidisation is disproportionately greater for large 'low impact' firms as their fees, regardless of the funding model adopted, will invariably rise in proportion to their size. The impact is compounded further if a similar non-tiered structure is applied for calculating of fees for the FOS, FSCS and Consumer Finance Education Body (CFEB).

  Although we only offer comment on insurance intermediation activities, a comparable enhancement across other fee blocks which may include products/ services that can be similarly categorised as high impact/ risk or low impact/ risk is likely to address similar inequities within those blocks. For example, a distinction should be made between lenders that were heavily exposed to the self certification market and those that were not.

Box 4. D
14 The Government welcomes views on the proposed alternative options for operating models for the FSCS.

We would support the most cost effective mechanism and anticipate that this would be as a single scheme. However, regardless of whether separate schemes are set up for CPMA and PRA activities, or the FSCS continues to operate as a single scheme, we believe the opportunity should be taken to utilise the large body of evidence gathered by the FSA, FOS and the FSCS in performing their respective roles of the causes and main contributors to market failure. The intelligence should be used to refine risk models and apportion the costs of market failures more fairly, particularly in respect of general insurance intermediation. An underlying principle should be that where a particular market failure has occurred, the source of any compensation required should be tracked back to those firms who participated in that market; rather than the blunt approach of firms having to contribute to compensation merely because they are in the same general category as the failed firms.

For example, the FSCS has recently identified PPI compensation claims as the most significant contributor to the costs levied on firms falling within the general insurance intermediation sub-class. The FOS voices similar concerns and the FSA recently announced challenging PPI complaint handling and redress rules, which they admit will result in further costs falling on the FSCS, and thus to levy-paying firms.

A two-tiered structure that is based on PPI sales activity would create a much fairer funding model allowing more accurate targeting against those firms that participated and profited most from this activity.

- Tier 1 fees would be based on the expected costs of non-PPI compensation claims and levied across all firms within the general insurance intermediation class in proportion to firm size;
- Tier 2 fees would be based on the estimated costs for PPI compensation claims and would only be levied on firms that have generated an income generated from such activities. In recognition that claims may relate to selling practices, since prohibited, that occurred some years previously, the methodology would consider total income generated from sales made since 14 January 2005 when insurance became regulated. We note that the Competition Commission, in their 'Market investigation into payment protection insurance' report, published 2009, concluded that the level of pure profit from PPI activity, to the tune of £1.4 billion in 2006 alone, was excessive and was able to specifically identify those firms that had profited most.

There is also an opportunity to apportion costs more fairly across other sub-classes. Failings can often be attributed to the actions of firms in other subclasses too, many of which may have profited significantly from the underlying issue. Again, using the PPI situation, examples include:

- <u>Product Providers/ Underwriters</u> – the failure of product providers, under the 'Responsibilities of Providers and Distributors for the Fair Treatment of Customers' rules, to review and act on appropriate MI, such as excessive penetration rates, exacerbated the problem of PPI selling failures as actions were not taken that could have minimised the risk and volume of mis-selling.

  Some PPI policies included nil refund clauses in breach of the Unfair Terms in Consumer Contracts Regulations 1999. Notwithstanding poor sales practices, this too will have been key driver of complaints, adding further to costs of redress and compensation claims falling on intermediaries.

  The Competition Commission estimated that after deducting the costs of claims and other expenses, product providers received in excess of £340 million profit per year from PPI sales.

- <u>Home Finance Providers</u> – single premium PPI was mostly arranged at the point of sale of a loan where an often substantial premium would be added to the original loan amount. Notwithstanding the commercial benefits negotiated with the product provider for associating their policy with their loan offering the lender also receives significant benefits from additional interest payments for the duration of the loan.

  PPI compensation costs fall on the distributor responsible for selling the policy and could include the interest charged on that proportion of the loan which paid for the policy. Any contribution by the lender tends to be discretional with full liability often falling on the intermediary alone. If an intermediary subsequently goes out of business the current FSCS funding rules mean that the proportion of the claim that relates to interest payments must be met in full by other general insurance intermediaries rather than the lenders who profited.

  Regards,

  Stuart Austin
  Compliance Department

HSBC

Douglas J Flint CBE
Chief Financial Officer
Executive Director Risk and Regulation

Rt Hon George Osborne MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

20 October 2010

Dear Chancellor,

I attach HSBC's response to HM Treasury's consultation on "A new approach to financial regulation: judgement, focus and stability". Overall, the direction of the changes proposed is fully supported by HSBC.

I suspect that the shape of many of our comments will be similar to those of other financial institutions. In one area, however, our approach may be different, and this is in the emphasis we place on macroprudential policy.

With points of reservation, we support most of the corpus of the Basel III recommendations for regulatory reform. But because of one, crucial, aspect, we are sceptical that the package will help to build a more stable financial system for the future. That aspect relates to the level of capital, which will be too high when banking lending is needed, and too low when crisis beckons.

We believe macroprudential policy, as set out in our response, could allow capital to rise as risk rises, and to fall as risk falls. Capital requirements, calibrated against risk, could be used as a tap to control the flow of credit into the economy, reducing it as bubbles develop, but also increasing it when the economy needs stimulus.

In short, macroprudential policy is not just about financial stability. A small movement in required capital ratios can tie up or release very significant capacity for lending. It is, in effect, a third macroeconomic lever to accompany fiscal and monetary policy, and one which could sometimes be deployed at times when fiscal or monetary levers have nothing left to contribute.

We would be very happy to discuss these ideas further with you.

Yours sincerely,

HSBC Holdings plc
Level 42, 8 Canada Square, London E14 5HQ
Tel: 020-7991 8888 Fax: 020-7992 4872
Web: www.hsbc.com

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

Consultation questions: HSBC Holdings plc responses

The Bank of England and Financial Policy Committee (FPC)

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

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

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

HSBC fully supports the broad direction of the response of the Basel Committee on Banking Supervision to the financial crisis. The comprehensive package set out by the BCBS includes a new approach to *levels* of capital. It has been proposed to the G20 that the minimum requirement for common equity of 4.5% should be supplemented by a capital conservation buffer of 2.5%, which could be extended by a further 2.5% in the form of a countercyclical buffer intended to protect the banking sector in periods of excess aggregate credit growth. A third measure, in the form of additional capital for "Systemically Important Financial Institutions" (SIFIs), is also under consideration.

HSBC believes that this approach to the *level* of capital introduces an element of complexity and inefficiency which could be avoided. We also believe that addition of an "indiscriminate" capital buffer could have the opposite effect of that intended: generalised capital constraint could redirect lending into areas of financial activity which produce higher returns, and it is often these areas which threaten financial stability. This could become exacerbated as a bank's capital level approaches the threshold of the capital conservation buffer.

Additions to or subtractions from the core capital ratio have a material impact on a bank's capacity to lend. In the case of HSBC, a change of 1% in the core capital ratio, at current levels of equity and leverage, translates to lending capacity of $100bn. Movements in the ratio therefore significantly adjust the potential flow of credit into the economy, and if used as a policy tool could equip the official sector with a macroeconomic lever to accompany fiscal and monetary policy.

There are precedents for the operation of such a lever. In 1936, Federal Reserve Chairman Marriner Eccles feared that "surplus" capital built up by the US banks in reaction to the Great Crash could be used to pursue high return activities, potentially threatening stability. In 1936 and 1937 he "neutralised" the surplus capital by raising reserve requirements. In fact the US economy had begun to recover, and needed the stimulus of lending supported by the level of capital banks had been holding before Eccles took action. Eccles' extraction of bank lending capacity stopped the recovery.

The purpose of recounting this episode is not to draw a parallel with the situation today, but to illustrate that management of private sector credit supply into the economy is a significant macroeconomic tool, which national authorities relinquish if they choose to follow an inflexible capital ratio for the banking sector.

Seen against a broader historical perspective, this choice creates a financial system incapable of responding to the dynamic of crisis. When money was defined by its relationship to gold, that relationship regulated both the price and supply of money. Considerable volatility followed departure from the gold standard. Monetarism restored stability only to the price of money, and because, unusually among commodities, money can be leveraged, stability of price did not secure stability of supply. In the 1990s and 2000s, for a range of macroeconomic reasons which included contemporary monetary policy, supply ballooned out of control.

The creation of the FPC and PRA makes possible a framework in which use of capital requirements as a policy tool to manage private sector credit supply could become reality, and HSBC has explored how this framework might operate. We believe that this approach also has sufficient flexibility to deal pre-emptively with many of the prime causes of crisis. Our ideas are very broadly compatible with those set out in the HM Treasury consultation document, but we would emphasise the following points of detail:

1. The prime objective of the FPC should be to identify exuberance or caution within the economy and assess whether, at a given time, capital ratios in the banking sector were adequate, too low, or too high.
2. The sole criterion for assessment should be risk. At times of systemic exuberance, increased likelihood of default and loss could require more capital than demanded by conventional risk weighting; at times of caution, authorities could judge that capital levels might be unnecessarily high, and could be eased.
3. Secondary factors such as competitiveness, economic growth or the need to foster vulnerable sectors within the economy would be inappropriate for a system which should be driven by risk.
4. Much of the necessary macroeconomic and systemic analysis needed is already undertaken for Financial Stability Reports. These, as the principle output of the FPC, could in future include a recommendation for the range for the core capital ratio in the UK banking sector.
5. New sources of macroeconomic indicators and data to feed FSR analysis might be identified and shared with regional and international macroprudential authorities, including the European Systemic Risk Board and the Financial Stability Board.
6. It is possible to envisage a target for the FPC equivalent to the MPC's inflation target. This could derive from a calibration of the government's appetite for risk, perhaps expressed as a limit to leverage, which could vary. For countries with international financial centres, such an approach might avoid arbitrary judgements about the desirable size of the financial

sector relative to the national economy. This concept is tentative at this stage.

7. Additional factors, which could also be analysed and addressed in the Financial Stability Reports, could include the coordination failures, infrastructure weaknesses and lack of transparency listed in Box 2.A of the HM Treasury consultation document.
8. Development of a macroprudential lever to manage credit supply would equip authorities with three macroeconomic levers, the other two being fiscal and monetary. The risk-based nature of the macroprudential lever would require independence from government, but this would put two out of the three levers in the hands of unelected bodies. FPC transparency and accountability would therefore need to be at least equal to those of the MPC. Transparency could be met through the publication of Financial Stability Reports and the minutes of meetings. Accountability to the government could require the Chairman of the FPC to present the FSR formally to the Chancellor of the Exchequer, with a full covering letter of explanation should the Committee recommend a change in the core capital ratio. We anticipate that such changes would be rare, not least because the availability of this lever could, of itself, pre-emptively damp enthusiasm for bubbles. Accountability to Parliament could include presentation of the FSR in public session to the Treasury Select Committee.
9. At times when risk is low in the system, and capital retained by the banks following a recession remains proportionally high, the FPC might wish to retain the authority to approve deployment of capital within the "conservation buffer" without penalty. This would allow full use of the macroprudential lever to stimulate economic growth when required, or when fiscal or monetary levers are not available.
10. Implementation of the recommendations of the FPC would be the responsibility of the PRA. Where the FPC identifies exuberance, and recommends an increase in the core capital ratio, the PRA could respond by raising the risk weighting on exuberant activity through Pillar II of Basel II. This could be achieved by calibrating an additional buffer of capital to be held against that activity, or by adjusting the Basel II scaling factor, set at x1.06, in respect of that activity. This "bottom up" approach would result in fulfilment of the FPC's "top down" general instruction for an increase in the core capital ratio. This would not preclude the use of other macroprudential tools if required, including loan-to-value caps, or changes to an institution's liquidity regime.
11. Capital reductions could be achieved through an instruction from the FPC to the PRA to examine risk weightings on certain categories of activity for which capital treatment appeared restrictively cautious, e.g. trade finance or equity support for SMEs.
12. Critical to achieving a "level playing field" would be adherence to a definition of capital consistent with the agreed Basel standards, and to a methodology for weighting risk also consistent with agreed Basel standards. Enhancing the ability of supervisors to weight risk accurately would be an important feature of the new system.
13. Issues such as capture of off-balance sheet credit generation and the link between capital mechanisms and liquidity are covered in CGFS and IMF papers relevant to the concepts outlined here.

Prudential regulation authority (PRA)

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

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

  Yes. When it functions as part of the exercise of macroprudential policy, it should be directly accountable to the FPC and should set out in detail the measures it has taken in pursuit of FPC recommendations. It should also make available aggregate data drawn from its supervisory function when this is required to assist the formulation of macroprudential policy.

  Except in the implementation of macroprudential policy, which should be based on risk assessment, its activities should have due regard to the impact of its activities on global competitiveness, competition and innovation

  The PRA's objectives could be further enhanced by including a counterbalancing objective that makes reference to economic growth, in line with the objectives recently agreed for the European Banking Authority, which must take due account of the impact of its activities on competition and innovation, global competitiveness, financial inclusion and the strategy for jobs and growth.

  Regard to the primary objectives of the CPMA will assist cooperation and coordination and will be helpful in resolving competing objectives.

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

  The principles of good regulation set out in Section 2 FSMA are deliberately constructed to be relevant over time despite changes to financial markets, the needs of users, and the economy. We believe that Section 2 is a good summary of the necessary attributes of good regulation in a competitive financial centre and would suggest that they – or at least their spirit - should be wholly retained for the PRA.

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

  Yes. It is important to distinguish between innovation per se and innovation that produces outcomes that are bad for the market, such as unnecessary complexity or lack of transparency. These issues should be tackled separately – including through the prudential framework. In this respect, paragraph 789 of the Basel II principles provides appropriately for the capital treatment of innovation.

Given that the macroprudential framework set out above should be capable of establishing an inherently more stable financial system, other PRA regulatory actions should have a clear requirement to have regard to competitiveness. Differences between responsibilities defined by legislation and principles enshrined in any charter for the PRA should be avoided.

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

  An additional requirement should be the need to promote market confidence.

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

The FPC should have overall authority and the ability to step in where implementation of initiatives by the FPC and CPMA could lead to overlap or contradiction.

An integrated model in respect of back office functions would improve coordination, minimise the risk of overlap or contradiction, and increase efficiency. It would allow streamlining of fee collection, authorisations, approved person approvals, change of controller approvals and monitoring and surveillance (see also our additional point 4 below question 14). The function should be accountable through clear reporting lines to the PRA or CPMA or a joint committee of the two.

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

The key functions should include the specific requirement to implement macroprudential recommendations affecting credit supply through Pillar II of Basel II, as set out above. Operating under the instruction of the FPC will provide the PRA with the authority to take counter-cyclical action when judgement leads to a perception of increased risk, and therefore a need for increased capital, at times when exuberance in the economy might prompt market practitioners to be seeking higher returns. Equally, the PRA will need authority when it takes action to soften capital requirements for certain activities for which capital treatment might otherwise have been over-cautious. An example is trade finance, where Loss Given Default assumptions and Credit Conversion Factors might unnecessarily restrict liquidity, but where the PRA could be reluctant to act unless instructed to trial a lower risk weighting against the pattern of real-time defaults.

Close consultation should be a feature of fine-tuning capital requirements, both for increases and decreases, with a mechanism available to enable new proposals to be put to the FPC. FPC decisions on capital, however, should not be open to review through this mechanism.

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

In addition to the need for consultation and cost benefit analysis to be undertaken in respect of the introduction of any new rules, a summary case for new rules should be put to the FPC to ensure that they do not conflict with macroprudential considerations.

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

The PRA should be subject to the same statutory safeguards, without streamlining.

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

In the first section of this response we have set out how the PRA should be answerable to the FPC in respect of the implementation of macroprudential policy.

Given the quasi-legislative rule-making function of the PRA referred to in the consultation document, the current accountability mechanisms seem rather weak. It is an increasing feature of other political systems (eg EU, US) that the head of financial regulators appear regularly before a committee in the relevant chamber. It would seem appropriate that the CEO of the PRA should expect to appear at least every six months before the Treasury Select Committee, and perhaps more frequently, to account for his/her actions.

Such an appearance before the Committee could be run in conjunction with the presentation of the Financial Stability Report to the Treasury Select Committee by the FPC.

Consumer protection and markets authority (CPMA)

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

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

We believe that the CPMA, through its conduct regulation of firms and wholesale markets, should have regard to firms' stability and that of the wider financial system by reference to the primary objectives of the PRA and FPC. Close co-operation and co-ordination between the FPC, PRA, and CPMA will be essential to the effectiveness of the new regulatory framework. We believe that conferring a statutory duty on each authority to have regard to the primary objectives of the other, will formalise that cooperation, encourage information sharing, and enhance the quality of oversight exercised by each authority. The paper recognises, and we agree, that this statutory co-ordination will need to be supplemented with mechanisms for operational co-ordination and, where appropriate, formal consultation.

We believe that the CPMA's objectives could be further enhanced by including a counterbalancing objective that makes reference to economic growth, in line with the objectives recently agreed for the European Securities and Markets Authority, which must take due account of the impact of its activities on competition and innovation, global competitiveness, financial inclusion and the strategy for jobs and growth.

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

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

We support retaining *all* the principles of good regulation for the CPMA which are currently set out in section 2 of FSMA.

Banks function in a global context and we believe the CPMA should have regard to the 'international character of financial services and markets'. We believe that it should also have regard to the desirability of maintaining the competitive position of the UK because this is fundamentally in consumers' interests, is vital to supporting and encouraging enterprise, and critical to the overall health of the financial services industry. While we would not wish consideration of the desirability of maintaining the competitive position of the UK to dominate CPMA's regulatory decision-making, nor indeed that the CPMA should regulate or promote competition, we think that in taking regulatory action and decisions, it must form part of its considerations.

We also believe that the principle to have regard to 'the desirability of facilitating innovation in connection with regulated activities' should be retained. The consultation paper argues that leading up to the crisis, a lack of understanding of the impact of complex new financial products and transactions' was 'facilitated by the view that financial innovation should be supported at all costs'. While we do not believe that the CPMA should support innovation 'at all costs', we do think it should have regard to the desirability of facilitating innovation because innovative products, properly developed and tested, can deliver real benefits to customers, are critical to business development and growth, and the overall health of the financial services industry.

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

In terms of the 'broader public interest considerations' to which the CMPA should have regard, we strongly support the CPMA having regard to the potential impact of policies or regulatory decisions on consumer and business lending. Our capacity to lend to consumers and businesses is vital to economic growth, and an essential driver of the economic recovery. Regulatory policies and decisions can impact our lending capacity and should be considered by CPMA as part of its 'broader public interest considerations'.

We welcome competition and diversity in the market, and we support the CPMA having regard to the need to maintain diversity in the financial services sector.

We do not believe, however, that the CPMA, should have regard to 'promoting financial inclusion where possible, by encouraging access to suitable products and services'. Promoting financial inclusion and encouraging access to products and services does not sit easily with the remit of the CPMA which is focused on the conduct performance of firms and wholesale market participants. It is right that CPMA supervise to ensure consumers are recommended or sold suitable products, but encouraging access to those products is a distinct issue, for which Government must set the policy framework. While CPMA should also, as a conduct regulator, have regard to promoting better understanding of the type of product and advice service a consumer is being provided, we do not believe that promoting 'understanding of the financial system' fits with its remit. This is a broader educational function that should be exercised by the Consumer Financial Education Body (CFEB).

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

We believe that the proposed accountability mechanisms for the CPMA should be strengthened. While the mechanisms provide for an annual reporting line from CPMA via HMT to Parliament, and an internal accountability line to the CPMA's board, we believe that there should be a more direct and formal accountability line from CPMA to HMT. This could take the form of a requirement for the CPMA to provide six-monthly reports to HMT, providing an overview of its performance against its objectives, identifying key market and consumer conduct risks, and the proposed action to address them. These reports, and HMT's responses, should be placed in the public domain. This would provide more direct and frequent oversight of the CPMA's work, and the reports could, in turn, be the subject of scrutiny and challenge by the Treasury Select Committee (TSC).

We are also concerned that the statutory consultation requirements for the PRA are not equivalent to those proposed for the CPMA. We believe that the PRA's rule-making function should continue to be subject to statutory processes, including consultation with a practitioner panel, wider industry and the public, and the attendant duty to carry out detailed cost benefit analysis prior the introduction of any new prudential rules. No rationale is provided for having different consultation requirements for the PRA: both the CPMA and the PRA will derive quasi-legislative rule-making powers, and in exercising those powers, should be subject to similar statutory consultation requirements. There is no evidence to suggest that the existing statutory consultation processes could not effectively support the PRA's new approach to regulation. The paper notes that HMT will consult the FSA and Bank of England to determine whether the current FSMA rule-making process needs to be 'simplified and streamlined to support the PRA's new approach to regulation', and we would also expect HMT to also consult the wider industry.

In terms of the external challenge provided by the consumer and practitioner panels, we would expect the existing statutory requirements in FSMA to be read-across into the new legislative framework for the CPMA. In particular, we would expect Section 11 of FSMA, which currently requires the FSA to provide the consumer and practitioner panels with a statement in writing of its reasons for disagreeing with their view or proposals, to be reflected in the CPMA's legislative framework. In addition, as currently required under FSMA, the CPMA should be required to publish and make publicly available their written statements to the panels.

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

In addition to their advisory capacity, we believe that the panels perform a critical role in providing external challenge to the proposed policy and rule changes of the FSA (and in future, the CPMA), in particular, in highlighting the practical implications of rule changes from industry and consumer perspectives.

Under Section 9 of FSMA, four sectors are *required* to be represented on the Practitioner Panel: authorised persons, persons representing authorised persons, recognised clearing houses; and recognised stock exchanges. We believe that the role and membership of the panels should be kept under review and determined when a more detailed picture of the operational framework of the CPMA and PRA is developed.

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

We support the proposals for the CPMA and the PRA to each set fees and make rules in respect of the activities within their remit. The rules, as currently required, should be subject to public consultation, and the setting of fees and levies subject to audit by the National Audit Office (NAO).

On fee and levy collection, we believe that having one body responsible would, on a practical level, be more convenient, less confusing, and minimise the administrative burden on firms.

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

We believe that the PRA and CPMA should make rules relating to the compensation and levies for the different classes of firms they supervise. This would mean having separate compensation schemes, ending the cross-subsidy between the different classes of levy payers. We support the proposal that the FSCS should continue to administer all compensation schemes.

Additional points from HSBC:

1. Perception of 'consumer champion'

The CPMA should neither operate nor be perceived as a 'consumer champion'. We believe that the label is unhelpful and creates the impression that the CPMA will act predominantly as an advocate for consumers, rather than as a conduct regulator of retail and wholesale market participants, with particular focus on protecting consumers.

The purpose of CPMA must be more clearly articulated. Our view is that it must ensure the development of a market place in which customers are provided with clear and understandable product information from which they can make informed decisions. It must operate as a unifying force in financial services: ensuring that firms are able to make the profits that they need to grow and develop, and to re-invest in the UK, by providing value to consumers.

2. Financial Ombudsman Services (FOS)

We agree that the FOS should function independently of the CPMA, as is currently the case with the FSA. We recognise the value in having an impartial forum in which customer complaints can be resolved, but we believe that the lack of an effective appeals mechanism for FOS decisions is a fatal flaw. Firms dissatisfied with an ombudsman decision by FOS currently have no independent mechanism to appeal its decision. While it is open to firms to apply for a judicial review of the decision, this would only focus on the way in which the ombudsman had arrived at the decision, not the facts and merits of the dispute. We believe that there is an urgent need for an independent appeals mechanism in those cases where FOS decisions have implications which go far beyond the individual case itself. The appeals mechanism must capable of determining what outcome is 'fair and reasonable in all the circumstances of the case' *(i.e.* the basis on which the FOS reaches decisions). While one option could be for an appeals mechanism to be provided through the existing Upper Tribunal (which will be able to hear appeals in relation to the exercise of powers by the FSA in relation to consumer redress schemes, *see below),* the Tribunal's remit is, in that regard, confined to judicial review grounds, and it would not be able to undertake a review of the facts and merits of the dispute. We would suggest that the availability of an independent review of decisions on a merits basis in those cases where FOS decisions have much wider implications is imperative, particularly in the current complaints environment.

We believe the proposed structural changes, of which the creation of the CPMA forms part, provide an ideal opportunity to address this important issue, and to take much needed steps to improve the accountability of FOS decision-making.

3. Consumer redress

We also continue to have reservations about the FSA having power, and in future, the CPMA, to put consumer redress schemes in motion when there is a significant difference of opinion on the legal position, rather than achieving legal clarity in advance of announcing a scheme. Experience with the new consumer redress arrangements will, however, enable us to see whether it provides legal certainty more quickly than we have seen the past, which is the interests of government, regulators, banks and their customers.

In this regard, however, we do continue to have fundamental reservations about the adequacy of the appeals process provided by the Upper Tribunal, given that its remit, and the matters to which it is permitted to have regard, are effectively limited to the grounds for a judicial review. Our preference would be for redress schemes proposed by the FSA to be subject to approval by the court or, at the least, for the Upper Tribunal to be permitted to assess appeals against the schemes on the underlying merits of the scheme itself.

4. Back-office function

Both the PRA and CPMA will each have responsibility for approving/registering firms. We believe that there should there be a 'shared back office' responsible for approved persons, HR, IT, finance and possibly other functions to ensure consistency. This could be managed by a joint executive committee made up of senior officials from the CPMA and PRA.

5. Managing the transition

We would also like to stress the importance of ensuring consistent regulatory oversight in the transition period to 2012, minimising the impact of the operational disruption, and ensuring as much continuity as possible.

6. Interaction with European Securities and Markets Authority

The consultation paper is silent on how the CPMA will interact with the new European Securities and Markets Authority (ESMA). It will be essential that the CPMA interacts and works closely with ESMA given its role in retail conduct of business supervision and oversight of wholesale markets.

7. Separate UK Economic Crime Agency

Thought might also be given to the overlap between civil and criminal prosecution and prudential and conduct offences. Under the current regime, both firms and individuals are usually investigated on a number of different grounds (e.g. breaches of Principles , market abuse, insider dealing, specific FSA Rule breaches or Systems and Controls breaches) . Effective coordination and/ or centralisation of enforcement may be key and we would question whether a separate enforcement agency may be more appropriate.

Markets and infrastructure

15. The Government welcomes views on the proposed division of responsibilities for markets and infrastructure regulation. / 16. The Government welcomes views on the possible rationalisation of the FSMA regimes for regulating exchanges, trading platforms and clearing houses.

HSBC is strongly in favour of the combined supervision of firms, market infrastructure, exchanges, clearing houses, trade data monitors and MTFs remaining with either PRA or CPMA so that it has oversight of front to back market operations on a day to day basis.

This may be particularly important for matters such as trade and transaction reporting to be centralised (which impacts exchanges and firms) and which would clearly have advantages, especially as we are witnessing a move within Europe towards trade data consolidation, and transparency. This could be achieved through a combined back office.

More detail on the operational relationship between the PRA and the CPMA would be valuable because of the possible effects of disagreement. Potential conflicts may arise because of the differing objectives and a speedy dispute resolution framework or at least clarity on the final authority may help avoid this.

It is important to recognise that the FSA remains a powerful player on the European and wider international stage. In deciding on the exact boundaries between the new regulatory authorities, it is important to consider how they will map to their EU and international counterparts. A CPMA representative is likely to be better placed to influence work in ESMA and IOSCO than a counterpart from the PRA, whilst the converse is likely to be true for the EBA and the Basel Committee.

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

For the reasons set out below, we do not believe that the UKLA should be merged with the FRC but rather that it should form part of a strong, cohesive markets division within the CPMA.

<u>1. The UKLA forming part of the CPMA is consistent with the Government's regulatory aims</u>

We support the move to a "twin peaks" model of regulation, whereby macro-prudential regulation is carried out by the Bank of England and conduct of business regulation by the CPMA. In our view, this model must however give the relevant authorities (i.e. the PRA and the CPMA) the power to conduct effective regulatory activities in relation to the areas under their respective remits. Locating the UKLA, as the UK's primary market regulator, in a different place to the CPMA markets division would be inconsistent with the Government's drive for a true "twin peaks" regulatory model that would avoid the perceived problems that arose as a result of the existing tripartite system.

<u>2. The focus of the CPMA's markets division should be on enforcement and implementation</u>

The majority of the UKLA's functions involve real-time monitoring and response followed by enforcement and implementation. The FRC is more focussed on policy development and is not a real-time regulator, instead reviewing the accounts of issuers from a corporate reporting perspective. In addition, its focus is on UK companies and furthermore not on the broad range of securities that fall under the UKLA's remit, which include debt securities, GDRs and derivatives in addition to equity securities.

3. There is significant overlap between the UKLA and the future markets division of the CPMA

The wholesale markets supervision function of the CPMA markets division will overlap considerably with the supervision functions of the UKLA. Combining the two is therefore likely to create operational synergies, consistency of approach and more effective application of regulation and enforcement, all of which will be to the benefit of market participants.

4.. The UKLA must remain a commercially-minded organisation

In order to ensure that London remains attractive as a global capital raising centre and also to facilitate efficient capital raising by issuers, the UKLA must remain a commercially-minded body. The UKLA must remain abreast of current market practices and developments and also be integrated into the wider regulation of the markets in the UK. This is more likely to be the case if it forms part of the CPMA markets division than if it is combined with the FRC, for the reasons given above.

5. The UK must have a strong voice in the EU

The markets division of the CPMA will be the UK's only voting member at ESMA. The EU regulatory agenda has had and will continue to have an extensive impact on the UK's financial services sector. As a result, the need for the UK to continue to have a strong voice in Europe is crucial. As has been the case with the FSA to date, it will therefore be vital that the CPMA markets division has the authority, technical expertise and proximity to UK markets to represent the interests of London's capital markets effectively and comprehensively. There will need to continue to be a clear, joined up approach to primary and secondary market regulation in order to achieve this. There is a clear risk that removing responsibility for primary markets policy from the CPMA would undermine its voice in this area. Furthermore, the UK's ability in the past to strengthen and improve the standards for listing in London has been one of the key reasons why London has been able to maintain and improve its position as a premier global financial centre. It is important that these "gold-plated" standards are preserved, including through a strong UK presence at ESMA, and not eroded in the face of European harmonisation. It is also worth noting that the Market Abuse Directive contemplates a single competent authority that will deal with all matters covered by the Directive, including both primary and secondary market issues.

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

There are no other aspects of regulation that obviously fall into this category. The FRC performs an effective function as currently constituted and should remain in a similar form following the implementation of the new regulatory regime.

Crisis management

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

We believe that the macroprudential mechanism described in this response should provide a flexible and resilient defence against potential crisis, and the accountability/reporting suggestions we have made are consistent with and build upon the HM Treasury proposals. Basel III proposals for capital levels do not, as currently set, provide sufficient flexibility to respond adequately to the common causes of crisis, or to enable private sector banking activity to contribute to recovery when needed.

No mechanism, however, can be complete proof against crisis, and HSBC will continue to work with the authorities on recovery and resolution planning, and on capital structures.

In the context of crisis, we note that the consultation document does contemplate the use of public funds, while correctly seeking to avoid this if at all possible. We suggest however that further research should be undertaken into the impact of socialising losses in the financial system, which in principle affects private citizens whether they are categorised as taxpayers or savers whose pensions are in funds which hold debt.

We note, for example, that public funds have generally been deployed following a political decision to forestall failure and full resolution, and stage a rescue. Rescue offers the potential of restoring at least part of the value of an institution, and returning it to private ownership at little net loss, and in some cases a profit, over the funds used to prevent a collapse. This aspect should be factored into overall crisis management planning.

Clearly there is a distinction between losses incurred as a result of resolution or rescue of an institution, and the widespread economic losses that result from a post-crisis recession. It is for this reason that HSBC believes that at the FSB and G20 level, more work could be done to build a resilient financial system, and that solutions on the lines of a workable macroprudential system using the principles set out in this response could make the issues of recovery and resolution less acute.

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

Economic circumstances and levels of risk vary. In the same way that the appropriate levels of capital should be set through macroprudential policy, trigger points for intervention could vary to reflect recommendations at the macroprudential level. A decision to raise or lower a trigger point should be endorsed by the FPC.

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

Pulling the trigger to put a failed institution into the SRR could indicate a failure of macroprudential policy, which should have identified increased risk levels at an earlier stage and required a concomitant increase in capital levels, and, if necessary, changes to the institution's liquidity regime. In these circumstances, it might be inappropriate for either the Deputy Governor for Financial Stability or the Deputy Governor for Prudential Regulation to manage resolution, and an alternative structure within the resolution authority might need to be considered. Resolution following failure as a result of other factors could be managed through the Deputy Governor for Financial Stability.

Impact assessment

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

We note that no breakdown of the estimate of transitional costs of £50m is provided. We anticipate that HM Treasury will publish a much more detailed analysis of costs and benefits, possibly as part of the consultation on draft legislation.

Consideration should be given to technical and infrastructure issues in any transfer from FSA to the new structure. Any reorganisation will impact firms' systems such as trade reporting and transaction reporting feeds and disclosures (for example). This could have a significant cost impact on firms and lead to issues during a transitional period.

Without the introduction of macroprudential policy set out in this response, we believe there is no evidence base for the assertion that benefits from the new proposals will include the reduction in frequency and severity of financial crises. This mirrors the assertion that bank investors will accept a lower return on equity because risks in the banking sector will be reduced. We believe that the assumption that the Basel III approach to capital levels will ensure a more stable financial system could prove unfounded, for the reasons we give in the second paragraph of this response.

Dear Sir/Madam

As a general insurance broker operating in the UK I would like to make the following comments in relation to regulatory reform:

1) The main risk to general insurance customers is that their insurance company will go into administration. The FSA appears to understand this but there is a loop hole in the policyholders protection Act in relation to blocks of flats. Since Mrs Thatcher made it easier for leaseholders to buy the freehold of their flats the Act has not taken into account the changes this has brought about. For example when Independent Insurance went bust about 8 years ago individuals who owned flats where left without insurance even though they had already paid for it and their claims went unpaid. This happened because the policies where in the name of a company for example : Block A Residents Ltd and not in an individual's name. The policyholders protection board initially refused to deal with flats owners because of this. When they relented they made it so difficult to claim that many people gave up. Any new consumer protection authority should look into this issue.

2) The latest problem created by the FSA is for small brokers. Many that I know have seen their annual fees increase from £450 to over £2000 in one year. The cause we are told is Payment Protection Insurance (PPI) which is sold by banks to customers who take loans out with them. I believe about 90% of the policies sold in the UK are by banks. Besides the banks there are also about 4 specialist brokers who have created nearly all the claims within the broking community for PPI claims. To small independent brokers it appears as if the FSA are writing themselves a blank cheque using small brokers money to deal with this issue. They detected the problem too late and are now using it as an excuse to pay themselves more. For a small company that must be authorized by the FSA there is no right of appeal or any consultation. The first most knew of these rises was when they received notice that their bank account was being debited. It is not acceptable that during the recession bureaucrats can increase fees like this- what planet are they living on?

3) There is another threat coming from Europe that general insurance brokers will be forced to disclose their commission automatically without the client asking to know it. At the present time brokers tell their clients if they ask but it does not automatically get printed on the policy schedule. If brokers and insurers are forced to disclose automatically some brokers will go out of business because in surveys consumers think commission is about 15% when sometimes it is more than this: 20% etc. The subsequent pressure to reduce commission will lead eventually to less competition in the market and so higher premiums. If there are less brokers there is less consumer choice and competition. Insurers will reduce commission without reducing premiums and will instead increase their profits.

Can you please ask the new authority responsible to look into this?

Yours sincerely,

Mrs Monica Hubbard MBA

Director

St Giles Insurance and Finance Services Limited

The Hundred Group
of Finance Directors

Investor Relations and Markets Committee

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

08 October 2010

Dear Madam / Sir

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

We are pleased to submit our comments on the above consultation

Who we are

The Hundred Group is a non-political, not-for-profit organisation which represents the finance directors of the UK's largest companies, with membership drawn mainly, but not entirely, from the constituents of the FTSE100 Index. Our aim is to contribute positively to the development of UK and International policy and practice on matters that affect our businesses, including taxation, financial reporting, corporate governance and capital market regulation. Whilst this letter expresses the view of The Hundred Group of Finance Directors as a whole, they are not necessarily those of our individual members or their respective employers.

Our views

The Hundred Group is committed to supporting the competitiveness of the UK as an International leader of business.

Underpinning the competitiveness of the UK is the strength of the UK capital markets – the integrity, commerciality and stability of which continues to be vital to the position of the UK as a global, respected, financial centre.

We welcome the Government's review of the current regulatory structure governing the UK financial markets and believe that it is well timed and in the best interests of UK business as a whole. In times of financial stress or crisis a measured, reflective response is essential, as is the ability, when appropriate, to readdress fundamentally structures which are no longer effective.

Overall, we are supportive of the propositions made by Government in the consultation and of the ambition for a "twin peaks" regulatory framework, but raise in this letter two areas of concern.

First, we caution against the removal of the requirement that regulatory bodies should be mindful of their impact on both innovation and the global competitiveness of the market they are regulating. We fully support the position of Government that the primary focus of these bodies must be towards establishing stable, trusted markets with integrity. Furthermore we understand that at times decisions must, and should, be made to support stability over and above and at a cost to innovation and competitiveness. However, to remove the requirement for these bodies to have regard to these elements would, in our opinion, be ill advised.

In our opinion the benefit of objectives which can at some points create tension in a decision making process should not be underestimated – the ability to create a well thought through debate and full understanding of the implications of regulatory change is, in our minds, the essence of sound decision making.

We do not see the reintroduction of these policies as meaning that financial regulatory bodies should bow to the developments of innovation 'at all costs' or maintain a competitive position which would place the UK markets at risk of instability. Indeed we would consider this to be directly at odds with the objective of maintaining the current integrity of the market. Rather that being mindful of global implications and encouraging innovation where appropriate will provide the UK with a basis for sustained growth and development over the coming years.

Secondly, we set out our concerns for the proposed merger of the UKLA and FRC. In our opinion the objectives and operations of the UKLA would be more appropriately located within the CPMA markets division. The UKLA has, over a number of years, developed a robust, pragmatic and commercial approach to maintaining the integrity and competitiveness of the UK markets for listed securities. We strongly believe that these attributes and objectives have greater synergies with the markets division of the CPMA and that fragmenting the transactional and real time supervisory functions of UK primary and secondary markets regulation will have an adverse impact on the quality and efficiency of the UK capital raising process.

In addition, we are mindful that the UK capital markets regulatory framework is set at EU level and consider that the positioning of the UKLA as the primary markets regulator within the CPMA markets division would provide the UK with the strongest, most cohesive voice in Europe through the ESMA.

We set out our responses to specific questions in the Appendix to this letter.

Please feel free to contact me if you wish to discuss our comments on the proposals.

Yours faithfully

Peter Will

Peter Williams
Chairman
The Hundred Group – Investor Relations and Markets Committee

APPENDIX

Q10 The Government welcomes respondents' views on:

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

We strongly support the retention of the requirements for the new regulatory framework proposed by HM Treasury to have regard to the desirability of facilitating innovation in connection with regulated activities, the international character of financial services and markets and the desirability of maintaining the competitive position of the UK.

We note and support the call for reconsideration by the Government of the appropriateness of the current responsibilities in light of the recent financial crisis. We also note the potential for tension of these responsibilities against the need for robust regulatory challenge to ensure the safety and soundness of risk-taking within the financial markets. We support the Government in challenging the current roles and responsibilities to ensure that the health of the UK financial markets are retained and promoted.

However, we believe that the objectives of innovation and global competitiveness are not at odds with creating and sustaining confidence in financial services and markets and market integrity.

In our opinion the UK markets have successfully sustained their global reputation through the financial crisis as a market with integrity and international gravitas. Contrary to the opinions expressed by Government we do not consider that the UK markets have suffered from a 'light-touch orthodoxy' nor a view that financial innovation has been supported 'at all costs'.

We believe that the reponsibilities of the PRA and CPMA should be focused on regulatory excellence, balanced with commercial prudence and with an eye to the global horizon.

The UK markets have grown, thrived and survived under this basis, allowing the associated users and members to benefit from its strength. In the current economic conditions we believe it would be wholly detrimental for any body regulating these markets to become internally focused without being mindful of the wider implications of any changes to that regulation.

We support the proposal that the primary responsibilities for the PRA and CPMA should be focused on their regulatory responsibilities and the need to promote confidence and stability. In addition, however, we recommend the reintroduction of innovation and global competitiveness to the secondary objectives to which the bodies must have regard to. We understand that at times regulatory bodies should, and must, make decisions which prioritise stability over innovation and/or competitiveness. However we believe that consideration of both will add a healthy 'tension' to debate and encourage a full and thorough understanding of post implementation consequences.

We note that the secondary objectives of both the PRA and CPMA currently include 'the principle that a burden which is imposed on a person should be proportionate to the benefits which are expected to result'. We believe that removing the requirement to look beyond the immediate impact on the person to the wider ramifications on the global stage could lead to an under estimation of the impact of regulatory burden.

In our minds the need for a strong regulatory environment is intrinsic to the global competitiveness of that market, and accordingly we strongly feel that the two should not be divided in order to prevent short sightedness of critical decision making.

Q17 The Government would welcome views on whether the UKLA should be merged with the FRC, as a first step towards creating a companies regulator under BIS.
We are of the opinion that the UKLA should not be merged with the FRC, but instead should, as the primary markets regulator, sit with secondary market regulation as part of the CPMA markets division. The operational synergies between the UK listing function and the rest of the markets regulator (market surveillance, investor protention, supervision of the trading infrastructure, policy and wider markets) are significant. It is also vital that the UK has a strong voice at ESMA. If the UKLA does not sit within the main UK securities regulator, the CPMA will only speak directly on secondary markets issues at ESMA. Given that the UK listing and markets framework is set at EU level this would limit the UK's effectiveness in representing it's interests in Europe.

We strongly believe that the objectives of the UKLA as the primary markets securities regulator are more suitably aligned with the CPMA markets division, and that the benefits to be achieved through working with the CPMA are significantly higher than the regulatory benefits suggested through a merger with the FRC. The UKLA is primarily a securities regulator rather than a companies regulator and of the 20,000 securities admitted to the Official List, only 6 per cent represent equity securities issued by UK companies, 74 per cent are UK and international corporate bonds and sovereign debt (gilts). The remainder includes structured products, debentures (which can also be counted as debt), warrants and preference shares.

The primary objective of the CPMA is to ensure confidence in financial services and markets, with particular focus on protecting consumers and ensuring market integrity. This objective is strategically aligned with the 2010 UKLA objectives to provide an appropriate level of protection for investors in listed securities, and to seek to maintain the integrity and competitiveness of UK markets for listed securities. In addition, the CPMA's responsibilities will include real time regulation of market conduct where firms and others (particularly corporate clients of financial services firms) participate in dealings in wholesale financial markets. We believe that the placement of the UKLA within the CPMA would therefore provide significant synergies in approach.

By comparison the objectives of UKLA are less aligned to the FRC policy orientated objectives of actively helping to shape UK policy and to influence EU and global approaches to corporate reporting and governance.

We are also mindful of the fact that the UKLA modus operandi of real time monitoring and response is more aligned to the activities of the CPMA and will provide practical synergies for the new Agency. This is also in diametric opposition to the current role of the FRC as a standard setter and post event check and balance on compliance.

As highlighted in HM Treasury's document, the Government recognises the crucial importance of the wholesale financial markets both to the operation of the financial system as a whole, and to London's position as a major global financial centre. We also note that the CPMA will be responsible for engaging with the new European Securities and Markets Authority (ESMA) to ensure that the right outcomes are delivered for London and the UK more generally. Given the increasing activity of the European Commission and of ESMA we would be concerned that the voice of the UKLA in Europe could be unintentionally marginalised through a move to the FRC. We support the ongoing competitiveness of the UK markets and highlight the need for UK representation in Europe to be considerate of the unique position of the UK market. We believe that this would be most effectively and efficiently done through the UKLA operating through the CPMA. Relying on dialogue between a separate companies regulator at the Department for Business and the CPMA to ensure the effective representation of UK markets policy in Europe would potentially dilute a key intention of the new 'twin peaks' model, which is to remove the possibility of no one body possessing the responsibility, authority or powers to represent or monitor the system as a whole.

18 October 2010

Our ref: ICAEW Rep 107/10

financial.reform@hmtreasury.gsi.gov.uk

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

Dear Sir

A new approach to financial regulation

ICAEW welcomes the opportunity to comment on the paper *A new approach to financial regulation* published by HM Treasury in July 2010.

ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council (FRC). As a world leading professional accountancy body, we provide leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

Our comments focus on the markets and infrastructure section, and particularly on Question 17 which relates to the proposed merger of the UK Listing Authority (UKLA) with FRC as a first step towards creating a companies regulator under the Department for Business, Innovation and Skills. It is important when considering this proposal to be clear about the objectives of such a merger.

UKLA and FRC have distinct cultures and both command international respect. In particular, we believe that the FRC is widely regarded as performing its current role very well. However, the current regulatory and oversight functions of FRC and UKLA have different objectives and different approaches are needed to perform the functions. It is important, whatever the design of the regulatory architecture, that the various regulatory and oversight functions are able to take an approach appropriate to their situation. A number of concerns have been raised that moving UKLA to FRC might change the culture and approach of UKLA. We would be equally concerned if it changed the culture of FRC, which we believe is generally a cost-effective and successful regulator. From the perspective of the FRC's area of regulation, we do not believe that a case has been made either that change is necessary or that, in any event, it is appropriate to risk the organisation's culture and effectiveness by undertaking the change.

One suggested advantage of bringing UKLA under the auspices of FRC is that it would bring together the supervision of all information companies provide to markets, whether in listing documents or annual reports, as well as setting corporate governance rules. This advantage is, we

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place London EC2R 6EA UK
icaew.com

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City

believe, overstated. The principal difference between UKLA and the FRC is that UKLA deals with more real time issues and is required to make market interventions when needed, whereas FRC tends to look at matters after the fact, often on a ‘comply or explain’ basis, and its actions can be addressed over a longer timeframe. These differences justify different approaches which may mean that there are few synergies between the two organisations.

A widely cited potential disadvantage of moving UKLA to FRC, rather than to the new Consumer Protection and Markets Authority (CPMA), is that it will split the work of the listing authority from the rest of markets regulation, and split primary and secondary market regulation, as well as the enforcement mechanisms and market abuse regulation. In truth, the advantages of the current integration of these aspects under the FSA regime may also be overstated. UKLA retains its own culture within the FSA and the markets division generally and UKLA, in particular, may be less integrated than other parts of the FSA. We note that the UKLA culture survived its relatively recent move from the London Stock Exchange to the FSA. A more significant risk in moving UKLA to FRC lies in the structural reform of European securities regulation. The new European Securities and Markets Authority (ESMA) will have increased powers over the development of prospectus and transparency directives. CPMA will have the UK’s seat on ESMA and so such a move would probably weaken UKLA’s influence over major international developments under its regulatory remit.

On balance, while we recognise that there may be advantages and disadvantages in UKLA sitting either under FRC or under CPMA with markets regulation, we are not convinced that a case has been made for changing UKLA’s current alignment by moving it to FRC. We believe that changes of this nature should only be made where a clear benefit has been demonstrated. On that basis and given the overall architecture for reforming financial regulation set out by the Government, we would favour leaving UKLA with the rest of the FSA’s current markets division in CPMA as this would represent the least significant change and would provide greatest stability. However, UKLA does need to retain a distinct approach to its functions than to other parts of the regulatory system, wherever it is located.

We are not clear as to what is intended for the suggested new companies’ regulator. We are not aware of compelling evidence to suggest that such a new regulator is needed and look forward to further consultation on this matter, particularly if the proposal is intended to change significantly any of the responsibilities or approach of FRC, which may well have unintended and unwelcome consequences for the matters currently under its remit. One other concern over the proposal to create this new companies regulator is that increasing the scope of regulatory responsibilities tends to increase the volume of regulation and the costs of regulatory compliance for businesses, without necessarily improving quality.

Please contact me should you wish to discuss any of the points raised in this response. We would be very happy to meet your team to explain in more detail how we have formed our views.

Yours faithfully

Iain Coke
Head of Financial Services Faculty

ICE

Atlanta Calgary Chicago Houston London New York Singapore

Financial Regulation Strategy
HM Treasury
1 Horse Guards Road
London
SW1 2HQ

Financial.reform@hmtreasury.gsi.gov.uk

18 October 2010

Dear Sirs

HM Treasury Consultation (Cm 7874): A new approach to financial regulation

We welcome the opportunity to respond to HM Treasury's consultation on proposed reform of financial regulation (the 'Consultation'). ICE Futures EU (the 'Exchange'), a UK Recognised Investment Exchange ('RIE'), and ICE Clear EU (the 'Clearing House'), a UK Recognised Clearing House ('RCH'); have set out a joint response below.

ICE is a provider of global market and clearing services; and has invested significantly in the UK. We are an increasingly important part of global infrastructure[1] and wish to stress the importance of clarity, continuity and stability in UK regulation.

Parts of the Consultation[2] are very high level, with little or no detail as to what is being proposed and with questions that are ambiguous or with no clear supporting evidence and rationale. Given the role that exchanges and clearing houses play in the regulation of UK financial services markets and in the protection of market integrity and the interests of investors, interested parties must have an opportunity to understand what is proposed by the various implementation proposals and to consider the implications of issues raised. We therefore would request that HM Treasury continue its dialogue with relevant stakeholders as policy is developed, and, in due course, consult fully and clearly on the resulting proposals in a manner that is consistent with the Code of Practice on Consultation.

The regulatory reform being proposed in the Consultation is substantial. We would emphasise the importance of clearly defining the roles and responsibilities of each of the authorities within any new structure.

---

[1] For example, ICE Futures EU has more than 160 Members, and daily market volumes represent a notional value of over US $10 billion.

[2] Of particular concern are the proposals in respect of the regulation of infrastructure provision at paragraph 5.17 of the Consultation.

ICE Futures Europe
Milton Gate
60 Chiswell Street
London EC1Y 4SA, UK
phone +44 (0)20 7065 7700
fax +44 (0)20 7638 4964
online www.theice.com

Using the headings and questions numbers as set out in the Consultation our specific comments are:

Governance and accountability [Questions 1, 2, 3, 4, 6, 7, 9, 10, 11, 12 and 13]

We consider that in order to contribute to a clear regulatory system composed of agencies with an unambiguous mandate and direct accountability, each authority should be assigned a single clearly defined objective. This should not however be unconstrained and each authority should have strong governance in line with current best practice and be legally required to balance its decisions and actions in line with clearly defined additional factors. Competitiveness and innovation in what are global markets are critical to consumer choice and the long term sustainability of UK financial markets and therefore each of the authorities should continue to have regard to these matters when performing their duties.

In addition we feel that the remit of the proposed Consumer Protection and Markets Authority ('CPMA') could be interpreted to have an emphasis on consumer protection. We would therefore advocate, within the terms of the mandate for the CPMA, an explicit requirement to maintain market confidence. If regulatory powers over infrastructure providers are to be given to the Bank of England, we would expect a similar provision to be applied.

The new regulatory framework should include:

- adequate disclosure of the structure and application of decision making processes and resulting decisions (both publicly and direct to affected parties, as appropriate);
- challenge of proposed measures and checks to ensure their effective ongoing usage; and
- a requirement for each authority to disclose how they have discharged their responsibilities in this regard (including in respect of funding arrangements).

While we recognise and endorse the need for clearly defined mechanisms to support decisions and the resolution of conflicts, we believe that it would be inappropriate for the Prudential Regulatory Authority ('PRA') to have an absolute right of veto over the CPMA in all instances, particularly given that in many instances conduct and prudential matters are inextricably linked.

We would welcome greater clarity on the processes that will be put into place to support decisions involving multiple authorities, and to ensure the timely and effective escalation and resolution of issues and conflicts, including where authority ultimately rests.

We note the proposal that the PRA will be responsible for making prudential rules for the firms it regulates, which will include remuneration. Such powers should not detract from the rights and responsibilities of shareholders.[3]

Markets and infrastructure

Regulation of Wholesale Markets [Questions 15 and 17]

The new structures should maintain, and strengthen the unique and leading position of the UK in wholesale markets, the systemic importance of exchanges and clearing houses for wholesale markets activity, as well as the strong correlation between conduct and prudential risks.

The proposal for markets regulation to be supervised through the creation of a new tripartite structure (the Bank of England, CPMA and the proposed merger of the UKLA with the FRC) will create significant challenges. The effectiveness of real-time market supervision may be impeded if the authorities are unable to intervene in a timely manner. The supervision of exchanges, clearing houses and other market infrastructure must be coordinated and integrated across the authorities involved in such activities.

Further, wholesale markets must be strongly represented in each of the authorities involved in their supervision. It is critical to the workings of the new regulatory structure that the markets division of the CPMA is substantive; with the same status as the consumer protection division.

Communication and cooperation with EU Regulatory Bodies [Question 15]

Regulation of UK market infrastructure is now determined predominantly at the EU level, with routine supervision still overwhelmingly at national level. The importance of the European and international levels in policymaking has steadily increased since the Financial Services Action Plan and, in the wake of the financial crisis, has greatly intensified. There is now a very significant weight of regulatory reform in train at EU level, both in areas of policy and in regulatory structures. The UK risks diverting effort and resource at the very time focus needs to be on ensuring that due weight is given to the UK voice in reshaping regulation at European level. The specialised regulators that HM Treasury plans to introduce following the dissolution of the FSA may further reduce UK influence as the membership of the EU regulatory authorities is divided up. Considerably increased resource will have to be devoted to both strategic and day-to-day co-ordination.

---

[3] Para 3.21 of the Consultation.

ICE

We are particularly concerned that the UK's influence on regulatory policy in relation to exchanges and clearing houses should be maintained. Given that the rationale for reform of the UK regulatory structures is that the current system failed – specifically the 'tripartite' – we would welcome further detail and clarification of how the CPMA, the PRA and the Bank of England (and other, relevant parties) are to work together, both with regard to supervision of UK entities, but particularly in participating in EU-level policy development and oversight. The proposed new structures do not sit easily with the four new EU Regulatory Bodies that are to begin work next year (namely the European Securities and Markets Authority ('ESMA'), the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Systemic Risk Board), and, though our own interest will primarily be ESMA, the EBA will also have an influence, particularly in the post-trade area.

Regimes for regulating exchanges, trading platforms and clearing houses [Question 16]

The UK has developed a strong position in global wholesale markets, which, subject to effective regulation and supported by market infrastructure, should be maintained. Viewed from an EU level, UK-based exchanges and clearing houses, supervised as UK Recognised Bodies, provide a substantial proportion of EU market infrastructure. The current UK regulatory regime has permitted market infrastructure to grow and thrive. We understand that HM Treasury is actively considering wholesale revision of the Recognised Body regime, by way of its abolition and redesignation of Recognised Bodies as authorised persons, or otherwise. There may need to be some consequential changes required to the regimes for RCHs and possibly payments systems as a result of the split in regulatory oversight arising from the creation of the PRA, CPMA and the allocation of responsibilities between the CPMA, PRA and Bank of England for clearing systems, central counterparties ('CCPs') and payment systems. But the rationale and justification for the proposed abolition of the Recognised Body regime has not been made clear. We therefore do not understand, nor can we comment on how the proposals for reform would enhance financial stability or the efficiency of the UK regulatory system. Market infrastructure was a key stabiliser during the financial crisis, continuing to operate effectively throughout.

The proposal needs to recognise the important regulatory and risk management functions undertaken by exchanges and clearing houses under the current Recognised Body regime; and should protect against the creation of the very form of financial supervision, reliant on 'tick box' compliance with extensive rules and directives at the expense of proper understanding and in-depth and strategic analysis, that is criticised in the Consultation and which would have the effect of reducing investor protection and market integrity.

The regulatory roles of Recognised Bodies include:

- The development and maintenance of detailed rule books which establish and support standardised derivatives contracts, conduct of business (ensuring that markets operate in a neutral, efficient and orderly manner) and risk management standards;
- Acting as frontline regulators in the monitoring and enforcing of those rules;
- In the case of clearing houses, managing member defaults (e.g. the Lehman's collapse) using rules carefully developed to interact with insolvency and other laws, thereby helping to manage and reduce systemic risk in times of crisis.

It should be noted that Recognised Bodies differ from each other, operating in different ways and covering different activities; the current regime allows for this, recognising that these bodies have significant understanding and expertise in offering their services and must be able to meet their (considerable) responsibilities with a degree of autonomy, in a flexible regulatory environment. It would be a mistake to assume that all regulatory policies are appropriate for all Recognised Bodies and each of the services they offer – for example, markets for shares are very different from markets for commodity derivatives; as is clearing of different financial instruments.

Exchanges and clearing houses operate in global markets. They are a proven model with a track record of performing even in the most challenging market conditions (e.g. those of the last two years); and the activities of the Recognised Bodies deliver real benefits to the UK regulatory structure and the UK economy. Exchanges and clearing houses have a unique role in maintaining rules in respect of their members and the services they provide. These rule making powers are mirrored in EU legislation (e.g. the Markets in Financial Instruments Directive ('MiFID')). In the UK the functions and status of exchanges and clearing houses is reflected in the current Recognised Body regime and supported by an intricate and interconnected body of legislation making the task proposed considerable, complex and with a high risk of unintended consequences.

Further, the proposals risk potentially significant adverse consequences for the attractiveness and competitiveness of UK markets. The regulation of Recognised Bodies is currently substantial. The UK regime is recognised internationally, is consistent with regulation in the European and US jurisdictions and has supported the UK's reputation for safe and well regulated markets and clearing houses, making it an attractive destination for international business. It is not clear to us from the Consultation or any subsequent discussions with HM Treasury how the proposed changes would enhance the stability, efficiency or strength of the UK regulatory system. Nor is there any evidence of the market, regulatory or Recognised Body failures that the changes are intended to correct or achieve; to date, this regime has

ICE

worked successfully. During the financial crisis clearing houses performed their functions of successfully managing defaults; while at the same time exchanges continued to operate well.

As a general principle, we would support rationalisation of legislation if it contributes to, and does not impair, market efficiency, stability and confidence. However, on the basis of information provided to date, we have no confidence that changes in the Recognised Body regime would deliver any of these outcomes. There is a real risk of unintended adverse consequences, including underestimating the complex interactions with other legislation, regulators and jurisdictions; detrimental impact on the reputation of Recognised Bodies as neutral, trusted bodies; and/or less flexibility for regulatory oversight. If HM Treasury wishes to review and revise the Recognised Body regime, we urge it to do so on the basis of a full and reasoned consultation, setting out the failings it seeks to remedy and the intended outcome.

We have attached background information on ICE Futures EU and ICE Clear EU Limited as appendices.

If you would like to discuss any of the issues raised in this response, please let us know.

Yours faithfully

Sir Bob Reid
Chairman
ICE Futures EU and ICE Clear EU

ICE

Appendix A

ICE Futures EU

ICE Futures Europe (formerly The International Petroleum Exchange of London Limited or the IPE)

ICE Futures Europe (the 'Exchange') is Europe's leading, fully electronic, energy futures and options exchange. It was established in 1980 and provides a highly regulated electronic marketplace where industry participants can manage their price risk exposure in the physical energy market.

ICE Futures Europe is supervised in the UK by the Financial Services Authority ('FSA') as a UK Recognised Investment Exchange ('RIE') under Part XVIII of the Financial Services and Markets Act 2000; and is an EU Market Operator operating a Regulated Market under MiFID. Clearing and settlement services are provided for all of ICE Futures Europe's contracts by ICE Clear Europe Limited.

The Exchange has admitted to trading twenty four energy contracts; and has more than 160 Members ranging from global investment banks, energy trading companies to proprietary individual or former floor traders, and daily volumes represent a notional value of over US $10 billion. The Exchange's main contract, ICE Brent Futures, is used in the complex for determining the price for almost two thirds of the world's crude oil.

The Exchange became a wholly-owned subsidiary of IntercontinentalExchange Inc. ('ICE Inc.') on 10 August 2001 following the acquisition of the Exchange's parent company, IPE Holdings plc by ICE Inc. on 18 June 2001. ICE Inc. was admitted to trading on the New York Stock Exchange on 16th November 2005.

Further information relating to ICE Futures Europe is available at the ICE Futures Europe section of the ICE Inc website (https://www.theice.com/futures_europe.jhtml).

ICE

Appendix B

ICE Clear EU

ICE Clear Europe is ICE's London-based clearing house which was established in 2008 to provide clearing services for all exchange-traded and OTC derivatives contracts traded on the energy markets operated by ICE Futures Europe ("ICE Futures" - a U.K. Recognised Investment Exchange) and IntercontinentalExchange, Inc. ("ICE Inc." - a U.S. Exempt Commercial Market). In July 2009, ICE Clear Europe launched clearing services for the OTC credit derivatives markets.

ICE Clear Europe is supervised in the UK by the Financial Services Authority ('FSA') as a UK Recognised Clearing House under Part XVIII of the Financial Services and Markets Act 2000; and is designated under the Financial Markets and Insolvency (Settlement Finality) Regulations 1999. Further, ICE Clear Europe is recognised as an inter-bank payment system under the Banking Act 2009 and regulated by the Bank of England.

ICE Clear Europe seeks to enable the efficient development of new cleared markets to support the risk management needs of its global customers around-the-clock, with the capability to offer services to an expanded range of asset classes and other exchanges seeking clearing services. ICE Clear Europe guarantees contract performance by acting as an independent central counterparty to every derivatives contract traded on ICE Futures Europe and ICE OTC markets. This ensures the safety, security and market integrity that are vital to the exchange trading process. The availability of cleared OTC energy contracts reduces bilateral credit risk and provides significant capital efficiencies through the ability to cross-margin both futures and OTC positions. On a daily basis, ICE Clear Europe provides clearing services for contracts with a gross notional value of approximately $40bn and holds $10-11bn worth of cash and collateral as margin.

ICE Clear Europe's credit default swap (CDS) clearing operations operate separately from its energy clearing operations, and includes a separate CDS risk pool, rulebook, membership and risk model. To date, ICE Clear Europe has cleared CDS contracts with a gross notional of over €3.5tn.

ICE Clear Europe has 58 Clearing Members which include global investment banks, financial intermediaries and energy market participants.

Further background information about the Clearing House may be found at: https://www.theice.com/clear_europe.jhtml.

IMF STAFF COMMENTS ON

A NEW APPROACH TO FINANCIAL REGULATION: JUDGEMENT, FOCUS AND STABILITY

Washington DC, October 18, 2010

Submission by:

International Monetary Fund
700 19th Street NW
Washington DC 20431

Submission to:

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

Contacts:

Michael K. Moore
Monetary and Capital Markets Department

Andre Meier
European Department

Please note that the views expressed in these comments are those of the IMF's staff and not necessarily of its management or Executive Board.

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

SPECIFIC POINTS

Chapter 2: The Bank of England and Financial Policy Committee (FPC)

Box 2.A outlines the key objectives of macroprudential regulation. We strongly support the proposed two-pronged approach, which aims at (i) improving the overall resilience of the financial system through appropriate general safeguards and (ii) contributing to macroeconomic stability by addressing cyclical imbalances. Importantly, both aspects are linked in the sense that cyclical variation in regulatory requirements can only be successful over the entire cycle if the financial system is sufficiently safe (and perceived to be so) even at the trough.

Paragraphs 2.30-2.38 focus more specifically on the functions and tools for the Financial Policy Committee (FPC). Given the need to respond flexibly to emerging imbalances and vulnerabilities, we support providing the FPC with a wide range of instruments. That being said, it seems *a priori* desirable for the FPC to rely chiefly on tools that (i) are targeted at the specific imbalance/vulnerability that has been identified; (ii) are most likely to be effective, including in the sense that they are robust to regulatory arbitrage and/or sufficiently straightforward to coordinate internationally; and (iii) do not unnecessarily restrict the freedom of financial market participants, subject to the overall objective of preserving financial stability.

The FPC's overall financial stability mandate could be usefully supported by the regular release to the public of suitable regulatory information as gathered through interim and end-year prudential return reporting. A prudential return process could include the following elements and benefits:

- Selected information for individual banks and their financial groups could usefully include: (i) balance sheet; (ii) income statement; (iii) schedule of loans and investments (e.g., aggregated by loan and investment types); (iv) schedule of impaired assets, charge-offs; (v) schedule on the funding structure (aggregated by deposits and other short- and long-term liabilities); (vi) reconciliation of capital structure (e.g., compatible with Basel II pillar 3); and (vii) off-balance sheet items.

- A regulatory reporting requirement would ensure a level of consistency, comparability, and frequency of information for an individual institution, across a group of institutions, and over time.

- The basis of presentation for the interim reports should be IFRS (the local reporting standard), with the audit requirement relevant to annual year-end reporting.

- The public reporting channel would be a useful mechanism to provide feedback to home and host supervisors that have a need for information about activities in the UK market.

As a macro-prudential tool, the reporting requirement would need to evolve as the FPC identifies trends in activities (e.g., growing concentrations of funding, purchase of structured products, etc.) that merit greater disclosure. Reporting requirements should not be static, but should undergo periodic reviews of their relevance.

Chapter 3: Prudential Regulation Authority (PRA)

The primary objective of the PRA will be "to promote the stable and prudent operation of the financial system through the effective regulation of financial firms, in a way which minimizes the disruption caused by any firms which do fail" (paragraph 3.5). In addition, it is intended that the PRA's powers to regulate will be at the level of the firm and include the following: (i) banks and other deposit-takers (including building societies and credit unions); (ii) broker-dealers (or investment banks); and (iii) insurers (paragraphs 3.12 to 3.16). This focus on regulated firms appears to introduce limits in the coverage of UK financial groups.

- In this regard, it would be appropriate to provide the PRA with the explicit authority and responsibility to regulate and supervise financial groups at the level of the group, and not just the level of the firms. Such an approach would be better aligned with the consideration for strengthening the PRA's OIVOP (i.e., enforcement) power (paragraph 6.17). The need for added legal power over the group-wide activities assumes even greater importance for arrangements for resolvability.

We support strongly the positions in paragraphs 3.9 and 3.10 that the responsibility for global competitiveness and innovation in financial services should not be the role of the regulator, and that safety and soundness should be paramount. There is a subsequent reference in the third bullet of paragraph 3.10 that any burden of supervision be proportionate to the benefits. This introduces ambiguity regarding the beneficiary. In this regard, it would be preferable to indicate explicitly that burden considerations should be counterbalanced by the recognition that a key benefit should be greater financial stability and transparency (e.g., from transparent regulatory reporting and disclosure that is relevant for market participants and users of financial services).

Chapter 4: Consumer Protection and Markets Authority (CPMA)

Paragraph 4.15 establishes that the CPMA will be solely responsible for the authorization and supervision of firms not regulated prudentially by the PRA. The CPMA will also write the prudential rules for those firms (i.e., firms other than banks, insurance, and broker dealers). This might set the stage for regulatory arbitrage as differences in oversight could motivate risk activities to move from PRA-regulated firms to CPMA-regulated firms (e.g., migration of activities to asset management, mortgage companies, leasing, and loan brokering firms). In addition, access by the PRA to information on CPMA-regulated firms within a common financial group (and CPMA access to information on PRA-regulated firms) would need to be addressed.

Chapter 5: Markets and infrastructure

Paragraphs 5.20-5.24 consider the transfer of powers that presently reside with the UK Listing Authority (which is part of the FSA) to the Financial Reporting Council (FRC). The nature of the powers that could be transferred appears to establish a third powerful regulatory agency (besides the PRA and CPMA). Such a step would raise important issues:

- As a general matter, listing powers should be assigned to the CPMA (i.e., essentially retained where they currently reside). Although there may be arguments for FRC engagement, it goes against global convention to move listing requirement rules away from the regulatory agency that is charged with market conduct regulation. This will introduce a new complexity for international coordination regarding globally active firms.

- To the extent that the proposal to move the listing powers to the FRC goes forward, it will be important to establish a clear link to the Financial Policy Committee (FPC). Specifically, the interaction between the FPC and the FRC should be broadly similar to the proposed interaction between the FPC and the CPMA and PRA. For example, paragraphs 2.48-2.51 discuss the FPC's proposed links with the PRA and CPMA.

Chapter 6: Crisis Management

Paragraphs 6.15-6.20 consider changes to enforcement powers for the PRA (also in paragraph 4.23 for the CPMA).

We endorse the introduction of a Prompt Corrective Action (PCA) regime as well as transparent trigger points at which the regulator would be expected to take specific actions as proposed in paragraph 6.17.

Moreover, we strongly support an expanded reach for the OIVOP powers to cover holding companies and unregulated entities within a group structure. This is an appropriate supervisory tool for addressing unsafe practices involving systemically important financial institutions.

- Not mentioned, however, is whether OIVOP-like powers would also be available against affiliated parties to a regulated firm. For instances, there may be the occasion where the PRA/CPMA would need to act against a third-party unregulated service provider (e.g., an IT service provider operating unsafely). Similarly, individuals may engage in activities that are unsound.

Paragraphs 6.21-6.24 address the special resolution regime (SRR). We are generally supportive of the positions taken. In this connection, an additional aspect to consider is whether an SRR should also apply to other types of systemically important financial institutions (e.g., an insurance firm, hedge fund, or stock exchange). In this regard, special criteria (and safeguards) could be developed that would allow the use of an SRR for other types of financial institution if the special criteria are met.

Independent Loss Adjusters Association

3, Station Road, Borough Green,
Sevenoaks, Kent TN15 8ER

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

15 October 2010

Dear Sirs,

Re: Response to Consultation Paper
A New Approach to Financial Regulation

I am responding to the above on behalf of the Independent Loss Adjusters Association.

The Association represents a number of independently owned Chartered Loss Adjusters and other professional practices engaged in the settlement of general insurance claims.

While a number of our members work only on behalf of Insurance Companies or Lloyd's Underwriters in connection with the investigation, evaluation and settlement of claims, and are currently not required to be regulated by the Financial Services Authority, others work additionally on behalf of Insurance Brokers, Local Authorities, Self Insured entities as well as for Commercial and Private Policyholders, in connection with the provision of advice and assistance with the presentation, negotiation and settlement of insurance claims on their behalf. When acting in this latter capacity they are required to be regulated by the Financial Services Authority.

A number of our members consist of small two or three director operated companies, partnerships, or sole traders who have, in the past, commented upon the disproportionate cost of periodic fees and the requirements to provide six monthly financial reports as well as maintenance of minimum capital requirement, when compared to the relatively small turnover generated from regulated activities.

In general, our members welcome the proposed division of prudential supervision and regulation of larger financial concerns such as banks and insurance companies, from the conduct of business regulation of these and other firms that provide financial services to retail consumers.

With particular regard to Question 10 contained in the consultation paper we would comment as follows:

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

As far as loss adjusters and other professionals acting for policyholders are concerned, provided that such firms do not hold clients monies, there would appear to be little benefit to be gained by requiring such firms, irrespective of their size, to hold minimum capital sums, or be required to provide six monthly returns including balance sheet, profit and loss account and other such information to the regulator, in addition to the annual returns required of any company, partnership or sole trader to HMRC and/or Companies House.

Accordingly we believe that regulation by CPMA should not include prudential supervision or financial reporting to the extent currently in place and which appears likely to form part of the supervision of those financial institutions which will be subject to regulation by PRA.

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

It is considered that the regulatory objectives set out in FSMA of: market confidence; public awareness; the protection of consumers; and reduction of financial crime are all objectives that should apply to CPMA, although their principle objective would seem to be that of “consumer protection”, given that more substantial financial institutions are to be regulated additionally by PRA.

It is considered also that the elements set out in subsection (3), to which the Authority should have regard, are also appropriate to CPMA, particularly “that a burden or restriction which is imposed on a person, on the carrying out of an activity, should be proportionate to the benefits… expected to result from the imposition of that burden or restriction”.

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

There would appear to be every need for any regulator to have regard to the impact of such regulation upon the competitiveness of any regulated firm, as there would appear to be little benefit if firms are regulated to the extent that they become uncompetitive with similar firms which fall outside the scope of regulation by virtue of the type of business they transact, their corporate structure or location, whether it be within or outside the European Community.

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

This would appear to be the area in which issues of consumer protection should be afforded a greater priority by CPMA than has previously been the case. By allowing PRA to concentrate on more macro-economic issues, as well as prudential regulation of larger financial institutions, the opportunity is available to tailor the conduct of business requirements more to the type of business being regulated.

In the case of Insurance Mediation this has almost exclusively been focussed on that of insurance broking as it affects both commercial and retail clients. The overall principles of treating customers fairly, maintaining ethical standards, of requiring adequate Professional Indemnity Insurance, as well as elements of status disclosure are those which should apply generally to all financial services companies.

As far as those of our members who act on behalf of commercial and private policyholders are concerned, there would seem to be a need to ensure that customer facing staff are adequately trained and/or supervised, as well as being able to demonstrate suitable experience in the particular field in which they are operating, whether it be loss adjusting, loss assessing, claims administration, claims management or risk management, and if necessary, that they are members of an appropriate professional body, such as Chartered Insurance Institute, Chartered Institute of Loss Adjusters, Institute of Risk Management etc.

In summary, therefore, we trust that by removing unnecessary elements of prudential supervision from smaller financial services firms, CPMA will be able to more effectively ensure that only those firms with appropriately trained and experienced staff are regulated for specific purposes, thus fulfilling each of the primary objectives of market confidence, public awareness, consumer protection and reduction of financial crime.

Yours faithfully,

David Toser ACII, FCILA, MIRM
for Independent Loss Adjusters Association

THE
INSTITUTE OF
CHARTERED
ACCOUNTANTS
OF SCOTLAND

QUAERE VERUM

Response from
The Institute of Chartered Accountants of Scotland
to HM Treasury

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

22 October 2010

INTRODUCTION

ICAS welcomes the opportunity to provide comment on the HM Treasury consultation on a new approach to financial regulation.

There has been much said and written about the causes and effects of the financial crisis over the past few years and we agree with HM Treasury that the time is now right to review the UK's tripartite regulatory system, which clearly failed, and seek to move this onto a more stable platform to help secure financial stability in the UK going forward.

We have not provided detailed responses to all of the questions posed by the consultation, but have sought to offer our views on each of the areas highlighted by the consultation.

1 Bank of England and Financial Policy Committee (FPC)

We are supportive of the proposed FPC and believe that it needs to have a clear, concrete and visible objective relating to financial stability and macro-economic policy. We also believe that there needs to be cooperation and an overall "joined-up" approach between the FPC, the Bank of England, HM Treasury and also the Monetary Policy Committee to ensure the future financial stability of the UK. There needs to be the creation of a stable environment which will allow banks and other financial institutions to return to a position of standalone strength. The level of supervision and regulation that is necessary to achieve this has to not only be strong, but also measured to allow these institutions the degree of flexibility that is necessary for them to deal with the many business issues that affect them both in the home market but also in the important international arena.

We also believe that there a place for secondary factors in the effective operation of the FPC but these should not be that important as to detract or deflect the FPC away from its primary objective. This primary objective should be the over-arching policy framework that the FPC strives to achieve.

The secondary factors should be similar to the "have regards" of the Financial Services and Markets Act and we believe there is a danger that if these are put in legislation then they may not be applied within the spirit of the FPC's activities.

2 Prudential regulation authority (PRA)

It would be inconceivable for the PRA to operate in isolation and disconnected from the primary objectives of the FPC and the Consumer Protection and Markets Authority (CPMA). For a new UK financial regulatory system to be effective, there needs to be clear lines of demarcation and communication between all bodies involved. Failure to do this could result in a backward step for the UK and lead to more market uncertainty which would be unwelcome.

While this would seem to necessitate an integrated model approach, it is possible this arrangement could complicate the regulation of firms due to the scope for misinterpretation and ambiguity that the current proposals leave. There is a real danger that if the proposals are not tightly and effectively managed, the potential for inefficiencies, operational challenges and duplication of work/effort would exist. This again could have the unintended consequence of an adverse market effect not to mention a possible strain on the relationship between the regulator and the firms it has to regulate.

It may therefore be preferable to put responsibility for authorising regulated financial activity within the one body; with the creation of separate departments within this organisation to deal with the different scale of operations of regulated firms.

We would agree that a more risk-based approach to the understanding of business models is necessary. It is however critical that this becomes a value added process and not merely a bureaucratic "box-ticking" exercise that serves little purpose. Aligning this to a judgement focussed approach which is sensitive to the complex structures/operating models of different organisations would be welcome and should be balanced proportionately so as not be overly prohibitive to small financial businesses.

3 Consumer protection and markets authority (CPMA)

In addition to some of the initial comments on primary objectives as noted in the above section on the PRA, we can see a potential problem with the CPMA fulfilling its roles at a "consumer champion" and the effective relationships that would need to be established with firms to be an efficient supervisor.

For the CPMA to be effective, it would need to ensure that it encourages competition and innovation in the sector. It should also make sure that the education of the public in financial markets is not underestimated as it would have an important role to play in establishing overall public confidence in the financial system. In order to achieve this, the CPMA will need to be a visible authority and one that the general public can relate to. This would necessitate a very high public profile and clear uncomplicated communication that avoids jargon and fosters an image of clarity, authority and forcefulness in the public perception that they can and will do an effective "policing" role in the interest of the consumer.

4 Markets and infrastructure

It is important not to dilute the influence and impact of the UK in European and global financial regulation. Due care and consideration will need to be given to any proposed structure to ensure that it is properly aligned with the European supervisory structure and we see it as vital that the UK does not attempt to introduce a new financial regulatory system that ignores the influence that European regulation has in this sector.

We do not believe that a merger between the United Kingdom Listing Authority (UKLA) and the Financial Reporting Council (FRC) to create a companies regulator under BiS is needed. We understand why such a proposal could seem attractive but this has to be weighed up with the fact that UKLA has worked well with the Financial Services Authority (FSA) for a number of years. UKLA has a much wider focus than the FRC, which is primarily directed at financial reporting and corporate governance and as such any forced amalgamation of these bodies would be a mis-match. It would appear to be an easier "fit" for UKLA to be aligned with the CPMA, given that they both would seem to have information and communication between participants and other stakeholders, very much at their core.

5 Crisis management

Arrangements for crisis management need to be visible and the fact that the Chancellor's responses to developments in financial stability and prudential regulation will be published should help increase transparency. We would caution that there should not be an over reliance on the bi-annual stability reports and all stakeholders need to be alive and responsive to any important issues that may develop between these reports.

We appreciate that it may be desirable to have set thresholds in place in order for firms to know where the boundaries lie for mandatory intervention to be deemed necessary. Firms need to take responsibility for their own actions, financial health and recovery and they may take comfort knowing there is a set of preventative measures in place to assist them in troubled times. However, there has to a recognition that any future financial crisis may be very different to the last one and in that respect, a regime that limits options and flexibility may end up causing more harm than good. The regulators will need to be very clear to themselves, the firms they regulate and the general public about what they will monitor in these situations and how they will spot the warning signs to help avoid another crisis. This will necessitate the development of a suitable suite of monitoring indicators as well as the continual consideration of banks' total exposure both in a UK and international context.

icsa. CHARTERED SECRETARIES

16 Park Crescent
London
W1B 1AH

Phone: 020 7580 4741
Fax: 020 7323 1132
E-mail: info@icsa.co.uk
Web: www.icsa.org.uk

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

Submitted by email to

financial.reform@hmtreasury.gsi.gov.uk

18 October 2010

Dear Sirs

ICSA response to the HM Treasury Consultation - a new approach to financial regulation: judgement, focus and stability

We welcome the opportunity to comment on this important consultation on the future of financial regulation.

The Institute of Chartered Secretaries and Administrators (ICSA) is the professional body that qualifies chartered secretaries. Many of our members are company secretaries in public listed companies, who take responsibility for their company's relationship with UKLA and compliance with Listing Rules, Disclosure and Transparency Rules and Prospectus Rules, in addition to corporate governance and statutory compliance generally.

In our response we make some general comments on the consultation and then some specific points on the content. Our specific points focus on the question relating to the future of the UK Listing Authority (UKLA) and the proposal for a new companies regulator (question 17 set out in Box 5.B of the consultation).

1. General Comments

We are supportive of the aim of the consultation in creating a new approach to financial regulation. The consultation highlights clearly the failures of the UK regulatory system that led to the recent financial crisis. What is not clear, however, is why this consultation includes a suggestion that there is a need for additional regulation of companies as a whole by way of a companies' regulator. At no point does the consultation suggest there have been any failures in the operation of the legal or corporate governance requirements for companies that would suggest a need for additional regulation. In addition, it is not clear why the consultation is suggesting merging the UKLA, a markets regulator, with the Financial Reporting Council (FRC), which is a 'standards setting' body.

2. The proposed merger of UKLA with FRC and the proposed creation of a companies' regulator

2.1 Regulatory function of UKLA

It is our view that, under the proposed new structure for financial regulation, responsibility for the UKLA should not be merged with FRC. For the reasons we set out below it is our view that the UKLA should fall within market regulation under the Consumer Protection and Markets Authority (CPMA).

The FRC is a 'standards setting' organisation, covering corporate reporting, corporate governance and actuarial practice of UK companies and involving post-event monitoring. It is also responsible for oversight of the regulatory activities of the accountancy bodies. By contrast, the UKLA has a strong operational focus as a 'real time' markets and securities regulator that provides efficient processes for capital raising and the listing of shares. Its key functions include ensuring immediate public dissemination of important information relating to listed securities, enforcement of its regulatory framework, and approving prospectuses for the listing of all securities, the vast majority of which are debt issues of various kinds. Of the securities admitted to the Official List, only 6% represent premium listed equity securities issued by UK companies. A large proportion of the issuers on the Official List in London are not UK companies.

As such, there would appear to be little correlation between the activities of the UKLA and the activities of FRC. There are greater synergies between the activities of UKLA and market supervision under the CPMA, which would be lost if the UKLA moved to the FRC, and we can see no benefit in separating these functions. CPMA will have responsibility for secondary market monitoring and we consider it would be detrimental to separate the supervision of primary and secondary markets as it would inevitably lead to less effective regulation.

As there is no evidence that the financial crisis resulted from any failings in market regulation or the activities of UKLA, we cannot see any benefit in making changes to the current position. We would therefore strongly support the UKLA falling within CPMA.

2.2 Europe

The majority of EU securities trading is currently undertaken in the UK and it important that London continues to be able to compete internationally. However, most of the regulations concerning securities markets emanate from the EU. ICSA has recognised for some time the importance of Europe to the future of UK companies. In recent years, a great deal of effort has been directed towards putting the case for what is important to UK companies and ensuring that what comes from Europe is both sensible and workable. It is vital for the future of UK companies that they continue to have a strong voice in Europe. The UK government has a key role to play in this area, which will be largely through the newly formed European Securities and Markets Authority (ESMA). It has been decided that CPMA will have the only seat on ESMA, therefore if UKLA becomes part of FRC, and ultimately, a separate regulator, UKLA will not have a voice in Europe.

The establishment of the UKLA outside the CPMA is not consistent with the government's aim of a "twin peaks" regulatory model. We would also reiterate the lack of any synergies between a securities regulator and a companies' regulator. We are not aware of any other countries that have merged these two regulatory activities and there is some doubt as to whether this is compatible with EU legislation under the Market Abuse Directive.

2.3 Powerful companies' regulator

We do not agree that combining the market regulatory function of UKLA with a companies' regulator under FRC would create a 'powerful companies regulator' (as suggested under 5.22). As set out above, the regulation of a securities market is very different from regulation of companies.

The consultation document does not give any reasons why it is thought that a companies' regulator would be of benefit and it does not explain what problems it is seeking to address. There were no failures of companies generally that contributed to the financial crisis.

The UK governance model relies on the 'comply or explain' principle and the periodic refreshing of the UK Corporate Governance Code (and associated guidance). By creating a new companies' regulator we risk setting up a role that could be at odds with the successful corporate governance model we have developed over many years. Unless there is shown to be a clear requirement for a new and powerful companies' regulator it would not seem sensible to progress on the assumption that this will happen.

The question of whether a companies' regulator should be established is very different from the issues of financial regulation the consultation seeks to address. If this proposal is being considered seriously, it should be the subject of a separate consultation so that the matter can be debated properly.

We would be pleased to expand on any of these points should you like to discuss any of them further.

Yours sincerely

Seamus Gillen

Seamus Gillen
Director of Policy

ICM
Institute of Credit Management
Empowering the credit profession

23 September 2010

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

RESPONSE OF THE INSTITUTE OF CREDIT MANAGEMENT TO A NEW APPROACH TO FINANCIAL REGULATION: judgement, focus and stability.

The Institute of Credit Management is the largest professional credit management organisation in Europe. Its 8,000 members hold important, credit-related appointments throughout industry and commerce, and we welcome the opportunity to comment on this consultation.

The Institute has no specific response to the paper and is broadly supportive of the proposals. It notes the intention to consult on the transfer of responsibility for consumer credit from the OFT to the new CPMA over a longer timetable. This is a matter much closer to its membership and it looks forward to engaging in this consultation in due course.

Glen Bullivant
Chair of Technical Committee

Website www.icm.org.uk
Institute of Credit Management
The Water Mill, Station Road, South Luffenham, Oakham, Leicestershire LE15 8NB

ICM - Empowering the credit profession

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

18 October 2010

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

Dear Sir / Madam,

Thank you for giving the Institute of Directors (IoD) the opportunity to comment on your consultation document, published in July 2010. Issues surrounding financial regulation are of considerable interest to the IoD and its membership. We are therefore pleased to present our views on your paper.

About the IoD

Founded in 1903, and granted a Royal charter in 1906, the IoD is an independent, non-party political organisation of 45,000 individual members. Its aim is to serve, support, represent and set standards for directors to enable them to fulfil their leadership responsibilities in creating wealth for the benefit of business and society as a whole. The membership is drawn from right across the business spectrum. 92% of FTSE 100 companies have IoD members on their boards, but the majority of members, some 70%, comprise directors of small and medium-sized enterprises, ranging from long-established businesses to start-up companies.

General comments

The Institute of Directors (IoD) agrees that it is sensible to incorporate macro-prudential regulatory activities and the micro-prudential regulation of systemically important financial institutions within the Bank of England under the proposed new Prudential Regulation Authority (PRA).

However, the IoD wishes to express its concerns about certain other aspects of the proposed financial regulatory architecture. These concerns are as follows:

1) The UKLA

We do not believe that it makes sense to separate the UK Listing Authority (UKLA) from the regulatory body that will be tasked with the regulation and supervision of wholesale capital markets.

By enforcing disclosure and transparency rules, the UKLA plays a significant role in ensuring that equity markets function in a fair and orderly manner. There is obviously a high level of synergy between this activity and that of regulating business conduct in wholesale financial markets. Consequently, we believe that it would be a mistake to split these two functions (which are currently undertaken within the FSA) between separate regulatory entities.

2) The CPMA

We are not persuaded by the logic of combining the regulation of wholesale financial markets and retail financial services within the proposed new Consumer Protection and Markets Authority (CPMA).

Wholesale and retail financial regulation give rise to different types of regulatory challenge and concern, and require a different approach. For this reason, we would encourage the Government to consider placing retail financial regulation in a separate regulatory body which can focus its entire efforts on becoming an effective champion for financial consumers.

However, if the proposed structure of the CPMA is retained, the markets division and the consumer division should be operationally separate within the CPMA. We would suggest that the two divisions are headed up by separate CEOs, each with a seat on the board.

3) The FRC

The Financial Reporting Council (FRC) is currently an independent regulatory body with responsibility for promoting high standards of corporate reporting. It also oversees the UK Corporate Governance Code and the UK Stewardship Code. We are satisfied that it is currently making an effective and independent contribution in its existing areas of responsibility. Consequently, until there is greater clarity in the overall financial regulatory structure, we do not advocate any changes to the position of the FRC in the regulatory system.

Answers to specific questions

Responses are provided to some of the specific questions that are posed in the consultation paper. We reserve our comments for issues which are of particular concern to the IoD and its members.

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

We support the creation of a FPC with a mandate to oversee prudential regulation and maintain financial stability.

We believe that the primary objective of the FPC should be supplemented with a strong set of clearly defined 'have regards' which it should formally consider when discharging its duties.

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

Given the significant contribution which the financial services sector makes to the UK economy, it is important that achievement of the FPC's primary objective is measured against the impact of its regulatory decisions on the competitiveness of the UK's financial markets and their position relative to other global markets. The FPC should, therefore, be required to have regard to the proportionality of regulatory activities and the need to consider the competitiveness of UK markets.

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

As suggested above, we believe these should form a set of 'have regards' which should be considered by the regulator in carrying out its primary objective.

It will also be important to ensure clear processes for oversight and accountability of the FPC. The current proposals indicate that the FPC Board will comprise a minority of independent members. However, in our view, this external membership should form the majority of FPC members, with Bank executives forming a minority.

It is important that these external members are sufficiently senior and well regarded. They should also be free of conflicts of interest in relation to their role on the FPC, and should represent a variety of business perspectives, i.e. they should not only be involved in the banking sector, but reflect the wider business community. Furthermore, there should be clear parliamentary scrutiny of decisions taken by the committee. We welcome the proposal in paragraph 2.59 in this regard.

Prudential Regulation Authority (PRA)

Question 4 - The Government welcomes respondents' views on:

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

As noted above, it is important that achievement of the PRA's primary objective is also measured against the impact of its regulatory decisions on the competitiveness of the UK's financial markets and their position relative to other global markets.

There is a strong link between prudential and conduct issues that has been widely acknowledged in the Consultation Document. There is therefore a high probability that the actions of one body will have an impact upon the primary objective of the other. It is therefore important to ensure an effective and consistent regulatory approach between the PRA and the CPMA (or bodies carrying out equivalent functions).

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

It is essential that the formation of policy and related supervisory activities are kept closely integrated to avoid the problems which arose in the tripartite system. There should be an effective flow of information between the regulatory authorities which supports their decision making processes.

The Consultation Document outlines a series of mechanisms designed to mitigate these risks. However, greater clarity is required on the precise mechanisms of communication and interaction, and the manner in which potential conflicts will be resolved.

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

The approach outlined may assist in enabling the PRA to take a more risk-based judgement-focussed approach. However, the quality of staff and the information flowing to those staff will be crucial. Focusing on recruitment and retention of suitably experienced staff with expert knowledge will, therefore, be essential.

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

No response.

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

No response.

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

Although we welcome the Governor of the Bank of England chairing the FPC and the PRA, it will be necessary for the boards of each to operate in an independent manner. Non-executive members of the board of the PRA should be sufficiently qualified and independent to offer diverse and differing views to those of executive members. It will therefore be important that these members are senior and highly respected industry figures.

Parliamentary oversight of the PRA, as with the FPC, is essential. We therefore welcome paragraph 3.40 stating that senior representatives of the PRA will be required to appear before the Treasury Select Committee.

Consumer protection and markets authority

Question 10 - The Government welcomes respondents' views on:

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

The IoD has significant reservations about combining the regulation of wholesale financial markets and retail financial services within the proposed new Consumer Protection and Markets Authority (CPMA).

Wholesale and retail financial regulation gives rise to different types of regulatory challenge and concern. Retail financial regulation is primarily concerned with overcoming significant asymmetries of information and expertise between market participants. This requires a different approach to that of a wholesale market environment involving professional and highly sophisticated counterparties.

For this reason, we would encourage the Government to consider placing retail financial regulation in a separate regulatory body which can focus its entire efforts on becoming an effective champion for financial consumers.

If wholesale and consume financial regulation are to be combined, it is crucial that, within the CPMA, the markets and consumer divisions are two operationally distinct bodies, each headed by CEOs of equal status.

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

We are generally supportive of the Government's proposals that the Board of the CPMA contains a significant number of non-executive members. We also agree that the CEO of the PRA should sit on the Board of the CPMA (or equivalent body).

Membership of the Board (both executive and non-executive) must be balanced to represent both the consumer and wholesale market remits of the CPMA.

It is important that the CPMA is subject to clear Parliamentary oversight. We therefore welcome paragraph 4.39 stating that senior representatives will be required to appear before the Treasury Select Committee.

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

No response.

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

No response.

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

No response.

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

No response.

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

No response.

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

We do not believe that it makes sense to separate the UK Listing Authority (UKLA) from the regulatory body that will be tasked with the regulation and supervision of wholesale capital markets.

By enforcing disclosure and transparency rules, the UKLA plays a significant role in ensuring that equity markets function in a fair and orderly manner. There is obviously a high level of synergy between this activity and that of regulating business conduct in wholesale financial markets. Consequently, we believe that it would be a mistake to split these two functions (which are currently undertaken within the FSA) between separate regulatory entities.

There is also an important cultural difference between the UKLA and the FRC. The UKLA deals with many issues in ‘real time’, e.g. relating to company disclosures, and is required to make market interventions. In contrast, the FRC tends to view regulation on a much longer time horizon. These differences justify a different working approach which reduces the synergies between the two organisations.

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

The Financial Reporting Council (FRC) is currently an independent regulatory body with responsibility for promoting high standards of corporate reporting. It also oversees the UK Corporate Governance Code and the UK Stewardship Code. We are satisfied that it is currently making an effective and independent contribution in its existing areas of responsibility. Consequently, until there is greater clarity in the overall financial regulatory structure, we do not advocate any changes to the position of the FRC in the regulatory system.

We are not clear as to what is intended for a new companies’ regulator. We are not aware of compelling evidence to suggest such a new regulator is needed. We look forward to further consultation on this matter, particularly if the proposal is intended to significantly change any of the responsibilities or approach of FRC.

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

We agree with HMT that the tripartite system contained a number of inherent weaknesses and contradictions that led to no one body possessing the responsibility, authority or powers to monitor the system as a whole. It is essential that a capacity for effective crisis management is a key feature of the new regulatory architecture.

Questions 20 - 22

No responses

Thank you once again for inviting the Institute of Directors to participate in this consultation. We hope you find our comments useful.

Yours sincerely,

R. Barker

Dr. Roger Barker
Head of Corporate Governance
Institute of Directors, 116 Pall Mall, London SW1Y 5ED
website: www.iod.com/policy

CAP/BBJ

15 October 2010

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

THE INSTITUTE OF INSURANCE BROKERS

Higham Business Centre,
Midland Road, Higham Ferrers,
Northamptonshire, NN10 8DW
Tel: 01933 410003 Facsimile: 01933 410020
E-mail: inst.ins.brokers@iib-uk.com
website: www.iib-uk.com

Dear Sirs

IIB response to HM Treasury
A new approach to financial regulation

The Institute of Insurance Brokers (IIB) is an association of UK insurance brokers. Our members perform a vital service to consumers and businesses, offering professional advice on insurance arrangements thereby helping to oil the wheels of our economy. Insurance policies, though increasingly commoditised and sold on price, are complex legal contracts and we are keen to ensure that customers continue to have ready access to experienced advisers.

Since 2005, when the insurance intermediary sector was shoehorned into the regulatory arrangements designed for banking and investment business, the number of independent intermediaries has declined enormously and those firms that survive are burdened with disproportionate compliance costs and bureaucracy. The FSA recognises that our sector presents a low risk to regulatory objectives. However, the regulatory fee this year for an insurance broker with a £5m gross income is in the region of £46,000. Firms would also incur significant compliance-related costs, which might involve employing a compliance officer or specialist consultancy services, adding perhaps a further £40,000 to annual expenditure. The huge FSCS levy required to fund claims against failed payment protection insurance (PPI) intermediaries has boosted this year's costs but, irrespective of compensation contributions, the regulatory fees paid by UK intermediaries tend to far exceed those paid by their European counterparts. No wonder our members are nostalgic about the former statutory regime of the Insurance Brokers Registration Council (IBRC), under which such firms paid less than £1,000 a year to be regulated, in their opinion, more appropriately by their elected peers and well-informed government appointees.

Unfortunately, the current system has not prevented systemic failure in the banking sector, consumers remain confused about how regulation helps them and the current regulatory arrangements for general insurance intermediaries are widely considered to be expensive and unwieldy. Our experience of the regulatory issues affecting banking and the wider financial services market is limited so we are responding in connection with matters most relevant to our membership.

In general, we agree with the approach set out in the Consultation Paper but, rather disappointingly, it does not put forward any firm ideas about the future regulation of insurance intermediaries. As our members appear destined to fall under the remit of the

CPMA, we have concerns that a body with such a wide and varied remit will continue to struggle to address the issues which affect lower profile, yet vital, sectors of the market such as ours.

Question 4
We support the idea of a new Prudential Regulation Authority and agree the PRA should have regard to the primary objectives of the CPMA and FPC. Broadly, the principles for good regulation (as set out in section 2 of FSMA) should be retained. However, bearing in mind that the insurance sector has proved itself robust despite the financial crisis, it is essential that the prudential supervision of insurance providers is proportionate and reflects international standards so as to avoid creating competitive disadvantage. We accept that prudential and conduct of business aspects may require different approaches, but if insurers are prudentially regulated by PRA and regulated for their conduct of business by the CPMA, we fear there could be confusion over their controlled functions and management responsibilities. There is an important public interest consideration here because over-regulation or uncertainty could lead to withdrawal of UK insurers from important markets, hence a reduction in the choice and availability of insurance products and services.

Question 10
We agree the CPMA should have regard to the stability of firms and the financial system as a whole. The need to have regard to potential adverse impacts on innovation and competitiveness is, in our view, fundamental. However, we would question whether the FSMA model provides a suitable legal framework for the CPMA's powers and functions.

A 'single integrated conduct regulator' may not produce the most efficient mechanism for promoting proportionality, innovation and competition across the range of UK financial services. Indeed the approach taken by the FSA (as a pan-industry regulator) has not created the level playing field for insurance sales that many people expected. For example, more relaxed rules for non-advised sales are thought to favour 'direct' product providers and the use of comparison websites, which ultimately encourage more consumers to buy purely on price, to forego valuable advice and, unwittingly, to compromise the legitimacy of their insurance cover. We believe the existing principles for good regulation form a solid basis for the CPMA but they should be reviewed as part of the more detailed consultation process.

Again, there is a wider public interest consideration inasmuch as inappropriate regulation could lead to the withdrawal of more firms from the insurance market and a consequent reduction in the availability, choice and affordability of insurance products.

Question 11
The FSA is often perceived as unaccountable, making rules which are sometimes unnecessary and incomprehensible. Therefore, we believe the accountability mechanism of any new regime must be geared towards greater transparency. Increased practitioner involvement would encourage firms to buy in to new arrangements and, at the same time, assist the regulators to better formulate and control both prudential and conduct of business standards. Some of our members would like to see a wholly separate insurance broking regulator but, under the CPMA umbrella, we envisage that a general insurance intermediary division could provide appropriate regulatory arrangements for our sector.

Question 12
We would not be averse to the retention of panels but we question their effectiveness in their present form. Insurance brokers and other intermediaries are represented on the FSA's Smaller Business Practitioner Panel along with credit unions, friendly societies, asset managers and others. Although this is an important forum, we believe its influence is very much constrained due to the diverse nature of the interests represented. Individual sectors

have specific concerns and we feel the experience and expertise of practitioners could be better utilised in developing and maintaining standards in their respective areas.

Question 13
Funding arrangements in relation to the CPMA should be subject to regular consultation as under existing FSA rules. However, greater transparency regarding the preparation and approval of annual budgets could help to ensure that regulatory management costs are better kept in check. The most cost-effective option should be adopted for the collection of fees and levies. We would not have any objection to the CPMA collecting fees and levies on behalf of all other regulatory bodies.

Question 14
On the question of the FSCS, we feel the scheme could comfortably fall under the remit of the CPMA but we have always opposed both the concept of a cross-subsidy which is inherent in the existing funding model and the 'unlimited' claims liability of insurance intermediaries. The idea that a small high-street insurance broker should be obliged to pay towards a failed bank has long caused consternation amongst our ranks and we know of no other scheme which offers potentially unlimited pay-outs to insurance claimants. We therefore welcome the suggestion that the operating model of the FSCS will be reviewed and look forward to any proposals which might promote a compensation system which is fairer to the innocent contributors.

In summary, our priorities for the CPMA would involve:

- Proportionate supervision and enforcement which is sensitive to the needs of different sectors of the market.
- Reducing the size and complexity of the current rulebook.
- Keeping costs and bureaucracy in check.
- A fresh mechanism for selecting regulatory board and panel members.
- A transparent system for budgeting and fee setting.
- Increased accessibility to and accountability of decision makers.
- Employing more sector-specific knowledge and expertise in the regulatory process generally.
- Clarifying the functions for which individual approval/authorisation is required.
- Rebuilding consumer confidence.

We are keen to be involved in any future discussions on the future regulation of the insurance intermediary sector and look forward to assisting in the development of the new regime.

Yours faithfully

Ann Peel FCII
Head of Technical Services

Email: ap@iib-uk.com

Intellect submission to HM Treasury

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

October 2010

Russell Square House
10-12 Russell Square
London WC1B 5EE

T 020 7331 2000
F 020 7331 2040
www.intellectuk.org

Information Technology Telecommunications & Electronics Association

Contact:
Ben Wilson, Head of Financial Services Programmes

Background

Intellect is the UK trade association for the IT, telecoms and electronics industries; industries that generate around 10% of UK GDP and 15% of UK trade. Our Members include blue-chip multinationals as well as early stage technology companies and play a crucial role in virtually every aspect of our lives. Intellect articulates a cohesive voice for these industries across all market sectors, and is a vital source of knowledge and expertise on all aspects of the technology industry.

Alongside the technology industry's considerable footprint in the UK, Intellect also enables many other industries to operate efficiently in today's economy including:

- financial services
- creative industries
- retail
- transport and logistics
- manufacturing
- defence and aerospace
- pharmaceuticals

We are a trusted partner for Government, both in terms of policy development and policy implementation across numerous sectors. We look to ensure that all relevant engagement of policymakers and regulators with industry is both easy and as valuable as possible in order that the technology industry may play the fundamental role it merits in the success of UK plc.

Intellect Financial Services Programme

Intellect's Financial Services Programme brings together over 150 suppliers of information systems, services and consultancy to the banking and insurance sectors.

Many of Intellect's Members are heavily involved in providing the fundamentally important technology platforms upon which the UK's financial services industry is built. For example, these Members help facilitate the 5.7 billion automated payments that are made through the banking system on an annual basis. Indeed, through Intellect our Members are working with the Payments Council to develop the future technology that will afford consumers and businesses alike more convenient, secure and efficient ways to conduct their transactions. Similarly, the 40 million online bank accounts that are registered in the UK would not function without the technological capability that our Members design and supply.

The relationship between the financial services industry and the technology sector is one of fundamental importance. Technology not only plays a critical role in the functioning of the financial services industry, it is a hugely important factor in ensuring that these institutions can operate more responsibly and remain competitive in the global marketplace. The right technology can help depress costs, reduce risk and increase the confidence of lenders and investors, all of which are of paramount importance in the current economic environment. Applied inappropriately or to the wrong ends and it can contribute to systemic risk, lead to reduced inward investment and ultimately have a detrimental effect on the economy.

Consequently, if the UK's banking sector is to be reformed to meet the challenges posed in recent years and provide the backdrop to economic recovery, policy not only needs to reflect what technology can facilitate today, but what it will enable in the future. Regulation will only be effective and durable if it takes into account how it will be implemented, and for an industry like financial services that relies so heavily upon technology, it is essential that policy is developed at all stages with a full understanding of the relevant technology.

Developments in recent years have presented the retail-banking sector with information technology challenges of a new, complex and demanding nature. Intellect, on behalf of its Members, has played a full role in the development of financial services policy in recent years and looks forward to doing so again at a critical time for the industry.

http://www.intellectuk.org/content/view/368/47/

Technology and financial services – an overview

The relationship between the financial services industry and the technology sector is one of fundamental importance. Technology not only plays a critical role in the functioning of the full spectrum of financial services, it is a hugely important factor in ensuring that the individual institutions within it can operate more responsibly and remain competitive in the global marketplace.

As HM Treasury's consultation points out, the UK's tripartite regulatory system failed in a number of ways, starting with a failure to identify problems that were building up in the financial services system. By facilitating greater, more accurate flows of information within and between banks, technology can diminish the threat of bank failure and systemic risk. The downfall of Northern Rock in 2007 was the first major event in recent years to highlight the need for financial institutions to have responsive, up-to date IT systems so that information can be shared, evaluated and acted upon. In 2008, the demise of Bradford and Bingley was, in part, because of antiquated information technology; the bank's senior figures did not have access to the company's up-to-date financial figures.

In the event of such a failure, the processes that will be in place to ensure that customers are guaranteed to get their money back, are technology enabled. It is these systems, when implemented, that will play a significant role in increasing customer confidence in their banks, tapering fear for the safety of their money and reducing the chance of another run on a bank.

By allowing new entrants to go to market with technology-enabled banking products and services, there is also the prospect of greater competition and choice for consumers. Indeed, technology can tread where regulation dare not – by helping to make it commercially viable for banks to lend to a wider cross section of suitable SMEs by allowing them to paint a more accurate picture of which SMEs are sound investments and which are not (as opposed to classifying all SMEs as undesirable 'risks').

However, there are also technology-based risks that equally need to be understood by regulators so that, where possible, they can be mitigated. The' Flash Crash' of May 2010, where the Dow Jones Industrial Average plunged 600 points and then recovered in the space of 15 minutes demonstrated how a system that relied upon technology to function could potentially be destabilised by this very reliance, with knock on effects for the economy. Similarly, the intertwined legacy IT systems that many established banks' business-critical operations are built upon, represent an obstacle to business change to meet ever-evolving regulatory, consumer and market pressures.

Consequently, if the UK's banking sector is to be reformed to meet the challenges posed in recent years and provide the backdrop to economic recovery, policy not only needs to reflect what technology can facilitate today, but what it will enable in the future. Regulation (and regulators) will only be effective and durable if it takes into account how it will be implemented and how the application of technology can be complementary. For an industry like financial services that relies so heavily upon technology, it is essential that regulatory authorities are equipped with a full equipped with a full understanding of it.

How the regulators in the proposed structure develop their expertise to fill the current knowledge gap could have a significant bearing on how successfully the three bodies work together, complement each other's activities and ultimately fulfil their objectives.

Overall

Potential lack of technology expertise within regulators

Intellect believes there is a significant omission in many of the recent regulatory and policy proposals from a number of Government departments, regulators and executive agencies specifically relating to application of technology to the development of financial services policy. In the context of HM Treasury's consultation *"A new approach to financial regulation: judgement, focus and stability",* this specifically relates to the technology expertise and focus of the proposed regulatory structure.

There is a general failure to recognise the importance of the technology that underpins the UK financial system, and the individual institutions within it, to its stability, prosperity and ability to deliver customer and economic benefit. This lack of understanding will translate into a negative effect on the durability and effectiveness of the regulatory regime as the development of technology outstrips the ability of regulation to develop as well. This will have the effect of restricting the evolution of the financial services industry as innovation is stifled, and/or it will fail to take into account the new regulatory challenges that the development of new technology poses.

Whilst welcoming the issues that it addresses, HM Treasury's consultation *"A new approach to financial regulation: judgement, focus and stability"* suffers from a similar oversight. Whilst it does focus upon the traits and expertise that the Prudential Regulatory Authority; the Consumer Protection and Markets Authority; and the Financial Policy Committee will require if they are to be able to tackle the problems of the last crisis and prepare for the next one, it does not focus upon the need for these bodies to have any technology expertise or experience. If regulators are to play an effective, but not unnecessarily restrictive role in the financial services sector, they must have an understanding of how these institutions (e.g. the banks) operate. It is now fundamentally impossible to do this without appreciating the technology that not only underpins existing banking institutions, but will drive changes to their operations and strategies in the future. An example would be a lack of understanding amongst regulators how the bank's existing legacy IT systems (i.e. the multiple layers of intertwined IT platforms within banks that have been built upon over many years, are at the heart of established banks' operations, and to alter them would require significant operational risk and cost) are actually having an impact upon these banks' abilities to alter their behaviour and business strategies.

If the current regulatory focus on the financial services industry is about ensuring that no more avoidable crises befall it; that consumers are adequately protected; yet ensuring the City remains competitive on a global scale and able to contribute to the UK's economy, there needs to be 360 degree consideration of all relevant issues and factors. Regulation and judgements not only need to reflect how technology can facilitate better policy today, but also what technology will empower the financial services industry to do for its customers, investors and the economy tomorrow.

Intellect believes that to assume that the PRA, CPMA and FPC will take on an element of technological expertise to complement and enhance their own specific remits under their own volition, is to effectively take a gamble with the ability of these bodies to perform their functions. It will leave the regulatory system open to potentially ill-informed decisions and will reduce the effectiveness of the regulatory regime as a whole. Under current proposals, too many responsibilities that could be described as essential to the PRA or the CPMA, are left to secondary statutory instruments. If the regulatory regime, as it is set out by HM Treasury, is going to be successful there needs to be a comprehensive framework of responsibilities for each of the three regulatory bodies and a commitment to ensure that the right resources and expertise will be in place to deliver these responsibilities.

Consequently Intellect believes that there should be a formal recognition of the role of technology within the Government's planned reforms through a commitment to develop better expertise and knowledge within this area and to establish and maintain lines of communication with industry.

Learning from the FSA

As a trade association, a key facet of Intellect's remit is stakeholder engagement to ensure a two-way exchange of information between members and stakeholders within a particular market area. One of the key shortfalls of the FSA in recent years has been a general reluctance to engage in a two-way dialogue with stakeholders outside 'the usual suspects' within the financial services industry. This is both a result of, and a catalyst for, a lack of awareness of the role that technology plays within the financial services industry.

Across other market areas, regulators have a strong relationship with Intellect, as they appreciate that the knowledge and expertise within our membership is critical to meeting their own specific challenges and objectives. For example, Intellect hosts a regular forum with Ofcom – providing a high level opportunity to discuss issues of strategic importance such spectrum allocation, Digital Britain and the digital switchover. Similarly, Intellect has a strong relationship with Ofgem on important issues such as SmartGrids. Indeed, Intellect is a chosen partner for many Government departments (e.g. Cabinet Office, HM Treasury, Home Office, plus others) in terms of assessing the feasibility of many initiatives by mapping them to technology capability within industry – Concept Viability.

It is common sense that if a particular industry or utility is based upon the application of technology, as indeed most now are, the regulator needs to have a two-way relationship with industry. This is so that it can seek advice in areas where it does not have definitive answers, ascertain what challenges are on the horizon and work towards solutions that are not only possible, but are forward-looking. To do so is not a concession of fallibility, quite the opposite, it demonstrates a willingness to take on board the views of experts and increase the regulator's potential for its outputs to be beneficial for consumers, industry and the economy. Crucially, it will also allow decisions to be made that will minimise the potential for wastage of public money.

Intellect provides an ideal source of neutral expertise for policy makers and regulators to tap into, representing the aggregated expertise of the companies that provide the IT platforms which underpin much of the financial services industry. As outlined above it provides this expertise within numerous other sectors that are critical to the running of the UK's infrastructure and services. However, over recent years, it has been unable to build this relationship with the Financial Services Authority (FSA).

The FSA has demonstrated a reluctance to attend industry meetings and engage in a meaningful dialogue that could assist their task of regulating such a critical (to the UK economy) and technology-dependent industry. When stating their reasons, the FSA has displayed a lack of awareness of the role that technology plays within and between financial institutions, and the technological impact of the various regulatory initiatives that are announced. We hope a reformed regulatory regime would address this and that appropriate expertise, and lines of communication to the technology industry, can be implemented.

Therefore Intellect believes that there are two possible solutions to this scenario that should be formally integrated into plans for the forthcoming regulatory structure for financial services:

- The employment of technology-knowledgeable individuals within the Prudential Regulatory Authority and the Consumer Protection and Markets Authority that can advise and make decisions based upon a knowledge of the fundamental systems that underpin the entire financial services industry

- An objective for all three bodies (the the PRA, CPMA and FPC) to seek industry advice on specialist issues of importance to the functioning and regulation of the financial industry (within the context of their own specific remit), and to set up channels of communication with industry (i.e. through forums, councils etc) that ensure that advice can be easily and quickly sought.

These are 'quick-win' solutions to problems that have been significant obstacles to the effectiveness of the FSA in the past and, as proposals stand, will continue to detract from the ability of the new regulators to perform their functions. It is critical that lessons are learned from the FSA in this regard and the same path is not followed.

Ensuring information sharing between the regulators and with financial services organisations

Intellect welcomes the Government's statement that there will be a review of the applications required by the new regulatory system in its entirety. However it is crucial that in this review the Government considers the lessons that have been learned from the recent banking crisis in terms of ensuring that accurate and relevant information can be shared between all relevant bodies. The review should have this theme at its centre.

As outlined above, the downfall of Northern Rock in 2007 was the first major event in recent years to highlight the need for financial institutions to have responsive, up-to date- IT systems so that information can be shared, evaluated and acted upon. The application of appropriate technology can reduce systemic risk and supplement the regulatory focus that is currently cast upon the banking industry. If counterparty risk cannot be assessed because of deficiencies in the flow of information within and between individual banking institutions, the effectiveness of the PRA, and consequently the FPC will be reduced.

Similarly, if the CPMA is to fulfil its role of identifying potentially significant consumer protection or market integrity issues it is anticipated that it also will need to have access to accurate and comprehensive flows of information from banks, so that it can evaluate and advise the FPC.

In a submission to Lord Sasoon's 2009 consultation on the Tripartite system of financial services regulation, Intellect highlighted some of the challenges that exist between the sharing of information between a number of regulatory bodies and indeed with the financial services institutions within the system. These challenges will continue to exist under the proposed system. All three regulatory bodies will need to have flows of information from the banks and with each other that allow them to fulfil their individual roles, in a co-ordinated manner.

Consequently, developing appropriate and uniform data standards that are universally accepted and adhered to by all actors within the banking system is critical to ensuring that data can be shared accurately and can be analysed by banking institutions and regulators to spot the build up of systemic risk. A key challenge is that information standards and formats differ from institution to institution and finding a means of standardising this information (and facilitating its sharing and analysis) is complicated by the legacy systems (see below) that are in place across most of the established, larger and most systemically important banks.

If the accuracy and flow of data is not treated as a priority by the new regulatory authorities, it could have the effect of undermining their effectiveness.

<u>Implementing crucial information systems</u>

As part of the IT systems required for the new regulatory system, Intellect would also urge the Court of the Bank of England and other relevant bodies responsible for ensuring that value for money is achieved in the procurement and implementation of IT systems for the new regulatory environment, to involve industry as early as possible to seek advice and work with those suppliers that will ultimately be rolling out the required systems anyway. On a a wider level, there is a strong argument for the proposed regulatory authorities to involve industry as early as possible in its deliberations for new initiatives, so that costly regulatory proposals can be evaluated, with duplication of effort and unnecessary expenditure (for government, regulators and financial service providers) kept to a minimum.

The case of the FSA's approach to implementing the Single Customer View (SCV) as part of the Financial Services Compensation is an example of how not to do this. Ernst & Young, who carried out the feasibility study for the FSA, estimated that the cost of adapting the bank's IT systems to accommodate this new regulation was in the region of £1bn. A commercially-focused SCV has been the goal of established banks for some time now, in order to manage individual customers' 'touch-points' and allowing a more personalised service. There is a strong argument that if the FSA had sought to involve industry at an early stage to determine how to its own SCV, the result would have been quicker and easier to implement; and significantly less expensive. At a time when there are two state owned banks that need to deliver value for money, it makes little sense for regulation to 're-invent the wheel' when there are systems already in place within banks that can be adapted to achieve the same result.

Intellect already partners with the Office of Government Commerce, HM Treasury and the Cabinet Office to ensure that such situations are avoided and it would seem logical that the Bank of England consider this path as well.

The Financial Policy Committee

As outlined above, Intellect believes that the FPC should be able to call upon a number of experts, either individuals or groups that can assist them in their work. There is a strong argument for the FPC being able to call upon the expertise of the technology industry as and when it is required. The right application of technology (specifically the flows of accurate information within the financial system) can assist the FPC in identifying the build up of systemic risk.

It is foreseeable that the FPC, in its capacity to suggest changes to make the financial system more resilient, will need to draw upon the expertise of the technology industry to evaluate holistic weaknesses in the system, identify areas where their oversight is limited and be made aware of how rapidly developing technology within the financial services system could also affect the stability of the financial services system.

Intellect would welcome the opportunity to work with HM Treasury, and the FPC to define how such an advisory capacity might work and feed into the FPC's own resources.

The Prudential Regulation Authority

On page 23, the consultation sets out that 'In future supervisors should focus more on understanding institutions' business models and strategies, with greater discretion to investigate and tackle risks and vulnerabilities within individual firms. As outlined above, it is inconceivable that the PRA will be able to undertake this task effectively if it adopts the same mindset as the FSA and disregards the impact that technology has upon the operations and strategy of financial services providers. The same can be said for the PRA's proposed responsibility to make rules about and approve Recovery and Resolution Plans (RRPs), in order to ensure the orderly wind down of systemic firms. The technology that underpins each individual financial services provider is different and in the cases of many of the more established, systematically important banks, is very complex.

These legacy systems are at the heart of established banks' operations, they are business critical, interdependent upon other elements of the banks IT infrastructure and are often running 24 hours a day. Adding new elements or removing them from these core systems (i.e. adding new systems to comply with regulation, or adding/removing new products or services for customers) is a complex and expensive process that will impact upon a multitude of different aspects of the banks' operations. It has in the past been compared described as 'open heart surgery for banks' and represents a significant risk with repercussions of loss of earnings, reputation, customers and potentially a knock on effect on the economy should there be a problem that disrupts the functioning of the bank. Consequently strategy and operational decisions are often made within the parameters that are set by these core systems and if the PRA is to be able to investigate and tackle risks and vulnerabilities in individual firms, it must understand how the systems in each firm works, and how changing them can tackle these risks and vulnerabilities.

If the PRA is to adopt a judgements-based approach to financial regulation and supervision of individual operators within the system, it will not only need access to relevant information from these individual operators (as outlined above, there is currently no standard format for this data amongst the banks – a challenge in itself for the PRA), but it will also need the capacity to understand the technology platforms that these individual businesses are built upon. It is also foreseeable that the PRA will need to call upon the expertise of the technology industry in an advisory capacity (to supplement its own technology-knowledgeable staff).

Given the importance of this issue, and the past reluctance of regulators and policy makers to address it (although only in the financial services sector, which is lagging behind other areas of government in embracing technology expertise as a policy-making tool) Intellect believes that the requirement to acquire this expertise should be formally set out in the current regulatory proposals. There are two possible solutions that can ensure that the PRA has the necessary tools to perform its role:

- The employment of technology-knowledgeable individuals within the Prudential Regulatory Authority and the possibility of a specific unit that is responsible for analysing and advising on financial services technology issues. As well as allowing the PRA to identify risks and vulnerabilities within individual firms, it will also facilitate meaningful and beneficial dialogue to take place between regulators and the technology industry so that regulation is realistic (i.e. it is applicable to the realities of the financial services system) and durable

- An objective for all three bodies (the the PRA, CPMA and FPC) to seek industry advice on specialist issues of importance to the functioning and regulation of the financial industry (within the context of their own specific remit), and to set up channels of communication with industry (i.e. through forums, councils etc) that ensure that advice can be easily and quickly sought. Intellect appreciates that the budgetary constraints currently within government mean that there is limited extra resource to apply to additional expertise – however the expertise within the technology industry is a resource that is available to be tapped, without drain on resource.

Intellect would welcome the opportunity to work with HM Treasury, and latterly the PRA to define such an advisory group.

The Consumer Protection and Markets Authority

Intellect believes that too much is being left to secondary statutory instruments to define how the CPMA will operate. If the financial services market is to be competitive and operate in the interests of the consumer, there needs to be clear direction as to what the responsibilities of the CPMA will be at this stage in the policy-making process. As outlined above, Intellect believes that a past reluctance to take into account the opportunities and threats that technology poses to the financial services industry, and the vital importance that it has to the delivery of effective and durable regulation, is an oversight that needs to be addressed now whilst the entire regulatory system is overhauled and made fit for purpose.

As is the case with the PRA, if the CPMA is to discharge its objectives effectively, it is essential that it understands how individual bank's operations run and how this affects the service that is delivered to the consumer.

Issues such as lack of consumer choice, high charges for credit and barriers to entry for new market entrants to the financial services industry can all be mitigated by the correct application of technology. It is important therefore that if the CPMA is able to protect consumers and ensure market integrity, it has a detailed understanding of the role that technology can, and indeed is, already playing in this sphere. On the other side of the equation, it is equally important that the CPMA has an understanding of technology within financial services so that it can identify when, directly or indirectly, it contributes to risk to consumers and the market.

Intellect's response to the Office of Fair Trading's review of *„Barriers to Entry, Exit and Expansion in Retail Banking'*[1] outlines these issues in detail, but in summary the CPMA needs to have the resources in place, or the links to industry expertise such as Intellect, so that it can develop an understanding of the following issues.

- **Increasing flows of capital to SMEs** – by improving the collation and sharing of credit risk information on SMEs between banks, more informed decisions can be made on lending to a sector that banks have largely treated as a commercial risk. Technology has a critical role in facilitating this sharing of data and as such, has a critical role to play in facilitating the UK's economic recovery

- **Increasing competition within the banking sector** – by reducing customer inertia through the development and provision of individual, transferable bank account numbers; the provision of customer-focused technology-enabled products; and reducing start-up costs for new entrants

- **Improving customer service –** There are currently issues surrounding the ability of banks to retire products that are unprofitable and exit these specific markets, and also in terms of delivering products that are suitable for individual consumers. The application of technology is both the problem and the solution in this instance and is an example of how the CPMA could perform its function more effectively with a strong understanding of the technology issues therein.

Regulation of infrastructure provision

Intellect believes that the requirement set out in HM Treasury's consultation for the CPMA to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector should be retained. However there should be a clear directive to not merely import the responsibilities of the FSA in this regard – instead there should be a more clearly defined role to protect and, crucially, not impinge upon innovation. In short the mistakes that have been made by the FSA need to be learnt from and corrected.

To this end Intellect believes that there should be a balance between transparent and appropriate auditing of suppliers to operators in the financial services market, and unnecessary and costly oversight that prolongs the

[1] Intellect submission, 'Barriers to Entry, Expansion and Exit in Retail Banking', July 2010
http://www.intellectuk.org/component/option,com_docman/task,doc_download/gid,4496/Itemid,102/

licensing process (extending ‘go to market’ time for the entrant) and which ultimately will in itself act as a barrier to competition within the marketplace. This in itself would be harmful to consumers.

Intellect recognises the need for regulatory oversight of the market infrastructure providers set out in point 5.12 however, the FSA’s current ‘adopted’ role of scrutinising the contractual relationships between banks (especially new entrants) and wider technology service suppliers (especially ICT suppliers that supply its systems and infrastructure) is not addressed in this consultation. The FSA is currently creating a barrier to entry for new banks by undertaking regulatory scrutiny of these technology suppliers, that it does not have the expertise to carry out.

In the current regulatory system this prolonged time frame, as a result of increased FSA scrutiny, could eventually have the effect of discouraging smaller ICT providers from forming commercial relationships with prospective and new entrants to the retail banking sector. It is simply not as profitable for smaller ICT providers to be involved in such projects as it would be for them to be involved in other, less scrutinised markets. Intellect believes (and has submitted to consultation responses to the Office of Fair Trading and the Treasury Select Committee to this end) that innovative IT-enabled customer services and infrastructure are important to new entrants’ entry and expansion in order to differentiate themselves from incumbents. A reduced field of suppliers to choose from will harm this ability and will ultimately harm the integrity of the market and choice for consumers. The public sector has, in recent years, seen a similar problem where smaller, innovative suppliers were discouraged from tendering for government contracts because of the costs of embarking on a time consuming and administration-heavy process. There is a danger that through increased regulatory scrutiny of ICT suppliers, the financial services industry could be sleep-walking into a similar situation.

This could potentially contradict its own objectives if the CPMA (like the FSA) does not have the necessary level of technical expertise to adjudge what technology is appropriate, what represents a satisfactory level of risk and what is in the consumers’ best interests with regards to ICT provision. The role that the FSA currently plays, whilst necessary, should be evaluated and refined where appropriate to ensure that the role that the CPMA adopts does not suffer from ‘mission creep’ and is appropriately resourced with relevant expertise.

Intellect believes there is an unnecessary degree of oversight on aspects of a potential entrant’s undertakings that will not have a direct bearing on its ability to undertake deposit-taking activities. The CPMA should of course be responsible for ensuring that prospective entrants are suitable and have appropriate capital and liquidity measures in place, but should look to streamline the process of scrutinising ICT suppliers.

Therefore, as is the case with the Prudential Regulatory Authority, Intellect believes that there are two possible ways of ensuring that the CPMA and its staff has the expertise and means to perform its role effectively, and should be further evaluated by HM Treasury and be formally integrated into its regulatory proposals:

- The employment of technology-knowledgeable individuals within the Consumer Protection and Markets Authority and the possibility of a specific unit that is responsible for analysing and advising on financial services technology issues that have an impact upon consumers and market integrity. This will allow the CPMA to reduce its reliance on individual financial services providers to explain issues to regulators, and allow the CPMA to form its own judgements on issues that affect consumers and market integrity.

- An objective for all three bodies (the the PRA, CPMA and FPC) to seek industry advice on specialist issues of importance to the functioning and regulation of the financial industry (within the context of their own specific remit), and to set up channels of communication with industry (i.e. through forums, councils etc) that ensure that advice can be easily and quickly sought.

Intellect would welcome the opportunity to work with HM Treasury, and latterly the CPMA to define such an advisory group.

Conclusions

If the reform of the regulatory structure that governs the industry is to be successful (i.e. ensuring stability, protecting consumers, contributing to the economy, but not being unnecessarily restrictive) Intellect believes that the new regulators have a duty to understand how technology influences the market and how it can help the market develop. Regulators need to understand how the market is underpinned by technology so that future regulation is not left redundant at best; and harmful to industry at worst by technology that is developing at a quicker pace.

As HM Treasury states, the failure of the current regulatory regime, and the success of the next one, depends upon the ability of the regulatory authorities to identify the build up of systemic or aggregated risk and act accordingly to mitigate it. The simple fact is that this cannot be achieved without ensuring that there is a flow of information between banks and to the regulators that is of sufficient accuracy and quantity. To reach a point that this flow of information is of a suitable standard, and this is not currently the case, will require a significant injection of will, resource and direction from the regulatory authorities.

Intellect believes that:

- There should be a formal recognition of the role of technology within the Government's planned reforms through a commitment to develop better expertise and knowledge amongst the regulators' staff

- The new regulatory bodies should learn from the mistakes that the Financial Services Authority has made in the past in failing to use the neutral expertise that is available to them outside of the traditional financial services interest groups

- More formal lines of communication should be established with the technology industry to each of the regulatory bodies to ensure that advice is available quickly when needed and to ensure greater stability, smarter regulation and improved implementation

- There should be more focus on the importance of flows of information within the financial services system – between banks, from banks to regulators and on an international scale. Regulators will not be able to perform their functions if they are not able to receive and analyse accurate information from the financial system

- The regulation of infrastructure provision, whilst necessary, should be refined to avoid discouraging smaller, innovative suppliers from being involved

With the establishment of the PRA, the CPMA and the FPC, there is an opportunity to address these issues and ensure that the new regulatory authorities are fully equipped to tackle the problems that a rapidly changing financial services system will face.

Intellect contact:

Ben Wilson, Head of Financial Services Programmes
T: 020 7331 2161
E: ben.wilson@intellectuk.org

International
Capital
Market
Association

ICMA

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

(by e-mail to financial.reform@hmtreasury.gsi.gov.uk)

18 October 2010

Dear Sirs,

HMT consultation cm7874: "A new approach to financial regulation: judgement, focus and stability"

The International Capital Market Association ("ICMA") is responding to HM Treasury's above consultation.

ICMA is a unique self regulatory organisation and an influential voice for the global capital market. It represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges, central banks, law firms and other professional advisers. ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years. See: www.icmagroup.org.

ICMA is responding in relation to its primary market constituency that lead-manages syndicated bond issues throughout Europe. This constituency deliberates principally through ICMA's Primary Market Practices Sub-committee[1], which gathers the heads and senior members of the syndicate desks of 21 ICMA member banks, and ICMA's Legal and Documentation Sub-committee[2], which gathers the heads and senior members of the legal transaction management teams of 19 ICMA member banks, in each case active in lead-managing syndicated bond issues in Europe.

We set out our response in the Annex to this letter and would be pleased to discuss them with you at your convenience.

Yours faithfully,

Ruari Ewing
Advisor - Primary Markets
ruari.ewing@icmagroup.org
+44 20 7213 0316

[1] http://www.icmagroup.org/About-ICMA/ICMAs-Committees/Primary-Market-Practices-Sub-committee.aspx.
[2] http://www.icmagroup.org/About-ICMA/ICMAs-Committees/Legal-and-Documentation-Sub-committee.aspx.

Annex

ICMA is responding to questions 17 and 18 only.

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

ICMA has several concerns regarding the above proposal and considers that the better merger counterparty for the UKLA is the CPMA.

Firstly, the proposed new companies regulator will essentially be a regulator of UK PLCs (that is, issuers with premium equity listings). This seems to us to be a very unsuitable regulatory focus for a department that is to include the UKLA, given that fewer than 10% of securities issues admitted to the UK's Official List are UK premium equity, with the remainder consisting largely of bonds and other securities, many issued by non-UK entities (including entities which are not companies, but sovereigns, supra-nationals and agencies). Such issues would fall largely, or even entirely, outside the scope of the new companies regulator within BIS. Instead of being a natural fit with the companies regulator, the UKLA would be a drain on its resources and would distract it from its main focus (UK premium listed equities) as it would have to devote very considerable resource in managing a significant volume of work that has nothing to do with its core purpose. The fact that the UKLA was part of a UK companies regulator would also be very off-putting to issuers that currently use the UK regulated markets but are not UK premium equity issuers. The position of the UK as an international market would therefore be damaged.

Secondly, the FSA's integrated responsibility for both primary market disclosure through prospectuses and conduct regulation in the markets generally allows it to perform its responsibilities more effectively than would be the case if the responsibilities were split in the manner suggested in the Consultation Document. The process of issuing new securities in the market involves a number of areas of regulation, that are necessarily linked together. Approval of prospectuses forms a part of this process, but depends on other aspects. So, for example, many new issues will involve production not just of prospectuses, but also of other disclosure documents such as advertisements or other marketing materials that are regulated by the advertisement regime under the Prospectus Directive and by the financial promotion regime under the Financial Services and Markets Act 2000. These regimes form part of market regulation (and therefore belong with the CPMA) and currently are subject to rules set out in the FSA's Handbook (for example, the regime for approval of financial promotion by authorised persons under COB 4). At government level, they are within the jurisdiction of the Treasury, not BIS, and should remain so, because they affect markets generally and not just UK premium equity issuers.

Equally, the most important matters that are required to be disclosed in a prospectus are those that are likely to affect the market price of the securities. This is a question which a regulator that is in daily contact with the market, such as the FSA or, in the future, the CPMA, is best placed to judge. There is, for example, a strong link between the judgements made by those regulating the disclosure regime for inside information under the market abuse regime (which will be within the CPMA) and the judgements made on the key disclosure elements in a prospectus. In both cases, the question has to do with the pricing effect of the information in the market. In the market abuse context, the market regulator regularly monitors disclosure of price sensitive information (that is, information that would, if made public, have a significant effect on the market price of securities) and often gets involved in discussion as to what needs to be disclosed or even whether disclosure is required. Experience derived from this role within the market regulator is invaluable in the context of the review of prospectus disclosure, the really important information in a prospectus being that which is necessary to make an informed investment decision (including under the recent amendments to the prospectus directive, essential information to enable investors to understand the risks of the securities being offered to them). Market regulators, who, through their close operational contact with the market, understand how markets react to disclosure (and therefore what needs to be disclosed), are much better at making these judgements than those whose primary focus is corporate governance and who have little or no regular interaction with the market. It may be argued that two entities charged with different aspects of primary market regulation can work effectively together through proper collaboration. But experience shows that a single body provides better regulation and cooperation than split responsibilities.

Thirdly, the UKLA's role involves the review of detailed information that can be beneficial from a broader supervisory perspective. This benefit will likely be lost if the UKLA role is separated from supervision. The UKLA's detailed, working level, knowledge of forthcoming new issuance is particularly relevant to the monitoring of market abuse (notably insider trading in existing related securities), which will be the responsibility of the CPMA. Equally, matters discussed in the listing or admission process (such as difficult issues relating to disclosure in a prospectus or those surrounding eligibility criteria) are very important to those monitoring, for example, timely disclosure of inside information under the market abuse regime. As the market abuse directive requires member states to nominate a single authority to ensure compliance with its provisions, and as market abuse is inextricably linked with the market regulation role that will be assigned to the CPMA, it makes good regulatory sense to leave the prospectus approval and listing process with the CPMA, rather than hiving it off into a corporate governance department with no responsibilities for protecting the market against market abuse. Again, it is unlikely that the split could be healed by effective cooperation between the different entities charged with responsibility because the dynamic sharing of granular knowledge at working level across organisational boundaries will never be as efficient, particularly when the main focus of the two entities is so very different.

Fourthly, most of the material legislation used in daily practice by the UKLA is based on EU Directives and Regulations that are elaborated in conjunction with Committee of European Securities Regulators (CESR), on which UK representation will be the responsibility of the CPMA (which also handles many other aspects of EU regulation). With the UKLA arguably being the most expert European regulator in terms of new issuance (at least in terms of debt securities), its merger into the companies regulator within BIS would deprive the CPMA and so CESR (and ultimately EU policy makers and legislators in Brussels) of part of their influence in developing financial regulation in this area. Furthermore, this may incidentally lessen the CPMA's, and so the UK's, ability to play a leading role in CESR (including in its transformation into ESMA) and in EU financial regulatory developments more generally. The problem will not be solved purely through the CPMA acting as liaison between CESR/ESMA and the new companies regulator in relation to matters that fall within the latter's jurisdiction. In practice, other regulators round the CESR/ESMA table will listen to those who have direct responsibilities for the matter under discussion. Those who have to take further instructions on nuances that emerge during debate or who cannot agree a proposal, because they have no direct authority to do so, will be ignored. As the responsibilities would also be split at government level between the Treasury and BIS, the UK's voice in Council would also be weaker than at present, where one Ministry speaks with direct authority for both the listing and admission aspects of regulation and market conduct.

Finally, it is difficult to see what problem this proposal is trying to solve. The crisis has not revealed any major defects in regulation of listing and admission of securities. The UK should not be disturbing regulation that works well and replacing it with something that is likely to work less well in the future, for reasons given above, particularly at a time when so many other important (and in many cases necessary) changes are being proposed and assimilated by the markets.

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

ICMA is not aware of any other aspects of financial market regulation which could be made more effective by being moved into the proposed new companies regulator.

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

18th October 2010

Dear Sir/Madam,

Consultation Paper - A new approach to financial regulation: judgment, focus and stability

International Financial Data Services ("IFDS") provides a range of services to the collective investment scheme and ISA Management industry via three FSA-regulated companies. International Financial Data Services (UK) Limited ("IFDS UK") provides outsourced dealing and, in conjunction with International Financial Data Services Limited, registration services to collective investment scheme and stakeholder pension products, supporting over 7 million accounts across 44 fund management companies (over 40% of the UK market). IFDS Financial Services Limited ("IFDS FS") offers investment wrapped products, such as ISAs, to investors in association with other regulated firms. IFDS Managers Limited ("IFDS ML") operates CIS products (unit trusts/OEICs) designed in conjunction with external asset management firms and product distributors.

Given our position in the market, IFDS are pleased to respond to HM Treasury's consultation paper 'A new approach to financial regulation: judgement, focus and stability.' We recognise that a wholesale change in approach will be a complex and difficult process, but even at this stage, there are some factors that can be identified as key to its success:

- The new bodies must be as harmonised as possible to ensure consistency of approach
- Overlap of responsibilities should be minimised to avoid unnecessary costs to the industry
- The positive aspects of the FSA's approach should not be lost in the desire to correct the problem areas, for example, the success of the FSA's consultative approach to regulatory change
- Any new regulation should be proportionate to the risk that it attempts to address

More broadly, the current economic climate means that firms in the financial sector, particularly smaller firms, will struggle to cope with significantly increased compliance costs if the transition to the new bodies is not effectively handled. The importance of the financial services sector to the UK economy, both as an employer and as a generator of revenue (and therefore tax revenue) should not be underestimated. Measures that might have a detrimental effect on firms in the sector should not be implemented without close consultation and only for demonstrable benefits proportionate to the costs involved.

All parts of the financial services industry have been tarnished by the actions of certain financial institutions. It must therefore be an on-going aim of the FPC to re-establish consumer confidence in an industry that is crucial to the long-term financial security of so many people, whether, for example, as an employer, a savings account provide, or an investment manager to a pension scheme.

To this end we see the FSA's work around financial capability as an important thread in preserving financial stability that should not be lost. The more that savers and investors are empowered to take responsibility for their financial decisions, the greater the likelihood that they will choose the right products to meet their needs, thus building trust in the industry and helping people to secure their financial futures.

We also note that the paper concentrates on deposit takers, insurance firms and investment banks. This might be appropriate insomuch as such firms are perceived as the biggest 'threat' to financial stability. However, there are many other types of regulated firms in the financial sector and we would ask HM Treasury to ensure that any new powers and regulations are applied proportionately to the risks that such firms might pose. Our own clients are substantial fund managers, but it is not entirely clear from the paper how such firms will fit into the new regime.

We would also suggest that HM Treasury give thought to how the financial sector will be represented within the EU and globally. The marketplace is going through a period of rapid change and the voice of the UK must continue to be heard if it is to retain its current status as recognized centre of excellence for financial services. We believe that this must be co-ordinated through a single point of contact and not diluted by the introduction of multiple representatives from the new regulatory bodies.

Finally, we believe that one of the FSA's great strengths has been its willingness to engage with the industry in a timely and open manner. We believe this practice has worked to the benefit of regulators, consumers and the industry alike, and should be continued.

Detailed responses to individual questions are provided below.

Should you wish to discuss any of our responses further please call me on 01268 444989. Alternatively please call Nick Turner, Compliance Technical Team, on 01268 445768.

Yours sincerely,

Clive Shelton

C J Shelton FCSI
Risk & Compliance Director

IFDS response to questions raised within Consultation Paper A new approach to financial regulation: judgment, focus and stability

The Bank of England and Financial Policy Committee

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

We believe that it is perfectly feasible for the FPC to have a single stated objective. However, it is a fact that one of the key motivations that has led to the perceived need for a new regulatory regime was an apparent lack of a clear demarcation of responsibilities and powers between bodies. As such it would seem logical to, at the very least, supplement any objective, or objectives, with statements describing the interaction between bodies.

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

As stated in our response to question 1, we believe that amongst the secondary factors that should be considered are, at the very least, the scope of the FPC's role and responsibilities in relation to the CPMA and PRA, and how the FPC will interact with those bodies and the industry as a whole. There are a number of other factors that stand out as good principles of regulation and indeed that are currently defined in FSMA 2000. In particular, the principles of proportionate regulation and the need to ensure that the UK financial sector remains competitive, both internally and within the global market place.

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

In the current economic climate, it is essential that the public and the financial sector have certainty. Whether this is best achieved through a list of 'have regards' to, or as a set of secondary objectives is perhaps not as important as how the FPC chooses to interpret its new role and the powers available to it. Our own preference is to preserve the 'have regards to' that exists in the FSMA 2000, since in our experience this has been reasonably effective.

Prudential Regulation Authority (PRA)

4) The Government welcomes respondents views on:

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

We believe that there must be clarity over the relative roles and responsibilities of, and the interactions between, the new bodies. This is particularly important given that the proposals posit a situation where some firms will be subject to regulation by both the PRA and the CPMA. In our view, it is therefore essential for the PRA to have regard to the primary objectives of the CPMA and FPC.

The principles for good regulatory practice would help to provide certainty to firms dealing with the PRA as well as ensuring that the PRA's actions and decisions take into account factors that might otherwise be missed.

We are unclear as to why HM Treasury have picked out these particular factors for special consideration. However, we feel that the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector is critical to enable UK financial services to compete globally and to provide customers with products that suit their changing needs in variable market conditions.

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

   Many groups will contain firms that are only subject to supervision by one of the new bodies. Therefore, if responsibilities are split between the PRA and CPMA for identical functions, it is essential that there is a consistent approach. It is not cost effective for firms to require two sets of procedures to obtain the same result e.g. approval of a person for a significant influence function.

   Similarly, if a firm were to fall under the remit of both the PRA and CPMA, which body would have precedence? Or would one application be viewed by both authorities who would then issue a joint decision? The potential for delay, confusion and duplication of processes for both firms and the regulatory bodies must be removed. In our view, the model must be closely integrated to achieve this.

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

   We believe this approach to be sufficient. Using FSMA 2000 as the starting point for new regulation should help to ensure a smoother and more cost effective transition to the new regime, which is essential given the current economic climate and market conditions.

   We believe very strongly that rule-making powers must continue to be subject to statutory processes, in particular consultation. We believe this was one of the more successful aspects of the FSA's approach, and one which allowed the regulator to obtain access to expertise within the industry as well as hearing the concerns of the wider public.

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

   We believe that safeguards are required for the PRA's rule-making function. These should include requirements to have regard to the principles of good regulation, as well as a requirement for an appropriate consultation process. We also believe that all new regulation should be cost-effective and proportionate to the risk it seeks to address.

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

   We understand that there might be occasions when current safeguards might need to be over-ruled. However, this should be on a case-by-case basis, only in exceptional circumstances and specifically in relation to maintaining financial stability.

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

   We agree with these proposed measures.

Consumer protection and markets authority (CPMA)

10) The Government welcomes respondents' views on:

- whether the CPMA should have regard to the stability of firms and the financial system as a whole, by reference to the primary objectives of the PRA and FPC
- whether some or all of the principles for good regulation currently set out in section 2 of FSMA should be retained, and if so, which

- whether, specifically, the requirements to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained
- whether there are any other additional broader public interest considerations to which the CPMA should have regard

As with our response to question 4), we believe that there must be clarity over the relative roles and responsibilities of, and the interactions between, the new bodies. This is particularly important given that the proposals posit a situation where some firms will be subject to regulation by both the PRA and the CPMA. In our view, it is therefore essential for the PRA to have regard to the primary objectives of the PRA and FPC.

The principles for good regulatory practice would help to provide certainty to firms dealing with the CPMA as well as ensuring that the CPMA's actions and decisions take into account factors that might otherwise be missed.

We are unclear as to why HM Treasury have picked out these particular factors for special consideration. However, we feel that the requirement to have regard to potential adverse impacts on innovation or the competitiveness of the UK financial services sector is critical to enable UK financial services to compete globally and to provide customers with products that suit their changing needs in variable market conditions.

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

We agree that the proposed accountability mechanisms are appropriate.

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

No comment.

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

No comment.

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

One of the primary aims here should be to preserve the FSCS's profile and integrity in the eyes of the public, where it has become a recognised and reasonably well understood safety net. In our view, this should involve preserving the FSCS's independence, irrespective of the mechanisms by which fees are calculated. Ultimately, fees must remain proportionate to the risks posed to customers.

Markets and infrastructure

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

No comment.

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

No comment.

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

No comment.

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

No comment.

Crisis management

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

We recognise that firms must have robust recovery and resolution plans. We would recommend that the FPC formalise its own approach to crisis management by developing and maintaining its own credible response plan for dealing with future crises and threats, in line with accepted best practice for business continuity.

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

No comment.

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

No comment.

Impact assessment

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

FROM THE CHIEF EXECUTIVE

THE WORLD
OF INSURANCE

International Underwriting
Association of London

N

ILAG

Investment & Life Assurance Group
The Practitioner Voice

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

18 October 2010

Dear Sirs,

HM Treasury CP – A new approach to financial regulation: judgement, focus and stability

ILAG represents members from the Life Assurance and Wealth Management industries. ILAG members share and develop their practical experiences and expertise, applying this practitioner knowledge to the development of their businesses, both individually and collectively, for the benefit of members and their customers.

Overview

Our response to the questions in the consultation paper should be set against our basic belief that as far as the insurance and investment industries are concerned - which represent the main interests of most of our members are <u>not</u> best served by having two regulators. Whilst we recognise a case for ceding back responsibility for prudential regulation and supervision of the banks to the Bank of England (BoE), other reforms should have been targeted at the internal workings of the Financial Services Authority (FSA) to achieve a more focused and sharper-looking organisation rather than dividing up responsibilities between two brand new institutions.

As such, we see no direct benefits for firms but instead one of significant cost arising out of the new regulatory structure and request that the Government re-consider its proposals in this context. We feel that dual regulation does not provide the certainty and robustness of regulation required, and brings with it the potential for regulatory overlap, omission of issues that fall between the two regulators' scope and duplication of systems and processes for firms, examples of which we set out below:

- Authorisation – dual applications required to PRA and CPMA for firms being regulated by both regulators

- Approved Persons - different functions to be approved by each regulator - for firms who are subject to regulation by both PRA & CPMA there will probably be a requirement for applications to vary permissions and make changes to approved persons to be submitted to both bodies; there must be a way of managing this better so that only a single application is needed, otherwise, there will be a lot of duplication of effort for both firms and regulators with no obvious benefit to either
- Supervision and Reporting – need for firms to deal with both regulators and report to both – with the possibility of having to maintain two distinct sets of systems and controls.

We would urge you to consider the implementation of a single 'portal' through which firms could deal with both PRA & CPMA.

We are also concerned as to the potential impact of forthcoming European directives on these plans and the resulting costs, including time and opportunity costs to our members if any EU requirement differs from the final proposals.

The 'judgment-based' nature of regulation will mean that its success will be dependent on the regulators sourcing and retaining good quality staff, with not only the necessary skills, competence and experience but also the strength of character to obtain explanations and not be inhibited from asking difficult questions. Although there can be no guarantees, we would hope that the members of the FPC would be able to spot potential trouble before it developed and if it did, devise strategies to minimise the impact. Such people would need the qualities of persistence and ability to see the flaws in prevailing orthodoxies.

There is a danger that over-regulation and over-emphasis on the rights and protection of consumers and consequent stifling of innovation will seriously damage a major source of UK wealth and employment, and we would hope that the Government would recognise this. Clearly a balance needs to be achieved to protect consumers and to recognise the importance of London as a financial centre.

We are also concerned that the CPMA might also stifle innovation in their duty to protect the customer by employing product regulation. Although we are aware that pressure for this may eventually also come from Europe.

In summary, with so many changes ahead, including those from Europe, it is impossible to quantify the impact and cost of meeting the new regulatory regime and, in particular, those in dealing with two regulators.

We would be happy to discuss our responses to the questions in more detail.

Yours faithfully

Mark Searle
Administration Team

Consultation Questions

The Bank of England and Financial Policy Committee (FPC)

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

In the light of the fact that the new FPC will have formal relationships with a wide range of other regulatory authorities and institutions, both internal e.g. MPC and external e.g. ESRB, we believe that its primary objective should be clear and unrestrained and be supported by other secondary objectives.

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

In the decision-making process, it should have regard to wider socio-economic and fiscal considerations in order to avoid ‘unintended consequences’.

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

We believe that these factors should be clear and prescribed in primary legislation at the outset to provide absolute clarity of responsibilities and objectives.

Prudential regulation authority (PRA)

4. The Government welcomes respondents’ views on:

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

Our response to these questions is ‘yes’ in that:-

- Firstly, the PRA cannot operate within an ‘ivory tower’ and must have regard to the objectives and actions of other bodies – indeed we suggest that the secondary factors listed (3.7) should be afforded more prominence in primary legislation rather than be termed as mere ‘have regards’

- Secondly, not only principles but also, where relevant, rules should be retained as contributing to good regulatory practice. This is the time to make those ‘have regards’ a key regulatory focus, especially as regards innovation and the competitiveness of the UK. This is essential for the wellbeing of UK plc and does not have to conflict with other regulatory objectives. At a time when many firms are moving away from the UK we would not wish to see further loss of income and talent

- Thirdly, that it must be aware of the need not to 'gold-plate' or over-regulate and to take account of national interest considerations in carrying out its responsibilities. It is not in the public interest to be overly restrict opportunities to them, as wells as the potentially harmful economic effect that such measures would have, for instance should regulation prove too restrictive firm's might consider it necessary to move their business overseas

- Fourthly, that it should observe the need for proportionality in its actions by properly balancing 'cause and effect' in the interests of the industry and the general public.

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

Whilst there needs to be a clear distinction of role and responsibility between the PRA and CPMA in granting/amending permissions etc, this will be an additional source of confusion and cost for those firms affected. As we have set out in our opening comments, we believe that these specific functions should be integrated into one body with, preferably, the CPMA given overall responsiblity and the PRA authorising the CPMA to act on its behalf.

Please also see our comments in our overview above.

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

We support the idea of a risked based approach but are sceptical as to how the term judgement-focused' will be reflected in practice. Whilst we recognise the added flexibility compared with a strictly rulebook approach, assessing each individual case according to its own circumstances may result in inconsistent judgements being made unless firms' supervisors are all sufficiently skilled and experienced. Instilling a judgements-based culture in a new regulatory organisation will take time and much will depend on the knowledge and relationship that a supervisor builds up with an individual firm. Indeed some firms, probably smaller ones, may prefer to be regulated under strictly rules supervision and the greater certainty it brings.

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

One aspect of the proposed new framework on which we are unequivocal is that the rule-making process must continue to be subject to statutory consultation process and that such process continues to involve the industry. Not only does such a process give early warning of intent to firms, but it also allows opportunity for comment and challenge by the industry and to ensure that new rules are compatible with 'good regulatory practice'.

We also believe that the requirement to produce cost-benefit analysis must be retained – and indeed strengthened - as an integral part of the rule-making process.

On many occasions in the past, the FSA has been reluctant to carry out full cost assessments and over-relied on sweeping assertions in respect of overall benefits. Greater rigour should be attached to such exercises in the future (see also Q22).

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

In the light of our comments on 7 above, we reserve judgement on how this can be achieved.

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

The various measures proposed appear to be soundly-based though, it should be pointed out, operating in a transparent, independent and accountable manner will further add to the organisation’s ongoing costs being shouldered by the industry. We would also inquire whether it is intended to establish a complaints process for regulated firms to use in respect of PRA actions.

We would recommend that an external complaints/appeals process is established that is operated outside the organisation in the interests of transparency.

Consumer protection and markets authority (CPMA)

10. The Government welcomes respondents’ views on:

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

Our response to this question is again broadly ‘yes’ for the reasons advanced in Q5 when addressing the PRA. In doing so, however, we must question repeated use of the term ‘consumer champion’ in the paper and hope that this does not appear in the enabling legislation because the CPMA must be, and seen to be, even-handed in its actions to retain the respect and trust of the firms it regulates. On the other hand, we do support the references to ‘promoting public understanding of the financial sytem’ and ‘promoting financial inclusion (4.12) and believe that, in this context, the role of the CPMA should be further extended to ‘promoting greater consumer awareness of responsibility for their own actions’.

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

These appear to be adequate though subject to further detail particularly in respect of the CPMA’s working relationships with the PRA in the Memorandum of understanding.

Again we would re-affirm the need for a statutory consultation process to involve the industry before introducing new rules (as in Q7).

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

As at present, these panels should comprise a wide cross-section of industry practitioners who are able to provide external scrutiny and challenge.

In order to function effectively CPMA should be required to take account of the representations made by all of the Panels. Whilst FSA would argue that they do consider representations made to them by the Practitioner and Small Business panels, they are not in any way bound to take any notice of them and quite often do not; the PPI debate is a case in point. Rather than the current informal approaches, the Panels' representations should be in writing and receive a written response from the regulator; setting out if need be why they are not following the Panels' recommendations. Since the Consumer Panel has no inhibitions about going public, we see no reason why the other Panels should not do so as well.

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

We endorse this approach as helping to reduce the administrative burdens on firms as well as, hopefully, the levels of the various fees themselves. In this context, we might also suggest that further savings be made by either integrating or outsourcing many of the administrative or establishment functions of the various bodies eg HR/IT departments. Such rationalisation should make for more cost-effective use of resources and avoid unnecessary duplications of task.

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

Any moves towards streamlining the operations of the FSCS as a means of reducing cost would have our support but, without further detail, it is difficult to form a judgement as to whether separate compensation schemes per sector, as identified, would be a better system than the present arrangements.

Markets and infrastructure

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

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

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

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

As our members do not have any direct involvement in these areas we have no comment to make.

Crisis management

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

The arrangements seem well-articulated bearing in mind that, as recognised, no two crises are likely to be the same and hence the need for flexibility and adaptability. Not only should actions of this nature be fully-coordinated but also where discretionary tools are available, care should be taken to use them in a prudent manner.

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

Again, the powers as described, would seem adequate for the purpose although we are surprised that no reference is made to the Solvency II (insurers) and Capital Requirements Directives (banks and investment firms) both of which when fully implemented, around the same time as the new regulatory regime, will impose further obligations and constraints on firms including powers of regulatory intervention.

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

We have no comments to make.

Impact assessment

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

The preliminary cost-benefit analysis, at the back of the consultation paper is threadbare in the extreme, based on only two options – 'do nothing' or 'proceed' - with nothing in between. It contains only a broad approximation of transitional costs for the new institutions and makes vague assumptions that, in the main, firms will notice *some* or only *minimal* cost increases of a transitional and on-going nature. We believe that overall costs will be of a far more significant nature and much greater analysis needs to be undertaken particularly at a time when many firms have to invest in upgrading systems and controls to accommodate Solvency II, CRD, IFRS Phase 2 and the Retail Distribution Review over the same period, as well as dealing with the revised rules within a re-written Conduct of Business Sourcebook.

We would also refer you to the comments on costs in our overview above.

Ends

Financial Regulation Strategy, HM Treasury

By email only financial.reform@hmtreasury.gsi.gov.uk

18 October 2010

Dear Sirs,

The Investment Management Association (IMA) welcomes the opportunity to provide comments on **Cm 7874 – A new approach to financial regulation: judgement, focus and stability**.

The IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes.

They are responsible for the management of £3.4 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. Taken together, our members form the largest asset management sector in Europe and second only to the US globally.

Our response to the questions posed is attached. If we can be of further assistance , please do not hesitate to contact us,

Yours faithfully,

Guy Sears
Director, Wholesale

65 Kingsway London WC2B 6TD
Tel:+44(0)20 7831 0898 Fax:+44(0)20 7831 9975

www.investmentuk.org

Response of the Investment Management Association to HM Treasury, Cm 7874 – A new approach to financial regulation: judgement, focus and stability

The Bank of England and Financial Policy Committee (FPC)

1 Should the FPC have a single, clear, unconstrained objective relating to financial stability and its macro-prudential role, or should its objective be supplemented with secondary factors?
2 If you support the idea of secondary factors, what types of factors should be applied to the FPC?
3 How should these factors be formulated in legislation – for example, as a list of 'have regards' as is currently the case in the Financial Services and Markets Act 2000 (FSMA), or as a set of secondary statutory objectives which the FPC must balance?

We support a clear unconstrained objective. The Financial Policy Committee's responsibilities will to an extent map across to those of the new European Systemic Risk Board and regard should be had to its objectives, which we understand to be that 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 Union that arise from developments within the financial system and taking into account macro-economic developments, so as to avoid periods of widespread financial distress. It shall contribute to a smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth*". This appears to reflect the appropriate balances.

Prudential Regulation Authority (PRA)

4 The Government welcomes respondents' views on:

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

  We think yes; and we address the interaction with the CPMA at 10 and 11 below. Just as prudential issues can have implications for consumers so a conduct of business issue can impact a firm prudentially, for example if the costs of redress are very high. Prudential regulation cannot be carried on completely divorced from a firm's impact on its customers. It therefore behoves the PRA to have regard to the CPMA objectives – and for similar reasons to those of the FPC.

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

  We think yes, although asset managers will not be regulated by the PRA they have an interest in well-regulated banks; it is hard to understand why a public body should be exempted from these principles. We would imagine that calls for the EU to reflect better regulation would ring hollow if the UK's PRA did not have to do so itself.

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

  We have explained at 10 below why we think this is essential for the CPMA and see no reason why it should not apply equally to the PRA.

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

  We have nothing to add here.

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

As regards remit, we understand that all insurers and banks will be prudentially regulated by the PRA along with proprietary dealers; notwithstanding that an asset manager may be in a bank or insurance group (including as a financial conglomerate), we understand that it will be regulated solely by CPMA. There is a technical issue over many asset managers having an investment-only captured insurance company as a subsidiary for wrapping some pension products in an insurance contract. In theory these would have to be regulated by PRA on the current proposals, which would seem unnecessary duplication, and we would therefore consider that the supervision of such entities, which are in essence nothing more than fund wrappers, should be by the CPMA.

As 3.16 and Box 3 B record, there are a number of areas where co-ordination will be required. The requirement to have regard to the other objectives is vital. To assess the adequacy of the other arrangements, further detail will be needed to understand how any particular systems and controls will be allocated to one or other of the regulators.

In the meanwhile, we consider in addition at least the following should be co-ordinated or co-located:

1. The gatekeeper roles – whilst decisions to authorise firms and approve individuals might sometimes fall cleanly to the PRA or CPMA, there will be many occasions for banks and insurers, and also for firms in groups with such, where an application will need to be considered by both. We consider there should be substantive consistency and procedural efficiency:
   a) On substantive consistency, Competent Authorities are required under 2BCD, MiFID, Solvency II and UCITS IV to consult one another and share information when considering controllers (Directive 2007/44). This requirement was introduced to address what was perceived as inappropriate national barriers being erected. Nevertheless it appears to have application to the CPMA and PRA as competent authorities within a member state. In any event this approach ought to be taken.
   b) As regards procedural efficiency, technology should support a single portal for all such information and a common administration of the process.
2. Data requests – the large amount of periodic and standing data that has to be supplied to regulators should also be collected through a single portal.

3. Visits and ad hoc requests for data should be co-ordinated and executed by a single team (even if of both regulators) wherever practicable. Liaison will be needed to prevent the "digging up the roads" problem that a firm will be forever addressing multiple requests and changes if such distraction (necessary though it may be) is not co-ordinated.
4. In addition, to the fullest extent possible, IT, finance and fee invoicing should be made through an integrated back office.

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

In practice the division in FSMA will merely be a start. The division of directive obligations and responsibilities will likely be more complex. Some directives do not permit more than one competent authority.

As mentioned above, it is hard to see how systems and controls can be cleanly allocated.

In principle, we believe a judgement-focussed approach to supervision would be appropriate, both for the PRA and the CPMA. The credit crisis in part arose because of a too ready acceptance by regulators globally of business models that turned out to be unsustainable and destabilising. Equally, the IMA supports the FSA's recent statement about its more intrusive "upstream" approach to retail conduct – products have been sold to retail consumers in recent years which should never have come to market.

But great caution needs to be applied to such an approach. It must not turn into systematic second-guessing of decisions taken by regulated firms, which in turn becomes an inhibitor of legitimate innovation. They key to this will be to ensure that only staff with the highest levels of skills, training and experience – including experience in the industry – are entrusted with such judgements. In this regard, the Financial Services Practitioner Panel and Small Business Practitioner Panel have proven a valuable source of advice and counsel to the FSA and can be expected to continue to do so.

In minimising the burden for firms, Government will need to address the disclosures a firm will need to make. The public case of the fine on Goldmans for not informing the FSA of a matter of which the SEC was aware could be applied to the new UK model. Should a firm assume that if it tells CPMA of a problem with an individual or a system that the PRA can be taken to have been informed or will firms need to double-report?

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

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

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

We address below safeguards in relation to CPMA as the regulator for asset managers. But in principle we do not see why the position of the PRA should differ.

Consumer Protection & Markets Authority (CPMA)

10 The Government welcomes respondents' views on:

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

  We think yes; though this should not then become a bureaucratic obligation to consult with the FPC or PRA on every initiative. By posing the obligation as a "have regard", little will change when considering for example the contents of a fee disclosure to consumers. However as the CPMA is expected to make the rules for the FSCS and its funding (especially if HMT determines by then that some aspects are then to be pre-funded), it is sensible to have regard to financial stability.

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

  These are:

  a) the need to use its resources in the most efficient and economic way;
  b) the responsibilities of those who manage the affairs of authorised persons;
  c) the principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;
  d) the desirability of facilitating innovation in connection with regulated activities;
  e) the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom;
  f) the need to minimise the adverse effects on competition that may arise from anything done in the discharge of those functions;
  g) the desirability of facilitating competition between those who are subject to any form of regulation by the Authority.

  We consider all have a place. Many are couched in aspirational terms and are unlikely as such to preclude CPMA taking necessary action. However they do set the expectation of culture and accountability that should be associated with a world-class regulator. See also our response under the next bullet point.

  Some would be concerned that "have regard" is too soft a test; for our part we acknowledge that in the extreme, for example a judicial review of a decision of the CPMA, the burden which the CPMA would need to overcome to show it had had regard may not be high, but it will nevertheless exist. And that will ensure that in a well-run CPMA, decisions will be made with its eyes open to these issues and not blind to them. Accordingly, we consider the principles should be retained, recognising that a strong senior management team at CPMA would likely want to apply them from a better regulation viewpoint in any event.

  We mention at 6 our concern that there should be a challenge mechanism as regards supervisory decisions by CPMA in light of a greater judgement-based approach.

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

  Undoubtedly yes. We acknowledge the concerns that an unbridled expression of innovation and even perhaps competitiveness may have in light of the financial crisis. But it should not be forgotten that these are expressed as "have regards" in relation to an objective of ensuring confidence with a particular focus on protecting consumers etc.

  We are most concerned to ensure competitiveness is retained. Even the current form does raise concerns that it is too easy to pay lip-service to it: *"In discharging its general functions the Authority must have regard to the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom"* .

  We have in mind the long-term competitiveness of UK financial services. Damage to competitiveness can be quickly introduced in the short-term by ill-judged rules, but the promotion of competitiveness must be addressed against a much longer-term horizon since sustainability is essential. These are difficult balances but we trust the CPMA will engage with the Panels in this respect.

  The need to have regard to the international character of financial services has not always been at the forefront of FSA's approach. Alongside all the usual claims for the UK is its position as a global centre for asset management. The claim of "thought leadership" should not be used by CPMA to introduce rules ahead of EU initiatives; the Davidson Review on the Implementation of EU legislation in November 2006[1] recommended: *"unless simplifying or reducing regulatory burdens, departments should not generally pre-empt upcoming European legislation by legislating in the same area".*

  CPMA will need to be vigilant to see that innovative products and services are indeed innovative *from the point of view of consumers and market users* and not merely innovative in the sense of actions which "innovate" so as to avoid the intended impact of rules. The growth of economy depends upon innovators disrupting, refining and developing existing components of products and services; but the CPMA should have a role in challenging, delaying and preventing ill-considered new products.

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

  Ensuring the objectives of the CPMA are rightly described is important; but an early appointment of the senior management team will be critical in setting the right culture for the CPMA.

  Of necessity, the objectives will always be drawn at a high and wide level to avoid any lacuna in powers. Beyond descriptions of the CPMA as a consumer champion, the consultation does not address whether the CPMA will need (as the FSA does) to have regard to the principle that a consumer should take responsibility for his own

[1] http://www.berr.gov.uk/files/file44583.pdf

decisions, in considering what degree of protection may be appropriate. This issue, of consumer responsibility, has remained intractable despite the FSA's previous extended debate and intellectual struggle with the concept. Disclosure, suitability and fairness must all be considered by the CPMA but the context must not be that consumers have no responsibility for their decisions - that would perpetuate a moral hazard in our system. For this reason and as a corollary to the points raised above about sustainability, we do not agree that the CPMA should be described narrowly, or indeed at all, as the consumer champion. We do, though, support the continued existence of FOS and the FSCS. These are essential elements in the UK's consumer protection framework.

In addition to competitiveness, the place of UK financial services within the EU and a Global marketplace needs to be considered. The CPMA will need to play a full and responsible role in the development in particular of the EU market overseen by ESMA. This will include providing resource but also recognising that in many areas a UK-specific approach adds to cost and duplication to firms providing services across the EU. That there will be ever increasing moves to a single Handbook and harmonised supervisory approaches in the EU ought to be reflected and CPMA ought to be expected to "work with the grain" in this respect.

The other factors identified at 4.12 on the impact of policies, promoting public understanding, maintaining diversity and promoting financial inclusion, could also be included.

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

Yes, we support the accountability mechanisms at 4.36 – 4.38. All are needed and the role of the NAO is particularly welcome; we have previously asked for a review of the cost and use of data collection.

As regards, the co-ordination and co-operation with the PRA and FPC, we would add:

- this needs to be two-way in relation to the PRA; it is right the PRA consults the CPMA on impacts that may arise from alterations in prudential approaches, not least as the CPMA will prudentially regulate a greater number of firms many of which are small businesses and prudential rules can have large effects on competitiveness.
- In terms of firms and groups subject to regulation by PRA and CPMA, we suggest there should be a committee charged with liaising on "digging up the roads". Firms in groups should not have to suffer multiple requests for information and multiple visits on overlapping issues. So far as possible the PRA and CPMA should co-ordinate data requests (especially routine reporting).
- See further our response at question 5 on different aspects of co-ordination and co-location.

We repeat our comments made at 6 above concerning judgement-based supervision. There is a need to ensure challenge can be made by affected firms and that judgements are applied consistently across all firms.

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

All three should have a statutory footing. We do not see why they should not also look across the PRA. The current Panels work well and we would envisage their strengths being built upon. There could be a mechanism requiring the CPMA Board to minute where and why they decide to reject in whole or part advice from one of the Panels.

We have previously remarked to the FSA about the notable gender imbalances across all the Panels.

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

We think it should be. See our response to question 5 in this regard as well.

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

We support segregated pools of support in principle, and this may become necessary if pre-funding is introduced for any class of levy payers. We remain concerned that cross-subsidy within classes and the ambit of classes themselves have failed to keep up with changes in the structure of the industry.

Markets and infrastructure

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

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

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

We maintain our view that a single unified market authority is needed. This authority would sit within the CPMA.

It follows that we do not support hiving off the UKLA; and we also question the wisdom of moving clearing houses and settlement systems to the PRA or the Bank of England, notwithstanding the Bank's role in the oversight of payment systems.

We consider that responsibility for primary market supervision is intimately connected with that for secondary markets. The UK listing rules require listed companies to make a wide range of disclosures which are designed to ensure the functioning of an orderly market. It would be unwise to separate these responsibilities from those for policing market abuse. Splitting the UK Listing Authority from the CPMA and moving clearing and settlement to the PRA would spread market regulation across three different authorities. We see substantial risk in this. It would bring about a less joined-up approach to market supervision, and a greater danger of market abuse. To be effective, the market regulator must be able to look across the whole transaction chain and understand each part of it. As to which, technically there can be only one UK competent authority under the Market Abuse Directive[2] and likewise only one under the Prospectus Directive. So, one of the CPMA (or Markets Authority) or the FRC will need to be given all relevant powers anyway from an EU legislative point of view.

Only one representative of the UK can sit at ESMA; leaving this to a CPMA that merely oversees some aspects of secondary market trading, with no intimate knowledge of clearing and settlement or primary market issues, would significantly weaken perception of the UK (which we suggest presently has the strongest market standing) and reduce the capability of the representative in negotiations (if instructions need always be sought from two other bodies).

We do not see the FRC as the real-time regulator that the markets will need. Transferring staff from the FSA for this purpose seems to be the only solution and suggests they should stay at CPMA. Also, the introduction, and so duplication, of real-time market data feeds at the FRC (as at the CPMA) to assess issuer disclosures would seem inefficient.

We understand the majority of listed securities for which FRC would then have to have a concern as the owner of the UKLA are not UK domiciled. We see UKLA as concerned with securities regulation and FRC with company regulation. We would question what synergies there will be in even presuming there is a proposal to create a Companies Commission in the UK.

That said, our concerns are not directly about competitiveness risks generally and in distinction to risks from a fragmented voice in Europe. We are sure the FRC is alert to such issues. We also acknowledge that presently CESR, and in the future ESMA, does cover policy areas that are within the FRC's concern. The present system does not dovetail perfectly with the new EU institutions either.

Focussing more on the proposal to move clearing and settlement as well, the lessons of the Tripartite authorities in a crisis suggest that similar mechanisms will need to be set up to deal with outages, trading halts and suspensions of trading, since each authority (and some EU ones as well) would have powers in this area.

We also wonder whether leaving CPMA only as a pre and mid-transaction regulator will impact the retention and development of staff. Such a narrow remit will preclude a healthy balance of experience and new views that a broader organisation can bring.

We would not therefore support the option canvassed in the Treasury consultation paper of splitting up the current arrangements for market regulation. Our concerns would be likely to be met, and some of the present weaknesses addressed, were the FRC to become part of a stand-alone markets authority containing trading venues, clearing houses and settlement systems. This is not however an option that is put forward in Cm 7874.

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

We have none to offer and oppose the proposals for any move.

---

[2] As recital 36 explains: *A variety of competent authorities in Member States, having different responsibilities, may create confusion among economic actors. A single competent authority should be designated in each Member State to assume at least final responsibility for supervising compliance with the provisions adopted pursuant to this Directive*

Crisis management

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

It is right to provide flexibility in these arrangements. Whilst it is understandable that the PRA will make rules for recovery and resolution plans (RRPs), to the extent that the FSA introduces limited RRPs for firms which hold client assets and money, these will cover a large number of firms to be regulated only by the CPMA. We think that the CPMA should continue to have this power.

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

As regards the comment of looking at OIVOP power changes for consumer protection, recent changes to the FSA's powers do seem very wide-ranging in any event, so we would need to see details of what is proposed to be able to comment on this point.

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

Whilst the Bank and the PRA, and in practice two Deputy Governors of the Bank will now exercise the powers, in contrast to the balance between the FSA and the Bank presently, we do not think this is reason for any significant change. We see four safeguards in addition to the split between Deputy Governors:

- The Code of Practice should we think be retained and express the new arrangements ex ante;
- The Banking Liaison Panel should be retained;
- The safeguards inherent in the legislation, such as the No Creditor Worse Off instrument, should be retained;
- We would expect and encourage the Treasury Select Committee, or any other expression of Parliament, to be prepared to seek explanations of behaviour from the Deputy Governors on an ex-post basis.

Impact assessment

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

We consider it too early to be able to quantify costs and benefits; though we do not consider that it should be assumed there will be no cost increase for firms in the CPMA. As implied, changes to rulebooks, notepaper and all statutory disclosures may be subject to transition but this remains to be explained.