

The respondent is Regional President of the Chartered Institute for Securities and Investments, Chief Executive of NW Brown Group and a director of the Association of Lloyd's Names. All of these are affected by the proposals, the views expressed are his own and not attributable to any of these organisations.

**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?

ONE OBJECTIVE

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

NO VIEW

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

NO VIEW

**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;

NO

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

YES

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

YES

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

IT SHOULD BE AWARE OF THE FACT THAT BANKING AND INSURANCE ARE DIFFERENT, IN PARTICULAR THAT THERE IS NO SYSTEMIC RISK ARISING FROM INSURANCE.

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?

INTEGRATED PREFERABLE

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

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

YES

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

PERIODICITY SHOULD BE INTRODUCED. AMENDMENTS OF SUBSTANCE SHOULD ONLY BE PERMITTED AT 5 YEAR INTERVALS.NO RULE CHANGES IN THE INTERIM.

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.

**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;

NO

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

YES, MOST.

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

YES

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

NO

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

YES

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

IT WOULD BE BETTER NOT TO HAVE PANELS BUT TO MAKE THE CPMA BOARD REPRESENTATIVE

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.

REASONABLE

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

IT WOULD BE BETTER IF IT WERE RATHER LESS BIASED AGAINST BUSINESS THAN APPEARS TO BE THE CASE TODAY.

**Markets and infrastructure**

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

NO VIEW

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

NO VIEW

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

NO

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 VIEW

**Crisis management**

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

THE BEST CHANGE WOULD BE TO REMOVE THE CAUSE OF CRISES BY LIMITING MARKET SHARE OF RETAIL BANKS TO 5% BY MAKING INSURANCE PREMIA FOR DEPOSIT INSURANCE PROGRESSIVELY MORE EXPENSIVE AS MARKET SHARE INCREASED ABOVE THIS LEVEL.

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?

A SLIT BETWEEN WHOLESALE AND RETAIL SHOULD BE RECOGNISED

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

NO VIEW

**Impact assessment**

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

THERE IS NO ATTEMPT AT A REALISTIC COST BENEFIT ANALYSIS. IF THERE WERE IT WOULD SHOW VIRTUALLY NO BENEFIT AND HEAVY COSTS. THE GOVERNMENT AND ALL OF THE FINANCIAL SECTOR AND THE PUBLIC WOULD BE BETTER OFF JUST GIVING BANK SUPERVISION BACK TO THE B OF E AND LEAVING THE FSA AS IT IS.

Marcus Johnson



## MEMORANDUM

TO:	Financial Regulation Strategy HM Treasury 1 Horse Guards Road London SW1A 2HQ Via email: <a href="mailto:financial.reform@hmtreasury.gsi.gov.uk">financial.reform@hmtreasury.gsi.gov.uk</a>	FROM:	PJ Di Giammarino, CEO, JWG <a href="mailto:PJ@jwg-it.eu">PJ@jwg-it.eu</a> <a href="http://www.jwg-it.eu">www.jwg-it.eu</a> 020 7870 8004
SUBJECT:	Consultation response to 'A new approach to financial regulation: judgement, focus and stability' from JWG Group		
Date:	18 October 2010		

### Summary:

As CEO of JWG, I am writing to you because our members believe that HM Treasury's reform of the tripartite model presents an opportunity to address a very important gap in the ability to control systemic risk.

JWG is a financial services think-tank which works with regulators, investment firms and their information technology supply chain to help determine how the right regulations can be implemented in the right way.

Over the past months we have conducted detailed research into the considerations for the practical implementation of a systemic risk regime, culminating in a report entitled '[Achieving supervisory control of systemic risk](#)', which we have attached to this letter.

The research included a thorough literature review of more than 300 official documents and over 30 interviews with representatives of central banks, regulators, supervisors, major banks, trade associations, academics and other members of the wider financial community. We conclude that a complete rethink, redesign and retooling is required to achieve an effective solution for systemic risk control. Our [findings](#) have been socialised with the Treasury Select Committee and have garnered widespread support, including amongst the UK's supervisory community.

Due to the lack of detailed understanding of the approach required to monitor systemically important financial activity, we believe that, unless measures are taken to address structural deficiencies in the proposed regime, the UK, which is currently leading in many regulatory initiatives, will be disadvantaged on the international stage.

For the avoidance of doubt, we are suggesting that, unless measures such as those set out in this letter are implemented, the monitoring function envisioned in the consultation may be unable to spot the next financial crisis and prevent another Lehman-like event within the next decade.

### 1. Weaknesses in the proposed approach

Current supervisory risk management tools are not equipped to manage today's global, 'system' level events, nor will they ever be, without material change. Outdated information architectures are being expected to monitor a complex, technologically advanced and continually growing marketplace.

Europe has recognised this gap and has mandated the creation of the European Systemic Risk Board which will have holistic view of the industry.



*"... one of the basic prerequisites for an effective macro-prudential function is the availability of a comprehensive set of information on the financial system that can be used for the detection and assessment of systemic risk. ... the national supervisors and national statistical authorities have the obligation to cooperate closely with the ESRB"*

ECB: 29 September 2010, The establishment of the European Systemic Risk Board – challenges and opportunities

Currently, the Bank of England and the FSA collect vast quantities of information about financial institutions, yet this is still not enough to fulfil their remit. Moreover, the information collection methods and models currently used to monitor the risks throughout the industry are not effective in quantifying the interconnectedness of firms and, thus, they are seriously flawed.

A 'new solution' to replace macro models that are disconnected from firm-level measures will be neither simple nor cheap. The problems are fundamental, long-standing and many of them currently unowned. Without an agreed roadmap, the potential cost could run into tens, or even hundreds, of billions. For this purpose, the Dodd-Frank Act mandated the creation of an Office of Financial Research (OFR) which has an estimated budget of \$500 million per annum.

An integrated technical platform, that aligns supervisory objectives to the actual data requirements from the UK financial system, is required. It has become clear that, for this platform to be successful, a systemic risk control infrastructure must be established and include:

- ▶ The design principles required for a new information system
- ▶ A supervisory information inventory and gap assessment
- ▶ An adaptable and future-proof target operating model
- ▶ A clear migration path, timeline and governance models
- ▶ A transparent assessment of costs, commercial models and tariff measures.

In discussions with the Bank of England and the FSA, we have heard that a lack of leadership, rather than financial resources or expertise, is the primary barrier to a more effective regime.

Wherever the future accountability may lie, an effective systemic risk control infrastructure can only be achieved with greater collaboration between the industry, the supervisors and other relevant disciplines. Success will require a high degree of cooperation with the EU (e.g., EC, ESAs, ESRB) and international bodies (e.g., IMF, FSB, CGFS, IOSCO, ISO, IASB, etc.) and, of course, the rest of the G20. Without such collaboration, any solution will likely be ineffective.

## 2. Suggested modifications to the supervisory mandate

We cannot build a new regime from the bottom up; it has to be created top-down. For this to happen, we believe that the 'technical and data' ownership aspects of systemic risk need to be better articulated and explicitly assigned in the final policy statements:

- ▶ Responsibility for designing and maintaining a new operating model for supervisory control of systemic risk
- ▶ Accountability for designing a technology platform that will likely be shared between micro and macro supervisors
- ▶ Ownership of the information and data standards required.

These responsibilities are not 'one time' tasks. Supervisory needs for a system as complex as financial services will evolve over time as new technical, market and regulatory innovations take place.

Though some of this is 'owned' today by the FSA and Bank of England, further clarification is required about who is accountable, to deliver what piece of the control infrastructure, in what timeframes, under



the new regime. The 'owners' need to make quick decisions about what kind of platform they require: the specification of new data, the analytical platform, procedures, measures and metrics, standards, etc.

In summary, the EU and US control systems are forming now and the position that the UK will take is a very hot topic in regulatory circles. In order for the UK to have a meaningful place at the table it needs to have a clearly articulated set of technical objectives of similar weight.

### 3 Conclusion

Our conclusion is that the UK needs to establish a body akin to the US Office of Financial Research to own the problems as we have set them out in section 2.

I trust that the above provides an appropriate starting point for this important matter. We would be delighted to work with HM Treasury to discuss the opportunity before us and would welcome a meeting with you to expand on these issues in more detail.

Yours faithfully

A handwritten signature in black ink, appearing to read "PJ Di Giammarino", is written over a light blue horizontal line.

PJ Di Giammarino  
CEO

Attachments: '*Achieving supervisory control of systemic risk*', September 2010



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

18<sup>th</sup> October 2010

Dear Sirs

### **A new approach to financial regulation**

Killik & Co was founded in 1989, to offer investment advice and trade execution services to the Private Client Stockbroking market. We currently operate from ten branch locations in the UK and one in Dubai, offering a range of financial services to our clients including traditional stockbroking advice, portfolio management, advice on CFDs and Spreadbets, Wills, and Trusts. We offer our own ISA and SIPP and have a separate Financial Planning arm called Killik Chartered Financial Planners, which holds prestigious Chartered Status and offers fully independent whole of market financial planning advice. We service approximately 24,000 clients and manage combined funds of £3.7 billion. We are members of the Association of Private Client Investment Managers and Stockbrokers (APCIMS).

Thank you for the opportunity to respond to the above consultation paper. We would like to comment as follows:

In the development of the new regulatory structure we would like to see a clear path for being able to influence and challenge at a European level. Whilst there is some mention of certain agencies liaising with foreign counterparts, there is no clear indication as to how this would work in practice and how the UK agencies will seek to safeguard the best interests of domestic businesses and consumers. Since Europe is the main driver for regulatory change, we think it is extremely important that responsibility for engagement with European agencies is clearly outlined.

The most obvious failing of the existing regulatory system was the falling between the gaps of the tri-partite structure of Bank of England, Treasury and Financial Services Authority (FSA). The consultation proposes a number of new agencies and attempts to explain how they will communicate with one another. However, there remains a danger that, for example, prudential and conduct matters are viewed in isolation by the Prudential Regulatory Authority (PRA) and Consumer Protection & Markets Agency (CPMA) respectively and that a lack of holistic viewing of an individual firm could result in a misunderstanding of the level of potential risk that it poses to consumers or the financial system as a whole.

We have felt that the FSA's 'one size fits all' approach to regulation inappropriate and ineffective, so would like to see any new regulatory body take account of the many different types of business it regulates and devise rules that are sector specific. As stated in the APCIMS response to this consultation, APCIMS firms have been critical of FSA for seeking to apply regulatory requirements aimed at mass-market sales of financial products to the tailor-made investment services offered by APCIMS firms. This has resulted in requirements being imposed which are not fit for purpose, are costly and burdensome and of minimal benefit to consumers.

We fully endorse APCIMS' response to this consultation and would therefore refer you to their detailed comments on the consultation questions.

If you would like to discuss any of the points we have raised, we would be pleased to do so. We do hope that you will carefully consider and take our points into account during the next stage of the regulatory reform development.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Penny Rooney', with a stylized flourish at the end.

Penny Rooney  
Compliance Officer

## **CONSULTATION PAPER 10/19 REVISING THE REMUNERATION CODE**

### **Q1: Do you agree with our proposed approach to the definition of code staff?**

We believe the proposed rule is unclear as to exactly what the definition of code staff means and therefore who in our organisation would fall under this definition. As an LLP, will Partners be treated as “employees” for the purposes of the code? Not all Partners could be viewed as ‘risk takers’ as regards the firm’s business strategy, so it would seem disproportionate to expect the requirements to be applied to them.

We agree with the suggestion in APCIMS’s response to this CP that, if the detailed requirements are to be applied to our sector, firms should be able to determine for themselves which individuals are the material risk takers and apply the rules accordingly. Guidance would however be needed as to what constitutes a ‘material risk taker.’

### **Q2: Do you agree with our approach to applying the code to firms, individuals and groups, as outlined above?**

We agree with a high level principle being applied, but not with the detailed requirements. As stated in our covering letter, we feel this is disproportionate and unnecessary for our sector given that we are already subject to SYSC, COBS rules and TCF considerations.

### **Q3: Do you have any comments on how the proposals contained in this CP affect equality and diversity issues?**

No

### **Q4: Do you agree with our proposals for changes to the remuneration principles 1-11?**

We think only the high level principle should apply. We concur with APCIMS’s detailed response to this question.

### **Q5: Do you agree with our general approach to remuneration structures as set out in the principle 12?**

We do not believe it is proportionate to apply the detailed requirements to a sector which does not threaten financial stability and is already subject to other regulatory requirements about remuneration.

As an LLP, we will have particular difficulty meeting a requirement to offer shares. Therefore any final rules will have to take account of different types of legal entity and we hope will also consider nature, scale and complexity of those businesses. One set of requirements for all will be difficult and expensive to implement with no obvious benefit to the overall stability of the financial sector.

### **Q6: Do you agree with our proposals, as set out in annex 5, for applying proportionality at the rules level?**

We do. We are a limited license firm that does not hold client money or assets and does not engage in proprietary trading. Therefore, many of the risks that these requirements seek to mitigate are not relevant to our business model. As stated previously, we believe that applying the high-level principle on remuneration to a firm like ours is sufficient.

In general, however, we are supportive of a regulatory approach that attempts to apply requirements in a proportionate way and believe that the Tables in Annex 5 are a good model for achieving this.

### **Q7: Which metrics and thresholds do you believe are appropriate to determine how different firms can apply the specific rules of proportionality?**

As stated above we would prefer only the high-level principle to be applied to our sector. We also believe that firms are best placed to assess the risk inherent in their business models.

**Q8: Do you agree with our proposed approach to risk adjustment?**

We agree with 4.28 that *“risk adjustment of variable remuneration will not, in and of itself, prevent excessive risk taking. Risk adjustment techniques to remuneration should be part of the firm’s overall culture and management of risk at various levels of the business”*

and also with 4.29 that exact risk adjustment techniques should not be prescriptive and that firms should be able to choose the *“techniques and measures most appropriate to their circumstances.”*

**Q9: Do you agree with our proposed transitional arrangements for implementation of the amended code?**

The proposal is to apply the Code from 1 July 2011 and in relation to 2010 compensation. If the full requirements of the Code are to be applied to our sector, we believe that a longer transitional period will be needed to give firms time to adjust their remuneration structures and manage employees’ expectations. We think there are a number of issues still to be resolved (application to different legal entities, competitive disadvantage, clarity over ‘code staff’ etc) and that the proposed timescale is therefore rather tight.

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I am writing on behalf of Land Securities Group PLC, a member of the FTSE100, in respect of the recent HM Treasury consultation on UK financial regulation. In particular, I am writing in relation to the question of whether the UKLA should be merged with the FRC or whether it should remain within the CPMA Markets Division.

Our view is that the CPMA Wholesale Markets Division is the appropriate place for the UKLA for the following reasons:

- There is a clear overlap with CPMA market supervision functions which provide both the opportunity for synergies and more effective application of regulation and enforcement.
- We need to preserve the attractiveness of London as a capital raising centre and, to do so, we need to have a quick and efficient listing and capital raising process in the UK. Having raised capital during the downturn (March 2009), it is absolutely clear that we need a commercially-oriented UKLA, which is up to speed on the latest market practices and at the heart of wider regulation of wholesale markets.
- CPMA markets division will be the only voting member at EMSA. Given the volume of EU securities trading which occurs in the UK, it is essential that the UK representative speaks on both primary and secondary market issues with authority. I believe it would be detrimental for our voice in Europe if responsibility for primary market policy was removed from CPMA. I am not aware of any other EU country that separates primary and secondary market regulation in the way proposed.
- The UKLA's functions, which involve real time monitoring and response (which was essential to our capital raising in March 2009) as well as implementation and enforcement, are not the primary functions of the FRC which is more focused on policy development.

Yours sincerely,

Martin Greenslade

UNCLASSIFIED

## **Response to HMT consultation paper on 'A New Approach to Financial Regulation: Judgement, Focus and Stability' of July 2010**

*By Professor Rosa M Lastra, Professor of International and Financial Law,*

*Centre for Commercial Law Studies, Queen Mary University of London*

Though the financial architecture was not *per se* a cause of the crisis, the Government proposes in this consultation paper a major regulatory and supervisory overhaul in response to it. As I have argued in a forthcoming paper with my colleague at the LSE, Luis Garicano, 'all existing architectures, independently of their specific characteristics, performed poorly at their mission. Whether twin peaks (like in the Netherlands), fragmented (like in the US), unitary (like in the United Kingdom with the FSA) or separated (like in France), most advanced countries suffered a severe hit to their financial systems'.<sup>1</sup> While in the UK the FSA has come under a great deal of criticism, in the US, the US Federal Reserve System and the SEC have been the subject of extensive criticism.

The proposed structure is centred around the key role of the Bank of England as the institution in charge of monetary policy, lender of last resort and the Special Resolution Regime<sup>2</sup>, macro prudential supervision, and oversight of micro-prudential supervision. While the establishment of the Financial Policy Committee within the Bank of England is a positive development, the benefits of the effective dismantling of the FSA - with the transfer of responsibilities to three authorities: a new prudential regulatory authority as a subsidiary of the Bank of England chaired by the Governor, a new Consumer Protection and Markets Authority and, possibly, an Economic Crime Agency<sup>3</sup> - are questionable.

The central bank's involvement in supervision is welcome, because of the synergies between supervision and monetary policy. The distinction between macro and micro prudential supervision is useful to understand the central bank's role. The central bank is the 'natural authority' to conduct macro prudential supervision and systemic risk control (monetary stability and financial stability go hand in hand), though compliance with market rules is best left to another authority. Central banks with or without direct micro-supervisory responsibilities should have macro-supervisory powers to identify negative trends, drawing on the statistical information that they already gather for monetary policy purposes, on financial stability reviews, on the information gathered by other supervisory agencies and on additional powers to request information from institutions or markets previously unregulated but that can cause systemic risk. The central banks should have a view of the 'forest' even though other supervisory agencies continue to supervise the health of each individual 'tree'. (Garicano-Lastra)

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<sup>1</sup> See Luis Garicano and Rosa Lastra, *Towards a new Architecture for Financial Stability: Seven Principles*, forthcoming in a Special Issue of the 'Journal of International Economic Law' (2010) on 'The Quest for International Law in Financial Regulation'.

<sup>2</sup> Notwithstanding the welcome introduction of the Special Resolution Regime by the Banking Act 2009, the Bank of England should not have availed itself to get involved in the highly legalistic, detailed and complex issues involved with regard to bank insolvency and pre-insolvency proceedings.

<sup>3</sup> In point 5.26 it states that the creation of an Economic Crime Agency will be the subject of a separate consultation in due course.

However, dismantling the FSA is hardly a solution to the 'problem under consideration', ie 'that the tripartite system of financial regulation failed to ensure financial stability'. In my opinion, it is not readily apparent for instance that the proposed 'transition from peacetime to crisis' (table 6.A in page 48) is a significant improvement over a well functioning tripartite arrangement that acknowledged the different intakes into the pursuit of financial stability by the three authorities currently involved. What is needed is better communication and clear lines of action and responsibility in times of crisis.

Financial stability is a goal difficult to define (more identifiable in its negative definition of what instability is than in its positive definition), and yet it is a most important policy objective, one that transcends institutional boundaries and geographic borders. Financial stability is a national, regional and international goal. Hence, national councils for financial stability should work together regional councils (in the EU, it will be the European Systemic Risk Board or ESRB) and international fora/councils (FSB etc). There are a variety of instruments that can help achieve the goal of financial stability. At the national level, the main instruments are supervision and regulation, lender of last resort and liquidity assistance, crisis management procedures and fiscal support in case of bank public recapitalization or nationalization. Financial stability, systemic risk/contagion control and sound banking and finance are 'close cousins'.

Acknowledging the lack of a clearly established analytical and operational framework for the understanding of financial stability, Tommaso Padoa-Schioppa has referred to it as a 'land in between' monetary policy and supervision. While in the past monetary policy, prudential supervision and financial stability typically formed a single composite, these functions have often become 'unbundled', due the advent of EMU in the euro-zone countries (with a centralized monetary policy and decentralized prudential supervision) and due to the transfer of supervision away from the central bank to a separate agency (a trend that is now being reversed). The central bank because of its unique position as banker to the Government and bankers' bank and because of its monetary policy and LOLR/ELA responsibilities is best placed to undertake a leading role in the pursuit of both monetary stability and financial stability (controlling systemic risk).

There are a number of issues that remain unclear in the consultation paper. For instance the distinction in chapter 5 of HMT document between regulation of markets/market conduct (as part of CPMA) and regulation of market infrastructure (a Bank of England responsibility) is far from clear. And how can one meaningfully divide the responsibility for supervising Lloyd's as suggested in 5.25?

Is this new supervisory structure going to prevent another crisis? The answer is not readily apparent, since the crisis had many causes and, therefore, the responses need to be multi-faceted. One should also remember – as Charles Goodhart has stated – that supervision is a thankless task, where successes are seldom publicised and failures are magnified.

The document does not establish a clear distinction between supervision (monitoring and compliance) and regulation (rule-making) and does not take sufficiently into account the international dimension.

As the UK embarks on yet another program of financial legislative reform (and there is a danger that the UK will lose credibility in the European debate by what appears to be in the eyes of many as a

constant tinkering with structure), while the US adopted the Dodd Frank Act in July 2010, and the EU tries to advance towards European solutions within the constraints imposed by Treaty provisions and fiscal considerations, we must wonder if somehow national reforms miss one of the key features of the crisis: its international character. We need to devise better frameworks for the resolution of cross-border banks and other financial institutions and we need to approach the problems posed by systemically significant financial institutions (SIFIs) with a coordinated international perspective. Global problems require global solutions.



18 October 2010

HM Treasury  
1 Horse Guards Road  
London  
SW1A 2HQ

Dear Sirs,

**Cm7874: "A new approach to financial regulation: judgement, focus and stability."**

LCH.Clearnet Limited ("LCH") is pleased to take this opportunity to submit its response to questions 15 and 16 in the above consultation document.

As a Recognised Clearing House and key element of UK financial market infrastructure, LCH has a pivotal role to play in the protection of markets and their participants, not only in the UK, but globally. In the interconnected world of financial services, a central counterparty clearing house ("CCP") is a major mitigating factor to the ultimate solvency risks of market participants, and its unique place should be fully understood and supported by the authorities which oversee it.

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

The Government's proposals in this area – i.e. to make the Bank of England responsible for overseeing CCPs and settlement systems alongside its existing responsibilities for payment systems oversight – would seem completely logical for stand-alone CCPs.

We feel however that the consultation document does not address one major dimension of that which all European CCPs will need to take into account in the immediate future. With the creation of the European Securities and Markets Authority ("ESMA"), CCPs operating in EU member states will be obliged to follow ESMA's rules at a very granular level. This raises two questions:

How will the proposed UK structure for the regulation of CCPs dovetail with the EMIR proposals? It is not clear to us that ESMA rules will not be "gold-plated" by additional regulatory requirements at national level, thus reducing the competitiveness of UK CCPs.

How will the CPMA and Bank of England operate together within the ESMA framework? If the Bank is responsible for oversight of CCPs, but it is CPMA which is the UK regulatory representative body contributing to ESMA, we are concerned that UK CCPs may be caught between regulatory constructs which have no pre-agreed means of resolution.

We cannot stress too strongly that any scenario which disadvantages UK CCPs can only detract from the effectiveness of UK plc, and more particularly London as an international financial marketplace, not to mention putting individual CCPs under unnecessary additional commercial pressures.

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

LCH has always been supportive of initiatives which improve and enhance the regulatory environment, in particular in the area of market infrastructure. However, we have some fundamental concerns with respect to HM Treasury's apparent intentions in the area of rationalisation of regulatory regimes.

We understand from very limited written and verbal communication with the authorities that the potential rationalisation of the Part 4 and Part 18 regimes would most likely result in the abolition of the Recognition regime. This implies that Recognised Bodies ("RBs") would become subject to the Approved Persons regime in its place. In short, we feel that this proposal takes the reform of the UK regulatory framework a step too far.

When one considers the agreed outcomes of the original deliberations of the G20, its primary goals were to strengthen the stability and effectiveness of the global financial system and infrastructure. The Government's objectives as mentioned in the consultation document are to make the UK regulatory framework stronger and more effective, and to improve stability, credibility and confidence – with all of which we are in conceptual agreement. However, it was the Approved Persons regime which patently failed (and incidentally the institutions subject to the Recognition regime which equally and obviously demonstrated their fundamental strength during the financial crisis – particularly during times of major stress, for example the collapse of Lehman Brothers). We are thus somewhat unsure as to how the abolition of the Recognition regime would achieve these objectives.

But our major concern lies not solely with the change of regime (which would clearly in itself be a further unnecessary distraction to all RBs, and a risk to regulation in the transition period), but with the considerable amount of both primary and secondary legislation (especially around bankruptcy provisions) which would need to be re-drafted and enacted. *These provisions are at the heart of the RBs' statutory protections.*

In our view there would be a) too much of this to be realistically carried out within the anticipated timeframe, and b) a real risk of creating non-trivial legal loopholes where these have only recently been fully eliminated, due to the significant complexity and inter-related nature of the current provisions across many statutes and regulations.

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We trust that the above provides you with a good view of our considered opinion with respect to those aspects of the Government's plans for regulatory reform which we feel will impact LCH, and would be delighted to discuss further.

Yours sincerely



Roger Liddell  
Chief Executive Officer, LCH.Clearnet Limited

UNCLASSIFIED

Dear Sir/Madam.

An invitation to forward our comments regarding small firms regulation.

Since its inception the FSA has been an absolute pain for small companies, selling insurance backed products, which in our case is used car warranties.

The six monthly firms online reporting requirement is draconian, difficult and totally unnecessary. With easy access to company accounts it should not be too difficult to establish a fit and proper business with adequate reserves?

Registration fees along with "compensation" levies and the mandatory professional indemnity makes it uneconomic for small business to comply. I hope these brief comments will be helpful.

Regards

Stephen Lee  
Director Motorite (Northwich) Ltd.

UNCLASSIFIED

Financial Regulation Strategy  
HM Treasury  
1 Horse Guards Parade  
London  
SW1 2AQ

18th October 2010

### **Treasury Consultation Paper a New Approach to Financial Regulation**

I am responding to this consultation paper on behalf of Leeds Building Society

#### **Leeds Building Society**

Leeds Building Society is the fifth largest in the United Kingdom, with assets of £9.6bn, over 650,000 members, and employing over 900 staff in 67 branches in the UK, and two in Europe.

#### **Q1 – Should the FPC have a single, clear, unconstrained objective relating to financial stability, or should its objective be supplemented with secondary factors?**

The FPC should have the maintenance of financial stability as its principal role, which should be supplemented by secondary factors, provided they do not interfere with its primary role.

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

The factors outlined in 2.28 of the paper are appropriate secondary factors. It is also important that the FPC promotes diversity in the financial services industry.

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

We consider, subject to 1 above, that there should be a secondary set of factors, which the FPC should balance with its principal role, and should not conflict with it.

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

- **whether the PRA should have regard to the primary objectives of the CPMA, and FPC;**
  - **whether some or all of the principles for good regulation currently set out in section 2 of FSMA, particularly those relating to good regulatory practice, should be retained for the PRA;**
  - **whether, specifically, the requirement to have regard to potential adverse effects on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and**
  - **whether there are any broader public interest considerations to which the PRA should have regard.**
- Yes
  - Yes
  - Yes - the combined effect of current regulatory changes is likely to have this effect.
  - The PRA should recognise the importance of diversity (see 2 above).

**Q5 - Is the model proposed in paragraph 3.16 appropriate, or would an integrated model be preferable?**

We consider that the approval process should be combined, as the situation could arise where an individual discharging a SIF with one regulator would be approved by the PRA, but not the CPMA. If this could not arise, because the two bodies were closely aligned, why impose on the industry the additional cost of two sets of approvals?

We also highlight that as far as possible, there should be no wholesale rewriting of the FSA Handbook, as this will increase the disruption likely to be caused by the proposed change.

**Q6 – Is the approach outlined in paragraphs 3.17 to 3.23 sufficient to enable the PRA to take a more risk-based, judgement-focussed approach to supervision?**

Yes, provided there is no overlap of functions with the CPMA, there is one ‘gateway’ for applications to be made, and that a proportionate approach is retained.

**Q7 – Are safeguards to the PRA’s rule-making function required?**

We consider the safeguards to rule making should remain. The consultation process would be enhanced if the regulator entered into wider public consultation before it had settled its view.

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

We favour any measures to improve the efficiency of the safeguards, provided they are retained.

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

We consider that all the accountability mechanisms, which are set out in Appendix 1 of the Building Societies Association’s response to your paper, should be retained.

**Q10 - The Government welcomes respondents' views on:**

- whether the CPMA 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 CPMA;
- whether, specifically, the requirement to have regard to potential adverse effects on innovation or the competitiveness of the UK financial services sector of regulatory action should be retained; and
- whether there are any broader public interest considerations to which the CPMA should have regard.
- Yes
- Yes – we have a concern that where there is a conflict between conduct of business regulation, and prudential regulation, the latter should take precedence.
- Yes
- As specified above, the CPMA should recognise the value of diversity in the financial services industry.

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

Please see the answer to Q9 above. In addition, we consider speeches made by senior FSA staff should not be regarded as an appropriate way to provide guidance, and this should be reflected in the legislation.

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

We agree with the proposal to retain all the existing consultative panels, and in addition, put the Small Business Practitioner Panel on a statutory footing.

**Q13 – The Government welcomes views on the proposed funding arrangements.**

We support the proposal to use the CPMA As a single gateway. However, we still have concerns about some of the funding mechanisms, which result in building societies paying a greater share, in relation to their income, than other firms with more complex, less risk-averse business models. We consider this aspect should be considered as part of the review of the regulatory arrangements.

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

We support the proposal for one compensation scheme, as this will avoid duplication, and, in principle, favour the ending of the cross subsidy between contribution classes. The FSCS funding model should also have a separate contribution class for building societies, for the reason outlined in the answer to Q13.

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

We support the proposal that the CPMA should regulate wholesale markets regulation, provided the differences in conduct of business regulation between retail, and wholesale markets are adequately provided for.

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

We consider the arrangements set out in 5.15 reflect the different roles intended for the CPMA, and the Bank of England.

**Q17 – The Government would welcome views on whether the UKLA should be merged with the FRC.**

Such a proposal would not affect the Society to any significant degree, although there seems a logic to merging two bodies as part of the process of creating a companies regulator, rather before this process has begun.

**Q18 – Are there other aspects of financial market regulation that should be moved into the proposed new companies regulator.**

See the answer to Q17.

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

The broader examination of crisis management is sensible, although, by its nature, crisis management cannot, in itself prevent a crisis, only limit the damage caused by it.

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

Whilst the subject could be worth examining, any additional powers would not necessarily prevent a future crisis, as it is impossible to predict the form it will take. The key is for the regulator to be effective, and the framework, and any specific limits, are secondary.

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

We agree with the proposal that contingency planning etc, is managed separately from the Bank's functions in relation to the PRA.

**Q22 – The Government welcomes comments on the impact assessment.**

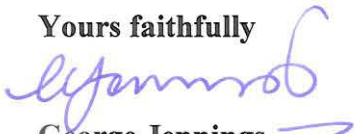
We make the following points in relation to the assessment:

- The changes will have a significant effect, coming in addition to the rest of the changes introduced over the past three years.
- As mentioned in our response to Q20 above, no-one can forecast the shape of the next crisis, other than that it will differ from the previous one, and there is always a danger, in such circumstances, of regulatory overkill.
- There should be a limit on the level of regulatory fees, in the light of the significant increases over the past few years. The adoption of common services should help keep fees under control. We agree that the regulation of all conduct of business rules in relation to borrowing should be with the CPMA, rather than divided between the FSA and the OFT.

- We consider that regulation should be rules, not principles based, because the effect of the latter is uncertainty, additional costs to the industry, and therefore the consumer. At present, where any doubt exists, guidance, which has much the same effect as rules, without the certainty, is produced.
- There should be genuine consultation on the new framework, rather than the current process, which is consultation in name only.
- There needs to be consideration of the effect of the cumulative effect of regulation. Over the past three years there have been a wide range a measures which, whilst individually a legitimate response to one aspect of the crisis, fail to take account of the overall effect. There is a danger that a continuation of this process will stifle competition, and act as a significant barrier to new entrants, something the Government wants to avoid.

I hope the Government takes these views into account, and welcome the opportunity to participate.

**Yours faithfully**



**George Jennings**  
**Deputy Secretary**



# **HM Treasury Consultation**

**“A new approach to financial regulation:  
Judgement, focus and stability”**

**Response from Legal & General Group Plc**

**October 2010**

## **1) Legal & General Group Plc**

Legal & General is one of the UK's largest financial services companies and is regulated by the FSA. We are a leading provider of risk, savings and investment management products in the UK, with £315 billion assets under management, more than seven million customers and over 9,000 employees worldwide. Legal & General welcomes this opportunity to respond to '*A new approach to financial regulation: judgement, focus and stability*'.

## **2) Executive Summary and Key Themes**

We believe that it is in the best interests of the financial services industry and its customers that there is strong and effective regulation both at a Prudential and Conduct of Business (COB) level. Effective regulation is essential in increasing consumer confidence, safeguarding financial stability and supporting economic growth. High-quality, stable and proportionate regulation not only encourages competition but it is also an important condition for investment in the UK financial services industry.

We agree that failures in the tripartite structure contributed to the banking crisis and consider this to be an opportunity to revise the structures, objectives and roles of our regulatory bodies, and the inter-relationships between them. We support the Government's proposed approach to reform. However, we believe that delivering effective day-to-day supervision is at least as important as reforming the institutional architecture of the regulatory system.

Our proposals and responses are based on what we consider to be the key elements of prudential and consumer regulation (see the relevant boxes 2 and 3 below) which we believe should form the basis of a coherent and effective regulatory system.

We believe that such a system, together with the Financial Policy Committee (FPC), would provide financial stability, leading to the minimising of systemic risks and shocks. It would offer consumer protection in the form of proportionate recompense in cases of abuse and protection of assets, including those of the taxpayer, in cases of institutional failure. The system needs to have appropriate process and oversight to ensure delivery of overall objectives, with high standards of consultation and an open working relationship with the financial services industry. If it works well it should deliver a competitive market for consumers. Its broader economic and policy goals would be to encourage competition consistent with consumer interests, promote UK competitiveness and investment, reduce cyclicality, and support the financial engagement of companies with individuals as borrowers or savers.

**Box 1****Who should regulate insurers?**

From an insurance perspective, the risks of dual regulation outweigh the advantages. We highlight below some of the complex and sometimes contradictory factors which need to be addressed in deciding where insurers should be regulated, namely:

- Scale and importance of the sector
- Non-or differently-systemic character of insurance companies
- Inappropriateness of transporting bank regulation to insurance
- The need for a deep understanding of the insurance sector by both prudential and conduct regulators
- The inter-related aspects of prudential and conduct regulation for insurance products, for example With-Profits and annuities

While there is no easy solution (see response to Q5, below), we can see the benefits of the Prudential Regulation Authority (PRA) and the Consumer Protection and Markets Authority (CPMA) jointly setting the framework for insurance regulation, but believe that the PRA should delegate micro-prudential supervision to the CPMA. We believe this would deliver more consistent and effective regulation and maximise the use of scarce expertise and resources for insurance supervision.

Before addressing specific questions raised in the Consultation, we would like to address a number of key themes:

- To regulate the financial sector effectively, it is important that the interests of all its components are represented. The UK insurance industry manages investments of £1.5 trillion, over 20 percent of the UK's total net worth; employs more than 300,000 people in the UK alone; is the fourth highest contributor of corporation tax: and is a major exporter, with one-fifth of its net premium income coming from overseas business. In order for the proposed institutions, and particularly the PRA, to deliver appropriate regulation of a uniformly high quality, the new model must give equal priority to the prudential regulation of insurance alongside that of banks.
- In particular, regulators need to be aware that insurers are not banks and cannot be subject to the same prudential regime. They differ in capital structure, leverage and the much lower importance of liquidity risks within their structure. In the event of insolvency, insurance companies can be wound down much more slowly. Unlike banks and building societies, you cannot have a run on insurance products because of their maturity profile. As a result, insurers present less systemic risk – indeed it is arguable that while they are core to the financial system, they are not 'systemic' in the same way as banks. It would therefore be inappropriate to replicate bank regimes for insurers.
- We consider it vital that regulators take account of the broader economy. While the consultation focuses on the provision of credit it should not

preclude the need for savings, pensions, and other financial products. We endorse the Chancellor's promise to 'support the culture of saving and those who show responsibility for themselves and others', and believe this must be an ingrained part of the UK's financial regulatory culture.

- While we recognise the importance given in the Consultation to the exercise of judgement by regulators, we are concerned about the creation of unfettered discretion and strongly support the need for judgement to be exercised within an appropriate legal framework which promotes accountability, transparency and consultation.
- The division between PRA and CPMA raises a number of important practical questions which need to be resolved alongside the institutional questions of cross-membership and cross-referencing of statutory purpose. In the interests of coherence, there is a need to avoid practical overlaps and underlaps, particularly where groups are being supervised by both institutions for prudential regulation (for example, insurance companies with asset management subsidiaries). We address separately the question of our preferred approach to supervision of the insurance sector (See question 5).
- We question the appropriateness of the CPMA serving both as a "Consumer Champion" and a regulator. While the importance of the consumer interest is beyond doubt, defining it is more complex (see box 2 and question 10 below) and we feel it is impossible for a single institution to act as both "counsel for the prosecution" and impartial judge.
- We would have welcomed more in the Consultation to clarify the objectives and accountability of institutions that do not fall directly under the remit of the proposed regulatory bodies. While the Consultation focuses on the inter-relations between the FPC and the PRA and CPMA, we would have welcomed greater focus on the governance and oversight of FOS, the FSCS and the CFEB and greater transparency of the interplay between the bodies.
- We believe that this consultation is an opportunity to address the inequities of risk asymmetry in the FSCS. We are strongly favour the proposals to end the current cross-subsidy between different financial institutions. This is discussed in more depth in question 14.
- This reform of regulation presents an opportunity to make a clear determination over the role of FOS. FOS was originally established as an alternative to the courts to adjudicate on individual disputes taking into account all the circumstances of the individual case. The governance and accountability of FOS was determined in the light of its role as laid out in statute. The reality is now very different. The FSA, through its rules in DISP, requires firms to take account of FOS decisions within firms' complaint handling processes. Thus FOS decisions are policy decisions, which only have to take account of, not follow, law and regulation. It is against all notions of good regulation for policy precedents to be set

without having to follow regulation and law and indeed without any consultation or robust and transparent decision making process. Additionally, the fact that the FSA cannot bind FOS in cases with wider implications has resulted, we would argue, in an inability for the regulator to achieve swift action in cases of consumer detriment such as PPI. We are also concerned that the ability of the new CPMA in protecting customers will be undermined as it is FOS decisions rather than CPMA rules which drive the industry to make changes, such as to literature or product design. This will mean there is no single point of accountability for consumer regulation.

- We believe that either:
  - The remit of FOS should be returned to making individual decisions, with the CPMA given the role of determining which of these decisions should be made policy for firms to follow; or
  - The governance of FOS needs to be significantly enhanced and it needs to be required to follow the principles of good regulation, including consulting on significant policy decisions and avoiding retrospective regulation.
- We would have welcomed greater clarity regarding the issue of regulatory reform in the respective realms of banking regulation and consumer credit. The legislative framework whereby these need to be regulated by separate bodies needs to be addressed, and the current regulatory reform process presents an opportunity to review consumer credit regulation within the OFT.
- Finally, the consultation could have done more to frame the nature of the proposed regulatory bodies' relationship with its EU and international equivalents. There is a danger that whilst focusing on domestic structures, UK financial services will lose out in key European debates. New regulations should not damage UK consumer outcomes, nor should they disrupt the competitiveness of the UK insurance market, which itself facilitates choice and good value for consumers. We are concerned that the new regulatory architecture will create a fragmentation of UK representation in Europe, with the PRA representing the UK in the EBA, and EIOPA and the CPMA in the same role for ESMA. While this could work, we believe that practical consideration needs to be given as to the current negotiations regarding the transformation of CEIOPS into EIOPA. Equally there will need to be close relationships established between the authorities in order to ensure that the correct UK representatives are involved in the EU bodies.

#### 4) Specific Consultation Questions

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

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

In our view, the creation of a single statutory objective is likely to lead to an unbalanced approach to financial regulation. The pursuit of financial stability should not exist in a vacuum, separate from the requirements of the broader economy, taxpayers and consumers, as this can create too much risk of “reckless over-prudence” and, depending on the approach taken, to procyclicality and other unintended consequences, as well as damaging competitiveness and consumer interests through the addition of excessive prudential costs.

The objective of the FPC should therefore be supplemented with secondary factors, in particular, if the regulator’s only objective is to stop banking failure then there is the potential that it will create unintended consumer detriment due to over-regulation.

The word “unconstrained” deserves closer scrutiny. We believe it is important that the FPC and associated institutions act within the rule of law, and with due regard to the existing, established rights of parties such as shareholders and bondholders in financial institutions, as well as those of depositors, policyholders and the taxpayer.

While we recognise the importance of judgement in the regulatory process, the proposed model arguably creates too much unfettered discretion with insufficient political oversight and too few checks and balances in place. Therefore there must be proper accountability, a commitment to meaningful consultation and an effective and independent appeal system that acts as a second eye and looks at overall stakeholder fairness. Without an effective appeal system of this sort, we are left with the sledgehammer of judicial review, which is very unwieldy and has limited remedies.

An effective model in ensuring transparency which may set a useful precedent for the FPC is that which is already followed by the Monetary Policy Committee (MPC). Not only does the MPC, publish the minutes of its meetings two weeks after the interest rate decision, in order to explain its thinking and decisions, it also conducts regular meetings with parliamentary committees and publishes an open letter from the Governor of the Bank of England to the Chancellor if it misses its inflation target by more than 1%. These aspects of transparency in no way hinder its ability to pursue its inflation target. All of these measures would be welcome in ensuring that the FPC is independent and accountable for its actions.

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

**Box 2                      Important Secondary Factors**

- Consumer protection, pricing and supply
- Market stability and sustainability
- Competitiveness
- The broader economy, including saving

We would support secondary factors that give consideration to the economic or fiscal impact of the FPC's macro-prudential decisions. We would also support a structure which, where appropriate, required the FPC to have regard for the statutory duties of other bodies such as the CPMA.

As well as the broader economy, the FPC should look beyond the banking sector (which is the understandable focus of this consultation) to take account of the broader financial impacts of its actions on, for example, pension funds long term savings (ie non-deposits) and other sectors such as insurance.

Any financial stability objective must include the impact on consumers' propensity to save and the likely impact of changes upon business users and the markets as part of its remit. Within this framework, a very high level of financial stability achieved at the cost of unaffordable products is a questionable prize. While efficiency and robustness are essential requirements for a stable economy, the FPC should not be able to neglect the affordability of products which provide protection for consumers, who otherwise risk failing to engage with long-term saving or protection products.

The FPC should certainly be required to consider the competitive position of the UK's financial services; actions taken by the body responsible for financial security and stability will need to be internationally co-ordinated to be effective. Equally, in exercising its powers the FPC must not disadvantage the UK against its international competitors without careful consideration and justification.

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

We believe that a list of "have regards" gives greater flexibility and pragmatism, however a set of secondary statutory objectives would give greater clarity and would guarantee that the objectives would be considered.

## ***Prudential Regulation Authority (PRA)***

### **Box 3 Macro- and Micro-Prudential Regulation**

- Monitoring and protecting the economy against systemic risk
- Protecting the taxpayer against the cost of bailouts
- Protecting depositors' and other stakeholders' legal interests
- Preserving viable and competitive markets
- Acting accountably and within the rule of law
- Setting regulation within a global context

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

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

Whether it is as a list of "have regards" or as a set of secondary statutory objectives, the PRA should balance its primary objectives with those of the CPMA and FPC in order to create a workable equilibrium between macro-prudential, consumer and market interests. We believe that it is in the public interest for the PRA to have regard not just for lending and the provision of credit, but also for saving.

We do not agree with the proposal that the PRA should not take account of the competitiveness of the industry in setting its rules. The UK financial services industry is a world leader and a strong regulatory environment is a part of this success, however it is essential that regulation does not damage the UK's position as a global centre for financial services or add costs for customers.

We suggest it should retain the regulation set out in section 2 of FSMA, as it is essential that the PRA is bound by the principles of good regulation. In addition, we see no reason why it would not be appropriate for the PRA to have regard for using its resources in the most efficient and effective way, or for it to ensure that any regulation imposed is proportionate to the benefits expected.



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

The Consultation document contains no detail on the proposed internal organisation of the PRA. There is, therefore, considerable danger that insurance supervision become sidelined in a banking dominated institution and that the insurance sector becomes subjected to inappropriate regulation designed with banking in mind and without sufficient representation at a senior level of those who understand the different nature of insurance.

An integrated regulatory model would be preferable in order to ensure the accountability of the individual authorities. Placing non-executive board members from non-banking financial institutions on the boards of the proposed bodies is important, but does not go far enough. Regulated institutions should be supervised by joint teams drawn from both the PRA and the CPMA, in order to ensure a more holistic understanding on the part of the regulators and to aid the practical process of delivering meaningful responses to regulators.

The consultation leaves group supervision arrangements unclear. While insurers will be prudentially regulated by the PRA, any asset management subsidiaries will be prudentially regulated by the CPMA and it is ambiguous as to how the group as a whole will be supervised. We are concerned that the prudential regulation for asset managers will be set by the CPMA, but in practice it will be the PRA that determines the level of capital that insurance groups have to hold and those with asset management subsidiaries may end up holding additional capital through capital add-ons imposed by the PRA. We believe that it is essential that there is one prudential rulebook across all sectors, owned by the PRA, with implementation by the CPMA for certain sectors. This will create consistency, which in turn creates coherency. We would argue that implementation of insurance prudential regulation would be better placed in the CPMA.

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

We would raise two concerns in connection with this question. First, a “risk-based” approach to supervision must recognise that there are differences between financial institutions. As we have emphasised above, it would be inappropriate to migrate a regime designed for banks to other parts of the financial sector, such as insurance.

Secondly, the Consultation emphasises the PRA being “judgement focused”. This gives rise to the possibility that the PRA will seek to intervene in firms without due process, giving rise to a lack of consistency in, and accountability for, regulatory decisions. In order for the supervision to be effective, it is

essential for the supervisory teams to be of a high quality and for policy to be consistently applied, within a meaningful framework of process. It is important that any judgements the PRA make must be transparent, subject to fair and transparent process and subject to scrutiny.

We also wish to highlight the intention in paragraph 3.24 for the PRA to reduce the current FSA handbook. Any effort to do so will need to consider that most rules, both prudential and conduct, now derive from EU directives, meaning that the PRA and CPMA will have a limited ability to adopt a different approach. The importance of Europe in this area needs to be recognised, as does the importance of the UK authorities engaging at the EU level.

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

Safeguards are required, as the rule-making function would be quasi-legislative. As such, it is important to ensure that the regulatory bodies have undertaken due process in making regulatory decisions. We believe that a practitioner panel, a wider public consultation and a detailed cost-benefit analysis prior to the introduction of new rules are both necessary and correct. We must also ensure that the PRA is accountable for its actions in a timely manner.

No regulator can be expected to be 'all seeing' and understand all the implications of its rules; removing the requirement to consult on proposed rule changes would lead to unintended consequences. All regulators must aspire to putting in place good and effective rules; practitioners and others can help ensure that the implications of proposed rules are fully understood by the regulator. As now, the regulator should still be able to implement rules even where they are unpopular, but with full understanding of the implications, and also to implement rules without consultation where there is an urgent need: however, we are not aware of any arguments that suggest that consultation over rules was a contributory factor in the financial crisis and to remove the requirement to consult would be a hugely retrograde step.

Equally, while we assume that PRA decisions would be subject to judicial review this is of limited use as it is a post-hoc, all or nothing approach, that would raise similar issues to those we have raised on FOS governance. A more effective safeguard would be to improve the transparency of the rule-making function in order to improve accountability.

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

The consultation suggests that the PRA will not need the safeguards about rule-making which are in FSMA – so it will not need to consult on rule changes or prepare CBAs, nor does there seem to be any mechanism to appeal decisions of the PRA. As noted above, we are very concerned about this suggestion, which suggests an increase in arbitrary powers, without appeal, for a branch of the executive.

We do not believe that there is a need to streamline the current FSMA safeguards. There is a substantial body of evidence that the FSA has applied a great deal of judgment in its recent micro-prudential regulation. To weaken in any way the need for the PRA to be held to account for its decisions or to remove safeguards to enable firms to 'argue their case' would be extremely detrimental. There needs to be proper explanation of the issues that the current safeguards pose to regulators before proposing to sweep them away.

It is in the best interests of regulators to understand the full implications of any changes before implementing them and this can only come from effective consultation. Additionally, whilst cost benefit analyses can be challenging to produce, preparing some form of impact analysis must be done to ensure that regulation is proportionate and its impact is fully understood.

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

In order to ensure that the PRA is a transparent, independent and accountable institution, we must also stress the importance of having non-executives on the board. Furthermore, it is essential that these non-executives include members of financial institutions that are not banks, in order to give a more balanced view of the financial sector as a whole.

As explained above, the UK insurance industry should not be underestimated as an important contributor to the economy. As an investor and a provider of capital and liquidity, it is, moreover, a core part of the UK financial system and as such should be appropriately represented.

## **Consumer Protection and Markets Authority (CPMA)**

### **Box 4 Complexities of Consumer Protection**

- Not all consumers will always make the right choice. This is as true with financial services as any other product
- Freedom of choice includes the freedom to make the wrong choice
- Championing one consumer group may be detrimental to others: eg by imposing higher costs or other barriers to consumers
- Consumer protection rules should not have the unintended consequence of reducing supply or competition eg by creating barriers to market entry
- Cost and length of sales advice processes are important to consumers and regulation needs to be proportionate
- Doing nothing can be as detrimental to consumers as buying the wrong product: this can be an unintended consequence of over-zealous regulation
- The relative weight of regulation around borrowing (light touch) and long-term saving (heavy process) needs to be addressed
- Consumers should be clear about the product they have bought, so that retrospective regulation is avoided

#### **Q10 The Government welcomes respondents' views on:**

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

While we agree that the CPMA should have regard for the financial system as a whole and acknowledge the specific focus that is to be given to consumer protection and market integrity, we would welcome further clarification and exploration of how this 'focus' is to be manifested. The absence of a clear definition of "Consumer Champion" raises two concerns:

- i) While consumer protection is vital, creating an express "consumer champion" which is also responsible for markets risks giving insufficient recognition of the need for the CPMA to understand how the industry and markets work as a whole. As we summarise in Box 2 above, defining the consumer interest is complex, and attempting to champion it without proper understanding of the broader market is unhelpful if not

actually counterproductive. We are therefore concerned that its remit as a consumer champion, will contaminate the approach of the CPMA regarding its supervision of the wholesale markets.

ii) An equally serious concern is that the stated emphasis on being a consumer champion creates impossible conflicts of interest and is entirely inappropriate for the CPMA given its role as a regulatory authority. We believe that the consumer markets authority cannot act as both a judge and a prosecutor, especially given the direction of the Consultation indicates that safeguards for regulated entities are likely to be reduced rather than enhanced.

To prevent the CPMA, in pursuit of its “Consumer Champion” remit, pursuing actions that risk financial stability, we would support the inclusion of the PRA objectives as “have regards” for the CPMA. We would also support the proposal that the CPMA be required to consult with the PRA before it takes any decision that could have a destabilising effect on the financial market. This requires close consultation between the CPMA and PRA at all levels and should not rely solely on cross-membership of the PRA and CPMA Boards.

As Lord Turner has noted<sup>1</sup>, the regulator’s ability to judge what may be in the consumer’s interest can be “faulty”. This can lead to increased costs which are ultimately borne by consumers themselves. He added that finding “the correct balance between consumer protection and consumer responsibility for choices freely made” is extremely difficult. Perfect consumer results are not possible and the CPMA cannot ensure that all consumers purchase products that are appropriate for their needs. Part of consumer responsibility is the consumer’s freedom to choose. This includes the freedom to choose products which they subsequently regret: regulation which allows people to make sensible choices inevitably opens up the possibility that others will make wrong choices.

It is important therefore that “protecting consumers” does not mean that they are shielded from every wrong decision. We believe that an appropriate definition needs to be enshrined with sufficient clarity in legislation. We would therefore suggest that some wording is embedded in statute to reflect these issues and to ensure that consumer protection is looked at holistically.

Under the current provisions in FSMA, the concept of ‘consumer protection’ is defined by a statutory objective which is informed by further statutory based guidance. Although we do not propose that this be carried wholesale across to the CPMA, we would welcome a similar approach.

One problem with the current provisions in FSMA relating to consumer protection is the focus on what is an ‘appropriate degree’ of protection without defining what ‘protecting consumers’ means. A change to the current wording in FSMA is therefore desirable to pick up not only the degree of protection that the FSA or the CPMA should seek to provide to consumers but also to

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<sup>1</sup> Speech by Adair Turner, Chairman, FSA, British bankers’ Association (BBA) Conference 13/07/2010

consider what considerations should be taken into account when looking at 'protection' measures. We have set out below in Box 3 proposed amendments to the current wording in clause 5 FSMA, with new wording underlined.

<b>Box 5</b>	<b>Protecting Consumers: Proposed Legislative drafting</b>
1)	The protection of consumers objective is: <del>to securing</del> <u>secure</u> the appropriate degree of protection for all consumers <u>in a manner which is proportionate</u> .
(2)	In considering what degree of protection may be appropriate, the Authority must have regard to— <ol style="list-style-type: none"><li>(a) the differing degrees of risk involved in different kinds of investment or other transaction;</li><li>(b) the differing degrees of experience and expertise that different consumers may have in relation to different kinds of regulated activity;</li><li>(c) the needs that consumers may have for advice and accurate information; and</li><li>(d) the general principle that consumers should take responsibility for their decisions.</li></ol>
(3)	<u>In considering what degree of protection may be proportionate on all consumers, the Authority must have regard to the impact of measure on consumers as a whole, including —</u> <ol style="list-style-type: none"><li><u>(a) consumer confidence in financial markets and/or products;</u></li><li><u>(b) public policy imperatives; and</u></li><li><u>(c) increased costs and other unintended impacts for consumers.</u></li></ol>
(4)	"Consumers" mean persons— <ol style="list-style-type: none"><li>(a) who are consumers for the purposes of section 138; or</li><li>(b) who, in relation to regulated activities carried on otherwise than by authorised persons, would be consumers for those purposes if the activities were carried on by authorised persons.</li></ol>

We believe that it would also be useful to include further considerations relating to its consumer protection objective which the CPMA should take into account. We would like to point out that other consumer regulators in the UK, such as Ofgem and the Legal Services Board, have objectives to promote and protect the interests of consumers where appropriate. We believe that the CPMA should hold a similar primary objective.

In doing so, the authority must consider that it may not be the case that the consumer is best served solely by more regulation or better education. In fact, consumer interests may be best served by more intense competition, and therefore enabling competition should be of paramount importance for the authority. In this respect, the governance of the CPMA must mirror that of the PRA by considering both the competitiveness of the industry and the desirability of facilitating innovation and competition.

We are concerned that the only references within the Consultation document regarding competitiveness relate to credit supply. This is too bank-focused and does not take into consideration the financial sector as a whole. One of the weaknesses of UK financial services regulation in recent years has been that the regulation of credit products has been very light in comparison to the regulation of savings products: this was a partial contributor to the bank crisis, the roots of which lay at least in part in excessive personal and corporate indebtedness.

The CPMA should also have regard for broader public policy objectives such as the promotion of savings, pensions and the risk of excessive household debt. It should concern itself with the issues of risk protection for consumers and the ability of the financial services sector to provide economic growth and employment. We believe this would best be achieved by introducing a legislative option for Government to issue guidance to the CPMA on these matters possibly on an annual basis, allowing appropriate responsiveness rather than embedding specific requirements into legislation.

**Q11 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 are appropriate, and we welcome the proposal to make the CPMA subject to the same requirements as the FSA. Conducting cost-benefit analysis prior to introducing new rules, as well as public consultation requirements, is a necessary part of its accountability. However the CPMA should take a more strategic approach than the FSA and should provide more clarity about its strategic aims over a fixed term period. The CPMA should also conduct and publish *ex post* impact assessments to determine whether its regulatory interventions have been successful or not. Additionally, the CPMA should regularly seek to remove rules that are no longer required or can be dealt with by alternative means.

We also believe it is important that non-executive board members of the CPMA are sufficiently empowered to hold the executive to proper account, particularly where the Chairman operates in an executive capacity.

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

We agree with the role and membership of all three panels for the CPMA, as proposed in the consultation. We believe that the membership of the practitioner panels should represent all parts of the financial services sector, as the interests of one party may dramatically differ from another. We believe that the CPMA should seek to use cross-panel working groups on specific issues to help to develop robust, effective regulation that delivers appropriate consumer protection.

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

We are supportive of the proposed funding arrangements and the CPMA's role as the sole collection body on the grounds of cost efficiency. We would also like to highlight the case of the Consumer Financial Education Body (CFEB) and agree that it should be operationally independent of the CPMA. While it is appropriate to wait a few years before reviewing the CFEB's operating model, we would like more clarity as to the consumer outcomes that the CFEB is expected to achieve and how it will be included within the overall governance framework. For instance, will the CFEB report annually on the achievements of the CPMA in supporting the CFEB's objectives? And will the CPMA provide transparent annual input into the CFEB's strategic plans to support its objective of consumer protection.

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

While we recognise the issue outlined in paragraph 4.46, we believe that the proposal for separate funds does not go far enough. We do not believe that it is fair for firms (and by consequence their customers) in other sectors to be responsible for failures elsewhere in the financial system. When the major differences between the business models and risk profiles of institutions are taken into account, the current scheme delivers clear and disproportionate risk asymmetry.

The retention of the FSCS in its current form, but with the removal of the general pool arrangements, may be effective in combating this risk asymmetry. However, we feel strongly that reform of the FSCS arrangements must avoid the introduction of pre-funding for insurance companies. Pre-funding might be appropriate and necessary for deposit takers given the liquidity risk and the systemic undermining of confidence if there is a 'run' on a deposit taker, however the failure of an insurance company is an entirely different matter. The liabilities unwind over a period and coupled with the very different capital requirements and fundamentally different leverage position means that there is little evidence of the need for pre-funding. Put simply, there cannot be a run on an insurance company, so while pre-funding may be appropriate for banks it is not for the insurance industry

***Markets and Infrastructure***

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

We are concerned about this fragmentation of market regulation and believe that there is a clear need for a strong market regulator which brings together



wholesale regulation in one body, with a clear remit to promote the interests of the UK's wholesale financial markets.

We believe that to make the best of the structure under consideration, two things need to be done:

- i) the regulation of the wholesale markets needs to be brought together in the CPMA. This will encourage coherent supervision and ensure that the UK's voice is heard in ESMA.
- ii) the statutory objectives and senior management structure of the CPMA must reflect the significance of wholesale market regulation to the UK economy.

However, in respect of the latter point, we are concerned that the CPMA will develop a culture which is dominated by issues of consumer protection (especially given its proposed "champion" role), and that this will affect the markets division which needs to be operationally distinct. Therefore the different approach to the wholesale markets needs to be reflected robustly in the statutory objective and in the management structure of the CPMA.

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

The regulation of market infrastructure and the regulation of market conduct are clearly intertwined. Therefore, we see no reason for the Bank to oversee Central Counterparties (CCPs) and settlement systems in isolation. To do so would lead to regulatory confusion, with institutions that are essential to the orderly functioning of the financial markets regulated separately from the markets themselves. We believe that, while the PRA should watch over the finances of CCPs, all other matters should fall under the CPMA.

We are in favour of OTC derivative regulations which are designed to curb excesses and to prevent systemic risk. However we are concerned about the impact that these will have on our end-user clients, which are predominantly pension funds and insurance companies (and their policyholders).

**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 would question whether there was any need for the UKLA to merge with the FRC, as the UKLA works very well as currently structured.

The argument for a potential merger is that all corporate governance, including the Companies Act, would be in the same place and it is far more appropriate that corporate governance is located here, rather than the Consumer Markets division.

The stronger counter-argument is that moving the UKLA to the FRC would further fragment the regulation of the wholesale markets, while these additional responsibilities would also pose a risk to the focus of the FRC's highly valued work on corporate governance. In addition, the deliberative, Board-based decision-making of the FRC is completely different from the immediate decisions on issues such as market suspension required by the UKLA.

We would therefore prefer to see changes made to the Governments blueprint to integrate financial market regulation under the CPMA in order to make it as strong a financial markets authority as possible.

We are also concerned as to how the listings authority will get its voice heard in Europe, just at the moment that the EU is starting to push corporate governance high on the agenda. The listings authority, will find a direct route to Brussels denied to them, as it is the CPMA who will be a member of the EU authority ESMA that will in future set the rules in this area. There is a broader point here, which is that under the proposals the FRC and the Takeover Panel also face the challenge of a lack of obvious institutional access to EU decision-making bodies.

Underpinning this issue, we would question the necessity for a companies regulator under BIS. We believe that the combination of legislation and "comply or explain" governance codes works effectively and there is no need to replace this with a new quango which straightjackets flexible self-governance.

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

As stated above, we see no need for a new companies regulator. However we would like to stress that the Takeover Panel should not be changed, as any link with Companies House would alter its independent status. We value the work of the FRC on corporate governance and we see no reason why this should be called into question when the existing arrangements work.

### ***Crisis Management***

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

We would repeat our broader concerns about transparency, accountability, due process and protection of stakeholders' existing rights under law. This includes a broader concern about consumer protection, and especially the protection of the economic interests of pensioners, who may be exposed to equity or bond instruments in failed institutions.

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

The Government should consider the need for powers of heightened supervision in the context of different sectors. We believe that additional resolution powers are not needed in the respect of insurers, as insurance failures are spread over a long period of time and can be dealt with by existing solvency requirements. It is also the case that regulatory bodies can intervene with insurers long before threshold conditions are breached (the third bullet point of paragraph 6.17)

We would also question whether the PRA should have the power to break-up failing companies in order to assist with resolvability, as this would violate shareholders' rights. Intervention must always be used as a last resort and this must not contravene the existing rights of individuals under the rule of law.

With regard to paragraph 6.17 we believe that the scope of the OiVOP powers needs to be made clearer. If it is decided that OiVOP powers should be enhanced so that intervention is mandatory at a specified threshold, then it is important that OiVOP is subjected to the same appeals and disciplinary procedures as other authorities. We appreciate that it is impossible to define in advance what sort of crisis should trigger intervention but the PRA has to confirm a trigger event. We would recommend an approach that is similar to the one used by the MPC whereby the regulator must write an open letter to the Chancellor in order to explain their actions. While this would not prevent the possibility that these enhanced OiVOP powers could be implemented unnecessarily, it is important that the regulator is retrospectively held accountable for taking interventional action.

**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 support the creation of appropriate safeguards against conflicts of interest within the Bank of England as it executes the dual role referred to in the Consultation document.

Our other concern here is, in line with our broader position, that there should also be appropriate transparency and accountability for actions taken under the Special Resolution Regime. While we appreciate the particular circumstances in which the SRR may be triggered, we believe that a formal, documented, trigger mechanism needs to exist, and that the decision-making process, including the rationale for triggering the SRR and the fact that the interests of all stakeholders are given due consideration is documented and publicly available after the event. We believe this would be an additional level of accountability beyond the potentially narrow accountability which the Chancellor of the Exchequer has to Parliament for use of public funds.

We have assumed that all actions under the SRR process will be potentially subject to Judicial Review. However, because this operates only after the fact,

we also propose that in non time-critical actions to trigger the SRR (for example in relation to insurance companies of asset managers) there should also be a facility for the firm to appeal the decision to an individual body before it is implemented.

### ***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 have not conducted an exercise to quantify the likely impact. However, it is likely that the costs involved will be considerable. In fact, there is a considerable risk that the ongoing costs of the new regime will be higher than the existing regulatory regime, especially as the Retail Distribution Review and Solvency II are on the same timetable.

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28 September 2010

Dear Sir

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

The Lending Standards Board (LSB) welcomes the opportunity to respond to the Treasury's consultation document 'A new approach to financial regulation: judgement, focus and stability'.

The LSB is the successor body to the Banking Code Standards Board (BCSB) and is the independent, not-for-profit company that monitors compliance with and enforces the provisions in the Lending Code. This is a voluntary code of practice, sponsored by the BBA, BSA and UK Cards, covering conduct of business in respect of overdrafts, personal loans and credit and charge cards to which all major providers of these products subscribe. A majority of the directors of the LSB are public interest representatives. The LSB is not a trade association or representative body.

The credit provisions of the former Banking and Business Banking Codes were transposed to and reinforced in the Lending Code and this Code is subject to essentially the same monitoring disciplines as conducted by the BCSB.

The LSB notes that the Government proposes to provide that the Consumer Protection and Markets Authority (CPMA) will have responsibility for the conduct of business regulation of all financial institutions, whether or not they are prudentially regulated by the Prudential Regulation Authority (PRA). It is also stated that the CPMA will regulate all conduct where firms provide services to consumers, but that such responsibility will not, at least initially, include the regulation of consumer credit, statutory responsibility for which currently rests with the OFT.

The Board of the LSB considers that the interests of consumers would be better served if there were a single statutory regulator of all retail financial services, including consumer credit. The LSB notes that the Government intends to consult on the merits of a transfer of responsibility for consumer credit from the OFT to the new CPMA in the autumn and the LSB will respond in more detail when that consultation is launched.

Yours faithfully

A handwritten signature in black ink, appearing to be 'RS', with a long horizontal flourish extending to the right.

Robert Skinner  
Chief Executive

**MEETING THE CHALLENGE OF FINANCIAL INCLUSION****INCLUDING****LIFEAFTERX'S RESPONSE TO A NEW APPROACH TO FINANCIAL  
REGULATION: JUDGEMENT, FOCUS AND STABILITY****1 Introduction**

There is broad agreement that good financial knowledge and professional advice is going to be more important than ever given demographic changes, the need to reduce the size of the welfare state and the need to correct the imbalance between public and private sector provision. If people do not manage their finances effectively themselves then this will put further pressure on the state's finances.

The goal is financial inclusion: a state where everybody has access to an appropriate range of financial products and services, allowing them to effectively manage their money.

However, the current market experts are forecasting that the majority of people in the UK will end up financially excluded. Even the Financial Services Authority (FSA) own Consumer Panel (CP) and the Small Business Practitioner's Panel (SBPP) are raising significant issues and concerns.

When speaking about the implementation of the Retail Distribution Review (RDR), Adam Phillips, Chair of the FSA Consumer Panel...Of course there are still significant issues to resolve; in particular how to ensure that the middle market continues to get access to suitable advice...<sup>1</sup>

Based on Dutch experience who implemented their equivalent of RDR in 2006, the UK can expect:-

- 30 to 50% of Independent Financial Advisers will have big problems to survive the next couple of years
- The mass market will not be served<sup>2</sup>

The FSA's own market research has found 25% of IFA firms are likely or highly likely to exit the market, with adviser numbers predicted to drop by 11% if all these firms close.<sup>3</sup>

LifeAfterX, a totally new personal finance service, seeks to plug the gap for financial advice for the mass market. LifeAfterX, has ethical behaviour at its heart and is delivered

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<sup>1</sup> <http://www.fs-cp.org.uk/newsroom/speeches/2010/ap240610.shtml>

<sup>2</sup> <http://www.ftadviser.com/FTAdviser/Regulation/Regulators/RetailDistribution/News/article/20100817/3dc2566a-a93c-11df-8493-00144f2af8e8/Dutch-courage-for-UK-advisers-over-RDR.jsp>

<sup>3</sup> <http://citywire.co.uk/new-model-adviser/rdr-will-eradicate-ifa-cottage-industry-but-leave-market-intact/a391475>

online and through telephone coaches. It may be described as an e-IFA that sources and engages with its customers via online social media. The service, which is built around life events, will help customers plan their finances and then, if they have a need, help them to buy the right products at the right time in their lives, in a cost-effective way. It also seeks to build long-term and sustainable relationships with its customers.

LifeAfterX fully supports the objectives of RDR and the creation of the new Consumer Protection and Market Agency (CPMA). If we can work with the Coalition Government, the current FSA and the future CPMA to improve financial inclusion for the mass market in the UK, we will be very happy to do so.

This paper is a proposal for positive action to improve financial inclusion.

The benefits to the Coalition Government will be to:-

- increase revenues
- increase the competitiveness of the UK financial services industry
- enable a smaller state
- enable the 'Big Society'
- increase financial inclusion

The objective of this document is to describe issues and recommended solutions which, if addressed, LifeAfterX believes will have a positive impact on improving financial inclusion in the UK. These issues and solutions fall broadly within the scope of questions 10 to 13 in Chapter 4 of the Consultation Paper, and our comments are therefore focussed on those specific questions.

## **2. Response**

**Q10.** LifeAfterX believes that there is a mismatch between:-

- Government and consumer expectations of what the FSA/CPMA can achieve and
- its ability to recruit sufficient suitably qualified and experienced staff and the ability of the industry to pay for it.

We believe that the CPMA should not be hidebound by the present FSA framework of advice requirements versus direct offer advertisements.

The laudable objective and expectation is that the future CPMA will have a more interventionist and pre-emptive approach to retail conduct regulation. This will not only increase its supervision of firms and take a greater role in enforcement but will also extend its activities into regulating products.

However, this will mean recruiting increased skilled staff with appropriate practical experience for the FSA with additional costs to the industry which we believe will not be sustainable.



We believe the CPMA should balance the consumer protection imperative against the desirability of improving financial inclusion and extending the scope of individual financial provision. Hence, we believe the CPMA should be given an additional statutory objective to increase consumer engagement with the savings and protection industry and to support innovation by the industry that leads to greater consumer engagement. It should have an explicit remit to encourage diversity of approach and to flex its regulatory requirements if it is safe to do so in cases where the proposed business model presents low risk to consumers.

LifeAfterX is but one experiment in this area and it may be that other approaches will also be tried.

Innovation in financial services needs regulation appropriate to the social fabric of the time. The current regulatory environment was developed pre internet, mobile and social media and does not yet fully reflect the consumer use of these services. Face to face advice is expensive to provide and less affluent customers who can still afford to buy financial services products need a more cost-effective option, eg using the internet.

IFA training requirements are 'one size fits all' and not focussed on individual customer segments. RDR introduces higher professional standards for IFAs including mandatory training to OfQual Level 4. Over and above this mandatory training, specialist areas have their own additional training requirements before any adviser can be authorised to sell these products, eg Islamic Mortgages

However, sections of the training, eg Inheritance Tax planning, are unlikely to be applicable to those on low incomes. We would support a much more modular 'pick and mix' approach to training. This would have mandatory common modules, eg financial regulation, ethics. Other modules would be dependent on customer segment and product area. The reduced training costs for those IFAs serving the mass market would raise the viability of business models directed towards increasing financial inclusion whilst still ensuring professional standards of advice are maintained.

LifeAfterX supports promoting public understanding of the financial system but believes MoneyMadeClear is not an appropriate cost-effective way of achieving it. The FSA define money guidance as "The Guidance and Information people need on the money matters that shape their everyday lives" The FSA define advice as regulated advice which requires a full factfind of information before advice can be given. MoneyMadeClear is a money guidance service.

We do not believe MoneyMadeClear will work because:-

- There are several reviews which have stated that it is boring and unengaging and much of the information on MoneyMadeClear is available elsewhere on the web. [www.bbc.co.uk/RAW](http://www.bbc.co.uk/RAW) provides financial information in a much more engaging and interesting way
- Although there is a promotional campaign underway, market research indicates most people have not heard of it

- Budgets can never stretch to a free national face to face advice service. Hence, for regulated advice, the consumer will need to be referred to and pay those very IFAs which are likely to exit the market or focus on High Net Worth (HNW) clients. In their absence, the 'man in the street' is likely to have no access to independent financial advice
- it is very expensive to run and, though in itself, a small additional cost when spread across the industry, when added to other costs, the overall additional burden risks driving more IFAs out of business

The FSA definition of independent advice is ....unbiased and unrestricted, and based on a comprehensive and fair analysis of the relevant market...IFAs will need to ensure that they have sufficient knowledge of all the products that could provide the desired outcome. In some areas, the number of products will make it practically impossible to comply! For example, there is no complete 100% 'whole of market' computer system that allows IFAs to compare all mortgages in the market before recommending the most suitable for their customer.

Some IFAs, as a result, to avoid a fine, may choose to call themselves restricted, even though in their and the customer's mind, they are independent in the sense of 'freedom to recommend any product from a wide range of product providers'.

If an IFA argues that what they do is provide independent financial advice and are required to follow procedures in the Conduct of Business Rules relating to giving advice to sell a product, it is difficult to see how they can argue that the implementation of a product is the primary service and thus exempt from VAT. As all IFAs know the hard part is the advice part of the service and selecting an appropriate product is the least dominant part of that service.

We also do not understand how you can fully remove commission bias, ie payment conditional on a sale being made, without removing the incentive of that payment. We therefore favour a fee based regime with all customers paying the IFA whether or not a product is purchased, and VAT being payable on the cost of advice given. This should also apply to tied advisers. We do recognise that there is a risk that people will not seek financial advice as a result of the cost but believe this is the right and fair thing to do.

Product complexity designed to hide high fees has been eroded and should continue to decrease as a result of the RDR changes encouraging simpler products for the mass market. We believe that the products themselves should remain VAT exempt to encourage their purchase.

**Q11** The FSA has statutory immunity from being sued for negligence in the absence of bad faith though a judicial review of decisions is possible once the regulatory processes have been fully exhausted. These regulatory processes are time consuming and the judicial review expensive.

We believe that this immunity should be removed based on the principle that the person or body that caused the problem through negligence should be responsible for the redress. As the taxpayer would potentially become responsible for redress, there should be much closer accountability to and scrutiny by Parliament making it easier for MPs to raise issues of concern from their constituents regarding the FSA in Parliament.

**Q12** We believe that to improve transparency and accountability the panels should publish formal recommendations to the FSA Board on the website and the FSA should publish formal responses with reasons on the FSA website if it decides not to adopt them.

**Q13** We do not believe the issue is about who collects the fees, the issue is that the FSA SBPP believes that these fee increases are unsustainable for small businesses.<sup>4</sup> Hence, the prediction of the number of businesses that will exit the market is highly likely to be an underestimate. At the time that the FSA conducted its research, some firms had not realised the full implications of RDR.

There is also a risk of an ever decreasing circle, if the number of IFAs declines, there will be fewer firms to bear the increased costs. More IFAs will in turn leave the industry, which will increase financial exclusion.

IFA fees are expected to increase both as a result of increased capital requirements arising from the RDR changes and increases in FSA fees.

From 2013, the FSA are proposing that an IFA must hold three months operating expenditure with a minimum of £20,000 in reserve at all times to meet the stated aim of providing ongoing support for consumers when a firm is wound up, but not burdening remaining firms.

However, where companies employ fully salaried staff this amount will be larger than where staff are paid on a salary plus bonus. Where bonuses are substantial, this could mean that it encourages the behaviour of 'hard selling'. So the companies having the smaller capital requirement could be the one providing the highest risk of misselling.

FSA fees are expected to increase because of:-

- improved FSCS funding
- increased funding for the Consumer Financial Education Body
- increased FSA staffing to support a more interventionist and pre-emptive approach to retail conduct regulation including a role in regulating products thought the costs of regulating products should fall on the product providers

If the principle is that the person, company or body that was negligent should be responsible for the redress then measures to prevent this in the future could be:-

- ensuring adequacy of PI cover held by advisers. If badly managed or crooked IFAs who have inadequate PI cover with significant exclusions who subsequently go into liquidation with the FSCS having to 'pick up the pieces' should we not be

<sup>4</sup> [http://www.sbpp.org.uk/topics/regulatory\\_fees\\_for\\_smaller\\_firms.asp](http://www.sbpp.org.uk/topics/regulatory_fees_for_smaller_firms.asp)

stopping those IFAs without adequate PI cover from trading? The insurance market fixes premiums based on its attitude and view of risk. Part of their risk is now effectively being assumed by the FSCS.

- If IFAs are ceasing trading leaving claims behind which lead to FSCS costs because PI cover no longer exists, then the increased capital requirement will only be effective if claims are known about at the time. If the business is sold, then the new company will need to address the risk of future claims in its own PI policy.
- If the cause was bad regulation not adviser failure, the regulator picking up the cost of the redress not the FSCS

In terms of FOS costs, those bodies incurring the most complaints in number and upheld by FOS should bear those costs. This principle should continue to apply.

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18 October 2010

Dear Sirs

## **A New Approach to Financial Regulation**

The importance of the way in which regulators are structured should not be over- or indeed under-emphasized. Structures can help or hinder achieving desired regulatory outcomes. This is true both at a domestic and international level. The Government's proposals are a step forward in seeking to address failings in the UK framework. Our response seeks to contribute to this discussion.

### **1 Reasons for change**

We see the Consultation as making three fundamental points:

- the UK regulatory structure must take into account and seek to mitigate macro-prudential risks;
- a more intense focus (through separate regulators) needs to be brought to bear on -
  - (a) prudential regulation, especially with respect to those firms carrying on systemically important activities, and
  - (b) consumer protection;
- the prudential supervision of individual firms must be judgment-based.

The Government believes that re-integrating the Bank of England (the Bank) into the regulatory structure and creating a new Financial Policy Committee (FPC) and Prudential Regulatory Authority (PRA) will help to address the prudential issues. In broad terms, we agree with this. Likewise, we agree with the idea of having a regulator, the Consumer Protection and Markets Authority (CPMA) concentrate on conduct issues (which are of primary day-to-day importance to consumers). Having regulators who are focussed on and experienced in what they do should help to contribute to a more effective regime.

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This is not to say that the proposed regime is without its potential issues. Indeed, our one major criticism of the Consultation is that it has not spelt out what the Government means by 'prudential' regulation, or what the dividing line is (if any) between prudential and other areas of regulation. This is at the heart of the debate as to whether the two regulators will co-ordinate their policies, rule-making, oversight and enforcement activities as effectively as they should, in order to achieve desired regulatory objectives but without unnecessarily burdening firms.

## **2 Prudential v conduct v market regulation**

Prudential regulation is typically taken to refer to regulatory capital and liquidity regimes, systems and controls regulation (including senior management responsibility and risk management) and rules for the protection of client money and assets. The regulatory capital regimes applying as between those firms which take risk onto their balance sheets and those firms which do not are, of course, different. However, the outcomes sought in relation to all firms is the same: that they have sufficient capital and liquidity to support their businesses. In addition, there is no reason to think that the systems and controls and client assets/monies protections are of some fundamentally different type as between firms which carry on different regulated activities, albeit that the degree of regulatory focus on the firms that pose greater risk should be higher.

Conduct regulation then deals with how firms conduct themselves principally with respect to their customers and counterparties. Market regulation picks up the supervision of trading venues, settlement and clearing systems and the detection and prevention of market abuse. Closely linked with the latter two is the regulation of securities and other investment product offerings and the control of issuers' disclosures.

This division is sensible and is broadly reflected in European legislation. We see little reason to define things differently, and would urge the Government to clarify that these are the categories it refers to under its proposals.

Often a desired regulatory outcome can be achieved through one or more of these areas. For example, consumer protection through disclosure is dealt with in conduct rules, market regulation and securities offering requirements. Likewise, a breach of, say, the conduct rules can involve 'prudential' issues, e.g. by bringing into question the appropriateness of a firm's compliance procedures and governance. In other words, there is no hard-and-fast dividing line between different areas of regulation. The Government's proposals need to take this into account. We do not suggest that this undermines the thrust of the Consultation Paper, but it does emphasize the imperative that the Bank, FPC, PRA and CPMA must often (perhaps always for certain firms or activities) work together as a single team. We suggest below one way of trying to facilitate this.

Moreover, it is perhaps easy to promise that the authorities will work together; it is more difficult to make sure that they do. We ask that the Treasury be explicitly tasked in legislation with the responsibility of monitoring this and, if needed, making it happen. At the very least, this ought to be the subject of a periodic review to be laid before Parliament.

## **3 Roles in relation to regulation**

Tied in with this are the different regulatory roles that can be played with respect to any one area. These divide into five principal roles: setting policy and designing rules to achieve that policy; authorising firms and individuals to carry on activities governed by the rules; monitoring and supervising compliance by firms and individuals; taking enforcement action for breaches; and dealing with potential and realised insolvencies.

Of these different tasks, the crucial one is, we suggest, determining and setting the policies and rules, partnered with ensuring that the 'regulatory agenda' is achieved. At first sight, this might be taken to suggest that once an authority has been tasked with regulating a particular area, it must perform all of the roles relating to that area. Consequently, once it has been decided to split regulation between authorities, it would follow that largely parallel regimes for licensing, etc. must follow. In our view, this does not necessarily have to be the case. Indeed, we would go further and argue that positive steps should be taken to guard against it. It is not only inefficient and wasteful of resources, but invites confusion and debate as to who is responsible for what, given the overlapping and interconnected nature of the financial markets and regulation.

In our view, the authority tasked with setting the policies and rules need not also take the frontline role in licensing matters, or indeed in supervision or enforcement. Nevertheless responsibility for ensuring achievement of and alignment with policy goals may require a greater or lesser degree of participation in each role, depending on the circumstances and the risks to be met. The greater the risk to the authority's policy goals posed either by the firm or activity being regulated the greater the participation required will be.

In other words, it would be quite feasible to have the FPC/PRA set the regulatory agenda and rules for prudential matters and then take a risk-based approach to executing the additional tasks associated with achieving those goals; without necessarily burdening them with everything else that a regulator might typically do. In large part, this is the macro-prudential role already suggested for the FPC. We believe that this role might be developed and also applied to the PRA to produce a more streamlined and efficient regime, as between it and the CPMA.

#### **4 A suggested alternative partnership between the authorities**

We propose a variation on the Government's suggested structure:

- FPC – as per the Government's proposals; it sets macro-prudential goals which are to be achieved through the micro-regulation of the PRA and CPMA.
- PRA – the PRA becomes responsible for setting the policy and rules for prudential matters for all firms (not just banks, broker-dealers and insurers). It delegates to the CPMA the day-to-day tasks associated with regulating individual firms. However, adopting a risk-based approach, for those firms or activities it regards as significant (a level the PRA must set), it plays an active role in partnering with the CPMA to ensure that the PRA's policy goals are achieved.

For example, for a firm wishing to be authorised to deal in investments (as principal), the firm will seek its authorisation from the CPMA, but the CPMA will be required to notify and consult with (and defer to) the PRA before granting that authorisation. (Not all firms that "deal as principal" are as significant, in risk terms, as say large banks and broker-dealers; so the PRA should not need to be as extensively engaged in the licensing and day-to-day supervision of such firms.) Similarly, before a major bank appoints, say, a person to one of its senior management positions requiring individual authorisation, permission will be sought from the CPMA, which again will notify and consult with (and defer to) the PRA before granting approval.

Significant institutions will be supervised by a single team, a partnership from both the PRA and the CPMA. Enforcement action will be executed by the CPMA, but again with the PRA taking an appropriate role according to the circumstances.

- CPMA – the CPMA is responsible for market regulation and for conduct regulation for all firms, and for executing the PRA's prudential regulation. The CPMA will set the policy and rules for markets and conduct issues. The CPMA will act as the frontline day-to-day regulator for all firms, but in partnership with (and sometimes at the direction of) the PRA in prudential matters for important firms and activities. The CPMA will be responsible for processing all licensing applications, etc. All regulatory notifications will be made to the CPMA, which will share all relevant information with the PRA (and the FPC). The CPMA will retain all regulatory data and, in effect, provide 'back office' support for the Bank, FPC and PRA. The CPMA would also take primary responsibility for enforcing the rules, again sometimes in partnership (and at the direction of) the PRA. (We note, in this regard, that we are strongly in favour of leaving enforcement powers – including for relevant criminal market abuse offences – in a single regulator to avoid 'double jeopardy' for firms and to avoid undermining the 'credible deterrence' threat.)

We have suggested this model, as we believe that regulation cannot be neatly divided up, and that we should be seeking operating efficiencies which do not endanger the policy objectives that the Government aims for. We would be pleased to discuss this further with you.

## **5 UKLA**

Our strong view is that the CPMA would be the most appropriate place to locate the UKLA. We have set out our reasons for this in more detail in our response to Question 17.

## **6 Unpicking FSMA**

The job of unpicking the tangle of the Financial Services and Markets Act 2000 (FSMA) and dividing it between the PRA and CPMA – whether in new legislation or by amending FSMA - will be far from straightforward. We are not alone in believing that financial services legislation has become overly complicated, unnecessarily bureaucratic and burdensome to comply with, and with too many criminal sanctions for 'administrative' failures. We urge the Government to devote sufficient resources to the task – resources that have deep experience of the financial services industry. We also urge the Government to take the time to 'get it right', despite the inevitable pressure to be seen to be moving forward.

If the Government is minded to leave as much of FSMA standing as possible, our approach at paragraph 4 above might be of some assistance: if the FPC/PRA were to take the role we suggest, with the CPMA acting at their direction on prudential matters, it might be possible to amend FSMA in a relatively simple way. In essence, the CPMA would step into the FSA's shoes under FSMA taking its powers and responsibilities. However, these would have to be limited with respect to prudential matters, e.g. by way of an override for the FPC/PRA. The latter's powers and responsibilities would need to be set out, but this might be done through a relatively small set of new provisions.

## **7 EU**

The recent financial crisis has seen an unprecedented wave of new regulation proposed. It is crucial that the international markets operating through London – to the benefit of the UK and more importantly the EU - are properly understood and fully represented in the debate as to how those markets should be reformed and regulated to avoid further crises. This is especially true in the EU.



All too often, the debate in the EU takes a 'nationalistic' approach, with 'the City' (currently) being disparaged for causing harm and labelled as being 'UK-centric'. Harm has been caused, and behaviour and culture may need to change – but to blame 'the City' out of hand ignores the benefits that the international (not just UK domestic) markets bring to the EU. We believe that the Government shares this view and that regulatory reform is one of the most pressing and important issues on the EU's reform agenda.

We appreciate the Government playing its part, but we are concerned that its efforts should not be accidentally undermined through a mis-match between domestic regulatory structures and those through which the EU plans to act going forward. For instance, while the European Banking Authority and European Insurance and Occupational Pensions Authority will play a crucial role in the 'prudential' space, it is the European Securities and Markets Authority (ESMA) that will likely have most impact on the day-to-day activities of most firms. Ensuring a strong and respected representation at ESMA – a body that can speak authoritatively for all aspects of the international markets – is crucial.

However, ESMA is not concerned solely with conduct or market issues. It also looks after many prudential areas, e.g. the systems and controls and client assets and money rules under the Markets in Financial Instruments Directive (MiFID). As we discuss further below, it also regulates securities offerings, and clearing and settlement systems. If the CPMA is to represent the UK at ESMA as effectively as possible, the CPMA needs to be engaged in all of these areas. Indeed, the European regulatory structures perhaps suggest that certain aspects of markets regulation, such as those undertaken by the UKLA, should stay with the CPMA (and not moved to a separate 'companies regulator'), so that the UK structures are clearly aligned with those in Europe. The partnership model we have suggested above goes some way to meet that need.

We hope that the inevitable disruption caused by implementing any new structure will not result in the FSA taking its 'eye off the ball' on any new or existing EU initiative. As the Government is aware, it is vital that the FSA continues to engage with industry and ensure that the international financial services sector is adequately represented at a global and European level.

## **8 Specific Responses to the Consultation Questions**

### **A. 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?**

- B. We recognise that macroeconomic stability helps reduce risks to the stability of the financial system and a stable financial system is able to sustain the supply of key services to the economy, even in the event of "material adverse shocks". Therefore, we agree that it is appropriate that financial stability should be the primary statutory objective of the FPC. However, it is important that the FPC's approach to financial stability also contributes to the maintenance of the important services that the financial services sector performs for the wider economy - for example, that it ensures the continued proper channelling of savings into investment, which is required in order to achieve sustained economic growth. Accordingly, we support supplementing FPC's primary objective with secondary factors.

### **Question 2**

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

The following factors should be applied to the FPC :

- The statutory objectives of the PRA and the CPMA.
- The impact of its decisions on the ability of firms to provide in a sustainable way important services to the wider economy.
- The impact of its decisions on the ability of consumers/users/issuers to obtain the financial services and products they want/need.
- The impact of its decisions on competitiveness and innovation.
- Proportionality, and the need to use its resources in the most efficient and economic way.

**C. 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?**

It would be preferable if the factors were formulated as secondary objectives, with FPC's primary objectives prevailing in the event of a conflict.

**D. Question 4**

**The Government welcomes respondents' views on**

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

Yes. Please see our response above.

We note that the suggested objective of the PRA appears to place greater emphasis on minimising the disruption caused by the actual failure of firms rather than reducing the likelihood of firms failing in the first place (albeit that this is we expect intended to be implicit). Nevertheless, given the impact that failure of a systemically important firm will have on confidence in the UK financial services sector (even where the winding down is conducted in an orderly manner), we suggest that regard should be given to ensuring that firms do not fail in the first place.

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

Yes, we consider that the principles for good regulation are an important part of the accountability framework for regulatory bodies.

We would have grave concerns if the PRA was given significant powers without the requirement to, for example, consult or analyse the proportionality of its decisions. It is our experience that input from industry can greatly improve the quality of legislation by ensuring that it is relevant, proportionate and effective. Please also see our response to Questions 7 and 8 below.

- **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**

Whilst we acknowledge that an “excessive” concern for innovation and competitiveness may produce certain adverse outcomes, ensuring that regulatory decisions do not unnecessarily or disproportionately damage competitiveness/innovation is still important. Therefore, we consider that it is appropriate that the PRA has regard to the effects of its decisions on competitiveness and innovation. Please also see our response to Question 2 above.

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

No comment.

#### **E. 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?**

Please see our suggestions on this at paragraph 4 above.

We note that the Consultation Paper is silent on how existing FSA-authorized firms and approved persons will become authorised and registered under the new regime, or how the EU passporting regime will work. We assume that detailed proposals will follow in due course.

#### **F. Question 6**

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

In principle we agree that a risk-based, judgment-focussed approach to regulatory supervision is sensible. Ultimately, achieving this depends on the PRA having appropriately senior and qualified personnel who understand and can challenge firms. In addition, it is important that the PRA exercises its powers in a proportionate and predictable manner and actually seeks to make regulation more effective as a means to reduce the likelihood of a future financial crisis rather than simply creating unnecessary layers of regulatory complexity, confusion and uncertainty. As already noted, much could be done to improve and simplify the rules.

Whilst we welcome the Government’s desire to reduce the existing prescriptive FSA prudential rules and guidance, as much of these rules are derived from European legislation, we question the extent to which the PRA will be able to reduce and simplify the rules and/or adopt super-equivalent requirements. Indeed, going forward it is likely that European legislation will have a greater role in setting the prudential regulatory framework for systemically important firms. Further, to the extent that the PRA is able to adopt super-equivalent measures, it is essential that it considers the impact that this may have on the competitive position of those operating in the UK market. We would hope that the Government works with its global partners to ensure that any measure it deems necessary to support financial stability is reflected in global agreements.

#### **G. Question 7**

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

Yes. See our response to Question 4 above.

It is not entirely clear why it might be appropriate that the PRA be subject to a lower standard of accountability and scrutiny than the CPMA. We are not persuaded that risk-based judgments require any reduction in accountability or scrutiny. At a minimum the same safeguards that are in place with respect to the FSA should be retained and applied to the PRA. We also note that the Consultation Paper is silent on whether a firm can appeal a decision of the PRA to an Upper Tribunal. This is an important safeguard that should be available.

**H. Question 8**

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

No comment.

**I. 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.**

Please see our responses to Questions 4 and 7.

**J. 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;**

Yes. Further, the desire to embed a culture of "consumer protection" in the CPMA must not lead it to lose focus on its other regulatory responsibilities with respect to, for example, market supervision.

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

Yes; see our responses to Questions 4 and 7.

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

Yes, see our responses to Questions 1 and 4 above. In addition, it should be recognised that consumers have a role to play in protecting themselves. So, in considering what consumer protection is appropriate, the CPMA should have regard to the principle that consumers should take some responsibility for their decisions.

**K. Question 11**

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

Yes.

**L. Question 12**

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

No comment.

**M. Question 15**

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

As the Bank will be responsible for ensuring financial stability in the UK financial system, we see much sense in the Bank taking greater responsibility for clearing houses and settlement systems. However, we wonder whether the model we have suggested at paragraph 4 above might be considered here too, with the Bank setting regulatory policy and rules, which would be implemented through and in partnership with the CPMA Markets Division. This would meet, we believe, the objective of having the Bank involved in regulating systemically-important infrastructure providers, but complemented by the CPMA's oversight of the markets which those providers support.

Furthermore, we are concerned that, at an EU-level, the regulation of clearing and settlement systems is primarily driven by ESMA – at which the Bank will not be formally represented. A more formal partnership with the CPMA may assist in addressing this issue too.

With respect to the responsibilities of the CPMA Markets Division, clarity on how the Markets Division will interact with the Conduct Division at the CPMA would be welcome.

**N. Question 16**

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

We believe rationalisation of the regimes would be sensible. This should involve considering the special default regime applying in relation to recognised exchanges/clearing houses in Part VII of the Companies Act 1989.

As the Government is aware, the European Commission's review of the Markets in Financial Instruments Directive will consider a variety of issues relating to how trading and clearing venues are regulated: to ensure that differences in regulation between different types of venue are justified and appropriate, to ensure that changes arising out of technological innovation are properly regulated, and to revisit pre- and post-trade transparency.

Any rationalisation or change to the FSMA regimes should take account of changes at the European level.

**O. 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.**

Our strong view is that the CPMA would be the most appropriate place to locate the UKLA for the following reasons:

- The UKLA plays an important consumer protection role through its responsibilities as to disclosure.
  - (a) First, it is responsible for ensuring that proper initial and ongoing disclosures are made by issuers; such disclosures are meant to ensure that investors have

sufficient information on which to base their investment decisions. This is also a primary concern of conduct regulation.

(b) Second, it is difficult to divorce the UKLA's role with respect to the handling and disclosure of 'inside information' by issuers and their advisers from the CPMA's mandate to regulate market conduct and guard against insider dealing and other market abuse. Splitting the UKLA from the CPMA's market supervision role risks weakening overall market regulation (and we note is somewhat inconsistent with the mandate under the Market Abuse Directive to allocate responsibilities for guarding against market abuse to a single authority).

- The UKLA is a securities market regulator (i.e. a regulator of issuers in relation to issues of securities), not a broader companies regulator. Moreover, it is primarily focussed on international securities issues - only a small proportion of the securities issues it has listed are equities issued by UK companies.
- This maintains the quality of the UKLA listing rules (which benefits the EU by offering a capital raising venue for international - EU and non-EU - issuers). The UKLA Listing Rules have their basis in EU legislation, but the UKLA has introduced additional requirements pursuant to its powers as UK competent authority over and above the minimum EU standards. This has enabled the UKLA to offer issuers a premium listing standard. This has been key to the UK's ability to attract overseas issuers. As the Government will be aware, the UK will be represented on ESMA by the CPMA. As the volume of EU legislation grows, the need for a strong UK voice in Europe is critical. We consider that removing responsibility for primary market policy from the CPMA will undermine that voice and may ultimately harm the quality of the UKLA listings rules that have attracted so many non-UK incorporated companies to London.
- Transferring responsibility for the UKLA's functions to a UK-centric companies regulator under BIS does not appear to be consistent with the international nature of the UK listings market (see our comments above).
- Where appropriate, the regimes governing securities offerings and disclosures should be aligned with those for other investment products, e.g. funds or insurance wrappers. There is less risk of disconnect and arbitrage between those regimes if those responsible for each are aligned.

**P. 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.**

No comment.

**Q. Question 19**

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

It is vital that the Government clarifies the circumstances in which the PRA will exercise its power to vary "at its own initiative" a firm's regulatory permissions.

We are also concerned by the proposal to extend the scope of the new authorities' powers to supervise unregulated entities – such as holding companies in the event of a regulated firm's

failure. Further clarity on what is envisaged here would be welcome as this represents a significant departure from the current regulatory framework.

**R. Question 20**

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

We would like to understand what the Government thinks might be better achieved through the authorities having additional intervention powers: better protection for the failing firm's clients, or a better chance of saving the firm from insolvency? If specific gaps have been identified in the FSA's current (extensive) array of powers, there would be merit in addressing them. However, we are not sure if any such gaps have been identified. It might be better to see if the current powers can be better used, before new powers are given.

**S. Question 21**

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

We are concerned about the potential for perceived conflicts of interest arising out of the multiple roles allocated to the Bank. For example, will the PRA be deterred from pulling the SRR trigger by concerns that this will amount to an admission of failure in respect of its micro-prudential supervision of the affected firm?

While the Government has acknowledged the potential for conflict of interest, its proposed solution - i.e., the operational separation of those potentially competing responsibilities - needs further work especially through the senior ranks of the Bank's governing structure in the midst of a financial crisis.

We appreciate the opportunity to contribute to the Government's thinking in this area. If you would like to discuss any of our responses above, please do contact Stephen Fletcher in our Financial Regulatory Group.

Yours faithfully



Linklaters LLP





## Letterhead of the Listing Authority Advisory Committee

Dear Sirs,

### Response to HM Treasury Consultation on financial regulation Cm 7874

I am pleased to enclose the submission of the Listing Authority Advisory Committee (LAAC) to HMT's Consultation on A New Approach to Financial Regulation. LAAC is composed of very experienced users of the financial markets, including issuers, investors and financial intermediaries. This paper reflects their views on the proposal to merge the Listing Authority with the FRC to create a new corporate regulator under the Department for Business, Innovation and Skills.

**LAAC believes that such a move would have very damaging consequences for market regulation and would seriously weaken the UK's voice in EU debates, which is the forum where most policy and regulation in relation to financial markets is determined. The Listing Authority should therefore remain part of the new markets authority (the CPMA), with which it has very close ties that should not be lost.**

Our view is based on the following key arguments, each of which is elaborated more fully in the attached paper:

1. The UKLA has very little in common with the proposed new corporate regulator because it is a **securities markets regulator**, and the UK corporate component of that market is only a very small part of the whole. Only around 600 of the approximately 21,000 listed issues are shares of UK companies (excluding investment entities), which would be the main focus of such a regulator, the bulk of the remainder being non-equity securities.
2. The **UKLA is necessarily a markets oriented** body, which gives it a very different focus from that required by a standard setting corporate regulator. For example, it monitors the market on a real-time basis to ensure that important information is disclosed as required; and it maintains the Official List, which involves daily admissions of securities, delisting securities as they are redeemed or cancelled, and suspending securities in response to market events. It also polices the public offer regime for both listed and unlisted securities, including the advertisement regime under the Prospectus Directive (PD), which gives it responsibilities in relation to how securities are marketed to the public and the power to suspend public offers.
3. The proposed move would **weaken market regulation**. The role of the UKLA is inextricably linked with the real-time market activities of the FSA. In particular, effective monitoring and enforcement of the **market abuse** regime (e.g. through suspension of offers and securities) requires particularly close real-time contact with the markets and is equally relevant to the roles of the UKLA and to those proposed for the CPMA. It is for this reason that the Market Abuse Directive (MAD) clearly states that **there must only be one authority for this purpose in each member state**. The proposed division of responsibility would be inconsistent with this requirement.
4. **EU legislation** now determines most policy and regulation in relation to financial markets. The new European Securities and Markets Authority only allows one seat to each state. However, it has jurisdiction over both the UKLA and the CPMA functions. The UK's voice at debates, and its influence, will be much reduced unless its representatives can directly address all aspects of ESMA's work, including matters such as the possible removal of the UK's unique super-equivalent regime for premium listed shares, which is highly valued by investors. The proposed move would also create a damaging division in responsibilities at government level, with two Ministries having split responsibilities when dealing with EU negotiations rather than one, as at present. Under the current proposals, three authorities would be directly responsible for markets regulation.

5. The proposed move of the UKLA would create additional **regulatory complexity** with divided responsibilities thus creating risks of conflicts or gaps appearing in regulation.
6. There has been no **market failure** in relation to the UKLA's activities that would justify any significant change of the sort proposed and therefore the proposals do not meet the principles of good regulation.

For these reasons, which are discussed in more detail in our enclosed response to the Consultation, We believe that the best place for the UKLA is within the CPMA as an integrated UK markets regulator.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Andrew Tusa', with a horizontal line underneath it.

Andrew Tusa  
*(Chairman, The Listing Authority Advisory Committee)*

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

# Response of the Listing Authority Advisory Committee to HM Treasury Consultation on financial regulation Cm 7874

## 1 Introduction

This paper is the response of the Listing Authority Advisory Committee (“LAAC”) to HM Treasury’s Consultation entitled “A new approach to financial regulation: judgement, focus and stability” dated July 2010 (Cm 7874). LAAC is composed of persons appointed by the FSA’s Board, and its members are chosen because they can accurately reflect the views of those who use the markets, such as banks who sponsor new issues, listed companies and other issuers and investors in securities. Its functions are to apply that collective experience in advising the FSA on the operation of its listing function and the FSA’s Board on major policy issues relevant to the Board which affect issuers of securities; and on proposals for the regulation carried out by and the policies and operation of the FSA’s listing function.

Given the remit of LAAC, the focus of this paper is on the proposals in the Consultation Document that relate to the UK Listing Authority function – particularly the suggestion that the UKLA might be merged into a new companies regulator under the Department for Business, Innovation and Skills (BIS).

## 2 Summary conclusions

In summary, we strongly disagree with the proposal that the UKLA should be moved to form part of a companies regulator within BIS and believe that such a move would produce very damaging results, both for the new companies regulator and for market regulation, for the following reasons:

**2.1 The UKLA is not a corporate regulator – it is a securities markets regulator.** Most of its work involves issues that would be outside the scope of a UK companies regulator. Indeed, only around 600 or so of the approximately 21,000 listed issues are shares of UK companies (excluding investment entities such as investment trusts), which would be the main focus of such a regulator. As a markets regulator, the UKLA is necessarily a markets oriented body, which gives it a very different focus from a standard setting corporate regulator. For example, it monitors the market on a real-time basis to ensure that important information is disclosed as required; and it maintains the Official List, which involves daily admissions of securities, delisting securities as they are redeemed or cancelled and suspending securities in response to market events. It also polices the public offer regime for both listed and unlisted securities, including the advertisement regime under the Prospectus Directive, which gives it has responsibilities in relation to how securities are marketed to the public and the power to suspend public offers. Accordingly, to move the UKLA into the new companies regulator would not only deprive it of its important links with the markets but would also divert the resources of the new companies regulator from its primary function. It would, in addition, make admission to the UK market less attractive to the significant number of foreign issuers of non-equity securities who currently use the market, who may well be deterred by the fact that a UK companies regulator will seek to regulate their activities in addition to their own domestic authorities and be less attuned to their needs, because of the regulator’s focus on the UK and equity.

**2.2 The EU’s market abuse regime** is an essential part of market regulation and therefore necessarily forms part of both the CPMA’s and the UKLA’s responsibilities. Those responsibilities apply across the whole range of the markets, from initial offer and admission of securities to the market to secondary market trading. The proper discharge of those

responsibilities requires real-time involvement with the market by both the CPMA and the UKLA, including monitoring of information, forcing timely disclosure of inside information and enforcement of the regime, on a case by case basis, through disciplinary action or even suspension of securities. The new corporate regulator will not have the necessary day to day contact with the market to enable it to discharge these duties effectively – and should not have it, given the different focus of its responsibilities. In addition, the **Market Abuse Directive requires that each state should appoint a single authority** to administer the market abuse regime (no doubt because of the perception that market abuse applies across the whole range of securities market activities and its supervision should not therefore be split between different authorities). The division of the UKLA from the CPMA, as market abuse authority, would therefore not only produce significant inefficiencies and weaknesses in the regulation of the market, but would appear to be contrary to an important concept of EU law. As market abuse affects the work of the UKLA as much as any other aspect of the market, this argues strongly in favour of the UKLA remaining as part of the CPMA. It is also important to note in this context that, while the team that discharges most of the UKLA's responsibilities under MAD does have an operational interface with the FRC (indeed, it is the only current such interface between the UKLA and the FRC), a merger of the UKLA with the FRC would seek to remove this team from the CPMA's MAD team, thus introducing the risks inherent in split responsibilities. This would also appear to be prohibited by the requirement to have a single competent authority for the purposes of MAD.

- 2.3** The proposal would significantly **weaken the UK's voice in the European arena**, both at regulator and at government level. The UK's representative on CESR (and, in the near future, the European Securities and Markets Authority or ESMA) would, unlike other member state members, no longer speak directly for listing matters; and the Treasury would equally no longer be seen by other member states as the direct representative for such matters in Council debates. As most law and regulation in relation to the UK's financial markets comes from the EU (and this is likely to increase in the near future) the UK needs a stronger, and more authoritative, voice in EU debates rather than the reduced influence that would result from the proposed move of the UKLA. This is particularly so if, as is possible, the EU moves to harmonise super-equivalent arrangements that apply to premium listing of shares. The UK has a unique super-equivalent regime, dealing with matters such as obligations to put important decisions to shareholder vote and disclosure for disposals of shares by management, that is highly valued by investors. Any move towards maximum harmonisation at EU level could lead to a reduction in the protection provided by this regime (or even, we fear, its wholesale abolition) and the UK will need to have a strong voice in the debate to prevent any such result.
- 2.4** We believe that the proposal in the Consultation Paper introduces **additional complexity and risk** by dividing between two authorities responsibilities that are necessarily linked and which, as mentioned earlier, both depend on "in the market" experience (which the companies regulator will not have). Indeed, the sum effect of the current proposals would be to create three separate authorities (the Bank of England, the CPMA and the new corporate regulator) with divided responsibilities for market regulation. Such a structure risks significant conflict in the way in which regulation is developed and implemented and the possibility that gaps will appear in the regulatory fabric.
- 2.5** We do not believe that change should be made unless it can be demonstrated that there has been a **significant regulatory failure** and even then any changes should be focussed on remedying the specific identified defects. The recent financial crisis did not arise from any failure of this sort in relation to the UKLA's functions and responsibilities. Indeed, an independent survey carried out for the UKLA this year has demonstrated an overall increase in

the levels of satisfaction with the way in which the UKLA has operated over the last few, crisis-ridden, years.

We explain each of these points in more detail below. Any discussion of the appropriate place for the UKLA's functions to be carried out necessitates having a clear picture of what those functions involve. Accordingly, in the Annex to this paper we have set out a general description of those functions and how those functions interact with certain other parts of the FSA.

### **3 Incompatibility between a UK companies regulator and the UKLA**

We believe that the proper functioning of the listing authority depends very much on regular contact with the market. It appears from the Consultation Paper that the new companies regulator is to have a focus on standard setting, similar to that of the FRC, which has, to date, dealt mainly with accounting, auditing and actuarial professions. This is in strong contrast with the UKLA, which has always had a very strong operational focus based on many decades of practical experience and close daily involvement with the financial markets – not just in developing rules and principles, but in applying them on a daily basis according to specific facts and situations arising in the markets. It is this operational focus that gives the UKLA its strength and earns it respect with those that deal with it (both within and outside the UK). For example, the UKLA:

- monitors, and intervenes in, the market on a real-time basis by forcing out announcements of information that could significantly move the prices of securities and suspending securities from trading where, for example, it believes that a false market may have developed;
- supervises sponsors (investment banks, stock-brokers and corporate finance advisory boutiques) that act as advisors to issuers of shares that are to be admitted to premium listing. This process is (in the context of an issue) highly interactive between the sponsor and the UKLA; and there is in addition regular and extensive contact between the UKLA and the sponsor community outside the context of an issue, through the UKLA's sponsor supervisory regime,
- maintains the Official List, on a real-time basis, admitting securities, delisting them as they are redeemed or cancelled and suspending them when false markets develop or in response to significant transactions. With a population of over 20,000 listed securities this is a major undertaking that requires significant resources and is necessarily responsive to market events.
- polices the public offer regime, ensuring that securities (including those that are unlisted) are not offered to the public without a prospectus. Part of this involves monitoring in the market advertisements and other financial promotion materials relating to securities, to ensure that they comply with the advertising regime under the Prospectus Directive. The UKLA also has the power to suspend illegal public offers. All of these functions are real-time and market-facing.

It is doubtful that such a focus would be maintained if the UKLA were moved to become part of a companies regulator within BIS, partly because the focus of that department will be on company regulation (and not, for example, what sort of risk disclosure needs to be made in relation to a new type of non-equity security issued by a non-UK, non-corporate entity); and partly because it will be the CPMA, not BIS, that has the most frequent and relevant contact with the markets, as their regulator, so that the UKLA within BIS would be cut off from much of its current market contact.

It is also difficult to see how the new companies regulator's scope would fit with the nature of the UK's securities markets, As explained in the Annex, the vast majority of the securities that are admitted to

the Official List are bonds and other types of non-equity securities. Specifically, only around 6% of the issues admitted to the UK's Official List consist of shares issued by UK companies with a premium listing (these being the issuers that would naturally fall within the scope of a UK companies regulator). Even among those issuers whose equity securities are admitted to the UK's regulated market, many are incorporated outside the UK (and are therefore not subject to UK company law) and will only have a standard listing, and therefore be largely outside the super-equivalent regime for premium listed share issuers. The overseas and debt issuers, who form the bulk of the market by volume of issuance, will therefore be of little or no relevance to a UK companies regulator.

A number of things follow from this. The first is that the significant resource that would have to be devoted to the high volume business of the UKLA that is irrelevant to companies regulation would divert very large resource, both monetary and other, from the main function of the new regulator, making it less effective at performing its main function (regulating UK companies).

The second is that the very large number of non-UK issuers of non-equity securities who currently use the UK's regulated markets will be deterred by the fact that their admission to the market will be regulated by a UK companies regulator, rather than, as at present, a listing authority that is part of the FSA, which regulates an international market for all types of securities issued by companies and other non-corporate issuers (such as sovereigns and supra-national entities) from around the world.

#### **4 Less effective regulation of the markets**

The Consultation Paper is right in stressing the need to promote confidence in financial services and markets. However, that objective will not be achieved by splitting the regulation of admission to the UK's regulated markets and regulation of market conduct between two separate bodies – the new companies regulator and the CPMA. Indeed, we believe that such a split would significantly weaken market regulation and jeopardise investor protection.

Regulation of securities markets is a spectrum, with strong links between initial admission to the markets and continuing conduct in the market after admission. This is particularly apparent in the area of market abuse regulation, because market abuse can affect all aspects of markets, whether it occurs at the time of initial admission to the markets or later. It can be triggered equally by misleading disclosure in a prospectus, or by a failure to make timely disclosure in the secondary markets after admission of information that would have a significant effect on the price of listed securities. It can also be triggered by misbehaviour of market participants. This omnipresent nature of market abuse is implicit in the requirement of the Market Abuse Directive for each member state to appoint a single authority to administer the regime. As a result of this single authority regime, the FSA is able to share experience between its teams derived from different aspects of the market abuse regime – for example, what is inside information for the purposes of the directive and monitoring market leaks (which occur equally in relation to new admissions of securities and secondary markets).

Equally, effective monitoring and enforcement of the market abuse regime involves constant, real-time involvement with the market, something that the CPMA will (and must) have but the new companies regulator will not (and should not) have if it is to achieve its main purpose. The CPMA as markets regulator will thus necessarily continue to be responsible for developing (through its role as a member of ESMA) and enforcing the market abuse regime in relation to disclosure, both in the primary and the secondary markets. As market abuse affects the work of the UKLA as much as any other aspect of the market, this argues strongly in favour of the UKLA remaining as part of the CPMA. It is also important to recognise in this context that the team that discharges most of the UKLA's responsibilities under MAD does indeed have an operational interface with the FRC. However, we think that the benefits of keeping the UKLA's MAD team together in the same organisation with the rest of the MAD team significantly outweigh the benefit that would be achieved by institutionalising an FRC/UKLA operational interface that already exists and works well. This view is reinforced by the fact the proposed merger of

the UKLA with the FRC would introduce all the risks that flow from split responsibilities, and would appear to be proscribed in this respect due to the requirement to have single competent authority for the purposes of MAD.

Again, a prospectus will be only part of the disclosure that is made to the market in the context of a new issue of securities. In addition, there will be advertisements and other materials that are subject to regulatory regimes other than that applying to prospectus approval. For example, the UK's financial promotion regime under section 21 of the Financial Services and Markets Act 2000 will apply to such other materials as will the advertisement regime under the Prospectus Directive. The FSA has specific conduct of business and other rules dealing with these regimes; and it polices those through its close involvement with the markets, on a real-time basis. In addition, the financial promotion regime applies to securities that are not admitted to the regulated market, as well as those that are, and to other types of investment services, and will therefore naturally fall within the scope of the new CPMA. It therefore makes good sense that the UKLA should remain part of the CPMA.

Close, daily, involvement with the markets is also important in relation to the different share disclosure regimes. For example, disclosure of long positions in shares is required by the Transparency Directive. Disclosure of short positions is subject to the short-selling/market abuse regimes. It makes no sense to split the two. To do so would only lead to unnecessary inconsistencies between the two regimes. And, as the supervision of each depends on close market involvement, they are most obviously within the remit of the CPMA than that of the new companies regulator.

Another area of regulatory overlap that would suffer from the proposed split has to do with share buy-backs. These fall within both the market abuse regime (where they enjoy a safe harbour under EU law), which will be administered by the CPMA, and the listing rules, administered by the UKLA.

The proposed move of the UKLA to a new companies regulator would also complicate the process by which new entrants (such as PLUS and NYSE Euronext) are received into the UK and assessed. Such assessment requires views to be taken from a markets perspective, and therefore falls most obviously within the scope of the CPMA.

Powers of suspension provide another useful example of the danger of a split. The FSA can currently suspend public offers, suspend listing and suspend trading. All three of these suspension powers are part of the UKLA's tool-kit; the last also forms part of the enforcement regime of the markets regulator (and would therefore remain with the CPMA). A split of the UKLA from the CPMA would therefore give rise to significant scope for duplicative powers of intervention and possible conflict.

## **5 Representation in the European Union**

Most legislation and regulation relating to the admission of securities to regulated and other securities markets (and to listing of securities) emanates from the European Union. With the arrival of the new European Agencies, with increased powers over national regulators, this is likely to increase. Indeed, there are already signs that the EU may wish to go beyond policy and look at operational matters – take, for example, CESR's current exercise looking at best market practices, which attempts to harmonise operational activities across member states in relation to things like prospectus approval methodologies (including the appropriate levels of due diligence that should be carried out).

For example, the provisions of the Financial Services and Markets Act 2000 that relate to such admission and listing implement the Consolidated Admissions and Reporting Directive (2001/34/EC) and the Prospectus Directive (2003/71/EC). The detailed listing, disclosure and transparency and prospectus rules of the UKLA also reflect (and to a large extent copy out) EU legislation including: the Regulation under the Prospectus Directive (Regulation No 809/2004 EC); the Market Abuse Directive (2003/6/EC) and the Transparency Directive (2004/109/EC) and reflect guidance on interpretation of

those Directives and Regulation made by the Committee of European Securities Regulators (CESR), which is shortly to become an EU Agency (ESMA).

One of the main purposes of the European legislation and regulation is to create a cross-border securities market within the EEA. Consequently, the legislation provides for mutual recognition (for example, of prospectuses approved in an issuer's single "home" state), maximum harmonisation in relation to prospectuses (so that it no longer matters which EEA authority approves a prospectus, because the rules that are applied will be the same) and the concept that a single "home" state authority is to have jurisdiction. This construct necessarily results in most policy decisions in relation to the regulation of listing or admission of securities being taken at a European level, with little or no discretion left to the national authorities.

Other areas, such as market abuse and ongoing disclosure by listed companies, their directors and securities holders, are harmonised by the Market Abuse and Transparency Directives. These Directives do not impose maximum harmonisation, but allow member states to impose additional requirements – an option which the UK takes advantage of, as discussed below. It should be noted that the Prospectus Directive, Market Abuse and Transparency Directives are all subject to ongoing review by the European Commission, so the EU regime will continue to evolve.

Given this legal and regulatory background to admission and listing, it is crucially important that a member state's listing authority is able to take part in discussions at a European level that produce the law and rules. However, CESR only permits one body per member state to participate in its deliberations (an arrangement which ESMA will continue). Therefore, if the UK were to entrust primary market regulation (i.e. listing) to a companies regulator under BIS and secondary market regulation to the new Consumer Protection and Markets Authority (CPMA), the UKLA would lose its voice in the European forum. Instead of speaking for itself in EU debates, it would have to use the CPMA as its mouthpiece. This will inevitably be much less effective than (as at present) a single authority that regulates primary and secondary markets being able to attend CESR or ESMA meetings and to speak for itself. Equally, at a higher level, the UK would be represented not by one Ministry but two – both the Treasury and BIS – thus making discussions in European fora between governments that affect both listing and secondary market regulation more difficult.

It is no answer to say that this problem can be resolved by suitable liaison between two authorities charged with different aspects of ESMA's responsibilities, with the CPMA taking instructions from UKLA and relaying those instructions to ESMA at a meeting. Those attending such meetings will only have influence if they are able to respond to ideas developed during meetings (even if they were not initially on the agenda) and if, when a compromise is developed during discussion, they are able to express a credible view as to its acceptability to the national regulator, because they are the national regulator. Those who cannot speak authoritatively in this way at meetings of ESMA will carry much less weight with their peers. They will also be much less useful as ESMA members, because they will constantly have to be reserving positions while they report back to those with the power to decide and take instructions.

It is also no answer to say that the problem could be cured by ensuring that the right person from the right UK regulator attends meeting where matters within their remit are to be discussed. Most meetings will involve discussion of more than one subject. The UK representative with the seat at the ESMA table must be able to address all of them.

The UK cannot risk such a weakening of its voice in the European debates on regulation, which will become increasingly important. The international markets that treat the UK as their home need a strong voice in Europe. They are extremely important to the UK, European and global economies. They are also unlike the securities markets of most EU member states, in that they deal with a much more diverse range of securities, and also have a much wider range of participants, both as issuers and as buyers and sellers (both from within the EEA and from elsewhere), than other member states.



They also draw a much clearer distinction between wholesale and retail markets than most other EU states. Because of these differences, the international securities markets that are hosted by the UK can often be misunderstood by regulators from other member states. For all these reasons, a strong voice from a UK regulator representing all aspects of ESMA's activities (including both prospectus content and approval processes and market regulation) is needed, both at government and at regulator level, to protect the UK's international markets from the unintended adverse effects of regulation that is more suitable for the less complex and more domestic securities markets of many other member states.

It is difficult to see how a regulator that directly is responsible for only part of the work that is within the scope of CESR's or ESMA's brief would be able to do this – or, indeed, would ever be asked to act as chair of any EU committee or working group.

The direct representation of both the listing and other aspects of market regulation at a European level is particularly important in connection with the UK's super-equivalent regime (which imposes obligations on issuers whose shares are admitted to the UK's regulated markets with a premium listing). As its name suggests, this regime imposes obligations (such as those to do with corporate governance and requirements to put certain large transactions to shareholder vote) that are additional to those imposed by the EU directives. These obligations provide additional protections to investors and are highly valued by them. They are also generally thought to be desirable by issuers, because they provide reassurance to the market and therefore enhance their market reputation. No other EU admission regime imposes comparable obligations. In addition, there is flexibility under the Market Abuse and Transparency Directives to impose super-equivalent requirements in the areas that they regulate – for example, in relation to major holdings of securities in listed companies, the UKLA's rules require disclosure at a lower threshold than mandated by the Transparency Directive. However, the recent consultation by the Commission on the Transparency Directive asks whether this should be amended to become a maximum harmonisation directive, thus removing this flexibility. It would clearly be very important to issuers and investors who value the UK's super-equivalent regime that any debate within the European forum on the subject should directly involve the UK's listing authority. This will not be easily achieved if the listing authority is hived off into a separate organisation, as proposed in the Consultation Paper.

## **6 Risks of structural complexity**

We are not clear from the Consultation Paper whether the proposals involve a mother/daughter, sister/sister or daughter/mother relationship between the FRC and the UKLA. All that does seem to be clear is the proposal that, whatever the relationship of the one to the other, both should be ultimately supervised by BIS.

Such an arrangement would be a triple peak solution – with peaks for prudential regulation, market regulation and listing – which is very different from the twin peak model that was heralded by the Chancellor in his Mansion House speech. At a more detailed level of focus, it can also be seen that this tripartite structure would be apparent within markets regulation itself under the current proposals. With the prudential aspects of clearing and settlement regulation sitting within the Bank of England, and the current proposal to split primary from secondary markets regulation by spinning out the UKLA from the CPMA, there would be three principal authorities with powers over markets regulation. Many people partly blame the separation of powers under the current, tripartite, regulatory system, and the resulting “under-lap” or falling between the cracks, for the failures of regulators before and during the recent banking crisis. Recent experience thus indicates that separation of responsibilities creates risk and is something to be avoided, unless there are very compelling reasons for it.

## **7 No identified regulatory failure**

We can find no such reason to support the proposed split. No one attributes the recent market crisis to failures in the prospectus approval or listing process. Indeed, this aspect of regulation worked well before, and throughout, the crisis, facilitating the necessary recapitalisation of many companies. This view is confirmed by an independent survey carried out earlier this year for the UKLA, a summary of which is set out in the recent edition of List! (see [List!26 Newsletter]). In the calendar years 2008 and 2009, a combined total of £125 billion was raised by UK premium listed companies through further issues (Source: London Stock Exchange Statistics). We therefore do not think that any case has been made for the separation of the listing function from the market regulator and the desire to create a UK companies regulator certainly does not justify a change to current arrangements.

## **8 Conclusion**

The Listing Authority should remain as part of a single markets regulator within the CPMA. The role of the new companies regulator within BIS should be confined, in relation to premium listed equity issuers, to the development of corporate governance and other codes (together with financial disclosure and other such matters) which are then incorporated into the listing regime for such issuers, administered by the CPMA.

## Annex

### Introduction

This Annex is divided into two parts. The first gives an overview of the responsibilities of the UKLA and how in general terms these interact with other parts of the FSA. The second part further illustrates the interaction of the UKLA and other parts of the FSA by setting out in tabular format key areas of regulation relevant to some specific common types of transaction and where the relevant regulatory responsibilities lie.

The purpose of providing this information is to illustrate the shared involvement of different parts of the current FSA, and consequently the synergy benefits that exist from UKLA forming part of the larger FSA.

### Part 1 - Role of the UKLA

#### Overview

The UKLA is the name used by the FSA when acting in its capacity as the competent authority for the purposes of Part VI of the Financial Services and Markets Act 2000 (see Handbook Glossary). Under Part VI, the UKLA's specific responsibilities include:

- **Official listing** – it is the competent authority for the purposes of the Consolidated Admission and Reporting Directive (“CARD”). In this capacity it makes the Listing Rules (LR).
- **Prospectuses** – it is the competent authority for the purposes of the Prospectus Directive (“PD”). In this capacity it makes the Prospectus Rules (PR”).
- **Market information** – the FSA is the competent authority for the purposes of the Market Abuse Directive (“MAD”) but the UKLA in particular implements Article 6 of MAD, through the Disclosure Rules which form part of the Disclosure and Transparency Rules (“DTR”). In addition the UKLA is the competent authority for the purposes of the Transparency Directive (“TD”) in which capacity it makes the Transparency Rules which form part of the DTR.
- **Corporate governance** – under Part VI the UKLA also has the power to make corporate governance rules to implement EU obligations.

Under Part VI, the UKLA has powers not only to make rules to implement the relevant EU legislation referred to above, but in general also has powers to make additional super-equivalent rules (subject to EU obligations).

The UKLA has a range of supervisory and investigatory powers and sanctions which it may use to enforce its rules. These include powers of direct real-time intervention (for example, to suspend listing or public offers) as well as powers, after the event, to impose financial penalties or censure persons who are in breach of its rules. In practice these enforcement powers are integrated with the other investigatory and enforcement activities of the FSA.

The UKLA's functions and powers are discussed in more detail below.

#### Official listing – Listing Rules

**Scope:** The Listing Rules set out the criteria for admission to the Official List and certain continuing obligations of listed issuers. The Official List is divided into premium and standard segments and comprises some 21,000 lines of securities of which approximately:

- 600 are premium listed shares of UK commercial companies,

- 350 are standard listed shares (most of which are issued by overseas companies and/or investment companies or are preference shares),
- 500 are equity issued by closed ended investment funds (premium listing),
- 140 are equity issued by a small number of open ended investment companies (premium listing),
- 300 are depositary receipts representing shares of overseas companies (standard listing),
- 3,700 are securitised derivatives (eg. warrants issued by banks and linked to the price of a particular index, commodity or share price) (standard listing),
- the remainder (approx. 15,000) are debt issued by issuers of many nationalities (standard listing).

**Premium listing:** In addition to the eligibility requirements mandated by CARD in respect of admission to the Official List, the LR include super-equivalent rules which apply only to issuers of shares and investment entities with a premium listing. The super-equivalent rules relate, in particular, to:

- eligibility for listing,
- the role and supervision of sponsors,
- listing principles (general principles regarding continuing behaviour of issuers),
- disclosure and shareholder approval of substantial and related party transactions,
- share buybacks, and
- corporate governance.

The UKLA discharges its duty to determine whether its eligibility requirements are satisfied in relation to premium listing applicants in part through the sponsor regime – relying on confirmations from sponsors as to certain matters. Thus the sponsor regime is a fundamental part of investor protection in relation to premium listings.

**Standard listing:** The LR also contain provisions relating to the standard listing requirements for shares, debt and debt-like securities, certificates representing securities, securitised derivatives, and other miscellaneous securities. The standard listing regime essentially reflects the EU minimum standards.

Under the LR, the UKLA approves listing particulars for certain types of securities which do not fall within the scope of the PD including securities which are to be admitted to trading on the Professional Securities Market (which is not a regulated market).

**Decision-making and enforcement:** In deciding to admit securities to listing the UKLA does not make an assessment of suitability for listing, on the basis that this should be a decision for investors, based on their own risk assessment. In accordance with its obligations under Part VI the UKLA will assess whether the eligibility requirements of its rules are complied with by the issuer. The UKLA may refuse to grant a new listing if it considers granting listing would be detrimental to the interests of investors. It may also cancel or suspend a listing where there are circumstances which preclude normal regular dealings in securities.

The Listing Applications team is involved in maintaining the Official List, which involves daily admissions of securities, delisting securities as they are redeemed or cancelled and suspending securities in response to market events. Given the number of securities in issue, the maintenance of the Official List is a significant undertaking which occurs on a real-time basis, and which is necessarily responsive to market and is closely related to the Company Monitoring function.

A number of the super-equivalent rules, in particular, involve disclosure requirements which are monitored and enforced by the Company Monitoring team alongside the DTR disclosure requirements and which

involve market monitoring on a real-time basis and intervening if necessary, for example to force disclosure or suspend listing.

**Interaction with other parts of FSA:** The functions of the UKLA under Listing Rules interact with other parts of FSA regulation in a number of areas. In particular:

- As regards supervisory functions there is an overlap in the area of sponsor supervision. The sponsor regime requires sponsors to support listing applications and certain other transactions by premium listed companies. The UKLA has a separate sponsor supervision function in relation to the sponsor regime, which requires it to supervise entities – such as investment banks, stock-broking firms and corporate finance advisory boutiques – in their capacity as market participants. Sponsors are required to be independent, and the independence rules bear a close relationship with FSA conduct of business rules relating to conflicts of interest.
- The power to suspend or cancel listing overlaps with the power of the FSA to suspend trading of securities under the rules based on MiFID. The UKLA exercises its power to suspend or cancel listing in co-ordination with the London Stock Exchange, so that any suspension or cancellation is concurrent with a suspension or cancellation of trading on the regulated market.
- The super-equivalent rules on share buybacks have a close relation with the market abuse functions of the FSA's markets division, since buybacks fall within the safe harbour to market abuse laid down by the Buy-back and Stabilisation Regulation (2273/2003/EC) made under MAD.
- The premium listing regime for investment entities has linkages with the UCITS regime.

## **Prospectuses - Prospectus Rules**

**Scope:** The Prospectus Directive is a maximum harmonisation directive and hence the UKLA has little discretion in terms of the content of the PR. The responsibility of the UKLA under Part VI is for approving prospectuses in relation to both:

- applications to trading on a regulated market, and
- other public offers.

The prospectus requirements apply to most types of transferable securities (including shares, wholesale and retail debt and derivative securities, asset backed securities, depositary receipts over shares and convertible securities), including securities issued by governments and local authorities.

The UKLA has responsibility for approving prospectuses not only of UK issuers seeking admission of securities to the Official List but also of:

- UK issuers seeking admission to a regulated market without seeking admission to the Official List (this may include entrants to markets such as PLUS or NYSE Euronext);
- non-EU issuers seeking admission to trading on a regulated market in the UK, if the UK is the “home state” for such issuers;
- non-EU issuers making public offers of securities in the UK without seeking admission to trading on a regulated market in the UK, if the UK is the “home state” for such issuers;
- UK or non-UK issuers making public offers of securities which are to be admitted to markets other than regulated markets in the UK, such as the Alternative Investment Market (“AIM”) or the Specialist Funds Market (these markets are regulated by the London Stock Exchange).

As suggested by the statistics given above in relation to the proportion of securities on the Official List which are non-equity, only a very small number of issues that are admitted to the Official List are subject to prospectuses approved by the FSA that relate to UK equity securities.

**Decision-making process:** The UKLA, in accordance with its obligations under Part VI, reviews prospectuses for the purpose of ascertaining that the prospectus contains the information required by the PD; it does not assess the suitability of the securities for admission to trading or public offering, although it has power to require additional information necessary for investor protection.

Under the “pass-porting” regime the UKLA does not have the power to review prospectuses of entities whose home state is not the UK, but will receive a certificate of approval from the approving competent authority in the relevant other member state.

**Preventing securities offers without an approved prospectus:** Beyond simple approval of prospectuses, the UKLA is responsible for policing the perimeter of the prospectus regime. This is a market regulatory and investor protection role which involves policing the making of public offers or admissions to trading on a regulated market without a prospectus. This includes determining the applicability of the exemptions to the prospectus requirement (these are laid down partly in FSMA and partly in the PR).

**Advertising regime:** The prospectus regime includes rules relating to other marketing materials in connection with an offer of securities (the “advertisement regime”). Enforcement of these rules can require real-time monitoring of marketing materials or events initiated by a range of market participants, including not only issuers, but also FSA-authorized persons such as investment banks and research analysts.

**Enforcement:** The enforcement of the public offers regime involves real-time monitoring. The UKLA has power to suspend a public offer if it is being made in breach of the prospectus rules.

## **Market information - Disclosure and Transparency Rules**

**Scope:** Article 6 of MAD and the TD are both concerned with market disclosure requirements which are intrinsic to fair and efficient markets. The DTR cover various elements of market disclosure derived from these directives as follows:

- DTR 2 – timely disclosure of inside information; control of inside information; insider lists (Article 6 of MAD)
- DTR 3 – disclosure by company insiders of dealings in securities (Article 6 of MAD)
- DTR 4 – disclosure of ongoing financial information (annual, half-yearly and interim) (Articles 4, 5 and 6 of TD)
- DTR 5 – disclosure of major share interests held by investors in UK issuers (including AIM issuers) and non-UK issuers for which the UK is the home state (Articles 9 to 16 of TD)
- DTR 6 – the mechanics of disclosure, and disclosure of information about meetings of securities holders (Articles 17 and 18 of TD).

**Enforcement:** The timely and fair disclosure of price-sensitive information is fundamental to market confidence and market efficiency. It is a key regulatory focus for the UKLA, which closely monitors company announcements, and dealing in company securities, in order to ascertain whether issuers are fulfilling their obligations to “disclose inside information as soon as possible” (DTR 2.2). This involves day-to-day monitoring of the market and a clear understanding of what information will constitute inside information in relation to a particular company. For example, the UKLA Company Monitoring team regularly investigates instances where sharp movements in the price of an issuer’s traded securities following an announcement by the issuer imply that the issuer may not have been complying with its obligations to announce inside

information to the market in a timely fashion. Such investigations have led to a number of instances of companies having full enforcement action taken against them, resulting in financial penalties being levied.

**Disclosure Rules and interaction with other parts of the FSA:** There is a close degree of coordination between the Company Monitoring function of the UKLA and the broader market abuse function of the FSA's Markets Division.

The FSA has responsibility for all aspects of market cleanliness: it is the authority empowered to enforce those parts of MAD implemented under ss.118 to s.123 FSMA (market abuse) as well as the elements of MAD which are implemented under DTR 2 and 3. In addition, the FSA is the prosecuting authority for the insider dealing offence under the Criminal Justice Act 1993 and for the misleading statements and practices offence under s.397 FSMA.

The obligation of prompt disclosure of inside information under the DTR is an intrinsic part of the market abuse regime. The UKLA has an additional role in ensuring clean markets through:

- its Model code for Premium Listed companies, which is designed to ensure directors do not deal in securities when there is, or might be perceived to be, unpublished inside information relating to their company, and
- the reporting obligations under DTR 3.

The benefits of combining the regulation of market abuse under a single regulator are implied by MAD which expressly states that there should be a "single" competent authority to ensure the application of MAD's provisions. These benefits include a common approach to the interpretation of "inside information" and to practical judgements about what information is inside information; and a co-ordinated monitoring and enforcement regime. In particular, the FSA has a range of sanctions available to it, in relation to instances of market abuse, but market participants benefit from clarity and certainty knowing that behaviour that could count as more than one rule breach or offence will be dealt with by a single regulator and with no risk of double jeopardy. For example:

- cases involving insider dealing might constitute market abuse under s.118 or insider dealing under CJA 1993 and, if committed by a person connected with a director, might also involve breaches of the model code and of the directors' dealing disclosure obligations under DTR 3. The FSA can investigate the dealings and the behaviour of the parties involved, make a determination as to whether information is inside information, and decide which type of sanction would be most appropriate to pursue. As a matter of policy, the FSA will not bring both a criminal charge and a market abuse action;
- an announcement of misleading information by a premium listed company could potentially be:
  - a breach of DTR 2.2 and Listing Principle 4
  - market abuse and/or
  - a breach of s.397 FSMA.

The FSA will deal such an occurrence under a single enforcement action. For example, in 2004 Shell, which had made misleading disclosures concerning reserves, received a Final Notice which found both (what would now be) DTR and LR breaches and market abuse, while the sanction (a significant fine) was stated to be for market abuse alone.

The collaboration required to co-ordinate enforcement under different headings would inevitably be less effective if it required co-operation of separate organisations with different objectives and potentially different financial arrangements regarding enforcement of actions and the use of proceeds of financial penalties. There would also be at least a perceived risk by market participants of double jeopardy, which could make the UK capital markets less attractive, in particular, to foreign participants.

Policy and application of the market conduct rules and enforcement of s.118 FSMA by the FSA's market conduct division inevitably have a close relationship with policy and application of DTR 2. The subject matters of two recent FSA publications illustrate this:

- Marketwatch 35 (July 2010) dealt with disclosures to the market by brokers selling shares on behalf of directors where this might constitute improper disclosure under s.118 FSMA; but the question of whether the information is inside information, in particular its price sensitivity, is one that is dealt with on a routine basis by the UKLA, which is also responsible for determining when an issuer is obliged to disclose such information to the market under DTR 2.
- Marketwatch 37 (September 2010) dealt with controls within regulated and unregulated firms and issuers regarding inside information with a view to preventing leaks. Again, the improper disclosure of inside information may constitute market abuse under s.118 FSMA, but may also involve breaches of an issuer's obligations to control inside information under DTR 2.

Guidance and policy information on topics such as these would inevitably be less efficient if it required the co-operation of two separate organisations.

**Transparency Rules and interaction with other parts of the FSA:** Another feature of efficient markets is transparency regarding significant positions in a company's securities. This area of regulation is split between UKLA rules (DTR 5) for disclosure of long interests in shares and related financial instruments and FSA rules (FINMAR) related to certain short selling disclosure requirements. These areas of regulation both require an understanding of complex financial instruments, and the calculation of such interests requires similar techniques; it makes sense for these to be under the same regulatory authority.

### **Corporate governance – DTR 7 and LR 9.8.6(6), LR 9.8.7, LR 9.8.7A**

The FSA's corporate governance rules, which are contained in DTR 7, relate to audit committees and corporate governance statements. They can be distinguished from other areas of UKLA regulation in that they do not originate from the EU financial services legislation but from EU company law directives. Under super-equivalence provisions the UKLA extends the application of the requirements relating to corporate governance disclosures to non-UK companies with a premium listing and to GDRs.

In addition, the Listing Rules contain the super-equivalent requirement for premium listed companies to comply or explain against the UK Corporate Governance Code..

### **Other areas of regulation relevant to UKLA activities**

Two further aspects of financial services regulation which the UKLA does not itself oversee but which are particularly relevant to the transactions by listed issuers which it does regulate are:

- the financial promotion regime (s.21 FSMA) – this overlaps with disclosure requirements under the Listing, Prospectus and Disclosure and Transparency Rules and in particular with the advertising regime under the Prospectus Rules
- the FSA's conduct of business rules for authorised persons (COBS), many of which implement provisions of the Markets in Financial Instruments Directive (MIFID).

The relevance of these rules to market transactions in respect of which the UKLA will have key monitoring and regulatory functions are illustrated by the examples set out in the tables below.



## Part 2 – Examples of transactions and issues dealt with by UKLA

Set out below, in tabular format, are the areas of regulation that are pertinent to a number of typical transactions or other issues that involve UKLA regulation, showing also where other parts of the FSA or other regulators will be involved.

Those parts of the FSA which are expected to form part of the Consumer Protection and Markets Authority (other than the UKLA) are referred to in these tables as the “CPMA”.

### Example 1: IPO (premium listing) by a UK plc

Issue arising on transaction	Regulator principally responsible (UK and where applicable EU)	Relevant rules (UK and where applicable EU)
Premium listing application	UKLA	LR
Role of sponsor	UKLA / CPMA	LR / COBS
Prospectus	UKLA / ESMA	PR / PD
Role of underwriter	CPMA	COBS / MIFID
Issuer publicity	CPMA	Financial promotion
	UKLA / ESMA	PR / PD Art 15
Bank sales force / syndicate activity	CPMA / ESMA	COBS / MIFID
	CPMA	Financial promotion
	UKLA / ESMA	PR / PD Art 15
Stabilisation	CPMA / ESMA	MAR 2 / MAD
Analysts research	UKLA / ESMA	PR / PD Art 15
	CPMA / ESMA	COBS / MIFID
	CPMA	Financial promotion

### Example 2: Abbreviated bookbuilt placing of significant shareholding in listed company by an investment bank on behalf of a director of the listed company

Issue	Regulator principally responsible	Relevant rules
Issuer announcement	UKLA / ESMA	DTR 2 / MAD
Director announcement	UKLA / ESMA	DTR 3 / MAD
Major shareholding announcement	UKLA / ESMA	DTR 5 / TD
Role of bookrunner (bank)	FSA / ESMA	COBS / MIFID
Bank salesforce activities:		

<b>Issue</b>	<b>Regulator principally responsible</b>	<b>Relevant rules</b>
• general duties	CPMA / ESMA	COBS / MIFID
• communications	CPMA	Financial promotion
• disclosure of inside information	CPMA	s.118 FSMA / MAD

### **Example 3: Substantial acquisition by premium listed company funded by rights issue**

<b>Issue</b>	<b>Regulator responsible</b>	<b>Relevant rules</b>
Inside information	UKLA / ESMA	DTR 2 / MAD
Prospectus	UKLA / ESMA	PR / PD
Class 1 circular	UKLA	LR
Role of bank as sponsor	UKLA	LR
Role of bank as underwriter	CPMA / ESMA	COBS / MIFID
Pre-marketing communications	UKLA / ESMA	PR / PD Art 15
	UKLA / ESMA	DTR /MAD
	CPMA	Financial promotion
Announcement of issue	UKLA / ESMA	DTR 2
Major shareholding disclosures	UKLA / ESMA	DTR 5 / TD
Short selling disclosures	CPMA	FINMAR
Announcement of results	UKLA	DTR / MAD
Placing of rump	CPMA	COBS / MIFID / MAD

### **Example 4: Suspected insider dealing in shares of listed company**

<b>Issue</b>	<b>Regulator principally responsible (UK and, where applicable, EU)</b>	<b>Relevant rules</b>
Unusual share price movement	UKLA (Company Monitoring) / FSA (Market Monitoring)	s.118 FSMA / MAD
Identification of inside information	UKLA / CPMA	DTR / s.118 FSMA / MAD
Dealing investigation	CPMA	s.118 FSMA / MAD
Enforcement	CPMA	s. 118 FSMA / CJA 1993



LLOYD'S MARKET ASSOCIATION

10 September 2010

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Dear Sirs

**Treasury Paper: A new approach to financial regulation  
July 2010**

**LMA introduction**

The Lloyd's Market Association (LMA) represents all the managing agents at Lloyd's, which manage the syndicates underwriting in the market, and also the members' agents, which act for third party capital. The Lloyd's market premium capacity for 2010 is £22.9 billion.

Whilst this response is distilled from the views of our members, the views of individual members may differ.

Abbreviations:

Paragraph references below are to the HM Treasury paper  
CPMA = proposed Consumer Protection and Markets Authority  
EIOPA = European Insurance and Occupational Pensions Authority  
FSMA = Financial Services and Markets Act 2000  
PRA = proposed Prudential Regulatory Authority

**General points**

The LMA recognises the need for strong regulation in the UK financial services sector and it is essential that this should work to increase market efficiency. We would like to make the following points on the Treasury's proposals:

- 1 We are concerned that the proposed architecture is essentially being created around the banks, where the problems lay in the current crisis and where the continuing source of systemic risk will lie; and that the result of this will be a system of regulation which is over-engineered, unsuitable and unjustifiably costly for the general insurance industry.
- 2 The consultation paper discusses the overlapping roles of the PRA and CPMA, and repeatedly emphasises the need for them to work closely together through an elaborate system of governance, which seems to defeat the reasoning



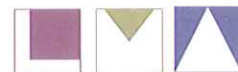
behind the creation of two regulators rather than enhancing the effectiveness of one.

### Lloyd's market

- 3 There is one paragraph on Lloyd's [Para 5.25], where it is proposed that some activities of managing and members' agents would fall to the PRA to regulate and some to the CPMA. Therefore, managing and members' agents would face triple-regulation, since Lloyd's itself is a statutory regulator.
- 4 Were it to be proposed that the managing agency team in the FSA would move to the PRA, this would give rise to a number of questions:
  - how many staff will be required in relation to managing and members' agency supervision in the CPMA?
  - What will they do (i.e. over and above work currently carried out by the FSA managing agency team)?
  - Will there be a lack of Lloyd's market expertise in the CPMA, if the FSA team goes to the PRA? Over ten years, the FSA has built up considerable expertise and this cannot be gained by the CPMA overnight.
  - How will duplication be avoided? Even within the FSA, as one organisation, this is a danger. It will be exacerbated across two organisations whatever governance arrangements are put in place, since each regulator will want to be effective in its own right?
  - How will consistency be achieved between the regulators, for example, in considering authorisations and permissions for firms and people?
  - How much extra cost will this involve in terms of levy to pay for two supervisors (effectively for the CPMA team, which will have to be trained, if the FSA team goes to the PRA)?
  - How much extra internal costs will managing agents have to bear, for example, if there are dual systems for authorisations, permissions, regulatory reporting, visits (ARROW-equivalents for PRA and CPMA)?
  - Will ARROW-equivalent visits, and the preliminary information requests made to managing agents, be co-ordinated by the two regulators?
  - How will the levy paid to Lloyd's, as a supervisor, be brought into account in assessing the overall cost of regulation for managing and members' agents?

We should be grateful if the Impact Analysis could be extended to cover these points.

- 5 We are concerned that these changes will take place concurrently with three major EU initiatives: Solvency II, which is currently consuming considerable resources within managing agents, Lloyd's and the FSA; the Intermediaries Directive Review, which we would expect to gather pace from this Autumn; and the setting up of the new EU super-regulator, EIOPA. Our concerns relate not only to UK government, regulators and firms taking their eyes off the ball when these initiatives are being negotiated and developed, because of the fundamental re-organisation of UK regulation; but also in managing the changes on several fronts when there is a finite amount of real expertise



available (and for which the government and new regulators will be competing).

### **PRA and CPMA rulebooks**

- 6 A considerable knowledge has been built up in relation to the FSA Handbook, as this has developed following industry consultation over more than ten years – we are concerned about the time and cost of preparing two rulebooks, and associated training, both for regulated and regulators.
- 7 We are particularly concerned with duplication of rules and potential inconsistencies – to take three examples, in the areas of levying, authorisations and enforcement (discussed below) – exacerbated by the UK tendency to “gold-plate” EU directives and regulations.
- 8 Levies: we strongly support the proposal that the CPMA raises levies on behalf of itself and the PRA (as well as for the FOS and FSCS), given that the CPMA will have contact with all regulated firms, to avoid duplication [Para 4.41].
- 9 Authorisations and permissions: for the same and additional reasons, we would argue strongly that the authorisation process for both firms and individuals should be run by the CPMA or centralised [Consultation Question 5]. This would minimise the risk of conflicting decisions and lack of consistency.
- 10 Enforcement: it is proposed that both the PRA and CPMA have their own enforcement functions [Para 3.25]. We do not believe it would be efficient to run parallel procedures and tribunals, and separate teams with the specialist skills; an enforcement case may involve both “prudential” and “conduct” aspects. Therefore, we believe this should be centralised.
- 11 We see no prospect of government being able to reduce substantially the statutory framework and rulebook of the PRA (as envisaged by Para 3.24) unless account is taken of these matters.

### **Lloyd’s brokers**

- 12 We understand that a firm proposal has not been made by the Treasury as to whether Lloyd’s brokers will be regulated just by the CPMA or by both the CPMA and PRA. We would make the following points:
  - a considerable amount of funds of managing agents and policyholders are held at any given time by Lloyd’s brokers, and therefore their financial strength is important for the market;
  - a managing agent may now be a related company of a Lloyd’s broker (since the legislative changes in 2008)
  - some managing agencies own service companies which sell insurance and which are appointed agents rather than authorised in the own right by the FSA.



- 13 Our view is that as much as possible of Lloyd's market regulation should be kept in one place, with supervisors who are experts: if it is the case that the FSA managing agency team will be located within the PRA, then regulation of Lloyd's brokers should also rest primarily with the PRA.

### Members' Agents

- 14 There are three firms of members' agents, which are LMA members. We understand that the powers of the FSA in relation to individual members of Lloyd's (which are not individually authorised at present) may be transferred to the PRA. Given this, and if it is the case that expertise in relation to Lloyd's will be concentrated in the PRA, we would advocate that members' agents are also regulated by the PRA. However, for all the reasons given above, duplication with the CPMA should be absolutely minimised.

### Impact assessment

- 15 The transitional costs of public authorities (Treasury, Bank, PRA, CPMA and FSA) in proceeding are estimated at £50 million spread over 3 years: we believe the costs of such extensive change over this period may significantly exceed this (some of the larger Lloyd's managing agencies are each spending £10m to £20m on Solvency II development alone, and there are 50 managing agencies of varying size operating in the market.).
- 16 The Treasury assessment is that some 1,500 to 2,000 firms would be supervised by the PRA and CPMA; that the effect of ongoing costs for these firms will be minimal; that these firms or groups are likely to incur more significant transitional costs; and that small firms taking deposits and "carrying out insurance contracts" would be supervised by the PRA as well as the CPMA.
- We do not believe ongoing costs will be minimal if firms are faced with substantial overlapping powers and rulebooks.
  - Transitional costs are likely to be significant for PRA/CPMA firms.
  - Where EEA firms apply for a passport from their home state regulator, will they effectively have a cheaper entry to the UK market than a UK start-up, which would need multiple approvals?

We should be grateful if you could take into account the views above expressed by the Lloyd's Market Association.

Yours faithfully

**David Gittings**  
Chief Executive

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

### **Lloyd's response to HM Treasury's consultation paper**

#### **1 Introduction**

- 1.1 We welcome the opportunity to comment on HM Treasury's consultation paper.
- 1.2 Lloyd's is a society of underwriters that operates as an insurance and reinsurance market. Its aggregate gross written premium income in 2009 was £22bn, 80% of which came from outside the UK<sup>1</sup>. Lloyd's is at the heart of the London insurance market, the world's leading international insurance and reinsurance centre, estimated to employ 50,000 people across the UK as well as many others in support services<sup>2</sup>.
- 1.3 As an international provider of insurance and reinsurance, Lloyd's has a close interest in proposals to change the UK's system of financial supervision. Lloyd's international competitiveness requires its home state supervisory system to be credible and competitive: credible, because Lloyd's ability to trade in other jurisdictions depends on acceptance of the efficacy of supervisory arrangements for Lloyd's; competitive, because the Lloyd's market must attract underwriting talent and capital from international companies, who will not invest if unnecessarily onerous and expensive regulations inhibit effective use of capital.
- 1.4 Our experience of being regulated by the FSA has been positive. The FSA has been a leading insurance regulator, with a strong and internationally acknowledged reputation for the quality of its supervision of general insurance. We do however recognise that, due to the banking crisis, the Government has determined that fundamental change is required to the UK's system of financial regulation. We do not seek to oppose this, but are concerned to ensure that the system of insurance regulation that has served the UK industry well over the last nine years is not damaged, as the Government seeks to address perceived inadequacies in the management and supervision of systemic risk within the banking sector.
- 1.5 Our comments are organised as follows:
  - 1.5.1 Executive Summary
  - 1.5.2 The regulation and supervision of Lloyd's
  - 1.5.3 Important issues not covered by the consultation document's questions.
  - 1.5.4 Responses to consultation questions

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<sup>1</sup> Lloyd's *Annual Report 2009* see <http://www.lloyds.com/The-Market/Tools-and-Resources/Publications>

<sup>2</sup> IFSL Research: [International Financial Markets in the UK](#), May 2010

## 2 Executive summary

2.1 The key points that we wish to make are set out below.

### 2.2 Supervision of Lloyd's

- The current arrangements for the authorisation and prudential supervision of Lloyd's and Lloyd's firms work well and should be retained under the new structure of financial supervision.
- Prudential supervision of the Lloyd's market should continue to be handled by a single authority. Following the proposed restructuring, the PRA should supervise the Society of Lloyd's, its relevant subsidiaries and the Lloyd's managing and members' agents currently authorised by the FSA. They constitute a comprehensive whole and should be supervised together. Fragmentation of this supervision across two regulatory authorities is unnecessary and inappropriate.
- The PRA's oversight of Lloyd's should continue to take account of Lloyd's oversight of risk within the market and its role in ensuring capital adequacy.
- Current authorisation arrangements under the Financial Services and Markets Act 2000 (FSMA) do not require members to be authorised persons. A restructuring of the regulatory architecture does not necessitate any change to the current system, which reflects the unique structure of Lloyd's and which ensures that regulatory objectives are met. Any requirement for the supervisory authorisation of members would duplicate Lloyd's own processes and place a substantial additional burden on the authorising body, without enhancing prudential supervision.

2.3 **Insurance regulation and supervision:** Contrary to the assertions of the Consultation Document, UK insurance supervision has not been "light touch". As was recognised by the Turner Review, insurers in the UK are subject to a much more demanding capital assessment system than exists in most other EU member states.

2.4 **Insurance and banking:** It is troubling that the approach set out in HM Treasury's document focuses almost entirely on supervision and regulation of banks, with insurer supervision treated as an afterthought. The new structure must recognise that insurance has a fundamentally different business model from banking. UK financial supervision must recognise the necessary differences between banking and insurance regulation.

2.5 **Interaction with the EU:** Much greater consideration must be given to how the proposed new structure and multiple agencies will interact with the EU. The UK must continue to be a strong and effective voice in the development of financial services regulation and supervisory issues within the new European Supervisory Authorities, supervisory colleges and other European institutions.

2.6 **Transitional arrangements:** The transition to the new structure will be a major upheaval. The insurance industry and the FSA are currently focused on implementing Solvency II, the FSA's largest single project and the biggest change in insurance regulation in European for over 30 years. It is imperative that the transition



process is well managed and does not prejudice the ability of the FSA/PRA and industry to ensure an orderly implementation of the new prudential solvency regime.

## 2.7 **Supervision of insurance intermediaries**

- All insurance intermediaries, including wholesale insurance brokers doing business in the London market, should be subject to CPMA oversight. The CPMA's internal structure must therefore make proper provision for the supervision of wholesale intermediaries.
- Controls over appointed representatives should be supervised by the authority regulating a representative's principal. For representatives appointed by insurers this will be the PRA. The CPMA will maintain the UK's register of insurance intermediaries, which will include appointed insurance representatives.

2.1 **Coordination between authorities:** The new regime must avoid duplication of regulatory oversight and measures must be in place to ensure proper and effective coordination between the new authorities. The two authorities should have a formal agreement in relation to firms subject to supervision by both, under which there is a single lead authority for each such firm.

2.8 **The Financial Policy Committee (FPC):** The FPC's anticipated role means that it must have access to sufficient levels of insurance expertise. At least one member should have experience in insurance, to provide a more balanced and informed view.

## 2.9 **The Prudential Regulatory Authority (PRA)**

- The PRA's internal structure should include a separate insurance division headed by a senior and respected individual, at the same level of seniority as the person responsible for banking regulation.
- Principles of good regulation must continue to apply to the PRA. It must continue to have regard for the international character of financial services and the desirability of maintaining UK competitiveness.
- The PRA's rule-making process must retain the full range of statutory safeguards that exist under FSMA.
- The PRA's decision-making process must be subject to appeals to the Upper Tribunal and a complaints mechanism.

2.10 **Authorisation:** Firms and persons should not have to be authorised by more than one supervisory body. A lead authority should be responsible for all a firm's authorisations, as well as those of its staff performing controlled functions.

## 2.11 **The Consumer Protection and Markets Authority:**

- Lloyd's primary concerns centre on the PRA. Nevertheless, similar considerations apply to the CPMA, which should be subject to comparable principles and statutory safeguards.
- The proposal that the CPMA acts as a "consumer champion" could affect its relationship with supervised entities and therefore its ability to achieve its primary objectives.

### 3 The regulation and supervision of Lloyd's

#### 3.1 Regulatory arrangements

- 3.2 Lloyd's is a statutory corporation, incorporated by Lloyd's Act 1871 and governed by Lloyd's Acts 1871 to 1982. Its principal objectives are the carrying on by its members of insurance business on their own account and the advancement and protection of their interests in connection with their business. Lloyd's governing body is the Council, established by Lloyd's Act 1982. Under this Act, it has the power to manage and supervise the affairs of Lloyd's, to regulate and direct the business of insurance at Lloyd's and to exercise all of the powers of Lloyd's. The Council has power to make byelaws to further the objects of Lloyd's.
- 3.3 EU insurance directives apply to the "association of underwriters known as Lloyd's"<sup>3</sup>. This approach acknowledges Lloyd's structure. All insurance business is carried on by members trading on their own behalf, but Lloyd's centrally (the Society or Corporation of Lloyd's) has responsibilities and makes arrangements for financial security and policyholder protection, meaning that it should be supervised as a single, collective entity. So EU insurance directives apply to Lloyd's as a collective body.
- 3.4 The FSA is responsible for regulating Lloyd's, managing agents and members' agents. Arrangements under the Financial Services and Markets Act 2000 (FSMA) for the authorisation and supervision of Lloyd's and Lloyd's market firms recognise the market's unique characteristics and Lloyd's responsibilities for market conduct and financial stability. Details of authorisation arrangements are set out in the annex.
- 3.5 We note the Government's intention to consider further how Lloyd's regulated activities will be supervised<sup>4</sup>. We welcome the opportunity to discuss with HM Treasury, the Bank and the FSA the optimal division of responsibility for supervision of the Lloyd's market.
- 3.6 The existing arrangements for the FSA's prudential oversight of Lloyd's, in combination with the Corporation of Lloyd's extensive systems of market supervision and control, have worked well. Since the FSA took over responsibility for the supervision of Lloyd's in October 2001 the Lloyd's market has been profitable in seven out of eight years, increasing the total resources of the Society and members from £4.1bn (31 Dec. 2001) to £19.1bn (31 Dec. 2009) and member capacity from £11.3bn (2001) to £18.1bn (2009)<sup>5</sup>.
- 3.7 During this period Lloyd's has dealt with the consequences of catastrophic losses, such as the terrorist attacks on New York on 11 September 2001, the 2005 Atlantic hurricane season and the 2010 Chilean earthquake. Yet all valid claims have continued to be paid. Furthermore Lloyd's, like other general insurers, played no part in the development of the global financial crisis of 2007 – 8. Throughout the crisis Lloyd's remained profitable, achieving a return on investments and strengthening its balance sheet.

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<sup>3</sup> First Non-Life Directive Art. 8(1); Life Directive Art. 6(1); Solvency II Directive Annex III

<sup>4</sup> Consultation Document para 5.25

<sup>5</sup> *Statistics relating to Lloyd's 2010* edition

### **3.8 Prudential supervision of Lloyd's and the Lloyd's market**

- 3.9 The overall objective of prudential supervision of Lloyd's is to minimise the risk that members of Lloyd's will be unable to pay valid claims.
- 3.10 The FSA's principles and high level requirements are contained in the High Level Standards block of its handbook. Many relate to prudential supervision and we expect the PRA to apply them to Lloyd's and Lloyd's firms following the restructuring.
- 3.11 The FSA's remaining prudential requirements are set out in the Prudential Standards handbook block. INSPRU 8 applies these rules to Lloyd's and managing agents. The Society of Lloyd's is required by the FSA to meet various prudential requirements, including:
- Establishing and maintaining systems and controls to address risks affecting the Lloyd's market.
  - Managing prudential, credit, market, liquidity and operational risks affecting members' funds at Lloyd's and Lloyd's own assets; and
  - Ensuring that members' financial resources are adequate to meet the liabilities assumed by them in respect of their insurance business at Lloyd's.
- 3.12 Consequently, the Corporation of Lloyd's devotes substantial resources (at least 150 people) in its Performance Management, Risk Management and Finance areas to ensure that risk is managed across the Lloyd's market. Lloyd's monitors, guides and directs managing agents' activities and the financial position of Lloyd's members. With regard to capital adequacy, Lloyd's assesses each member's capital needs using Lloyd's Economic Capital Assessment model and conducts an annual solvency test at individual member and aggregate market level. With regard to the management of underwriting risk, Lloyd's reviews and approves syndicate business plans, which must be prepared in accordance with Lloyd's guidelines and monitors syndicate performance against those business plans. It has a dedicated risk management function, to identify and manage the key risks which affect the Lloyd's market overall and individual managing agents. For example, each syndicate must report regularly to Lloyd's its loss estimates from a series of hypothetical disaster scenarios, using consistent and appropriate methods and assumptions. This is one tool used by Lloyd's to monitor and manage the aggregation of risk in the market.
- 3.13 Managing agents are required by the FSA to:
- Establish and maintain appropriate controls over risks affecting insurance business carried on through syndicates, including credit risk and market risk, within limits that are substantially the same as those for insurance companies.
  - Assess the capital needed to support the insurance business carried on through each managed syndicate (the syndicate ICA).
- 3.14 As managing agents and members' agents are subject to the regulatory oversight of both the FSA and the Corporation of Lloyd's, the FSA and Lloyd's have a formal agreement on Co-operation Arrangements, dated August 2007 (copy attached). This sets out the arrangements by which the FSA and the Corporation of Lloyd's co-operate on supervision, to ensure its effectiveness and efficiency. In determining its oversight of managing agents and members' agents the FSA takes account of the very significant controls exercised over the market by the Corporation (as required

under INSPRU). These arrangements are well established and have proven to be very effective.

3.15 The implementation of Solvency II will require some modification to these arrangements to reflect wider changes to the prudential regime. Lloyd's and the FSA agree that FSA oversight will continue to be focused at the aggregate market level, so as to ensure the prudential solvency of "the association of underwriters known as Lloyd's". The FSA will therefore continue to take account of the work performed by Lloyd's in overseeing the management of risk by managing agents and at market level and its role in ensuring the adequacy of capital.

3.16 These arrangements should continue in place after the PRA assumes responsibility for prudential supervision of Lloyd's and Lloyd's managing agents, albeit subject to any amendments necessary to reflect the new architecture. They are effective in ensuring that all valid claims on Lloyd's policies continue to be paid, recognise Lloyd's structure and formal legal status and avoid unnecessary duplication.

3.17 HM Treasury's is aware that the prudential supervision of Lloyd's and other specialist insurers in the London market requires particular consideration. As a joint FSA/ HM Treasury Discussion Paper said in February 2006:

*"Prudential regulation needs to take account of the diverse nature of the insurance industry. The London Market provides a good illustration of this...Because the customers in the London Market are insurers themselves or large companies, the appropriate regulatory balance between policyholder protection and ensuring that cover is available and competitively priced may be very different from retail insurance markets."*<sup>6</sup>

3.18 We believe that supervision of all the entities engaged in the Lloyd's market – the Society of Lloyd's, relevant subsidiaries, managing agents and members' agents - should be focused in the PRA, rather than dispersed across different agencies. Together, these entities make up a comprehensive whole and the supervision of individual entities benefits from supervisors' understanding of the overall picture and of the operations of other parts of the market.

### **3.19 Supervision of conduct of business within the Lloyd's market**

3.20 Some of the FSA's Principles for Business relate to conduct of business and apply to all firms. We expect that the CPMA will continue to apply these principles to all firms.

3.21 Most FSA conduct of business requirements are set out in the Business Standards block of its handbook. The Conduct of Business sourcebook does not apply to Lloyd's-specific activities, although managing and members' agents may have permissions to which it does apply.

3.22 The Insurance Conduct of Business sourcebook explicitly applies to managing agents, in the same way as it applies to insurance companies. The Society of Lloyd's does not conduct insurance business and the sourcebook does not apply to it.

3.23 We expect that the CPMA will take responsibility for the measures set out in the Redress block of the FSA Handbook, covering processes for handling complaints and compensation. These include provisions for the Society of Lloyd's to handle complaints against members arising from their insurance business, as well as

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<sup>6</sup> [Solvency II: a new framework for prudential regulation of insurance in the EU](#)

complaints from members and former members. This section also includes the rules for the Financial Services Compensation Scheme, which applies to Lloyd's in respect of policies issued after 1 January 2004.

3.24 We consider that the CPMA should engage with Lloyd's in the following manner:

- CPMA high-level conduct of business principles will apply to all firms, including the Society of Lloyd's, members' agents and managing agents.
- CPMA rules on handling complaints against, and by, members will apply to the Society of Lloyd's. The existing processes will remain in place. The arrangements for Lloyd's inclusion in the FSCS will also continue, responsibility for levies resting with the Society of Lloyd's.
- Notwithstanding Lloyd's obligation to comply with high-level conduct of business principles, its interaction with members will continue to be viewed as part of prudential supervision and therefore the responsibility of the PRA. Lloyd's relationship with and controls over members is bound up irrevocably with ensuring that members have adequate capital to pay valid claims, the key prudential consideration. Most members are corporate bodies, individual members constituting a small and diminishing portion of Lloyd's total capacity. Any split between the CPMA and the PRA of oversight of Lloyd's relations with members will risk confusion, duplication, overlap and discontinuity.
- CPMA conduct of business requirements will apply to managing agents' interaction with clients.
- Neither the Society of Lloyd's nor managing agents should be subject to separate authorisation from the CPMA, in addition to authorisation by their lead supervisor, the PRA. As we argue later, no firm should be subject to dual authorisation, which is simply needless duplication that will not help either supervisory body to achieve its objectives. .

3.25 Insurance conduct of business supervision internationally and in the UK differentiates between types of customer, the more onerous disclosure and other requirements applying only to contracts with private individuals. We expect the CPMA will continue this approach and will focus particular attention on the protection of UK private consumers. It is relevant to note that most Lloyd's policyholders are non-UK, often large commercial entities or insurers purchasing reinsurance and that all business is arranged via insurance intermediaries. CPMA supervision of managing agents' conduct of business should take this into account and ensure that the regulatory burden is minimised.

### **3.26 Enforcement powers**

3.27 The Council of Lloyd's has statutory powers to regulate the business of insurance at Lloyd's<sup>7</sup> and Lloyd's has enforcement powers over persons working within the Lloyd's market, as does the FSA. The exercise of those powers is also subject to the terms of the Co-operation Agreement between Lloyd's and the FSA. The Agreement sets out how the two bodies should determine which should take action, to avoid a firm or individual being subject to more than one set of proceedings for the same alleged

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<sup>7</sup> Lloyd's Act 6(1)

wrongdoing. In the recent past, formal proceedings by either Lloyd's or the FSA against Lloyd's firms or their employees have been rare.

- 3.28 The separate rulebooks and powers of enforcement of the PRA and the CPMA will apply to managing agents, so it is likely to be necessary to replace the existing Co-operation Agreement. We suggest that, in the interests of supervisory co-operation, it is replaced by a single new Agreement between Lloyd's, the PRA and the CPMA.

### **3.29 Members' agents**

- 3.30 Members' agents provide advice and administrative services to Lloyd's members in relation to their insurance activity. Lloyd's byelaws require a member to be represented by a members' agent unless they have a dispensation from Lloyd's Council<sup>8</sup>. Most larger, corporate, members who provide the majority of Lloyd's capacity have such dispensations and most of the clients of members' agents are traditional names, with unlimited liability, or corporate members set up to provide individuals with the ability to carry on Lloyd's business with limited liability.
- 3.31 We believe that members' agents should be supervised by the PRA alongside other Lloyd's entities. There are just three members' agents and the traditional names who form an important part of their client base are inevitably declining in number (from almost 15,000 in 1994 to 693 in 2010), as Lloyd's ceased admitting members on this basis in 2003. The FSA views members' agents as "low risk" and as not meeting their threshold for Arrow visits. Members' agents' primary activity of advising members on Lloyd's participation – with its connotations for the syndicates they join and the capital they provide - is considered to be ancillary to Lloyd's prudential oversight and so members' agents are supervised alongside other elements of the Lloyd's market in the FSA's Wholesale Insurance section.
- 3.32 Prudential oversight of three members' agents by the CPMA would have no affinity with the CPMA's other tasks and would require the CPMA to develop its own centre of expertise, which would not be efficient or economic. It is our belief that members' agents should be supervised by the PRA and not be subject to CPMA prudential oversight.

### **3.33 Lloyd's members**

- 3.34 All insurance business at Lloyd's is carried on by the members of Lloyd's. In 2010 there are 2,138 members, organised into 84 syndicates. Members may be individuals, trading with unlimited liability (as stated above, Lloyd's no longer admits members on this basis), or corporations or partnerships, with limited liability. Members are "passive capital", with no discretion over the underwriting and other policies of the syndicates they join; such policies are the exclusive responsibility of managing agents. Members do not carry on insurance business except as participants on Lloyd's syndicates<sup>9</sup>.
- 3.35 Members are subject to requirements laid down by Lloyd's Council. They must apply for admission, demonstrating that they are suitable to be a member. The FSA's prudential requirements for Lloyd's require it to ensure that members' financial resources are adequate and Lloyd's has detailed and comprehensive financial requirements for members, in line with FSA rules, which mean that all their assets

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<sup>8</sup> Membership Byelaw, para 24

<sup>9</sup> INSPRU 8.2

supporting their Lloyd's business are held on trust for the benefit of insurance creditors subject to the control of third parties such as the Corporation of Lloyd's.

3.36 Members are not authorised persons under FSMA (see the annex). We consider that neither the essential purpose of prudential supervision of Lloyd's – minimising the risk that members will not be able to meet valid claims – nor the PRA's proposed primary objective – promoting the stable and prudent operation of the financial system – requires the authorisation of members, for the following reasons:

- Authorisation of members would simply replicate Lloyd's existing processes, which are already subject to supervisory oversight.
- Supervisory authorisation of individual members takes no account of Lloyd's collective status under EU insurance directives and ignores the chain of security by which Lloyd's ensures that all valid claims are paid.
- Authorising over 2,000 members, as well as new applicants (there were 205 new members at the beginning of 2010), would be a substantial additional task for the PRA, requiring significant additional resources.
- The existing approach to the authorisation and supervision of Lloyd's provides a proven high level of protection, both to individual policyholders and to the overall financial system. For nearly 10 years the FSA has viewed it as the optimal approach to achieving its regulatory objectives and there is no evidence that they are wrong in this view: no informed voices have suggested that it is insufficient or that a different approach will be more effective.
- When the existing approach was put in place, the FSA commented:

*"...it is possible to envisage a situation in the future in which the resources available to Lloyd's centrally were small in relation to the business transacted, and in which Lloyd's itself had little control over the risks assumed and the assets held by a few large corporate members. Were such a situation ever to occur, it is likely that we should wish to authorise and regulate those members direct."<sup>10</sup>*

In fact Lloyd's central resources are substantially greater than they were 10 years ago (they have increased from £342m in 2000 to £1,126m in 2009) and it retains control over the assets of all its members. There is even less need for the direct authorisation of members today than there was when the existing arrangements were put in place.

- FSMA s. 316(4) sets out the issues to which the Authority should give particular consideration before deciding to exercise its option to authorise members directly (see annex). A reasoned consideration of these issues demonstrates no necessity to exercise that option.

### 3.37 Lloyd's capacity allocation scheme

3.38 Lloyd's oversees a capacity allocation scheme, whereby a member can realise any value attaching to the surrender of their right to participate on a syndicate for a subsequent year of account, through a process referred to as an "auction". We consider that this scheme should be supervised by the PRA, as part of its prudential supervision of Lloyd's.

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<sup>10</sup> [CP16 The future regulation of Lloyd's FSA Nov. 1998](#)

3.39 The scale of the scheme and its particular characteristics mean that it does not resemble an organised financial market provided by an investment exchange. For example, members cannot trade in Lloyd's capacity: all transfers are for members' own use and cannot be re-transferred in the same year. The capacity traded is therefore an insurance asset, rather than an investment asset. There are a limited number of auctions each year (four in 2009), taking place towards the end of the calendar year and the capacity transferred is only a very small portion of Lloyd's total capacity – in 2010 to date amounting to £160.1m, less than 1% of total capacity. The process is best supervised, as at present, as part of the overall prudential supervision of Lloyd's, by supervisory staff who have knowledge and understanding of Lloyd's through the exercise of their day-to-day responsibilities.



## **4 Other important issues**

### **4.1 Insurance regulation and supervision**

4.2 Insurance regulation is the set of rules and standards governing insurance undertakings; insurance supervision is the process of overseeing insurance undertakings, in order to ensure that rules and standards are properly applied. In practice they are intertwined, so are frequently considered together. Their objectives are set out in the Solvency II Directive, recital 16:

*“The main objective of insurance and reinsurance regulation and supervision is the adequate protection of policy holders and beneficiaries...Financial stability and fair and stable markets are other objectives of insurance and reinsurance regulation and supervision which should also be taken into account but should not undermine the main objective.”*

4.3 Insurance regulation and supervision in the UK are designed and applied in accordance with a series of international standards: principally EU Directives (e.g. the Life and Non-Life Insurance Directives, to be replaced by the Solvency II Directive), which in turn are aligned with the Principles, Standards and Guidance of the International Association of Insurance Supervisors (IAIS).

4.4 Modern insurance supervision takes an economic-based, risk-oriented approach, applying requirements proportionately and taking into account the diverse nature of the insurance industry. This is in line with the proposed approach of the PRA, as outlined in the Consultation Document.

4.5 The Consultation Document’s suggestion that UK financial services supervision in recent years has been “light touch” does not reflect experience of insurance supervision since 2001 and is damaging to the interests of the UK insurance industry in an international context. From the end of 2004 UK insurers have been subject to the Individual Capital Adequacy Standards (ICAS) framework, which is much more demanding than the capital assessments of most other EU member states. The FSA is a far more active and intrusive insurance supervisor than its EU counterparts: there is no equivalent in other member states to the ARROW visits or the “Treating Customers Fairly” initiative, for example. The Turner Review identified that supervisory approaches involved:

*“A balance between conduct of business regulation and prudential regulation which, with the benefit of hindsight, now appears biased towards the former. This was not the case in all sectors of the financial industry: the FSA for instance introduced in 2002-04 major and very important changes in the prudential supervision of insurance companies which have significantly improved the ability of those companies to face the challenges created by the current crisis.”<sup>11</sup>*

4.6 The restructuring of financial supervision and its application to all types of financial entity, should be based on factual analysis and recognition of the strengths, as well as the weaknesses, of the existing system.

### **4.7 Insurance and banking**

4.8 The new structure must recognise that insurance and banking business models are fundamentally different. Whilst we agree with the Government’s enhanced focus on

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<sup>11</sup> [The Turner Review: a regulatory response to the global banking crisis](#) p. 87

macro-prudential regulation, which corresponds with initiatives at international and EU level, it is troubling that the approach set out in HM Treasury's document focuses almost entirely on the supervision and regulation of banks, with insurer supervision treated as an afterthought. It is essential that full consideration is given to insurance supervision and that the necessary differences between banking and insurance regulation are taken into account.

- 4.9 Insurance does not present the same systemic risks as banking: insurer failure, whilst undesirable, does not create the same risks to the financial markets and the wider UK economy as bank failure<sup>12</sup>. Consequently, regulatory measures that may be reasonable and proportionate when applied to banks are likely to be entirely inappropriate and damaging if applied to insurers.

#### **4.10 Interaction with the EU**

- 4.11 UK financial regulation is conducted in a context set by the EU. The rules applied by UK supervisors are, in most cases, derived from EU Directives. The role of EU institutions will be enhanced by the introduction of the new EU supervisory structure in January 2011, which will introduce the European Systemic Risk Board and three European Supervisory Authorities. UK supervisors' capacity to adopt approaches or apply requirements that differ substantially from those at EU level is therefore severely constrained.
- 4.12 UK supervisors' interaction with EU legislative and supervisory bodies is therefore crucial. The significance of financial services to the UK economy makes it essential that UK supervisors are important, respected and influential voices in regulatory debates at EU level. They can thereby provide informed contributions to the legislative process, to ensure that EU legislative provisions are reasonable, proportionate and take account of UK interests. Working with HM Treasury, the FSA has established itself as a leading player on the global stage. It is an effective and well-regarded contributor to the development of EU regulation and this reputation should be maintained by its successors.
- 4.13 The PRA and the CPMA must work together closely to coordinate a single UK position on EU matters. We note that the PRA will take the UK lead on EIOPA and will be represented on EIOPA's Board of Supervisors<sup>13</sup>. It will need to coordinate closely with the CPMA when EIOPA considers conduct of insurance business questions. The PRA and the CPMA will also need to agree on UK representation in cross-border supervisory colleges appointed to oversee groups, which have both prudential and consumer protection responsibilities.
- 4.14 The EU's role in financial supervision has implications for the ways that the new bodies can operate. The core function of the PRA will be to implement EU prudential rules on a transparent and consistent basis. It may adopt a more judgement-led style, to the extent that this is permitted by EU rules, but this must not lead to "gold plating"<sup>14</sup> or the imposition of additional requirements that put UK financial firms at a disadvantage.

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<sup>12</sup> Geneva Association: [Systemic Risk in Insurance](#) March 2010

<sup>13</sup> Consultation Document para 1.18. UK representation on CEIOPS' Managing Board is currently provided by the Pensions Regulator. EIOPA's enhanced regulatory role and powers make it desirable that equivalent EIOPA representation is provided by the UK's insurance supervisory authority.

<sup>14</sup> The Coalition: our programme for government: "*We will end the so-called 'gold-plating' of EU rules, so that British businesses are not disadvantaged relative to their European competitors* "

#### **4.15 Transitional arrangements**

4.16 The transition to the new structure will be a major upheaval for supervisors and for those that they supervise. It is important that this transition is well-managed and that there is no loss of focus by the FSA (and its successors) on current, and highly important, debates on insurance regulatory issues at EU and international levels.

4.17 The key legislative initiative for UK insurers is Solvency II implementation. This is the biggest change to European insurance regulation for more than 30 years and the FSA's largest single project. Priorities for the newly-formed PRA will be to continue the FSA's constructive involvement at EU level in the development of the Solvency II legislative and supervisory package and to ensure implementation of Solvency II within the UK. The transition process must not affect the ability of the FSA/PRA to ensure an orderly implementation of the new prudential solvency regime. We are encouraged by Lord Turner's recent statement that:

*"We are focused on minimising the disruption for regulated firms, and on ensuring that the ongoing cost of the two separate organisations is no higher than it would be for the integrated FSA."*<sup>15</sup>

4.18 The departure of experienced FSA staff ahead of the restructuring is a concern. Not only have all three managing directors now resigned, but there was a 128% increase in the overall numbers leaving in the second quarter of 2010, possibly contributing to an increase in the length of time – from 11.4 weeks to 19.5 weeks – it takes the FSA to grant authorisation<sup>16</sup>.

#### **4.19 Supervision of insurance intermediaries**

4.20 Insurance intermediaries are not mentioned in HM Treasury's document, but we understand that they will be supervised by the CPMA. We therefore expect Lloyd's brokers to be subject to the prudential supervision of the CPMA rather than the PRA.

4.21 Lloyd's brokers play a particular role within Lloyd's and the wider London market. It is important that the CPMA's arrangements for supervising them take into account the differences in this role from the operations of high-street retail brokers. Lloyd's brokers operate predominantly as wholesalers, handling international business rather than dealing with UK consumers. They hold substantial amounts of insurance funds in trust accounts, representing premiums and claims in transit. Insurance undertakings, including Lloyd's managing agents, have an interest in the supervision of Lloyd's brokers' money handling arrangements as, should those arrangements fail, insurers may sustain a financial loss.

4.22 The CPMA's internal structure should therefore reflect the importance of the wholesale insurance intermediary sector by including a separate wholesale insurance intermediary division to handle the supervision of Lloyd's brokers and other wholesale intermediaries.

4.23 A further category of intermediary requiring special consideration is appointed representatives. We believe that appointed representative arrangements are best supervised by the authority responsible for regulating their principals.

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<sup>15</sup> Lord Turner [Mansion House Speech](#) 21 September 2010

<sup>16</sup> Reynolds Porter Chamberlain press release 9 August 2010

- 4.24 Under FSMA and rules made thereunder, appointed representatives are registered insurance intermediaries although they are not authorised persons. An authorised insurer or insurance intermediary must take responsibility for an appointed insurance representative's activities. The FSA does not supervise appointed representatives directly.
- 4.25 Regulating appointed representatives therefore means supervising the controls imposed by their principals. This task is carried out through supervision of an undertaking's systems and controls and therefore is best considered as part of prudential regulation. Consequently, we suggest that, although the CPMA will maintain the UK register of insurance intermediaries (including appointed representatives), the PRA, rather than the CPMA, should be the lead authority for the supervision of arrangements by which insurers appoint representatives.
- 4.26 Coordination between authorities**
- 4.27 It is important that, so far as possible, supervisory duplication and overlap are avoided. Supervisory interaction with insurers should be concentrated in the PRA, and the CPMA's role should be limited to oversight of the processes by which insurance products are sold to consumers, an area in which insurance intermediaries play a key role. This is how the division is organised between prudential and conduct of business regulation in other countries which have adopted a similar structure, such as Australia.
- 4.28 The proposed supervisory structure creates an obvious but serious risk that there may be either duplication of regulatory oversight or failure to co-ordinate activities in an appropriate and effective fashion. The Consultation Document acknowledges the importance of effective co-ordination between the new authorities and makes various proposals for achieving this. It is important that effective measures and protocols are put in place to ensure proper co-ordination between the authorities. It is essential that the responsibilities of each body are clearly defined and that operational boundaries are properly demarcated.
- 4.29 The Netherlands has a similar "twin peaks" supervisory model. The two authorities have a formal "covenant", entered into in 2002 and updated in 2004 and 2007, which covers issues such as:
- Designation of a lead authority with overall responsibility for supervision of each institution and coordination of supervisory activities.
  - Agreement on which aspects of a firm's management come under prudential supervision and which under conduct of business supervision.
  - Rules for consultation and sharing of information.
- 4.30 We suggest that the PRA and the CPMA have a similar formal agreement. It is particularly important that the two supervisory bodies agree on the lead authority for all firms and groups subject to supervision by both and that, so far as reasonably possible, all supervisory interaction is channelled through the lead authority.

## 5 Responses to questions

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

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

The FPC’s macro-prudential role means that its primary focus will be on the banking sector. Its make-up, with six Bank of England executives out of 11 members, reflects this.

The FPC can give directions and recommendations to the PRA and the CPMA, so it will have a direct impact on insurance supervision. It is important that it can give full consideration to the implications of its actions on all financial sectors and that its actions are properly targeted to address identified problems, minimising “collateral damage” to other sectors. In this context, we welcome HM Treasury’s recognition of the importance of ensuring that the Committee has access to sufficient levels of expertise in areas other than banking, such as insurance<sup>17</sup>. To ensure this, at least one member of the FPC should have experience in insurance, to provide a more balanced and informed view of the wider financial services sector.

### 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 believe that this would be sensible.

- **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 PRA should continue to be subject to principles of good regulation. We are surprised at the suggestion that it would be desirable for it to operate other than in accordance with those principles. Applying principles of good regulation to UK insurance supervision has not caused problems.

On the principles set out in FSMA s. 2(3), our comments are as follows:

- Principles (a), (b) and (c) should be retained;
- Principles (d) and (e), see answer to next question;
- Principles (f) and (g) could probably be merged into a single principle of the desirability of maintaining competition.

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<sup>17</sup> Consultation Document para 2.43

A requirement for the PRA to have regard for principles of good regulation will help to determine its future culture and approach. Such a requirement does not override its primary objective, of promoting the stable and prudent operation of the financial system. If there is any conflict, the primary objective will prevail.

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

The PRA should continue to have regard to the international character of financial services and markets and the desirability of maintaining the competitive position of the UK.

We noted earlier the critical role of the EU in UK financial regulation and the consequent importance of interaction between UK financial supervisors and those in the EU. International considerations go wider: many regulatory initiatives originate with the G20, the Financial Stability Board (FSB) or other international bodies. The International Association of Insurance Supervisors (IAIS) is an important factor in the development of insurance regulation and the FSA is an influential voice in its deliberations. As a member of the FSB, the UK has committed to undergo an assessment under the IMF – World Bank Financial Sector Assessment Programme every five years<sup>18</sup>. International liaison and interaction will therefore be an important aspect of the PRA's work and this requires explicit recognition in the principles of good regulation.

Maintaining the competitive position of the UK will, we believe, remain a Government priority. We note that, for example, the Independent Commission on Banking appointed in June 2010 is required to pay specific attention to "*the competitiveness of the UK financial and professional services sectors and the wider UK economy*"<sup>19</sup>. Other governments and international bodies recognise links between regulatory policy and industry competitiveness: the European Commission intends that Solvency II, for example, should increase the international competitiveness of European insurers<sup>20</sup>. It is therefore appropriate for a government body with significant influence over the competitiveness of a key economic sector to have regard to this important consideration.

If the PRA does not take this principle into account, there is a risk of damage to the UK's financial sector and therefore to its economic wellbeing. At Lloyd's we are well aware that capital providers have a global perspective and can be prompted to switch their activities by government action. The Sarbanes-Oxley Act in the US demonstrates that even well-intentioned regulation can do harm to a national economy out of proportion to the benefits bestowed. There is nothing inevitable about the London insurance market's current success. It faces significant competitive challenge from international markets such as Bermuda and Switzerland and from more benign tax regimes.

The consultation document notes that:

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<sup>18</sup> [FSB Framework for Strengthening Adherence to International Standards, Jan. 2010](#)

<sup>19</sup> [Independent Commission on Banking Terms of Reference](#)

<sup>20</sup> [European Commission press release 10 July 2007](#)

*“There is a strong argument that one of the reasons for regulatory failure leading up to the crisis was excessive concern for competitiveness leading to a generalised acceptance of a “light-touch” orthodoxy...”<sup>21</sup>*

We believe that this is debatable: chapter 1 of the Turner Review<sup>22</sup> entitled “*What went wrong?*” makes no reference to this argument in its comprehensive account of regulatory developments preceding the crisis. As noted earlier, there is no evidence that excessive concern for competitiveness has led the FSA to adopt a “light touch” approach to regulation of the UK insurance sector. An uncompetitive UK financial sector is unlikely to contribute to the PRA’s objective of a financial system operating on a stable and prudent basis.

A requirement to have regard for international competitiveness would not mean that this need be a prevailing characteristic of UK supervision. The PRA’s key concern would remain achievement of its overriding objective.

**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 model proposed by paragraph 3.16 will require some authorised firms and persons to seek authorisation from two separate organisations. This is a bureaucratic and inefficient proposal, representing a move to a less effective model than the FSA’s existing integrated authorisation system. Even if the authorities aim to coordinate their activities, there are bound to be increased delays for consultation, coupled with a greater administrative burden and the possibility of conflicting decisions by the two bodies.

No firm or person should require authorisation by more than one supervisory body. As suggested earlier, we consider that every firm subject to the rules of both bodies should have a lead authority, responsible for all the firm’s authorisations. This responsibility should extend to authorising a firm’s staff performing controlled functions. This approach is consistent with the proposed functions of the two bodies set out in 3.20 and 4.18.

It is necessary to consider how to administer the system of EU passporting. UK authorised firms should not need to apply to both the PRA and the CPMA for passporting approval. Presumably the PRA would handle outward passporting for UK insurers and the CPMA would handle the inward process for all EU firms, as EU firms are subject to home state prudential regulation.

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

The approach outlined appears sufficient and we note that a consultation on draft legislation will take place early in 2011. We hope that the review of FSMA will recognise the need to minimise disruption and implementation expense in the changes it proposes.

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<sup>21</sup> Consultation Document para 3.9

<sup>22</sup> [FSA: The Turner Review, a regulatory response to the global banking crisis March 2009](#)

- 7) Are safeguards on the PRA’s rule-making function required?**
- 8) If safeguards are required, how should the current FSMA safeguards be streamlined?**

Safeguards are required. The rule-making function must be subject to similar safeguards to those set out in FSMA. Consultation processes are not just a safeguard for those subject to rules; they result in better drafted, better targeted and more effective regulation, more likely to achieve supervisory objectives.

The Consultation Document contains no arguments that removing or streamlining statutory safeguards are good ideas. Rather, it notes that safeguards reflect that:

*“...the power to make rules in this way is a quasi-legislative power that would normally be subject to Parliamentary oversight.”<sup>23</sup>*

The retention of safeguards is entirely compatible with the PRA’s proposed approach to regulation. Existing safeguards include provision for situations where full compliance with safeguards might be inimical to wider supervisory interests: for example, the FSA is not required to consult if delay would be prejudicial to the interests of consumers<sup>24</sup>.

The removal or reduction of safeguards such as public consultation would put the PRA at odds with international approaches to rule making. The European Commission’s recent Communication on *“Smart Regulation in the European Union”*<sup>25</sup> says:

*“Consulting citizens and other stakeholders both when developing policies and when evaluating whether they have done what they set out to do is an essential element of smart regulation.”*

The International Association of Insurance Supervisors’ Insurance Core Principles and Methodology<sup>26</sup> say:

*“The supervisor must recognise that transparency and accountability in all its functions contribute to its legitimacy and credibility, and the efficiency and stability of the market. A critical element of transparency is for supervisors to provide the opportunity for meaningful public consultation on the development of supervisory policies, and in the establishment of new and amended rules and regulations. To further ensure the proper and efficient operation of the market, supervisors should establish clear timelines for public consultation and action, where appropriate.”*

To reiterate a point made earlier: the UK has committed to implement international financial standards, including the IAIS Principles.

The Government has hitherto been committed to public consultation on regulation, as shown by the activities of its Better Regulation Executive and its Code of Practice on Consultation.

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

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<sup>23</sup> Consultation Document para. 3.22

<sup>24</sup> FSMA s. 155(7)

<sup>25</sup> [Smart Regulation in the EU](#), 8 October 2010

<sup>26</sup> [IAIS Insurance Core Principles](#), October 2003



The paper emphasises how the PRA will benefit from the Bank's culture (3.29), expertise, experience and credibility (3.34). This may apply to the supervision of banks but has limited relevance to the supervision of insurers. The PRA will be a credible supervisor of insurers only if it benefits from the transfer of insurance supervisory expertise and experience from the FSA. It must employ adequate numbers of qualified actuaries and other staff expert in insurance risk.

The PRA's governance will be dominated by the Bank: it will be accountable to the Bank's Court on administrative matters, the PRA's Board will be chaired by the Governor and its CEO will be the Deputy Governor for prudential regulation. The Deputy Governor for Financial Stability will also be a member.

The Bank's senior management's focus on banking risk means that the PRA should adopt a sectoral rather than a functional internal structure, with a separate section dedicated to insurance supervision. It should have a senior "Head of Insurance Supervision", with a seat on the PRA's Board, and a status similar to senior banking supervisors. This will ensure that insurance supervision receives adequate attention. It is also required by the PRA's engagement in international insurance regulatory dialogue, which necessitates senior and authoritative representation.

The section on "Transparency and accountability" implies that some or all of the FSA's existing accountability mechanisms could be withdrawn from the PRA<sup>27</sup>. It is important that this does not happen. The PRA's decisions, like those of the CPMA, must be subject to appeals to the Upper Tribunal and a complaints mechanism. The suggestion that these are under review and may not be necessary for the PRA is at odds with their explicit retention for the CPMA<sup>28</sup> and the Consultation Document's statement that:

*"The Government considers it to be very important that clear mechanisms of governance and transparency be established around the new regulatory bodies, and further believes that these should be at least as rigorous as those placed on the FSA."<sup>29</sup>*

The PRA's set-up must take account of EU requirements such as the Solvency II Directive, article 297, which says:

*"Member States shall ensure that decisions taken in respect of an insurance or a reinsurance undertaking under laws, regulations and administrative provisions implementing this Directive are subject to the right to apply to the courts."*

## **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**

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<sup>27</sup> Consultation Document para 3.38

<sup>28</sup> Consultation Document para 4.36

<sup>29</sup> Consultation Document para 4.31

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

Our primary concerns centre on the PRA, in view of its responsibilities for the prudential supervision of Lloyd's and the Lloyd's market. We consider that similar considerations apply to the establishment of the CPMA, so our answers to questions 4 also apply here.

References to the CPMA operating as "*a strong consumer champion*"<sup>30</sup> are disturbing. The CPMA will have a range of functions, some of which have nothing to do with retail consumers. Its supervision of conduct of business will include the exercise of enforcement processes, in which it must appear impartial between the various interests involved. Although its role will include consumer protection, it should not operate as an advocate for consumers to the exclusion of all other interests. This approach to its functions would conflict with its primary objective of ensuring confidence in financial services and markets and make it more likely that its engagement with financial services firms is on an antagonistic basis.

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

These mechanisms appear to be appropriate and sufficient. We consider that the PRA should be subject to similar mechanisms.

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

We agree with the continuation of the three existing panels. It is important that representation on the two practitioner panels should continue to represent all areas of the financial sector.

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

We agree that it is desirable for there to be a single fee-collection body. The process of fee- and levy-setting must be transparent and the fees charged must reflect the nature and extent of the work carried out. The proposals must not lead to a significant increase in fees for authorised firms.

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

We do not see any merit in the suggestion that the FSCS should be split between the PRA and the CPMA and consider that it should continue as a single entity. At the same time, we do agree that the current cross-subsidy arrangements should cease and believe that this should be pursued irrespective of the future structure of the FSCS.

We understand that the FSCS is currently under review by the FSA. We consider that any proposals for changing the FSCS should be put on hold until the completion of the restructuring necessitated by these proposals and the finalisation of relevant EU proposals, such as those on insurance guarantee schemes.

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<sup>30</sup> Consultation Document para 4.3

## **Markets and infrastructure**

We do not have any comments to make on this section of the Consultation Document. The markets division of the CPMA will not regulate Lloyd's.

## **Crisis management**

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

These proposals appear satisfactory. As noted earlier, the core activities of insurers do not pose the same risks to financial stability as those of other financial sectors. However, insurer insolvencies do not need to be avoided at any price, as winding up an insurer is an orderly process, spread over time, without the systemic risks that arise from bank insolvencies. The EU Directive on the Reorganisation and Winding-up of Insurance Undertakings (2001/17/EC), which has been implemented into English law, provides an internationally agreed framework in which insurer insolvencies can be handled.

## **Regulatory authorisation within the Lloyd's market**

### **1. The Society of Lloyd's**

The Society of Lloyd's has statutory recognition as an authorised person by the Financial Services and Markets Act 2000 (FSMA), s. 315. It has permission to carry on the following activities:

- (a) arranging deals in contracts of insurance written at Lloyd's ("the basic market activity");
- (b) arranging deals in participation in Lloyd's syndicates ("the secondary market activity"); and
- (c) an activity carried on in connection with, or for the purposes of, the basic or secondary market activity

### **2. Managing agents**

Managing agents are authorised persons. Their key permission is "managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's". Their activities usually require them to have other permissions, such as "assisting in the administration and performance of a contract of insurance".

### **3. Members agents**

Members' agents are authorised persons. Their key permission is "advising on syndicate participation at Lloyd's". Like managing agents, their activities require them to obtain additional permissions.

### **4. Members**

Under FSMA s. 316, members are not required to be authorised persons unless "the Authority" so directs.

s. 316(4) states that:

*In deciding whether to give a direction under subsection (1), the Authority must have particular regard to—*

- (a) *the interests of policyholders and potential policyholders;*
- (b) *any failure by the Society to satisfy an obligation to which it is subject as a result of a provision of the law of another EEA State which—*
  - (i) *gives effect to any of the insurance directives; and*
  - (ii) *is applicable to an activity carried on in that State by a person to whom this section applies;*
- (c) *the need to ensure the effective exercise of the functions which the Authority has in relation to the Society*



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18 October 2010

**Sent via email to:** [financial.reform@hmtreasury.gsi.gov.uk](mailto:financial.reform@hmtreasury.gsi.gov.uk)

Dear Sir or Madam,

**HM Treasury White Paper: A new approach to financial regulation: judgement, focus and stability**

Lloyds Banking Group plc ("the Group") was formed on the 19th of January 2009 following the acquisition of HBOS plc by Lloyds TSB plc and consequently became the largest retail bank in the UK. Its main UK business activities include retail banking, commercial and corporate banking, insurance, pensions and investments. The Group also operates an international banking business with a global footprint in 34 countries.

The Group welcomes the opportunity to respond to HM Treasury's White Paper: *A new approach to financial regulation: judgement, focus and stability* ('the White Paper'). We have worked extensively with the BBA throughout its consideration of the White Paper, and fully endorse the BBA response. This endorsement is, in part, the purpose of our letter. However, we are also taking this opportunity to articulate further some matters which are of particular interest to the Group. While many of these points have been made by representatives of the Group during meetings with HM Treasury officials and Government representatives both prior to and during the consultative phase, it is appropriate to set these out in writing as the formal consultation period closes.

As ever, we would be most willing to discuss any of the points made in this letter, or indeed issues raised in any of the responses which HM Treasury receives and on which HM Treasury believes our insights may be of assistance.

**A fit for purpose regulatory system**

The White Paper starts from the premise that, while there is emerging global consensus on the fundamental causes of the crisis, explaining the crisis purely in term of global trends ignores a similarly fundamental point that 'there were real and significant failings in the UK regulatory framework'.

The paper proceeds to discuss these failings over sections 1.5 to 1.8:

- the broad ranging brief of the FSA which has both micro-prudential and conduct of business objectives;
- the lack of definition of responsibilities among the Tri-Partite actors (HM Treasury, the Bank of England, and FSA) which exacerbated difficulties during the financial crisis;
- the absence of effective macro-prudential supervision and, by extension, the failure to link macro- and micro-prudential policy; and
- FSA's reliance on a 'tick box' approach to the detriment of exercising judgement.

The White Paper concludes that radical reform is required, and we appreciate that the Government is firmly set on the path to reform as outlined in the White Paper. Our position is aligned with all legitimate stakeholders on the matter of reform- our desired outcome is a fit-for-purpose regime at a broad level that achieves the following:

- monetary stability (to be delivered via the Bank's Monetary Policy Committee);
- financial stability / sound and internationally coordinated macro-prudential supervision (via the Bank's Financial Policy Committee);
- soundness of financial institutions / micro-prudential supervision (via the Prudential Regulatory Authority under the Bank); and
- orderly, well-functioning markets and fair treatment of consumers / conduct of business supervision (via the Consumer Protection and Markets Authority).

While there were indeed failings in the UK regulatory system, structural reorganisation of itself is not a complete answer. Ultimately it will be down to supervisory practitioners to work in such a way as to deliver a truly different and effective regime. While a 'risk-based' approach is reasonable, this must be based on a real, deep analysis of what the risks are both in quantitative and qualitative terms, combined with a clear prioritisation and understanding of how these risks interact. This is necessary to ensure that action taken is well-calibrated, and the aggregate impacts of individual proposals can be assessed.

We note the White Paper's comment that FSA has 'made significant progress' to address problems in the wake of the financial crisis. In some respects, we agree with this assessment; Lord Turner's analysis of the crisis, for example, has been a helpful contribution to global debate. However, some FSA responses have been more knee-jerk, for example:

- the Single Customer View (SCV) initiative – coherent arguments were made that, in the event of a bank failure, consumers would be more concerned to ensure continuity of service (direct debits, access to funds via ATMs, etc.). FSA proceeded with plans for a seven-day payout mechanism which, it has subsequently transpired, does not align with EU proposals and now requires last minute re-calibration;
- a super-equivalent liquidity regime with consequential impacts on lending practices; and
- stress-testing models based on assumptions not well aligned to European partners.

It is important to keep FSA's progress in perspective. Indeed, the regulator has already noted in its submission to the Treasury Select Committee inquiry significant risks which may attend the quality of supervision during the transition process. We are also watchful on this front, as we are on the quality of outcome from the reform process generally.

### **Regulatory infrastructure reform**

The White Paper clearly sets out the Government's intended direction of travel, and it is perhaps fair that, as a consultation document, the White Paper does not 'answer all the questions'. Indeed, we welcome this as an indication that the Government is open minded on the details of reform.

Key areas which we consider require further deliberation are as follows:

- **The arrangements which will ensure a reasonable and, critically, a publicly acceptable level of real accountability for each actor in the new regulatory infrastructure.**

It is important that the statutory objectives for each authority are appropriate in a wider, holistic context. The White Paper proposes a single primary objective for each authority. Initially, this appears attractively simple. However, we believe that such narrow focus may ultimately deliver sub-optimal results, e.g. for the Prudential Regulatory Authority (PRA), a willingness to sacrifice growth and economic recovery on the altar of a 'sterile stability'. We do not believe that the provision of very light touch 'have regard to' secondary objectives, (against which there will be few practical mechanisms to hold the authorities to account), provide enough of a check and balance.

The White Paper also questions the merits of retaining the statutory consultation process. We appreciate that the removal of a *requirement* to consult, does not mean that the Consumer Protection and Markets Authority (CPMA) or the PRA would be *prevented* from consulting with the industry in future, and we presume the driver behind the question is the desire to enable the CPMA and PRA to respond in a timely manner to developments. However, a formal, open and mandatory consultation process helps protect the authorities from the very damaging perception of a lack of transparency, with 'deals done behind closed doors'. This may serve as a deterrent for new entrants to the UK banking market, or for the re-entry of those foreign banks which withdrew in the face of the financial crisis (contrary to the Government's desire for a more diversified UK banking environment, with greater overall funding capacity). More fundamentally, the design process for new regulation is more effective, and produces better quality regulation capable of practical application, where all the key stakeholders and subject matter experts (including both regulators and industry) and included in its development.

The proposals are somewhat light on the arrangements by which the Chancellor, the Government and, more broadly, Parliament will be able to:

- (1) hold the Bank to account for its macro-prudential and micro-prudential oversight responsibilities; and
- (2) ensure that the Bank's forward looking policy will support, and will not undermine, broader agreed socio-economic aims.

It should be feasible when drafting legislation to establish a process by which socio-economic policy aims are communicated to the Bank (FPC and MPC), the PRA and CPMA. We would support an approach for the FPC which mirrors the letter written to the Governor of the Bank in his capacity as chair of the MPC, (and which place the 'hard' MPC inflation target in the context of wider Government policy).

- **That arrangements will be robust to ensure coordination between the authorities and limit the potential for unreasonable overlap or under-lap; and that policy direction will be coordinated.**

The BBA response discusses coordination between the Bank, FPC, PRA and CPMA in some detail; we agree with the observations and support the recommendations which the BBA response makes.

We would also highlight the implications which arise for the Financial Ombudsman Service (FOS) in the revised structure. We welcome the White Paper's assertion that the FOS must not stray from its role as an independent arbiter by appearing to show a systemic favouring of consumers over firms. In light of the proposals to strengthen

consumer focus by introducing a new conduct regulator, the Government should take the opportunity to re-emphasise FOS's purpose and strengthen its independence as an arbiter of individual complaints. It should also look at the relationship in the context of whether FOS's remit remains appropriate in light of the CPMA's rule-making function. Currently, FOS is not 'bound' by regulation, and we believe it should be. In recent years, FOS's ability merely to 'have regard to' (but not be bound by) regulatory rules has allowed it to assume a quasi-regulatory role, with its 'bulk' decisions undermining regulatory policy. This can create unfairness and regulatory uncertainty for firms, with resultant adverse consequences for consumers (e.g. by creating a risk-aversion to the provision of new or enhanced product offerings). In particular, firms can find themselves in a position where, even though abiding by all relevant regulations, they can still be ruled by FOS to have acted wrongly, and be required to provide redress. It also undermines the role of the CPMA as the lead conduct regulator.

We believe the links between CPMA and FOS should be limited to the collection of levies by CPMA on behalf of FOS. Appointment of the Board of the FOS should move to within the purview of HM Treasury, and be subject to the Code of Practice on Public Appointments. To ensure accountability, the FOS should be subject to largely the same requirements as the CPMA and PRA, e.g., Annual Reports, National Audit Office scrutiny and a much more viable appeals process. It may also be appropriate for FOS to have a representative role on the Financial Services Consumer, Practitioner, and Small Business Panels.

On a related matter, we encourage the Government to look at the regulatory regime for Claims Management Companies (CMCs). CMCs have become an ever more dominant feature in the retail financial services landscape, and their activity has now increased to account for circa 28% of complaints referrals – a trend that looks set to continue, particularly as regulation of CMCs remains largely ineffectual. As CMC regulator, the Ministry of Justice (MoJ) is limited in its ability to deliver satisfactory protection for the clients of a CMC it has suspended or de-authorised. As the MoJ stated in the case of Cartel Client Review: "If you are a customer of CCR your agreement with them, as with any provider, is a private contractual matter between yourself and the provider in which MoJ cannot intervene directly."

It will be very disappointing, if having gone so far in redefining the regulatory landscape for consumer protection, the Government is unable to deliver a full package of reform which runs the gamut of consumers' and the retail financial services providers' experience.

- **Whether the transition process and delivery of existing initiatives is manageable.**

FSA already had a substantial programme of activities prior to the announcement that the Government would restructure the UK regulatory regime. Planned initiatives must therefore compete with an ambitious existing change programme. This is exacerbated by the fact that several members of the FSA leadership team have left or indicated an intention to leave the organisation. As FSA's submission to the TSC comments, "overall turnover was 7.6% at the end of August 2010" representing the highest turnover of staff since January 2009; one business unit is noted to have a turnover level of 16%. Issues with staff present a real risk to the quality of policy and supervision during the transition.

Some initiatives, such as the Retail Distribution Review (RDR), are at a crucial stage in development when firms need to engage with FSA to get clarity on the regulator's intentions. As individuals leave or are focused on the restructure, getting access to FSA is proving increasingly difficult. We would also note that both the RDR and the Mortgage



Market Review look set to overlap with forthcoming EU initiatives and that the EU is engaged in policy development which will further add to FSA's workload during transition.

We recommend that the Government impresses on FSA the need to review its initiatives, identify the critical deliverables, and re-prioritise its focus on these. If this self-audit of regulatory priorities for the transitional period does not take place, we expect that:

- firms may incur significant costs implementing change which is subsequently unpicked or revisited by CPMA in the near term;
- policy, which will necessarily be made in haste given the short timescales for transition, will not be fit-for-purpose (with consumers not well-served by the regime);
- focus will be diverted from influencing EU policy development, to the detriment of the UK national interest (as was the case when the EU was developing the Financial Services Action Plan whilst the UK was creating the FSA).

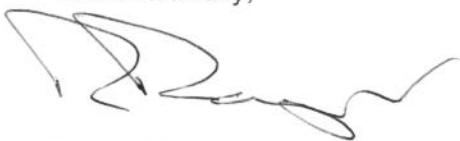
• **Whether the impact of the EU has been adequately factored into the proposals.**

As is well set out in the BBA response, and highlighted by a range of commentators, there is an urgent need for Government and HM Treasury to focus on how, in the near term, the transition to the new structure will impact on the UK's influence in the EU, and how, in the longer term, the UK structure will align with the EU superstructure. Staff resourcing for the EU bodies is very light by comparison with the FSA / CPMA / PRA structure, and will look to draw significantly on national regulators for support. The UK should target a level of representation for the UK within the European Supervisory Authorities (ESAs), which mirrors the proportion of EU financial services activity which is domiciled in the UK.

In conclusion, if it would be helpful to the Government and HM Treasury, we would be most willing to discuss these and any other issues relating to the reform programme further. Please do not hesitate to contact me, and I will be pleased to make such arrangements as are necessary.

Lloyds Banking Group plc and its subsidiaries and associated companies ("the Group") regards the content of this document (the "Information") as confidential information. It is provided subject to the requirement that the FSA will not disclose the Information to third parties, in part or in whole, in any way which may result in the Information being either directly or indirectly attributable to the Group. Subject to the foregoing, the Group consents to the listing of its name as a respondent.

Yours faithfully,



Rupert Raynor  
Regulatory Development Director  
Lloyds Banking Group plc



18<sup>th</sup> October, 2010



Financial Regulation Strategy  
HM Treasury  
1 Horse Guards Road  
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Dear Sir

**Response to Consultation Paper on the proposal  
New Approach to Financial Regulation – CM 7874**

LIIBA is the Trade Association representing Lloyd's Insurance Brokers. Lloyd's brokers generate some £1.9bn in invisible exports. London Market brokers introduce virtually all of Lloyd's business and a significant proportion of London companies business, as well as placing considerable volumes of business in International Markets. They handle in excess of £60bn of insurance premiums and claims annually. Some of our members also handle significant amounts of small/medium sized commercial, as well as, personal insurances

We have not responded to your individual consultation questions directly. While we are not in favour of dividing responsibility for the insurance sector between the PRA and CPMA we accept that the decision has been made. As such our principal concern is to seek to ensure that a consumer focused CPMA recognises the very real differences between retail and wholesale business and that these differences are properly accommodated both structurally and philosophically within the CPMA.

The Consumer Protection and Markets' Authority will assume responsibility for the conduct of business of all financial services firms. We understand that it is under this Authority that regulation of London Market intermediaries will also fall for prudential regulation. It is understood that the CPMA will adopt a more proactive, interventionist approach to retail conduct regulation. The consultative paper indicates an appreciation that the focus of wholesale market conduct regulation is different from retail customers. However, it

concentrates on wholesale investment markets and exchanges. It is largely silent on the approach to individual firms involved in the wholesale sector. This is a cause of great concern to our members.

We would like to raise a number of specific points:

- The Regulator must properly observe the differences between wholesale and retail business. To this end we believe it is of fundamental importance that the composition of the CPMA Board, the Rule Book, and the CPMA's approach to supervision adequately reflects the different issues facing the wholesale sector.
- Some insurance intermediaries are owned by insurers and some insurers (and possibly in the near future some Lloyd's Managing Agents) are owned by brokers. It is not clear to us how such groups will be supervised. Will this mean that some intermediary groups are prudentially regulated by the PRA? We strongly support the statutory principles of good regulation in terms, for example, of competitiveness and innovation and would wish these to be preserved.
- We believe that the CPMA must adopt a full and open consultation on its rule book
- We believe that excessive intervention in the right of commercial self determination of firms, for example in staff, business models, business strategies etc. should be resisted.
- We fully support the continuance of improved enforcement capability and principles-based, risk-based regulatory policy, rules and supervision, so as the principles do not become a means of unfair and unpredictable enforcement/disciplinary practice should be strongly supported.
- There are a number of interlocking relationships between wholesale insurers and intermediaries, for example, Lloyd's Brokers handle significant sums of premiums and claims monies belonging to both insurers and clients. Appropriate prudential regulation of intermediaries, recognising the complexities of accounting for international insurance and reinsurance business is very important.
- An over-riding consideration is the importance of having an effective and proper management team at the CPMA. We have concerns that the FSA Senior Management Team will favour a move over to the PRA. There have already been a great number of changes in regulatory and supervisory management of our sector in recent months. It is vital to the success of the new regulator that there are appointments at senior level of those who understand the wholesale Market and its relevance to the UK economy.

At this stage it is not clear to us on many issues where responsibility of the Treasury ends on these aspects and where the CPMA begins. Clearly it is vitally important that the Head of the CPMA is appointed and a shadow management structure is put in place as quickly as possible.

We would very much like to begin discussions with you on some of these aspects as soon as possible.

Yours faithfully,

Jonathan Palmer-Brown  
Chairman

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**Deputy Chief Executive**

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15 October 2010

Financial Regulation Strategy  
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BY EMAIL

Dear Sirs

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

### **Summary**

1 The London Metal Exchange ("the LME") welcomes the opportunity to comment on the Government's consultation paper on a new approach to financial regulation issued on 26 July 2010.

2 The LME is a recognised investment exchange under the Financial Services and Markets Act 2000 ("FSMA") and for that reason the LME will restrict its responses to the proposals in Chapter 5 of the consultation paper. Set out in the attached appendix is a summary of the role that the LME plays in the international base metals trade and industry.

3 The LME supports the proposal that the Markets Division of the new CPMA should be operationally distinct. The LME believes that no case has been put forward that would justify undoing the recognition regime for exchanges and clearing houses.

### **Markets and Infrastructure**

4 The LME welcomes the Government's proposal that responsibility for market conduct regulation will be located within an operationally distinct division of the new CPMA. Effective regulation of UK based exchanges will require that the Markets Division of the CPMA has clearly set out objectives that recognise both the need for effective regulation and the important roles that the UK based exchanges play in the UK, EU and world economies. A strong and coherent focus for the Markets Division

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of the CPMA will help ensure that it develops and retains the necessary expertise in, and understanding of, the exchanges and markets that it will regulate.

5 The LME welcomes the Government's proposal that the Markets Division of the CPMA will represent the UK in ESMA. There is momentum within the EU for pushing through widespread changes to financial services regulation. London is unique in that it hosts a number of regulated commodity exchanges that do not exist in the other EU member states. It is important that the correct level of expertise and informed opinion is taken into account at all stages when EU legislation is formulated and implemented. ESMA will have a strong role in developing EU regulation for exchanges. The Markets Division of the CPMA will have an important role in contributing to the work of ESMA. In contributing to ESMA's work on the regulation of exchanges the credibility and cogency of the Markets Division of the CPMA will depend on its ability to demonstrate its understanding of the UK based exchanges that it regulates.

### **Recognised Investment Exchanges and Clearing Houses**

6 The LME was surprised to see in paragraph 5.17 of the consultation paper that the Government proposes to consider whether there is scope for rationalising the two regimes contained in FSMA under which trading platforms and CCPs are regulated. The consultation paper does not discuss the proposal in any detail. The consultation paper neither identifies disadvantages of the recognition regime for exchanges and clearing houses nor identifies advantages in abolishing the regime. There is no clarity about what has prompted the suggestion that the recognition regime might be abolished. A subsequent paper headed "*Part 18 of the Financial services and Markets Act 2000*" was issued by HM Treasury in September 2010. This subsequent paper also fails to identify any disadvantages of the recognition regime or identify any advantages in abolishing the regime.

7 HM Treasury officials kindly agreed to attend a meeting with representatives of the UK recognised investment exchanges and clearing houses on 4 October 2010. Representatives from the Financial Services Authority and the Bank of England were also present. The exchanges and clearing houses explained to the HM Treasury officials that in order to be able to respond effectively to the consultation paper the exchanges and clearing houses would need to understand the reasons behind the proposal to transform the recognition regime. The reasons given at the meeting were all based on an assumption that abolishing the regime would simplify the regulation of exchanges and clearing houses. That assumption is not correct. Unravelling the recognition regime would be a radical step liable to lead to unintended consequences. The recognition regime for exchanges and clearing houses has worked well for over twenty years; adapting the regulated firms regime to accommodate exchanges and clearing houses would be far from simple; and there is no evidence of a gap in the regulation of exchanges and clearing houses that needs to be filled.

8 The recognition regime for exchanges and clearing houses was first given expression in the Financial Services Act 1986 and was repeated in FSMA. The



recognition regime for exchanges is based on the principle that the power to regulate an exchange and the responsibility for regulating that exchange should not be separated. If the power to regulate the exchange but not the responsibility were held by one body and the responsibility to regulate the exchange but not the power were held by another body, the resulting disruptive tension would damage the effectiveness of the regulation of that exchange. The exchanges are front-line regulators of their markets.

9 The Financial Services Act and FSMA both recognised that the power to propose rules for regulating an exchange ought to rest with the body that has the day to day responsibility for running that exchange. The recognition regime introduced the necessary checks and balances to that power and responsibility by setting out in the recognition requirements the objectives and standards that an exchange's rules and procedures must meet and by giving to a statutory body the responsibility for measuring whether an exchange satisfied the recognition requirements. The recognition regime has served its purpose well and has been a significant factor in contributing to London's effectiveness as the home for European based commodity exchanges that serve not just domestic price discovery and risk management but the full extent of international price discovery and risk management.

10 The exchanges play the crucial role in ensuring the orderly operation of their markets. Although UK legislation sets out the broad purpose and need for orderly markets, it is each exchange that knows best the rules and procedures that will be effective in creating order in its markets. In the case of the LME, this starts with the design of its metals futures and options contracts. The LME devotes a great deal of its energy to the metal brand listing and warehousing arrangements for its metals because it recognises that these are the essentials ingredients in generating trading that will produce price discovery and price convergence with physical prices on settlement. Rules and procedures for maintaining orderly trading free from manipulation are developed by the daily observation of what works and what does not work in each market. Securities markets have different drivers and pitfalls from commodity markets. The markets in different commodities have different drivers and pitfalls from each other. The LME believes that it is best placed to have the leading role in determining what rules and procedures will generate trading in base metals that is orderly and free from manipulation.

11 The quasi-public body status of the LME has been recognised a number of times. At the time of the Tin Crisis in 1985, when the International Tin Council defaulted on its LME tin contracts, the action taken by the LME to suspend its tin market in an orderly way was upheld by the High Court because the court recognised the need for a body that held the central position to be able to take action quickly for the benefit of all users of the market. The LME has twice been subject to judicial review in respect of its system for approving warehouses to store metal on LME warrant. Although the actions of the LME were upheld in both cases, the Court of Appeal confirmed that the role that the LME played made it a body whose actions were subject to judicial review.





12 FSMA introduced statutory immunity for exchanges in recognition of their quasi-public body status. This status flows from the price discovery and maintenance of orderly markets functions that exchanges perform. The ability and need for exchanges to make rules binding on the users of their markets are an essential part in maintaining an orderly market free from manipulation.

13 Although the FSA must decide whether an exchange satisfies the recognition requirements, under the recognition regime there is healthy debate between the FSA and the exchange about the details of how the exchange will achieve the results required by the recognition requirements. The LME would suggest that the debate between the FSA and the exchange produces more effective regulation of a market than would be the case if there were no debate.

14 The serious implications of the proposal to abolish the recognition regime are not reflected in the space allocated to the issue in the consultation paper or in the subsequent paper issued by HM Treasury in September. The LME believes that the absence of a clear articulation of the reasons for the proposal or any written set of options makes it very difficult to reply to the consultation paper in a meaningful way. The LME would welcome the opportunity to discuss the proposal, the reasons for its inclusion in the consultation paper and the serious implications of any proposed changes to the recognition regime that might subsequently emerge.

Yours faithfully

**Diarmuid O'Hegarty**



## **THE ROLE OF THE LONDON METAL EXCHANGE IN THE INTERNATIONAL BASE METALS TRADE AND INDUSTRY**

1 The London Metal Exchange is the world's premier base metals market. The LME is a highly liquid market and in 2009 achieved traded volumes of 111.9 million lots, equivalent in value to \$7.41 trillion annually and \$29 billion on an average business day. Based in London the LME is a global market with an international membership and with more than 95% of its business coming from overseas. More than 450 brands of metal from over 60 countries are approved as 'good delivery' against LME contracts. There are over 500 LME approved warehouses in 39 locations covering Europe, Asia and North America.

2 The LME operates futures and options markets in ten industrial base metals. Seven of these, aluminium, copper, zinc, lead, nickel, tin and aluminium alloy, are mature markets where the daily LME official prices have become the accepted reference prices for the world trade in those metals. The LME launched steel billet futures contracts in 2008 and cobalt futures and molybdenum futures contracts in 2010. These newer contracts have not yet matured into the accepted reference prices for their industries but the steel billet futures contract is approaching that stage.

3 Base metals are amongst the few commodities that lend themselves to a globally traded reference price and it is for this reason that the LME has become the world centre for the trading of that price risk. Base metals lend themselves to global reference prices more so than other commodities because the relative cost of shipping metal around the world is low compared to the value of the metal. This low relative cost of shipping limits the size of regional variations. The LME provides a global reference price because LME listed warehouses are in the three regions of Europe, Asia and North America.

4 Copper and tin have been traded on the LME since 1877. Lead was introduced in 1903, zinc in 1915, primary aluminium in 1978 and nickel in 1979. The two grades of aluminium alloy are recycled primary aluminium and were introduced as contracts in 1992 and 2002.

5 All LME metals have different characteristics but the price discovery process for each of them is the same. The LME listed delivery locations in Europe, Asia and North America are in areas of net consumption or transshipment ports that are conduits to areas of net consumption. LME listed brands represent a significant proportion of the physically traded metal. For example, LME listed grade A copper brands represented 60% of world production capacity for grade A cathodes in 2009.

6 The LME is an on-exchange forwards market. Each LME futures contract is an obligation to deliver metal against payment on the settlement date. On a trading date, the available settlement dates are every business day out to three months, every Wednesday out to six months and every third Wednesday in the month out to



ten years. LME contracts are based on physical settlement by the transfer of ownership of metal stored in licensed warehouses; this guarantees price convergence as the far futures settlement dates converge on the cash settlement date (i.e. two days from the trade date). The ability to make or take delivery of metal against an LME futures contract on the settlement date prevents any divergence between the LME settlement price and the physical metal price.

7 Settlement of LME futures contracts is first by offset and then by delivery of the balancing position by means of LME warrants. This takes place on the settlement date so that ownership of metal changes hands on the day: there is no settlement window. Offset allows those who trade on the LME to reduce the number of LME warrants necessary to settle their obligations on a settlement day to the net exposure. For example a producer who hedges his risk to a drop in metal prices will sell for delivery on a future date on the LME. He will close out his hedge by buying back an equal amount of metal for delivery on the same date on the LME. The metal delivery obligations will offset exactly and result in no LME warrants changing hands but the price differences will produce a net cash payment on that date.

8 An LME warrant is a bearer warehouse receipt that represents the ownership of a specific number of tonnes of an identified producer brand, stored in an identified shed operated by an LME approved warehouse company. The LME devotes a great deal of effort to maintaining the metal brand listing and warehouse approval systems because the reliability of metal stored in LME approved warehouses underpins the integrity of trading and price discovery.



11 October 2010

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### **HM Treasury: A new approach to financial regulation**

These comments on the above paper are submitted on behalf of the London Society of Chartered Accountants (LSCA) and have been prepared by its Personal Financial Planning Committee (PFPC); further details about the LSCA and the Committee are given at the end of this letter. The PFPC welcomes the opportunity to comment on the proposals. As usual, we have concentrated on the matters of most immediate importance to our members, i.e. those that directly affect professional firms or the direct associates of professional firms.

#### **General**

We would like to make some high level comments on the proposed legislation. Changing the regulations puts a burden upon firms. New regulations have to be incorporated into compliance manuals, staff have to be trained, stationery and forms have to be changed and clients may have to sign different documents. The effect is to increase the costs to the industry and thus to clients and overall reduce the savings of the public. The retail financial services sector is already preparing itself for another round of major changes as a result of the Retail Distribution Review.

We fully appreciate that there are good reasons for changing the structure of the regulatory system, but we strongly urge the government and the regulators to make changes only where they are necessary and can be cost justified. Most firms will be regulated solely by the Consumer Protection and Markets Authority (CPMA) and we strongly recommend that the rule book for the CPMA should be lifted word for word from the FSA Handbook, with only changes that can be cost justified on consumer protection grounds being made.

Secondly, it is important that the Government should continue to bear in mind the fact that the financial services is an international industry, in which the UK is a market leader and is a major source of employment, revenue and tax receipts to the UK. The government must ensure that its new structure does not reduce the competitiveness of the industry.

Thirdly, we feel that much more should be done to improve consumer education, starting in schools, and we hope that the Consumer Financial Education Body will be making a significant impact in this area.

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

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

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

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

We consider that the basic objectives should be supplemented with secondary factors and that they should be ‘have regards’ as in the FSMA. We deal with this in more detail below.

### ***4 The Government welcomes respondents’ views on:***

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

The events of the past few years have served to demonstrate that the wilder claims of the efficient market theorists have proved to be wrong. But we consider that it is still the case that competition and market forces are the most efficient economic drivers for consumers in most cases and that recent events have by no means disproved this. A regulatory system that did not have regard to innovation and competitiveness would rapidly stifle the industry. We therefore strongly urge that 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 for both the PRA and for the CPMA. Similarly, the emphasis on regulation should remain on interventions to improve the efficiency of markets.

We agree that the PRA should have regard to broader economic public interest considerations

***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?***

Whichever model is eventually chosen, it is critically important that the two organisations should liaise closely with each other. Shared or adjacent premises would be helpful.

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

We have no comment.

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

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

We consider that the 'have regards to' requirements of the FSMA have worked well and should be replicated in the requirements of both the PRA and the CPMA.

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

We have no comments.

**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.**

See our answer to Q7 above. We consider that the 'have regards to' requirements of the FSMA have worked well and should be replicated in the requirements of both the PRA and the CPMA. We do not consider that the CPMA should have regards to promoting public understanding of the financial system - that should be the task of the Consumer Financial Education Body. If the third bullet point is to be incorporated, we suggest that the word 'maintain' in the first line be changed to 'consider', to indicate that the CPMA may consider that current diversity is insufficient and needs improving (though arguably this bullet pint is included in the requirement to consider competition).

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

No comment.

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

We particularly welcome the statutory recognition of the Small Businesses Practitioner Committee.

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

We agree with the proposals.

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

We strongly urge the Government to retain one scheme. Having more than one scheme would lead to differences in rules and interpretation which would be confusing and unacceptable to consumers and firms. Although the principle of cross subsidy is much disliked, in practice it has proved necessary throughout the life of the various compensation schemes.

We note the proposals in 4.56 to give the CPMA further responsibilities taken from the OFT. Our feeling is that the CPMA is an already large organisation and increasing its responsibilities and therefore size is likely to reduce its efficiency.

**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.**

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

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

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

**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 have no comments on these items.

Yours sincerely



Elizabeth Allen, Committee Secretary on behalf of  
Roger Purcell  
Chairman, LSCA Personal Financial Planning Committee

### **About the LSCA and its Personal Financial Planning Committee**

The LSCA is by far the largest of the 22 district societies affiliated to the Institute of Chartered Accountants in England and Wales (ICAEW). It has a membership of over 30,000, representing nearly one quarter of all ICAEW members, and also provides services for other ICAEW members who live or work in London. London members, like those of the Institute as a whole, comprise a mixture of those working in all sizes of practice and those working in businesses both large and small, or otherwise not in practice. They include many members operating at the heart of industry and commerce in the City of London, as well as those working in the largest accountancy firms, with a wide range of expertise.

The purpose of the LSCA's Personal Financial Planning Committee (PFPC) is to champion financial planning services as a practice opportunity for members, and to provide appropriate support and assistance. It sees its objectives as representing the needs of members in practice and associates of firms who either currently provide financial planning services or who should be so doing. The committee also regularly liaises with representatives of other bodies whose work may impact LSCA members and responds to consultation and other papers on financial services and related matters issued by the FSA, HM Treasury and others, making representations on members' behalf.

In 2003, the PFPC established a Financial Services Discussion Group. The Group provides a forum for members to keep up to date with developments in financial services regulation compliance, investment ideas, personal financial planning and new investment products. Membership is open to all accountants (not just ICAEW/LSCA members) involved in financial services practices, whether in a compliance function or providing advice to clients.





## **LSEG Response to HMT Consultation: “A new approach to financial regulation: judgement, focus and stability”**

**18 October 2010** Submitted to: [financial.reform@hmtreasury.gsi.gov.uk](mailto:financial.reform@hmtreasury.gsi.gov.uk)

### **Introduction**

The UK financial services sector is a key contributor to the real economy. It supports in excess of 300,000 jobs in London<sup>1</sup> alone and in 2009, contributed in excess of 10 per cent of total tax revenues<sup>2</sup>. The London Stock Exchange (LSE) itself is an essential facilitator of non-bank finance to UK companies and the access to equity finance provided by its markets has been a major economic stabiliser for UK companies during the crisis. £161 billion has been raised by UK businesses, both large and small, through the LSE since the run on Northern Rock. This compares to the £200 billion pumped into the economy through the Bank of England’s Quantitative Easing programme<sup>3</sup>.

The LSE is home to over 2,000 UK companies that have a combined value of over £1.75 trillion. It also plays a key role in attracting international companies to listing in the UK. Currently over 591 international companies from 70 countries with a combined market capitalisation of £1.913 trillion<sup>4</sup> are listed on the LSE’s markets, underlining the international scale and global importance of London’s financial markets.

### **Executive Summary**

- The CPMA’s consumer and markets divisions must be operationally distinct and run by separate CEOs who report into an overarching Chairman. This is essential to ensure an appropriately balanced regulatory approach supporting both retail and wholesale business.
- The UKLA must be placed within the CPMA to achieve a true “twin peaks” regulatory model, ensure continued effective regulation of the UK’s primary and secondary markets and maintain a critical influence over the development of European regulatory policy.
- The Recognised Bodies regime should remain separate and distinct from the authorised firm regime. This is essential to maintain the high standards of market regulation for which the UK is renowned and to preserve its reputation as an international centre of excellence.
- We believe the above points are fundamental to the competitiveness and attractiveness of the UK’s financial services sector and to preserving the benefits this delivers to the real economy. The Consultation must achieve an outcome that does not endanger this.
- HMT must ensure that it consults fully and clearly on any proposals before taking action.

<sup>1</sup> International Financial Markets in the UK – May 2010 (<http://www.thecityuk.com/media/154873/ifm%20in%20the%20uk%2005%202010.pdf>)

<sup>2</sup> Total Tax Contribution – PricewaterhouseCoopers LLP second study of the UK Financial Services Sector for the City of London Corporation – December 2009 (<http://217.154.230.218/NR/rdonlyres/F825E02D-B7CD-4AA8-8467-3B8A7999F9DF/0/TTCreport.pdf>, paragraph 3 2).

<sup>3</sup> LSE Data and the Bank of England’s website

<sup>4</sup> LSE Data. These are companies that are either listed on the Main Market or admitted to AIM

## PART A: LSEG Key Points

In this Part A we highlight the key issues arising from the Consultation Document in the context of the LSE's operations. These issues, together with responses to the questions in the rest of the Consultation Document, are set out in further detail in Part B.

### **The CPMA must be able to represent the interests of, and act as a champion for, both consumers and wholesale markets**

- **The CPMA must be operationally distinct and independent from the PRA and the FPC** – it is essential to the UK's regulatory standing and its influence in European policy development that the CPMA is not viewed as a second-tier regulator. The head of the CPMA must command equal status to the head of the PRA and be appropriately qualified to represent and support the dual policy areas of consumer and wholesale markets regulation.
- **The markets division and the consumer division must carry equal weight** – in order to ensure this, we suggest that the two divisions should be headed up by separate CEOs, each of whom is an industry expert and a member of the Board. **In addition, the CPMA should be known simply as the Markets and Conduct Authority (“MCA”).**
- **The markets division must be strong and cohesive** – the new regulatory structure must recognise both the importance of the interests of investors and the significant benefits which wholesale markets deliver to the UK economy. We estimate that the capital raising activities of firms listed or admitted to our markets help to support in excess of 8 million jobs across the UK<sup>5</sup>. A strong link must be maintained between primary and secondary markets to ensure effective regulation and maintain the UK's reputation for high quality markets which are safe for investors.
- **The CPMA must speak with knowledge and authority in Europe** – the UK will only have 8 per cent of the vote in the European Securities and Markets Authority (ESMA), despite accounting for approximately 60 per cent of trading activity in Europe. The CPMA will be its sole representative at ESMA. It is therefore essential that the CPMA's markets division can authoritatively speak for both primary and secondary markets to ensure it has the greatest possible credibility to enable it to represent effectively the UK's interests in Europe.

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<sup>5</sup> Thomson Datastream – based on employment numbers for UK companies listed or admitted to our markets. This does not account for those companies who rely on listed entities for their business.

## To ensure effective regulation, the UKLA must be part of the CPMA markets division

- **There is substantial overlap between the UKLA and the CPMA** - the vast majority of the UKLA's functions involve real-time monitoring, response, implementation and enforcement. These activities are vital to maintaining market quality and the confidence of investors, both institutional and retail, in UK markets and overlap significantly with activities which will be carried out as part of the CPMA's markets monitoring functions. However, they are not the primary functions of the policy development-focused FRC.
- **Placing the UKLA in the CPMA wholesale markets division is consistent with the Government's model** – which seeks to avoid the problems that arose with information flow in the current tripartite system.
- **There is a real need for a commercially-orientated UKLA** – to ensure the attractiveness of London as a capital raising centre is preserved and in the interests of UK companies, it is vital to have a quick and efficient listing and capital raising process in the UK. This requires a commercially-oriented UKLA, which is up to speed on the latest market practices and developments and integrated into the wider regulation of wholesale markets.
- **UKLA is a securities, not a company, regulator** – of the c.20,000 securities admitted to the Official List, just 6 per cent represent premium-listed equity securities issued by companies which are subject to FRC corporate governance policy-making and oversight<sup>6</sup>.

## Recognised Bodies must maintain their current regulatory regime as market infrastructure providers

- **The proposal to rationalise the RB and authorised firm regimes fails to recognise the key differences between RBs and authorised firms and the important public functions which RBs carry out** – RBs are a key part of the UK's frontline regulatory regime and their activities deliver real benefits to the UK economy. For example, LSE facilitates and supports crucial access to capital for companies<sup>7</sup>. The risks associated with operating an RB are very different from those generally associated with the operation of an authorised firm.

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<sup>6</sup> This is still only 28% if all securities on the Official List (bonds, structured products, warrants etc) attached to such premium listed issues are included. Under the Listing, Prospectus and Disclosure Rules (LR) 9.8.6(5) & (6) a Premium Listed company must comply (or explain why it has not done so) with the UK Corporate Governance Code. All other issuers with a Standard Listing must comply with the Disclosure Rules and Transparency Rules (DTR) 7.2.2 – these require them to make reference to whichever corporate governance code they choose to apply in their annual report. Data sourced from the FSA website.

<sup>7</sup> Please see over in our "competitiveness of the UK's financial sector", page 4

- **The proposals will introduce significant complexity, yet it is not clear they 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 and facilitating critical access to capital for UK companies. Since the run on Northern Rock in September 2007, £161 billion has been raised through the LSE's markets, in comparison to the £200 billion that the Bank of England has pumped into the economy through QE.
- **The proposals risk significant adverse consequences for the attractiveness and competitiveness of UK markets** – the regulatory burden on RBs is significantly higher than on other network providers such as MTFs. Combining RBs into the same regime will reduce regulatory standards, undermine investor and issuer confidence and endanger the UK's reputation for safe and well regulated markets, making it a less attractive destination for international business.

**The competitiveness of the UK's financial services sector must be a key priority for the Government and should be reflected in the objectives of the new regulators**

- **The financial services sector provides real benefits to the UK economy** – it supports in excess of 300,000 jobs in London alone and in 2009 it contributed in excess of 10 per cent of total tax revenues<sup>8</sup>. We estimate that the capital raising activities of firms listed or admitted to our markets help to support in excess of 8 million jobs across the UK<sup>9</sup>. The sector is also essential for the support of SMEs - our stock market for smaller companies (AIM) has raised £70 billion for high growth companies since its 1995 launch.
- **The world's capital market** – London is the leading financial centre in the world<sup>10</sup>. In 2009, London accounted for 16 per cent of global further issues by money raised and around a fifth of global foreign equity trading<sup>11</sup>. It accounts for 70 per cent of the global secondary bond market, 75 per cent of global Eurobond trading and 34 per cent of foreign exchange trading<sup>12</sup> and there are currently 591 international companies from 70 countries with a combined market capitalisation of £1.913 trillion<sup>13</sup> listed on our markets, underlining the international scale and importance of London's financial markets. Over \$1.6 trillion of equities are managed out of London, with \$888 billion invested in international equity assets, more than any other major financial centre (including New York at \$804 billion and Paris at \$202 billion)<sup>14</sup>.

<sup>8</sup> "Total Tax Contribution – PricewaterhouseCoopers LLP second study of the UK Financial Services Sector for the City of London Corporation – December 2009 (<http://217.154.230.218/NR/rdonlyres/F825E02D-B7CD-4AA8-8467-3B8A7999F9DF/0/TTCreport.pdf>, paragraph 3 2).

<sup>9</sup> Thomson Datastream – based on employment numbers for UK companies listed or admitted to our markets. This does not account for those companies who rely on listed entities for their business. It should be noted that there is no empirical link between capital raising on our markets and job creation. However, capital raising is used to fund companies' growth strategies and operations

<sup>10</sup> The Global Financial Centres Index 8, September 2010, Z/Yen Group

<sup>11</sup> International Financial Markets in the UK – May 2010 (<http://www.thecityuk.com/media/154873/iffm%20in%20the%20uk%2005%202010.pdf>)

<sup>12</sup> Data from the CityUK and IRSG, 2009

<sup>13</sup> LSE Group data, September 2010. These are companies that either listed on the LSEs Main Market or admitted to AIM.

<sup>14</sup> Ipreo, June 2010

- **It is imperative that UK policy makers and regulators have regard to UK competitiveness when taking regulatory decisions** – the failure to take account of regulatory developments on a global scale, particularly in the context of a dynamic and rapidly changing industry environment, runs the real risk that the UK's markets lose their appeal for international business, delivering a serious blow to the UK's economic health.

#### **Need for full and fair consultation**

- **HMT must ensure that it consults fully and clearly on its proposals and should operate its consultation procedures in a manner that is consistent with the Code of Practice on Consultation** – several of the Consultation proposals are discussed in very high level terms, set out no supporting rationale or evidence and pose general questions, the basis of which is unclear. We ask that any proposals are fully articulated and properly consulted on to ensure careful and comprehensive consideration is given to their likely impact, given their significant and far-reaching implications for the safety and security of UK financial markets, the protection of both institutional and retail investors, the ongoing competitiveness of the UK as a place to do business and the health of the UK economy.
- **Interested parties must have a fair opportunity to understand and consider what is proposed by the various implementation proposals and to respond fully to the issues raised** – in accordance with the Code of Practice on Consultation, it is essential that detailed proposals in relation to the RB regime (question 16) are provided for full consultation prior to any action or decision by the Government on this issue.

## PART B: Responses to Consultation Paper Questions

This section contains LSEG's more detailed responses to the specific questions posed in the Consultation Document

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

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

- 1.1 LSEG supports the creation of the FPC with a mandate to oversee prudential regulation and maintain financial stability.
- 1.2 We believe that the primary objective of the FPC should be supplemented with a strong set of clearly defined 'have regards' that it is required to 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?**

- 2.1 Given the important contribution which the financial services sector makes to the wider economy<sup>15</sup>, it is essential 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. It is our view that the FPC should therefore be required to have regard to the factors set out in sections 2 (c) – (f) of FSMA 2000, namely the proportionality of regulatory activities, the facilitation of innovation 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?**

- 3.1 As suggested in paragraph 1.2, we believe these must form a strong set of 'have regards' which must therefore be duly and properly considered by the regulator in carrying out its primary objective.
- 3.2 In addition, it will be critical to ensure clear processes for oversight and accountability of the FPC. The proposals indicate the FPC Board will comprise a minority of independent members. It is essential that these

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<sup>15</sup> See page 1, Introduction and page 4, Part A

members are sufficiently senior, well regarded and influential in industry, as well as being highly qualified. They should also, ideally, be free of conflicts of interest in relation to their role on the FPC and other business commitments. Further, there must be clear parliamentary scrutiny of decisions taken by the Committee. We welcome the proposal in paragraph 2.59 of the Consultation Document 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.

4.1 As noted above<sup>16</sup>, the financial services sector delivers significant benefits to the UK economy. It is therefore critical that **achievement of the PRA'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. It is our view that the PRA should therefore be required, in carrying out its primary objective, to have regard to the factors set out in sections 2 (c) – (f) of FSMA 2000, namely the proportionality of regulatory activities, the facilitation of innovation and the need to consider the competitiveness of UK markets.

4.2 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. In order to ensure an effective and consistent regulatory approach, we agree that it is essential that the PRA has regard to the primary objective of the CPMA, and vice versa.

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<sup>16</sup>See Page 1, Introduction and page 4, Part A



**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?**

- 5.1 The PRA and the CPMA should remain two distinct bodies, with neither exerting control over the other and both carrying equal regulatory weight. **The head of the CPMA should command equivalent status and prominence to the CEO of the PRA and must be fully qualified to represent and support the dual policy areas of consumer and markets.** This is essential to ensure the credibility of both as effective regulators who are seen to preserve the high standards of regulation and market quality for which the UK is known and as key influencers in the development of European regulatory policy, through their representation in the new European Supervisory Authorities.
- 5.2 Whilst we are supportive of each authority being solely responsible for policy decisions, conducting supervisory and enforcement activities and granting or amending approvals for areas within their remit, there will be an overlap of activities between the two bodies, in particular the authorisation and removal of permissions. The associated risks of ineffective communication, duplication, overlap and underlap will need to be carefully managed. It is, therefore, key that the formation of policy and the related supervisory activities are kept closely integrated to enable the effective flow of information between the authorities, and to support the decision making process.
- 5.3 The Consultation Document outlines a series of mechanisms designed to mitigate these risks, including inclusion of the CPMA head on the Board of the PRA (and vice versa) We agree that this is important. **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?**

- 6.1 The approach outlined may assist in enabling the PRA to take a more risk-based, judgement-focussed approach which we consider would be appropriate. However, it is essential that the rule making functions of the PRA are subject to the same safeguards that currently exist for the FSA, and which will be applied to the CPMA. These include the necessity to consult, both publicly, but also potentially to a set of statutory panels, in the same way that the CPMA will be required to do. Detailed market failure analysis and a robust, though relevant, cost benefit analysis should also be mandatory.
- 6.2 In addition, 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.
- 6.3 Finally, a clear set of objectives and ‘have regards’, as referenced in our response to question 4<sup>17</sup>, will be crucial to ensuring such an approach remains balanced and effective.

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

- 7.1 Please see our response to question 6 above.

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

- 8.1 We would cautiously welcome any streamlining of these safeguards that would allow the PRA to react to market developments decisively and quickly, whilst remaining open and transparent. The use of cost benefit analysis should also be scrutinised to ensure that the analysis remains robust, is firmly embedded in the decision making process and that it is applied consistently across all objectives. We would also advocate that the analysis be subject to independent review within a defined time horizon.

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<sup>17</sup> See paragraphs 4.1 – 4.2.

**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.**

- 9.1 Though 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 necessary that these members are senior and highly respected industry figures.
- 9.2 The corporate governance arrangements of the PRA are not as clear or balanced of those of the CPMA – it is important that the views of the NEDs and the regulated community are taken into account when decisions are made and that such decision-making is transparent and fair. It is not clear why the NEDs of the PRA should be effectively excluded from decision-making, when their role on the CPMA is stronger and clearer. Further, such an approach may affect the quality of individuals that can be attracted to become NEDs of the PRA, in that they may not be party to relevant decision-making whilst being responsible as directors for decisions made.
- 9.3 Parliamentary oversight of the PRA, as with the FPC and the CPMA, 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 (CPMA)

### Question 10 - The Government welcomes respondents' views on:

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

10.1 As with the PRA and the FPC<sup>18</sup>, given the importance of the UK financial services sector to the UK economy, **achievement of the CPMA's primary objective must be 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. Therefore, the primary objective of the CPMA should be supplemented with a strong set of 'have regards' which should reflect the principles for good regulation set out in sections 2 (c) - (f) of FSMA 2000.

10.2 We expect that the CPMA will have regard to broader public interest and retail investor considerations, in particular, helping to educate the public about the role of financial services and encouraging more active retail participation in UK financial markets<sup>19</sup>. In this context we believe that that appropriate emphasis must be placed on protecting the interests of investors and consumers, particularly retail investors, who need the support and protection of an adequately resourced and influential body to act on their behalf. However, given the important benefits which wholesale markets deliver to the real economy, **the CPMA's wholesale market functions should carry equal weight to its consumer protection role. For both sides to be effective and act in the interests of their respective remits, it is crucial that within the CPMA, the markets and consumer divisions are two distinct bodies, each headed by an industry specialist CEO, reporting into an overarching Chairman, and each of whom is a member of the Board and Executive Committee.**

<sup>18</sup> See responses in paragraphs 2.1 and 4.1

<sup>19</sup> LSE itself has recently launched a number of initiatives to encourage retail investor participation. For example, in February 2010, the LSE launched the Order Book for Retail Bonds (ORB) to give private investors greater access to fixed income investment; in July, the LSE announced lower market data charges for retail investors and at the beginning of September, we updated our web site aimed at providing educational and free news and alert services to private investors

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

- 11.1 We are generally supportive of the Government's proposals that the Board of the CPMA is comprised of mainly non-executive members. We also welcome the fact that the CEO of the PRA will sit, ex officio, on the Board of the CPMA and vice versa. We are concerned at any suggestion that the PRA will act as the lead authority in any conflict with the CPMA. **It is essential, to ensure its credibility as a key UK regulator and its influence and authority as the UK's representative at ESMA and in promoting the interests of investors, that the CPMA is an equal and distinct authority, and not regarded as a second tier regulator. The head of the CPMA should command equivalent status and prominence to the CEO of the PRA and must be fully qualified to represent and support the dual policy areas of consumer and markets which are critical to the UK's economic well-being.**
- 11.2 In addition, membership of the Board (both executive and non-executive) must be balanced to represent the consumer and market remits of the CPMA. To achieve this, the non-executive members should be drawn from a mixture of industry and investor backgrounds and must be sufficiently senior and influential individuals who are experts in the relevant areas and able and willing to take a dissenting view from those of the executive members. Further, these views must be taken into account during the decision-making process.
- 11.3 Further, as noted in paragraph 10.2 above, we consider it essential that the CEO of each of the CPMA's markets and consumer divisions is a member of the Board and of the Executive Committee.
- 11.4 It is important that the CPMA is subject to clear Parliamentary oversight. We therefore welcome paragraph 4.39 in the Consultation Document 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.**

- 12.1 The CPMA must continue to consult and be subjected to external challenge. We therefore regard the three statutory panels as an essential "control" on the CPMA's regulatory decision-making activities.
- 12.2 As a broad principle, and as noted in paragraphs 10.2 above, the CPMA should have equal emphasis on markets and consumers. This should be reflected in the role and composition of the Practitioner and

Consumer panels. Both should be equally strong champions for wholesale markets and consumers (including retail and institutional investors) respectively. We also suggest that, depending on the remit of the proposed Consumer Panel, more specialist Consumer Practitioner Panels or Markets Practitioner Panels may be required.

- 12.3 We also welcome the Small Business Practitioner Panel being placed on a statutory footing to ensure that all industry participants and the interests of their end customers are represented.

**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.**

- 13.1 We welcome the suggestion that the CPMA will be the lead authority in collecting fees on behalf of the FPC, PRA, FOS, FSCS and CFEB. This is logical given that the CPMA will directly interact with all firms through its conduct of business role.
- 13.2 **However, the process through which fees are set and levied must be transparent and fees themselves must not distort competition between entities conducting similar or the same activities.** As such, fees must be proportionate and balanced and the process should be subject to oversight, potentially by the NAO. This is essential to ensure effective competition and innovation in UK markets, in the interests of investors.

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

- 14.1 We express no views on this question.

## Markets and infrastructure

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

- 15.1 We note the proposed division of responsibilities for markets and infrastructure regulation. We support the regulation of CCPs and payment systems by the Bank of England given their systemic importance, significant capital requirements and potential exposure to other market participants' default, in particular the aspects of risk management, treasury management and margin. However, it is not clear from the Consultation Document whether CCPs will be regulated by the Bank on a prudential specific basis, or more generally. Whilst there may be a cross-over with the CPMA, both on conduct issues and in relation to representation at ESMA, this division does not appear to be clean or clear. **It is critical that any split of responsibility does not undermine the ability of the Bank to conduct its prudential oversight of CCPs.** We believe that there should be a further Consultation on the detail before detailed comments can be made.
- 15.2 Exchanges and trading platforms will be regulated by the CPMA. Wholesale markets provide an important contribution to the UK economy<sup>20</sup>. It is therefore essential that they are well regulated and understood. As such, the markets division within the CPMA must be strong, well resourced and distinct from the consumer division. This is critical to the continued success of London as an attractive venue for international investors and issuers, and to ensure the CPMA's credibility and authority to enable it to represent effectively the UK's interests at ESMA.
- 15.3 **We strongly disagree with paragraph 5.14 in the Consultation Document** which suggests that modern infrastructure providers, such as exchanges, are not distinguishable from "most large firms in the financial services industry, particularly those involved in dealing in securities and derivatives either on their own account or on behalf of customers". There is a fundamental difference between (1) an entity that takes systemic risk through dealing on its own account or on behalf of its clients or provides a trading platform for a discrete set of the most liquid profit-generating securities admitted to trading on an exchange; and (2) a market infrastructure provider such as an exchange, which provides fair and non-discriminatory access to all for a wide range of securities. Please see our response to question 16 for further detail.

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<sup>20</sup> See Page 4, Part A

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

- 16.1 Currently Part 18 of FSMA deals with the Recognised Bodies (RB) regime for Recognised Investment Exchanges and Recognised Clearing Houses. It sets out the framework for the approval, operation and regulation of stock exchanges and clearing houses. Part 4 covers permissions for Authorised firms (i.e. investment firms) carrying out regulated activities. These include investment banks carrying out investment activity either on their own behalf or on behalf of clients.
- 16.2 It is clear that there will likely need to be some consequential changes to the regimes for RCHs and 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, CCPs and payment systems.
- 16.3 However, we also understand that HMT is actively considering the wholesale abolition of the RB regime and re-designation of all RBs as authorised firms. **The rationale and justification for this is not made clear in the Consultation Document, nor has it been adequately explained to us in discussions with HMT.**
- 16.4 Specifically, the Consultation Document:
- **Fails to recognise the fundamental differences between RBs and authorised firms** – in particular, the regulatory responsibilities of RBs, which are a key component of the UK's highly regarded regulatory standards, the scope of activities undertaken and the very different risk profiles of the various bodies. **The UK's regulatory regime must be able to recognise and address the fundamental differences between RBs and authorised firms in order to ensure effective regulation and the preservation of the UK's status as a global financial market.**
  - **Does not explain how the proposed "rationalisation" would enhance the stability, efficiency or strength of the UK regulatory system** – the objectives of the Consultation Document which are stated to be to address "the operational failings of the [tripartite] system", including "regulation of conduct within the financial system". **Far from enhancing stability, efficiency and strength, a combined regime risks reducing regulatory standards to the lowest common denominator.**



- **Does not set out the issues which HMT is seeking to address in relation to any rationalisation** – there is no evidence of RB failure and no case for change is made. During the financial crisis, infrastructure providers continued to operate their markets effectively and in an orderly manner, remaining open whilst other parts of the financial sector seized up. As such, infrastructure providers were a key stabilising force. This is evidenced by the £161 billion raised through primary and secondary issuances on LSE’s markets since September 2007 relative to the Bank of England’s £200 billion QE programme. **In order for interested parties to have a fair opportunity to respond properly to the question, and consistent with the Code of Practice on Consultation, HMT must set out and consult on the deficiencies which it has identified in the current arrangements and the specific proposals which are being considered to address these.**

16.5 The combination of the RB and authorised firm regimes may appear to be a more efficient regulatory solution in theory. However, in practice, the need to address the significant number of complex issues which arise means there will be no meaningful reduction in regulations.

*Differences between RBs and authorised firms*

16.6 **RBs perform important regulatory functions which ensure neutral, efficient and orderly markets in the UK and are fundamental to market confidence and the interests of investors, both institutional and retail** – RBs are a key part of the UK’s frontline regulatory regime, setting standards and ensuring that market participants act in accordance with rules designed to ensure the safety and fairness of their markets for the benefit of investors and other market participants. As part of its activities, an RB is required to write and enforce market rulebooks, conduct surveillance of its markets and intervene when necessary to ensure its markets remain orderly<sup>21</sup>. An RB may also need to discipline its members (primarily authorised firms, or issuers in the case of a securities exchange) where it is found that they have contravened the rules. RBs are also required to maintain and operate default rules<sup>22</sup>. These were critical to maintaining orderliness and confidence in response to the collapse of Lehman Brothers. Authorised firms do not, and are not required to, maintain these rules, but rely on the relevant Recognised Clearing House to operate these rules in relation to trading conducted on their platforms. **The statutory immunity for RBs carrying out regulatory functions underpins their ability to conduct these important investor protection and market quality activities.**

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<sup>21</sup> The Recognition Requirements within the Recognised Investment Exchanges and Recognised Clearing Houses (REC) sourcebook, which govern the overall regulation of RBs specifically require RBs to have “transparent and non discretionary rules and procedures that provide for fair and orderly trading and establish objective criteria for the efficient execution of orders” and “clear and transparent rules regarding the admission of financial instruments to trading” (REC 2.6.2 and REC 2.12.2A). Authorised firms, to the extent that they operate trading platforms, have some similar but much less stringent responsibilities under the Multilateral Trading Facilities chapter of the Market Conduct sourcebook (MAR5) (for example, REC 2.12.2A does not apply under MAR 5).

<sup>22</sup> Pursuant to Part VII Companies Act 1989

- 16.7 RBs co-operate with other regulatory bodies by sharing regulatory information which is key to ensuring effective regulatory oversight in the UK and internationally** – this is a key element of the G20 objectives. RBs are required to "...be able and willing to cooperate by the sharing of information or otherwise, with the [FSA], with any other authority..."<sup>23</sup>. The guidance in REC specifically requires RBs to be actively involved in information sharing with other authorities, in participating in international fora and in co-operating with the FSA and other regulatory bodies. For example, LSE is actively involved in the ISG (Intermarket Surveillance Group), FIN-NET, IOSCO and CRO. **Whilst authorised firms do have obligations to deal in an open and co-operative way with FSA, the obligations do not extend to any broader or global regulatory activities.**
- 16.8 RBs perform key public benefit functions which deliver real and important gains to the wider economy** – LSE, for example, provides access to capital, through its AIM market, which is crucial to the growth and development of SMEs. Since the launch of AIM in 1995, £70 billion has been raised for SMEs; £3.75 billion so far in 2010. Innovative, high technology smaller companies financed by equity as opposed to credit are key to the delivery of the long term economic growth required for a sustainable recovery in the UK. UK based companies on AIM **employ in excess of 250,000 people and support a further 320,000 jobs indirectly**. Around **£12 billion is contributed to GDP** by AIM companies, with a further **£9.4 billion supplied through Gross Value Added** and in 2009, **£1.8 billion was contributed in tax revenues**<sup>24</sup>. AIM is also regionally diverse; 57 per cent of UK AIM companies are based outside London and approximately 20 per cent are incorporated abroad, attracting important international business. LSE has also launched a number of initiatives focused on providing greater access to markets and better education for private investors<sup>25</sup> with a view to increasing the choice available to private investors. Other RBs will no doubt be able to demonstrate similar wider public benefit functions.
- 16.9 The risk profile of RBs is very different from that of authorised firms** – a significant proportion of authorised firms conduct risk-taking activities in that they take balance sheet risk by dealing for clients or on their own account, as well as providing investment advice and holding client deposits. RBs, in contrast, provide robust market infrastructure which authorised firms use to undertake their activities. They do not deal in securities on their own behalf or for clients, do not offer investment advice and do not take deposits. The primary risk associated with RIE activities is IT failure affecting the continued provision of market infrastructure. This risk is regulated by the SYSC requirements under REC<sup>26</sup> and monitored closely by the FSA.

<sup>23</sup> REC 2.13.1 (2)

<sup>24</sup> "Economic Impact of AIM and the Role of Fiscal Incentives" (Grant Thornton and LSE), September 2010

<sup>25</sup> In February 2010, the LSE launched the Order Book for Retail Bonds (ORB) to give private investors greater access to fixed income investment; in July, the LSE announced lower market data charges for retail investors and at the beginning of September, we updated our web site aimed at providing educational and free news and alert services to private investors

<sup>26</sup> Systems and Controls within REC (REC 2.5.1)

*Potential impact on regulatory standards*

- 16.10 Seeking to impose the more rigid approach of the authorised firm regime risks reducing the quality and closeness of dialogue between RBs and their regulator** – the current RB regime is based on high level rules and principles which promote and encourage regular discussion and co-operation between the RBs and the FSA. During the financial crisis, the RBs worked closely with the FSA, ensuring they continued to act as a stabilising influence<sup>27</sup> despite issues in relation to other market participants. A move to the more formulaic approach taken to the supervision of authorised firms will reduce the quality of this dialogue and information flow, adversely impacting the regulators' level of understanding of RB plans and activities and endangering the quality of regulation, to the detriment of market participants and investors, both retail and institutional.
- 16.11 Combining the RB and authorised firm regimes risks reducing regulatory standards to the lowest common denominator** – London's RBs are widely regarded as ensuring high standards of fair, neutral and transparent regulation. This makes them attractive destinations for global business investors, issuers and market participants. For example, there are currently 591 international companies on the LSE's markets from over 70 countries with a total value of £1.913 trillion<sup>28</sup>. **Removal of RB status will create an economic incentive for RBs to reduce regulatory standards** – the LSE would seek to align itself with MTF and other network provider competitors which are subject to a lighter regulatory burden than RBs. Further, combining RBs into the same regime as their own authorised firm members and customers could seriously undermine the ability of the RBs to maintain the quality of their markets, enforce rules and impose discipline on their authorised firm peers, to the prejudice of investors.
- 16.12 The reputational impact of removing RB status could severely damage the RBs' ability to market London and the UK as a major destination for global capital to the detriment of UK issuers and the UK economy more generally** – any reduction or perceived reduction in regulatory standards would undermine investor and issuer confidence and endanger the UK's reputation for safe and well regulated markets, making it a less attractive destination for international business.

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<sup>27</sup> See paragraph 16.4, bullet 3

<sup>28</sup> As of the end of September 2010

### *Greater complexity of regulatory framework*

**16.13 The need for rules to deal with RB specific functions will result in a larger number of complicated provisions** – HMT officials have suggested that the development of multi-lateral trading facilities (MTFs), regulated as authorised firms, is an argument for regulating exchanges under the same regime. It is wrong to assume that the growth of MTFs in the equity sector, competing with exchanges and with each other, is symptomatic of exchanges generally; it is not. Further, this fails to recognise the complexity of RB functions, the differences in the operations of each<sup>29</sup> and the unique activities of RBs, which are critical to maintaining the UK's reputation for well regulated and attractive markets.

**16.14 Placing the RBs in an authorised firm regime would require consideration of the following factors, not addressed in the Consultation Document:**

- A detailed analysis of the functions and different market structures of each RB relative to authorised firms; specific rules to address these and the special regulatory activities of each RB; and all consequent amendments required to existing legislation.
- The requirement under Part VII Companies Act 1989 for RIEs and RCHs to have **default rules**; how far across the authorised firm regime would this requirement flow?
- The **statutory immunity** from damages available to RBs that allows them to undertake the public interest activities identified above; what would be the appropriate parameters for this?
- What **competition regime** would be applied to the former RBs and/or to authorised persons; would the competition regime under general law be sufficient/appropriate to deal with the particular issues currently managed within FSMA?
- What range of **investment services permissions** would be made available to the former RBs under the authorised firm regime. The RBs would be likely to seek extensive permissions to balance out the negative impact of the consequences on reputation and international competitiveness. To what extent is this consistent with EU legislative moves and some of the perceived negative effects of fragmentation?
- **Possible outcomes from the EU legislative agenda**, particularly in critical infrastructure<sup>30</sup>, which currently remain uncertain. To what extent will UK divergence undermine the ability of UK markets to compete in Europe and on a global scale?

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<sup>29</sup> Different exchanges conduct materially different types of operations. For example, the LME is instrumental in standardising contracts in industrial metals, whilst the LSE operates a growth market for small companies and admits equity and debt securities to its markets.

<sup>30</sup>For example, European Markets Infrastructure Regulation (EMIR) and the Markets in Financial Instruments Directive (MiFID) will have material impacts on market infrastructure in the UK

*Need for full and fair consultation*

- 16.15 **HMT must ensure that it consults fully and clearly on its proposals and should operate its consultation procedures in a manner that is consistent with the Code of Practice on Consultation** – several of the Consultation proposals, for example question 16, are discussed in very high level terms, set out no supporting rationale or evidence and pose general questions the basis of which is unclear. Any proposals must be fully articulated and properly consulted on to ensure careful and comprehensive consideration is given to their likely impact, given their significant and far-reaching implications for the safety and security of UK financial markets, the protection of both institutional and retail investors, the ongoing competitiveness of the UK as a place to do business and the economic health of the UK economy.
- 16.16 **Interested parties must have a fair opportunity to understand and consider what is proposed by the various implementation proposals and to respond fully to the issues raised** – in accordance with the Code of Practice on Consultation, it is essential that detailed proposals in relation to the RB regime are provided for full consultation prior to any action or decision by the Government on this issue.

**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.**

- 17.1 The LSE is responding to question 17 in its capacity as a significant global markets operator with direct experience of operating primary and secondary markets.
- 17.2 The LSE provides markets, such as the Main Market and AIM, and trading platforms which enable companies from around the world to gain access to London's significant pools of capital. London accounts for some 23 per cent of European equity trading<sup>31</sup>, and so far this year £20 billion has been raised on our markets.
- 17.3 In addition, the LSE has direct experience of the challenges involved in, and work of, a listing authority, having been responsible for the UK listing regime until May 2000 when the LSE demutualised and the FSA, acting as the UKLA, became the UK competent authority for listing pursuant to FSMA 2000.

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<sup>31</sup> This includes trading in equities for both the LSE and the MTFs – based on data from FS and the LSE

*A strong capital market delivers real benefits to the wider UK economy*

- 17.4 An effective primary market is critical to the ability of companies to raise capital for growth and development. This in turn supports a vibrant secondary trading market and delivers significant benefits to the real economy. **It is therefore vital to the UK economy that the UK's primary markets regulator provides a primary markets regime which continues to deliver efficient access to capital by remaining attractive to issuers and investors.**
- 17.5 LSE, through its primary market offering, is an essential facilitator of non bank finance to UK companies. The access to equity finance provided by its markets has been a major economic stabiliser for such companies during the crisis<sup>32</sup>.
- 17.6 Our successful and highly regarded primary market in the UK attracts a wide range of domestic and international investors<sup>33</sup>, both retail and institutional. These investors provide important liquidity which reduces the cost of capital for companies<sup>34</sup>, thereby making it cheaper for them to raise finance, and support a vibrant financial services sector in the UK.
- 17.7 This in turn delivers benefits to the wider economy. **Last year, the financial services sector contributed in excess of 10 per cent to HMT in tax revenues. In addition, we estimate that UK companies admitted to our markets support in excess of 8 million jobs<sup>35</sup>** (this does not include those jobs provided throughout the value chain such as suppliers who depend upon these companies).

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<sup>32</sup> See paragraph 16.4, bullet 3

<sup>33</sup> With close to £600 billion invested in international equity, London has more international capital invested in equity assets than any other major financial centre (IPREO June 2010)

<sup>34</sup> An underwriting syndicate to a capital raising issue faces a number of risks, including inventory risk from receiving the shares, adverse selection risk if they maintain a net position as well as a number of sunk costs. The higher these risks, the higher the likely intermediation costs. Demsetz (1968) first documented the inverse relationship between intermediation costs and liquidity. Another benefit of high liquidity is tighter spreads, which reduce transaction costs. Since 2000, FTSE 100 time weighted spreads have declined by some 80 per cent.

<sup>35</sup> Thomson Datastream – based on employment numbers for UK companies listed or admitted to our markets. This does not account for those companies who rely on listed entities for their business. It should be noted that there is no empirical link between capital raising on our markets and job creation. However, capital raising has been used to fund a companies' growth strategy and/or their continued operations

*The UKLA plays a critical role in ensuring the UK's primary market remains an attractive destination for issuers and investors*

17.8 The UKLA performs 3 key functions which are critical to the ongoing safety and attractiveness of the UK's financial markets:

- **It provides and enforces the regulatory framework for the listing of securities in the UK which is critical to maintaining the UK's reputation for high regulatory standards** – this includes the UK's unique super equivalent regime, which provides the choice of a "Premium" listing for issuers, and higher regulatory standards which provide additional comfort for investors. We believe that this is a key contributor to the UK's attractiveness as a listing venue for many international as well as UK issuers and investors, both retail and institutional. There are currently 591 hundred international companies from 70 countries admitted to our markets.
- **It performs the key investor protection role of ensuring the immediate public dissemination of important information relating to listed securities** – the Disclosure and Transparency Rules and Listing Principles require listed companies to assess, in a timely fashion, how any information they hold affects the accuracy of information they have previously disclosed to the market and whether this information is inside information<sup>36</sup>. Inside information must be announced to the market as soon as possible to allow all investors the opportunity to make informed investment decisions. The effective real time enforcement of these obligations is a crucial part of the UK's investor protection regime and critical to preserving confidence in the UK's financial markets. On average approximately 23,000 regulatory announcements are made per day<sup>37</sup>.
- **It approves new prospectuses for those issuers wishing to list, providing vital support for UK companies needing to raise capital** – the efficiency and speed of this process is crucial to the ability of companies to raise finance for their ongoing operations and/or corporate activity.

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<sup>36</sup> Disclosure and Transparency Rule 2.2.1R states that an issuer must notify a RIS [Regulatory Information Service] as soon as possible of any inside information which directly concerns the issuer, unless certain exceptions apply. Listing Principle 4 states that a listed company must communicate information to holders and potential holders of its listed equity securities in such a way as to avoid the creation or continuation of a false market in such listed equity securities.

<sup>37</sup> Source: Market news services on the LSE website which displays announcements provided by all Regulatory Information Services.

*The CPMA's Markets Division is significantly better positioned than the FRC to ensure the continued achievement of the UKLA's objectives.*

17.9 The FRC's responsibilities are narrow in scope, covering only UK companies and reporting practices and involving after the event review and supervision. This means the FRC has little, if any, experience of the operation of capital markets and the real time monitoring functions which are critical to maintaining the reputation and quality of the UK's financial markets and protecting investors.

17.10 **CPMA markets division demonstrates significantly greater overlap in functions and experience with the UKLA than FRC** – closely related to the market supervision functions which will be carried out by the CPMA, by far the greater part of UKLA's responsibilities involves the real time supervision and enforcement of its rules and the approval of transactional documentation for a wide range of UK and international securities. The ability to operate on a real time basis is critical to ensuring both a speedy and efficient listing process for companies seeking to raise capital and a transparent and well-regulated market which is attractive to and safe for both retail and institutional investors. In contrast, FRC is responsible for developing corporate governance policy for just 6 per cent of premium-listed equity securities issued by companies<sup>38</sup>. The fragmentation of markets regulation could adversely impact real time monitoring and supervision of markets, to the detriment of UK investors and issuers.

17.11 **CPMA will be the UK's representative at ESMA in Europe** – it will therefore be responsible for negotiating the UK's position on policy initiatives which have a direct impact on the operation and structure of the UK's financial markets. Direct experience of the issues under negotiation will give CPMA greater influence and authority in this arena and is more likely to ensure equal weight for primary and secondary market positions and consumer/investor protection considerations. No other EU country has separated responsibility for regulating primary markets from the regulation of secondary markets. The separation of primary and secondary markets policy development could weaken the UK's position in Europe at an especially critical time for European policy development.

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<sup>38</sup>This is still only 28% if all securities on the Official List (bonds, structured products, warrants etc) attached to such premium listed issues are included. Under the Listing, Prospectus and Disclosure Rules (LR) 9 8 6 (5) & (6) a Premium Listed company must comply (or explain why it has not done so) with the UK Corporate Governance Code. All other issuers with a Standard Listing must comply with the Disclosure Rules and Transparency Rules (DTR) 7.2.2 – these require them to make reference to whichever corporate governance code they choose to apply in their annual report. Data sourced from the FSA website.



## *Lack of Synergies between UKLA and FRC*

17.12 The FRC has identified 4 synergies with UKLA<sup>39</sup>. Whilst we agree that there is some interaction between the FRC and UKLA in these areas, the fact remains that the FRC is a standard setting body, not a real time regulator. **We consider that any overlap is superficial and does not address the important market surveillance functions of the UKLA which require effective real time supervision and enforcement.**

17.13 **The Accounting Standards Board (ASB).** The FRC states that the ASB, which provides guidance on narrative reporting in annual reports, may correlate with the UKLA's guidance on narrative reporting in periodic financial reporting documents required by the Listing Rules and the Disclosure and Transparency Rules (such as the 'annual financial report' and the 'half yearly financial report')<sup>40</sup>. However, this differs in scope and approach from the UKLA. Firstly, the ASB sets the standards for accounting for UK companies. However, the UKLA (working with the LSE) has an international outlook – 41 per cent of issuers on the Official List, and 51 per cent of securities are issued by non UK issuers<sup>41</sup>. Secondly, to the extent that the UKLA is involved in guidance on narrative reporting, it is primarily through its implementation of the Transparency Directive (and some super equivalent requirements) in the Listing Rules. These standards are formulated in Europe and so in order to continue to discharge this part of its role properly, UKLA needs a voice at ESMA. Thirdly, FRC's activities in relation to accounting practices relate to standard setting rather than active monitoring. In our experience, this means that issues are actioned several months after the event and over a protracted period. In contrast, UKLA works in real time and in accordance with transaction timetables. This is a critical difference; it is essential that UKLA is able to react quickly and decisively at the time an issue arises for the capital raising process to remain effective and useful for companies.

17.14 **The Financial Reporting Review Panel (FRRP).** The FRC argues that the FRRP, which enforces standards of narrative reporting in annual reports, could work with the UKLA's enforcement of narrative reporting in prospectuses. However, the Prospectus Directive (PD) does not require the UKLA to carry out any scrutiny or enforcement of narrative reporting; it simply requires the inclusion of relevant financial information. Further, to the extent that FRRP makes recommendations following a review, these tend to relate to future years' accounts so are irrelevant to the prospectus vetting process carried out by the UKLA. Finally, as noted above, the UKLA must take action and make decisions on a real or near to real time basis for the capital raising process to remain relevant and useful for companies. As such, a transactional approach is essential.

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<sup>39</sup> As noted by Baroness Hogg: <http://www.accountancyage.com/accountancyage/news/2270784/frc-highlight-four-significant>

<sup>40</sup> Disclosure and Transparency Rules (DTR 4.1) and Listing Rules (LR9.8)

<sup>41</sup> Main Official List and LSE data

**17.15 The Auditing Practices Board** – the FRC notes that this provides guidance on the role of auditors in relation to listing documents, which are then relied upon by the UKLA in assessing suitability for listing. However, a key element of assessing suitability for listing is the sponsor regime operated by the UKLA. This is more closely associated with the monitoring of investment firm conduct which will be carried out by the CPMA. In addition, the reporting standards for listing documents, which are set by the Auditing Practices Board, are not formally part of the listing regime and do not apply to overseas accountants of overseas issuers. As noted above, some 51 per cent of listed securities are overseas securities. As such, any overlap is negligible.

**17.16 The UK Corporate Governance Code** – the FRC is responsible for maintaining the UK Corporate Governance Code and promoting its widespread application which the FRC says is similar to the UKLA’s ongoing monitoring of listed companies’ continuing obligations. The FRC does not actively monitor compliance with the Code - it is left to investors to assess whether the companies in which they invest have complied with the Code or provided an adequate explanation as to why they have not. Nor does the UKLA - the Listing Rules simply require a "comply or explain" statement. Furthermore, the Code applies to only those companies with a Premium Listing of equity shares. These represent a very small proportion of the securities over which UKLA has jurisdiction<sup>42</sup>. Finally, as noted above, the real time monitoring approach of the UKLA is far more closely aligned with the real time activities of the CPMA than with the FRC’s activities.

*Overlap between UKLA and CPMA Markets Division*

**17.17 The synergies between UKLA and CPMA are significant and are in our view more likely to ensure that the UKLA’s critical real time monitoring functions are preserved to the benefit of market quality and investor confidence.**

17.18 According to the Consultation Document, the CPMA will have “a primary objective of ensuring confidence in financial services markets, with particular focus on protecting consumers and ensuring market integrity”. Its responsibilities will include the regulation of “market conduct where firms and others (particularly corporate clients of financial services firms) participate in dealings in wholesale financial markets”. This is a broad scope, covering activity in relation to “all financial instruments and other derivatives contracts” traded in the UK, not just company shares.

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<sup>42</sup>See paragraph 17.10

17.19 These responsibilities are closely aligned with many of the UKLA's own functions. Specifically, UKLA conducts the following activities in relation to all securities under its jurisdiction<sup>43</sup>:

- **As competent authority under the PD the UKLA approves prospectuses and enforces the public offer and advertisement regimes** - in enforcing the PD's public offer and advertisement regimes, the UKLA is responsible for ensuring that a prospectus or appropriate documentation is produced by issuers each time they seek to raise funds or issue more securities, and that communications surrounding offers of securities comply with the requirements prescribed by the PD. Its activity is, by its nature, transactional. As a consequence, the UKLA is market-facing, and its work is predominantly real time due to the need to accommodate transaction timetables, react rapidly to market developments and protect investors. **This closely complements the conduct regulation which will be carried out by the CPMA, including the enforcement of the Financial Promotions regime.**
- **As competent authority for Listing under the Consolidated Admissions and Reporting Directive (CARD), the UKLA manages the Official List, ensures compliance with its super-equivalent rules and supervises the conduct of sponsors** – this involves close liaison with market infrastructure providers (such as PLUS and LSE, for example, in managing the admission, cancellation and suspension of listed securities) and with the lead FSA supervisors in relation to sponsor monitoring. Sponsors are financial market participants such as investment banks, broking firms and independent corporate finance boutiques which provide expert advice to issuers under the Listing Regime. There are currently roughly 70 firms on the sponsor list, including all the major investment banks. **This function is very closely aligned with the conduct supervision activities which will be carried out by the CPMA and requires regular and close co-ordination with the document vetting function carried out by the UKLA.**
- **As competent authority for parts of the Market Abuse Directive, UKLA undertakes real time monitoring of the market to ensure timely disclosure of important information to investors** – this role is discharged through press and real time price monitoring, and is supported by price alerts received from market operators such as the LSE. The UKLA's Company Monitoring Team works closely with its document vetting team who provide important intelligence on live transactions and issues and the FSA's market conduct team; both deal with inside information, both are often closely involved in the same cases and both require

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<sup>43</sup> See paragraph 17.10

a comprehensive understanding of market developments. **This activity is closely aligned with the market monitoring functions which the CPMA's market division will undertake.** This operational inter-dependence and the need for a single operational entity is underlined by the Market Abuse Directive, from which these responsibilities are derived and which requires a single competent authority for these purposes.

- **As competent authority under the Transparency Directive, UKLA ensures that issuers comply with periodic financial information disclosure requirements** – whilst FRC supervises content of annual and half yearly financial reports, UKLA's role is more focused on ensuring disclosure and is therefore closely associated with its other real time supervision responsibilities.
- **Primary markets policy development** – this involves engagement with CESR (to be replaced by ESMA) in relation to the development and enforcement of EU primary markets policy and engagement with market stakeholders in relation to the super-equivalent parts of the FSA Handbook. The relationship with ESMA is particularly important and is dealt with in paragraphs 17.20 to 17.23 below.

#### *Representation of the UK in Europe*

**17.20 The UK's ability to defend its unique listing regime in Europe is critical to its attractiveness and competitiveness as a global financial centre.**

17.21 The UKLA's rules derive primarily from European Union Directives. However, the UKLA has been allowed to preserve its unique "super-equivalent" regime. Super-equivalence has allowed the UK to develop a 'Premium Listing' offering which has higher standards, choice and flexibility than the EU minimum 'standard listing' and as a result allows inclusion in the FTSE index standards<sup>44</sup>.

17.22 This is unique to the UK and key to attracting business here: In previous reviews of the Listing Regime (1993, 2003, 2008), responses to FSA consultations have shown that market participants value many of the super-equivalent standards as they provide an appropriate balance of investor protection, practitioner certainty and flexibility. We have recently seen Indian Essar Energy and Tanzanian African Barrick Gold raise money in London through a Premium Listing.

**17.23 It is therefore critical that this is defended at EU level and specifically in ESMA, which will play a key role in the development of primary markets policy.** Only the CPMA will represent the UK at

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<sup>44</sup> A Premium Listing provides the potential for inclusion in the FTSE UK series of indices which includes the FTSE 100, FTSE 250 and FTSE Small Cap indices. Access to these indices is often seen as one of the key benefits of achieving a Premium Listing since so many investment mandates - particularly in respect of the vast amount of capital represented by tracker or quasi-tracker funds - are driven by the FTSE indexation of shares.

ESMA, since each Member State is entitled to only one voting member. Whilst it is possible that the CPMA could coordinate with the FRC or a new companies' regulator to lobby at ESMA, we do not believe this is sufficient or appropriate. It should be noted that, despite the majority of trading activity occurring within London, the UK will only have 8 per cent of the vote at ESMA. In order to ensure maximum influence in relation to primary market policy in this forum, we believe that CPMA must be able to demonstrate clear understanding of the relevant issues and direct expertise and experience in this area. This is particularly the case for AIM. In the last 15 years, AIM has helped support and develop SMEs and protect investors through an appropriate balance of flexibility and regulatory standards. **If the UKLA and development of primary markets policy are not both located within the CPMA, there is a real risk that the CPMA will only be able to represent the UK in the EU effectively from a secondary markets perspective.**

### **Impact of Section 73(1)(d) FSMA 2000**

- 17.24 The Consultation paper questions whether it is right to include a requirement that, in pursuing its objectives, the UKLA must have regard to the general duty set out in Section 73(1) of FSMA 2000 and, in particular, the desirability of facilitating innovation in respect of listed securities (c) and maintaining the competitive position of the UK (d).
- 17.25 **The UK's attractiveness as a financial centre to international investors and issuers is critical to the effectiveness of the UK's primary markets as a source of capital for UK companies and the delivery of wider benefits to the economy as a whole. We consider that by far the greater risk is a lack of development and innovation that will undermine the UK's attractiveness as a capital raising and investment centre, and therefore undermine the benefits which a vibrant financial services sector delivers to the real economy.** Whilst recognising the potential for conflict inherent in a regulator being also required to operate subject to the objectives of facilitating innovation and maintaining the UK's competitiveness, we do not regard this as a serious risk. As noted above, a key feature of the UK regime which is core to its international attractiveness and reputation is the UKLA's super equivalent regime. Furthermore, there have been examples where a more restrictive approach by the UKLA has resulted in business moving away from London. For instance, a recent decision by the UKLA not to sign a non-binding MoU with Russia meant that 25 pre-IPO companies who were considering listing were instructed by the Russian Government to consider listing away from London. An understanding of the very real commercial impact of decisions made by the UKLA on the success of London as a financial centre is key to the successful implementation of the new regulatory structure.

**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**

18.1 We note that BIS has put forward plans for the creation of a new companies regulator. We do not currently believe that there is a necessity for such a body:

- The FRC already deals with Corporate Governance and account disclosure policies.
- There is no evidence that the interests of investors, whether retail or institutional, are prejudiced by the current arrangements.
- It is not clear what other 'policy' areas would be included.
- We are of the view that it would not be appropriate to include bodies such as the Panel on Takeovers and Mergers in a new regulator. The Takeover Code regulates the conduct of companies, advisers and bidders. These are not only UK entities but can include, for example, bidders from outside the UK. Further, much of the Panel's activity requires a real time approach consistent with transaction timetables. This requires a different skill set and approach from the skill set and approach required for general corporate governance and company regulation.

## Crisis management

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

19.1 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.

19.2 In the absence of any detail it is difficult to make a meaningful contribution to this section.

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

20.1 Please see 19.2

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

21.1 Please see 19.2

## Impact assessment

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

22.1 The impact assessment is extremely high level and fails to consider the potential effect of the proposals on:

- **The attractiveness of the UK's markets as a place to raise capital, conduct corporate activity and invest** – as noted in our responses throughout the document<sup>45</sup>, the UK's markets provide a key contribution to the wider UK economy through the provision of capital, job creation and generation of revenues.
- **The importance of the UK's continued ability to influence EU policy development** – focus on the domestic structure in the context of a heavy regulatory agenda in Europe must not divert key resource away from representing the UK's interests in the EU debate. As noted in our Part A<sup>46</sup> and in our response to question 17, the new structure must ensure that the UK's influence in this regard is preserved for the future to enable it to ensure that its markets remain competitive.
- **The potential adverse impact on the quality of regulation of UK markets** – the assessment assumes that the proposals will result in a "reduction in frequency and severity of financial crises in the UK". This is unsupported by evidence. Further, the assessment fails to address the rationale for the changes proposed in paragraph 5.17 of the Consultation Document, explain how these would strengthen financial stability and consider any risks arising from such a major and complex change. In this regard it is important to note that the UK's market infrastructure was a key stabilising influence during the financial crisis and continued to operate safely and efficiently, providing critical access to capital for UK companies<sup>47</sup>.

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<sup>45</sup>See Part A, Page 4

<sup>46</sup>See Part A, Page 2, Bullet 4

<sup>47</sup> See, paragraph 16.8